

Response of the Institute of Business Ethics to the Financial Reporting Council consultation on Directors' Remuneration

The Institute of Business Ethics is a charity supported by business, whose purpose is to promote high standards of ethics. Current subscribers include leading FTSE 350 companies, as well as several overseas entities. The IBE is an independent organisation and does not lobby on behalf of business. Instead it seeks to assist with the understanding and implementation of high standards of corporate behaviour, with the objective of promoting trust in business generally.

Executive remuneration is an important part of the equation. IBE surveys show that in five of the six last years it has been the single largest source of public concern with regard to business. Last year it was eclipsed only by taxation as an issue. Building confidence in a remuneration system that rewards genuine success while giving no credit for failure is critical to the establishment of trust in business. It is also vital for the maintenance of morale and motivation among employees more generally.

We believe there is a need for more informed general debate on reform of executive remuneration but we understand the specific and limited nature of the consultation and the desire of the Financial Reporting Council not to re-open the UK Corporate Governance Code in a general way at this stage. We are therefore confining our comments to the specific questions raised.

We believe there is a case for extending the provisions around claw back to give a comply-or-explain expectation that companies will have provisions to recover and/or withhold variable pay. It would make sense for the Code to adopt the terminology used in the regulations with regard to recovery and withholding sums paid or to be paid. More particularly we would like to see the code specify circumstances in which claw back might occur to include lapses of agreed standards of corporate behaviour in areas for which the executive concerned had assigned responsibilities. These would normally include serious breach of health and safety requirements, bribery and corruption and failure to enforce agreed labour standards among suppliers.

All of these are areas where lapses can lead to reputational damage and loss of public trust which can put the franchise in jeopardy. The damage is compounded when the public perceives that executives in charge face no consequences for what has happened. We do not believe there should be legal constraints in adopting such a provision provided that the claw back arrangements are clearly spelled out in advance and agreed as part of the contract negotiations.

Based on the evidence presented in the consultation document we do not see any reason for restricting the right of serving executives from other companies to sit on remuneration committees as long as they meet the normal conditions of independence. The voting record does not show that this creates a problem and we consider that serving executives may have an important role to play in understanding and refining performance criteria.

Finally, we consider that the Code should encourage companies to respond promptly when they have evidence of significant shareholder dissent on remuneration. An important feature of governance should be accountability and constructive dialogue. The issue is that dialogue should take place, not whether companies, who are supposed anyway to disclose their voting results promptly, should declare that they have encountered opposition. The Code should therefore create a specific expectation that companies will seek to enter dialogue when they have encountered significant opposition. It should be up to companies and shareholders to define what constitutes significant opposition as this will vary both between companies and over time. It should also be clear that dialogue on remuneration is a healthy process which should not normally be confined to periods following a disappointing vote.

We hope these answers will assist you. The Governance Code plays an important role, and we do not believe in change for change's sake, but two out of the three proposals offer an opportunity for useful modification which, we believe, would enhance public confidence by promoting fairness and transparency.

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