Catherine Woods
Financial Reporting Council
Fifth Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

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Directors' Remuneration

Dear Sir/Madam,

Thank you for giving the Institute of Directors (IoD) the opportunity to comment on your consultation paper, Directors' Remuneration, published in October 2013. Issues surrounding corporate governance and company law are of considerable interest to the IoD and its membership. We are therefore pleased to present our views in respect of your proposals.

About the IoD

Founded in 1903, and granted a Royal Charter in 1906, the IoD is an independent, non-party political organisation of around 40,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. 92% of FTSE 100 companies have IoD members on their boards, but the majority of members, some 70%, comprise directors of small and medium-sized enterprises, ranging from long-established businesses to start-up companies.

General comments

The following are our responses to specific questions from the discussion paper[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?**
- **Should the Code adopt the terminology used in the Regulations and refer to "recovery of sums paid" and "withholding of sums to be paid"?**
- **Should the Code specify the circumstances under which payments could be recovered and/or withheld? If so, what should these be?**
- **Are there practical and/or legal considerations that would restrict the ability of companies to apply clawback arrangements in some circumstances?**

We believe that "clawback" provisions in respect of variable pay represent an important means of avoiding "rewards for failure". Excessive exit payments to executives who have failed to create value for

[1] Please note that we have not provided an answer to every question. We have only provided answers where we have a defined view or contribution to make.

shareholders or who have damaged the reputation or long-term prospects of their enterprises undermine the legitimacy of the entire business sector. As a result, we feel that the Code should make a clear recommendation that companies should adopt clawback provisions which would allow them to recover and/or withhold variable pay in exceptional cases of misstatement or misconduct. This recommendation should go further than merely suggesting that consideration should be given to the use of clawback provisions (which is the current Code recommendation).

It would make sense for terminology to be used which is consistent with the Regulations.

However, we do not believe that the Code should go into detail in respect of the circumstances in which clawback should be applied. This is too prescriptive for a code of governance, and should be left to individual companies – following full disclosure and dialogue with shareholders - to determine. In that respect, we believe that the existing regulatory requirements (for disclosure of clawback arrangements in the remuneration report) are sufficient.

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

We do not support this proposal.

There is no compelling reason to believe that serving executive directors will take a different perspective on executive pay to that of recently retired or former executive directors, who will still be allowed to serve on remuneration committees. Hence we see this recommendation as flawed. It will also cause significant disruption to the functioning of existing remunerations committees – a change of around one third of their membership would be needed in the FTSE 100.

The implication of this recommendation is that directors with an executive background cannot be trusted to determine executive pay, and should be outlawed from remuneration committees. We do not agree with this assumption, which we believe will be divisive in its effect within the boardroom. If such a perspective were taken to its logical conclusion, there would be few remaining board members able to serve on remuneration committees (as most NEDs come from an executive background). Directors with particular kinds of professional background could find themselves concentrated on particular board committees, which would be divisive of the collective decision-making of the board.

A better way of broadening the remuneration perspectives of remuneration committees – with the valid objective of achieving moderation in executive pay – would be to improve the diversity of the board as a whole. This is more likely to lead to a more sustainable change of boardroom attitudes with respect to executive pay and other key boardroom responsibilities, with positive implications for the legitimacy of executive remuneration.

- **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?**

No. We believe that the Regulations provide clear and sufficient guidelines regarding how companies should report the details of the shareholder vote on the remuneration report. It should be a matter for shareholders and companies to determine if a vote against the report is “significant” or not, and how to respond. The meaning of “significant” may vary considerably in different cases, depending on the circumstances or ownership structure of the company.

Thank you once again for inviting the Institute of Directors to participate in this consultation. We hope you find our comments useful.

Yours sincerely,

Dr. Roger Barker
Director of Corporate Governance and Professional Standards
Institute of Directors, 116 Pall Mall, London SW1Y 5ED
Tel: +44 (0)20 7451 3344
Email: roger.barker@iod.com
Website: www.iod.com/policy