Winning Shareholders' Support
MM&K Remuneration Dinner 26 January 2015

MM&K regularly hosts dinners for Chairmen, Remuneration Committee Chairs and Chief Executives. For each dinner we select a topical subject for discussion. This time the subject was ***"How to win shareholders' support for remuneration changes"***.

Summary of discussion

NEDs are concerned to do the right thing for the company, in order ultimately to build value for the shareholders in the long term. Decisions by the remuneration committee about remuneration policy are made with this objective in mind.

The UK government has given the shareholders of main market listed companies the power to approve the directors' remuneration policy and boards are obliged to make decisions within this policy. Institutions are resistant to building flexibility into the policy and this is particularly problematic when it comes to recruiting new executives.

It makes it essential for companies to talk to major shareholders in advance on any change to remuneration that comes close to being a policy change. But the objectives of institutional investors are often very different from the goals of remuneration committees; moreover views vary between different investors and between the fund managers and corporate governance staff within each investment organisation. The attention of both the latter groups can vary throughout the year.

Nevertheless, remuneration committees have to persist, and diners had good advice for each other on how to get the best response from investors – above all by keeping them well informed of proposed changes throughout the year and by being very persistent in following up requests for consultation.

Introductory remarks

Cliff Weight, of MM&K, introduced the subject. He said the new requirements for disclosure of and voting on directors' remuneration have changed what remuneration committees need to do. Remuneration policy requires a binding vote and, once this has been approved, companies cannot do anything that is not within the policy. In consequence policies need to be written with some flexibility. But shareholders do not approve of too much flexibility.

The advisory vote on remuneration is less of a problem as it is only advisory. Nevertheless, companies do not want a large vote against so remuneration committees need to be aware of shareholders' concerns.

The ABI is now part of the Investment Association (IA) and its guidelines are issued by the IA. Towards the end of last year, the IA reported on the effectiveness of shareholder consultation. They said that some companies:

- Stated they were *consulting* shareholders but were actually *informing* them about decisions which had already been made;

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- Consulted too late for proposals to be properly considered;
- Missed out important information, eg about plan structure or performance conditions;
- Did not inform shareholders when consultation had closed and explain what had been decided;
- Did not disclose bonus targets: retrospective disclosure of annual bonus targets has deteriorated under the new regulations and too many companies are using the 'commercially sensitive' opt-out.

The NAPF has published useful guidelines, saying, inter alia:

Prompt and clear communication on governance issues (including changes in board structures and responsibilities) and on remuneration policies greatly assists in developing good relations between companies and their shareholders. Investors do not wish to micro-manage businesses and thus will hold the remuneration committee accountable for making appropriate judgements. The NAPF expects companies to articulate how their pay policies meet the NAPF Principles in a manner which is most appropriate for their company.

Circumstances which may warrant a vote against the proposed remuneration policy include:

- Insufficient alignment with shareholders – eg a director's shareholding requirement of less than two times salary;
- Performance criteria which are not stretching enough or consistent with the company's strategy;
- An absence of clawback and malus provisions;
- Too much flexibility for 'exceptional' circumstances;
- A recruitment policy which is vague or provides unlimited or substantial headroom above existing policies;
- Bonuses which are guaranteed, pensionable or 'one-off'.

And practices which may trigger a vote against the historical remuneration report include:

- Basic salary increases in excess of inflation or those of the rest of the workforce;
- An omission to use appropriate discretion, for example failing to scale back awards in light of how performance was achieved;
- Insufficient disclosure of performance conditions.

The NAPF have provided advice on the steps a remuneration committee can take to gain investor support:

- Prior consultation on proposals with key investors, shareholder bodies and/or advisers well in advance of implementation and any vote at a general meeting –

remuneration committees should be prepared to have face-to-face meetings where required;
- Understanding investors' views, concerns and objectives (such as those around dilution, alignment, and preventing rewards for failure);
- Clearly communicating in the annual report and/or the notice of general meeting the remuneration policy and its objectives; how it has been formulated and why it is in the best interests of long-term shareholders and makes good business sense. This explanation should cover, if applicable, why the remuneration committee has departed from any best practice/investor guidelines;
- Fully disclosing executive remuneration arrangements, including fixed and variable pay, performance measures, objectives and targets and how these are linked to business strategy and business planning, including risk management;
- Being prepared to discuss finalised proposals on an ongoing basis with shareholders;
- Remuneration committee chairmen being prepared to attend meetings with investors and making themselves available as requested during the consultation period. Additionally, board chairmen and remuneration committee chairmen making themselves available and meeting with their investors on an annual basis to discuss:
    - Investors' views of the company and its position in the market;
    - The performance of the business and its strategy;
    - The quality of the board and the management team;
    - Corporate governance practices and executive remuneration policy.

But will shareholders have the time, high level expertise and resources to be able to talk to remuneration committees? The MM&K December 2014 survey of 400 Chairs and NEDs, *Life in the Boardroom,* gives insights on this question. Survey participants said:

- The new regulations had not made much difference apart from the extra time needed;
- 82% said they could get the access to investors they needed; and 74% could get access to the right people.

This is a generally more positive picture than one might guess from reading the press and the press releases of consultants and proxy voting agencies. Nevertheless a small minority of survey participants expressed strongly their dissatisfaction with the availability of shareholders.

Cliff highlighted the need for companies to be clear in their proposals. 32 listed companies last year had to give further reassurances to shareholders because their policy statements were felt not to be sufficiently clear or comprehensive to win shareholders' support in a binding vote. He asked whether it is satisfactory to leave details to be sorted out during the engagement process.

Cliff posed three questions that dinner participants might like to consider:

- Will you have to go back to shareholders to change your policy? Do you need to add more flexibility in case exceptional circumstance may arise?
- Do you think shareholders will try to 'screw down' directors' pay levels, the amounts of flexibility and payments for failure?
- Do you agree that it is useful to talk to leading shareholders? And to proxy voting agencies?

Cliff then opened up the discussion to the meeting.

Discussion

Attitudes and responsiveness of shareholders

The discussion started with a lively debate about the difficulties of getting an adequate response from shareholders. It was clear that diners had had varying experiences and some were very critical of institutional investors.

> *I am surprised that such a high proportion of people in the LIB survey were happy about the quality of consultation with shareholders. I find it very difficult to consult. It is like talking to a vacuum. Shareholders' responses are very late in the day and when they are upset they blame the rem co. They do not seem to realise that the rem co has to negotiate with the executives.*
>
> *I have found that shareholders don't support the remuneration committee. Don't they realise we are not trying to push as much dosh as possible in the direction of the executives?*
>
> *Shareholders are transient and their objectives do not match those of the rem co. Shareholders say they want you to be in for the long term but as soon as you turn round they have gone.*

This last perception was echoed by others:

> *Shareholders always say "we want the executives aligned over the longer term" but they do not hang around themselves.*
>
> *Shareholders say - will you stay for 3 years? I say will you? Alignment is a big fiction.*

But not all agreed:

> *That does not equate with my experience. We found that 45% of our shareholders had been with us for 18 years (surprise was expressed around the table by some, but not by all).*

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The conflict of objectives between the fund managers in the institutions and the corporate governance people was then discussed:

> *There is another problem, the split within the institutional shareholders between the governance people and the fund managers. The governance people tend to have a view that follows the trend.*
>
> *The fund manager is not part of the 'compliance thing' within the institution.*
>
> *There was a time when the fund manager would see that the share price had gone from 13p to 50p and was happy to leave a company to make its own choices about executive remuneration. But now the fund manager has to fall in with the institution's compliance requirements. No longer do they give way because you are an upper quartile performing company.*

…and the conflicting objectives of different shareholders:

> *Consistency between shareholders and from a shareholder over time is a problem.*
>
> *Compliance is box-ticking. But the remuneration design stipulations vary between different shareholders.*

Some sympathy was expressed for the institutional shareholders' problems:

> *We cannot blame the shareholders, who are under pressure themselves from society. Companies have failed to control executive pay.*
>
> *They have 8,000 companies to deal with - you can't expect much attention.*

This led to discussion on the priorities that shareholders place on remuneration in the broader investment context:

> *It is only at the AGM time when the governance people get involved.*
>
> *Shareholders do want to talk to directors because they too are worried.*
>
> *They will listen OK, but they are worried whether their own corporate governance people will support them.*
>
> *Investors are highly aware if not highly engaged. But they want to engage a couple of times a year only.*

Mutual trust was seen as key to any solution to these problems:

> *It is an issue of trust. Shareholders need to trust boards. But there is a problem of standardisation in shareholder requirements which is not conducive to trust.*

What emerged in the discussion was a sense that the non-executive directors are far more to be trusted with the future of a company than the institutional investors, whose motivations and objectives are very different:

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NEDs try to do the right thing. "Right" means to create shareholder value and also the right thing for society.

Most boards want to do the right thing. Most shareholders do not. They do not care. They just tick the boxes. It's down to us!

Perhaps companies should rate the shareholders!

The discussion turned to other subjects for a while: first succession planning and external competition.

We are always readying two or three people to take over.

In smaller companies it often is not possible to find an internal candidate. But you must still plan succession. This might, for example, involve building contacts with a number of head-hunters.

There was some disagreement about the extent to which companies are at risk of losing top executives to global markets.

And some disagreement about the extent to which remuneration committees will manipulate bonus plans to level up pay:

We noticed that, however a company performs, the total variable pay seems to end up the same. Depending on the LTIP pay-out, the rem co seems to adjust the bonus (as they have more discretion over this element).

That is not right - bonuses are determined by the targets and rules.

Then there was a discussion about AIM companies and how they should approach remuneration consultation and 'best practice':

Our Nomad said – don't go to talk to fund managers.

There is no point in having a discussion. As an AIM company you get palmed off with juniors cutting their teeth.

The meeting re-emphasised the requirement to follow the approved remuneration policy. The example of BG's recruitment of Helge Lund from Statoil was used as an illustration of this problem. When recruiting, the company was forced by shareholders to scrap an upfront share bonus to comply with the already approved recruitment policy; it had to go back to the candidate and change the agreed terms (he he still took the job!)

The influence of proxy advisers was raised and how to deal with it:

There is a misjudged power of ISS over the US investors. So our company had to court ISS next time round; but this did work.

I agree. ISS are box-ticking. But you can change their view. You cannot engage them on the real design issues, but you can make them understand better what your policy is.

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The discussion was then brought round to the theme question: "how can you win support from shareholders"

> *Some institutions don't even bother to reply to your messages. But you have to persist. You need their vote to get a change in the remuneration policy.*
>
> *Get the communication process right: send a letter first, then ring up – they'll say "oh you sent a letter - I'll read it"; then call back.*
>
> *Ring in the spirit of enlisting their support: "we are reacting to difficult company circumstances and we need your support" – but also be firm "this is what we need to do".*
>
> *Focus on the fund managers before the governance people. The Stewardship Code requires firms to publish the point of contact with the fund manager.*
>
> *Persist on the telephone and in writing.*
>
> *We use comparisons with peer groups to sell our needs to the institutions.*
>
> *It is important to have a peer group, a view of the market, but not to follow it slavishly.*
>
> *We keep the shareholder informed all the time throughout the year. Then they cannot turn round and say they did not know or complain. This can work well.*
>
> *Yes, but it is a tedious task (agreement round the table). The shareholder's people do not want to be engaged. You have to drive the conversation.*
>
> *If things are going wrong, that is the time to visit - to visit suppliers and to visit shareholders. Institutions will always take a call. Don't put your head down. Owning up and sharing the problem, that is how you build trust.*

Cliff summarised the issues:

You have to comply with the tick boxes if necessary. There is a problem with engaging, as investors have to balance the time in discussion on remuneration issues with that on strategy and investment. Remuneration consultation is potentially time consuming. Nevertheless 92% shareholders voted for the company remuneration reports so companies must be getting something right.

The majority of shareholders are interested. The problem is we don't know what they are interested in!

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