UKSA

UK Shareholders' Association
1 Bromley Lane
Chislehurst
Kent
BR7 6LH

Phone: 020 8295 1667
Email: policy@uksa.org.uk
Web: www.uksa.org.uk

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

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Directors' Remuneration: Consultation document October 2013

UKSA is pleased to respond to this consultation. We comment on one single issue in response to the final para. 21 of the consultation, which asks 'if any of the three broad areas of the Code need revising in the light of market practice'.

Section D.1 of the Code – 'The Level and Components of Remuneration' – states the following as its 'Main Principle':

'Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.'

We submit that the final sentence beginning 'A significant proportion…..' should be removed. It undermines the authority of the whole to have guidance so at variance with current evidence. We draw attention to the following:

- The Kay Review, Chapter 11, which demonstrates how the general types of remuneration structure currently in use have adverse consequences. It goes on to recommend that incentives should be related to sustainable long-term business performance and then provided only in the form of company shares to be held at least until the executive has retired from the business. Professor Kay also questions, as UKSA has done in its own evidence to the Department, the need for bonuses at this level at all.

- The recommendation by Pirc made in February 2013 that shareholders should vote against all Long Term Incentive Plans (LTIPs), regardless of content, saying 'the model had proved ineffective due to amendments and manipulation'.

- The forensic analysis by Andrew Smithers – most recently in his book 'The Road to Recovery' – of the damage that current remuneration practices are doing to the real economy. To quote from his summary on pp 230/231: 'The change from having senior company officials remunerated largely by salary to the present system in which the income is predominately from bonuses and stock options was encouraged by business theorists who assumed that this would cause management and shareholders to have identical interests . ……. Under current remuneration contracts, the interests of management and long-term shareholders have been driven even further apart ………… The issue now is how to undo the damage that has been done.'

- The avalanche of formulaic payouts to executives reported in the popular press that are seen to be unearned and are undermining respect for business leaders.

The experience of UKSA members is that 'incentive' remuneration is in practice asymmetric (usually all upside and no downside). It is now well understood that this encourages risk-taking to create volatility at the expense of sustainable growth. This has long been clear to private shareholders, who have the virtue of independence but have no channel for consultation and no voting rights when holding shares through nominee accounts.

It would be UKSA's preference to substantially re-write Schedule A ('The design of performance based remuneration for executive directors'), but we recognise that may not be immediately practical. The removal of damaging guidance is an essential first step.

John Hunter
UKSA Policy Group