High Pay Centre

Response to FRC consultation on revisions to the corporate governance code – Feb 28 2018

We are grateful for the opportunity to respond. We offer substantial comments only where we feel there is a distinct High Pay Centre point of view to contribute. Other answers will be much briefer.

We recognise the high regard in which the UK tradition of corporate governance reform is held. It has been a long journey of over 25 years since Sir Adrian Cadbury's first report. An enormous amount of good and serious work has been carried out, and we acknowledge the FRC's contribution in attempting to distil the essence of that learning into a more effective and practicable code.

Q1. Do you have any concerns in relation to the proposed Code application date?

No concerns.

Q2. Do you have any comments on the revised Guidance?

We welcome the attempt to achieve greater brevity and clarity.

Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

It seems unlikely to us that a nominated non-executive director would be regarded by the workforce as an objective or reliable representative of workforce views. Indeed, such a person would not truly be a representative at all. Elected representatives (employee directors) from the workforce would do the job better. A formal workforce advisory council could work well, especially if it incorporated some of the current roles of the remuneration committee ie it brought a discussion on pay at all levels in the business into the boardroom, as well as making possible a broader discussion on corporate purpose and practice.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

SDGs have proved a useful discipline and starting point for boardroom discussion in some companies. Their further use could be encouraged.

Q5. Do you agree that 20 per cent is ‘significant’ and that an update should be published no later than six months after the vote?

Yes to both.

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

Yes, we agree with this.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

After five or six years of committed work independence will necessarily be diluted. This does not mean that a director has to leave the board. But they should perhaps no longer be seen as independent.

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

A maximum period should be specified but could be relaxed where shareholders and other stakeholders agree.

Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

Yes, this will improve matters. There has to be far more explicit and public action from boards in this area. A tougher code will help promote this.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

Yes.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

If we are serious about improving ethnic diversity on the board and in executive ranks there have to be targets, measurement and reporting. This is a normal cost of doing business. Companies should have this data and should be managing it.

Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

Yes.

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

Yes.

Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

Yes. The RemCo could become a far more constrictive and creative force in the life of a business. It could include the role envisaged in the “formal workforce advisory council” as a means to facilitating greater engagement with the workforce.

We believe the current RemCo model is inadequate. There is currently no “shopfloor” perspective present in the room. It also seems inefficient and disproportionate for a committee to spend so much time essentially worrying about two or three pay packages. There must be more to steering a successful enterprise than this. An intelligent, productive RemCo could do so much more – not least, establish a fair and rational pay structure for the whole business.

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

We need to introduce much more scepticism on the question of “variable pay” or “performance-related pay”. LTIPS have created confusion, dissatisfaction and, in places, justified outrage. See our research here [http://highpaycentre.org/pubs/no-routine-riches-reforms-to-performance-related-pay](http://highpaycentre.org/pubs/no-routine-riches-reforms-to-performance-related-pay)

RemCos should be exercising judgment and discretion (see next question). Base pay could arguably be higher on occasion, with bonuses awarded where merited, as judged by the RemCo. But the pseudo-science and unnecessary complexity of LTIPS should be removed. Have the directors promoted the success of the business, yes or no, and have they done it well? This is not an impossible question to answer. Consultants need not be hired to help a RemCo answer it.

We welcome the government’s investigation into the role of share buy-backs and support the Institute of Directors’ view that their use should be monitored closely.

The guidance should also recognise that it is not necessarily the failure to align pay with performance that is the most problematic aspect of prevailing pay practices. The concern is that pay awards are simply too large – and this is a view shared by investors. 85% of respondents to a survey of pension funds by the Pensions and Lifetime Savings Association felt that executive pay awards were too large. The Code should emphasise that executives should take a sceptical view of the need to make provocatively large pay awards and interrogate a) whether such awards are really necessary to retain or incentivise key staff and b) whether the handful of individuals who demand the kind of payments that have become commonplace are so critical to their company.

Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

It will give some impetus. In the end there is a limit to what codes can do. Well-paid, autonomous professionals have to exercise judgment and make moral choices. Owners should act like owners who are interested in their investments.

UK Stewardship Code Questions (we answer only a selection of the questions here)

Q20. Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?

The corporate governance code rightly identifies corporate culture as a critical element of good governance, with an emphasis on key drivers of culture, such as remuneration.

It would be consistent for the FRC to recognise the importance of culture to good stewardship. High pay and a lack of diversity in the asset management industry and the financial services sector more widely are recognised to have contributed some of the scandals and controversies that have bedevilled the sector since the financial crisis. It would therefore make sense for the stewardship code to mirror the corporate governance code by asking investors to explain how the culture of their company, in terms of pay and diversity, contributes to good stewardship.

Q22. Would it be appropriate to incorporate ‘wider stakeholders’ into the areas of suggested focus for monitoring and engagement by investors? Should the Stewardship Code more explicitly refer to ESG factors and broader social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?

Yes. As changes at major investors such as BlackRock and Vanguard would suggest, ESG factors are rightly seen as being increasingly important. Environmental concerns must feature prominently in any discussion between companies and their investors, as much as any other metric, including financial ones.

Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?

Yes.

Q29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?

Yes.

Q30: Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?

Yes.

Q31: Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?

Yes. A simple and clear statement, with relevant measures, would help support this.

Ends