HOUSE OF COMMONS

Business, Energy and Industrial Strategy Committee

Oral evidence: Corporate Governance, HC 702

Tuesday 6 December 2016

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Watch the meeting

Members present: Mr Iain Wright (Chair), Richard Fuller, Peter Kyle, Amanda Milling, Amanda Solloway, Michelle Thomson, Craig Tracey, Anna Turley, Chris White.

Questions 157-260

Witnesses

I. Amra Balic, Managing Director, Head of EMEA, BlackRock Investment Stewardship, BlackRock, Sir John Hood, Chair, Compensation Committee, WPP, Jan du Plessis, Chair, Rio Tinto, Helena Morrissey, Executive Remuneration Working Group, The Investment Association.

II. Dr Hans-Christoph Hirt, Executive Director, Hermes, Stefan Stern, Director, High Pay Centre, Professor Charlotte Villiers, Professor of Company Law and Corporate Governance, University of Bristol Law School, Andrew Page, Partner, New Bridge Street.

Written evidence from witnesses:

- BlackRock
- Helena Morrissey
- Professor Charlotte Villiers
- New Bridge St
- High Pay Centre
- Hermes

Examination of Witnesses

Amra Balic, Sir John Hood, Jan du Plessis and Helena Morrissey gave evidence.

Q157 **Chair:** Good morning, everybody. Welcome to our Select Committee's inquiry into corporate governance. We are looking in particular today at executive pay compensation. For the purposes of the record, could you introduce yourselves and tell us the company or organisation that you are representing?

Amra Balic: Good morning. My name is Amra Balic, and I am from BlackRock. I work for BlackRock Investment Stewardship team, and I am head of the team covering Europe, the Middle East and Africa. I am based here in London.

Jan du Plessis: Good morning. I am Jan du Plessis; I am Chairman of Rio Tinto, an international mining company.

Sir John Hood: Good morning. I am John Hood, and I am representing WPP. I am a board member and I chair the Remuneration Committee, and have done for the last two and a half years.

Helena Morrissey: Good morning. My name is Helena Morrissey and I am here in my capacity as a member of the Executive Remuneration Working Group, which was set up by the Investment Association in September 2015, because of our view that executive pay was not working.

Q158 **Chair:** We have an awful lot to cover this morning, so I would ask you to be succinct in your answering, and I hope that we will be succinct in our questioning. I have two questions for you all to start with: is there a disconnect between executive pay and workers' pay?

Amra Balic: There are certainly issues with executive pay in the UK that need to be addressed, but please allow me to take a step back. BlackRock is an investment manager, and everything we do, we do purely on behalf of pensions savers, people like yourselves. We actually manage your pension—normal people like nurses, doctors and firefighters who are saving for their retirement. We look at pay from the perspective of performance. I want to highlight this, because if the companies that we are investing in do well, our savers will benefit from that. We have identified certain issues in the UK market, and I would like to highlight three—

Chair: If you do not mind, I do not want a speech; I just want the question answering. Is there a disconnect between workers' pay and the pay of Chief Executives?

Amra Balic: We think that there are certain issues that need to be addressed. Some of the issues are in relation to complexity of pay; some are in relation to metrics for performance as well as the responsibility of the board, which needs to be reaffirmed. We feel that the boards need to own pay. I am sorry; I am taking a little bit of time, but I will get to the point. Pay for performance is what we believe in, but it is important to highlight that that needs to go hand in hand with paying people for a job done.

Q159 **Chair:** We will come on to those themes, and particularly the link between pay and performance, as a good part of our session this morning. Jan, is there a disconnect between the pay of Chief Executives and the pay of workers?

Jan du Plessis: At its heart the issue we are discussing today is the breakdown of trust between society and large and global business, big business. The question of pay is certainly one of the reasons why that trust is broken now. There is an issue; in short there is a good reason why we are all here today.

Sir John Hood: I agree.

Helena Morrissey: I agree as well. Perhaps one number: the FTSE is trading at roughly the same levels as it was 18 years ago and over that period executive pay has more than trebled, which obviously suggests that there is a lack of alignment.

Q160 **Chair:** That comes onto the second question I want to ask you all. Is there a disconnect between executive remuneration and the performance of companies?

Helena Morrissey: In many cases there is, and to pick up the point that Amra made, or had started to make, one of the problems is that often remuneration for executives is very complex. I do not think even they understand the performance parameters that drive it, much less the general public. I also think that, possibly since the financial crisis, there has been an overly pessimistic view of economic prospects, and some of the performance hurdles that were set were too low.

We have had a third factor of a lot of inflation due to uncertainty over what was designed to be performance-related pay and LTIPs—long-term incentives plans. Because they are performance parameters, people wanted to have more to make up for the lack of certainty. I think that, yes, there is a problem there.

Sir John Hood: I can only answer on the specific of the company where I am Chair of the RemCo. We have demonstrated in our submission that the alignment between performance and shareholder value creation is very strong.

Q161 **Chair:** Jan, is there disconnect between the performance of a company and what that company pays its Chief Executive, and executives in general?

Jan du Plessis: As Chairman of Rio Tinto, I would like to believe that we have got it quite right in generally aligning performance or shareholders' experience with what our executives earn. However, I do think more broadly that there is a problem. At its heart, it is so often not easy to even measure performance. Is it short-term or long–term? Is it share price, earnings, cash or dividends? It is a complex matter. I will say, in short, that 30 years ago, when I started first working with long-term incentive plans, they were very simple, with almost no performance criteria. Over time people have brought in more and more criteria by which they want to measure performance. I am the first one to say to you today that in many British public companies, incentive plans are too complex by far.

Chair: Anything to add?

Amra Balic: Not much. I agree that in some cases there is a disconnect between pay and performance.

Q162 **Chair:** My final line of questioning at this moment is to you, Jan, and to Sir John, in terms of company representatives. You have admitted that there is a disconnect with Chief Exec remuneration, the pay of workers, and the performance of companies. Given that you are on the boards of major companies, what are you going to do about it? How are you going to reconnect and produce that reaffirming of trust that has been lost?

Jan du Plessis: It is not a simple question; it is a complicated one. Certainly there has been a lack of trust in large business that has been growing over the last 10 years, because of the global financial crisis and its aftermath. There is a real issue. Big companies have to work harder and harder to earn the respect and trust of societies within which they operate. If you are a mining company that is critical, because without it you cannot operate as a mining company. It is a big challenge that we should take seriously. Pay is an element of it, but the answer is not easy. When you are an international company, operating globally in lots of different countries and different situations, the solution is not easy.

Chair: Sir John, anything to add?

Sir John Hood: I agree. I think Jan has put it very well.

Q163 **Chair:** Is there anything that you think needs to be done with particular regard to your company? Do you think there is a disconnect there and anything extra that has to be done?

Sir John Hood: I think we were talking in general about business and the wider community when we answered the earlier question. There is always an issue about stakeholder validity and verification of the rights of companies to exist. This is a very complex question and a complex set of interactions are being addressed here. Companies always have to work very hard to ensure they have legitimacy with the full range of their stakeholders.

Q164 **Chair:** Do you think that you are, as an individual company, doing that?

Sir John Hood: We work at it very, very intensely, yes.

Chair: And that is true of Rio Tinto as well.

Jan du Plessis: Absolutely.

Q165 **Amanda Solloway:** I would like to look at the pay reforms of 2013 and see if they are bedding in. I wonder whether they have had the impact they were expected to have.

Amra Balic: They have had an impact, at least to an extent, as we expected. Unfortunately, as we already mentioned, we continue to see some companies that do not necessarily capture the link between pay and performance very well. The key thing that we will be doing going forward is holding boards accountable. We will be voting against Committee Chairmen going forward if we feel there is a disconnect between pay and performance.

Jan du Plessis: They have worked very well and are continuing to work very well. I am the first to say to you that, for example, I know that in the last year or two there were occasions when we were dealing with specific remuneration questions, where we would have wanted to do one thing but we realised that our approved remuneration policy would not allow that. I think that has been good. The system is working well; it is working its way through still. I think sometimes we should give it a bit more time before we make further changes, but I think it has been effective.

Sir John Hood: I agree that it has been effective. It has also shown, not anomalies, but the impact of some elements of pay for performance plans, which can raise questions. If you take WPP and the award that has created so much furore to Sir Martin Sorrell this year, it is an award that results from a five-year scheme, so long-term performance interest over five years that was approved by shareholders back in 2009 and then disapproved by shareholders in 2012, and terminated at that stage.

However, because it is a five-year scheme and runs out over five years, we are seeing the results of that scheme, with shareholders disapproving, still appearing in 2016 and for the last time in 2017. There are some counter-tensions here, where what was legislated in 2013 and implemented in 2014 by way of votes on policy plans, and much stronger engagement with institutional owners in particular, is all very good. However, the results of five-year schemes can create anomalies, as we have just seen. If we change that scheme in 2013, we will not see the results until we publish results for the 2017 financial year, which will be in 2018.

It is a long time lag, and there is nothing that can be done about that, because if we do want to have long–term measures of value creation in our incentive schemes, then we are going to have to accept that where design is not approved at any stage down the track by institutions, there will be a hangover.

Helena Morrissey: I do not see how we can say it is working when we obviously have the distrust at present between big business and the rest of society, particularly over executive remuneration. I would disagree with my other panellists. I do think it is a work in progress, and you could point to some evolution, but not necessarily the revolution that is required. I also think it is quite early days. In 2017, 50% of the FTSE companies will be going through their second triennial binding vote on remuneration policy, so it is still quite fresh. I think we should stand back from it all and say that although this country perhaps has better standards, better holding to account, better shareholder engagement and better corporate governance structure than other countries, it is not good enough yet.

Q166 **Amanda Solloway:** Continuing on from that, perhaps Helena first: have there been unexpected consequences, perhaps, of the reforms? I am thinking perhaps of transparency. Has it inadvertently made pay or remuneration higher, whereby people are possibly being assessed against other companies, saying, "I expect that," rather than looking at their own performance and impact on that company?

Helena Morrissey: There are a number of factors behind the inflation of executive pay, and that would be one of them. The over-dependence of many companies on their remuneration consultant is another factor, where you have a rather standardised approach to remuneration. Also, remuneration consultants will be bringing to the attention of the boards or Remuneration Committees that pay might be below the median. Everybody wants to catch up or go beyond the median.

The transparency generally is a good thing; flexibility is also a good thing, and it is compatible with simplicity. However, we need to have another careful look and try to wean companies off overdependence on so-called experts, who have set up a whole other industry around advising companies, and tend to push people down the same approach, which is not necessarily the right approach for that company.

Sir John Hood: I would just like to make one comment on the point you raised in your question about pay inflation. Two of the factors that are not taken account of in the use of the language of pay inflation is the fact that many of these companies are growing rapidly. They are incredibly international and very complex, dealing in a highly intense technology innovation environment, which is very competitive. The price of talent rises in those circumstances. It rises because of growth; it rises because of complexity; it rises because of the magnitude of the task; and it rises because, at the lower levels of the organisation, there are not enough of the highly talented people you want to acquire for the firms that are competing in the space. I do not think this can be discussed, absent looking at the dynamics of the growth of firms, and absent looking at the dynamics of labour markets, not just in this country but globally.

Q167 **Amanda Solloway:** Are companies therefore self-regulating in terms of assessing that talent, in terms of pay? I am just thinking that there is a danger, is there not, of a company that has a similar kind of brief, that looks and thinks, "We have that talent," but might not have that talent or contribution? Has that been an inadvertent effect?

Sir John Hood: The labour market is a regulator, at the end of the day, wherever you are operating. For example, we are operating in more than 110 countries in the world. We only have 17,000 of our 130,000 fully owned full-time employees in this country; it is only 17,000 of nearly 200,000 if you include our associate companies. We are looking all the time at marketplaces that are highly variable in their pay and reward structures, competition for talent, dynamics and so forth.

Amra Balic: I think there has been a real unintended consequence of the quality in content of disclosure in the UK around pay. We see that through executive pay: benchmarking has become one of the key reasons why we see pay increases year on year. We also call it chasing the median: people know how much their peers are paid, so that becomes an important starting point, rather than reference point. On the use of remuneration consultants, we also feel that there needs to be more clarity, disclosure and transparency around their use, and also who pays them. Is it the management team or the board? Ultimately the answer is that we feel transparency has had a role to play.

Q168 **Amanda Solloway:** One final question: I am just thinking about whether there should be limits on transparency. I will put that to you first.

Amra Balic: No, I do not necessarily think that we need to limit transparency. We really need to limit use of that transparency and how boards are using benchmarking. Benchmarking should be used as a reference point, not as a starting point.

Jan du Plessis: May I say I agree with the basic proposition? I think transparency, perversely, has had unintended consequences. However, we live in a time where it is very hard to argue for less transparency. For example, in our case, because we are also subject to Australian listing requirements, we publish fully all information that we would normally publish in the UK in respect of our Chief Executive and in respect of the 10 most senior people who form our Executive Committee. We have to be more transparent than any typical UK public company. I think that is right, but it is problematic.

Q169 **Craig Tracey:** Can I ask a quick point, carrying on the theme of unintended consequences? I wondered what the panel's view was of publishing pay ratios between staff. What would be the potential unintended consequences of introducing that—pay ratios between the highest and lowest earners?

Helena Morrissey: I and the Executive Remuneration Working Group were in favour of the publication of the median to CEO pay ratio. Clearly it is one of the measures that has been cited in terms of inflation of executive pay versus that of the average worker. The only unintended consequence that I can think of, talking about my own industry—but perhaps it is not a bad thing—is that sometimes ratio could look relatively low, because the average worker is highly paid. One could argue that the Prime Minister, obviously, is looking for prosperity for all, and one way to reduce the ratio would be to have everybody paid more. You can only do that if you have successful businesses, so it is maybe not a bad thing.

I do not think that this is a legitimate counter-argument, but I will put it on the table. Sometimes you get a distortion because some industries as a whole pay the average worker much more. Clearly, within the sector good comparisons could be made, and it would also show just what the gap is between the top and the bottom.

Sir John Hood: For a global services firm, which WPP is, I am not even sure what the word "worker" means. I will just leave that with you as a thought piece. I go back to what I said a moment ago. We have close to 130,000 wholly owned employees in the wholly owned businesses, of whom 17,000 are in this country. In South Africa we have 32,000; in China we have 14,000; in India we have 14,000. I could go on through the world. I am not sure what this concept of "average" means, nor what the concept of "worker" means in a professional global services firm.

Q170 **Craig Tracey:** So from your perspective it would not be feasible to implement it in any way.

Sir John Hood: Correct.

Jan du Plessis: I take the view that if the publication of pay ratios is a political tool to put pressure on companies to keep a lid on pay, and that is what is required, of course that is what we will do. In truth, if I can be transparent, I am highly sceptical as to what it will mean. We as a company employ about 55,000 people worldwide. Approximately 300 of them are at our head office in London, and the other 54,700 are all over the world, where pay and working conditions are vastly different.

Quite honestly, I am not sure it would mean anything for us, and it could actually have unintended consequences in terms of how we adjust our global portfolio, either buying or selling or not buying or selling businesses that sometimes might operate in countries where the wages, by definition, are quite low. I would not die in a ditch on this point, but, being honest with you, I am quite sceptical; I think it will tell us nothing.

Amra Balic: I think the question has already been answered.

Helena Morrissey: Could I just add one thing in response? I think in the past, in 2011–12, BIS did a review of disclosure around gender balance at different levels of companies, and companies said they did not know who their senior management were. That was one of the responses that was accepted. Sometimes, while there are legitimate points that have been raised, clearly companies do know what an average worker would be paid in a particular country. I would just caution the Committee about saying, "It is all too difficult," because I think there can be validity around some of these measures.

Q171 **Chris White:** Good morning. If I can go back to Sir John for a brief moment, following Amanda Solloway's question. You were talking about the changing pace in terms of technology, innovation and growth. Do you think executive pay is a function of those, and would you suggest that a smaller company or one with less technology or innovation would not be able to adjust for similar remuneration?

Sir John Hood: My point was that we operate in labour markets that are changing very rapidly, owing to the need for more and more highly skilled people, as technology evolves in the ways that it is, particularly in the sort of professional services that we offer.

Q172 **Chris White:** Can I come back? This is just to clear up my own thinking. Are you suggesting that Chief Executives who are paid a considerable amount are expert technologists?

Sir John Hood: No. What I am suggesting—

Chris White: They have similar management skills to a good Chief Executive of any company.

Sir John Hood: No, the point I was making in answer to that question was simply that one thing that is often missing from this question of increasing remuneration of Chief Executives over time is the fact that many of the companies they are running are growing rapidly. They are growing in terms of their geographic footprint and their product portfolio. They are growing because, in our case, digitisation is pervasive and is enabling us to do many more things that otherwise we could not do before, in terms of data analytics and so forth.

The complexity and scale of the organisation, the range of products and services it offers, and its geographic footprint have all grown rapidly. There will be a remuneration implication of a much larger business, as well as a remuneration implication of value creation as a result of growing the business profitably.

Q173 **Chair:** Is that really the case though, Sir John? It seems to me that WPP is a massive global success story. It is global in its reach, but one single individual, in the shape of the Chief Executive, cannot possibly control those global operations.

Sir John Hood: I am not suggesting—

Chair: It would be devolved to managers, so why provide that superstar salary in respect of something where you need proper management processes throughout the globe in order to keep control of what is going on?

Sir John Hood: Could I just make clear that Sir Martin does not have a superstar salary? He has a salary that sits within the range of other CEOs in the UK. Martin Sorrell, the Chief Executive, has an incentive programme that rewards him highly for value creation and for increasing shareholder wealth. His remuneration is very highly levered to that. At expected value, 84% of his remuneration is about value creation. The bulk of that, all bar about 8% of that, is rewarded in shares, and he keeps those shares. He holds them for ever, other than those he sells for tax. He has held them for ever, and built a holding of 1.7% in the company, because he wants to be totally aligned with the shareholders' interest.

As he has led the company, he has created value at a very, very high level, and has been rewarded very highly for it.

Q174 **Chris White:** I do not think that is in doubt, but you talk about an alignment between shareholders' interests and interests of executives. In your compensation section of the annual report there is a very clear graph about historical TSR performance. There has been a fivefold increase in shareholder returns over the past few years—five years, I think. Yet in terms of returns to the Chief Executive, that is tenfold. Why is that gap widening?

Sir John Hood: That is simply because of the scheme that I spoke about, which was closed in 2012 as a result of shareholders, who had voted it in in 2009, resolving that it was too generous and too highly geared. Since then, we have been operating with a much more lowly-geared scheme, and if you look on the annual report, on page 148 you will see a set of ranges there for the likely outcomes, once that scheme cuts in in 2017.

Q175 **Chris White:** I want to be quick, but I want to follow this on. You talk about adding value. Is the Chief Executive sitting at his desk in the morning saying, "Wow, I have just added another bit of value; I have created something really brilliant"? Or is it perhaps his employees who one day dare to dream of adding a similar level of value?

Sir John Hood: Yes. Our incentive schemes scale down through the organisation, to your point. They scale down through the executive ranks. We have about 50,000 of our employees who are awarded shares this year, and over time over 130,000 have been awarded shares in the company.

Chris White: I just wanted to pick up in terms of long-termism. You may be aware that the IoD in its written evidence proposes moving away from bonuses and LTIPs and moving towards paying the right salary for the job. What is your view on that, first of all?

Amra Balic: Absolutely, we still believe that pay for performance is a very important starting point. Ultimately, however, that needs to go hand in hand with what you need to pay for a job done. The answer to that is not always "the most".

Jan du Plessis: I would of course agree with that. It is important that companies do take a long-term view. In the mining industry it is a very long cycle of business, and I am proud to say that a few years ago we moved our long-term incentive plan up to five years. As I am sure the Committee would know, the vast majority of incentive plans in the UK today have a three-year vesting period. Some have a four-year vesting period. We have a five-year vesting period, which I think is right, because you can only assess your performance over a five-year cycle–in my opinion arguably even longer, but that becomes very impractical and our executive would resent that.

I am proud of that; I think it is right. Focus on the performance of the company over the long term is important. I will say again that I think there is too much complexity in many remuneration schemes in Britain today. Frankly, even in our own company some aspects of our schemes are unnecessarily complex.

Sir John Hood: I agree. Rewarding for long-term value creation is very important. Our schemes have been five years for a very, very long time, as have Rio Tinto's. I also think that there is merit in annual bonus and long-term incentivisation, because there are matters every year that need to be addressed and incentivised, as well as satisfying the long-term value creation underpinning purpose of the company. I think there is merit in both having an annual bonus, properly prescribed, and in having long-term incentive schemes.

Q176 **Chris White:** Do you think they would do a better or worse job without an incentive scheme? Would they do less if they did not have these incentive schemes?

Sir John Hood: They probably would go and work overseas.

Q177 **Chris White:** Before I bring you in, I just want to talk about the UK Corporate Governance Code. Do you think it is effective in promoting and securing long-term performance incentives? Can we come to you, Helena?

Helena Morrissey: It is a mix of the code and obviously other aspects of how the market is set up. Perhaps I can pick up on some of the points from the previous one, and hopefully address that at the same time. This argument about global competition for talent is a little bit difficult to justify, because really it is only the US market that we are talking about, as an outlier, when one looks globally. I would agree with the implication of your question: "If you paid executives somewhat less, would they stop working so hard?" I do not think they would.

I refer to the *Harvard Business Review*, which suggests that key executives are motivated by lots of other things besides money, and the analysis done by Mercer's earlier this year, which said that the best paid CEOs failed to offer the best value for money. They looked at the value for money within the FTSE and listed people according to how much value is added.

Q178 **Chris White:** You are suggesting there is no link.

Helena Morrissey: I think what we are talking about often is a limiting case, echoing Amra's point. There is a point you would say, "Surely someone would get out of bed and go to work and do a good job for £20 million; it does not have to be £60 million." There is a point, is there not, when we are talking about the limiting cases here? We need a bit of a reality check on what we are trying to signal for all stakeholders. The Corporate Governance Code can only go so far in playing its part. Shareholders, obviously, have to do their part. Companies have to act responsibly. I think it is time, as you are doing, for a really sweeping review.

Q179 **Chris White:** Apart from pay, how would you encourage long-termism? How would you encourage long-term thinking about a firm? What are the other drivers—or is that the main driver and there are other drivers?

Helena Morrissey: It is a driver, and clearly for key executives they will want to work somewhere where they are well remunerated for their contribution. However, the people I know who actually feel their business enables them to fulfil their own potential feel that they gain from being able to create something for their employees, that they can inspire, and that they can create change in the marketplace. Most people who are executives would honestly say that they do it for more than just the money. There is a sense of satisfaction that they are creating value for a broader community.

Q180 **Chris White:** Apologies that I keep asking you the question, but you said that the code can only go so far. What do you mean by that, or that the code only goes so far?

Helena Morrissey: Clearly we have a comply-or-explain code here, which is a very valuable part of how we do business in the UK. However, it means that then people need to be held to account if they are not particularly complying or explaining. That often puts a burden of proof on the shareholders to ensure that the code is properly enacted. It is just one of the key aspects that we can use to ensure that things are done properly.

Q181 **Chris White:** Jan, can I just ask you: when you responded to the Chair, you were talking about a breakdown in trust. Is that a fair assumption of what you said in your earlier answer?

Jan du Plessis: Indeed.

Q182 **Chris White:** Do you think that decisions should be based on evidence of a link, or on public perceptions of fairness?

Jan du Plessis: In theory, I should have said purely the link, but the reality is that perception is important. In a sense, in the real world we live in, perception sometimes becomes the truth. Sometimes this is tough, but companies have to try to deal with that perception as best they can. You cannot ignore the perception. If there is a perception issue, that has to be addressed.

Q183 **Chris White:** Would you like to add to that?

Amra Balic: Yes; I would just add that for us, that comes back to the board. It is the board's responsibility, first of all to make sure the link between pay and long-term performance exists. Secondly, it is down to the board to ensure that the broader context is taken into account.

Q184 **Chris White:** I have just one more question. You have just come right to where I hoped you would. How important is the CEO in reality? Obviously, some of you have to be slightly more careful than others in what you say.

Amra Balic: We believe that the quality of the management team is absolutely crucial in delivering strong, long-term performance of companies.

Chris White: So that is "not very"?

Amra Balic: No, the answer is we think it is very important, but it is the responsibility of the board to ensure the team are remunerated in the right way to drive long-term behaviour.

Chris White: I am not specifically talking about pay in this instance. I am talking about whether you would miss them if they were not there.

Amra Balic: Absolutely.

Chris White: Would you miss the CEO?

Amra Balic: Yes.

Jan du Plessis: I would like to confirm that I think the Chief Executive is extremely important. I would rather say frighteningly important. I do not mean to be flippant at all, because I am making a serious point, but I am a rugby fan, and if you look at how the England rugby team is performing, it is outstanding, not having lost a game for 14 matches. I am making a serious point. The only thing that has changed, apparently, is a new manager. The same team and the same players have changed beyond recognition. I am making a serious point. I ask myself, "How is it possible that apparently one individual can come in and change the mindset of an entire team of players, who now are world-beaters?" I am quite seriously making the point, to illustrate that the top leadership of any organisation is critically important.

Sir John Hood: As a New Zealander, I might question the "world-beaters" bit, but I agree 100% with what Jan said otherwise.

Helena Morrissey: I would say no man or woman is an island. Obviously, we have had examples where a bad CEO has done something quite difficult, and destroyed a company. We have had examples of where a good CEO has added value. However, I would say that if we have correct corporate governance, it is much more important to have a good management team and good board holding them to account.

Q185 **Peter Kyle:** Thank you to Chris for opening up such rich seams of questioning. Jan, why do you think the manager of the English rugby team does that job without asking for £20 million?

Jan du Plessis: I do not know exactly what he earns.

Peter Kyle: It is not £20 million.

Jan du Plessis: No, it is not £20 million, but I could say to you, for example—maybe one gets into silliness here, which I do not mean to—

Peter Kyle: We are not, because—

Jan du Plessis: If you compare rugby players with football players, of course, it is a different world. In the world of rugby I have no idea what he earns, but I would guarantee that he is probably the highest paid manager in the world of rugby. That is a guess, but probably I am not far wrong.

Q186 **Peter Kyle:** Sir John, if I could just follow up on your point, you did make the point quite clearly about the role of the Chief Executive creating value for a company. Sir Philip Hampton is Chair of GlaxoSmithKline, and previously of Sainsbury's and the Royal Bank of Scotland, so he has been around the FTSE 100 a fair amount. He has said that the larger a business is, arguably the less credit the CEO deserves for creating value. That is because of the corporate infrastructure that is in place.

I have the exact quote here, which says, "the role of CEOs is often overstated." Particularly when the company gets large, there is so much infrastructure in place, and many other senior managers of extremely capable skill-set, driving value throughout the company. It becomes absurd that at the very, very top you have one person who is taking so much responsibility and credit for driving value throughout a very complex organisation.

Sir John Hood: Yes. I was not trying to say that, to be honest. I was talking about the importance of the CEO as leader of the organisation, but I also made the point that our incentive programmes are scaled down through the organisation, in recognition of the very point—

Q187 **Peter Kyle:** Sir Philip is not wrong, then, to make that point?

Sir John Hood: No. It is in recognition of the very point that Sir Philip is making, that we recognise there is a large, very significant number of our employees who are all part of this engine, as he describes it, and create the value. However, it needs leadership.

Q188 **Peter Kyle:** The core of the question is, therefore, why that one role at the very top is taking such a large and disproportionate part of the remuneration, when the other managers who are very senior are creating so much value for the company elsewhere.

Sir John Hood: That is exactly what the shareholders reacted against in 2012, and why we have had a much lower levered scheme from 2012 onwards, the results of which you have not seen, because it is a five–year scheme. The other one has yet to run out. It is exactly that point that was addressed.

Q189 **Chair:** Helena, Chris mentioned pay ratios between the Chief Executive and the average worker, and you responded. Do you think there should be pay ratios between the Chief Executive and the rest of the executive team?

Helena Morrissey: Yes. I had not thought of it before, but now we are having this conversation, I think it is a very valid point. If we are trying to avoid the over-concentration of power that has sometimes led to difficulties in companies, that would be a good idea.

Q190 **Chair:** What do other people on the panel think about that sort of suggestion?

Jan du Plessis: Personally, I am not sure it would be helpful, but I say again that for Rio Tinto we already publish, in full detail, the pay of our top 10 people—exactly what they earn, their bonuses, their rewards, their pensions and everything. It is all there, so calculating it just requires a calculator.

Q191 **Chair:** Jan, can I stay with you? You were talking to Chris about a five-year period being a suitable long-term perspective in respect of shareholder return and an executive remuneration package. Can you tell me how it works in Rio Tinto? Can I just say: over the last five years your company has seen revenues halved, capital expenditure cut by 62%, net debt increase by 68% to $13.8 billion. As a means of trying to keep the share price high, you have doubled the dividend. You have had a share buyback, and yet the share price has fallen, over that five-year period, by 9%. In that context, Chief Executive compensation has risen by 25%. How on earth can that be justified?

Jan du Plessis: Can I respond? Some of the facts and figures you quote I do not recognise, but it does not matter.

Chair: I am reading the annual report.

Jan du Plessis: I understand the question. In good faith, I will respond to the question, even if it is to say that we unfortunately did not double our dividend; we unfortunately halved our dividend, for example. However, it does not matter, because I do understand the question. I will give the answer in good faith, as best I can. We have traditionally had two ways of measuring our share price performance: relative to a global mining index, and relative to a global share price index, to try to measure how we are doing relative to other companies. If I may say to you, to honestly give you an example, that in the boom years of the mining industry we were doing extremely well, and people were all happy with our performance.

We then went to our shareholders and said, "We should not measure our success just relative to the general equity index, because if you are a mining company and you are experiencing a boom, it is easy to do well." We then asked our shareholders, "Can we suggest that going forward, for half of that we should measure our performance relative to both criteria?" In fact what has happened in the last five years is that we have underperformed the general share indices, and typically our schemes at the moment will pay out almost nothing, because we have done much worse than general equity indices.

However, we have done much better in relative terms than the rest of the mining sector, because we have a good business with low-cost assets. In fact, although the share price has come down, we have done very, very well compared to our global mining peers. That is why, to some extent, our executives, I think quite rightly, deserve a payout.

Q192 **Chair:** Put simply and bluntly, the rationale behind that, in terms of the remuneration committee, is: "We are not as rubbish as other people in the mining sector; therefore we justify a 25% uplift in our Chief Executive's pay."

Jan du Plessis: I would not put it like that, but I would say—

Chair: You more or less did.

Jan du Plessis: Honestly, to give you a very genuine and transparent answer, the problem we have is that in the boom years, it is easy to look like a genius. It is easy to think you are a genius, whereas actually you are just lucky. You happen to be in an industry that is experiencing a tremendous boom, which is what we saw in the mining industry in the first decade of this century.

When the boom turned, we said to people, "It is clear that, just because you are in the right industry at the right time, it does not make you a genius. It does not mean you deserve a fortune. Managing a company in the downturn is even tougher," and that is what we are trying to say here. Yes, if the industry globally is in a downturn, if you manage that well, and you manage it better than others, I think you have done a good job.

Q193 **Chair:** I genuinely do not understand, from the perspective of a shareholder. You have seen revenues halved, the company moving from profit to loss and the balance sheet shrunk. Then long-term value creation requiring capital expenditure has been cut by something like two-thirds. Why do you not see an absolute fall in Chief Executive remuneration?

Jan du Plessis: To take, for example, capital expenditure, the harsh truth is that in 2012 we were spending far, far beyond our means. We were living way beyond our means. We had to cut the amount of capital we were putting into the business, because we could not afford it. What we are doing today is much more realistic in terms of what that company is able to afford. That would be an example of something that is a difficult decision, but the right decision for the business.

Q194 **Amanda Milling:** One of the terms that everyone on the panel has used at some point in this session so far—I think it has been demonstrated quite well—is the concept of complexity in executive pay. It is something everyone talked about in the opening remarks. I am just wondering what could be done to simplify it. It also goes back to the point about public trust. The more complex this is, as was just explained, the greater the real danger that the confidence of the public is eroded.

Helena Morrissey: When the Executive Remuneration Working Group first met, about a year ago, within 15 minutes examples were cited, just like the one the Chair has just cited, in which it was very hard to rationalise good payouts on the basis of poor performance. Yet there seemed to be carefully thought through parameters for LTIPs. The reverse is also relayed by members of the group, some of whom are Chairs of Remuneration Committees. The words used were, "It was like a lottery."

The parameters were so complex, and so many different thoughtful, but ultimately erroneous, performance hurdles were set, that you ended up with nobody really quite knowing what would drive the returns, and having to adjust after the fact. That is what was done for WPP. The suggestion we made was to say, "Let us stop pretending that these hurdles can be set with great foresight. Let us make some suggestions." We did suggest that each company could come up with its own parameters, but one suggestion we made was to give restricted shares that did not have complex performance hurdles.

One way then to help with the inflation and deal with the inflation of pay that we have seen echoes the point made about holding periods. If you have a very long holding period, executives quite rationally tend to discount the value of that. They think it will be less certain, so they ask for more. We said, "If you make it more certain, if you just give out shares, then you could perhaps discount, and by 50% of the current awards." People would trade more certainty, we would not be pretending we have a science when we really have an art, and it would be a way of deflating the level of executive remuneration. That was just one suggestion.

Q195 **Chair:** I apologise for interrupting, but is there an appropriate vesting period that could be put across companies, or would it be individual sectors, like-for-like companies or individual companies? What sort of vesting period should there be?

Helena Morrissey: We did think that three to five years was about right, partly because, as I say, if you say it is 10 years, which is ideally how long you would want executives to hold their remuneration for, then

a) some executives do not serve that long, and b) they would discount it too much and you would end up giving out far too much. We felt that three to five years was okay, and that individual companies should work out the parameters for their own business. They might have a long cycle of production, or they might have a short, very rapidly changing one.

Q196 **Chair:** Should they try to even that vesting period out, so executives get little bites of the cherry every year, rather than going up progressively high, and then having a big leap, as we have seen with WPP?

Helena Morrissey: One of the things we were trying to do, and I think it would be helpful if this were in some way echoed by your recommendations ultimately, is that individual companies should come up with "This is what we believe in; this works for our company," and then sell it in to the shareholders and stakeholders, to earn trust properly. That would genuinely reflect their own parameters. We suggested that, and said, "You might want to consider apportioning it out over a number of years so that you do not get a cliff, and you get a more gradual averaging out."

However, we were not prescriptive. One of the big elements that keeps being circulated is trust, and we do not think that you can gain trust if you just copycat somebody else's scheme and pretend it suits your own business.

Q197 **Amanda Milling:** Would there be potential unintended consequences as a result of that kind of framework that you just described?

Helena Morrissey: Clearly, one of the downsides of giving out just shares that did not have the performance parameters, besides being still imposed, is that it does seem to fly in the face of pay for performance. As I say, one of the hopes would be that that would reduce the amount that you give out. Also, you would be able to use your annual bonus, and the awards of future grants of long-term incentives, to reflect actual performance. There is no very straightforward answer if you are trying to create transparency, simplicity and lower overall levels, and recognise that people have, as we have discussed earlier, more reasons to do a great job than just getting paid like hitting the jackpot. We are trying to avoid that.

Sir John Hood: I understand the last point. We do use restricted shares. We use them on occasion for recruitment and for retention. However, we are very strongly about incentivising performance, and aligning with shareholder interests. We think, therefore, that performance shares are a better instrument in that respect. We think the question then is about leverage in the scheme—the leverage of the number of shares and the rate at which those shares increase with value growth.

It is also important to recognise that certainly WPP, and I imagine many other FTSE companies, have a significant US shareholding, and a significant shareholding outside the US and the UK. Therefore, we have institutions in different jurisdictions that have different views on restricted shares and performance shares. One thing we would need to talk about very carefully, if you wanted to make recommendations on the restricted share line, is whether or not British companies would be able to persuade the majority of their shareholder base that restricted shares alone were an adequate incentive, given those issues of wanting to reward performance and shareholder alignment.

Jan du Plessis: Let me firstly repeat that. I think even in the case of Rio Tinto, elements of our remuneration are so complex that even I struggle to understand it, and that is a big statement. It is an admission. This is a real issue. I would be the first one to argue for a much more simplified scheme. So what is the "but"? The "but" is, first, if you put a room of well-meaning, experienced people together to talk about these things, there will be differences of opinion to begin with, because it is complex. If it was not complex we would not be here.

The second illustration is that in the case of Rio Tinto's annual bonus scheme, 20% of our payout is linked strictly to the safety of our employees. At our company, safety really does come first. We will never negotiate on that. It is unusual, and many other companies will think it is nonsense, but for us it is very, very important. A year ago, in the context of work we did with a number of institutions in relation to global warming, we adopted a resolution at our AGM in which we made a number of commitments on what people do in order to deal transparently with the challenge of global warming.

The question was then, "If it is so important to you, why do you not build it into your pay schemes?" I say it as an example; it is really difficult to begin to bring in carbon footprint and so on in your long-term pay schemes. That is an example of the complexity that you can build on top of complexity on top of complexity. It is very easy to become trapped into accommodating lots of different people with different interests. It could be about safety, because of environment issues, or because of whatever.

The challenge we all have is to keep it simple. It is too complex; I would love to keep it simpler, but I would like to reiterate the point that has been made. In the case of Rio Tinto, our shareholders are in the United Kingdom, across Europe, in Australia and the United States and across Asia, and many of them would fundamentally disagree with much of what is being said here. They would even disagree with much of what I say. Therefore, our problem is that we come up with pay plans, and we need those to be supported by our shareholders to the tune of 80% or 90%. That is quite hard when there are differences of culture and opinion.

Q198 **Chair:** If I can nip in very quickly, Jan, you mentioned that safety comes first in your company, and yet in terms of remuneration, which is quite rightly part of the overall package, the Chief Executive got 100% of the relative component of the bonus for safety. The Chief Financial Officer got

150% of the bonus relative to the safety component, yet four people died. How does that show, in terms of the values of the company? There were fatalities and yet they still got over 100% of the recommended bonus.

Jan du Plessis: Just to clarify something that is misunderstood, and then I will give a proper answer to the proper question, I think the way our scheme works is purely odd mathematics. In fact the target is calculated as 200 and then scaled down, so 100 is half.

Chair: Yes, I have it in front of me. So it is 200%, but because people died, they only got 100% and 150%, respectively.

Jan du Plessis: Mining is a dangerous business. We work with lots of equipment; we work underground. It is a dangerous business, which is why safety is so, so, so important. Sadly, as far as I know, in our 140-year history, we have never had one year without a fatality. I hate to admit it, but it is true. Therefore, if you take safety seriously, to say to your Chief Executive, "If there is a fatality you get zero on safety," sounds politically appropriate but is not realistic. Sadly, we have never had a year without a fatality.

Chris White: Would that not give him an incredible incentive?

Q199 **Chair:** "You get a bonus if there are no fatalities on your watch." That is a massive incentive; Chris is absolutely spot on. That would drive performance, and it is in keeping with the culture and values of your organisation, because you have said safety comes first.

Jan du Plessis: Safety really does come first. By the way, this is a good challenge. We often talk about this in our company. I will say again that when you have a 140–year history, and you have never had a year without a fatality, I am sorry but if I can use the term, this is a trap of political correctness. I would say to our Chief Executive, "Unless you eliminate fatalities, you get zero bonus." May I say, if one is not very careful, very quickly you will be forced into creating other ways of compensating somebody, because he says to himself, "I will never get a bonus for safety."

Q200 **Chris White:** You are suggesting that this is custom and practice. You are not looking as though this is something that could be addressed. Even outside a pay scheme, this is something that could and should be addressed.

Jan du Plessis: It would be hard for people who do not know our company to understand how seriously we take safety. Safety is, at every board meeting, the first agenda item; before we talk about profit or cash or anything, we talk about safety. It is a very, very important topic at our company. It really comes first. However, when you employ 55,000 people worldwide, working in dangerous conditions, with heavy equipment, doing dangerous jobs, the reality—I can just look you all in the eye—is that it is extremely hard to eliminate fatality. We are doing our best. We could not try harder.

In the mining industry, I know we have an outstanding reputation for safety. I know it. I am proud of it. It is horrible to have fatalities. Every time we have a fatality, I get a message to that effect within about one hour from our Chief Executive. He will wake you up in the middle of the night to say, "Jan, we had a fatality in Australia or Canada or wherever." It upsets us. We investigate it. The whole board gets a full report. We take it very seriously. I cannot tell you how important it is to us.

I am sorry to say that to tell our Chief Executive, "If there is a fatality you will get zero," honestly, ladies and gentlemen, would be playing to the audience. It is not a way of encouraging the multitude of things that we actually do on a day-to-day basis to improve safety statistics. Our safety record on injuries per worker per hour of work has been declining consecutively for the last 15 years, in a way that is most impressive. We have done good work; it hurts us when we have a fatality. It is really painful. I could not express my sentiments with greater sincerity.

Q201 **Anna Turley:** It just seems to me that the remuneration and the risk here are not aligned. Those who are putting their lives at risk on a day-to-day basis, who are working in your mines, what is their remuneration? The CEO, to be fair, is not risking his life and limb. We are talking about his remuneration, and the gap between those at the top and those who are doing this extremely dangerous work. It seems to me that the people who are putting their lives at risk are not the ones who are being remunerated for the risk and the investment they are putting into your company. I just put that out there.

Jan du Plessis: I do not think so. I am quite proud of what we pay our people. Clearly, it varies from situation to situation, but I think we generally pay our people well. I think we pay them well for an important job.

Q202 **Michelle Thomson:** On a slightly different topic, you will have noticed that I have been sitting here quite quietly and listening. Previous sessions we have had on this have broadly been summarised as, "Everything is fine around corporate governance." Today, we can summarise as "executive pay is difficult and complex, but everything is fine." Helena, you made a very interesting comment when you said that the comparative with the US in terms of executive pay was significant. You were pointing out that that was not the case elsewhere. I am interested in knowing more about your views. Would you confirm that is the case? What led us to that point, and, critically, what can we do to change it—to move away from this: "It is difficult, it is complex, but everything is fine"?

Helena Morrissey: It is fair to say that in the US corporate governance standards are very different from ours in a whole manner of respects. Often there is the same CEO and Chairman, for example, which is obviously long outdated practice here. There are many, many different aspects. In fact Newton, in this AGM season of 2016, voted against management 79% of the time, against 17% in the UK. At the opposite end of the spectrum, continental Europe and Asia were around 50%. That is just to give a flavour. It is not just on remuneration; often it is on board structure and other aspects of corporate governance.

The question that we should be looking at as a whole for corporate governance is: are we satisfied with an improvement, since Sir Adrian Cadbury did his review in 1992? You could argue we have had a continuous improvement. We have continued to assess and to improve and to change the code, and to work hard to have what is, internationally, a good standard. We are relatively good, but is that, in absolute terms, good enough? I would just throw down the gauntlet.

Q203 **Michelle Thomson:** I am most interested in your view, because it is hard to compare like with like, I agree, in general corporate governance. However, it is specifically on executive pay that we seem to be locked in this dance with the US that is quite out of kilter with what happens elsewhere. There are many large economies that are operating global companies, but do not seem to have the issue to the same extent that we do. I am interested in your views around that and what could be done.

Helena Morrissey: As has already been said by Sir John and Jan, we do obviously have a global market for talent. However, I do want to stress that the US is out on a limb. Often you can add a nought onto remuneration for executives here, and that will be comparable to the pay packages in the US. I think it is completely disconnected from the rest of the globe, and we should not worry quite so much. We might lose the occasional executive who might be tempted by a very large pay package. However, I come back to the points made earlier; I believe that people do a job to do a good job, and not all of us are completely motivated by the pay packet. We just want to be genuinely reasonably well rewarded.

I have spoken to Asian executives, and they have talked about having a nought less than in the UK. We need to decide for ourselves what the right framework is, and accept that there may be one or two who perhaps we do not need, if that is all they are motivated by.

Q204 **Michelle Thomson:** How can we do that? How can we take the radical action you are suggesting?

Helena Morrissey: I think this whole review and the Green Paper on corporate governance that includes executive remuneration ties in with wanting to set the right standards for society and business relationships today. I think we need to be bold, and be very proud of being a leader globally in terms of strong standards. Obviously, we want to make sure companies continue to want to list here, and we do not want to completely go overboard, but I think we can set what our principles are.

To add caution to Mr White's question about listening to all the reasons not to do something, sometimes we have to say, "This is the end state that we have in mind, where people are not disputing pay for executives, where they feel that all stakeholders' interests are taken into account, and where there is prosperity for all."

Q205 **Michelle Thomson:** Do you think the Green Paper goes far enough?

Helena Morrissey: Obviously, it sets out a whole range of suggestions, so it is not prescriptive in that sense. It is asking for feedback, obviously, on a range of things. On issues that we are not necessarily addressing today, like workers on boards, I would say that a Stakeholder Committee, for example, does not quite wash with me. I have seen people sanitise what they discuss with other stakeholders.

On executive remuneration, my personal view is that it could go further, but as long as we took the further limiting case of the suggestions, then I would feel it was progress. Ultimately, we should check against the problems that have occurred in the last several years, and say, "Would it catch those ones? Would it prevent those happening?" I am not 100% sure it will. I do not want to be here in two years' time having the same discussion.

Q206 **Amanda Milling:** I just want to ask Amra my initial question on complexity, because I think you raised it in the first instance. However, I also, in that discussion, would be interested in your views. What I am hearing is that there are some structures to these schemes that mean that you cannot fail. You are rewarded for failure whatever way. I would like your views on that element too.

Amra Balic: I think we all recognise complexity, so I will not repeat that. We think that structures are the key issue with complexity. Policies that pay out over a certain period of time, that are rewarded at the point, potentially, where the company was doing reasonably well, for example, will be paying out to an extent, regardless of what happens in the future. I think this is problematic from a perception point of view, and it is something we need to look at from the perspective of communication and explaining that.

We heard earlier about some pay policies that are still paying out today that were approved six or seven years ago. Going forward, what would be useful for investors would be to have some more transparency around how some of the policies could be paying out in, let us say, five or six years.

I cover Europe also. It is very interesting, from my perspective, to see that this is the market that, for 13 years, has had some shape or form of vote on pay. It was advisory, but since 2013 we have had a binding vote on policy. This is still the market where I spend by far the most time talking about pay—more than any other market in Europe. As we speak, I probably have around 100 consultation requests that my team is dealing with.

From that perspective, I think we are willing to work with you, the Committee, to help you get us to the point where pay becomes one topic that we talk to the companies about, and does not overshadow more critical points around strategy and execution of strategy. We very much welcome your work.

Chair: That is very helpful.

Q207 **Peter Kyle:** The discussion has been so rich, and I will try to be crisp, because I know we are pushed for time, and I am getting a look from the Chairman. Amra, if you had more power to influence executive pay, would you use it?

Amra Balic: I think we have enough power. What we will certainly be doing more of going forwards is holding boards accountable for what they do in terms of pay. What is happening as we speak is that we are preparing a paper and a letter that will be going out in coming weeks to 350 UK companies. It will specifically outline some of the market-level concerns that we feel exist, such as pay rises year on year, pension contributions and use of benchmarking. We will hold Chairmen of Remuneration Committees directly accountable for what happens with pay, if we feel the pay is not linked to performance, by voting against.

Q208 **Peter Kyle:** You have had those powers, all the ones you just listed, for a very long time. Yet either you have not exercised the influence you have, or it has not been listened to by the other side. Why?

Amra Balic: They have been exercised—not necessarily always in the same way, because we do believe, and I think you will probably hear this from my companions here, that there are different circumstances and companies need to be looked at on a case-by-case basis. We have used that power, but I think that power, going forward from our perspective, will be directly linked to what we do and how we feel about pay for performance.

Q209 **Peter Kyle:** Do you agree that executive pay is a consequence of the short-termism in—

Amra Balic: We have not touched performance targets. They are as problematic as complexity. Performance targets have far too often been focused on share price performance or the short term.

Q210 **Peter Kyle:** Correct me if I am wrong, but according to the structure of your business, you are remunerated based on an annual performance system and you are exerting an influence over the businesses in which you invest.

Amra Balic: I am afraid that is not correct.

Q211 **Peter Kyle:** You can see where I am going with this. Is not the whole system driving towards short-termism? You are making demands on companies based on the way you are remunerated, which in itself is pretty short term.

Amra Balic: We are not remunerated on an annual basis, on the basis of one year's performance. BlackRock believes in pay for performance, and our portfolio managers' remuneration is directly linked to the performance of the funds, which is measured over different points, going as far as five years.

Peter Kyle: So five years is the longest period over which—

Amra Balic: Yes.

Peter Kyle: So you see where the short–termism is embedded. Just to broaden this—

Amra Balic: Can I just stop you there?

Peter Kyle: Yes, of course you can.

Amra Balic: It is really important to highlight that close to 90% of BlackRock's investment in equities today is through so-called index tracking strategies. What that means is that there is no decision to buy or sell; we invest in companies because they are constituents of certain indices. We are invested for the long term.

Q212 **Peter Kyle:** I appreciate the clarification. I have one final question, just to broaden this. The reason we are asking these questions is that it sounds as though we are having a discussion within the sector and within the industry itself. The reason why this is important, and executive pay is important, is not just the relationship between shareholders and companies. This is now a nationwide, and in fact a global, issue, which is expressed to us politically and in various different ways.

If we look at the way in which politics is structured now, and the decisions that the country is making, there is a very clear sense in the country that some people are running away with everything, and some people are being left behind with nothing. This is a point at which the public discussion is coming into the boardrooms. This is not just an inward-looking conversation that you now have the freedom to have amongst yourselves. The country and the public are now inviting themselves into this conversation, which is why we are having it in the first place.

If I could just ask a final question, starting with you, Jan, about the motivations for a Chief Executive? About five years ago, the Government started to increase the performance pay of teachers in schools. Increases to pay were linked strictly to performance. It had no impact whatsoever, and of course the academic research into this shows that pay is a very low motivational factor for teachers. This is repeated in various other sectors.

What impacts the motivation of teachers most is being able to have a demonstrable impact on young people's performance. It is being part of a team that is rewarding and motivating young people and delivering outcomes to young people. What is it, in your experience, that motivates Chief Executives and drives them most?

Jan du Plessis: Chief Executives are typically highly committed, highly driven people, who are committed to achieve great things over the time of their tenure as Chief Executive. I do very much believe in the importance of pay for performance, but it can be overstated. I am agreeing with you; it can be overstated.

Q213 **Peter Kyle:** Answer the question directly: what do you think are the top one or two things that motivate and drive Chief Executives in your experience?

Jan du Plessis: Whether people believe they have been successful will ultimately, in the long run, be measured based on whether they have created value for shareholders.

Peter Kyle: Sir John, you are welcome to contribute.

Sir John Hood: I agree with that point.

Peter Kyle: At what point did pay supersede offering Chief Executives a really good opportunity? At what point did pay become the defining factor of attracting talent?

Q214 **Chair:** Is it to demonstrate the size of their antlers, in respect of, "I am bigger than anybody else here"? Is that what drives and motivates them — that they have to be seen to be the best?

Jan du Plessis: I think there sometimes could be an element of that. That is a frank answer.

Q215 **Chair:** That means the ratcheting up of pay, does it not?

Jan du Plessis: A little bit, yes, Mr Chairman; that could be the case. Can I say in the case of Rio Tinto, that I hope my attitude has demonstrated that I think there is a problem? I do think there is a problem. However, at the risk of sounding like I am denying that there is a problem, can I just give you three statistics quickly, from my perspective? There are a number of Chief Executives in mining companies today, in Canada, the United States, Australia and elsewhere, who have been recruited from Rio Tinto directly to become Chief Executives at other companies, companies that are typically much smaller.

We are the second biggest mining company in the world, by far. They are currently running businesses that are much less complex, much easier, and, in Canada, the States, Australia and elsewhere, they are earning more than our people. That is a complexity. Our current Chief Executive is French. The previous was Australian. The previous was American. The previous was Australian. We really do operate in a global market, and 10 of our current Executive Committee are foreigners. We do not have one British-born executive in our top team. There are Spaniards, Belgians, Canadians, French, Australians and Mongolians. It really is a global business.

I am trying to give you my problem. It is a global business that we are competing in, and it is tough.

Sir John Hood: Could I just turn your question around a wee bit? I think the starting point may be somewhere different. I think it is that the demands of our owners, our shareholders, are very intense. They are competing among their competitors to find the very best investments for their investors, to maintain and grow their own businesses. The demand for performance is very, very intense. There is a natural inclination, in any organisation, for there to be agency costs between the purpose of the organisation and the motivation of the people within it.

The incentive schemes that we have are designed, as far as possible, on a performance basis, to get rid of as many of those agency costs as we possibly can, to align the interests of management with shareholders, to create that superior shareholder value that our shareholders want. We can take this argument as far as you want, back into quarterly reporting and everything else, but I think it really starts at that point. Boards have to be sure that they have done everything possible to get rid of agency costs, so that they are employing Chief Executives who are motivated to give the sort of performance that investors are—

Q216 **Peter Kyle:** To finish off, my core point is that I have had the real privilege—and it is a privilege, because I have learned a huge amount from it—of meeting quite a number of FTSE 100 Chief Executives and Chairs. In conversation with them, when I ask what motivates them and gets them out of bed in the morning, it is beating the competition, delivering value, succeeding for employees and being able to stand up before employees and see their faces when they deliver success. It is all these sorts of things that they talk about.

Sir John Hood: Those too, yes.

Q217 **Peter Kyle:** And yet nobody is going to turn down a great pay packet. It strikes me that there has been a huge failure in the system to throw money where, very often, money is not the deciding factor for many of these people, who are so driven to make it to the very top. I just put it out there. I realise that you are speaking on behalf of companies, and you might not want to—

Sir John Hood: My only reply to you would be to say, "Sit on a board one day of a FTSE 30 company without a Chief Executive, because the Chief Executive has, for one reason or another, gone, and try to hire one without thinking about what the labour market requires you to pay, and what the labour market requires you to incentivise at." It is quite a challenge. I can assure you: it is not just a UK challenge. We have to look at the world to find the best leaders of our top global companies.

We are not doing this in isolation. We are not playing flippantly with numbers. We are trying to design systems that best align the interests of the shareholder with the performance of the company and the leadership qualities of the Chief Executive. That is what we are trying to do. This is a very complex equation we are trying to solve.

Anna Turley: I would like to focus on Remuneration Committees, and it fits in perfectly—

Sir John Hood: Excuse me; can I just check one thing? How long are we running, Chair?

Chair: I am going to go on to 11, if that is okay, Sir John.

Sir John Hood: Thank you.

Anna Turley: It segues perfectly into the factors you have just said have driven that. What I will do for brevity of time, Chair, if it is okay, is to ask a few sub-questions and then ask you each to respond to particular elements of that, whichever is of most interest to you. What are the drivers and the factors that Remuneration Committees look into when they are creating this kind of package? Are there any incentives at all within the pressures they feel to keep pay low and to reduce pay? Is there any pressure put on them at all to keep pay to a minimum?

How are they engaging with stakeholders, whether that is employees, shareholders, or others in the market? Are they proactive in doing so, and again, what is driving them to do that?

What level of authority and independence would a Remuneration Committee have? Do they feel obliged or under pressure from their Chief Executives? Do the non-exec directors put pressure on them to continue to ratchet up pay? Do they feel they can challenge a board and a Chief Executive in terms of coming to the package they present? It is a generic question, and I would be grateful if you would just pick up the elements within that that you feel you would like to, starting with Amra, if I may.

Amra Balic: We feel that Remuneration Committees are incredibly important in setting pay. We think they are the ones to be held accountable for what they do in that space. Conversations around pay with Remuneration Committee Chairmen or members of a Remuneration Committee in the UK are high. We spend, as I mentioned earlier, a substantial amount of our time talking about pay with different Committee Chairmen.

We think directors' duties—this probably comes under the umbrella of directors' duties and competencies—are incredibly important for Remuneration Committees. Often, directors need to stand up in front of a management team and say no or "We need to think about this again." From our perspective, we look at Remuneration Committees and their Chairmen to create pay packages that will work for executives and incentivise the right behaviour over the long term. I really highlight that it is over the long term. At the same time, they should be cognisant of some broader issues—for example, inequality—that have been mentioned in different contexts in this conversation.

Jan du Plessis: I would like to respond by making two points. One is that at Rio Tinto, certainly at our Remuneration Committee meetings, there is quite a considerable period of time at every single meeting without a single executive or professional adviser in the room. It is just the members of the Committee—just them as the Committee—and they can talk to each other frankly and honestly about the challenges, the issues and what they really think. It is quite healthy that we create an environment where we can be frank and honest and critical of those not in the room. These debates do not take place with executives or remuneration advisers looking on. That is quite important.

Q218 **Chair:** Why do you commission remuneration consultants?

Jan du Plessis: We still listen to the remuneration consultants, of course; we take their advice. I just think it is quite important sometimes to make your own judgment as well, and that is our job. Of course, when the decision is taken, we have the remuneration consultants in and they give us their advice. I just wanted to give you the assurance that we do have serious sessions when we are completely private, which I think is really important.

The other point I would make is that I think as a company we believe in regularly talking to our owners, our shareholders. Our Remuneration Committee Chairman, and I, as Chairman of the board, regularly talk to shareholders. We find them quite responsive, and I have to say that over the last five years, on a typical year, approximately 70% of our shareholders have actually voted, and typically well over 90% of shareholders vote in favour of our various reports.

We think that we have quite a high level of engagement with our owners, and with 90%-plus support for what we do, quite a high level of support for the decisions we make.

Q219 **Anna Turley:** Can I just ask quickly: as well as the consultation with the shareholders, do you consult with your employees throughout the organisation as well? Do you have any—

Jan du Plessis: We do not consult with our employees. We of course know what they are being paid, but we do not consult with our employees.

Q220 **Chair:** Would you like workers on Remuneration Committees?

Jan du Plessis: I think that would be very unhelpful, if I may say. The reason I say this is that in well-managed companies there is complete integration between a number of elements. There is developing and understanding the strategy of the business—what you want to do over the next five years—the way we should execute strategy on a year-on-year basis, and obviously the performance of the business. There are your targets for a given year, the management talent available to you, how the management are developing the performance, and therefore what you pay them. There is a coherent integration of all these elements.

I do not think it is possible to slightly artificially separate out remuneration decisions. It is quite right that shareholders should vote on it, but in a decision-making forum, those things need to be properly integrated. On top of which, if I may say, Sir John has already alluded to the fact that sometimes it is difficult to know what is a worker. If I can speak for Rio Tinto, practically speaking we employ 300 people in the UK, in our head office and their average pay is £100,000 per year. I am sure we would all agree that is not what we have in mind when we talk about workers.

Therefore, the other 55,000 minus 300 work elsewhere in the world. I have no idea how we would identify that worker, whether it is a Mongolian, a South African, an Australian or a Canadian. It is very hard to go there. As much as I want to respond to this discussion with an open mind, to be honest, I do not think having a representative on the committee from one of our 300 people, who earn on average £100,000 per year, will take us any further.

Q221 **Anna Turley:** Sorry to keep on, but you are presumably unionised within your organisation. Do you have union representation in any way?

Jan du Plessis: Not in the UK because at our head office they are all well-paid people and senior executives. We do not have a union in the UK. We of course have unions in many, many different parts of the world. You will appreciate that we have unions in different countries and provinces all over the world. As a practical matter, I have no idea how we would determine which union or which worker would be represented and how that would work. I am trying to be constructive, but I will be honest: I have no idea how we would do it.

Anna Turley: I appreciate your answer; thank you very much. Sir John.

Sir John Hood: I agree with everything that Jan said. There are only two things I would reinforce. First, whereas there is always a temptation to criticise the role of consultants, they play an important role in giving us up-to–date information about labour markets and where they are at, and what others are doing and why. They help us to understand well the dynamics of the labour market. I would also reinforce Jan's point about the independence of the Remuneration Committee. It is the Remuneration Committee, based on its own deliberations, that comes to the final decisions, which it then brings to the board table.

I would also reinforce the point about keeping a close dialogue with our institutional owners in particular, so that we understand what they are thinking and they understand what we are planning and thinking with respect to our policies going forward.

Helena Morrissey: If I could just make a couple of points, the Executive Remuneration Working Group made 10 recommendations in total, three of which were around the strengthening of the Remuneration Committee and its accountability. These are the practical suggestions, as well, that we would like to see reflected in enhancements to the Corporate Governance Code. For example, for the Audit Committee Chair, there is a requirement to have recent and relevant experience, and there is no such requirement for the Chair of the Remuneration Committee. We think the Chair of the Remuneration Committee should serve at least a year on the Remuneration Committee before becoming the Chair, which is not always the case.

We do not always see–although Jan is obviously exemplary–the Chair getting involved or attending meetings, or having some connection with the workings of the Remuneration Committee, which we think, again, would be helpful so that you do not end up with something being overruled or not understood.

Sir John Hood: The Chair of the company.

Helena Morrissey: The Chair of the company, sorry. Thank you, Sir John. Also, although obviously we have had some good examples here of the independence of the judgment of the Remuneration Committee, some, we think, do rely more on their consultants.

I would like to make one additional point, because obviously there has been some discussion about the shareholder engagement, including around the previous questions. At some point Mr Kyle made the observation that there was a joined-up chain here of people all doing something, and resulting in a system that, when you stand back from it, does not really work. One of the problems with the shareholder engagement is that it is often in the specialist environment, social and governance groups within institutional shareholders, and this does not always, again, get reflected in what the mainstream portfolio manager is thinking, doing and acting. I do not think that is always because they are very highly paid. Sometimes they do not want to have a bad relationship with the companies they invest in, and so forth.

However, there is something more that the fund managers need to do, to move this from niche to mainstream and take their part in the responsibility that we all have, to involve the public and make sure that everybody is happier as a result of these investigations.

Q222 **Chair:** I opened up the questioning by talking about disconnect—disconnect between pay of executives and workers, and disconnect between executive pay and company performance. You have quite rightly talked about that disconnect between businesses and society. Who is responsible, primarily, for that disconnect? Is it boards? Is it RemCos? Is it executives themselves? Is it shareholders? Is it the shareholder advisers? Is it Government for not regulating? Could you identify where that disconnect comes from, and where should we, as a Committee, target our attention in how to remedy that disconnect?

Helena Morrissey: Everybody is complicit in this.

Chair: It is everybody's fault.

Helena Morrissey: It is, because it is a bit like a frog in a boiling pot that does not notice. There are various elements that are around, and everybody has been playing a part in what has ended up in this disconnect. That may seem to be a forlorn hope, then, to solve the problem, but it is one reason why, going back to a point I made earlier, I would not take excuses for an answer. Everyone will point the finger at somebody else and say, "Oh it is not our fault; it is because the shareholders are not engaged, or not every shareholder votes, or the RemCo is not listening to employees," and so forth.

Everybody, every single part of the chain, needs to see the standards improved.

Sir John Hood: I think we can come at this in many different ways. I might myself think that it starts a long way back, and that what we are seeing in our societies is a greater and greater disconnect between those people who have been well educated and well trained and have good jobs, and those people who unfortunately have missed out as a result of poor education. They have seen jobs move away from where they live, and their skills not suited to the current world. They are working, if they do have jobs, in very poor conditions and with low pay.

There is something in all of this about the way we are approaching the education and the educational opportunities in this country. Getting back to the point that was made about incentives in schools, I completely agree with the point. Different types of people become teachers in schools with different environments. We have to get a much better operating education system in this country so that people have a) the skills, and b) the understanding to be members of 21st century society.

Jan du Plessis: Chairman, I could not put it more eloquently than Sir John. He has put it very, very well. I think there really is an issue; I certainly do not have an answer. I am simply saying I would like to contribute as much as I can towards finding solutions. This was very eloquently put; at the heart, that is the issue we all face.

Amra Balic: It is important to highlight that there are different roles and responsibilities of the different parties that you mentioned. I generally believe that we need to work as a group together, to actually think about how we move society as a whole forward. I would just like to point out something else, which is that technology is pushing more people out of work than a lot of other things we have discussed today, and we need to be cognisant of that.

Q223 **Chair:** Ladies and gentlemen, thank you very much for your time. I apologise for keeping you longer than expected, but I did so deliberately, because we were getting a lot out of you. Thank you again, and we appreciate it.

Examination of Witnesses

Dr Hans-Christoph Hirt, Stefan Stern, Professor Charlotte Villiers and Andrew Page.

Q224 **Chair:** Thank you for coming to give evidence. Sorry for keeping you waiting. Could you just tell us who you are and what organisation you represent, and then I will crack on with questions?

Andrew Page: Good morning. I am Andrew Page, and I am the Managing Partner of New Bridge Street. New Bridge Street is the remuneration consultant to around one-third of FTSE 350 listed companies.

Professor Villiers: Good morning. I am Charlotte Villiers, Professor of Company Law and Corporate Governance at the University of Bristol.

Stefan Stern: I am Stefan Stern, Director of the High Pay Centre think tank, which looks at the issue suggested by our name. In the spirit of transparency I should say that earlier this year we did receive a small but welcome financial contribution from Hermes.

Dr Hirt: I am Hans Hirt. I work for Hermes Investment Management. Hermes is owned by the BT Pension Scheme. I head up a special team at Hermes that is doing stewardship work with companies all around the world, for 42 big pension funds, which is partly addressing the problem of collective action and the costs of stewardship.

Q225 **Chair:** I am conscious of time, and conscious that I do not want to keep you too long. I will ask colleagues to be as crisp as we can, including myself, and I would ask you to do the same for answers, if I may. Could I just start by asking what the factors are that have been responsible for the ratcheting up of executive pay over the past 20 or 30 years, and what we can do about it?

Andrew Page: There is a good body of academic research looking at some of the factors that have driven executive pay over the last 20 or so years. I refer the Committee, for example, to work at the LSE by Van Reenen and Bell on this matter. Some of the matters that are cited are around globalisation, broader capital markets, and the impact of technology. Simply put, those factors have allowed Chief Executives and other senior executives across organisations to exert much more influence on much larger organisations, and therefore potentially to create much more value. That has been reflected in their pay.

Q226 **Chair:** In brief—I know this is a simple question but very complex to answer—what can be done about that?

Andrew Page: A lot has been done already. The problem that I perceive is not necessarily one of high pay; it is more one of a misalignment of pay and performance. I think many investors would take that view. An enormous amount has been done to ensure that pay and performance have been brought into line, particularly since the financial crisis in 2008. I am happy to expand on some of those aspects.

Chair: We will come on to those matters and themes, if we can, later on.

Professor Villiers: I think short-termism is a real problem, and to a degree a lot of this discussion centres on trying to align interests between managers and shareholders. Whilst I obviously see the point of that, there are societal issues at stake as well. Often, for example, the employees are pushed out of the picture. Concentrating so much on the shareholders' interests is part of the problem.

Stefan Stern: People have been asking for more and getting it. I would echo Helena Morrison's final answer; it is a systemic problem, and therefore it is wrong to point at any one player and say, "It is all their fault." There has been a collective failure and a gradual ratcheting up, to the levels that we see today. There are some, frankly, slightly self-serving arguments used about the difficulty of the job, scarcity of the talent, or technological change. Briefly consider the history of the 20th century: two world wars, hyperinflation, financial crises, technological change; it has never been easy to run a big company. I do not think it is necessarily so much harder now.

Q227 **Chair:** What needs to be done about it? If there is a systematic problem, what needs to be done in order to change that?

Stefan Stern: The Green Paper raises the possibility of some interventions, all of which we think are necessary and good. The publication of pay ratios, employee representatives on the Remuneration Committee, and the better engagement of asset managers with the binding annual votes are all steps in the right direction. Ultimately, you are touching on the fact that this is a cultural problem. It is about attitudes and behaviour, and it is quite hard to regulate for that in the end. You need a collective effort, and people to recognise that things have gone too far.

Q228 **Chair:** Does the Green Paper go far enough?

Stefan Stern: The questions are all open ones, so I am hoping for the best.

Dr Hirt: I think there are two critical factors. One is the increasing complexity of packages, and the attempt to align the interests of shareholders and management. This has increased complexity; no one understands any more, and we even had the admission here earlier that sometimes even executives do not understand it. Sometimes we speak to remuneration consultants rather than the board themselves about remuneration because they are not able to understand it in full detail.

The attempt to align, focusing on factors like TSR and EPS, is a problem. It is also about accountability or maybe cultures, and about Remuneration Committees probably not doing as good a job as they could. There is also a role for investors, who could do more on average.

Chair: Thank you; that is very helpful.

Q229 **Michelle Thomson:** I am interested in some brief thoughts about the impact of the 2013 pay reforms on transparency, and unintended consequences. Just picking up on something that you said, Dr Hirt, to what extent does the current complexity of the pay packages inhibit transparency? It is a fairly general question, but I am interested in that specifically as well. Perhaps you would like to go first.

Dr Hirt: Yes, absolutely. Sometime it is just a problem that no one has really thought about how much could be paid out as a result of a package. The Rem Committee should really be coming to shareholders and saying, "Here are the scenario analyses. This is what could happen if the company performs particularly well." That should be coupled with the fact that about 75% of incentive schemes actually pay out. It is almost wrong to speak about variable compensation, because most of these pay schemes pay out.

It is probably pushing it too far to say there is concealing of payments, but something we are saying in our remuneration proposal, "Would it not be more honest to say, 'Here is the total figure'?" Maybe we should be paying much more simply, in fixed pay in particular, and as a result we could pay less.

Q230 **Michelle Thomson:** Professor Charlotte, I can see you are nodding your head, so perhaps you should come in on this.

Professor Villiers: Yes. I agree with what Dr Hans has said. I think there are lots of elements to the pay package. It is not just the variable aspect or basic salary. We have bonuses, pensions and various add-on perks. It is a very complex package that we see people at that level receiving. That, first of all, makes it very difficult to read the reports. The evidence suggests that since the Greenbury Report was published in 1995, annual reports have been extended extremely, and that makes it more difficult for the shareholders to see what is going on. They then have to rely on ratings agencies, etc, to try to make some sense of all of this. That is the first thing.

I think that the variable aspect is problematic. If we cannot see the total sum, how can we work out what the pay ratios really are? Publishing the pay ratios, in principle, will be necessary, but I understand that of course there would be a number of consequences, and we have to think quite carefully how we go about that. In your question, you started off with the possibility. Evidence suggests that some companies are selectively looking at particular kinds of employees, or even geographically selecting. In the end, what we are seeing is compliance or creative compliance, rather than really complying with the spirit of what we are trying to do here. That is something we would need to address.

Q231 **Michelle Thomson:** Has the principle of transparency contributed here with ratcheting up the overall package?

Professor Villiers: Yes. I think that the evidence tells us that.

Michelle Thomson: I do not know if anyone else wants to come in, because I am very aware of time, Chair.

Andrew Page: If I may, you raised two points about transparency and complexity, and also the 2013 regulations require very full transparency on pay packages. I think I would say that investors, and anyone else who cares to read an annual report, have the full facts available to them. To your second point, though, on the complexity: yes, they are complex arrangements, and that makes them difficult to navigate at some points.

On that point about complexity, however, I would simply say this: no company, certainly none that I know of, starts out from the basis of trying to create a complex scheme. The complexity in a scheme arises because there are multiple stakeholders, different investors, and different views on various elements of pay, and because companies themselves are complex. In a sense, this complexity, whilst many companies would identify it as an issue and indeed are seeking to de-layer it, is not there for its own sake.

Stefan Stern: The simplest form of payment is cash, which everyone understands. It is quite striking how much people tend to bemoan complexity, but then say there also seems to be no way out of it. The variable pay elements are problematic and highly complicated. Share prices move for all sorts of reasons, completely beyond the control of CEOs or boards, because of commodity prices, geopolitical events, and so on. Some of the core elements of so-called performance-related pay elements are problematic. Cash would be a lot simpler.

Q232 **Chris White:** Good morning. You sat through the previous panel, and I have some similar questions to ask you. If I could start in terms of long-termism, do you think that is encouraged—or should be encouraged—through remuneration?

Andrew Page: Long-termism comes in two slightly different forms. There is the question about when remuneration is paid, and there is the question about, where performance is measured, the period over which it is measured. As you heard from some of the previous panel, the large majority of United Kingdom companies measure performance over a period of three years in their long-term incentive schemes, and pay it out over a period of three years, often with deferral to a fifth.

Since the financial crisis, there has been a very significant move towards long-termism. You have seen companies putting more of their pay into long–term schemes. To the extent that they pay through annual measurement—in other words through annual bonuses. They defer a significant portion of that into shares and defer it for a long period, often up to three years. In addition to that, there has been an additional protection on those deferred amounts, which is the possibility of recovery and withholding. If the payment is later found to have been made erroneously, the company has a right to go and seek to reclaim part of that, or not to pay what has already been paid.

Q233 **Chris White:** Does that happen often?

Andrew Page: It has been used mercifully rarely, but I think, like a fire blanket, most companies are glad to know that the possibility exists, were they to need to use it. As I say, very few companies have had to resort to that.

Professor Villiers: Some people in the industry tell us that the long-term investment plans do not work as well as they ought. I am not really an expert on that aspect, but the remuneration policies and plans that we put in place should be long-term in terms of what we are expecting from the top, but right through the company.

Q234 **Chris White:** To ask a slightly different question, then, do you see a link between company performance and executive pay? That is one for the panel, really.

Professor Villiers: Performance is itself a complex concept, because there are different aspects of performance. There are lots of different ways to measure performance. If we concentrate, for example, on TSR or EPS, then we are narrowing it down far too much.

Q235 **Chris White:** What I am talking about is not so much measuring performance as how you incentivise performance. Does pay act as the main driver in that, or is it just one of the many issues and not the most important issue?

Professor Villiers: I think it is an important driver, but I do not think it is the only driver.

Q236 **Chris White:** As Peter said in the previous panel, there are so many other ways to get somebody out of bed in the morning than to give them a huge stack of money.

Professor Villiers: Yes. If we are looking for the long-term success of our company, we do have to be mindful of what we pay people. However, I think we have to be mindful of what we pay people through the whole company, first of all. Secondly, I think that long-termism is not just about pay but about how we treat all the people working in the team. It is a team effort. Good, successful companies recognise that their success comes from team effort. In the earlier panel, you asked the question, "Are CEOs important for driving value?" Of course they are, but so is everybody else.

Stefan Stern: I do not think five years is long-term. I think you were employed a year and a half ago for a five-year stint here. I do not suppose you think—

Chair: It does seem rather less.

Stefan Stern: You made my point for me. I do not think five years is long-term. I think the question of performance is very complicated.

Briefly, on the rugby point, the England coach said himself on the radio yesterday that credit should go to the players. Leadership is important, of course, but he was very clear on that. He is not on the pitch. He is not scoring tries or tackling people. The players are doing the work, and that is just a team of 15, or 22. I agree completely with what Charlotte just said.

Q237 **Chair:** Who does it well? I think Chris might want to come back on this, but can you name and praise? Which companies think, "It is all about our people."? The Chief Executive obviously has to manage a complex organisation, but it is done within the context of recognising that the true value creation is through its workers and through that shared ethos? Who does it well?

Professor Villiers: The obvious example that many people point to would be the John Lewis Partnership, but I know it is not a complete bed of roses there.

Q238 **Chair:** What about a FTSE 100 company in the traditional sense?

Stefan Stern: I suppose ARM Holding proved its worth, and its attractiveness to the acquirer, who has paid an enormous amount of money to buy it, but that is a slightly rarefied, specialist industry. Clearly, the contribution of very intelligent, capable people, producing extremely valuable products and services, is clear.

Q239 **Chris White:** I will be really brave. We have mentioned rugby. How do you compare, say, the manager of the England football team to the manager of the women's hockey team? How do we work out the incentivisation? Who is creating the wins? Who is doing the better job, on a pure basis of remuneration?

Stefan Stern: Of course, with football you are talking about a highly lucrative—lavishly so—global industry, with TV rights, agents and genuine superstars, as well as some so-called superstars, able to ask for enormous amounts of money. Excellent though I am sure women's hockey is in this country—did they not win a gold medal?—it is not quite yet able to command similar rates of pay. That is a market competition factor.

Q240 **Chris White:** Going back to that question, then, and Professor Charlotte, I think you started to answer: how relevant and how important, in reality, is a Chief Executive? You talk very much about the team.

Professor Villiers: Yes, I do. A Chief Executive is, of course, really important, partly for the message they send out to their staff. If they behave well, it is a good role model. Culturally the CEO is extremely important. If you have a good culture, you bring people along with you. I can talk about the same within the university sector. A head of school can make all the difference, but at the end of the day we rate our law school on the contribution that everybody makes.

There is a bit of a market element to this, so when you are comparing, for example, the football team with the hockey team, yes, market elements come into play. I also think that social justice issues are normally left out of the discussions, certainly in the corporate governance literature. That ought to be brought in more strongly.

Dr Hirt: It is a very important role, and can make a real difference, but there are also differences between types of CEOs. I think you spoke earlier about Sir Martin Sorrell, who is more an entrepreneurial type of CEO. If you look at Bill Gates or Jack Ma, they are much more important for their companies than a hired CEO who stays for five years and moves on. It is an important role with lots of responsibility, and should be rewarded appropriately, but there are few superstars who could pick their job and work in Germany, Japan, the US or England, just moving around and commanding a salary. I think the global market for executives is a little bit more restricted than is commonly argued.

Stefan Stern: From a corporate governance point of view, we do not actually want CEOs taking very big decisions on their own. This is Charlotte's point about the team. Big decisions should be taken by the board—

Q241 **Chris White:** So is the biggest decision a CEO should make identifying who his team should be?

Stefan Stern: Hiring, yes. Sir John Harvey–Jones said, "Hire the cleverest people that you can, and delegate as much as to them as you can."

Q242 **Chair:** Stefan, on a similar point, can I just ask: what is the appropriate trade-off and balance between paying someone a substantial sum of money in cash, and addressing the structural weakness in our British economy, which is that we focus too much on short-term rather than long-term value creation? How do you trade those off?

Stefan Stern: This is where the judgment, or discretion, as it is sometimes called, of the Remuneration Committee comes in. They have to try to make the most intelligent and useful assessment of the performance of the business under that leadership that they can. You will have seen the work by Andrew Smithers. I think the book is called *The Road to Recovery*. He has some seriously good data on the perverse incentive for managers, partly because of the share price tie-up, to suppress, delay or reduce investment and expensive capital expenditure in the short term because it will have implications for earnings per share, and so on.

However, it might, over the genuine long term, produce some interesting returns. I am talking about over 10 years. There is some quite persuasive evidence in Smithers that the short-term can have serious long-term harm for the business.

Q243 **Amanda Milling:** In the last session we talked a lot about complexity. I wanted to touch on that again: particularly. Dr Hirt, in your written evidence you talk about a simpler pay structure. I was just wondering if you could explain that further. You talk about a suggestion that pay structures need to be much simpler and less leveraged than at present, but what is the answer? What is the solution?

Dr Hirt: Yes. We issued a paper last month on remuneration expectations, which we have been discussing with lots of companies, but the idea is quite simple. As Stefan said, if the average salary is about £5 million—the whole package, with fixed variable bonus and long-term incentive scheme—and if you were to go, say in the UK, to £3.5 million all in cash, then in the eyes of the receiver this would be the same. There is discounting if you have uncertainty about pay, and there is also the time lag. By very simply saying, "We get rid of all the complexity, all the incentive schemes," you could move to a lower pay if you were to pay in fixed.

We realise that we are where we are, so we probably cannot move all the way to fixed pay. What we were suggesting is paying much more fixed, paying part of this in shares and having probably just one incentive scheme, and focusing not on TSR or EPS but factors that take into account performance for stakeholders. That means taking into account how you deal with employees, what you contribute to the environment, bringing factors that are not factored into the share price into the equation and into remuneration systems.

Q244 **Amanda Milling:** In the previous panel, I got a sense that you can design structures so that somebody will fail but still be rewarded for failure. How can you address this? In terms of your recommendations, does that go some way to address it? What other things could be done to solve that situation?

Dr Hirt: Other significant things include more discretion by the Remuneration Committee. I started talking about how sometimes even Remuneration Committees seem not to have thought through what payouts could be. They need to do a better job before they present packages to investors, but then they also need to use the discretion they already have, particularly on the variable pay. If there is a performance, if something goes wrong at the company, they should also use the downward discretion they already have under many plans, which is not exercised often enough.

Q245 **Amanda Milling:** So they are not being as robust as they should or could be.

Dr Hirt: As they should, yes.

Amanda Milling: Does anybody else have any points on this?

Andrew Page: Just to follow on that, what would concern me is that clearly it is possible to design a programme such as you have described, which would lead to rewards for failure, but no company would wish to do so. It would concern me, if companies were to move substantially towards fixed pay, or fixed pay in cash, as some of the witnesses have suggested, that that possibility is increased. In the structures that we have at the moment, if one looks at the pay package, let us say, of a FTSE 100 Chief Executive, some 80% or more is linked to performance.

You heard from Sir John previously that in the case of his company, it is higher still. That leads to a very strong alignment between pay and performance. There is a subsidiary question as to how one defines that performance, but if you can get past that, unambiguously one has paid for performance. If you move to a cash base or a fixed pay scheme, that possibility of pay for failure has to be increased.

Q246 **Amanda Milling:** Are there any other additional points?

Stefan Stern: I think it is very difficult to address the performance of the CEO of a great big company. That is why there should be judgment and discretion, and if you think someone is not doing a good job, perhaps they should be fired. You are then not paying for performance; you are getting rid of someone. I am not sure it is necessarily as complicated as has been suggested.

Q247 **Peter Kyle:** I apologise for a bit of a woolly question to you all. You mentioned John Lewis; it was almost inevitable that it would come up at some point. I chaired, in a previous role, a lunch session with the Chief Executive of John Lewis, about how they create value and the style and way that they do things.

He made a very important point, which was, "For people who want to point to our model as a way of delivering fairness and value, you have to explain why, so many times in the 1970s and 1980s, we lost money when we had the same model. At the end of the day, we need the same quality of leadership as any other business in any other sector, and we go out and find that quality of leadership, and you cannot succeed without it." What he did then go on to say is that they will not hire people for whom the primary motivation is remuneration.

They have quite a sophisticated way of detecting, through the recruitment process, what people's priorities are. He said that it is a very regular occurrence that they reject applications from people they feel are too motivated by money. Now, of course, they have built a business model on that, and that is at one end of the spectrum, and we do have a spectrum. The thing I really struggle with, including today's session, is why the rest of the spectrum lacks diversity when it comes to people who are motivated by money. Why are there not more people, particularly in the FTSE 200, and more businesses, who are not just injecting more and trying to find people who are motivated primarily by things other than money, and asserting it, with a different remuneration package? Do you have any comments as to why this is the case? Why is it that there is one outlier, or a couple of outliers, and the vast majority of others have just gone down this path of really quite high remuneration? There is so little diversity. Stefan, you might want to lead.

Stefan Stern: There is certainly some herding, if I can use that expression, or groupthink. Frankly, I think we heard it from our two company Chairmen a bit. For 20 years we have been told, "Our people are our biggest asset", but then we also heard that they did not really know what workers were any more. There is a disconnection there, or a deracination there, with a certain group of people at the top who are very used to very big numbers. That is the systemic point. They are desensitised to the vastness of some of these numbers. They have lost sight of what, perhaps, it is much harder at John Lewis to lose sight of, which is that connection through to the shop floor, partly through ownership.

Q248 **Chair:** Should workers on the Remuneration Committee be suggested?

Stefan Stern: Absolutely. I would have to ask Mr du Plessis what he meant by "unhelpful". To whom is it unhelpful to have employee representatives? I think it would have been extremely helpful to BP if a couple of people from an oil rig had been in the room when Bob Dudley's proposed pay package was being discussed, because they would probably have asked some fairly straightforward questions.

Their questions would have been rather like yours about the Rio Tinto CEO package: how it could be justified and what the explanation and rationale was for a big pay rise when thousands of people were being laid off, and the share price and oil price were way down. On the contrary, it would be helpful to have employee representatives in the RemCo.

Professor Villiers: Coming back to your point, a big change occurred in the 1970s and 1980s. Certainly, in the corporate governance literature, we see a real emphasis on the agency theory, shareholder primacy. We have continued going down that road, and here in the UK we are particularly prone to it. That is possibly why you are seeing so many companies going towards thinking, "Finance, finance, finance."

Coming back to your point, Mr Wright, I do think we should have workers on the Board. It would ground some of the thinking. Jan earlier talked about the lack of trust and the perception by the public, and they are important issues. I think that that is partly why we have had a Brexit vote. There is a real feeling out there among the public, and you also made the point that the public are inviting themselves into this conversation, and rightly so. We have to bring ourselves back to say, "What is right here?"

It is interesting that a number of companies are establishing Ethics Committees. I feel that perhaps a closer connection between the Remuneration Committee and the company's Ethics Committee would be helpful. Having intelligent workers on that Committee would do no harm whatsoever.

Dr Hirt: We support this proposal on rethinking board composition, or at least exposing members to different perspectives. We do not think there are enough different professional and societal backgrounds. I do a lot of work personally in Germany, where you have employer representatives on boards and the feedback is very positive from both sides. This works well. In the UK you have employee representatives on Trustee boards, so the BT Pension Scheme has some employee representatives on boards, and again this works very well.

We are very supportive of exploring these ideas. There are different ways of doing this. We would certainly not advocate mandatory rules, but considering it further, there are different ways you could also think about stakeholder panels that feed into the board. We are very supportive of the underlying idea.

Q249 **Chair:** Before I bring Anna in, this is an important point. I am getting some consensus on this in terms of worker representation, industrial democracy, or whatever you want to call it. Can I just ask, Hans-Christoph, in terms of what you are suggesting about a stakeholder panel, would that be compatible and consistent with our unitary board status in our country? How would that link in with directors' duties? In law, directors are directors. Do you see any problems with that at all?

Dr Hirt: All the options, I think, in the Green Paper are clearly compatible with the law. Today, you can have an employee representative on a board, provided he or she is elected by the shareholders. Just encouraging it via the Corporate Governance Code is an option. Stakeholder panels or stakeholder committees would be below the board level, so there would not be an issue about directors' duties. Clearly, everyone who is on the board owes the same duty as any of the other directors. The beauty is that it is already possible to go forward without major legislative changes.

Professor Villiers: In fact, I think it would help. One of the most important sections in the Companies Act is section 172, but it is also a very controversial section, because it feels vague. If we invite stakeholders, to whom that section makes reference, into discussion, it might help directors to fulfil their duties under that section. I think it would be helpful.

Andrew Page: I build on that, in fact, because it is important and valuable that the views of the broad workforce are indeed reflected in those discussions, and that they are brought to the table in the Remuneration Committee, and indeed, on wider matters, at the board table in general. The additional point I would make, on your point, Chairman, about the unitary board, is that if one were to start to appoint directors as board directors, it would start to violate the established model of directors having broader responsibilities rather than sectional interests. I think that would probably be an unhelpful development in corporate governance.

However, having their views represented, whether through a conduit onto the board or through some other means such as a stakeholder committee, is incredibly valuable. Certainly many companies I work with already have ways to bring that view into the boardroom or are seeking ways to do so.

Q250 **Anna Turley:** I would like to come to remuneration boards in a second, but before we do I would like to talk a bit about consultants—particularly, Andrew, as we have you in the room. I am grateful for all of your views on the role of consultants in this, but perhaps you could talk us through the process you go through. Who are you accountable to? What do they ask of you? With whom do you engage? What do you take into account when advising a Committee? Is there any pressure on you at all to keep pay at a reasonable level, or do you feel there is a constant pressure on you to ratchet that up? Also, to add into that, forgive my ignorance, but I do not know how you get your funding. Is there an incentive for you to have a higher package, and do you get a percentage of that as a consultant, or do you have a flat rate?

Andrew Page: There are quite a few questions there. Let me start to address them one by one. On the question as to how we become appointed and for whom we work, in the vast majority of cases, we work for the Remuneration Committee, and our accountability is to the Chairman of the Remuneration Committee and the Committee itself. They hire us, and ultimately it is their responsibility, if they do not like us, to fire us as well. Our accountability is very clear. Clearly, during the course of our work, we have contact with a whole range of representatives from the company. It may be the Chief Executive, the Chief Financial Officer, representatives from the company secretariat, the HR department, the other non-executives on the Board or the company Chairman—a whole host. However, our accountability always remains very clear through that process.

Our fees are generally agreed with the Remuneration Committee Chairman, and, in response to your last question, the way we are remunerated is on the basis of the work that we do. There is never a relationship between the recommendations we make and the pay we receive. To answer your other question, I would certainly say for my part and on behalf of my firm—but I think I can probably speak more broadly for the industry—that we do not feel a pressure to direct pay in a certain direction.

Just to give a little bit more context around that, the advice that we give goes beyond questions of pay levels. There was a question about transparency earlier. Pay levels for listed companies have been disclosed for many, many years, and are disclosed in full. We collate those data and publish it for free. There is not a great deal of money there. What we advise companies on is the way in which they structure their remuneration packages, the way they link it to performance, and the way they seek to comply with certain governance requirements—a lot of the broader aspects. The level of remuneration is really a relatively small part of that.

Q251 **Anna Turley:** Do you feel any onus towards simplifying that? A lot of the discussion we have had throughout this inquiry has been about the complexity of the package. Are you working towards simplifying, or do you see benefits in making things more complex?

Andrew Page: I can see no benefits in making things more complicated, and I would agree with the assertion that I think has been shared around the room today and with the previous witnesses, that these arrangements are often quite complicated. In an answer to a previous question I described some of the reasons why I think some of that complexity has arisen. Companies themselves are complicated. They work across many business lines and across many countries in the world. That in itself creates complexity, particularly when one starts to measure the performance of those companies.

Secondly, when companies are seeking to put in pay plans, which are often linked to performance, they will seek the guidance of and consult with their major shareholders. Those shareholders do not speak with a single voice. They have different views, and one of the roles of the Remuneration Committee Chairman is to balance those perspectives. Sometimes that implies an element of compromise; sometimes compromises are complex.

However, in answer to your very first question as to our role in this, wherever possible we will seek to take out that complexity and de-layer it. All of those Remuneration Committee Chairmen and Chairwomen who employ us would be absolutely whole-heartedly behind that aim.

Q252 **Chair:** Are you unique amongst remuneration consultants in doing that?

Andrew Page: I would say probably not. I am probably not best placed to make that judgment, but certainly if I look across my own firm, I do not think so.

Q253 **Anna Turley:** Can I ask other colleagues on the panel for your view on consultants and the relationship they have with Remuneration Committees, perhaps starting with Professor Villiers?

Professor Villiers: I defer to Andrew's expertise on this one. What Andrew is saying sounds quite good, but the Remuneration Committees are a bit caught sometimes, possibly. My understanding from the guidelines that come out to them is that there is not an awful lot expected of them in terms of how many times they are supposed to meet. The latest guidelines from ICSA suggest that they only need to meet twice a year, or a minimum of twice a year, which seems to me remarkably infrequent. I would be surprised if that were the case generally. I would anticipate they meet more often than that.

Obviously, they have the expertise of consultants, who will give them the market view, which I think is helpful. Again, I come back to the point that it is not just about markets.

Stefan Stern: RemCo is clearly a difficult job. It has been said that RemCo Chair is the job that everybody wants done but no one wants to do. If you are a popular RemCo you are probably not doing your job very well, and there should be difficult discussions. I understand, again, the systemic point, as a connection. It is not easy to be a robust pay consultant and keep all your clients, if you are regularly off delivering news that does not go down very well. As a colleague at the *Financial Times* said, there is a gap in the market for the pay consultant who can guarantee bottom quartile pay packages. That is not a gap that will probably be filled.

I also note that, if there were much simpler payments, i.e. predominantly cash, that would probably be quite a blow to the pay consultancy industry.

Dr Hirt: We are not privy to discussions between RemCo consultants and companies, so it would be difficult for me to comment. What I mentioned earlier is certainly a concern: that in some cases only the remuneration consultants understand what is going on in a scheme, and then also communicate to shareholders. That clearly should not happen.

Q254 **Chair:** Hans-Christoph, can I just talk about shareholder engagement in this, as a final line of questioning? To what extent is executive remuneration important to shareholders?

Dr Hirt: It is very important. As Amra said earlier, it takes up a very significant amount of time.

Q255 **Chair:** Why do they not tend to engage in respect of some of the votes at AGMs, with regard to this?

Dr Hirt: I would agree that not everyone does as much as some of the leading houses do in this space. I would certainly say one of the things we are proposing in the paper, and have put in the written submission, is that there is also more to be done for investors. They need to be implementing policies and also being clear absolutely how they implement policies in their voting behaviour and also in their engagement with companies.

Q256 **Chair:** How can that be done? What clear recommendations could you provide us with on that?

Dr Hirt: Part of it is that fund managers could reach out to the funds and institutional investors for whom they manage money, and get clearer instructions on their voting policies. The next step is getting more oversight on how these policies are implemented. There are real question marks. Every investor has a voting policy, but it is not clear how consistently they are implemented in practice. There is also a case to do more at an AGM like WPP, with maybe two or three institutional investors speaking out at the AGM, raising concerns at the event. I would fully agree there is more to be done also on the investor side.

Q257 **Chair:** Do you agree with the concept of annual binding votes when it comes to executive remuneration?

Dr Hirt: It is probably not the most important item, but we are supportive of it. We have a system in place where we have a three-year vote on the policy, and an annual vote on remuneration. That seems to be working reasonably well. However, we have said in the paper that it would not be harming the landscape of rights. Shareholders do seem to have sufficient rights, so it is not on top of the agenda. We are not against it, but it is not clear, for example if you look at Switzerland, where a couple of years ago they introduced binding votes on an annual basis, what difference that has made in practice.

Q258 **Chair:** Would not a clearer and more successful and effective recommendation be that we should make every director's contract contingent on approval by the shareholders?

Dr Hirt: There are already annual elections of directors, so that exists.

Q259 **Chair:** I am thinking of the nature of that contract, and the pay and compensation that is awarded with it.

Dr Hirt: That is an interesting proposal, but it also goes well beyond what is currently proposed.

Q260 **Chair:** Yes, but should we consider it?

Dr Hirt: I am not sure it would focus very much on the one–year period. We were also slightly hesitant about annual elections. If you want to give directors time to get up to speed, then there is also the question of whether you want to have annual elections.

Chair: Does anybody have any comments on that?

Professor Villiers: When "say on pay" was first introduced in 2002, I think it was a mistake to create an advisory vote. I think it sent out the wrong message. We have had that now for quite a long time, and obviously with the relatively recent introduction of binding votes for the policies, maybe we should give that a chance to bed in. This coming year will see more votes on the pay policies, but I do take Hans's point that perhaps now we have the binding vote on the policy, maybe the binding vote on the payments made is less of a key focus. If we did introduce it, there would be further complexities that would come in and we would end up with further unintended consequences.

Andrew Page: The question about the binding vote is an interesting one. I would say that by and large we have had the binding vote on policy now for three years, with a binding vote on actual remuneration outcomes. To move to a situation of binding votes on actual pay outcomes seems to us to be solving a problem that really only existed in a minority of companies. The vast majority of listed companies, I think, could agree with their investors that they have stewarded the questions around executive pay well over that period.

Therefore, to impose the uncertainty that a binding vote on actual pay outcomes brings upon every company is potentially unhelpful. There may be more merit, I would suggest, in looking at a situation that identifies those companies who failed to gain adequate support in a particular vote, or maybe in two successive votes, and place stronger requirements around those—

Chair: You would need something like a supermajority of 75%?

Andrew Page: Yes. It would need to be thought through, but I think that that proposal has rather more merit, in a sense, than a blanket approach of a much harder regime for every single listed company.

Chair: Thank you very much for your contributions; we really appreciate it. Again, apologies for keeping you so long, but we have got a lot out of this. Thank you again for your time. Thank you, colleagues.