Remuneration Committee Dinner 22 January 2007

Independent Remuneration Solutions and MM & K on 22 January 2007 held a dinner for clients, most of whom were Chairman of companies or Chairmen of the Remuneration Committee. Over dinner, there was a discussion on the theme of adding value through corporate governance and remuneration.

Summary of Discussion

1. There is mistrust between Boards of Directors and Institutional Shareholders. Post Higgs and the "glittering dinner at the RAC" relations seemed to be better, mutual trust improved and tension eased. Now there are signs that mistrust is growing again. This is reflected in Remuneration Committees where non-executives feel that they are not allowed to make decisions but have to follow the guidelines of shareholders which are intrusive and often unhelpful.

2. Corporate governance can add value, but rarely does. The corporate governance people in institutional shareholders need to up their game. They need to build trust with their own fund managers as well as with investee companies and discuss business issues. Currently they are often unhelpful, focus on techie rule books and try to tick their boxes. They adopt a role as policemen rather than helping the businesses move forward.

3. Remuneration in Private Equity investment companies is simpler, equity based, with low or no bonus, risk of failure/downside and focussed on the initial deal and subsequent liquidity events. Salaries are set at basic middle class existence levels (enough to pay the groceries and school fees). The amount of equity for managers is 10 to 20% of the total and the equity will be leveraged up to several times. Equity gains are taxed at 10% with no NIC for the company, which makes equity rewards much more attractive than cash. Managers are closely monitored by investors.

4. The contrast with a typical quoted UK plc is stark:-

Private Equity backed company	Quoted company
Pay structure is simple	Pay structure is Complex – many plans
Equity is key component	Incentives through annual bonus and long term plans
Equity gains taxed at 10%	Equity gains taxed as income at 40% +1% NI and 12.8% NIC
Salaries set at basic level	Salaries ratcheted up each year
Low or no bonus	Bonus opportunity typically 100% of salary – more in bigger companies - and trend is rising. Very few CEOs get nil bonus
Risk of failure/downside	Often generous severance terms and good pensions
Dilution of 10 to 20% and mainly front end loaded	ABI/NAPF guideline of 5% over 10 years = 0.5% p.a.
Strongly leveraged	Modest debt /equity leverage
Managers closely monitored by investors	Most shareholders have small (<5%) stakes and need to build consensus over time before they can convey their view to Boards about management performance

5. LTIPs and options in quoted companies have to have performance conditions. These are nearly always TSR and/or EPS or a mixture of each. Companies say in their remuneration reports that their pay is linked to strategy, but the performance measures in the long term incentive plans are not strategic. A fast growth company, a recovery company and a "steady as she goes" company ought to have different performance measures which reflect their strategic gaols. Currently this rarely occurs.

6. Consultation produces lots of different views. We (i.e. the companies) know this before we start. We also know we will not be able to satisfy all investors. Companies tend to steer the middle course and not satisfy anyone. Consultation is a necessary process, but rarely adds value.

7. Some remuneration advisers advise against proposing a strategically sensible remuneration plan which does not meet the corporate governance guidelines or tick the relevant boxes. One Chairman recounted being told by his broker that his remuneration proposal was strategically sound but advised him not to pursue it as his investors would not be willing to vote for the plan. MM&K consultants present were extremely surprised at this and said they would have advised the Chairman to proceed with his strategically sound plan and would have helped convince his shareholders to vote for the plan.

8. There is obfuscation of language in annual reports and in the remuneration reports. This is driven by legislation and regulations. Some people felt reports could be written more clearly and it was worth doing so, whilst others felt it was not worth the effort.

9. It is often unclear who owns your shares, who owns the economic interest and who owns the voting rights. Deciding what is the Board's obligation to shareholders is extremely complex.

10. When consulting with shareholders it is crucial to find out at what price(s) they bought their shares. This colours their views about the company and its management.