Association of British Insurers

Financial Reporting Council (FRC)

Directors' Remuneration – Consultation Document

ABI Response

The ABI

The ABI is the voice of insurance, representing the general insurance, protection, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK.

The ABI's role is to:

- Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
- Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation.
- Advocate high standards of customer service within the industry and provide useful information to the public about insurance.
- Promote the benefits of insurance to the government, regulators, policy makers and the public.

We welcome the opportunity to respond to this consultation on the Directors' Remuneration aspects of the UK Corporate Governance Code.

1) **Is the current Code requirement sufficient, or should the Code include a "comply or explain" presumption that companies have provisions to recover and/or withhold variable pay?**

The ABI's Principles of Remuneration outline members' expectations for companies to introduce performance adjustment (forfeiture of all or part of a bonus or long-term incentive award before it has vested and been paid) and clawback (recovery of sums already paid to a participant) provisions to their variable remuneration arrangements. Therefore, the ABI would welcome the Code to require all companies to have provisions to recover and/or withhold variable pay on a 'comply or explain' basis. ABI members believe that these provisions will help to avoid payments for failure and promote a long-term focus of the executive management.

Market practice and shareholder expectations have developed considerably since the original wording was introduced to the Code. Clawback and performance adjustment provisions are now relatively common across the corporate sector, not just in financial services. The Code should be updated to reflect investor views and market practice to ensure that performance adjustment is captured, as well as clawback. The wording should

also be updated to ensure that remuneration committees consider circumstances other than misstatement or misconduct (see question 3).

2) **Should the Code adopt the terminology used in the Regulations and refer to "recovery of sums paid" and "withholding of sums to be paid"?**

We agree that the terminology should be consistent between the Reporting Regulations and the UK Corporate Governance Code.

3) **Should the Code specify the circumstances under which payments could be recovered and/or withheld? If so, what should these be?**

The circumstances in which performance adjustment and clawback can be implemented need to be agreed and documented before variable remuneration awards are made. The remuneration committee should review the circumstances in which these provisions can apply and ensure that they are appropriate for the individual circumstances of the company. The circumstances should, in each case, be clearly disclosed to shareholders.

The remuneration committee should also consider the enforcement power they have to implement each process. The Code should not outline specific circumstances in which performance adjustment or clawback provisions could be used; rather, the remuneration committee should establish the circumstances which are most appropriate for the company.

4) **Are there practical and/or legal considerations that would restrict the ability of companies to apply clawback arrangements in some circumstances?**

Our experience from speaking to companies and lawyers is that clawback is legally harder to implement, as the participant already owns the shares. Therefore, in general, shareholders accept that performance adjustment will apply to a broader range of circumstances than for clawback.

5) **Are changes to the Code required to deter the appointment of executive directors to the remuneration committees of other listed companies?**

There is insufficient evidence to indicate that executive directors having membership of a remuneration committee of another listed company is a failure of the current governance system. Furthermore, shareholders and Chairmen alike consider serving executives having non-executive positions as beneficial. This potential change could reduce the number of executives willing to take up non-executive positions, which could have a negative effect on board effectiveness and companies generally.

Therefore, the Code does not need to be amended and any change could well be counterproductive.

6) **Is an explicit requirement in the Code to report to the market in circumstances where a company fails to obtain at least a substantial majority in support of a resolution on remuneration needed in addition to what is already set out in the Regulations, the guidance and the Code?**

   If yes, should the Code:

   - **set criteria for determining what constitutes a 'significant percentage';**
   - **specify a time period within which companies should report on discussions with shareholders; and/or**
   - **specify the means by which companies should report to the market and, if so, by what method?**

7) **Are there any practical difficulties for companies in identifying and/or engaging with shareholders that voted against the remuneration resolution/s?**

This issue does need to be addressed in the Code. In recent years, a number of companies have stated publicly that the majority of their shareholders supported the company and, therefore, it was a successful vote, despite a significant number of shareholders having voted against the resolution. Too often these companies see the 51% that supported them rather than the concerns of the 49% of shareholders who did not.

Companies should state publicly when a significant minority of shareholders have concerns as a result of a proxy vote and commit to consult major shareholders to understand their concerns and how these can be addressed.

The ABI supports the approach outlined in the GC100 and Investor Group guidance, which specifies that a company should make specific reference in its Regulatory Information Service (RIS) announcement of its AGM result that there has been a significant vote against a resolution and provide a commitment to engage with shareholders.

This provision should apply to all resolutions. If it relates only to remuneration resolutions, we would be concerned that remuneration resolutions will be seen as more important than any other AGM resolution in the Code.

We support the GC 100 and Investor Group guidance that votes in excess of 20% could be considered significant, subject to the individual circumstances of the company. A company with a single shareholder who could trigger the significant threshold every year is not the same as a company with a disparate shareholder base. The Code should reference and draw on the Guidance and allow individual companies to establish the appropriate level dependent on their circumstances: it should not be specified in the Code. The Code should also encourage companies to consider whether to take into account withheld votes. Whilst withheld votes have no place in law, they are often a sign of significant concern by shareholders.

Once a company has provided a commitment to engage with shareholders on a particular issue, it should be required to report back to shareholders through an RIS announcement on the outcome of the discussions and what actions the company has taken. We have heard

from many companies with concerns on having to respond within a set time period. Whilst shareholders can understand the difficulties of engaging with some investors, shareholders believe that the issue should be dealt with as a matter of urgency and companies should seek to respond within 3 months of the vote.

As the consultation paper outlines, we would expect that, as part of their stewardship responsibilities, shareholders will normally inform the company that they will be voting against a resolution and the reasons why.

8) **Is the Code compatible with the Regulations? Are there any overlapping provisions in the Code that are now redundant and could be removed?**

The current wording does not need to be amended.

9) **Should the Code continue to address these three broad areas? If so, do any of them need to be revised in the light of developments in market practice?**

Yes.

The FRC should consider strengthening the wording in Schedule A on deferral. Currently, the Code states: “There may be a case for part payment in shares to be held for a significant period”. To ensure greater alignment between executives and shareholders, investors encourage remuneration committees to introduce deferral of annual bonuses and for the deferred shares to be subject to performance adjustment provisions. The Code should strengthen the wording on deferral to encourage it in all circumstances; this is logical given the proposed change on clawback and performance adjustment.

6 December, 2013