ICSA: The Governance Institute

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Submitted by email to: caroline.f.pearce@thomsonreuters.com

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Dear Caroline

**Review of the Directors' Remuneration Reporting Guidance**

ICSA: The Governance Institute is the international professional body with primary responsibility for governance. Our Royal Charter requires us to lead 'effective governance and efficient administration of commerce, industry and public affairs' and we are the qualifying body for Chartered Secretaries. Our members are the usual point of contact for engagement between the issuer and its investors in governance matters and corporate reporting. As such, they have considerable experience in discussing with investors the practical application of these guidelines and so we welcome the opportunity to respond to this consultation.

In preparing our response we have sought input, amongst others, from members of the ICSA Company Secretaries Forum, which includes company secretaries from more than 30 large listed companies from the FTSE100 and FTSE250. However, the views expressed in this response are not necessarily those of any individual members of the Forum nor of the companies they represent.

Our members had no specific comments on your existing guidance, which is felt to work well, although it has been suggested that, as is to be expected, it reflects the resources of, and the issues primarily affecting, the largest companies. We do have a few specific comments on the matters that you have identified as needing to be factored into the 2016 review, which we hope may be helpful:

*Linking remuneration to company strategy*
We believe that this is very important. When reviewing company reports in preparation for the ICSA Awards 2015, the judging panels and I were struck by the lack of linkage in some annual reports, not just between strategy and remuneration, but between strategy and risk; strategy and KPIs, KPIs and remuneration etc. There should be a clear and logical story linking all these aspects together demonstrating the critical dependencies between them.

*Applying the Guidance on discretion*
This would be helpful. There is still some confusion amongst both investors and issuers between the terms 'judgement' and 'discretion' – there shouldn't be, but there is. More guidance would be helpful, particularly around how investors expect the use of upward and downward discretion to be reported.

*Performance targets: protecting genuine commercial sensitivity yet achieving transparency*
This remains an area of some contention – the feedback that we have heard (from issuers) is that investors regard many fewer matters as commercially sensitive than they do. Some practical examples of what might be, and what might not be, accepted as commercially sensitive would be helpful.

*Remuneration component maxima*
This is another important issue as compliance levels would appear to be poor.

*The research paper published by the Department for Business, Innovation & Skills in March 2015 on How companies and shareholders have responded to new requirements on the reporting and governance of directors' remuneration*
We had concerns with some parts of this document, prepared for BIS by Manifest, notably around the recommendation that companies provide an explicit 'nil return' statement in the report, around consideration of shareholder views and on the treatment of abstentions. We would therefore suggest that the GC100 and Investor Group exercise caution when taking these aspects of the research report into account.

On 'nil returns' our view is that, particularly where the matter is one subject to audit, no such statement is necessary and we would welcome guidance from the group to that effect. We see 'nil return' statements of this kind as the sort of 'clutter' that we should all be focussing on cutting from annual reports. This recommendation may reflect a position taken by the authors of the research paper.

On the consideration of shareholder views, we believe that the judgements applied in the research report reflect the views of the authors rather than the regulatory requirement or published guidance and we are certainly not persuaded that it is either necessary or appropriate for companies to provide the level of engagement that the authors deem desirable – "all shareholders have been contacted and/or surveyed". In our opinion the levels of engagement we have seen have been encouraging.

Finally, regarding abstentions, Manifest persists in its inclusion of abstentions in a calculation of 'dissent', treating them as, effectively, a vote against the resolution. Quite apart from the fact that this is wrong both in law and in fact – an abstention is, by definition, not a vote – there can be many reasons why a shareholder may abstain from voting and this does not always equate to dissent. We would strongly recommend that this approach not be taken in the guidance and that the reporting structure be left as it is.

There is one new point that we would ask the GC100 and Investor Group to consider for the next edition of guidance which relates to the responsibility of investors to respect pay policies that they have approved. Companies have been advised by many of their investors that their expectation is that companies will not seek to change remuneration policies outside the three-year cycle other than in exceptional circumstances, resisting the temptation to tinker with policies unnecessarily. However, where in the intervening years a company has paid strictly in accordance with that shareholder-approved policy, we believe that it is not unreasonable for there to be an equal expectation placed on investors to support the implementation of a policy that they have previously approved and which is being implemented by the directors that they have appointed, unless there has been an egregious exercise of judgement or discretion. This should, particularly, be the case where the company has

contacted the investor to offer engagement, but that offer has been declined or ignored. We have received some (anecdotal) evidence from companies that this has not been the case and that some investors or their advisers have sought to move the remuneration policy goalposts, typically where the quantum outcome is greater than they originally expected. We quite understand that investors may not have the resources to engage with every company in their portfolio but, where the company has sought engagement about an issue, it seems perverse to object to the implementation of a previously agreed remuneration policy when an offer of engagement has not been taken up.

Remuneration reporting is increasingly important, not least in repairing public trust in business, but is hampered by the variety of interests that it seeks to meet. Companies must navigate between the Scylla of developing remuneration policies that are genuinely driven by the individual circumstances of that company and the Charybdis of investor requirements which are, quite understandably, not identical. Each investor will, as it has a right to do, have different 'red lines' on topical issues – for example, and we intend no criticism by this, one has publicly stated a policy on LTIP retention periods which will result in a vote against even if all other parts of the policy would merit support. It can be difficult for a company to please all investors unless a policy is designed which delivers to the lowest common denominator. This in turn is hardly compatible with designing a policy fit for the particular circumstances of your own company.

Finally, as I mentioned above, we have heard a view expressed that the guidance reflects the resources of, and the issues primarily affecting, the largest companies and believe that it would be helpful were your group to include ourselves and the Quoted Companies Alliance to offer a slightly different perspective in the future. Certainly ICSA would be happy to be involved.

I hope our comments are useful. If you would like to discuss them, or would like further information, please contact me.

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