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Dear Mr Walker

### **Executive pay: consultation on enhanced shareholder voting rights**

ICAEW welcomes the opportunity to comment on the consultation paper *Executive pay: consultation on enhanced shareholder voting rights* published by Department of Business, Innovation and Skills (BIS) on 14 March 2012, a copy of which is available from this [link](#).

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

This response reflects consultation with the ICAEW Corporate Governance Committee which includes representatives from the business and investment communities. The Committee is responsible for ICAEW policy on corporate governance issues and related submissions to regulators and other external bodies.

We have previously commented on the issues covered in this consultation. Our responses to *Executive Remuneration Discussion Paper* (ICAEW Rep 111/11) and *A long-term focus for corporate Britain – A call for evidence* (ICAEW Rep 07/11), published by BIS in January 2011 and in November 2011 respectively, are available from this [link](#) and this [link](#).

We have chosen not to answer the twelve specific questions in this consultation paper but to provide you with comments on a number of key matters that we consider of importance when considering executive remuneration and framing the legislation announced in today's Queen's Speech.

## **Our comments on the consultation paper**

We welcome the overarching objective of the Government to address the issue of executive remuneration and to consult on its proposal intended to regulate and facilitate dialogue between shareholders and management by way of enhanced voting rights for shareholders.

The issue of executive remuneration has attracted a high level of shareholder and public attention. There is widespread criticism of perceived weak links between pay and performance and lack of transparency. In this context, we have been supportive of the Government's related initiatives such as simplifying the disclosure of directors' pay arrangements in annual reports to facilitate a meaningful dialogue between the board and shareholders. We also support a revised advisory vote on the implementation of remuneration policy as proposed in this consultation.

In terms of the introduction of an annual binding vote on future remuneration policy, however, we are unconvinced that shareholders need powers beyond an advisory vote on executive remuneration policy and think it would be disproportionate to require the level of support as high as 75% in annual binding votes over future remuneration policy and termination payments.

In our view and in the light of recent shareholder actions at AGMs, shareholders appear to have sufficient mechanisms to change company policy on pay if they so wish with an annual vote on director re-election. They are also able to challenge any remuneration report or intended share plans they do not agree with. When taken together with requirements in the Companies Act 2006 that company directors act in the long-term interests of shareholders, existing shareholder powers appear to be effective in restraining pay. We note that simple majority approvals appear to be sufficient.

Where an effective dialogue between shareholders and a board already exists, shareholders would be unlikely to be interested in exerting a binding vote annually as it may potentially damage engagement with the board and would invariably incur costs on both sides. We believe that any new proposal should aim to encourage shareholder engagement in the process of companies developing their remuneration policy and addressing concerns previously raised. In this context, binding votes could be usefully introduced, for example:

- as a step-up measure where a board fails to take account of recommendations previously made by shareholders without satisfactory explanation; or
- in tandem with an initial advisory vote which would trigger a binding vote if a majority approval is not obtained.

In either case, we believe that a binding vote should be used on an ad hoc basis, not annually by default, in order to highlight situations that call for enhanced shareholder engagement.

A routine, annual binding vote on future remuneration policy may also have a detrimental effect on the role of the remuneration committee that ultimately develops the remuneration policy. The ultimate remuneration outcome will still rely to an extent on the discretion of the remuneration committee. Where shareholders refuse to back the remuneration policy which the remuneration committee continues to consider appropriate, this may lead to the authority of the latter being diluted and shareholder frustration.

## **Need for a review**

We encourage the Government to introduce a review clause into any new legislation, so that after three years there is an in-depth review to ensure that the adopted solution is having the appropriate impact and there are no adverse unintended consequences of its operation.

## Considering executive remuneration in a wider context

Share ownership in the UK has increasingly become disparate and complex as in many other modern capital markets. Today, major market participants are not just institutional investors but also hedge funds, private equity funds, sovereign wealth funds, activist investors and intermediaries including proxy agents. We have raised concerns in our previous responses on treating shareholders as an identifiable and homogenous group when considering their powers such as votes.

We also believe that the on-going concentration on remuneration-related issues in boardrooms and in dialogue between boards and shareholders is becoming disproportionate as there are other matters, such as future business strategy, which are of fundamental importance for investors, the public and the economy.

Finally, we propose that the role of shareholders in executive remuneration should be considered in a wider context of corporate governance. Fresh and innovative thinking is needed when looking at the ways in which market participants seek to incentivise boards, managers and each other to act in the interests of those that they are meant to serve. Fundamental areas that we suggest could be usefully researched are:

- why certain incentives are failing and how people can be incentivised to achieve longer term strategic objectives;
- what new mechanisms are needed to link pay to value creation; and
- how pay fits into broader issues of human capital governance.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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