

Business, Energy and Industrial Strategy Committee

Oral evidence: Corporate Governance: Delivering on fair pay, HC 928

Wednesday 6 June 2018

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[Watch the meeting](#)

Members present: Rachel Reeves (Chair); Vernon Coaker; Drew Hendry; Stephen Kerr; Peter Kyle; Mark Pawsey; Anna Turley.

Questions 229 - 408

Witnesses

I: Charles Cotton, Senior Performance and Reward Adviser, Chartered Institute of Personnel and Development; Clare Chapman, Remuneration Committee Chair, Weir Group; Marion Sears, Remuneration Committee Chair, Persimmon.

II: Andrew Ninian, Director, Stewardship and Corporate Governance, Investment Association; Robert Hodgkinson, Executive Director, Technical, ICAEW; Sarah Wilson, Chief Executive, Minerva Analytics Ltd; Euan Stirling, Global Head of Stewardship and ESG Investing, Aberdeen Standard Investments.

Written evidence from witnesses:

- [CIPD - written evidence](#) | [PDF version](#) ( 92 KB) 
- [Investment Association - written evidence](#) | [PDF version](#) ( 293 KB) 
- [ICAEW | - written evidence](#) | [PDF version](#) ( 130 KB) 
- [Minerva Analytics Ltd - written evidence](#) | [PDF version](#) ( 227 KB) 
- [Aberdeen Standard Investments - written evidence](#) | [PDF version](#) ( 83 KB) 



Examination of Witnesses

Witnesses: Charles Cotton, Clare Chapman and Marion Sears.

Q229 **Chair:** Thank you very much for coming to give evidence to our Select Committee today on corporate governance, focusing on executive pay. We have two evidence sessions this morning. The first will last probably about an hour. We have quite a lot of questions to get through. I will start off, if I can. My first question is to you, Charles Cotton. How would you summarise the changes we have seen in the last 12 months on executive pay? Do you think there have been any changes in attitudes from boards or remuneration committees when setting executive pay?

Charles Cotton: If you are looking at pay levels, we note that in 2016 there had been a significant fall. However, our initial analysis for the financial year ending 2017 shows quite a significant increase again. It is too early to say whether that increase will then be carried on into 2018. In terms of the levels that are being paid, there has been a movement back.

Q230 **Chair:** Do you want to give us an idea of what those levels are and the sort of increase we have seen in the last couple of years?

Charles Cotton: We estimate the increase that happened in 2017 was around a fifth. It can be influenced by the make-up of the FTSE 100. In June, you saw two new entrants, and one of those organisations had a significant, large LTIP payment for its top four individuals.

Q231 **Chair:** What is the average pay of a chief executive for a FTSE 100 and a FTSE 250 company?

Charles Cotton: For a FTSE 100, it is probably going to be a few million. For a FTSE 250, we do not look at that.

Q232 **Chair:** When you say a few million, that is quite a range. Do you know what the average pay is?

Charles Cotton: Yes, I have the figures here. I was trying to do it off the top of my head. I think the figure was—

Q233 **Chair:** I think it is about £3.5 million.

Charles Cotton: Yes, £3.5 million. If you are looking at the average, it went down to £4.5 million in 2016.

Q234 **Chair:** Do you think that levels of executive pay are about right, too high or too low?

Charles Cotton: We believe that there are a number of issues with executive remuneration. One is how you define a successful organisation. Predominantly, it is focused on financial measures, which can be equally important as people measures, such as employee turnover, commitment or engagement. Another issue we have is the assumption that the only



HOUSE OF COMMONS

people who have actually achieved that success are those at the top of the organisation, a handful of individuals, rather than seeing performance as a collective endeavour, and that the only way you can really incentivise these individuals at the top is by giving them barrel-loads of money.

Q235 Chair: We are going to come to a lot of these issues in more detail, but overall, in your assessment, are the levels of executive pay we see at the moment about right, on the high side or the low side?

Charles Cotton: It is subjective but, if you look at how executive pay has performed against the pay of typical employees, it has increased very greatly. It is not in line with that. It is not in line with the growth in the economy. It is not in line with the growth in productivity. Yes, on those measures I would say that executive remuneration is too high.

Q236 Chair: What would your view on that be, Clare Chapman and Marion Sears?

Clare Chapman: If I put my hat on for the purpose of a company that has made a submission, using the PwC data, if you look over the last five years at the FTSE 350, in actual fact there has been pretty much stability in executive pay levels. It has not risen significantly and has not outstripped employee pay. Now, there have been outliers in all of that, but broadly speaking pay has been flat.

I would also make the comparison, for those of us who are working in multinational businesses, that UK executive pay is broadly speaking about 30% to 40% lower than in the US. For those of us who are trying to attract the talent needed to grow multinational businesses, we need to be mindful of an international environment. Pay excess is never right. It is the responsibility of remco chairs to make sure we never pay a penny more than is needed to ensure the right long-term performance for the business, but there is not the evidence that it has been excessive over the last five years.

Q237 Chair: It has gone up compared to average pay in the UK and, indeed, the US.

Clare Chapman: If you look at the PwC data for the FTSE 350 over the last five years, it has not outstripped employee pay. Given that inequality after tax and benefits has fallen since the financial crisis, but there has been a failure in the rise of average living standards, I am sure that is not how it feels for many individual employees. But the longitudinal data of the FTSE 350, particularly over a longer timeframe, shows what the levels of increase have been.

Q238 Chair: You are a non-executive director and chair of the remuneration committee at Weir, and I think at Kingfisher as well.

Clare Chapman: Correct.

Q239 Chair: At Weir, what is your chief executive paid?



HOUSE OF COMMONS

Clare Chapman: The chief executive at Weir is paid £600,000 to £700,000.

Q240 **Chair:** What is the total pay that he took home last year?

Clare Chapman: I will need to get you the single-figure number.

Q241 **Chair:** This is what you were coming in to give about evidence today. Maybe you could help me, Marion Sears? What was the chief executive paid last year and the year before at Persimmon?

Marion Sears: In the 2017 accounts, it shows that he was paid £675,000 and it was a 2% increase, in line with the workforce, on the year before.

Q242 **Chair:** What about total pay?

Marion Sears: In the 2017 accounts, it included the first vesting of the Persimmon LTIP and the pay was about £45 million.

Q243 **Chair:** What is the average worker at Persimmon paid?

Marion Sears: I do not have that figure at my fingertips, but I am happy to talk about Persimmon as a special case.

Q244 **Chair:** You are chair of the remuneration committee at Persimmon, are you not?

Marion Sears: I have been chair since December last year.

Q245 **Chair:** You do not know what average pay is, as chair of the remuneration committee.

Marion Sears: Up until now and since I have been chair, I have been very focused on the Persimmon LTIP problem that we have had. I have been working flat out on that. Since the new FRC requirements coming in that will require remcos to have responsibility for wider pay, we are going to start a big piece of work on all of this in remco next month.

Q246 **Chair:** Is one of the reasons that people are unhappy about the £45 million that was paid to Jeff Fairburn because the success of a company reflects the work of everybody and, in the case of Persimmon, the Government Help to Buy scheme? Is the pay of the average person in the organisation not quite pertinent to the issue of pay at the top of an organisation?

Marion Sears: Yes, it is, but this is such a special case that it is an irrelevant multiple. I have looked at pay ratios.

Q247 **Chair:** It might not be that irrelevant to somebody doing an ordinary job at Persimmon, might it?

Marion Sears: I completely agree.

Q248 **Chair:** You do not know that number. Maybe you can get back to the Select Committee with that.



HOUSE OF COMMONS

Marion Sears: I can look it up now if you would like.

Q249 **Chair:** I would have liked you to be able to come with that information but, seeing as you do not have it to hand, perhaps you could get back to us with that information. Do you know whether Persimmon is a living wage employer?

Marion Sears: Yes.

Q250 **Chair:** It is a living wage employer. What does the lowest-paid person in your organisation get? Is it the living wage or is it above that?

Marion Sears: I do not look at it like that from a macro point of view. The first question I ask is: do we comply? Is everybody paid the living wage? The answer is yes. Then we look at the real living wage. If you include all pay for all of our staff, almost all—I think it is 97%—are on the real living wage, which is higher, and I am pleased about that.

Q251 **Chair:** You are not accredited by the Living Wage Foundation, then.

Marion Sears: No, we are not accredited, although we are talking to them about the possibility of that.

Q252 **Chair:** You would have thought that an organisation that can pay £45 million to its chief executive might be able to afford to pay the living wage to everybody in the organisation. Would you not think that?

Marion Sears: I agree, and we are talking to them about that at the moment.

Q253 **Chair:** It would be good to have back from you the ratio between the top and bottom person in the organisation, and between the top and the middle, for the year that the pay of £45 million was made to your chief executive. Clare Chapman, do you know what the average person in Weir Group is paid?

Clare Chapman: The ratio depends on what the criteria, which have not been published yet, are going to be, but it is approximately 20 to one.

Q254 **Chair:** Are you a living wage employer at Weir Group?

Clare Chapman: We are, yes.

Q255 **Chair:** Do you think that, when pay is set, it should just be left to the market or do you think that companies have a wider responsibility to society? I will maybe start with you, Marion Sears.

Marion Sears: Companies definitely have a wider responsibility. The most important thing is to get the basic salary right, and then the piece around it correct, with the appropriate discretions.

Clare Chapman: Absolutely, you have to get the pay right, at all levels. Weir is an engineering company. It has a proud heritage of 150 years. We want to be around for another 150 years. The reality is that you need to make sure you get the pay right to do that.



HOUSE OF COMMONS

Q256 **Chair:** I have another question to ask, while you are here. We took evidence a couple of weeks ago as a Select Committee on the gender pay gap. What is the gender pay gap in your organisation?

Marion Sears: For the group, as opposed to the statutory, because that is a more meaningful way to look at it, the median hourly rate for Persimmon group is 8%.

Clare Chapman: For Weir, it is 10%.

Q257 **Chair:** What proportion of women do you have in the top quartile?

Clare Chapman: I would need to go back and look at the particular statistics for that. The reality is that, if you take a look at Kingfisher, from recollection about seven of the top executives are women, including the chief executive, the finance director and the commercial director. In different businesses, the profile looks different. As an engineering company, one of the things we are putting a lot of focus on is bringing more female engineers into the business.

Q258 **Chair:** Do you know, Marion Sears?

Marion Sears: Yes. Was it females in the upper quartile you wanted?

Q259 **Chair:** Yes, that was one of the things you had to publish with the gender pay gap.

Marion Sears: It was 18%.

Q260 **Chair:** Okay, so it was 82% male.

Marion Sears: Yes.

Q261 **Chair:** I think there was just over £100 million shared between three people at Persimmon. Were any of those who get those very large pay-outs women?

Marion Sears: Not of the top three, but the scheme covered 133 plan participants. I do not know the exact number, but there are certainly senior women in that.

Chair: Maybe you could get back to us with that as well. We will move on to the next question. Some of these issues will come up later during the session.

Q262 **Drew Hendry:** Perhaps I could ask Clare Chapman and Marion Sears before coming to Charles Cotton on this one. Do you see shareholders as a whole taking a tougher line on executive pay this year?

Clare Chapman: Yes. There are two ways of answering that. As the Weir Group, this year we have taken quite an important policy change to our shareholders and to the proxy agencies. I have seen a high level of engagement in helping us to get that design right. There are two features of that. A lot of the large shareholders in Weir have been shareholders for a long period of time. They are engaged, they are informed, and



HOUSE OF COMMONS

therefore you can have a very, very constructive dialogue. In my experience, yes, investors have been very engaged. I would expect that, given we have taken quite a big—

Q263 Drew Hendry: Will they be tougher?

Clare Chapman: They were certainly challenging conversations. My observation, looking at the AGM season more generally, is that investors have certainly been tougher on annual salary increases, as well as ensuring that there is a strong relationship between pay and performance.

Marion Sears: I do not find them tougher. The shareholders that I have dealt with, for the various companies I have been on the board of, have been very informed and very engaged for some years. I do not find a change, but I have had a lot of engagement with shareholders recently, in the context of this.

Q264 Drew Hendry: You do not feel that executive pay will be an issue for your shareholders going forward.

Marion Sears: Executive pay is absolutely an issue, but I do not feel it has changed in the last year. It has been an issue for three or four years now.

Q265 Drew Hendry: You cannot see that environment being tougher.

Marion Sears: I do not think it can get tougher. The scrutiny is very high, appropriately high, and it is hard to imagine it being higher.

Charles Cotton: We would like to see investor scrutiny not just focused at the top level but looking throughout the whole organisation at how people will be rewarded. What behaviours, skills and attitudes are being rewarded? Why are they being rewarded, and how? Is that reflective of the purpose of the organisation? Too often, there is a focus just at the top, ignoring what is going on in the rest of the organisation, which can lead to corporate scandals in the near future.

Q266 Drew Hendry: Is the combination of binding votes on pay and advisory votes on pay reports effective? Are companies listening and responding to shareholder concerns?

Clare Chapman: I am on a remuneration committee in the United States as well as two in the UK. Interestingly, if you look across a long period of time, on pay, it has had an effective role in putting more discipline into some areas of executive pay. An example would be around disclosure. On most annual bonus schemes now—for about 90% of the FTSE 100—there is retrospective disclosure of bonus targets. That is a good thing, because it enables a much more open dialogue between shareholders and companies around where the targets are put at appropriate levels. I think the scrutiny has had an impact.



HOUSE OF COMMONS

Marion Sears: I agree. The structure of the three-year policy vote and the annual advisory vote works quite well. When you are working in an approved policy, you have grid lines that are clear and they are clear to everybody. That is helpful.

Q267 **Drew Hendry:** Sticking with Persimmon, what lessons has Persimmon learned from shareholder dissent?

Marion Sears: The lesson we have learned from the whole pay debacle is that there should be remuneration discretion for undesirable outcomes. That is probably No. 1. We would have handled it better if we had had earlier and more joined-up communication with shareholders.

Our communication was right in the end, but it was late and that was not good. Thirdly, it has reaffirmed for me something that I already knew and strongly believe in, which is that any remuneration policy structure, whatever it is—LTIP, bonus, restricted stock—if it is designed to ensure that management own as many shares as possible for as long as possible, that has to be a good thing.

Q268 **Drew Hendry:** You mentioned you felt that Persimmon was late in getting the message out. How do you mean? What timescale are you putting on that?

Marion Sears: We only really engaged properly with shareholders after the chairman and remuneration committee chair resigned.

Q269 **Drew Hendry:** After the event?

Marion Sears: No, after our chairman and remco chair resigned. I became chair in December. Then there was a lot of engagement, and our AGM, where it was voted on, was in April, this last month.

Q270 **Drew Hendry:** Weir Group, what was your experience of engaging with shareholders and driving through change in policy on pay? What obstacles did you come up against and how did you overcome them?

Clare Chapman: Golly! We engaged very significantly with shareholders because, by moving to a policy based on deferred shares and up to seven years of pay-out, that was consistent with what this Committee recommended, but different to what was happening significantly within the FTSE.

One of the things we did was a lot of consultation. We did some very detailed consultation with the Investment Association, our big shareholders, ISS and Glass Lewis right at the very beginning of the process, where we started to share our thinking. They helped us shape the recommendations, but we then took them out into a much broader consultation with our larger shareholder base. That resulted in over 92% support at the AGM. My observation would be that investors put time into the consultation, and at the beginning of that our big shareholders particularly helped us do some thinking about the shaping of the design itself.



In terms of barriers, there are two very significant ones, which I am sure you will hear from those giving evidence. First, there is a very disparate set of views among shareholders, particularly those shareholders that are more US-based, versus shareholders that are more UK-based. Often, that fragmentation of views among the shareholders makes it difficult for companies to know exactly what is being asked for by the shareholder group.

Q271 Stephen Kerr: First of all, Charles Cotton, what is best practice in terms of the split between salary and potential bonus awards?

Charles Cotton: Common practice among the FTSE 100 at the moment is that about half of all remuneration is through the LTIP, and a further 25% is through bonuses. Looking at the evidence from behavioural science and behavioural economics, we would suggest that, rather than relying on LTIPs, which are too big, reward the wrong things and demotivate the rest of the workforce, organisations would probably be better off looking at smaller, more immediate cash bonuses and using those.

Q272 Stephen Kerr: Salary is 25%, bonuses are 25% and LTIP is 50%. Is that what you are saying? That is the breakdown.

Charles Cotton: Yes. Salary is about 20%, and then the pension and the benefits represent the difference.

Q273 Stephen Kerr: You mentioned the demoralising effect of an LTIP on the workforce. Can you expand on that?

Charles Cotton: The CIPD did some research a couple of years ago and we found that 60% of employees reported that the high levels of executive remuneration had a demotivating effect on them.

Q274 Stephen Kerr: They felt they were doing all the work and someone else was getting—

Charles Cotton: Yes, someone else was getting all the money. That is why we think there are a number of issues when you are making decisions about executive remuneration, taking into consideration the efforts of the rest of the workforce, what they are getting paid, as well as what the evidence out there shows about the impact that these systems have.

Q275 Stephen Kerr: The TUC has suggested there should be a 10% limit on the total amount of pay that is subject to incentives. What would be the effect in terms of recruiting top talent to this country, if that kind of idea took hold?

Charles Cotton: There was some research carried out by the LSE a few years ago that found there was not a difficulty in terms of recruiting and selecting top talent to organisations; there were lots of people out there. I am not sure. It may have an impact on recruiting talent from overseas



HOUSE OF COMMONS

but it would not necessarily have an impact on recruiting talent within the UK.

Q276 **Stephen Kerr:** Unless they went overseas.

Charles Cotton: Yes.

Q277 **Stephen Kerr:** Should it be left to the companies themselves to make the decision about the split? We are not talking about the magnitude of the total pay-out; we are talking about the split.

Charles Cotton: Yes, organisations should think about, in their circumstance, what a reasonable split would be to incentivise and recognise the achievements of both the individual and the organisation as a whole, and have discussions on that with the investors.

Of course, we have to have a mindset change among the investor community, to start thinking more broadly about how success is achieved within an organisation. It is not just about the financial measures, such as profit and earnings per share, but it is about the contribution of employees.

Q278 **Stephen Kerr:** You are alluding there to my next question, which is about whether bonuses should relate to financial performance—whether they should be narrowly focused on those types of metrics, or whether there should be a broader set of indices against which these payments are made. What is your view on that?

Charles Cotton: Definitely broader, yes, because earnings per share, revenue and profit are very important, but they are outcomes of people are managed and developed within the organisation.

Q279 **Stephen Kerr:** One of the interesting statistics that comes out of the Purposeful Company's work is that only 15% of FTSE 100 companies include customer satisfaction as a bonus objective. That is quite remarkable, is it not?

Charles Cotton: Plus the fact that that will probably be 10%, 15% or 20% of a bonus, so it is quite small overall.

Q280 **Stephen Kerr:** You do think that other considerations such as customer satisfaction should be included in this, and should be a bigger, meatier part of the incentive package.

Charles Cotton: Absolutely, yes. I could not agree with you more, especially in safety critical industries. We have seen more stuff around accidents, which is great, but why can organisations not report more on how they are managing their people?

Q281 **Stephen Kerr:** When you ask why they cannot, should the Investment Association and the FRC take a more direct involvement, maybe taking a lead on all of this?

Charles Cotton: Yes, they should be challenging the CIPD.



Q282 **Stephen Kerr:** Challenging or doing more than challenging? There is lots of challenging going on at the minute.

Charles Cotton: Yes. They should say that more information should be reported. The question is how and what. The CIPD as an organisation is carrying out research into that. In the next few weeks, we will be producing a framework to help organisations report on their people, because we have found that there is very little reporting of people and their achievements. If there is anything, it often tends to be a PR puff.

Q283 **Stephen Kerr:** Let us turn to the companies now. What lies behind this? What is your motivation when you design bonuses for senior executives, Marion?

Marion Sears: There are two things, really. One is to incentivise and one is to focus the mind on the right things: the things that the board together wants the company to achieve.

Q284 **Stephen Kerr:** Flesh that out a bit. Is that financial, going back to the previous discussion?

Marion Sears: You made the point about customer satisfaction. We call it customer care at Persimmon. For the last four years, it has been a bonus part. It is very important to us. As part of the new change we have had since the pay row, as it is known, we have increased the proportion of the bonus that is paid for customer care going forward.

Q285 **Stephen Kerr:** You have published all that, have you?

Marion Sears: Yes. It is in my chairman's letter. That is an example of symbolism, to show what the board collectively wants to achieve.

Clare Chapman: Broadly speaking, similar to Marion, it is about incentivising the long-term value creation you want and the behaviours you want. Within Weir, we have made a very significant change of our annual bonus scheme, and 30% of the annual bonus is tied to the improvement of what we call strategic measures, which would include customer, innovation, technology: those things that we know will drive future earnings. We have made a very significant change in that direction.

We have done something very similar in Kingfisher, where we halved annual bonuses but we tied the delivery of them to the strategic milestones, which in effect are improving the underlying businesses. In Weir, we have moved the long-term incentive programme to be deferred shares, which are paid out or vested over up to seven years. It is very much a case of rewarding executives in the same way that you would be rewarding investors.

Q286 **Stephen Kerr:** What part does customer satisfaction or customer care play? Are staff surveys and engagement surveys part of it?

Clare Chapman: Indeed.



Q287 **Stephen Kerr:** Is it a meaty part, though? As Charles Cotton was saying, is it a percentage of a percentage of a percentage?

Clare Chapman: Inevitably, there is some percentage of percentage, but the big headline message from me on both Kingfisher and Weir is that, within the Weir Group, those strategic measures including customer satisfaction and employee satisfaction are 30%; within Kingfisher, the strategic milestones drive 100% of the annual bonus. Much more focus is on the improving of the underlying fundamentals in the way you are saying.

Q288 **Stephen Kerr:** I have a question here, which is kind of the litmus test question to all of this discussion we are having. To what extent does all of this actually influence the decisions and the behaviour of senior executives?

Clare Chapman: There is a lot of evidence on this area, and some important emerging evidence in the Alex Edmans and Purposeful Company data you have seen, which is that, when you give executives cliff-edge targets, such as the traditional LTIPs, they tend to drive to the target, which can lead to short-term behaviour. It is another important data point that reinforces where this Committee came to before, which is that deferred shares vesting over a long period of time are much less likely to get the unintended consequences of driving short-term behaviours.

Q289 **Stephen Kerr:** Are investors and shareholders not looking for short-term results? Is that not one of their prime drivers? How do you persuade those investors to move away from supporting short-term, dash for growth type objectives towards this more patient, long-term approach? How do you do that?

Clare Chapman: Partly, it is through making sure that you get your share register aligned with what the purpose of the company is. I mentioned before that in the Weir Group, from recollection, our biggest shareholders have held our shares for approximately eight years. That suggests that those larger shareholders have a long-term interest in the long-term value of the company. One of the important responsibilities of the Board is to align that share register with the strategy of the company.

Q290 **Stephen Kerr:** Is that what went wrong at Persimmon? Did you have the wrong sort of investors?

Marion Sears: No, we had the right sort of investors. What went wrong was that we had an incentive scheme that was a contractual entitlement without any discretion or cap. The company did very well; it was actually a stunning business performance, but that gave rise to a total shareholder return and share price performance that resulted in sizeable outcomes in terms of value for the executives.

Q291 **Stephen Kerr:** Customer satisfaction is perhaps not a key factor in that package of levers.



HOUSE OF COMMONS

Marion Sears: Customer satisfaction was 10% of the bonus until just recently, and we have increased it. We have now put 30% of the bonus going forward on non-financial metrics. Customer care particularly is half of that, but the other half is made up of people-related things.

Q292 **Stephen Kerr:** Snagging lists are part of the calculation.

Marion Sears: Every customer is important in that respect.

Q293 **Stephen Kerr:** What about the strength of link between executive bonuses and those for employees? It was alluded to earlier by the chair when she opened the questioning. Marion, would you like to continue on the link between executive bonuses and bonuses for employees?

Marion Sears: In an ideal world, you have a cascade down, a mirror image structure. That is the way that the guidance is going. It is the best way to run a company. At Persimmon, we put the bonus structure in for the executives. Up until now, it has been the executives' responsibility to implement the bonus going down, but they have waited to see what we did at the top and then mirrored it to some extent, as they think appropriate, within the business. It will be changing and remco will have more responsibility in this area in the future.

Q294 **Stephen Kerr:** Should there be a stronger link with executive bonuses?

Clare Chapman: Yes. There needs to be strong evidence that all employees can share in success. That is the headline on that. The executive proposals we just had approved at the AGM included a new share scheme for all employees.

Q295 **Peter Kyle:** Marion, executive pay has increased in the last decade by a very large margin. Why have remco chairs been so ineffective at restraining executive pay?

Marion Sears: In some cases they have, and in some they have not. I have administered two LTIPs where, in one case, the executives got paid well because the business performed very well and, in another case, the business did not perform so well and the executives did not get paid so well. There are always outliers. If you are referring to Persimmon, that case is an outlier, as I have explained.

Q296 **Peter Kyle:** Clare, if you look at the pay since the financial crash for the bottom 20% of private sector workers, it has not kept pace with the cost of living. When you look at executive pay over the same period, it has increased exponentially. It is not just a fact that executives are better at pay negotiation than you are as remco chairs? You are not able to keep pay restraint for the people you have oversight over to the same degree that the executives you are monitoring are over their own workers.

Clare Chapman: As I mentioned before, there are examples of what you are talking about, Peter. I acknowledge that but, broadly speaking, if you look at all the data, there is not the evidence that executive pay is outstripping employee wage increases.



HOUSE OF COMMONS

As you will have seen, another one of the hats I wear is that I am on the Low Pay Commission. I would absolutely concur with your view that attention needs to be given to the pay at the lower end. The changes made in the living wage and minimum wage are a very, very important part of that.

Broadly speaking, attention is needed at both ends of the pay scale. I do not think there is broad evidence that there is a big outstripping at the top end versus the bottom end. There are examples of that but, if you look at the last five years, there are not extreme examples of it.

Q297 **Peter Kyle:** Marion, do you have an answer to that? It is a fact that, for the bottom 20% of private sector workers, the pay increase has not outstripped the cost of living. It is also a fact that it has done for executive pay. Why are your executives better at pay negotiation than you seem to be as remco chairs?

Marion Sears: It is different in every company, but one thing that has changed in the remuneration landscape in recent years is the need for discretion, clawback and malus. If you were to talk to the remuneration consultants, they would tell you that every remco chair in the land is coming to them to ask about discretion wording for bonus and LTIP policies, and what is called malus and clawback. That is harder, because you are trying to get money back after it has been paid.

Q298 **Peter Kyle:** What benchmarks do you use for your organisation when you are hiring? Is it the medium for the industry and the sector?

Marion Sears: When we are hiring?

Q299 **Peter Kyle:** Yes. Sorry, when you are negotiating pay, setting pay levels and remuneration levels for executives.

Marion Sears: For an existing executive who is there, they are on a package, and the guidance we would always look to is how much the workforce pay is going up. If workforce pay goes up 2%, we would expect to give the executive the same for their basic salary.

Q300 **Peter Kyle:** You do not pay to industry averages.

Marion Sears: No.

Q301 **Peter Kyle:** Clare, is that the same for you?

Clare Chapman: We would be informed by them but, to your earlier point, higher pay for scarce skills is a feature of our economy. If you take a look at executive pay, I do not think it is going up any more quickly than other high-skilled professions like law, finance, media or sport.

Q302 **Peter Kyle:** It has a higher starting point.

Clare Chapman: It has a higher starting point, and that is why we would always be informed by external benchmarks but, equally, we would be informed by internal benchmarks as well, because we want to ensure



HOUSE OF COMMONS

there is some connection with what we pay internally as well as with the external benchmarks.

Q303 Peter Kyle: The reason we are asking this is because several of us on this Committee sat on the Carillion inquiry. The Carillion remco was pegging to medium pay; it was pegging to medium pay in its industry. Of course, all the while, the company was disappearing from under their feet. We are looking to see why that could happen and whether that is widespread. Looking at testimony today, I am not sure we see something fundamentally different from the Carillion experience. Would you disagree with that?

Clare Chapman: Let me take a real life example. Within Kingfisher, when the new chief executive was appointed, we appointed at a pay that was less than a predecessor and less than industry benchmarks, recognising the experience level of the individual. We would want to move her closer towards industry benchmarks as she demonstrates delivery and experience. You will see that appointments are often made very mindful of the experience that individual brings to the role, but also mindful that these are scarce skills in a highly competitive environment. In many of the organisations that remco chairs sit on in the FTSE 100, the reality is that you are competing outside of the UK as well, so you need to be mindful of those benchmarks.

Q304 Peter Kyle: Most of the questioning you are getting from our Committee today is your ability to push back on high demands for executive pay. What is the opposite? What are the obstacles to pay restraint? Where is the pushback to you when you are trying to achieve restraint in executive pay, Marion?

Marion Sears: I am not sure I understand your question, sorry.

Q305 Peter Kyle: We are questioning you on where you are pushing back on executive pay. Where is the opposite coming from? Where are the obstacles to you restraining executive pay? Where is the pushback coming from? Is it the executives themselves who are coming to you and demanding higher pay?

Marion Sears: No—

Q306 Peter Kyle: If there was no push for you for greater pay, there would not be any increases.

Marion Sears: I am thinking of when you appoint a new executive versus when you have somebody in post. When you appoint a new executive you have the boundary of your existing approved policy, so you can only go in that, but when you run a search and are looking at new candidates you have to take into account what you have to pay to get them. That then sets the pay going forward.

Q307 Chair: One of the issues around the role of non-executive directors is how much time they have to devote to their different roles. Clare



HOUSE OF COMMONS

Chapman, how much time do you devote in an average week to Weir Group?

Clare Chapman: I joined the board in the middle of last year and, in the period of time to get to the new remuneration policy, I must have invested about 100 hours. When you are going through a new set of policy recommendations, it is very time consuming. I am not sure quite how that converts into days per week, but it would have been at least one or two days a week while we were going through the development of the policy period.

Q308 **Chair:** What about the time you devote to Kingfisher?

Clare Chapman: When we were going through the policy period, it would have been very, very similar. Because of the transformation that Kingfisher has been doing, it has been very time consuming for the non-execs as well. Among all three of the boards I am on, that is probably close to five days a week.

Q309 **Chair:** In addition, you are on the Low Pay Commission, the co-chair of the Purposeful Company and also a trustee of Lambeth Partners. Do you not sometimes worry that you are spread too thinly across different organisations?

Clare Chapman: Absolutely not. Being a remuneration committee chair is very time consuming and, as you have seen, there is a lot of complexity to hold on to. Doing more than three would be difficult, but doing three is perfectly possible.

Q310 **Chair:** Marion Sears, how much time do you spend at Persimmon?

Marion Sears: Since December when I became remco chair, I worked almost full time until the AGM in April. That goes with the territory. On a normal basis, I would imagine, if you are on the board of a corporate and chairing a committee, you should allow a day a week, perhaps.

Q311 **Chair:** You are also a non-executive at Dunelm, WA Capital, Fidelity and Aberdeen; is that right?

Marion Sears: Yes. Fidelity and Aberdeen are investment trusts. They are not the fund management houses.

Q312 **Chair:** How much time do you spend in your role as a non-executive for those organisations?

Marion Sears: The investment trusts are less because they are not operating companies; they are simply investment companies. There are four meetings a year. Dunelm is an operating company and, in my head, I would say a day a week, but I am not on any committees there so in fact it is probably a bit less.

Q313 **Chair:** What about WA Capital?

Marion Sears: That is a full day. It is a private firm.



HOUSE OF COMMONS

Q314 **Chair:** You do not worry that you are spread too thinly.

Marion Sears: No. The fact that I put all the time into Persimmon when we had the issue shows that I could deal with that.

Q315 **Mark Pawsey:** I think we all agree that greater transparency and more effective reporting would be beneficial. The Government would certainly like to see that and made that clear following the previous Committee's report. Charles, have you seen any evidence of better-quality reporting?

Charles Cotton: We would like to see more use of graphics and charts in the committee reports. They can be quite wordy.

Q316 **Mark Pawsey:** In the committee reports?

Charles Cotton: Sorry, in the remuneration reports that are voted on. It can be difficult for the common man and common woman to understand what is going on.

Q317 **Mark Pawsey:** Are they made deliberately complicated, in your view?

Charles Cotton: I am not sure they are deliberately made complicated; they are dealing with complicated issues.

Q318 **Mark Pawsey:** Does it not suit some companies to dress it up in very complicated terms that people have to wade through to get there, so they perhaps lose the will to do that or maybe do not understand?

Charles Cotton: I would not know. The challenge is that they are trying to deal with long-term incentive plans, which are very complex and can be at times opaque to explain. That was one of the criticisms that I had earlier. If we did not have long-term incentive plans, it would probably be a lot easier to communicate what the organisation was rewarding and why. But I would not say that organisations are deliberately going out of their way to make their reports as complicated as possible.

Q319 **Mark Pawsey:** It is just a by-product of the system we have.

Charles Cotton: Yes. They tend to copy what other reports look like as well.

Q320 **Mark Pawsey:** How do we effect change? How do we get change in the nature of reporting? How can we simplify it so it becomes much more transparent to everybody what is going on?

Charles Cotton: We would like to see more reporting on the people management aspects, not to make the report even larger, but to have a focus on those key elements, again using innovative graphics. Again, it is for the industry to push for better and more comprehensive reporting. The other challenge is more diversity of thinking. Again, we do not quite have the diversity that we would like to see in remuneration committees. Hopefully, if we did, we would see more remuneration reports that were more comprehensible.

Q321 **Mark Pawsey:** May I ask Clare Chapman and Marion Sears why you and



HOUSE OF COMMONS

other remuneration committees have allowed these bonuses and incentives to be so complicated? We identified in one report that it took 30 pages in order to explain what was happening. Why is it so complicated and how do we simplify things?

Clare Chapman: It is a really important question. I commend what the FRC has done in terms of laying out a new design for the strategic report, starting with a company's purpose, going on to its strategy, looking at operating model and KPIs. Assuming that is done well at the front of the annual report, it becomes much simpler to use the remuneration report to say how we are using remuneration to bring about those changes. That will bring some simplification.

The other thing is that, because pay with LTIPs did get very complicated, having good disclosure on that has led to reports becoming longer. One of the features of using deferred shares over long periods of time is that you significantly simplify the way you are doing reward. That will be reflected in reports. This year, the Weir report is much simpler as a result of it, albeit that we did put some extra pages in to reflect the nature of the conversation that we had had with shareholders.

Q322 **Mark Pawsey:** Claire Chapman would say the Weir report was better, wouldn't she? Charles Cotton, do you believe it was better? Are you familiar with it? Did you recognise an improvement?

Charles Cotton: We focus mostly on the FTSE 100, so I could not comment but, yes, anything that makes it easier for people to comprehend is only going to be a good thing.

Q323 **Mark Pawsey:** Marion Sears, we have spoken about moving on to factors of other than purely financial factors. Is it not the case that some of those other factors are going to be more discretionary and judgmental? Is there a danger, in fact, that what we are already describing as very complicated and difficult to understand is going to become more so?

Marion Sears: Yes, it is incumbent on remuneration committees to keep the objectives that they set in the non-financial metrics simple enough so that the whole board agrees what they are focusing on. May I comment on your other question? The letter that the committee chairman writes at the beginning of the section is not prescribed. That should be the vehicle through which to say, on one page, in words, to a shareholder, what is going on. In the Persimmon report, I wrote it myself and it sets the record in one place. Then all the complexity can follow.

Q324 **Mark Pawsey:** That is an outline and an explanation.

Marion Sears: Absolutely.

Q325 **Mark Pawsey:** Is that adopted by everybody?

Marion Sears: Yes.



HOUSE OF COMMONS

Q326 **Mark Pawsey:** Can I ask about the Investment Association register of shareholder dissent. Charles, is that having any impact? Are people paying attention to that? Is it too new?

Charles Cotton: It is relatively new but, yes, organisations are looking at it. Journalists and commentators are looking at what the votes are and what steps the organisations have been taking to engage with their shareholders.

Q327 **Mark Pawsey:** Are companies bothered about being on that register? Are Weir Group and Persimmon on it? Would they be bothered if they were?

Marion Sears: Persimmon is on it because of the last AGM.

Q328 **Mark Pawsey:** Is that a matter of concern?

Marion Sears: It is nothing to be proud of.

Clare Chapman: Weir is not on it. The feedback I have shared with the Investment Association is that the register is a good thing, but it should be far more focused on repeat offenders. There are already about 200 companies on it. The threshold is set too high. A special resolution only requires 75%. My advice to them would be to focus it more on repeat offenders and set the threshold at the same level as we would for approval for a special resolution.

Q329 **Chair:** Maybe you could have a red, amber, green thing, so over 25% you could be red, and between 15% and 25% amber.

Clare Chapman: To be honest, if you are demonstrating you are not listening to shareholders, that will flag you up as being a repeat offender. If there are two occasions where that is happening, going on the register makes a lot of sense. Having fewer companies makes it a really significant deal that you are on the register because of the reputational factors that come with it. When you have so many people on it, you run the risk that, if you are not being innovative, you are not on the list. That is one of the risks you have with the register in the way it is currently constructed.

Q330 **Chair:** There are two things you have raised. There is the 25% threshold and changing it to that. You also suggested you need to be on it for more than one year.

Clare Chapman: The recommendation we made through the Purposeful Company was about evidence of repeat offenders, so it would not be the first occasion; it would be the second occasion, if you are demonstrating you are taking resolutions that are not being supported.

Q331 **Chair:** For something like the Persimmon case where, if you do not mind me saying so, Marion, it was such an egregious example of a bonus pay-out, would that not deserve to be on the list, even when it first happened? You would not want another £45 million pay-out to the chief



HOUSE OF COMMONS

executive before they got on, would you?

Clare Chapman: There may well be circumstances where you say it is a first-strike issue, but they would be very few and far between.

Q332 **Anna Turley:** Can I start with a really basic yes/no question for all three of you separately? Do you accept the fundamental principle that executive pay is excessive and is a problem that needs to be tackled?

Clare Chapman: Excessive pay is never appropriate and a remuneration committee should not pay a penny more than is needed to get the right talent in, but a board has a fiduciary duty to ensure it has the right talent to deliver the long-term value of the company. Therefore, you do need to pay the right amount to get that talent.

Q333 **Anna Turley:** I did not quite phrase that right. I did not mean to ask whether excessive pay is wrong, but at the moment is executive pay excessive across, say, the FTSE 100? Persimmon is in the FTSE 100, is it not? Weir is just looking to get into it.

Clare Chapman: Kingfisher is in the FTSE 100.

Q334 **Anna Turley:** Okay, so take the FTSE 100. Do you agree that there is a problem that pay is excessive in the FTSE 100?

Clare Chapman: All the evidence suggests that the issue is more one of pay design than pay quantum, except in the few instances of outliers where there is a quantum issue. We read about those regularly in terms of WPP and Melrose, et cetera, but within the bulk of the FTSE it is more an issue of pay design than pay quantum.

Q335 **Anna Turley:** That was not quite a yes or a no. I will try with Marion. What is your view?

Marion Sears: In some cases, yes, but in general, no.

Q336 **Anna Turley:** Charles?

Charles Cotton: Yes.

Q337 **Anna Turley:** Taking as a starting point that there are issues to be dealt with for some in the pay design, as you qualify it, who should be undertaking and doing that? We have a corporate governance code that does not have any explicit sanctions in it from the FRC; it just says it is on a comply-or-explain basis. Is that sufficient? Can we rely on shareholders to put that pressure on? Should the FRC have a stronger role to play in enforcing a stronger set of guidelines for a revised code? Is the FRC up to the task?

Clare Chapman: There is not a market failure with regard to the ability of investors to apply stewardship to the companies they invest in. That would be the first point. There are instances where better quality of stewardship could be applied, particularly where an investor is not a long-term shareholder of a company. By and large, I do not think you could say there is a market failure.



HOUSE OF COMMONS

Marion Sears: I think you will find a policy vote works quite well, because there is this very clear boundary and it is an AGM-voted-on boundary. I think stewardship works. The shareholders are very much on the case of pay now. We just need to make sure that the conversations we are having take place in good time and between all parts of the institutions.

You have fund managers who really look at the investment performance and you have stewardship teams that look at governance. It is important that the executives get the message from both, and the non-execs get the message from both. That can all be done within the existing framework, but we all need to do it.

Charles Cotton: We need more engagement from investors in what is being rewarded, how and why, rather than focusing on the narrow metrics that there are at the moment. There is a role for the FRC. If its role is going to be expanded, presumably it would need additional resources to do that.

Q338 **Anna Turley:** We mentioned binding votes. In our previous report, we recommended that there should be annual binding votes in the event of a vote against over 25% of the pay report. Do you think that is workable and doable? Do you think there should be strengthening in the annual binding votes?

Charles Cotton: Yes.

Marion Sears: I would say a binding vote focuses the mind more than an advisory vote.

Clare Chapman: I do not think you would want a policy vote more than once every three years because, for a lot of companies, their long-term plans are three to five years. To be doing annual votes on policy would be far too frequent.

Q339 **Vernon Coaker:** Can I ask about pay ratios? It is quite astonishing, the evidence this morning, shining a light on all this. We should remind ourselves the minimum wage is £7.83 an hour. The living wage is £8.75 outside London. You can see why the questions have been asked here about the differences, and why there is frankly such disquiet about it, because people cannot believe this. Was it £42 million or something?

Chair: It was £45 million. What is £3 million between friends?

Vernon Coaker: I beg your pardon. Then there is somebody on £7.83. I have just looked at some of the salaries at Weir Group and at Persimmon. That is the general context of it. Charles, what about pay ratios? The Government are going to introduce a statutory requirement to do that. That is a good thing, is it not?

Charles Cotton: Yes.

Q340 **Vernon Coaker:** Why are they not doing it at the moment? Have you



HOUSE OF COMMONS

asked your members? Hardly anybody is doing it at the moment, and yet the Investment Association has asked people to.

Charles Cotton: The CIPD as an organisation has been publishing its pay ratios for a number of years, and if you waded through the reports you can calculate them. Just as gender pay gap reporting has been a game changer in encouraging stakeholders to think about how women's work is valued, this will also lead to a bigger conversation about how employees' work is valued and how various remuneration practices take place. For instance, one of the things I would imagine upsets many employees is the fact that their pay is going to be rounded up to the nearest pound.

Q341 **Vernon Coaker:** You are in favour of pay ratios. Will you be communicating that to people who are members? Will you be making that widely known to people?

Charles Cotton: Yes. The CIPD, together with the High Pay Centre, has been carrying out this research for the last couple of years. One of our recommendations is that organisations should publish their pay ratios. Next month, we expect the paper to come out requiring organisations to do that. I think it will start a conversation both within the organisation and with its stakeholders about what has been rewarded, why and how things can be improved.

Q342 **Vernon Coaker:** It is quite handy knowing that you are in favour of that. I will condense this down a bit, because we are a bit pushed for time. At Persimmon and Weir Group, what are the pay ratios at your companies at the moment? Do you know?

Clare Chapman: At Weir it is about 20:1. Vernon, again, we are literally waiting for any day now. BEIS has consulted on the right formula for calculating pay ratios, and we are expecting that any day now. The expectation is that it will be reported. Over in the US, where I am on a board, it has been a requirement to publish pay ratios for at least a year now.

Q343 **Vernon Coaker:** You are happy with the requirement to publish pay.

Clare Chapman: The one big danger is that people will start to compare across companies. Depending on how people-intensive and frontline-intensive your business is, it is going to be different by sector. It will be very important that there is accountability on how it has changed year on year within your own company, because that is where there needs to be transparency and accountability as to what is driving the difference.

Q344 **Vernon Coaker:** You think sector by sector is a better way.

Clare Chapman: Sector by sector is a far better way of looking at the data. That is certain, but we as a board will be looking at our own pay ratio and understanding how it changes over time.

Marion Sears: Pay ratios will be a useful tool as the remco comes into having—



HOUSE OF COMMONS

Q345 **Vernon Coaker:** First of all, do you agree with the requirement there will be for companies to publish pay ratios? There will not be any choice, but do you think it is a good thing?

Marion Sears: It will be a useful tool to look at, to see what is happening in an organisation.

Q346 **Vernon Coaker:** Is it a good thing?

Marion Sears: Yes, it is always good to look at data and measure. Up until now, the remco's duties have really been about executive pay, but its duties will widen to the full workforce. Pay ratios will be an obvious way to examine that.

Q347 **Vernon Coaker:** The Government are looking at doing it between CEOs and an average, are they not, rather than what you have just said, which is between different tiers of management?

Marion Sears: Once you get into pay ratios, you can cut it many ways. That will be our job.

Q348 **Vernon Coaker:** Why have businesses not done it now? Why does it require statute to do it?

Clare Chapman: Boards that recognise—

Q349 **Vernon Coaker:** That is all fine, but why does it require the Government to tell them?

Clare Chapman: I would not automatically assume, Vernon, that, just because it is not published, boards do not look at it. We have been looking at issues around fair pay at Kingfisher and Weir for a number of years. It is more a case of that there will be an industry standard now around which reporting will happen. That will lead to a different type of debate.

Q350 **Vernon Coaker:** Marion, why is it not done? Why does the Government need to statutorily require it to be done?

Marion Sears: It is done in many ways in different companies. Individual companies have done things in their own way. As Clare says, this will require everybody to do the same thing. Requiring a measurement shines a spotlight. It will be helpful.

Q351 **Vernon Coaker:** It will be interesting to look at the actual pay ratios, but to have to statutorily require people to do it shows part of the problem, does it not? Charles, does that not show part of the problem? Big companies with this corporate pay are changing their behaviour, and the remco boards are starting to look at doing something differently, partly because of embarrassment, the public disquiet that there is and the damage it does to the reputation of their various businesses.

It is only because there is a light being shone on it that this is being done, but it still takes the force of the law to require companies to do



something that ordinary people would probably expect them to do. They are incredulous at some of this.

Charles Cotton: The challenge in the past was that organisations would have found it difficult to collect and analyse this data. However, advances in new technology mean it is now a lot simpler. Organisations were reluctant to start publishing their data if they were going to be the only organisation within their sector or nationally, because then the light would be shone on them. Technological advances mean that they should be able to produce this data. You should be able to work out how many people you employ and what they are getting paid.

Q352 **Chair:** Is the truth not that companies publish an awful lot of data, even if it is not comparable across companies, to put themselves in a good light? The problem with the sort of data that Vernon has been asking about is that it does not paint you in a good light, and that is why you have not published it. That is a rhetorical question. Do you have any workers on your remuneration committee, Clare Chapman or Marion Sears?

Clare Chapman: We have a non-executive director who has special responsibility for understanding staff engagement issues.

Q353 **Chair:** Are they a worker at the company?

Clare Chapman: No, she is a non-executive director.

Q354 **Chair:** The answer is no, then, Clare. You do not have a worker on it.

Clare Chapman: We have a non-executive director who is specifically responsible.

Q355 **Chair:** That was not my question, with all respect, Clare Chapman.

Clare Chapman: With respect, Rachel, when the corporate governance options were laid out, one was for a non-executive director—

Q356 **Chair:** I know that, Clare Chapman. I am aware of what the requirements are. However, I was asking you a specific question, to which the answer is no. Marion Sears, do you have a worker on your remuneration committee?

Marion Sears: No.

Charles Cotton: Yes.

Q357 **Chair:** Thank you very much, Charles Cotton. Of your members, Charles, do you know what proportion would have workers on their remuneration committees?

Charles Cotton: It is very small. We have not done any research, but we could not find anything for the FTSE 100 about how many organisations had a dedicated employee rep on their remuneration committee. We could not find anything.



HOUSE OF COMMONS

Q358 **Chair:** I just want to come back to a couple of issues; I am aware of the time. One of the things that this Select Committee looked at previously was the long-term incentive plans. There is some evidence that companies are trying to move away from them, but one of the barriers that we hear is that institutional investors are influenced by attitudes in the US to LTIPs. Clare, what is your experience of Weir Group on that?

Clare Chapman: We have a large number of US investors, and they voted in favour of the Weir scheme to move to a deferred share scheme over up to seven years. You are able to bring shareholders with you. You need a compelling case. In the case of Weir, given that we are in oil and gas and mining, it is difficult to anticipate the value of the oil price next week, let alone in three years' time. The volatility of our sector meant that we very much came into the category that the IA working party showed: that we are in a sector where LTIPs do not work. Therefore, the American investors were persuaded by our argument to put in deferred shares.

Chair: That is very helpful.

Marion Sears: I have seen LTIPs work. In the Persimmon LTIP case, there was not a discretion and it would have changed everything if there had been. Let us not say LTIPs do not work, but they need to be structured correctly. I am enticed by the simplicity of the restricted stock model, but the overriding principle is to have executives owning as many shares as possible.

Q359 **Chair:** To come back to the specific point about the role of US investors, is that a barrier to moving away from LTIPs or is that not a relevant consideration?

Marion Sears: We do not have many US investors. We are a domestic company.

Q360 **Chair:** One other thing I wanted to pick up on is this issue of clawing back bonuses, because it is something that came up during our inquiry on Carillion. Should there be some minimum standards, maybe set and policed by the FRC or someone else, about when you can claw back bonuses? Should it be made easier to do that?

Marion Sears: That is probably happening in itself anyway without the enforced standards, because of what is going on. Remco chairs are asking themselves, "How can we make sure our discretion or claw back is watertight?" I know that remco chairs are asking themselves that.

Q361 **Chair:** You do not think you need someone to set standards of what that might look like.

Marion Sears: It would not make a difference to me. If I was putting a structure in, I would make sure it was good by taking proper advice, but a standard might be helpful.

Q362 **Chair:** You come from Persimmon and you were on the board of



Persimmon not when the LTIP was set but certainly while it was in place. The idea that companies are complicit themselves, certainly from the experience of Persimmon, would suggest that you may need some outside organisation to say, "Wait a second; that is not a good standard".

Marion Sears: The world has changed a huge amount since 2012 when that Persimmon LTIP was designed and implemented.

Q363 **Chair:** Carillon had this bonus clawback thing changed only in 2016, so it has not changed that much.

Marion Sears: I see.

Clare Chapman: There are two things. First, in both Kingfisher and Weir, our clawback requirements are more stringent than what is in the guidelines. However, there is one thing that would be very useful to solve for, and Marion is right that work is going on in this. It is quite difficult to prove in law that you can apply a clawback in an insolvency situation unless you can demonstrate an individual's contribution. That is the thing we now need to make sure we can find a solution for in law.

Q364 **Chair:** We will move now to the next session, but thank you, all three of you, for coming to give evidence this morning.

Examination of Witnesses

Witnesses: Andrew Ninian, Robert Hodgkinson, Sarah Wilson and Euan Stirling.

Chair: Thank you for coming to give evidence this morning. I think you were all sitting in for the first session, so you will have heard the themes we are covering this morning, on this issue of corporate governance and executive pay. The first question in this session is from Drew Hendry.

Q365 **Drew Hendry:** I will start with Sarah. Would you agree that there has been an improvement in remuneration policies and outcomes this year? If so, what figures should we use as evidence that underline that?

Sarah Wilson: You are right to focus on the fact that, depending on the number you look at, you can get a different answer. If you look at the single figure of total remuneration, it looks as though pay has gone up. That is the statutory figure. If you look at other forms of disclosure, it has gone down. This can be very confusing, because the single figure is what everybody has been told to use. It has many systemic problems, and we have encouraged BEIS and the FRC to take a look at this. It would be a bit like driving your car and only looking in the rear-view mirror, when any good driver knows they have to use the wing mirrors, the rear-view mirror and look ahead on the road.

While a single figure sounds very seductive because of its simplicity, there should be three single figures that boards present: total remuneration awarded, realised and realisable, so that people can see



HOUSE OF COMMONS

the long-term picture, the mid-term picture and the picture now. We have certainly seen things improve and, over the last three or four years, pay on a total remuneration awarded basis has been flat for chief executives and finance directors.

Q366 Drew Hendry: What response have you had to the suggestion that those three figures should be used?

Sarah Wilson: When the initial design proposals were put forward, there was a degree of sympathy for that proposal. We presented considerable evidence for it. Ultimately, we were concerned that there was too much influence from possibly US accounting standards and practice. We hope BEIS will revisit this, because it is not complicated for this to be presented, but I think it was an overwhelmingly political decision in the end. It has been very useful to have a single figure, because it has made people stop and think about the data and be more probing about it. That has to be a good thing.

Q367 Drew Hendry: Euan Stirling, what would have been the principal drivers of pay restraint over the past year? Has the public and political pressure had an impact? What have been the main obstacles?

Euan Stirling: The public and political pressure has had an impact and has certainly emboldened shareholders to take quite a strong line when they are reviewing remuneration plans. Obstacles are wide, varied and differ from company to company. The point was made in the earlier session that company executives can be very successful and proficient negotiators. If you look at the job that the remuneration committees have up against that, that is probably one of the biggest obstacles. It is company executives themselves in many cases.

Q368 Drew Hendry: Are you satisfied with the progress on the recommendations of your working group, Andrew, on executive pay?

Andrew Ninian: The primary recommendation was there should be no one-size-fits-all for remuneration, and that companies should have the flexibility to choose the right structure for their own company and their own strategy. In the last couple of years, we have made changes to our principles to make clear that we are following the recommendations of that working group. Now, we are seeing a greater debate within companies and they are thinking about what the right structure is for their business. We have started to see a small number of companies bring in different structures with restricted shares or deferred bonuses. We are seeing a small amount of change. It has been gradual change. It has not reflected the wider debate. A lot of companies are waiting to see what happens to the first movers.

Q369 Drew Hendry: Given that small change you have described, why are you only calling for companies to consider reducing remuneration potential? Are companies doing so?



Andrew Ninian: I think you are referring to a letter we wrote last year that highlighted the reductions that a number of the FTSE 20 had portrayed in their remuneration policies. That is what we were trying to get a sense of. These FTSE 20 companies were showing the lead, the likes of BP and GlaxoSmithKline, in reducing the opportunity in their pay policies and were encouraging other companies, if it was appropriate, to follow that lead across the wider market.

Q370 **Drew Hendry:** You previously used a really interesting expression. What does “taking account of the wider social context” mean in practice? Should you not be taking a much stronger lead than that?

Andrew Ninian: We think that companies should be taking account of that social context and what is happening in their employee base. It is why we have been supportive of pay ratios. We have asked companies for the last two years to demonstrate the pay ratios. The key driver behind that is that we want companies, and boards in particular, to be more articulate on quantum for their chief executives: why do they need to pay that level for these individuals, and why is it right in their individual company’s context? That pay ratio is one way in which they can demonstrate that the pay level for their CEO is right for their business.

Q371 **Drew Hendry:** We will stay with you but, widening it out to everyone else, are shareholders engaging well enough to be effective stewards of companies?

Andrew Ninian: I believe they are, but it requires a two-way engagement. We get a lot of requests for engagement from companies. As an example, before the policy year last year, we had 200 letters or requests for meetings from companies as the IA, the Investment Association. Some of those letters were a real consultation. They were companies coming to say, “I want to hear your views. I want to understand what you feel, and we will take that on board, reflect and change the structure based on your feedback”.

Other companies write a letter or come to investors and say, “Here, this is what we are doing; this is what we have decided on. We would like your feedback, but we really just want your feedback so that we know how you are going to vote at the AGM”. We want companies to focus on that first element: to really consult, listen to their shareholders, take on board their feedback and see how they can use that feedback to change the structure of their plan.

Euan Stirling: If I could elaborate on that, I completely support what Andrew has said. In our experience, while you see the latter example that Andrew gave, in recent years we find that companies are in more cases coming with more acceptable proposals than was the case in the past. Referring back to your original question as to whether the public and political pressure is making a difference, I think it is. We are seeing more thoughtful and considerate proposals being put forward by companies,



HOUSE OF COMMONS

but there are always exceptions that draw the headlines and cast questions on this whole process.

Robert Hodgkinson: The way we approach this issue is one that starts off with that political and social context, as a body that is trying to attract young people into business and has a huge membership spread across business. People are really frustrated that business is not addressing this fundamental reputational issue that affects everyone. Our approach, while very much admiring the way in which the relationship between investors and remuneration committees in companies is being finessed and improved, is to ask the basic question is about what the management of the business is doing about this issue.

That is why—and I think you have a copy of this paper—we took this issue on as a business issue, a huge reputational issue for business, of how you end excessive pay. If you approach it in a business-like way, funnily enough, a lot of the solutions do not particularly come down to improved or enhanced communication between shareholders and remcos. Useful though that is, it is not the heart of the issue.

Sarah Wilson: I would echo what Andrew said, that you have a difference of opinion as to what constitutes consultation between shareholders and companies. There is also confusion sometimes as to who is the appropriate party to be doing the consultation. Our industry is often criticised for not engaging with companies, but I would point out that we are analysts, not shareholders.

It is much more important for companies to have the dialogue with the fund managers and governance experts, because they are the ones who have made that decision to invest in that company. It has been very easy for some companies to finger-wag. Naturally enough, they feel under pressure and it is easy for people to scapegoat. We have to remember that the Greenbury report was 20 years ago, when we started talking about executive pay. We should have grasped the nettle of communication a lot sooner than we have done.

Q372 **Drew Hendry:** Euan Stirling, can you explain your role in opposing the pay report at Persimmon this year? Why do you think the majority of votes were still cast in favour?

Euan Stirling: I cannot speak for other investors, unfortunately. I have a strong sense that that was a very disappointing outcome for shareholders, even though the result was close. I think the final vote was 52:48 in favour of the remuneration report.

The reason why we voted against it and chose to attend the AGM to voice our concern was that the unaltered result of that long-term incentive package would have set a new high watermark for executive remuneration in the UK, which we felt was a bad thing in so many circumstances, particularly relating to business's position in society, and



HOUSE OF COMMONS

in particular the brand and reputation of Persimmon as an individual business.

Q373 Drew Hendry: To what extent are the shareholders responsible for approving the 2012 LTIP at Persimmon in the first place?

Euan Stirling: They definitely play a part in that. The plan when it was proposed was the subject of significant consultation. We as an institution were informally offered assurances about the monitoring of that plan as it developed, which proved to be pointless and worthless. That affected our judgment about the ultimate outcome, but there were many parties in play that created the long-term incentive plan. Shareholders were one.

Q374 Chair: Euan Stirling, you voted in that way on Persimmon but, when there were big shareholder revolts at Pearson and AstraZeneca, you were not part of them.

Euan Stirling: No. We have not owned significant amounts of shares in either of those companies. It was not a particular concern to our clients in those instances.

Q375 Peter Kyle: Sarah, do you think that institutional shareholders should be doing their own analysis or contracting it out, as seems to be the case at the moment?

Sarah Wilson: There is analysis and there is analysis. There are thoughtful shareholders who are doing their own analysis. I would draw a difference between the collection of the raw data and organising it in a structure where somebody can use it and make informed decisions.

If you are hinting that there are some people out there who robotically follow recommendations, this is a genuine concern, because it undermines the work of thoughtful shareholders and it is something that should definitely be explored. Proxy advisers or proxy analysts like our organisations would have to be invented if we did not exist, in the same way that services like Reuters or Bloomberg, for example, exist. We can then present the data in a standardised format.

For example, we have been looking at pay ratio data for 20 years. We have been looking at gender differences for 20 years. It is then a matter of how that gets on to people's to-do lists. In the same way that, say, the Office for National Statistics has to draw together the data that is trustworthy, we have to separate out those roles. We do not engage. We let our clients do the engagement.

Q376 Peter Kyle: Do you see a difference in the decision-making or the outcomes from shareholders who use proxies and those who do their own research? Do you think there is a visible difference in behaviour that we can point to?

Sarah Wilson: You will find that the Financial Reporting Council's tiering exercise has taken that on board. There are people who are, you might say, robo-voting. They have set a bright lines policy and that is it; they



HOUSE OF COMMONS

will let the computer set and forget. BlackRock has made it very clear, for example, that it uses service providers as an input into its process. This is where the FRC's review of the stewardship code is going to be helpful because, rather than simply stating, "We use X", it is to explain how a decision is made. This is the importance of regulation asking the right questions to get the right kinds of behaviours from people. Just saying, "We have ticked a box" is not enough.

Q377 **Peter Kyle:** Euan Stirling, you use proxy advisers quite heavily, do you not?

Euan Stirling: Yes, we do.

Q378 **Peter Kyle:** Are you not concerned that the market is dominated by one provider, the ISS? Do you not think that that warps and distorts it?

Euan Stirling: We are always concerned when there is a monopoly position. ISS has been a valued provider to us for a number of years, as an institution. The way that we use them, though, is interesting to analyse. We do not just accept their recommendation. We use them as an input. We provide them with a custom voting policy, so they do not necessarily influence us; we influence the votes that they cast on our behalf. There are numerous occasions when an ISS recommendation will say one thing and we will choose consciously to do another thing.

Q379 **Peter Kyle:** Do you have an example?

Euan Stirling: Yes. We vote in favour of certain directors' re-elections where ISS encourages votes against. It will be because our understanding of the director's responsibility and importance to that board developed over many years of engagement with that board. Typically, it results from us having a longer-term relationship with that company and understanding where the board is trying to take the company.

Q380 **Peter Kyle:** By your own explanation, then, for companies where you do not have that granular expertise, you are very reliant on proxies.

Euan Stirling: Then we need to establish a policy and follow that through unless there are exceptions that we identify.

Q381 **Peter Kyle:** So yes.

Euan Stirling: No, we do not simply accept the ISS policy. We ask them to take our custom policy and apply that to the votes. For example, this is maybe outwith this Committee's interest, but we take a much more stringent line on US remuneration that ISS does. We vote against many more US remuneration resolutions that ISS would encourage us to because we have a custom policy that it applies for us.

Q382 **Peter Kyle:** Robert, your face is saying that you want to say something.

Robert Hodgkinson: I just wanted to emphasise that this discussion within the present system is something that maybe does not encourage



HOUSE OF COMMONS

us to think of new ways of solving a really major problem that we in business face. Sarah properly referred to Greenbury. Way back in even the Cadbury report, there was an emphasis on some principles for how you thought about executive remuneration, like the executives have no role in it, which seemed like a good idea at the time, and you do everything through a remuneration committee.

You actually use remuneration to promote the success of a company. Those sound like sensible things but, for most people, their remuneration is about doing a job, doing it well and getting paid. If they do not, they might get fired and, if they do it especially well, they might get a bonus. It set up a whole different set of rules, which then gets us into the possibility of what we have seen.

That is why, when we looked at this issue of how you solve the problem, we went back to some more basic issues about what the executives would do to apply what we could call the L'Oréal principle: would they be prepared to say, "I get this and I am worth it because this is what I do"? It is about trying to apply some lateral thinking so we do not keep tormenting the same group of people, saying, "Why are shareholders not doing more?" It is great of them to do it but it is not their role to run the company and manage its reputation.

Q383 Vernon Coaker: I have a couple of big questions, but I will try to roll this up, because of time. The current system, in my view, is bust in the way it is working. It is unacceptable to carry on in the way that it is. Most people out there, if you go to my own constituency and I am sure in other people's constituencies, look at the structure of pay we have at the moment with astonishment. The world we have been talking about this morning, for my own constituents, is like something that could be taking place on the moon.

Therefore, there is this demand for change that we heard about earlier on, that you will hear and that some of you are trying to bring about with your investors and so on. How is this going to happen? How is this structure of pay going to change? Is it just something we are going to wish for? Sarah, you said you were talking about this 20 years ago. Is the structure of pay going to change through regulation, through best practice, through embarrassment, through public pressure? How long is it going to take? That is a massive question, but it goes to the core of all of this. It is nice to talk about it here this morning, but so what?

Euan Stirling: There is a provision in the Companies Act 2006 that stipulates that all directors should support the best interests of the company. This was one of the issues that we tried to raise in connection with the executive directors' insistence on taking these grossly excessive rewards. Was that in the best interests of the company? Was it supporting the company's brand? Was it supporting the company's position in society? Was it fair? We did not believe so.



HOUSE OF COMMONS

I am not aware of any prosecutions being made under this particular provision, but it is something that we have looked at very carefully and have considered.

Q384 **Vernon Coaker:** That is so interesting. Thank you for that. That is the 2006 Act. Here we are in 2018. How is this all going to happen? You talk to these people more than I do. When is the change going to take place? Are we just going to say to people, "Excuse me, chairman of Persimmon. That is totally unacceptable. I know you have been good because you are not having X million; you are only having £45 million"?

Robert Hodgkinson: It goes back to points you have raised in the previous session.

Q385 **Vernon Coaker:** How is it going to change, Robert?

Robert Hodgkinson: It is about making people realise that they can take responsibility for it. That is the thrust of our work. You can say to a group of businesspeople, "Solve this as a business problem", because they would never accept with an air of resignation that it is just the way it is that our customers will always think we give them a rotten deal or are excessively priced. That is what management is there to do.

We have parked this issue away from running the business and it has now become the most reputationally damaging issue affecting business. Yet, the chair of the board, most of the board and the executive management are excluded from this because it is parked somewhere else, where they say, "If you do not like the outcome, I would refer you to the remuneration committee chair and their dialogue with investors".

Q386 **Vernon Coaker:** That is very helpful. Andrew, taking what Robert and Euan have just said, what are you advising, as the Investment Association? At the next board meeting or where the shareholders are saying, "This is causing us huge reputational damage. We are going to get rid of long-term investment plans. We are getting rid of large bonuses", is that going to happen voluntarily? Is it going to happen? Pay ratios have not happened. We will have to legislate to do it.

Andrew Ninian: It is something we have been calling for.

Q387 **Vernon Coaker:** I know you have, as you heard me say in the last meeting. What about all the rest?

Andrew Ninian: We need to get companies to understand.

Q388 **Vernon Coaker:** They do not understand that it is unacceptable for somebody to be getting £45 million while people are going to food banks?

Andrew Ninian: Directors need to understand that they need to address this issue.

Q389 **Vernon Coaker:** I am not on about addressing it. Sorry, I do not mean to get frustrated, but do you see the frustration? I apologise, but do you see the frustration?



HOUSE OF COMMONS

Andrew Ninian: We are seeing a change. Is it quick enough? No, probably not. We are seeing individual directors being held to account by the shareholders for their actions and where they are getting the remuneration decisions wrong. We are seeing a small number of companies change the scheme to simplify it. We need to be careful about regulation.

If you regulate on structures, you are moving the problem, rather than solving the problem. We talked about our working group. One of the reasons they did not say, "Everyone should go to restricted shares" was the concern that you are moving the problem rather than solving the problem. The structure needs to be aligned with the business strategy and it needs to be about how we make sure we are paying an individual for delivering on long-term value for shareholders.

Why LTIPs were introduced in the first place was to try to create long-term alignment between the management who were running the company on a day-to-day basis and the long-term shareholders who owned the shares and wanted the management to do the best thing for the company, to deliver long-term returns for them as shareholders and ultimately the pension savers who hold through my members.

Q390 **Vernon Coaker:** This has been very interesting. I will come to Sarah in a minute but, before I do, there was just one bit in there that was very interesting.

Chair: That is faint praise. He has never said that to me.

Q391 **Vernon Coaker:** The significant part, and correct me if I have this wrong, Andrew, was where you said that one of the worries you had was that people would simply move. In other words, you would clamp down on one area. Are you saying that people would find a way of ensuring that their remuneration is not adversely affected, by getting themselves paid in a different way?

Andrew Ninian: That is always an unintended consequence.

Vernon Coaker: I am not telling them to do it.

Andrew Ninian: The analogy people use is that it is like a balloon. If you clamp down on it somewhere, the air goes somewhere else. Yes, but my answer was more that you are not solving the root cause of the problem; you are moving the problem.

Sarah Wilson: One of the challenges we have had is this idea of a best practice rather than a good practice. A bit like teaching to the test, people have felt under pressure to conform to requirements. The IA's suggestion that we move away from one form of remuneration to boards explaining what they are doing and how it links to the intrinsic company performance is good. But, in some respects, simplification has not been sufficiently radical. You could argue, when you look at the latest research,



particularly when you look at behavioural economics and occupational psychology, you could be more radical and end up with a better result.

For example, if we look at bonuses, there is no proof that a bonus in the short-term leads to long-term performance. In fact, it could skew performance to the short-term rather than the long-term. We have recently done some work for Nesta on innovation and research and development, for example, looking at the way that performance metrics are used. Too many schemes are very focused on EPS and TSR without any explanation of how they are going to get there. You look at other KPIs disclosed in the annual reports and there does not seem to be any connection between those key performance indicators and how the reward is set.

We could be more radical on simplification, moving away from the idea that “this is best” to say that “these are examples of good”. Otherwise, advisers will say “that is the best” and that becomes the floor and not the ceiling. We should encourage remuneration chairs: we are not going to give them black marks because they are doing something different or unusual, as long as it is well articulated and shows a clear connection. The gaming of the system is very important. In the past, without a doubt, the system has been gamed.

Q392 **Vernon Coaker:** I think that is what Andrew was getting at, the gaming.

Robert Hodgkinson: Can I quickly make a comment about helping people get out of the hole they are in? A lot of people might think there is a hole and would like to get out of it, but it all seems too difficult and, if you put your head above the parapet, you will get shot down. That is why we have—and it maybe sounds trite—a 10-point-plan.

There are things to do. First of all, there are things to do to get you into the game of having a dialogue with the public. Accept it is a valid public interest. Accept that pay is really important for a whole range of reasons. Accept that you have to look at your whole company structure. Accept that you have to use simple language and you are going to talk about fairness.

If you do that, at least you get past the problem of people thinking you just do not get it. Then do some practical steps like helping people to understand and being very open about what your job is and what you do. People make these contrasts with footballers, but at least they know what they do. Do that.

Be prepared to engage people properly in a conversation. Do not just dump them with a 40-page report and say, “Make what you want out of that”. Encourage dialogue. Then think about doing things like admitting mistakes and showing you have learnt. That is a way of thinking through it. It is not just one thing, to say that we have suddenly decided we are all going to take a pay cut or brazenly stick to what we have. You need



HOUSE OF COMMONS

some stepping stones to help with what looks at the moment like walking on water.

Q393 **Chair:** To come back to the point I asked in the previous session about long-term incentive plans and the feelings of investors towards them, Euan Stirling, at Aberdeen, do you think that LTIPs have passed their sell-by date or do they still have a role? To Andrew's point that, if you push down somewhere, the problem shows up somewhere else, is that your view?

Euan Stirling: I am afraid it is. It is sad to admit that history would suggest that. If you look at the regulation and legislation around bankers' bonuses, I do not think bankers get paid much less than they did pre-crisis; it is just differently structured because regulation has been put in place on one part of their remuneration structure. Unfortunately, yes. There are very good long-term incentive plans that do not pay-out grossly excessive amounts and do align interests. I would not malign long-term incentive plans. They are the abused, not the abuser, in this case.

Q394 **Chair:** On the other issue I raised previously around clawback and malus, does there need to be greater clarity on when bonuses should be allowed to be clawed back? This goes back to some of the issues that we uncovered on Carillion, but they were bonus schemes that were changed quite recently to make it harder to claw back bonuses. Do you think that the IA, the FRC or somebody needs to provide some greater oversight to make it easier to claw back bonuses?

Euan Stirling: Absolutely. Just making that journey a little bit easier, standardising wording and terms, would be very, very helpful indeed.

Q395 **Chair:** Who do you think should provide that?

Euan Stirling: That could be passing a poisoned chalice to somebody. I will look over to my right. The great thing about the Investment Association is that it is a collective body. You would get a collective view from the industry. The Investment Association would be able to facilitate that. The FRC I am sure would play a part, as well.

Q396 **Chair:** What do you think, Andrew?

Andrew Ninian: As we put in our evidence, there are two things that need to be addressed with clawback. First, we need to have an honest conversation about whether the triggers are right. We have two standard ones across the market, material misstatement and gross misconduct, where clawback is usually used. We think that those should now be reconsidered and extended, but we need to do that quite carefully.

Secondly, there needs to be a bit more process and documentation around how clawback is enforced, making sure that all the different documentation is consistent and companies are not inadvertently



restricting their ability to use clawback by how they are communicating to the participants in remuneration.

Q397 **Chair:** We took evidence from Aberdeen during the Carillion inquiry, but I have not asked the Investment Association about its view of what happened at Carillion. Were you aware of the changes they made to the ability to claw back bonuses in the case of serious reputational damage? Were you aware of those changes that were made?

Andrew Ninian: In the way that investors would have looked at it at the time, they changed their clawback wording to the standard approach across the market. Looking back in retrospect, given the events that unfolded, it was a massive change, but they did move to the market standard, to triggers that are used across the FTSE.

Q398 **Chair:** You think that what Carillion moved to is just standard. You think that other companies have clawback rules that make it as hard as it was. How on earth do you ever get a bonus back? If you cannot get the bonuses back from the directors at Carillion, who on earth can you get a bonus back from?

Andrew Ninian: They moved to normal circumstances for a FTSE company, circumstances that were more likely to happen, because a material misstatement or a gross misconduct for a FTSE company is more likely than it going bust. It is why we are questioning whether these are the right triggers and whether they should be extended. We have some companies that include reputational health and safety but, across the market, we need to have a conversation about what the right triggers for clawback are.

Q399 **Chair:** I think Aberdeen had some concerns about the changes that Carillion made.

Euan Stirling: Yes, but I would try to focus on what we can do from here. One of the things that we are trying to encourage is for directors to hold more shares for longer periods of time. In the case of Carillion, if they had done that, you would not look to claw them back because there was nothing to claw back. They would be worthless.

Q400 **Chair:** How do you do that?

Euan Stirling: We have been doing that as an industry. We have had to push very hard to get to where we have got to. Additional weight behind us is helpful, but it does require a change on the part of the directors' attitude and the company.

Q401 **Chair:** I do not want to revisit the whole Carillion thing, but it was partly to see what went wrong and partly to see what lessons could be learned. What Andrew was saying to us, that the Carillion rules around clawback were just in line with what the rest of the industry had, I think should set off red warning lights that other companies have clawback schemes just like Carillion's. You might, in the case of another company collapsing,



HOUSE OF COMMONS

again be unable to get any money back from the people who crashed the company.

Sarah Wilson: The PRA has done some very good work on clawbacks. This is where there should be some interdisciplinary communication to bring in other people's thinking. We certainly did flag up the Carillion clawback change. For many of our clients, that was a trigger for them. It is a very good example of where best practice works against you because, if they felt they were moving to best practice but it was not actually very good practice, everybody is harmed by that.

Chair: That is a very good way of putting it: best practice is not always very good practice.

Q402 **Anna Turley:** We have received a lot of evidence in this Committee, and these have been extreme examples, but take BHS and Carillion. Looking specifically at the role non-exec directors, the evidence we have received has really cast doubt on whether they have provided any kind of effective challenge and ever been willing to rock the boat. Do you have any evidence that non-exec directors are offering genuine independence and challenge to the system? I do not know if anyone in particular would like to volunteer. Robert, you are nodding.

Robert Hodgkinson: The non-execs' role in this is channelled through the remuneration committees. There is probably quite a lot of uncertainty about the role of the entire board, including executive directors, in addressing this issue.

It is certainly critical of non-executive directors, but, without saying, "Oh, well, it is the system", I am not sure we have a system that is well designed to give non-executives a good basis for challenging what is going on and talking about the big business issues of what we are doing to our reputation and whether we can justify this to the public, rather than focusing on quite a narrow conversation with the people who are really interested in the rather esoteric science of remuneration. Maybe they get channelled away from that in the board. I doubt there are big discussions to say, "Hang on, guys; what are we doing about remuneration as a business issue?"

Euan Stirling: If I could answer the question on a slightly more broad footing and move it away from remuneration, non-executive directors are the people we as shareholders employ to control the board. They have to do that. We have a responsibility to make sure that that happens in a functional way.

We cannot do that by just sitting on the sidelines. We need to engage with them. It is not just the chairman; it is not just the senior independent director; it is the audit committee chair and the remuneration committee chair. We need to understand how the board works and how they are presenting that challenge to the executives over strategy, the remuneration that supports that strategy, everything. By



HOUSE OF COMMONS

and large, it works very well. You have high-quality individuals doing very diligent work in support of our clients' long-term objectives.

Inevitably, though, there are exceptions that cast doubt on the rule. I guess that is what we are dealing with to a degree today. Focusing in on remuneration, some remuneration committee chairs are very thoughtful, in our experience. They do think about how the results of their deliberations will be reflected on the company, its reputation and its brand. We see our role as important in making sure that that happens in as many cases as possible. We have limited resources, so we also need to rely on the efficacy of the efforts of the directors themselves to carry that out. That is a really important factor, and that is why I referred to that clause in the Companies Act earlier.

Q403 Anna Turley: We have talked a bit about having workers on remuneration committees. Do you see that proposal as helpful in terms of encouraging a better pay policy for companies?

Sarah Wilson: We do not have any evidence to suggest that it is going to work one way or another. You could argue that this is an opportunity for some of that experimentation. If we look back to the section 172 issue of companies being run in the wider interest, shareholders are very important but companies have to be aware of their other obligations. Having more diverse remuneration committees and boards has to be a good thing. As for whether those workers would just be marginalised in the discussions, it is something that would have to be protected against.

To link this back to the previous question about NEDs, one of the things we have not talked about is why there are not more executive directors on boards who might provide some more input to the non-executive directors' views and be a pipeline for more diverse directors in the future. We have often ended up with boards in what we call the two-in-10 model. There is the CEO, the CFO, and everybody else is a non-executive director, so we do not have any visibility of the pipeline coming through. Companies should be encouraged to experiment. It is the only way we will know if it is going to work.

Andrew Ninian: We feel, in the debate that this Committee has started and the Government are taking forward, that it is about how boards and remcos are hearing from stakeholders and all employees. The question about having one employee is whether they reflect an employee base of 170,000, which is the case of a lot of big UK PLCs. The question is more how the remco hears from employees as a whole, rather than necessarily having one employee to represent one view. It is about widening it out and hearing that stakeholder voice, rather than an individual employee being the panacea.

Robert Hodgkinson: I have one specific that you might want to pick up.

Chair: Then we will move on to the next question.



Robert Hodgkinson: We would be in favour of that employee participation in remuneration committees, but it has to be that they do it as directors, because otherwise they do not have the broad knowledge of what is going on; they just have this specialist remit, which exacerbates the problem of people focusing on remuneration in isolation. Our next paper is on how employee directors add value. In the way the code is presently framed, they would count as executives and so would not in fact be able to sit on the remuneration committee. There is a vicious circle here. If you appoint employee directors, the one thing you cannot do is put them on the remco.

Q404 **Mark Pawsey:** I want to ask about the role of investors and the information that investors have. Perhaps I could address my remarks to Euan, to start with. You said earlier that one of your roles is to understand where a board is taking a company. Of course, that then is a measure of the ability of that board. The ability of that board is the quality of the individuals on it.

While Vernon Coaker has very effectively articulated the concerns about the remuneration levels of some executives, this is an international market, is it not? The chief executives of many UK FTSE companies are overseas nationals and there are many British nationals working in overseas companies. We have to attract the right talent here.

Do you have any concerns that, if we drive down too hard on executive pay, we might not be able to attract the people with the capability of leading our major companies forward? Are remuneration committees concerned about retaining talent? Are they not sometimes setting up a package because they know they have somebody good running this business and they do not want to lose them?

Euan Stirling: I have to say, in our experience, it is a standard refrain of a weak remuneration committee chair. If you have a difficult problem, one of the easiest things to do if you have money is to throw money at it. We prefer a much more thoughtful approach where the remuneration structures and quantum are considered in light of the company's competitive position, its position in society and its brand. The vast majority of CEOs are native to where the company operates.

Q405 **Mark Pawsey:** The fear that a good quality executive, if there is not a great bonus package, will up sticks and go is misplaced.

Euan Stirling: In most cases, yes, I would say.

Robert Hodgkinson: It is part of the UK's tradition in being leading developers of corporate governance around the world. Every progressive move has faced the challenge that it will be fine, except we will be out of step internationally, so you will cause problems. That is actually not our history over the past 25 years. People say, "Actually, this is a better way to run things", but do not dismiss the fact that there might be some short-term issues. If we want to retain leadership in an area like this,



HOUSE OF COMMONS

there might be some risk, but that is better than the risk of businesses' reputation continuing to fall at the first fence.

Q406 **Mark Pawsey:** Andrew, do you agree?

Andrew Ninian: We often hear the excuse that we need to pay more to retain them. As investors, we want the best person there to be running the company for the long term to generate value, but often it seems that some remcos feel the easiest answer is to throw money at the problem.

Q407 **Mark Pawsey:** Do we need to embolden these remuneration committees in some way, train them better and make them move effective?

Euan Stirling: Yes. To a large extent, that already happens.

Q408 **Mark Pawsey:** We are still seeing the abuses that are giving Mr Coaker such concern.

Euan Stirling: Yes. We share that concern. We really do, and we work very hard on this specific issue. It tends to be a lightning rod for other difficulties on the board. We often find that really poor succession planning leads to really poor remuneration outcomes, because the board and the remuneration committee leave themselves with no option. Successful planning in preceding years would have left them with options. If they had a dominant personality in the chief executive's role who said, "Pay me that or I walk", they could say, "Walk; we have alternatives". It is a broader issue than just remuneration. It often speaks to the structure and the behaviour of the directors on the board.

Chair: Thank you very much, all four of you, for coming to give evidence to us today and for your candour on some really, really important issues for British business. Thank you.