

Business, Energy and Industrial Strategy Committee

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

Tuesday 16 October 2018

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Watch the meeting

Members present: Rachel Reeves (Chair); Vernon Coaker; Drew Hendry; Stephen Kerr; Peter Kyle; Sir Patrick McLoughlin; Mark Pawsey; Antoinette Sandbach.

Questions 409-552

Witnesses

I: Orna Ni-Chionna, Chair, Remuneration Committee, Royal Mail Group; Peter Newhouse, Director, Executive Vice President for Reward, Unilever; Bruce Duguid, Head of Stewardship, Hermes Equity Ownership Services.

II: Luke Hildyard, Director, High Pay Centre; Georgina Marshall, Head of Global Research, Institutional Shareholder Services (ISS); Alan MacDougall, Managing Director, Pensions & Investment Research Consultants Ltd (PIRC); Tom Gosling, Partner, PwC.

Examination of Witnesses

Witnesses: Orna Ni-Chionna, Peter Newhouse and Bruce Duguid.

Chair: Thank you very much to the three of you for coming to give evidence to our Committee this morning on corporate governance, looking at executive pay. We have two sessions this morning. This is our first panel. We appreciate you giving up your time today. We have a number of questions and we are going to start with Drew Hendry.

Q409 **Drew Hendry:** Good morning. In general terms, how have you seen the approach taken to executive pay by shareholders change over the past two years? What do you think has caused the shift?

Orna Ni-Chionna: Shareholders have got more involved and more focused. The governance teams have become bigger and more detailed in



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their inquiry. That is a good thing. I do not know what has caused the shift. I suspect it is pressure from all sorts of organisations, including Parliament. I definitely see a turn towards more detail and more focus.

Peter Newhouse: I would say the same, so more engagement, more dialogue and more active concern about getting things right.

Bruce Duguid: Good morning. There has been increased scrutiny of executive pay by investors. There is now the Investment Association shareholder register, which puts a focus on companies that have had high levels of dissent. We have also seen rising levels of voting against companies by investors and indeed by Hermes. We recommended not supporting on 28% of proposals in the last season.

Q410 **Drew Hendry:** Staying with you, how has your approach to voting on executive pay evolved over the past two years? Have you voted against more pay policy and pay reports than previously?

Bruce Duguid: We have. The trend has risen. It has gone up from around 10% or 15% four years ago to towards 30% now. We tightened our policy in a number of areas. First, we seek much greater simplicity of schemes. We do not like to see complex proposals of more than two components. We do not like to see very highly levered schemes where there is a high ratio of variable to fixed pay. We also just generally test any levels of what we might regard as excessive pay and take a tough stance on that.

Q411 **Drew Hendry:** How do you rate excessive pay? What is your benchmark for that?

Bruce Duguid: You have seen high levels of pay take place, for example, at WPP, £70 million, or at Persimmon, where I think it was £45 million. Generally, more than about £10 million is a trigger to look carefully. That seems an incredible sum of money, but it would always get an inquiry.

Q412 **Mark Pawsey:** I wonder if I could keep my questions to Mr Duguid, please, and ask you about the role of institutional shareholders. Could you tell us a little about the Financial Reporting Council's stewardship code? Is that adequate? Is that helpful? I gather it is due to be amended. How would you like to see it changed?

Bruce Duguid: The stewardship code is a very positive thing. It came in in 2010. We supported it. We provide a stewardship service to over 40 asset owners and some asset managers, so that is our business. The challenge with stewardship codes is to demonstrate that they are really being adhered to in action and to have some sort of oversight over enforcing those codes. That is where you need to see the change happen and to see a greater depth of engagement across the whole market. There tends to be pretty good engagement with the largest of companies by all the asset managers in the UK market.

Q413 **Mark Pawsey:** How does that work in practice? Do asset managers and



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company management sit down in a room and have a chat? What are the practicalities? How does it work?

Bruce Duguid: There are a whole series of different shareholders out there, who will each be doing their own analysis. That, in a way, is one of the strengths of the market, that you get different perspectives. Companies will reach out to their top 10 shareholders and perhaps other opinion formers, for example ISS, which is a property service provider that you are going to hear from later today.

Q414 **Mark Pawsey:** Isn't the engagement sometimes with the very people who are receiving very high levels of pay? Does that not make for an uncomfortable meeting?

Bruce Duguid: The teams who may be doing this are not necessarily receiving very high pay, but there is that challenge of perhaps maintaining perspective. We are talking about high levels of pay but we are also talking about being able to make comparisons between different companies and judge what may be over the market versus a standard rate of pay.

Q415 **Mark Pawsey:** Do institutional shareholders come together to have a pre-meeting? Do you approach a company with one voice or are there disparate views among shareholders?

Bruce Duguid: Often, there will be separate bilateral meetings. Sometimes, companies will bring together a number of investors at a collective forum with, for example, their remuneration committee chair and they will explain the details. That will often then lead to a follow-up afterwards that may be one on one, where you can really kick the tyres and understand the details. Investors communicate between each other in various informal forums, so that is a way of exchanging information. Sometimes, we will come out and say publicly what we think. For example, in 2016, we put out a press release to say that we thought the WPP pay was far too high and we went to the AGM to express our views.

Q416 **Mark Pawsey:** Had you got the agreement of other shareholders in making those comments?

Bruce Duguid: In that case, no, although we represent other shareholders, our 40-odd clients. In that sense, we have their approval, but it is not a collectivised approach in that case.

Q417 **Antoinette Sandbach:** With the increasing trend for nominee shareholders, we have lots of small shareholders that are effectively held in one nominee account. In the old days, those shareholders used to get the voting forms themselves, in terms of executive pay. Now that does not happen anymore. Should there be greater engagement with small shareholders? For example, if my pensions investment had been changed, should I not be able to have a say on how the pension fund exercises its voting rights?



Bruce Duguid: The asset managers will represent those small shareholders in the big funds they hold, be they retail or institutional on behalf of pension funds. We represent the institutional side at Hermes. Can we find a route to hear the voice of that individual beneficiary who may have a view expressed? That is something that has been debated from time to time, but it is complicated to gather that data. You might need some sort of app or website process. It is also the question of simply understanding the issues. This is one of our bones of contention with the current system, that it tends to be over-complex, so it is very difficult to understand exactly how the package has turned out the way it has. That would defeat many people's capability of analysis.

Q418 **Mark Pawsey:** Sticking with the issue of stewardship, I wonder if we might ask the representatives of Unilever and Royal Mail whether, in your assessment, institutional investors exercise their stewardship role appropriately in your businesses.

Peter Newhouse: I believe they do, but it varies as well. Some of the smaller institutional investors do not have the resources to do as much research as the bigger ones do. Therefore, the quality of the debate is not always as good as it could be. They rely more heavily upon the proxy voting advisers, for example.

Orna Ni-Chionna: I agree. Large institutional shareholders exercise their stewardship very well and the smaller ones rely somewhat on the proxy agencies. They do a good job now of explaining exactly what is going on and giving people a lot of information on why they recommend that they should vote in a certain way.

Q419 **Antoinette Sandbach:** Mr Newhouse, I wanted particularly to ask about Unilever's pay policy and what it was hoping to achieve, and why there was so much opposition to it, particularly from the major advisory firms.

Peter Newhouse: We were trying to achieve four things that are very much in line with the thinking of the Green Paper. The first one is simplifying what it is that we were doing. The second one is to make longer-term arrangements for incentives. The third one, which is the most important, is to give the assurance that management have a very strong stake in the company, so they own shares, which was the major plank of our proposals.

Q420 **Antoinette Sandbach:** That does not deal with why there was the opposition.

Peter Newhouse: No, but, if I go back through the process, we spent two years talking to investors about our proposals, and then we implemented them in two phases. In the first phase, we received strong support. In the second phase, we did not receive such strong support. We had a significant minority of shareholders opposing it. There were concerns about the quantum of pay and the level of change we were implementing in one go.



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Q421 **Antoinette Sandbach:** Why has executive pay gone up so much when your original intention was to keep it stable?

Peter Newhouse: I do not think it has actually gone up so much. There are three pieces that are worth focusing on. The first is fixed pay. We proposed an increase in fixed pay for the CEO and CFO. The CEO subsequently declined to take that increase. The second area is that we proposed a large increase in annual bonus on a like-for-like basis, but under our new policy that bonus would be invested in Unilever shares over the longer term to give the individual a stronger stake in the whole thing. The third piece that gave some concern was potential increase in maximum pay if all performance targets were exceeded.

Q422 **Antoinette Sandbach:** What have you learnt from the shareholder engagement and the reaction to the changes you made? What do you think might have made that engagement more effective, particularly around the second tranche?

Peter Newhouse: Change is difficult. If you want to change things, especially if you want to change things radically, it is quite difficult to explain a lot of moving parts simultaneously. That is a good lesson for us. Also, sensitivity around executive pay definitely changed over the two years while we were making these proposals, so these are things we need to take into account.

Q423 **Antoinette Sandbach:** Mr Duguid, what did Hermes do around the way you voted in respect of Unilever's pay policy and why?

Bruce Duguid: We were balancing up two aspects of this scheme: the idea that there would be an increase in the CEO's pay, and then the structural changes that were taking place. We actually came down in support of the scheme, against that high level of dissent, although obviously with the majority. The reason we did so was because we wanted to see the system change. We wanted to see the simplification. We wanted to see the reduction in the ratio of variable to fixed pay that took place and the increase in the shareholding requirements that would take place. We balanced that as being worth the potential rise in the salary. We took the context that the CEO's pay had not risen in the last five years and the 5% increase was still less than the average worker at Unilever had received. We are looking for a systemic change in the structural policies, so that perhaps was why we were more interested in that half of the equation.

Q424 **Chair:** Peter Newhouse, how much did the chief executive of Unilever earn last year?

Peter Newhouse: It was €11.66 million.

Q425 **Chair:** How much did that increase by on the year before?

Peter Newhouse: I have not got that percentage but it was from a base of €8.37 million, so that is approximately 20%. That is total pay, including incentives.



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Q426 **Chair:** How much did the share price of Unilever go up during that time period?

Peter Newhouse: I think it went up quite significantly, but I have a better statistic for you, which is even longer term. Going back to 2008, 10 years ago, the share price was £15.65, and it is now at around £40. Over the long term, Unilever has created quite substantial shareholder value. For example, market capitalisation 10 years ago was about €43 billion, and it is now about €135 billion.

Q427 **Chair:** I am just interested in what happened last year, because obviously you had quite a large shareholder rebellion: 35% of shareholders voted against the pay.

Peter Newhouse: We have two holding companies and it was 64% in the UK and 73% in favour in Holland.

Q428 **Chair:** That was quite a large shareholder revolt over that 20% pay rise to €11.6 million.

Peter Newhouse: Our remuneration report, which is the implementation of the current policy, was passed with a high majority, in the 90s. The issue the shareholders were concerned about was the change in the remuneration policy and it was the change in the remuneration policy that received a significant minority of shareholders' votes against it.

Q429 **Chair:** On 2 May, 35.8% of shareholders voted against the directors' remuneration policy.

Peter Newhouse: In the UK AGM.

Q430 **Chair:** Yes, this year. You have not yet published a statement of action undertaking that vote. Do you plan to do so, and, if so, when?

Peter Newhouse: Yes, we do. We have said that we will be engaging with shareholders around now actually, so we are planning meetings for the second half of October, towards the end of October.

Q431 **Chair:** Do you think Unilever has a good record of engaging with shareholders?

Peter Newhouse: Everybody could improve. The great thing about corporate governance is that it should be a dialogue, so we will be actively engaging in that dialogue.

Q432 **Chair:** Should that not have happened before the meeting on 2 May? Obviously, that is a substantial vote against. We are now five months, almost six months, on from May. You have not yet published that statement of action. You are saying you are doing that about now, but should that not perhaps have happened before the vote or quite soon afterwards?

Peter Newhouse: As I mentioned, we did go through a process, which was really a two-year process. In the first year, as set out in the 2016



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report and accounts, we outlined the principles that we intended to subsequently apply to the executive directors, so we have been through a long process of engagement. Recently, we have been busy with other things.

Q433 **Chair:** Yes, and on other things as well you have struggled to get the support of shareholders. Shareholders voted against your proposal to move your headquarters to the Netherlands as well. Is there something of a pattern here, that the shareholders are not that happy with the decisions being made by the board of the company?

Peter Newhouse: That did not actually go to a vote. We will be talking to shareholders in the next few—

Q434 **Chair:** It did not go to a vote but why, Mr Newhouse, have you not moved to the Netherlands?

Peter Newhouse: We know there is a significant minority of shareholders who are concerned about that. We will be discussing it with them in the weeks to come.

Q435 **Chair:** Is there not a bit of a pattern here, Mr Newhouse, that you propose something, whether it is on remuneration or the location of your headquarters, shareholders do not like it very much and then you decide you had better do a bit of engagement? I am suggesting, Mr Newhouse, that perhaps you could improve things by discussing things with your shareholders a little sooner, and therefore making recommendations, as a board, that your shareholders, the owners of your company, are more supportive of. Do you think that is a lesson to be learnt?

Peter Newhouse: I understand what you are saying, yes.

Q436 **Chair:** Do you agree?

Peter Newhouse: Yes. It sounds like a sensible way of looking at it.

Q437 **Chair:** Good, I am glad you agree. I hope we will see a change in the way Unilever discusses things with shareholders. Can I ask another question? Going back to the issue of pay, Unilever is an accredited living wage employer, which I am sure the whole Committee would agree is a good thing. You said that the pay of the chief executive went up by about—

Peter Newhouse: 20%.

Q438 **Chair:** —20% over the last year. What happened to average pay in Unilever across the whole workforce in the last year?

Peter Newhouse: It went up by about 3%. Also, I would like to say that, in terms of the change in the chief executive's pay, the majority of that change was due to incentive payments, as Bruce mentioned. In terms of fixed pay and certainly in terms of salary, the salary has not moved much over the last 10 years. We have only had a small increase



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over that period of time. The current chief exec, Paul Polman, is paid less than the previous incumbent 10 years ago, in terms of salary, fixed pay.

Q439 **Chair:** What is the ratio of pay? Do you know what the ratio of pay is between your chief executive and the average earnings at Unilever?

Peter Newhouse: Yes, we have published pay ratios already. That shows our commitment to good corporate governance. We are continuing to be a pioneer in respect of those sorts of things. We have published ratios that show the relationship between different levels of the organisation, not just the relationship of the CEO to something like the median worker. What we published last year shows that the ratio of the CEO to our Dutch and British populations was 134. Next year, we will be complying with the code and showing the ratio against the median UK earnings level.

Q440 **Chair:** According to the CIPD, the CEO pay ratio to average employees for the last financial year was 315 to one. Is that a number you recognise?

Peter Newhouse: Yes, that probably is about right.

Q441 **Chair:** That is quite different from the number of 134 that you just gave me.

Peter Newhouse: Yes, but, as I mentioned, that is what we published in our report and accounts, so that is what you will see there.

Q442 **Chair:** Why the difference? There is quite a big difference between 134 to one and 315 to one.

Peter Newhouse: We were publishing it and calculating it on a different basis to the new basis, but we will be publishing it on the new basis in the next year's report and accounts.

Q443 **Chair:** So 315 to one is a fair summary of the ratio between what the chief executive earns and what the average person at Unilever earns.

Peter Newhouse: Yes, average in terms of the UK. That is probably about right. I do not have that number in my head, but that is probably not far off.

Q444 **Chair:** Bruce, is that about normal for a FTSE 100 company?

Bruce Duguid: I gather the pay ratio is around about 146 to one in the FTSE 100 at the moment. The challenge with the pay ratios is that, if they are calculated off the CEO's pay, because of the volatility in the pay, 75% of which is variable, you are going to see them change quite a lot from year to year. I think the pay ratio peaked in 2009 at 150 and then has not really substantially changed as a trend in the last nine or 10 years. If you look from one year to the next, or try to compare two companies, you will not necessarily be able to see a pattern.

Q445 **Chair:** Is 315 to one a bit of an outlier, or are there many companies in



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the FTSE 100 that have pay ratios that high?

Bruce Duguid: This data has not been published for all the companies, but I think the average is about 146 or something towards 150. There will be ranges, because sometimes CEO pay could double or triple in one year and then could halve in another.

Q446 **Chair:** At the moment, Unilever's pay ratio would be about twice as high as the FTSE 100 average.

Bruce Duguid: I do not know this data intimately myself, but I gather it is quite possible to have pay ratios that go into the 300 to 500 range.

Q447 **Peter Kyle:** Orna Ni-Chionna, can I turn to you now and ask about Royal Mail? You and your committee made the decision to pay Rico Back a £5.8 million advance before he took up his post. How did you come to the conclusion that that was good value for money?

Orna Ni-Chionna: I would like to clarify that the payment to Rico Back was not an advance. It was payment for negotiating the end to a contract that had been created in 2000 when GLS was bought by Royal Mail when it was still in state ownership. That contract was highly unusual. It was very much about running GLS as an entrepreneurial organisation in which Mr Back had a lot of freedoms. He had a lot of elements of control over GLS and Royal Mail's activities outside the UK.

Q448 **Peter Kyle:** Let me rephrase the question. You authorised a payment of £5.8 million in order to secure Rico Back as chief executive. How did you come to the conclusion that that was good value for money?

Orna Ni-Chionna: We did not authorise the payment in order to secure him as chief executive. We negotiated with him for several years to change this contract and the payment was made to change the contract while he was still chief executive of GLS. He remained chief executive of GLS after that payment. I just want to be clear: it was not a signing-up payment or in order to secure him as chief executive of Royal Mail.

Q449 **Peter Kyle:** But the £5.8 million was paid and it was paid in order that he can take up the position of chief executive.

Orna Ni-Chionna: No, it was not.

Q450 **Peter Kyle:** It freed up the opportunity for him to become chief executive.

Orna Ni-Chionna: It was paid in order to break the contract because at Royal Mail we increasingly, at board level, had felt uncomfortable that GLS had such a contract, that we were overseeing such a contract. It was a highly unusual situation but it made sense. While Royal Mail was somewhat bureaucratic in the past, GLS had created enormous value, enormous success. It had grown, under the leadership of Mr Back, to €3 billion of sales, approximately €300 million of profits, and it was really being run as an entrepreneurial element. We felt we needed to stop that and take back the control that a board needs to have, and we were also



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investing in GLS by now, but we had to buy out his contract to do that. His pay had been substantially higher than our chief executive under that contract. The aim was to take back control to the board. While we were doing that, we rebased his pay down. That final negotiation did not happen until May or June 2017, so the payment did not happen until then, but the negotiations had been going on for some time.

Q451 Peter Kyle: Once £5.8 million was being considered, did you look at how else that money could be spent in order to solve the management challenges? Did you just carry on going down one track and not even consider the alternatives?

Orna Ni-Chionna: If we just step back and look at the situation, obviously £5.8 million is a substantial amount of money. I completely agree with you. Rico Back had created enormous value within GLS. We were keen to keep him as a motivated employee of GLS and chief executive of GLS within the Royal Mail Group. As a result of the negotiation, we paid that amount of money at the end of the negotiation.

Q452 Peter Kyle: What alternatives did you consider? If that kind of money is in play, what alternatives did you actively consider, as a committee, to Rico Back?

Orna Ni-Chionna: The alternative would be to not break the contract, but we felt very strongly we needed to break the contract and have the control that shareholders would expect the board to have.

Q453 Peter Kyle: No, you are justifying the decision. I am asking you if you considered any alternatives and what they were.

Orna Ni-Chionna: Mr Back was and remains a very talented, very successful executive, who had created an awful lot of value. We wanted to retain him in the business.

Q454 Peter Kyle: Just answer the question. You did not consider an alternative. You had one option on the table and you paid whatever was necessary to make that offer, that one opportunity, happen.

Orna Ni-Chionna: I am not quite sure I understand the question, because we wanted to retain Mr Back in the organisation but on a different contract. Then it was about the price of breaking the contract.

Q455 Peter Kyle: As a committee, you did not even consider any alternatives to Mr Back. That is my point. The question you considered as a committee is "How much will it cost to get him?" rather than "The price tag is going up and up and up. Are there any alternatives to Mr Back?" That is my question. You did not consider any other names. You did not speak to any other headhunters. You did not look at any other alternatives to him.

Orna Ni-Chionna: We were not negotiating this contract to hire Mr Back as the chief executive. We were negotiating this contract to change the



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contract that Mr Back had as the chief executive of GLS and keep him as chief executive of GLS.

Q456 **Peter Kyle:** Did you know that he would not be domiciled in the UK when you were having these conversations?

Orna Ni-Chionna: At the time, he was domiciled in Switzerland. He was running the business from Switzerland. He was in the UK very frequently by then because he was helping us build our parcels business and making a big difference to our UK parcels business.

Q457 **Peter Kyle:** Where he is domiciled was not relevant to you.

Orna Ni-Chionna: Not in the context of this contract. We were focused on taking this contract, the rights associated with this contract, and a very high pay structure associated with this contract, away so we could normalise the situation. I realise that the juxtaposition with his becoming chief executive a year later can confuse the issue and did confuse the issue in the press. They were actually completely separate items.

Q458 **Peter Kyle:** In 2009-10, Adam Crozier, your former chief executive, was paid a total remuneration of £858,000. In 2017-18, eight years later, Moya Greene was paid £1.797 million. By my calculations, that is an increase of 109% in eight years. In that same period, what was the increase in your frontline postal workers' pay?

Orna Ni-Chionna: With respect, I have different figures for Adam Crozier's pay than you have. The figures that I have for Mr Crozier's pay for the last three years of his—

Q459 **Peter Kyle:** No, 2009-10 I have here. The total remuneration was £858,000.

Orna Ni-Chionna: I do not think that was for a full year, because his salary was £633,000 and his pension contribution was higher than that, so his salary was much higher than Moya Greene's. In the last three years of his full-time employment with us, he got considerably more than Moya Greene got in her last three years of full-time employment with us.

Q460 **Peter Kyle:** In that period, how much is frontline postal workers' pay increasing?

Orna Ni-Chionna: Her pay in the last three years, for example, would be about 20% lower than his in the last three years. Frontline pay has gone up from 2010 to 2018 by 24-point-something percent, I think.

Q461 **Peter Kyle:** What is the pay ratio from chief executive to average earnings?

Orna Ni-Chionna: I have been looking at ratios, because I am very aware of them, and there are different ways to calculate it. The ratio of chief executive to average pay is 32.5. That is average pay. Our frontline workers get lower than that, so I thought it might be helpful to take the starting average pay for a postman, which is £23,000, and calculate the



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ratios on that basis, just to be clear. For Moya Greene's salary last year, it was a ratio of 24: in other words, her £547,800 to £23,000. If I take her full pay last year of £1.8 million, the ratio is 78, so it is about half of what you were hearing earlier for the FTSE 100. I am not even sure that is like for like, because 78 is the total of what she got against the £23,000 for a postman before overtime and allowances. If I were to take the overtime and allowances for a postman, which would bring it up to nearly £27,000, that 78 would be lower, but I did not actually calculate that.

Q462 Peter Kyle: Why do you think 70% of your shareholders voted against the annual report on remuneration?

Orna Ni-Chionna: Obviously, that was a huge disappointment and indeed a shock to us. We were obviously very anxious to find out why. We knew that ISS, which has been mentioned earlier, had recommended voting against the resolution because of the contract Moya Greene had, which resulted in this payment to her at the end of her employment if she were to leave at a date chosen by us. We wanted to make sure we had fully understood that, so we commissioned an independent expert to interview our 10 largest shareholders, if they would, and they did all agree to see her, so that she could get an honest view of why they had voted against and what the big issues were. The overwhelming big issue was indeed Moya Greene's contract. That was why they voted against us.

Q463 Peter Kyle: But that is entirely reactive. What you are describing is trying to find out why they voted against. Why were you not in touch with what they were thinking in the run-up?

Orna Ni-Chionna: That is the mistake we made. I was hearing that the shareholders were happy with the pay that had been reported in the annual report. That may have been true of those who invest, the fund managers, as opposed to the governance teams within the investors. It clearly was not true of the governance teams within the investors. As soon as we published that annual report, we should have gone out to those governance teams and engaged with them. I have apologised since for not doing that. It was a big mistake for us to make, and we absolutely should have done.

Q464 Peter Kyle: I appreciate the sincerity with which you regret that, but does it not paint a picture where you are intensely focused on the needs of the chief executive and blind to the considerations of the shareholders? Why is it that you and your committee just go weak at the knees when it comes to a powerful chief executive, and yet seem completely incapable of paying the same kind of attention to your shareholders?

Orna Ni-Chionna: The situation with Moya Greene's contract was that we had mentioned it in the prospectus, and we mentioned it every year in the annual report, so we were lulled into believing that they understood it. It was just this contract that was the big problem for them. That was the reason ISS said to vote against our pay report and that was the No. 1



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reason that shareholders gave us for having voted against that pay report. We were lulled by the fact that we thought we had explained it well, and perhaps we were too close to it, and we were lulled by the fact that nobody had raised any questions at all about it when our chief executive, and indeed our chairman, had been going around the shareholders.

Q465 **Peter Kyle:** You say “raised questions”. You did not ask the question. Bruce, how did you vote?

Bruce Duguid: We recommended voting against Royal Mail, both last year and this year. It was for the reason explained. It was the concern about a 12-month package being paid with a bonus at target during a period that was not actually worked. We would typically see prorating taking place. That means you only get a proportion of that payment for the time that was worked. Even if this were a contract that apparently had legacy and could not be avoided, we felt there was room for manoeuvre to discuss that with the person involved and potentially come to some sort of alternative arrangement.

Q466 **Peter Kyle:** When you have these thoughts, is it your job to call up the company and say, “We have some concerns”, or is it their job to be in touch with you, finding out whether you have any concerns?

Bruce Duguid: It has to go both ways. We were not a top 10 shareholder with Royal Mail. It is quite a small holding for our clients so we were not having the conversations about this before the publication of the annual report. One of the challenges here is that, once the report is published, the die is cast and you cannot change that arrangement. The engagement needs to happen quite a lot earlier even than that. There was explanation in the policy that prorating would be the normal approach and I do not think it was completely explicit that that could not apply to this particular package.

Q467 **Chair:** Orna Ni-Chionna, on Friday last week I went delivering the post in Bramley, in my constituency, with a postal worker called Lauren. I do not know how much she is paid but you suggest the average person delivering the post is paid about £23,500. Is that right?

Orna Ni-Chionna: Let me be clear. Outside London, £22,500 is the starting, inside London just under £27,000, before overtime and allowances, and that is the average of £23,000 that I quoted earlier.

Q468 **Chair:** I just did a bit of maths, and for £5.8 million you could employ something like 252 people to deliver the post. I do not know about other members of the Committee, but I think our constituents would probably prefer those 252 postal workers rather than £5.8 million being paid to one person who I do not think even pays tax in this country. Does the new chief executive pay tax in this country?

Orna Ni-Chionna: He absolutely does pay tax in this country.

Q469 **Chair:** He is not domiciled here.



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Orna Ni-Chionna: No, but he is paying full UK tax and NI on his earnings.

Q470 **Chair:** Will he pay full UK tax on the £5.8 million?

Orna Ni-Chionna: The £5.8 million was paid last year when he was working for GLS. It was paid through the payroll in GLS Netherlands.

Q471 **Chair:** Royal Mail is paying £5.8 million to somebody and that tax is not even paid in this country. That money could have been used to employ around 250 people delivering the post to UK taxpayers and citizens.

Orna Ni-Chionna: At every point, one can say that money could be spent on this or could be spent on that. I realise that is a situation we all face.

Q472 **Chair:** With respect, Ms Ni-Chionna, it is a decision that you and your business have to make. As people who use the postal service—and we all do, we all have to and I think we all support Royal Mail and want to support Royal Mail—all our constituents have an interest, when we buy the stamps to send our Christmas cards, birthday cards and all the rest of it, that the money we pay is well spent by you.

Orna Ni-Chionna: Absolutely.

Q473 **Chair:** Peter was asking you before if you had thought about other ways you could spend £5.8 million. There are lots and lots of ways, but employing 250 people to deliver the post would be one option.

Orna Ni-Chionna: Yes. We are a very big business and we spend a lot of money on a lot of things, including the wages and salaries of our 160,000 staff worldwide, of whom 140,000 are in this country. I think our total wage bill is £3.8 billion for the UK alone, for example, and then we have NI contributions as well.

Q474 **Chair:** Let us come back to the issue of the shareholder vote. I think you said in the answer to Peter Kyle's question that you heard that shareholders were happy and were surprised by the 70.17% vote against the directors' remuneration policy on 19 July. Were you only listening to 30% of shareholders, because 70% of them voted against the package?

Orna Ni-Chionna: Either we were listening to only 30% of shareholders or we were listening to the wrong individuals within those shareholders.

Q475 **Chair:** Again, we are getting a bit of a pattern here. Peter Newhouse has already said that, on both the headquarters of Unilever and remuneration, they were not listening sufficiently to shareholders. We have not called the two of you because we are specifically concerned about your engagement with shareholders, but it seems to be a theme, which Hermes has also expressed, about a lack of engagement. It is three months now since that meeting on 19 July. You have not yet published an additional statement of action undertaking the vote against. Do you plan to do so, and, if so, when?



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Orna Ni-Chionna: Yes, we will be publishing the statement of action within six months of that meeting, as we said at the time.

Q476 **Chair:** Okay, so we can look forward to receiving that early in the new year.

Orna Ni-Chionna: It will be published on the website early in the new year, exactly.

Q477 **Chair:** Okay. Again, we have this issue that you should have been engaging with shareholders ahead of that vote in July, and instead you are going to publish something on your website at the beginning of next year. Do you think you have learnt the lessons, Ms Ni-Chionna, and are now sufficiently engaging with your shareholders?

Orna Ni-Chionna: I can assure that you we have learnt the lessons and we are very engaged with our shareholders now. I would like to say, in my defence, that I have been very engaged with shareholders since privatisation, over the past five years. On this one occasion, we simply miscalculated. We wrote to shareholders when the annual report was published, saying, "If you have any concerns, let us know", and none contacted us, but we should not have just done that. We should have been chasing them, ringing them and demanding a meeting so that we were in there, explaining to them and engaging them on this very controversial issue. We should have done it and we did not do it.

We got a huge amount of information out of the deep interviews that were run with the 10 largest shareholders and, on the back of that, have started going to meet them. We met several of them last week. I have a meeting with one this afternoon and several more over the next few weeks. I can assure you that I will be very engaged with shareholders to make sure we do not have this problem again. I am very aware that Royal Mail is a very special company. We mean a lot to people. Our postmen and women mean a lot to people. I am very proud of the fact that we have increased their pay by 25% over the past eight years, that we pay way above the national living wage and the voluntary living wage, and that we are hiring 23,000 Christmas seasonal workers.

I really am embarrassed that we got this engagement with shareholders so wrong, and I want to assure the Committee that we will not do that again. We have a very responsible attitude to pay, as you have seen from the figures I have quoted on pay ratio, on Moya Greene's pay relative to her predecessor. We intend to stay that way.

Q478 **Chair:** That is welcome. I have one final question on how you make decisions. The Government are obviously very keen that a workers' voice is heard on the board of a company. How do you ensure that the voices of ordinary workers, people like Lauren from the Bramley sorting office, are heard on the board of Royal Mail and in the decision-making process?

Orna Ni-Chionna: We have a number of events that run throughout the organisation several times a year, run by the executive. There are town



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hall meetings where 200 or 300 people get together with some of the senior management to discuss issues. We have had 1,000 of those, for example, in the last year.

Q479 **Chair:** Do you have a worker on the board of your business?

Orna Ni-Chionna: We do not have a worker on the board. That is one option that has been put forward. We will need to decide what we do. One option is a worker on the board. Another option is a panel specially commissioned, and a third option is a non-executive director.

Q480 **Chair:** Do you think some of the mistakes that you have made and have admitted making—we appreciate your honesty on that—could have been avoided if you had had one of the postal workers on your board to maybe give you the view from the front line of your business?

Orna Ni-Chionna: I suppose it is a hypothetical question.

Q481 **Chair:** You just said you spend a lot of time talking to the workers. What feedback do they give you about the £5.8 million?

Orna Ni-Chionna: They have not mentioned it.

Q482 **Chair:** I am absolutely astounded by that, given you have had 1,000 town hall meetings and you engage with all these workers. Either they do not feel comfortable telling you this—

Orna Ni-Chionna: Let me back off. I do not know whether the town hall meetings have discussed that issue. I apologise for misleading you. I meant that when I have been out with postmen they have not mentioned it. That is a very narrow and very different interpretation. I am sure some of them will have mentioned it.

Q483 **Peter Kyle:** I should put on the record that my brother is a postman down in Brighton. He mentions it.

Orna Ni-Chionna: Yes, I am sure. It would make complete sense. I simply meant when I last went out with a postman, so I want to take that completely back. I did not mean that.

Q484 **Chair:** Is this not the point, Ms Ni-Chionna? You are making decisions without engaging with your shareholders. You have admitted that and we see that with the strength of feeling of your shareholders. I expect that Peter's brother is not the only postal worker who has concerns about these sorts of payments being paid to one man at the top of the organisation who does not pay tax in this country on the £5.8 million. Workers are not being included in the decision-making processes either. Do you think you should maybe look again at who is on the board of your business and whether you should have somebody from the front line there to challenge perhaps, with all respect, Ms Ni-Chionna, some of the complacency on the board of Royal Mail?

Orna Ni-Chionna: I do not think there is complacency on the board of Royal Mail. There are two parallel processes going on here. We are very



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proud of the fact that our postmen and postwomen are the best paid in the industry. We are very keen to make sure that Royal Mail survives and thrives in a difficult environment, against huge disruption, so that we can maintain those well-paid jobs, the highest paid in the industry, with the best terms and conditions in the industry. To do that, we need to have well-paid, strong management at the top with the right skills, talent and experience. When we get into that, as remuneration committee chair, you find yourself having to look at comparators and you end up with these figures of pay that you are well aware of.

Q485 Vernon Coaker: Can I just ask the companies first, Unilever and Royal Mail, what your objectives are in setting bonuses? What are you seeking to achieve?

Peter Newhouse: Engagement of the workforce is an important feature, being clear about what we think is success. For example, top and bottom-line growth and cash are our three metrics for annual bonuses. For people below the executive director level, we also have personal objectives, which are built into the assessment of their contribution to the company.

Q486 Vernon Coaker: What are the objectives of the bonus schemes for Royal Mail?

Orna Ni-Chionna: The objective of the bonus scheme is to make sure that we pay for performance. The performance that we are looking for has a range of elements, including financial performance as well as customer satisfaction, employee satisfaction and safety.

Q487 Vernon Coaker: Let us start to unpick that. I will come to you, Bruce. Where was customer satisfaction in all that? What is your view on bonuses and what should or should not be included? Of the top 100 FTSE companies, only 15% mention customer satisfaction as part of the way in which they pay bonuses to their chief executives and so on.

Bruce Duguid: We are looking for incentivisation of the right behaviours that drive long-term value and a system that does not pay any more than is necessary in order to do that, so it is not overinflated. We want to see the right type of metrics used, and that takes account of all the different key stakeholders of a business, so customer service if it is that type of organisation. We found Unilever's sustainability index attractive, as a quarter of the value of—

Q488 Vernon Coaker: It is interesting that that was not mentioned.

Peter Newhouse: I was talking about annual bonus.

Vernon Coaker: Yes, I know the point you are making.

Peter Newhouse: I would be happy to talk about it.

Vernon Coaker: We will come back to that, yes.



Bruce Duguid: We like to see a balanced scorecard of financial and these more strategic or stakeholder-related metrics. The challenge can be how to make sure they are measured properly and a proper narrative is given as to how performance has taken place. We want to see more than just the financial.

Q489 **Vernon Coaker:** If we called stakeholder matrix “customer satisfaction”, that would be a good way of putting it, would it not? If I spoke to people out on the bus or on the train, using Unilever or Royal Mail, I would not talk about stakeholder matrix. I would say, “How good do you think they are doing?” Why do you think more companies are not doing that, having that as part of a bonus? Part of the bonus is how well people think you are doing, and yet only 15% of companies mention that, according to the figures we have. Why do you think that is?

Bruce Duguid: It is maybe looking at what drives the share price in the relatively short term—

Vernon Coaker: The share price is more important than the customer satisfaction.

Bruce Duguid: —and not necessarily looking at that long-term driver.

Q490 **Vernon Coaker:** Sorry, just to cut through, the short-term interests are more important than the longer term.

Bruce Duguid: I think that is how many schemes are designed, and it is one of the problems of their design.

Q491 **Vernon Coaker:** That is the crux of it, though, is it not? That is what we are trying to drive, through all the stuff that goes around, such as stakeholder matrices. You are saying to this Committee—tell me if I get this wrong, because it will go on the record, so I do not want to misquote you—that for too many the short term trumps the longer term.

Bruce Duguid: Yes. For too many, shorter-term financial drivers are seen as the entire goal of the incentivisation process and not those longer-term drivers, which would include some non-financial attributes, for example customer service or long-term sustainability of the business. I have seen health and safety measures for mining companies or decarbonisation metrics for energy-intensive companies, oil and gas companies. We think that is the right thing to do. In general, the incentive system used in the UK is too short term.

Our recipe for changing that would be to have a larger part of pay paid in the form of shares in the company to the executive, so they take the same long-term interest as the investors have. That would be over a longer period, a five or 10-year period, with long holding periods.

Q492 **Vernon Coaker:** That is very interesting. We are a bit short of time, so there are just a couple of other things. On the issue of sustainability, if you would not mind, if Oxfam was here it would say there is no real incentivisation on social and environmental matters. There is a bit of a



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line somewhere. These so-called soft things are not really the business of companies. Companies have great big corporate governance statements on social responsibility. In your view, is that given as great an emphasis as it should be in the various schemes that operate?

Bruce Duguid: The emphasis is there in the company reports, but it is not as highly present in the key performance indicators that get financially remunerated. Ultimately, the two should come together, because what drives good business will drive good financial results, but over a one-year or even a three-year period you would want to see more balance.

Q493 **Vernon Coaker:** What would the workers say to all this? What do you think the workers think of all this?

Bruce Duguid: Workers, a bit like executives, may be confused about what drives pay because it is very complicated. A typical executive will have a one-year annual bonus system and they will have this three-year long-term incentive plan, but there are three of them in operation. There is a year to go on one. There are two years to go on the second. There are three years on the third. It is a very complicated arrangement and so it is difficult to understand what executive pay is.

Q494 **Vernon Coaker:** We have to move on: I apologise. If you would like to write with that information, that would help.

Bruce Duguid: Yes. Thank you very much.

Q495 **Stephen Kerr:** To continue from where Vernon was, Mr Duguid, around long-term incentive plans, companies could move away from what you just described as rather a complex system towards something else, deferred shares for example.

Bruce Duguid: Yes. We think a deferred share or restricted share scheme is a better arrangement, and could become a more normal and standard default arrangement. It would not necessarily work in every case, but you would have a higher fixed pay, which recognises there is a going rate for a very senior high-performing executive, but that would then be paid at least half in shares, so you get the long-term alignment. Then you would not have this overpayment for the volatility that exists and the discounting in an executive's mind of the uncertainty in that variable pay. You would deflate the system by making it more certain what the outcome was.

Q496 **Stephen Kerr:** You are trying to influence this, presumably. You think this is going to change the behaviour of senior executives.

Bruce Duguid: We do, so long as those shareholdings are held for a long period of time. If they are high enough, let us say five times your average annual salary, the variation in share price, let us say plus or minus 20%, will be equivalent to the same in your base pay. There is good evidence that, if you take into account shareholdings of executives, there is much greater alignment of outcome to performance of the



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company than if you just look at the cash bonuses that get paid. Moving to higher levels of share ownership and more fixed pay would be a better system all round.

Q497 **Stephen Kerr:** By “deferred shares”, you mean they cannot exercise their rights over those shares for a number of years.

Bruce Duguid: It means they cannot be sold, typically for a five-year holding period, with a phase-down process even after that period. We would like to see them held even after departure, so if you leave you still have a stake in the business you have helped to build. That is very important.

It is important to say there is a concern that this could be payment for failure, potentially. If you fix pay, what if an executive does not do well? There are two safeguards. First, you can have underpins put in place that protect key elements, for example the health of the balance sheet, the payment of dividends, good corporate governance practices. Particular failures are identified and would not allow these shares to be kept. Secondly, of course, it is not easy to keep your job as a CEO. If you are a board director, your job is to ensure you are still doing performance management. The average tenure of the CEO has fallen from eight years, I think, in 2010 to five years or less now. That is where you put the emphasis.

Q498 **Stephen Kerr:** I have a series of very quick questions to ask the companies. Why do you continue with long-term incentive plans, Mr Newhouse?

Peter Newhouse: We have actually changed ours quite radically. It is very much in line with what Bruce has been describing. We do not use deferred shares but we basically ask people to invest their own money, after paying tax, in Unilever shares, and then we match those shares. That gives all our people a very strong commitment to Unilever and the performance of the company.

Q499 **Stephen Kerr:** That is a share-plus sort of arrangement. Is that mandatory for your senior executives?

Peter Newhouse: No, it is not.

Q500 **Stephen Kerr:** How does that compare at all with what we have just heard?

Peter Newhouse: Let me try to describe it more clearly. We have cascaded this down through the organisation. If I personally do not invest my bonus, after having paid tax on it, in Unilever shares, my total pay will fall. If I invest in Unilever shares, I have the opportunity to get a performance-based match over a period of four years.

Q501 **Stephen Kerr:** This bonus you are talking about is still contingent on the achievement of this long-term incentive plan.



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Peter Newhouse: Not quite.

Q502 **Stephen Kerr:** What is the bonus, then? How do you calculate the bonus?

Peter Newhouse: As I mentioned to Vernon, it is based on personal objectives and, for people below the board level, personal objectives plus financial objectives for the organisation. Over the longer term, having invested in Unilever shares, we also include sustainability.

Q503 **Stephen Kerr:** It is all based on the short term.

Peter Newhouse: It is actually very long term, because that whole series of things lasts for six years. Then there is a requirement to hold shares for another two years for the executive directors.

Q504 **Stephen Kerr:** I am not sure I quite grasp that, but let us ask Royal Mail. Why do you persist with LTIPs?

Orna Ni-Chionna: We have considered what Bruce has talked about. We see the merits of that. I am not certain that our shareholder base would support it at the moment. As Bruce said, many shareholders still prefer long-term incentive plans instead.

Q505 **Stephen Kerr:** Is this being influenced by what is happening elsewhere? Is this an agenda set by the US, in short? Are corporate expectations in the US driving the way we operate here?

Orna Ni-Chionna: They may be outside Royal Mail. Our long-term incentive plan pays out at a much lower percent of salary than the long-term incentive plans for most UK corporates, so it is, relatively, a lower part of our overall pay than it would be for most companies of our size.

Q506 **Stephen Kerr:** How much are you influenced by the agenda set by US corporate expectations?

Orna Ni-Chionna: We are not.

Stephen Kerr: You are not.

Orna Ni-Chionna: No.

Q507 **Stephen Kerr:** What about Unilever? Your global competitors are American corporations.

Peter Newhouse: Yes, absolutely. We measure our performance against international companies, including US companies, but we measure our pay against European companies. We are very much a European company. Although we realise American companies pay a great deal more than we do, we are not trying to compete in that market.

Bruce Duguid: There is a challenge in convincing the shareholder base of this type of move. You have heard from Clare Chapman, who went through the experience at Weir Group and successfully convinced 92% of



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investors, but it took a lot of time and effort to do so. It is about explaining that this is not payment for potential failure by fixing the amount of pay.

Interestingly, I think there is a challenge with the US shareholder base. Quite a few FTSE 100 companies will find that half or more of their shareholder base is in the US. They have been going slightly in the opposite direction, from what they called restricted share units to performance share units. This seems to be going backwards on their old system. Their old system did not have such long holding periods, did not have the underpin arrangements. That is where the communication is required, to explain that it is not the same as the old ways in the US that they are trying to get rid of. It is something better, but it is also linked to long-term value.

Q508 Stephen Kerr: A basic accusation that is made against remuneration committees, frankly, is that you are dictated to by the senior executives you work with, that they negotiate you into a corner. Is that true or false? I know you are going to say "false", but I am going to ask you anyway.

Peter Newhouse: I think our CEO is on record as having concerns about pay, so that is clearly not the case.

Q509 Stephen Kerr: Yes, but it does not stop the pay going up and up and up. What is your incentive to keep executive pay down?

Peter Newhouse: Our pay has been really very stable on a fixed basis. The incentives have gone up and down.

Q510 Stephen Kerr: That is a product of excellent negotiation from senior executives, I would suggest.

Orna Ni-Chionna: Obviously, I would like to say "false" as well. Again, we are proud of the fact that at Royal Mail we have had a very responsible attitude to pay. We are at the lower end.

Q511 Stephen Kerr: What is the incentive? What is driving it? Why is it in your interest to keep executive pay down, because it does go up? However you calculate it, base salary, bonuses, it is going up.

Orna Ni-Chionna: It is in our interests to keep it down, because that is right for shareholders. That is right for the company. It means we can spend more on other things.

Stephen Kerr: I wish we had time to go into this a bit more, but time has beaten us.

Q512 Vernon Coaker: Very briefly, there is a new corporate governance code. What difference is it going to make?

Bruce Duguid: There is a much higher emphasis on remuneration in the code now than there was before. There is particular emphasis on the alignment of workforce pay to executive pay, and there are guidelines on



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how to set pay, including the idea of having a cap on pay, which we have long requested and supported, and shareholding post-departure. There are guidelines there that give emphasis to the direction of travel. It is comply or explain; it is not binding, so you cannot be sure that this is going to make a step change to the system.

Q513 Vernon Coaker: Should it have been binding? Should there have been more enforcement measures included within it?

Bruce Duguid: It is very hard to make executive pay arrangements binding in any particular way, because there are special circumstances and it is complicated. This, plus the Investment Association guidelines, which will include even further guidelines on the idea of fixed pay and restricted shares, all give a confidence that the system is beginning to move in that direction.

Peter Newhouse: It will make a difference. Over the last 10 years and more, executive pay has become a lot more transparent, clearer and has improved in general. There will always be instances where people find legitimate concern, but the general direction of travel is quite positive. The price that everybody pays for it is a very long directors' remuneration report compared to what it used to be in the past, but the increased transparency that arises from that is a benefit.

Q514 Vernon Coaker: What about remcos? How do you feel about their role? Do they work?

Peter Newhouse: Yes, they do, and it has to be one of the toughest jobs around. People take it very seriously.

Q515 Vernon Coaker: Why is it tough? You are there to hold the chief executive to account. You turn around and say, "Look, it's my job to tell you you're trying to get too much money. That is my job. I know you are my friend, but that is it".

Peter Newhouse: It does not quite work like that.

Q516 Vernon Coaker: How should it work, then?

Peter Newhouse: It works with a good corporate governance framework that people and companies can use to set the right policies for the future, irrespective of the current incumbent. It is something that should be done for the long-term success of the company.

Orna Ni-Chionna: I agree. The new corporate governance code is a good thing. It will bring more transparency, and formalise the need for boards and remuneration committees to be more thoughtful, up and down the organisation, about what the workforce gets and how that is arrived at, versus what the top management gets.

Q517 Vernon Coaker: Would it not help the overall framework, whether the remcos, the governance code, the FRC and all that sort of thing, if there was more of an element of enforcement, as a final resort? Would that not



help with public confidence?

Orna Ni-Chionna: Yes. I would have to think about which parts of it you would enforce in order to answer that question well. Enforcement would make things simpler. If there is a rule you have to stick by, it is always simpler, and that could be a good thing in some circumstances and it could take away too much discretion in others.

Vernon Coaker: You have to pay the minimum wage. It was massively controversial, but it was law.

Orna Ni-Chionna: It was, exactly.

Q518 **Vernon Coaker:** Would it not help to say you have to do this legally: "You cannot have a pay ratio more than", or "You can't do this", or "If you do that, that is the consequence", or "The remcos will sort it out; if not, the FRC will step in"? Should the code of governance have said that?

Bruce Duguid: There are two areas we have promoted. First, there should be very clear communication of what the pay is. Although there is the annual report, not everybody will wade through that document. We have advocated for a letter that would be written by the chair of the remuneration committee or the chair of the board to every worker, to explain what executive pay is. If you can survive the test of explaining it in the clear light of day, maybe you are getting it right. The other is to have very clear caps on pay, so there is an upper cap above which pay cannot go. There are always unforeseen scenarios in schemes that can lead to very high, or what are considered absurd, levels of pay.

Vernon Coaker: So you have a maximum pay limit.

Bruce Duguid: At least it could be very clear what that is.

Chair: Thank you very much for coming to give evidence today. There was a lot of food for thought on pay ratios, involving the voice of workers and engaging with shareholders, so thank you very much for your time this morning.

Examination of Witnesses

Witnesses: Luke Hildyard, Georgina Marshall, Alan MacDougall and Tom Gosling.

Chair: Thank you very much to the four of you. I think you all sat in on the previous session and you are aware of the purpose of the inquiry on corporate governance and executive pay. We appreciate your time this morning. Stephen Kerr is going to start with the first question.

Q519 **Stephen Kerr:** I would first like to ask HPC and PwC how you would summarise the change in the levels of executive pay over the last 12



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months.

Tom Gosling: Overall, pay has essentially been flat in real terms since before the financial crisis. It is volatile, because so much of senior executive pay is in the form of bonus schemes and long-term incentives. We may come back to discuss that but, in essence, the underlying trend line across all the datasets shows that it is broadly flat. This year, in contrast to previous years when we saw a marked decline in the highest levels of pay—so the upper-quartile pay had come down every couple of years—we have seen it go up again.

To look at what is behind that, the High Pay Centre's report very helpfully lays out the individual top-10 cases. We have had an unusual number of cases this year of realisations from one-off schemes that were put in place before the new policy regime came in, in 2013. Once you look through that, the underlying picture is that, overall, executive pay is flat. It is not going down, but it is not going up either. It is a broadly flat trend for a decade.

Luke Hildyard: I would not disagree with what Tom has said. We saw a big increase in the average pay for the FTSE 100 from about £4.5 million to closer to £5.7 million. As Tom says that was driven by a handful of extremely high pay packages at a small number of companies. We also saw our figures, which are of the FTSE 100 only, go up. The median went up by 11% from about £3.5 million to close to £3.9 million. That is still quite a big increase compared to what the wider workforce has experienced.

Q520 **Stephen Kerr:** Why is that? Is that driven by one or two examples? That would be huge.

Luke Hildyard: No, this is across the board. As Tom says, that was an increase on last year, but it was back to the level of 2015, rather than at a historic high.

Q521 **Stephen Kerr:** Is that pay or is that bonus?

Luke Hildyard: That is total pay.

Q522 **Stephen Kerr:** That is total pay, so what element of the package is this?

Luke Hildyard: LTIPs continue to be the biggest proportion of the pay packages, yes.

Stephen Kerr: They are lucrative.

Luke Hildyard: I think 82% of FTSE 100 companies paid an LTIP last year and about £3 million of that was driven by some very high ones. The median is more like £1 million.

Tom Gosling: Even the increase in the median was distorted by half a dozen companies paying anomalous payments compared to their previous policy. I would emphasise that, overall, I am not saying pay is



going down. It is not, but the idea that it continues to go up and up is not true.

Q523 **Stephen Kerr:** Okay, but there have been some increases. To go back to Luke, is this is on the back of improved company performance and share price growth?

Luke Hildyard: I am not a stock market expert, but you would say the performance of the stock market has driven pay increases.

Stephen Kerr: It is not entirely dependent on talent.

Luke Hildyard: Whether you would attribute that to the individual brilliance of the executive is much more questionable.

Q524 **Stephen Kerr:** It could be currency deflation. Do companies based in the UK need to pay more than most European companies to attract talent?

Tom Gosling: No, not particularly. There are a couple of aspects about the UK versus the rest of Europe. Once you account for the fact that relatively generous pension schemes in continental Europe are not typically very well disclosed, total pay for UK executives is broadly comparable to total pay in similar-sized companies in places such as Germany, Switzerland and even France and Spain. There are countries such as Sweden that pay very much lower than in the UK, and it might be interesting to hypothesise about why.

There are two other important factors about UK pay compared to the rest of Europe. First, pay in the UK has been driven much more by shareholder preferences around pay structures, because we have had shareholder voting on pay for a very long time now. That means that a greater proportion of pay in the UK is based on bonuses and long-term incentives. It is paid in shares held over the long term. Pensions are much lower. Also, for good or ill, we have opened ourselves up to international recruitment of talent much more in the UK. This is not about people leaving the UK to go abroad, but actually 40% of CEOs of FTSE 100 companies are non-UK nationals, which is matched only by Switzerland within Europe, at 50%. In most countries it is under 20%. We have a lot of companies that are only British by virtue of being listed here. All those factors together affect the dynamics and cause pay, on a pound figure, to be slightly higher than in the rest of Europe. Other than in countries such as Sweden, it is not dramatically higher.

Luke Hildyard: A couple of years ago, we looked at global pay across the Fortune Global 500, the world's biggest companies. We found that less than 1% had poached a CEO from an international rival, and around 80% had promoted from within. The idea that it is such a transferrable skillset is perhaps overstating it a little.

Alan MacDougall: We have just done a study of executive director appointments from January 2017 to end of March 2018. There were about 211 appointments during that period, and only 35 were



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appointments from companies or organisations outside of either the existing company or another one in the sector. The idea that there is a global market for these kinds of jobs is slightly misleading.

Stephen Kerr: That is confirming evidence. Thank you.

Q525 **Antoinette Sandbach:** Can I ask Georgina and Alan if you think executive pay is too high? Should it be left to the market? Do companies have a social responsibility to equality, or to preventing social inequality? That is probably a better way of putting it.

Georgina Marshall: Maybe I can answer that by talking about how we analyse pay and report on that to our clients, who are institutional investors. We look at many different factors around CEO pay in particular and how companies report on it. To some of the points made in the first panel, a lot of it is about the information and explanations that the companies give for why they have chosen those particular metrics and pay-out levels.

Q526 **Antoinette Sandbach:** Can we take an example? Why was it that the ISS recommended the Persimmon LTIP?

Georgina Marshall: First, I do not have that information with me but, actually, we did not recommend on the pay for Persimmon. We will generally look at the level and structure of pay, and the performance measures behind it.

Antoinette Sandbach: So you are saying that you did not recommend support for the Persimmon LTIP in 2012.

Georgina Marshall: I do not know for 2012, I am afraid.

Q527 **Antoinette Sandbach:** Could you write to us about that?

Georgina Marshall: Yes, I could certainly do that.

Antoinette Sandbach: There has been quite a lot of concern about the way that pay packet was made.

Georgina Marshall: I will follow up on the pay policy.

Q528 **Antoinette Sandbach:** I am conscious of time and have quite a limited period of time. Do you think there is a responsibility for boards to address social inequality? I am sure your written evidence explains how you work pay out. My question is this: is pay too high? Should it be set by the market?

Georgina Marshall: Pay absolutely can be too high. We have heard many examples of that this morning. Both investors and companies need to think about that, in terms both of company performance and their stakeholders, as well as their shareholders.

Q529 **Antoinette Sandbach:** Do you think the market is the right place to set pay?



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Georgina Marshall: The market does not set pay. The market can take a view on pay and be part of a healthy contribution to how pay is set.

Alan MacDougall: It partly depends on what you think the market is. Let us assume that it is a collection of individual decisions across institutions. Our view would be, first, yes, pay is generally too high for the purpose. The purpose here is to pay executives appropriately for the job in hand. I assume you are talking about executive pay. One of the problems we have is that executive jobs are not advertised. Actually, that is not technically true. We have come across one or two companies in the FTSE 350 that have advertised executive jobs in the past, but they are overwhelmingly not advertised, so it is difficult to see what the market view about pay is, because it is not an open market.

One of our demands is that there should be open advertising. I see an amendment in the code, published this year, which is at least a step forward to that. The other issue is that companies do not really have a concept of how their workforces are paid. They have the figures, the data and the outcomes of bargaining with unions, but they do not have a concept of how their employees are paid. If you do not have that concept, you do not have a very clear concept of how executives should be paid.

Q530 **Antoinette Sandbach:** What would you do to address that?

Alan MacDougall: You have to establish some kind of fair pay policy, possibly per sector and certainly across similar businesses. Part of that argument is derived from the report by Will Hutton on fair pay. Was it 10 years ago? It was certainly a long time ago. He did it for the public sector, but some of the metrics he used are perfectly appropriate for the private sector. It is bizarre that executive directors in publicly listed companies are the only market in the UK where the terms and conditions of pay are completely different from everybody else, and I really mean everybody else.

Q531 **Antoinette Sandbach:** Can I look at that difference between the UK and the US? How do companies manage that differential pay policy when they are big multinational companies?

Alan MacDougall: There are two things. First, they do not take the opportunity, when they have a vacancy, to re-establish a baseline contract of employment for executives.

Q532 **Antoinette Sandbach:** Do they in the US?

Alan MacDougall: No, but one of the problems with that is, if you do not do it every so often, you do not have a sense of the value of that post. Generally speaking, they appoint, fill the post and then spend a year or maybe two years negotiating with the outgoing firm that the individual has come from about their legal entitlements. One of the problems with that is, because they do not set a transparent contract of employment for executive directors, which should be agreed by shareholders perhaps



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every three or four years, in my view, they do not have a sense of whether or not they are being shafted, frankly speaking.

Antoinette Sandbach: Mr Gosling, is that something you agree with?

Tom Gosling: I do not entirely. The direct response to your question about how companies are dealing with the US CEO pay differential is that most UK companies now, certainly at the CEO level, would not pretend to compete with US CEO levels. There is a dramatic difference. It is just a different world. Where the rub comes is at the executive committee level, because many multinational and UK-headquartered companies are global in their operations, so will recruit to their executive committees from around the world. You see differences in how people are paid depending on location. In general, US-based executives are just paid more than UK-based executives, so they accept internal inequity within their organisations.

The points on recruitment are well made. An area of important focus for companies, in ensuring they are getting the best value from executive pay, is having really good succession planning. One thing that puts a board in a horribly weak position is having a chief executive who is departing when there is no internal candidate because, as soon as you go outside, you end up paying more.

Q533 **Antoinette Sandbach:** Mr Hildyard, have you seen downward pressure or changes in attitude to executive pay over the last two years?

Luke Hildyard: Rhetorically, perhaps.

Antoinette Sandbach: But not in outcome.

Luke Hildyard: Not in outcome, no.

Q534 **Vernon Coaker:** Can I ask ISS and PIRC about this? It is something that people out there will be quite surprised about, shareholders outsourcing their stewardship responsibilities and the debate there is about that. How much notice do they take of you and how dependent are they on your advice and services?

Alan MacDougall: They broadly value the services because they pay for them. It is a market approach. I think it is a myth that shareholders outsource their stewardship or governance responsibilities to us. They look to us to provide them with the data and the analysis, so they can make more informed decisions about their responsibilities of governance and stewardship. It is the case that too few institutional investors—and I will speak only for pension funds in these circumstances—are active enough in these areas. We would like our client base to be more active than it is, although, I have to say, we have some clients that are very active, active beyond the services they receive from us.

Q535 **Vernon Coaker:** So they should do more themselves as well.



Alan MacDougall: I think they should. The stewardship code gives them the framework in which they can do that. To be blunt, the stewardship code is not particularly onerous and a lot of it is broken in practice. For example, quite a few investors do not publish their voting guidelines or recommendations.

Q536 **Vernon Coaker:** So that is something they should do.

Alan MacDougall: Yes, absolutely. One of the problems with doing it, as the asset managers keep moaning about, is that there is not a common disclosure format for it. If there could be something instituted, I am not necessarily suggesting through legislation, but definitely as best practice guidance within the framework of the stewardship code, there would be a transparent process of disclosure that applied to everybody. For example, if you look at SSGA's voting outcomes, its latest figures are for May last year, whereas we and Hermes are a quarter behind. That is partly because we value it.

Vernon Coaker: That is a really important point.

Alan MacDougall: It is an important point about disclosure. If you have disclosure in a common format, you can compare across. When so-and-so says, "I'm doing this with my remuneration recommendations", you can look and compare across the market.

Georgina Marshall: Our services are designed to help investors be more active and better stewards, in a way. None of our clients have to buy our services; they do that because they are interested. That is my experience across our broad investor base, across many investors. Institutional investors cover a broad spectrum but, generally, our clients are extremely interested and use the information we give. It is not just voting recommendations; it is data, analytics and a lot of information that helps them to be more informed. Many of our most active clients and the largest ones as well actively use that information.

Q537 **Vernon Coaker:** I will just ask Tom and Luke what they think of what has been said. From the advice you have given us, we should be pressurising you to put more pressure on, in terms of the votes that happen at AGMs. You are the people to whom we should come, to influence what happens.

Georgina Marshall: We often hear this accusation of investors blindly following advisers of some sort. Actually, most of our clients would laugh at the idea that they buy services from us and blindly follow them.

Q538 **Vernon Coaker:** Are you on bonuses, by the way? Do you get bonuses for your services or is it just a fixed amount?

Georgina Marshall: Generally, it is a fixed amount for research. There are certainly no bonuses related to the voting outcome. There is a fixed amount for research and other services.



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Vernon Coaker: That was going to be my next question until you answered it.

Alan MacDougall: Do you mean staff?

Q539 **Vernon Coaker:** No, is it based on the vote outcome?

Georgina Marshall: No, not at all.

Alan MacDougall: That would be a conflict of interest.

Vernon Coaker: Yes, it would be.

Luke Hildyard: In terms of pressure on companies through shareholder votes, the number of FTSE 350 companies experiencing significant dissent on annual reports has not changed dramatically or been up or down over the past four or five years. About 20 or 30 companies a year is pretty typical. There were two pay-related resolutions defeated this year for last year, so it is still a minority of cases. As we have seen, pay is not increasing rapidly, but it is still very high and public confidence, as witnessed through opinion polls, seems disapproving.

Q540 **Vernon Coaker:** Are you encouraging Alan and Georgina to make more representations about the level of executive pay and bonus? Is your pressure on them to give more advice to their institutional shareholders to be calling on people at the votes they make to give more emphasis to executive pay restraints?

Luke Hildyard: Yes, I think so, although they are providing a service.

Q541 **Vernon Coaker:** Of course, I understand that. I am saying that you work for the High Pay Centre, so you will be saying to them that their advice to the shareholders should be to listen to what the public are saying. The public are fed up with levels of executive pay. They are fed up with the way that bonus schemes work and what the Chair was talking about earlier, with respect to the Royal Mail Group and what we heard then, and they want something done about it. They are bemused by the fact that everyone says they want something done about it, and yet the pace of change seems incredibly slow. Is that what you are saying to me?

Luke Hildyard: Yes, that is a very pithy way of putting it.

Tom Gosling: I have a couple of observations on the whole stewardship question. First, we need to be careful about putting pressure on service providers, such as ISS and PIRC. Actually, the accountability sits with the end investor. Service providers provide a critical service, because otherwise you would have lots of investors trying to repeat their own analysis. There is an issue, however, which is that investors are being put under pressure to exercise their voting rights. On the one hand that is correct but, actually, they care about levels of executive pay a little less than the public probably does. We have an issue that proxy voting recommendations are influential in voting outcomes, particularly when an investor is in the bottom part of a company's register. The stewardship



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code needs to make it clear that it is the investor's responsibility to exercise strategic judgment, rather than just following an agency recommendation, which can happen among certain categories of shareholder.

There is an uncomfortable truth underlying all this, which is that listed company CEO pay levels are not out of line with what we see in high-pay and scarce-skill occupations across different sectors of the economy. That is why shareholders, who also see what happens in private companies and other walks of life, apply less pressure to this than the public might like. If the real concern is about inequality, you need to look at the root causes of inequality. They are not a governance issue around executive pay; they lie in quite different policy dimensions.

Q542 **Peter Kyle:** I will try to be pithy like Vernon. Georgina Marshall, do you think you are getting everything you need out of pay reporting?

Georgina Marshall: It is patchy. Disclosure by companies is better than it was. It has improved significantly over the past few years in the UK, due to various initiatives by us, the FRC, the GC100 and Investor Group, for example, but it is still very patchy. One of the areas that we see very patchy information on, which is a significant part of pay, is bonuses. LTIP performance targets tend to be better disclosed by companies now, but different components and measures of bonus payments are not necessarily, and they form a significant part of pay.

Q543 **Peter Kyle:** You say "patchy", but no one has been stopping any company from disclosing anything. The good companies and the companies that take transparency seriously will have been doing this for a long time anyway. Within the rules at the moment, the companies that are being evasive, which have something to hide and are willingly trying to obfuscate or hide some kind of relationship between pay and performance, are still able to, under the rules. Is that correct?

Georgina Marshall: They are, but it is more about the quality of the explanation of the thought process that goes into it. It is not necessarily a deliberate attempt by many companies to obfuscate. We know through our engagement as a service provider with companies, which come to explain their pay policies as they do for their shareholders, that there can be some very high quality of thought. It is not always disclosed in the explanation of the outcomes of pay.

Peter Kyle: You say it is not wilful.

Georgina Marshall: I said it is not always wilful.

Q544 **Peter Kyle:** I stand corrected. It is not always wilful, but perhaps something more pernicious is a sense that it is our business; it is our company. Leave us alone to get on with it. It is a reticence.

Georgina Marshall: That is really hard to tell, but the focus on the higher levels of dissent, the less than 80% support, is bound to



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encourage those companies that may be lagging in that respect to better disclose their thought process and, I hope, to be proud that they have put quality into that and are explaining it to their shareholders.

Alan MacDougall: I have a couple of points. First, there is a general problem with company communications to shareholders on controversial issues. The Chair raised a lot of questions in the previous session about whether Unilever and the Post Office should have communicated to shareholders more quickly after the vote on pay this year. There are no obligations on companies listed on the stock exchange to have those kinds of communications, apart from what is mentioned in regard to the vote on pay. As the answers indicated to you, frankly, it is not followed up properly.

One of the things the stewardship code should do—or maybe the corporate governance code should do—is to have a requirement for the forms of communication that should take place. We have been trying to get a face-to-face meeting with the owner of Sports Direct for two and a half years. Now, I know it is difficult for the Committees and the House to get that kind of face-to-face meeting.

Peter Kyle: I will give you that story offline.

Alan MacDougall: As a shareholder, in this capacity representing the interests of the Local Authority Pension Fund Forum, which has 79 pension funds in it with £275 billion in assets behind it, we are finding it difficult to get the face-to-face meeting. New obligations on companies to communicate better would be helpful. The other issue goes back to the licence-to-operate argument. One of the things the Committee could usefully do for the future is investigate the basis upon which corporations exist legally, because that goes to the heart of questions like whether they have an obligation of fairness. Do they have an obligation of communications with their owners? Do they conceive of themselves as owning the company, which they do not technically do? There are big philosophical questions there, especially because the European basis of company law is very different from the UK basis, in the sense that lots of changes will be necessary if Brexit comes to pass. Therefore, the Committee could usefully run the flag up the pole for debate on the future of the corporation and what it really means.

Q545 **Peter Kyle:** “If Brexit comes to pass”, I note. Tom, your body language was betraying you.

Tom Gosling: It was just on this point about bonus disclosure. The law, in regulations introduced in 2013, requires bonus targets to be disclosed retrospectively, unless they are commercially confidential. In the initial stages, probably too many companies relied on that commercial confidentiality clause. In this area, a combination of proxy agency and shareholder pressure has very successfully called companies out, and we have seen the market move very rapidly. This year, we saw some instances of material votes against remuneration reports purely because



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of the quality of disclosure, not because there was a particular concern about the outcome. My own view on that point is that the market is sorting it out and companies are pretty rapidly coming into line.

Q546 **Peter Kyle:** Do you take a view on these things for companies for which you are a client or are you just agnostic?

Tom Gosling: We recommend fully transparent disclosure. We have run Building Public Trust Awards around all aspects of corporate reporting for well over a decade now, and we have always promoted the idea that there should be transparency around reporting of bonus targets.

Q547 **Chair:** I have a couple of final questions. We spoke about LTIPs in the previous session a little. Maybe this is for ISS and PIRC. Are shareholders generally in favour of moving away from LTIPs or is there a divergence of views?

Georgina Marshall: There is a divergence of views. A lot of shareholders absolutely support the idea that an executive's pay should be aligned with the performance of the company, which is a fundamental concept of the LTIP. However, that can also be achieved through restricted shares, so there are different ways of achieving it. Many investors feel that the company should make the case for whichever incentive scheme it chooses, tie it to its own strategy and then present that to its shareholders.

Q548 **Chair:** Do you have a view at ISS?

Georgina Marshall: We do not have a view that we prefer one against the other. We look at how well it is disclosed, how well the company has explained how it chose what to do and how it thinks that will work.

Alan MacDougall: Since the introduction of LTIPs, we have been monitoring them across the All-Share in the UK. Three years ago, we came to the conclusion that, frankly, they were not long term, they did not incentivise and they were not plans, because remuneration committees had too many powers to vary them in year. We recommend to clients in our annual shareholder voting guidelines, three years ago, that we simply opposed them in principle and looked for greater innovation among companies.

Now, there is a downside to that, which is that some of our clients do not agree with us, but they accept that we have a right to make recommendations to them on that basis. The overwhelming majority of clients agree with us. The difficulty has been that the rest of the market has been slow to catch up. I do not know how many, but I think three or four fund managers—maybe Luke knows—have come out against LTIPs, which is positive. There is a contradiction within the market, as Georgina says, between those who like them and those who do not. The key question that we should drive towards an evidence base to determine is whether LTIPs have worked. If we can get to a point where there is



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general consensus among investors about whether they have worked, what has and what has not worked, we can move beyond them.

Q549 **Chair:** Who is doing that work?

Alan MacDougall: Nobody is yet. Maybe Luke is.

Q550 **Chair:** Who should be doing that work?

Alan MacDougall: We are going to be doing it for our own client base, but the issue is that we want to look more favourably at companies that are trying to move away from it. The problem we have is that, this year, we abstained on two remuneration votes at two companies that are trying to move away from it. The reason we abstained was that we could not support their move forward 100%, because it still had problems that replicated problems they had in their LTIP.

Q551 **Chair:** That is a follow-up question really. If you are moving away from something, you have to move towards something else. What do you want them to move towards, Mr MacDougall?

Alan MacDougall: At this point in seminars, I usually hold up a blank piece of paper and say, "Take that away, Company, and look completely freshly at the whole programme of remuneration". In practical terms, we need to move towards restricted share structures, but we need to rebalance between salary and incentivisation. The evidence seems to suggest that the kind of financial incentivisation everybody is trying to operate does not actually produce the goods.

Chair: You would rather have a higher proportion of a fixed salary, like most people receive, and some sort of deferred share option.

Alan MacDougall: We prefer corporate bonuses, so the company as a whole makes a bonus, which is distributed internally.

Georgina Marshall: LTIPs themselves have evolved over the last few years. What used to be called an LTIP tended to have a three-year horizon in the UK. That is not very long term at all. That has definitely shifted. There are longer holding periods now, up to five years and some even longer. LTIPs themselves have evolved somewhat in response to the general investor view that companies need to take a longer-term view of their incentives.

Chair: Tom, I also wanted to get your view on the public register of shareholder dissent. I know you have views on that so, as well as answering the question on LTIPs, maybe you could give a view on that.

Tom Gosling: I am happy to talk about it. I just have a point on the academic evidence base. As part of my role at London Business School and on the Purposeful Company think tank, I undertook a comprehensive review of the academic evidence on executive pay and looked at this question of LTIPs. There is definitely not a one-size-fits-all model and I would not want to propose that, but there clearly is a problem with the



extent to which we have target-driven pay in pay plans at the moment. About 80% of an executive's package is typically target driven and, undoubtedly, there is evidence that actions can be taken to hit those targets that are shorter term rather than longer term in nature. While we would not recommend banning anything or banning LTIPs, if there is going to be a different norm, something that involves simpler schemes with longer-term shareholding at its core, as opposed to multi-year target-setting, would be a better norm. The evidence base exists to support that.

My own experience is that investor views are quite locked in on this. Some investors absolutely agree with that and some are still very locked into an idea around pay for performance, narrowly defined. US investors in particular, as your witness from Hermes said, feel they have just fought to get performance conditions into pay and do not particularly want to reverse direction. There is some signalling that can be done. I was really pleased that the UK corporate governance code took out its bias in favour of one form of pay over another. That was a step forward, but investors need to work together on this.

On the public register, first, it is absolutely right that shareholders are applying pressure to remuneration committees on pay, because that is part of the market working around pay, so is really important. The public register can form a part of that. I think it needs to focus more on repeated offenders than on one-time offenders. Sometimes a company makes a decision that it believes is fully in the interests of its shareholders, and some shareholders just disagree with that. Remember that a 25% vote against is still a 75% vote in favour. A proxy voting agency recommendation can tip the vote below 80%.

There are a couple of things. First, it is a little bizarre that we have chosen a threshold that is above what is required for a special resolution. That seems a bit odd; why 80%, not 75%? There should definitely be a focus on repeat appearances on the register because, in most cases, people go from a vote below 75% to getting it up again next year and responding to the feedback loop.

Alan MacDougall: I have one short point about shareholder consultation. Companies moan a lot about having to go round the market talking to people about their particular proposals coming up at the AGM. Our recommendation is that they should hold stakeholder meetings once a year, well before the annual report is finalised, bring people together and, frankly, wash their dirty linen in public. If they are going for a new pay structure that they do not think some people in the marketplace are going to like, they should be forced to debate it in front of their key stakeholders. That way, you save an awful lot of time and money.

I had an argument with a South African miner about this; well, it was Anglo American. They said they spent almost £10 million¹ a year going



around global markets trying to ascertain what the response to particular proposals would be, instead of bringing them all together and saying, "This is our annual meeting. We are going to propose this. You can tell us what you like". There is a downside to that from a shareholder point of view, which is that the shareholders would have to talk in public about their own views of what the company is proposing. That quid pro quo would be good.

Luke Hildyard: On the IA register, it is worth noting the corollary of what Tom said about a recommendation from ISS or whoever tipping them into that 20-plus percent level of dissent. It is very often the case that the less-engaged shareholders will just go with the service provider's recommendation, whereas the more engaged will be voting against. It might be that 75% are in favour and 25% against, but the 25% against are the more closely engaged shareholders and, therefore, that is worthy of notification.

Q552 **Chair:** The truth is that most shareholders do not engage at all, so it is not that you have 75% in favour and 25% against. Usually, you have a large proportion not taking part at all. Is that not right?

Tom Gosling: We see that, when an investor is in the top 10 or 15 of a company's register and has a material holding, they engage very well in the UK. The issue with engagement is what happens outside that. That is understandable, in a way, if you have a very small holding. The problem arises if we take the view that governance equals voting, which is a danger because investors that do not have the resources or interest in engaging are more likely not to think about it and follow somebody else's recommendation. I am not sure that that leads to a better outcome than them not voting.

Georgina Marshall: If you look at investors who are not top 10 shareholders, who are our clients, who are paying for our services to be better informed about the companies they own, they tend to come to us or to another service provider because they want to be better informed. They know that they cannot necessarily, in a broad portfolio particularly if they are small investors, engage with every company that they hold around the world to the depth that a service provider can in giving them that information. They are placing a lot of trust in us and hold our feet to the fire to make sure that we have good policies, based on good practice and a good, robust process in looking at what the company is presenting. Therefore, we give useful and reliable advice and information. The easiest and simplest thing is for investors to vote with management, but that is not what they want to do.

Alan MacDougall: You are absolutely right. The other thing that overlays all this is the shift between active management and indexation. Most people cannot be active, in the sense that we assume they could be, if they are in an index fund. The other problem with that is that index

¹ Witness correction: the figure should be £1 million



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fund managers will not split out the votes. If you have 35% of the market in index funds, you can be sure that 10% to 15% of that part represented in the index may well want to be more active and vote its shares differently from the index manager. The index managers are refusing to facilitate that. There is no technical problem and it is not a big cost factor; they just do not like the loss of control. If you talk to State Street, Legal & General or BlackRock, you get this blank answer. Well, in some cases you get the answer, "It is actually not your job. We're better at it", which is a slightly more arrogant approach, but that is a fundamental problem on the market now.

Chair: Thank you, all four of you, for coming to give evidence this morning. This was incredibly informative and really added value to our inquiry into these issues, so thank you very much for your time.