

EXECUTIVE REMUNERATION

**THE POLICY OF THE NATIONAL INVESTING BODIES
OF THE CHURCH OF ENGLAND**

AND

**THE ADVISORY PAPER
OF THE ETHICAL INVESTMENT ADVISORY GROUP
OF THE CHURCH OF ENGLAND**

August 2024

THE EXECUTIVE REMUNERATION POLICY OF THE NATIONAL INVESTING BODIES

The National Investing Bodies' policy on executive remuneration is set out in sections 1 to 10 below on the advice of the Ethical Investment Advisory Group (EIAG):

The Executive Remuneration Policy of the National Investing Bodies

1. This policy sets out how the National Investing Bodies (NIBs) use their voice and votes as shareholders on the issue of executive director remuneration. It is not intended to be a comprehensive piece about remuneration in business or society.
2. The policy has been developed because, as shareholders, we are the owners of publicly listed companies. We appoint a board of directors, executive and non-executive, to run the business on our behalf. We have a fiduciary duty to express our views on directors' remuneration in engagement with the companies we own and to vote at company meetings. The system by which boards set the remuneration of directors cannot work properly if shareholders do not diligently exercise their responsibility for remuneration.
3. The remuneration of non-executive directors is generally uncontentious, and we have taken the decision to focus on executive remuneration. While it is common for two or more executives to sit on the board of a publicly listed company we have focused on the remuneration of the highest paid executive director – usually the Chief Executive Officer (CEO), as they typically receive the most public and shareholder attention.
4. Practical responses are required if the NIBs are to exercise their investor responsibilities. To achieve this, the NIBs have developed a series of stewardship principles to guide our assessment of executive remuneration. This follows an analysis of the policy context around executive remuneration, factors influencing executive remuneration practices and consideration of corporate governance and social issues.
5. We have taken as our starting point the NIBs' established position that responsible businesses contribute to a good society and human flourishing. The NIBs look to public companies to provide a significant proportion of their returns. Executive directors perform a difficult and important role that requires a high level of skill, enterprise and innovation. It is right that they should be rewarded appropriately, and it will not serve the common good if taking up directorships at publicly listed companies is stigmatised or if talented individuals are discouraged from aspiring to senior executive positions.
6. We value the contribution to society of those who lead our public companies. Our aim is to encourage considered reflection in boardrooms on the ethical issues associated with executive remuneration, not for it to be inferred that remuneration schemes that breach our principles are unethical.
7. While we have focused on executive remuneration at publicly listed companies, excessive remuneration is found in many parts of society: private business, private equity, hedge funds, other investment management, professional services, sport and entertainment. The NIBs are exposed to excessive remuneration as a result of their investment mandates with asset managers as well as through their shareholdings in public companies.
8. In developing this policy, we have looked at the theological reflections of the Ethical Investment Advisory Group (EIAG) and the views held in the Church of England today. We have sought to develop a policy through which the NIBs can exercise their responsibilities on

executive remuneration in a distinctly Christian way. This is not a straightforward matter. While biblical and theological principles can inform our approach, they do not offer ready, practical responses to every aspect of the complex world of executive remuneration schemes, and the views of Christians on what is fair and appropriate vary, quite legitimately.

NIBs' Stewardship Principles on Executive Remuneration

9. The NIBs have decided to adopt the following principles for shareholder engagement and voting on executive remuneration:

One: Remuneration schemes should not breach local good practice.

- a. The NIBs should take advice from proxy voting advisers on the level of base salaries, schemes' adherence to the corporate governance standards of the stock market on which the company is listed and the country in which the company is headquartered, and the extent to which there is consistency between the remuneration of the board and company earnings, profits and returns to shareholders. Executive remuneration schemes should not breach good practice in these regards.
- b. Irrespective of where the company is headquartered, particular attention will be placed on the following:
 - i. The Remuneration Committee's use of discretion during the year, both positive and negative;
 - ii. The need for malus and clawback provisions;
 - iii. The time frame applied to joining awards; and
 - iv. The level of individual directors' shareholdings¹.

Two: The NIBs should challenge the bonus culture.

- a. The NIBs should use their voice to uphold the role of salary and challenge the size of annual bonuses. The NIBs would not expect executive directors in receipt of competitive salaries to be offered annual bonuses of more than 100% of base salary for target performance. Awards of more than 100% of base salary can only be justified if an executive director has delivered extraordinary results through exceptional performance to the significant benefit of shareholders.
- b. Remuneration schemes in which base salaries are kept below market levels will need to be analysed differently from schemes in which high salaries are paid. Annual bonus schemes which are paid substantially in shares and are subject to performance-related deferral in such a way that they serve also as long-term incentive plans will also need to be analysed differently from schemes that are accompanied by separate long-term incentive plans.

Three: Variable remuneration schemes should prioritise long-term over short-term performance.

- a. Variable remuneration schemes should prioritise long-term over short-term performance. The NIBs should not expect to see maximum potential awards under an annual bonus plan exceeding potential awards under a long-term incentive plan.

¹ Executives at UK companies are expected to have shareholding requirement of 200% of salary.

- b. Long-term incentive plans should cover periods of five to seven years and should normally be paid in shares held for the long term in order to reward permanent value creation.
- c. Long-term incentive plans that offer excessive rewards should be challenged.
- d. Where restricted awards (i.e. time-vested rather than performance-based shares) are utilised, the NIBs expect the vesting period to be commensurate with the time frame directors expect capital expenditure decisions to impact the company. We do not wish to impose a one size fits all approach but are mindful of the Investment Association's proposal for a five-year holding period. Where committees believe that this is too long a period, they should explain why a shorter period is consistent with its business cycle. Likewise, as investors we may consider the five-year period to be too short in some circumstances. Awards should not vest, in any circumstance, before the agreed period, even on cessation of employment².

Four: Non-financial as well as financial performance metrics should be incorporated into variable remuneration schemes.

- a. All variable remuneration schemes should reward executive directors against ethical, social and environmental metrics appropriate for the individual company, not just financial metrics or movements in the share price and dividend. This is particularly important where directors are required to have regard to all the stakeholders in the business, as in the UK.
- b. The NIBs should not expect to see remuneration schemes in which neither the annual bonus plan nor the long-term incentive plan incorporates ethical, social or environmental metrics.

Five: Remuneration reports should demonstrate how executive remuneration is consistent with remuneration arrangements for the rest of the workforce.

- a. Companies should approach remuneration and reward in a holistic way for all staff. They should disclose the extent to which schemes offered to executive directors are offered exclusively to executive directors or also, where appropriate, to other staff.
- b. They should disclose pay ratios and the way in which they monitor and manage internal pay differentials and trends.
- c. Executive remuneration schemes that create pay differentials that are higher than those of peers, despite equivalent business models, should be challenged, as should schemes in which, over the long term, the remuneration of executive directors rises disproportionately to that of other staff.

Six: The Chair of the Remuneration Committee should enjoy the confidence of shareholders.

- a. The NIBs may escalate their stewardship activity in relation to voting, for example, a NIB may decide to vote against the re-election to the board of the Chair of the Remuneration Committee if a NIB is voting against the Chair's remuneration report for a second consecutive year, unless there is clear evidence that the committee has applied downward discretion to address misalignment between pay and long-term shareholder interests.

² [Investment Association Principles of Remuneration 2019.](#)

10. The NIBs are advised by the EIAG to use discretion when implementing these principles in their voting –including to use ABSTAIN votes as well as FOR or AGAINST votes – where:
 - i. the analysis by the NIB’s selected proxy voting adviser is deemed deficient by them;
 - ii. an executive does not draw a salary or only draws a token salary but does receive substantial variable remuneration, skewing the ratio to salary;
 - iii. there are local regulations or tax regimes which distort executive remuneration practice;
 - iv. there is insufficient information to judge whether there has been compliance with one or more of the principles; or/and
 - v. there are other special circumstances.

THE ADVISORY PAPER OF THE ETHICAL INVESTMENT ADVISORY GROUP

The following sections summarise the deliberations of the Ethical Investment Advisory Group (EIAG) that have informed our policy recommendations to the National Investing Bodies.

The EIAG's purpose is to support the national investing bodies of the Church of England to invest ethically in a way which is distinctly Christian and Anglican. This shall be achieved by offering timely, non-binding and practical Advice, and support to the investing bodies. The investing bodies may develop policy drawing on the advice of the EIAG. The development, adoption, and implementation of any policies drafted as a result of the EIAG’s advice remains the responsibility of each individual investing body.

Note that this document is under review and will be updated. In the future, papers will more clearly reflect the longstanding governance practice where each NIB independently decides on and adopts ethical investment policies.

1. THE PRACTICE OF THE CHURCH

- 1.1 In the early Church, issues of wealth and private ownership were approached in line with Jesus’ command to his disciples to give up their possessions. This tradition was, and continues to be, reflected in monasticism with its vow of poverty.
- 1.2 Since the time when Christianity became the majority religion of the Roman Empire, most Christians have, however, lived, worked, related to property and operated financially within the prevailing economic system, whether agrarian and slave-based, feudal, capitalist or communist. This was not simply a matter of the Church “selling out” to secular values. The earliest Church had expected God’s Kingdom to be realised very soon and so had given relatively little thought to an ethic for the long term. The demands of discipleship changed when the coming of the Kingdom in its fullness was seen to be further off. As a result, Christian idealism had to be tempered by the God-given duty to cherish the Earth and the created order and to nurture generations yet to come.
- 1.3 Through all the ensuing centuries, the Church has benefited from the giving of Christians earning their living within the prevailing economic system.

2. THE CHURCH OF ENGLAND TODAY

- 2.1 The Church of England has to grapple with issues of remuneration. While it may not be a model for business, we wish to be open about how we approach remuneration ourselves. Clergy are paid modest stipends: the national minimum stipend at the time of writing is £23,800³. Stipends are not uniform – higher stipends are paid for senior clergy roles. The highest stipend, for the Archbishop of Canterbury, is three and half times the national minimum stipend.
- 2.2 The Church of England employs lay workers at a national and local level. In these roles staff are salaried and pay is generally consistent with the wider non-profit sector. In some areas,

³ <https://www.churchofengland.org/sites/default/files/2017-10/gs-misc-1148-clergy-stipends-authority-report.pdf>

including investment, the Church of England is required to recruit, retain and motivate suitably qualified professionals, which can involve remuneration consistent with the sector, including provision of variable pay. While benchmarking is conducted, it is used with discrimination. As an employer, the Church of England is clear that the employment package is not only financial, and that remuneration will not be commensurate with that of some other employers.

- 2.3 The National Church Institutions are transparent about the remuneration they offer and the differentials within their organisations. Their annual reports each disclose remuneration ratios, both between the highest and lowest paid in the organisation, and between the highest paid and the median.
- 2.4 Clearly, how best to reward executive directors is not a defining matter for Anglican Christian orthodoxy. A range of views are held by members of the Church. Some worry that the debate on executive remuneration fails sufficiently to acknowledge the benefits that business and wealth creation bring to society. But almost all Christians feel uncomfortable about great financial inequalities.

3. BIBLICAL GUIDANCE

- 3.1 Like many modern ethical issues, there is no direct biblical guidance about the questions facing us regarding executive remuneration. The Bible recognises human skill, enterprise and innovation, together with property and business, as part of the created order. At the same time there are some important biblical themes concerning fairness and promptness in pay and about rebalancing great financial inequalities which we should note, as well as many warnings about the dangers of wealth to be heeded.
- 3.2 From earliest biblical times, there is a recognition that people should work for pay and not be taken advantage of, including employing relatives: thus Laban asks Jacob to name his wages (Gen.29.15); thieves are to stop stealing and work honestly (Eph. 4.28); Paul goes so far as a direct command that those who do not work, should not eat (2 Thess. 3.10). Like many ancient cultures, women were responsible for much of the economic activity which provided for the household (Proverbs 31). Even Paul prided himself on working with his own hands (1 Thess. 4.11; 2 Thess. 3.6-15; see also Acts 20.35), despite the principle that “the worker deserves his pay” being applied to those who share the gospel (Luke 10.7). It is significant, however, that Paul does not avail himself of this right to be paid for the sake of the gospel (1 Cor. 9.3-18).
- 3.3 The practice of withholding wages from employees, especially after the end of the working day, or from the poor, is particularly condemned throughout the Bible (Lev. 19.13; Deut. 24.14-15; Jer. 22.13; Mal. 3.5; James 5.4). In addition to telling the rich young man to keep the commandments, Jesus instructs him not to “defraud” which probably refers to holding back wages (Mark 10.19).
- 3.4 With regard to pay differentials, 1 Tim 5.18 suggests that elders who are good leaders, especially in preaching and teaching may deserve a “double compensation”. However, elsewhere Paul refers to the idea of “equality”, *isotēs*, drawing on the story of manna in wilderness, where everyone ended up with the same whether they sought to gather more for themselves or not (2 Cor. 8.12-15; see Exodus 16.16-20). This resulted in his collection among the wealthier churches in Greece for the poor in Jerusalem (Rom. 15.25-27). The suggestion is that in financial matters we should always take account of the community around us.

- 3.5 Within the Old Testament, attitudes to wealth are mixed: there are some suggestions that wealth is a gift from God or a sign of his blessing (e.g., Gen.13.2; Ps. 112.3; Eccl. 5.19; see Job throughout for this debate), yet there are also warnings of the dangers of riches and commands to care for the poor (Deut. 15.1-11; 24.18-22; Ps.49; Amos 2.6-7; 4.1; 8.4-6). The New Testament is much more uniform: Jesus issues a stark warning that you cannot serve God and mammon (variously translated as wealth or even materialism, Matt. 6.24), so that money should be given away (Matt. 6.19-33; Luke 12.22-34). “How hard it will be for those who have wealth to enter the kingdom of God. . . It is easier for a camel to go through the eye of a needle than for someone who is rich to enter the kingdom of God” (Mark 10.23-27).
- 3.6 In Luke’s version of the Beatitudes, it is the poor who are blessed, with woes to the rich (Luke 6.20, 24); similarly, in the parable of the rich man with the poor man Lazarus at his gate, their fortunes are reversed in the judgement (Luke 16.19-31). While many parables use economic illustrations (such as the workers in the vineyard who all receive the same pay, Matt. 20.1-16, or the parable of the talents or pounds, Matt. 25.14-30; Luke 19.11-26), their main point is about the sheer grace of God rather than financial instruction.
- 3.7 Paul’s teachings are similar, with his warnings against “greed” (Rom. 1.29; 1 Cor.5.10-11; 6.10) and exploiting others (1 Thess. 4.6): “[let] those who buy [be] as though they had no possessions, and those who deal with the world as though they had no dealings with it. For the present form of this world is passing away” (1 Cor. 7.30-31). James issues similar warnings about favouring the rich (James 1.9-10; 2.1-13). The key warning is that “the love of money is the root of all evil” (1 Tim. 6.10).
- 3.8 These New Testament teachings are also worked out in the examples of Jesus and Paul. Jesus gave up his family business of being a “craftsman” (Matt. 13.55; Mark 6.3) choosing instead the lifestyle of a wandering ascetic with “nowhere to lay his head” (Luke 9.58). On the other hand, Paul seems to have continued to work (1 Thess. 4.11; 2 Thess. 3.6-15; see also Acts 20.35 and 28.30) in order not to burden others. Those with wealth, like Zacchaeus, give it away to others (Luke 19.1-10), while the early Christians practised a sharing of wealth and possessions: Barnabas is commended for his generosity, while Ananias and Sapphira pay the ultimate price for attempting to deceive the Holy Spirit over withholding the profits from their land-sale, Acts 4.32-5.11). On the other hand, there are others who own houses who use them for the early Christian mission and as places to meet and worship (Acts. 18.7-8; 21.26; Rom. 16.3-5; 1 Cor. 16.19; Col. 4.15).
- 3.9 All of this biblical teaching is to be set in the wider narrative of a God who creates and cares for the entire universe, with all its riches. Yet Jesus does not count equality with God something to be clung on to, but rather he empties himself to humiliation and crucifixion (Phil. 2.5-11). As Paul concludes, “For you know the gracious act of our Lord Jesus Christ, that though he was rich, yet for your sakes he became poor, so that by his poverty you might become rich” (2 Cor. 8.9).

4. THEOLOGY

- 4.1 Businesses are responsible for the provision of the goods and services that are so important to all our lives. They generate economic growth, taxation receipts for social services, and employment, allowing individuals to express their God-given desire and ability to work and to serve, to be rewarded for their skills and to discharge responsibility to their families and others. Businesses can be places of social interaction, community and flourishing relationships, and places of discipleship and responsibility. Businesses are vehicles for wealth creation without which there can be no wealth distribution.
- 4.2 However, businesses cannot contribute, to their full potential, to a good society and human flourishing if they have no regard for the society in which they operate, and if individuals in business have regard only for themselves. Christians believe in the importance of communities and that individuals cannot flourish without strong social bonds.
- 4.3 It is a fundamental tenet of Christianity that all individuals are equal before God. When material rewards become vastly unequal, it becomes harder for people to perceive the truth of equality before God since it is contradicted by their experience of the world. When people treat their remuneration as indicative of their personal worth the truth of their equality before God is obscured. This is not just a spiritual trap for the rich: poorly remunerated people can become convinced that they are worthless in God's eyes because they feel worthless in the eyes of the world.
- 4.4 Not surprisingly, there is a strong and historically well-established strand of Christian thinking which places a high premium on material equality, and which calls the Church to model a counter-cultural emphasis on equality in its practical affairs and in its challenge to the world. This theological position is informed by the belief that Christians are called to live in this world by the standards of God's Kingdom and to offer the world a vision of the heavenly kingdom through the practical example of the Church's practice and teaching.
- 4.5 Another strand of theological thought seeks to balance the counter-cultural calling of the Church with a sharp awareness of the capacity of sin to corrupt even the best human intentions. This approach, sometimes called Christian Realism, seeks to transform the world into something closer to the Kingdom of God through incremental change which can commend itself to reasonable people and which recognises that Christians are no less fallible than others.
- This approach is neatly summed up in the comment of Archbishop William Temple that, "The art of government in fact is the art of so ordering life that self-interest prompts what justice demands"⁴.
- 4.6 In the theological interim between Pentecost and the end of all things, Christian ethics must hold idealism and realism in tension. Whilst the Church's calling is always to hold the vision of God's Kingdom before the world, that Kingdom is inaugurated in Christ but remains to be fulfilled. Over-emphasis on the Kingdom vision can obscure the fact that Christians are sinners and the Church is still a fallible human institution.

⁴ William Temple, *Christianity and Social Order*, Harmondsworth: Penguin Books, 1942, page 42

Too much accommodation to “realism”, on the other hand, can obscure the vision of the Kingdom which Christians are committed to pursue and under-estimates the degree to which human sin can be challenged and overcome, even in this world. The history of Christian ethics shows the constant need for idealism to act as a corrective to realism, and vice versa.

- 4.7 Yet, as these two strands of theological thinking interact in the life of the Church, a position on remuneration for work done begins to emerge. Christians are deeply cognisant of their vocation to model the priorities of God and to express in practical terms God’s equal valuing of every human being. Of course, Christians will hope that people of ability will take on responsibilities and burdens gladly and sacrificially on behalf of the common good. Yet this ideal is tempered by the awareness that human frailty puts the perfect realisation of Kingdom values beyond our reach and some concessions from the ideal must be made if the fallen world is to embody the godly virtues of peace, justice, sustainability and creativity as well as the ideal of equality.
- 4.8 Differentials in remuneration, therefore, become justified if, as a result, other virtues are enabled to flourish. But it is worth bearing Temples epigram in mind. Christians recognise the fact of self-interest, but they recognise the demands of justice. When self-interest rides roughshod over common understandings of distributive justice, Christians cannot be comfortable with the society that results.
- 4.9 In seeking to balance justice and self-interest, Christian ethics will recognise that differential remuneration for the purpose of rewarding different contributions, creating incentives and compensating for responsibility is not wholly without foundation. But it is important that such differentials are justified by some reasonable calculus linking higher rewards to greater contribution, skills and responsibility and that those who are lower paid are also rewarded fairly. Furthermore, the constant corrective pressure of the fundamental belief in the equality of all before God does not allow Christians to tolerate great inequalities in material well-being. Although Christians believe in generosity and the use of wealth to alleviate the plight of the poor, this does not make either the accretion of great wealth by individuals or great wealth inequality desirable. Charitable giving is a duty of all people and this duty can only be realised if gaps between rich and poor are not excessive.

5 ADVICE CONTEXT

5.1 Trends in director remuneration and inequality

- 5.1.1 Income inequality and executive compensation are two of the most controversial issues facing society in both an economic and political sense. Historically, boards have focused on their own executive remuneration policy without considering the wider public debate on inequality. This wider debate can and should influence boards.
- 5.1.2 According to the High Pay Centre and the Chartered Institute of Personnel and Development the average (median) full-time worker in the UK earns a gross annual salary of £29,574, while an average (median) FTSE 100 CEO annually earns a pay packet of £3.9 million; hence CEOs only need to work until 1pm on Friday 4 January 2019 to earn the same wage of a typical British full-time worker⁵.
- 5.1.3 Total pay for the CEOs of FTSE 100 companies has increased significantly in percentage terms over the last 20 years, taking into account that the average pay of a FTSE 100 CEO back in 1998 was c.£1m⁶. In 1998 the ratio of average FTSE 100 CEO pay to the average pay of full-time employees in the UK was 47:1, while in 2018 the ratio stood at 132:1.
- 5.1.4 As for non-executive directors, according to KPMG⁷, in 2017, the median fee paid to Chairmen of FTSE 100 companies ranged between £275,000 to £450,000. Over the same period, the median base fee for non-executive directors ranged between £61,000 and £72,000 (further fees on top of the base fee are paid for additional board responsibilities and participation in board committees).
- 5.1.5 Whilst the foundations of economic and societal disparities lay beyond the boardroom, stark pay differentials between top executives and average workers raise indignation amongst the media, politics and general public. A lack of empathy toward inequalities can ultimately hurt companies themselves and augment the calls for further regulation; for instance, Persimmon's ex-CEO was asked to leave by the board in 2018 because his £75m pay-out was damaging the firm's reputation⁸.
- 5.1.6 The increases in total executive remuneration that we have seen in recent years have been introduced largely not through rises in base salary but increased opportunities for variable remuneration. Deloitte reports that in 2018/9 "the median level of maximum bonus opportunity in FTSE 100 companies has increased from 190% to 200% of salary for the chief executive, and from 150% to 160% for other executive directors. This is the first change for other directors since 2008. The inter-quartile range for all roles remains at 150% to 200% of salary. In the top 30 companies the median maximum bonus potential for the chief executive remains at 200% of salary and has increased from 185% to 195% of salary for other executive directors".

⁵ <http://highpaycentre.org/blog/its-fatcat-friday-ceo-pay-for-2019-surpasses-the-amount-the-average-uk-work>

⁶ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf

⁷ <https://assets.kpmg/content/dam/kpmg/uk/pdf/2018/01/2017-kpmg-guide-to-directors-remuneration.pdf>

⁸ <https://www.theguardian.com/business/2018/nov/07/persimmon-boss-asked-to-leave-amid-ongoing-outrage-over-bonus>

- 5.1.7 It is unusual for a FTSE 100 CEO not to receive a bonus. Between 2014 and 2018 only 4% of FTSE 100 companies paid no bonus. In 2017/18 we also note that bonus pay-outs for chief executives were similar to those paid to other executive directors.
- 5.1.8 Most executive directors are eligible for long term incentive plans (LTIPs) as well as annual bonuses. Across all FTSE 100 companies the median usual award for the chief executive has increased from 250% of salary to 275% between 2016/17 to 2017/18. In the top 30 companies the median award is 400% of salary. Deloitte reports in 2018 that “All but six of the FTSE 100 companies with a long-term incentive plan award performance shares. Of these six companies, two operate restricted shares, one operates performance-based matching on deferred bonus shares, one has a combined annual and long-term plan, one has a value creation plan and one operates a one-off plan with a single award over ten years”.
- 5.1.9 At the end of the LTIP performance period, which has traditionally been three years, the proportion of the shares to be released to the CEO is calculated according to the company’s performance over the LTIP period. The value of the shares awarded will depend on the award price. If the share price has increased, then so too will the value of the award relative to the CEO’s salary at the start of the performance period. If it has decreased so too will the value of the award relative to the CEO’s salary at the start of the performance period. Thus, the director is rewarded even in a falling market.
- 5.1.10 Following the review of the UK Corporate Governance Code (2018) long term share awards should be subject to a total vesting and holding period of five years. In 2018 75% of performance share plans in FTSE 100 companies complied with the new provision. The application of the holding provision varies depending companies’ market capitalisation and operating sector.
- 5.1.11 Analysis by Deloitte shows that while the size of maximum potential LTIP awards for FTSE 100 CEOs has increased in recent years, the actual value of the maximum potential LTIP awards has not increased on account of poor share price performance.
- 5.1.12 Some shareholders have been calling on companies they invest in to restrict pension payments to executives for several years. The case for change was strengthened after the publication of the 2018 Corporate Governance Code, which required that executives’ pension contribution rates should be aligned with those available to the wider workforce.
- 5.1.13 Deloitte’s annual review of FTSE 100 director pay showed that since the New Code’s publication, 21 companies have updated their pension policy, reducing the pension allowance for new appointments, and two companies have introduced a cap on contributions for new appointments. While the median chief executive pension contributions were unchanged at 25 per cent between 2017 and 2018, the upper quartile dropped from 30 to 25 per cent and the lower quartile from 20 to 16 per cent.⁹
- 5.1.14 By contrast, the average FTSE 100 employer contribution to staff pensions is between 8.7 per cent and 10.5 per cent, according to Willis Towers Watson, the consultancy¹⁰.

⁹ <https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/tax/deloitte-uk-tax-your-guide-directors-remuneration-in-ftse-100-companies.pdf>

¹⁰ <https://www.willistowerswatson.com/en-GB/Insights/2018/09/ftse-350-dc-pension-scheme-survey-2018>

5.2 Factors influencing executive remuneration practice

- 5.2.1 The internationalisation of markets is assumed to be one of the factors behind the 20-years steady increase in executive remuneration. The increase in the size of the biggest multinational companies has created mega-businesses – and a tendency towards monopoly – where the chief executive carries huge responsibility and the stakes are high.
- 5.2.2 The market for executives is more global (although the extent to which this is the case can be exaggerated by proponents of high executive remuneration). Practices in one market (e.g. in the US where executive remuneration is considerably higher than in the UK) can have a knock-on effect on remuneration in other markets. The very high rewards that have come to be available in other areas of work, the financial sector and associated professions, have had a distorting effect on the level at which remuneration becomes ‘competitive’ and on remuneration expectations.
- 5.2.3 Boards clearly must take remuneration decisions in a business context. In the absence of restraining factors, if a company has a committed, successful management team that enjoys the strong support of shareholders, remunerating executive directors competitively in relation to the market will seem the most appropriate way to boards of discharging their practical responsibility. In the absence of restraining factors, where a business is doing well, bringing its employees income and job satisfaction, and providing useful goods or services to society, remunerating executive directors competitively in relation to the market, in support of the continued success of the enterprise, may seem the most appropriate way to boards of discharging their moral responsibility. Before the collapse in the economy and government finances in the wake of the financial crisis, and the consequent increase in the experience of economic hardship, demand from society for restraint was weak. After over ten years of reducing the budget deficit and associated austerity, the wider societal desire to restrain excess is reminiscent of the post-privatisation discontent of the mid-nineties.
- 5.2.4 Asset managers dominate modern shareholder registers and shareholder voting. They are, or should be, the main stewards of executive remuneration. But as we have noted they are high payers and usually conflicted. They tend to remunerate their own executive directors and managers generously, with an emphasis on annual bonuses, so it is not normally in their interests to challenge high levels of remuneration or the bonus culture. Furthermore, their experience tends to be that they retain clients if they achieve good short-term financial performance, so it is not normally in their interests to challenge corporate short-termism; indeed, they are likely to perceive it to be in their interests to encourage it. The beneficial shareholders whose money is actually invested (i.e. individual savers) rarely have any involvement in the discourse on directors’ remuneration.
- 5.2.5 Investor dialogue with boards can therefore focus on incentivising executives to deliver financial returns within the fund manager’s time horizon (which may be months rather than years) – and trying to ensure that the executives whom they believe will deliver these returns do not leave the business. If the conversation about remuneration is thus stunted it is not surprising that schemes are geared towards high financial rewards for making the numbers over short time periods.

- 5.2.6 While there are intermittent signs of asset managers scrutinising executive remuneration more carefully against company performance, there is not yet evidence of consistent votes against management year-on-year, indicating that asset managers, like remuneration committees, do not feel that they have a moral role, or mandate, to set limits on remuneration if corporate performance has been good. Again, until now, demand from society for asset managers to play such a role has been weak.
- 5.2.7 Companies which model different and values-based systems of remuneration, with lower rewards to senior executives and lower pay differentials, tend not to be listed on stock exchanges. The John Lewis Partnership is the well-known example. All employees there are partners and the company's constitution states that the pay of the highest paid Partner will be no more than 75 times the average basic pay of non-management Partners, calculated on an hourly basis¹¹.

5.3 What motivates people at work?

- 5.3.1 There is plenty of research that indicates that money is not the prime motivator of people at work. In *Drive: The Surprising Truth About What Motivates Us*, Daniel H Pink¹² draws on four decades of scientific research on human motivation to make a powerful case that autonomy, mastery and purpose are the three key motivators. The secret to high performance and satisfaction, according to Pink, is not external financial reward but the human need to direct our own lives, to learn and create new things, and to do better by ourselves and our world. Such non-financial rewards enjoyed by chief executives are rarely acknowledged or articulated by company boards and remuneration committees.
- 5.3.2 Remuneration committees may understand money does not motivate their executive directors on a day-to-day basis. But they may nonetheless fear that an executive director's motivation to stay with a business may be affected by the extent to which the director is able to fulfil a desire for financial reward and recognition in a society that defines success as financial success.
- 5.3.3 Furthermore, thanks to increased requirements on companies to make disclosures on executive remuneration, and comparisons made by remuneration consultants, executives are aware of what peers are earning. Remuneration committees may fear that executives will ask themselves whether they are being rewarded in line with peers, in line with what they could earn elsewhere, and in line with what they believe they have contributed to the success of enterprise. For executives thinking along these lines, not being rewarded 'fairly' may also affect an executive director's motivation to stay with a business. Consequently, remuneration committees can become nervous if the remuneration they offer is below median. This leads to constant upward pressure. The ratchet effect is, many feel, an unintended consequence of increased disclosure requirements. This can be seen in the increase in size and complexity of remuneration reports. By way of example, the 1995 Barclays Annual Report devoted seven (7) pages to remuneration and directors received: salary; an annual bonus (subject to an overall maximum of 50% of annual salary); a profit share; executive share options (valued at 100% of salary, based on exercise price multiplied by number of award); taxable benefits (less than 10% of base salary); and pension contributions, albeit the directors were members of final salary schemes.

¹¹ <https://www.johnlewispartnership.co.uk/content/dam/cws/pdfs/about-us/our-constitution/john-lewis-partnership-constitution.pdf>

¹² Penguin Putnam Inc, 2009.

Fast forwarding to today, the remuneration report has increased in size to twenty-seven pages (27), although the basic components have not changed significantly (the pension is now defined contribution and share options have been replaced with an LTIP).

5.4 What is the role of executive directors?

5.4.1 In the UK the responsibilities of company directors are defined widely in the Companies Act (2006).¹³ These responsibilities, especially to stakeholders, are insufficiently acknowledged both by directors and in executive remuneration schemes. The Act specifically requires company directors, when considering what will promote the success of the company, to have regard to:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

5.5 Problems that can arise with variable remuneration

5.5.1 Different markets have different customs, cultures and expectations about executive remuneration. Sometimes regulation creates distortions (for example, in the US, there are tax disadvantages associated with paying salaries in excess of \$1m which have contributed to the practice of designing executive remuneration in the US heavily around variable remuneration). Policy on executive remuneration must take account of local context; no one approach can be applied uniformly on a global basis.

5.5.2 Most executive directors are salaried. Executive directors' salaries should constitute the fair reward for labour of which the Bible speaks. According to our theological understanding, differentials between executive directors' salaries and those of other employees should be commensurate with the levels of responsibility and expectation placed upon executive directors. Salary, uniquely, can reward an executive director's role in its totality, to promote short and long-term success; to advance financial and environmental/social performance; and to meet unforeseen as well as foreseen challenges.

5.5.3 The Ethical Investment Advisory Group are content that there can be a role for variable remuneration on top of salary, such as to incentivise and reward strong performance, promote the alignment of purpose between executives and investors, reduce fixed costs in volatile business sectors and include employees in the distribution of profits.

¹³ www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf, section 172

- 5.5.4 Investment and ethical questions can be raised about variable remuneration, however. Target-driven variable remuneration risks narrowing work to a transactional relationship, achieve 'x' and receive 'y'. It may diminish the scope of what executives are expected to do and, by working against autonomy, mastery and purpose, even de-motivate.
- 5.5.5 There is a lack of research evidence that the variable remuneration offered to executives produces better performance by them¹⁴. A previous Chief Executive of Deutsche Bank, John Cryan (2015) states: "I have no idea why I was offered a contract with a bonus in it because I promise you I will not work any harder or any less hard in any year, in any day because someone is going to pay me more or less".

5.6 It is hard to design performance metrics that will capture durable corporate success

- 5.6.1 Any performance metric can be gamed or produce perverse incentives and unintended consequences (as we have seen in the financial sector). Most performance metrics reward executive directors most when times are good for the business, economy and stock markets, and least when times are tough. However, it is often when times are tough that executives are actually putting in the greatest effort and doing their most important work for the company.
- 5.6.2 Discretionary bonuses may enable a more flexible, rounded view. But in the wrong management environment they may give rise to manipulation of employees and over-work.
- 5.6.3 An advantage of retaining salaries as a major component of executive director remuneration can be that salaries build in natural restraint. Remuneration committees find it hard to justify, and to get shareholders to accept, large increases in base salary. Increases in base salary can be scrutinised against inflation, increases in pay in the organisation as a whole or changes in the size and complexity of the business.
- 5.6.4 The question both investors and remuneration committee members should ask is "what is the right level of variable remuneration?" When variable remuneration results in the quantum of remuneration being less subject to scrutiny, the societal inequalities and spiritual risks for executives that trouble Christians are likely to be the result.
- 5.6.5 While executive directors are expected to be entrepreneurial, and often purchase shares with their own funds as well as receiving them as part of their remuneration, they are not normally entrepreneurs. They have not generated a new business concept, risked everything by devoting themselves to it and created a successful new enterprise in the way that an entrepreneur may have done. Executives cannot expect the same level of variable rewards from business as entrepreneurs of this kind. The way rewards are shared between shareholders and executives will be different.

¹⁴ <https://hbr.org/2016/02/stop-paying-executives-for-performance>

- 5.6.6 Provision of excessive variable rewards for executive directors can miss this point. In extreme circumstances excessive variable rewards may eat into shareholder returns, especially if a culture of entitlement or greed is fostered throughout the business. Investors' shareholdings may be diluted through share-based awards; distribution of profits may be skewed disproportionately towards employees rather than shareholders; huge rewards at the top of a business may damage internal employee cohesion and common purpose; pursuit of risky and/or short-term revenues may destroy shareholders' wealth in the long term. In egregious cases public outrage at excess or business failings may risk a company's social licence to operate.

5.7 The importance of companies taking a long-term approach

- 5.7.1 If a business is run for short-term profit, it may appear to make sense to put the interests of the company above those of society. If a business is run for long-term profit, it is clear that the company can only prosper by serving the society in which it operates (harm caused to society will catch up with it). Creating permanent value and being a force for good are mutually reinforcing. Sustainable returns for investors are the by-product.
- 5.7.2 The NIBs are long-term responsible and ethical investors. They manage endowment funds, need to make reliable distributions and are required to meet pension liabilities many decades ahead. Remuneration schemes that drive executives to generate short-term profits at the expense of long-term sustainable returns are entirely inappropriate for them.
- 5.7.3 The current typical timeframe for vesting of longer-term awards, three years for performance with an additional two-year holding period, does not reflect our long-term investment approach. Additionally, the time frame attached to the performance element of the award is only slightly shorter than the average UK CEO tenure, which is between 4.2 and 5.6 years, depending on if it were a planned or a forced succession.¹⁵ This increases slightly in the US to 7.5 years¹⁶.
- 5.7.4 Tenure should not be confused with the timeframe for accountability for actions taken, which leads us to conclude that such awards should vest for a longer period and should not vest on cessation of employment, creating an incentive to ensure that the CEO focuses on the longer-term success of the company, not just the period while they are at the helm.
- 5.7.5 This does not mean that companies should ignore the short-term, but it is vital that executive remuneration emphasises long-term performance over short-term performance; allows for clawback of bonuses awarded for short-term behaviour that has turned out to be damaging in the long-term; and recognises the importance of rewarding ethical, social and environmental performance.
- 5.7.6 If companies prosper by operating ethically and serving the societies in which they operate rather than focusing on short-term profit, then their executive remuneration schemes should reward and encourage strong ethical, social and environmental performance.

¹⁵ <https://www.pwc.co.uk/press-room/press-releases/uk-ceos-have-less-time-than-ever-to-make-an-impact.html>

¹⁶ <https://www.equilar.com/blogs/351-ceo-tenure-drops-to-five-years.html>

- 5.7.7 This is consistent with the Investment Association’s recommendations which maintain that “remuneration committees may consider including non-financial performance criteria in variable remuneration, for example relating to environmental, social and governance (ESG) objectives, or to particular operational or strategic objectives. ESG measures should be material to the business and quantifiable. In each case, the link to strategy and method of performance measurement should be clearly explained”¹⁷.
- 5.7.8 Companies can be wary of introducing such measures of performance into remuneration schemes, fearing that they are less rigorous metrics than financial indicators. But experience of measuring environmental and social performance is growing. There are well tried and tested means, for example, for measuring the quality of stakeholder relationships through opinion polling. Asking customers whether they would recommend the company and employees whether the company is a great place to work have been shown to be strong indicators of corporate performance.
- 5.7.9 Measures of performance will vary from company to company, but we believe that creation of permanent value comes about through paying attention to numerous interrelated factors, including financial, manufactured, human, intellectual, natural and social capital, and ethical behaviour.
- 5.7.10 In our view, specific issues that ‘non-financial’ metrics might cover include:
- ethical business conduct such as tax, bribery and treating customers fairly;
 - positive staff relationships, staff development, health and safety, leadership succession-planning and respect for lives outside work;
 - positive relationships with customers, suppliers and local communities;
 - respect for human rights and co-operation with those seeking to create the right conditions for a just society (e.g. NGOs, government); and
 - environmental sustainability (e.g. greenhouse gas emissions, water efficiency). This is especially important considering the growing existential threat of climate change, backed with tougher regulatory regimes on carbon emissions, make reductions imperative for carbon-intensive companies.

5.8 A holistic approach to remuneration across the company

- 5.8.1 It follows from our biblical and theological observations on fair pay and equality that all staff should be valued fairly for their contribution to the success of an enterprise and appropriately remunerated. Variable remuneration may be appropriate for other members of the workforce as well as executive directors. Pay differentials within a company, and trends, should be monitored and managed. Such differentials should not be restricted to the CEO against the median employee but should also include gender and ethnicity.
- 5.8.2 This is not to say that there is a universal ‘right’ internal pay ratio between the CEO and employees.

¹⁷ <https://www.ivis.co.uk/media/13874/Principles-of-Remuneration-Nov-2018-FINAL.pdf>

- 5.8.3 Pay differentials will vary according to a number of factors, including the nature of the business, the culture of the company, the countries in which the business operates, and the extent to which basic labour functions are contracted out. Disclosure in this area will need to take account of the risk of unintended consequences (which we have seen as a result of increased disclosure of executive remuneration), such as the incentive to outsource low paid work. “Over two thirds (67%) of FTSE 100 CEOs are paid more than 100 times the average UK salary. Ninety per cent of FTSE 100 CEOs are paid at least 100 times more than the National Living Wage”¹⁸, while in the US the median chief executive pay ratio for 2018 was 254:1, up from 235:1 in 2017 when only two-thirds of the companies it tracks disclosed such figures . In both the UK and US, CEO pay ratio disclosure have become a mandatory annual reporting requirement for companies. It is not difficult to envisage a situation where a company may wish to outsource its ancillary services to reduce its pay ratio. For this reason, it is imperative that, where companies can exclude certain groups of employees in reporting formats, the emphasis should be placed on the company to justify why the exclusion of a particular group is appropriate.
- 5.8.4 It is our hope that monitoring and management of pay differentials will encourage companies to take decisions on remuneration across the company holistically, as a matter of corporate culture and values, and with awareness of the potential impact of differentials on staff motivation, social inequality and social cohesion. Both highest to lowest remuneration, and highest to median, ought to be helpful indicators for management and boards. Rather than simply stating that the remuneration committee takes account of pay elsewhere in the company when setting executive remuneration, committees should be encouraged to explain who its pay policy for the wider work force differ from that of the chief executive. Where the remuneration committee feel it is appropriate to define the wider workforce by a geographic constraint, it should explain why that cohort is the most reasonable example. This should be supported by a time series analysis of the maximum CEO annual pay opportunity; the actual amount received on the statutory single figure basis; and the remuneration of the median employee. As with company accounts, any adjustments to prior year figures should be clearly set out, and ideally this information should be available for a five to ten-year period.
- 5.8.5 In relation to gender pay reporting, US shareholders have been vocal in asking for pay gap reporting, while changes in the UK Equality Act made this disclosure compulsory for companies in Great Britain with more than 250 employees (from April 2018). According to US investor, Arjuna Capital, and US research agency, Proxy Impact, the median income for women working full-time is only 77% the income of men on a global basis. In 2019 US investors filed several shareholder resolutions seeking transparency on this matter. Arjuna Capital, a vocal institutional investor on gender pay, also launched Gender Pay Scorecard; the analysis shows that global companies still need to analyse their current pay structure and disclose their gender pay differentials.
- 5.8.6 The NIBs support gender pay gap reporting and expect companies to disclose their approach to addressing pay differentials based on gender. It is important, however, that companies do not become fixated on financial remuneration to the detriment of other factors that motivate the workforce. We welcome companies stating that there is much more to their offer to their workforce than financial remuneration, and that their offer is not predicated on their employees being able to get richer with them than they could with the competition.

¹⁸ <https://www.equalitytrust.org.uk/resource/pay-tracker-comparing-ceo-pay-ftse-100-average-pay-and-low-pay-uk>

5.9 The importance of the remuneration committee chair

- 5.9.1 The NIBs place their trust in boards to make appropriate decisions for companies, including on remuneration. It is vital that decisions on remuneration are not determined by slavish benchmarking, nor outsourced to remuneration consultants, but made responsibly by independent directors in the best interests of the company and its shareholders. If the NIBs are not satisfied with a company's approach to executive remuneration this should be reflected in voting for the re-election to the board of the Chair of the Remuneration Committee.
- 5.9.2 Where incentive-based remuneration is in place, the remuneration committee often has discretion over the application of targets. Indeed, the scheme rules for many LTIPs will not include the specific targets which must be attained before the award vests, but instead will make reference to the disclosure in the remuneration report or notice of meeting, with a caveat that the remuneration committee cannot impose less stringent targets without first seeking shareholder approval. As our agents, remuneration committee members should be clear that shareholders expect that such discretion can work downwards as well as upwards. The good leaver provision is the most obvious example of discretion which should be addressed.

5.10 Retention and compensation for loss of office

- 5.10.1 While remuneration committees purport that each policy is designed to attract, retain and motivate executives, there are numerous examples of executives, and CEOs in particular, being offered increased packages to work elsewhere. One feature of these is the offer to replace any outstanding incentive awards with an equivalent award of shares in the new company. This willingness to 'buyout' existing awards only serves to undermine wider remuneration practices, but also shareholders' attempts to address remuneration practices more widely. Equally, despite the move away from three year rolling contracts, which were prevalent in the early 1990's, the level of compensation payable has not reduced, as the three-year salary payment has been replaced with compensation for expected incentive payments.

5.11 Conclusion

- 5.11.1 The system and culture of executive remuneration that has developed over the last thirty years, today faces unprecedented questioning. Turning the tide will take courage and leadership from both the non-executive directors who determine remuneration and the executive directors who receive it. It will take courage from asset managers. But above all it will take engagement from the asset owners whose capital is invested. We will work collaboratively and in particular support companies who take risks and model a different way of doing things. We shall continue to reflect on appropriate ethical investment policy with regard to executive remuneration in this challenging and evolving area.