Corporate Governance Reform

A response to the Department for Business, Energy and Industrial Strategy Green Paper

Introduction

We are writing to respond to the Corporate Governance Reform green paper on behalf of the National Employment Savings Trust (NEST). We welcome the Government's move to consult on potential developments to the UK Corporate Governance framework and in particular its recognition of burgeoning executive pay and the increasing disconnect between some companies and the wider society in which they serve. We agree with much of the green paper's analysis and agree that this is a good time to assess whether more can be done to improve the UK's already high standards of corporate governance.

To date we have been supportive of seeing many aspects around corporate governance encouraged in the form of helpful guidance. We agree that where current structures have not delivered desired outcomes a debate about whether these should be strengthened, is timely.

About us

NEST is a defined contribution (DC) pension scheme that UK employers can use to meet the new workplace pension duties set out in the Pensions Act 2008. NEST is designed to be an easy-to-use, low-charge scheme. It has a public service obligation to accept employers of any size that want to use it to comply with their new duties.

NEST Corporation is the Trustee body that runs NEST. The Trustee Members set NEST's strategic direction and objectives. Their duties are the fiduciary duties of any trustee. They include acting in the interests of the members whose money it holds in trust, and to abide by the regulatory framework the scheme exists within.

At the time of writing NEST is working with over 265,000 employers, has more than four million members and nearly £1.5 billion in assets under management. A key aim of the scheme is to provide members the benefits of a good value, quality occupational pension scheme, whoever their employer and however much they save.

NEST invests and owns stakes in thousands of companies globally and is likely to be among the very largest institutional asset owners in Europe in the near future. How these companies are governed and run is a concern of the members of NEST as it will be a determinant of the performance of NEST's funds and members' incomes in retirement.

About our response

We are responding to questions one to eight from the first two sections on executive pay and strengthening the employee, customer and wider stakeholder voice respectively. We will not be commenting on section three on privately-held businesses. NEST's current holdings are mainly in developed markets and in listed companies.

Our high level view on executive pay

We agree with the consultation's analysis that there is a widespread perception that executive pay has become increasingly disconnected from both the pay of ordinary working people and the underlying long term performance of companies. NEST's four million plus members are almost all on low to median pay, so this is an issue that is particularly relevant to NEST and its purpose to provide a high quality pension scheme at low cost. Like the Government we believe that getting pay right for the challenge of leading some of the largest UK companies is important. That includes paying senior leaders appropriately and making sure pay structures are aligned to long term goals of growth and sustainability.

From our engagements with senior executives in the companies we invest in we would observe that many of those who step into a board role are just as likely to be exercised by the puzzle and challenge of leadership and its achievement as they are by pay and reward. The more recent attempts to link pay, performance and share price raises concerns as to whether senior executives are being provided with the right motivational drivers that long term investors like NEST and other pension funds would wish to see.

Senior leaders have a very significant role in the long term success of any organisation and should be rewarded appropriately for this role. In addition success is the result of the hard work by all employees in a company. The wide and increasing pay disparity between executives and those lower down an organisation that has been evidenced in recent years and presented in the consultation document, appears to us to create the risk of undermining corporate sustainability as well as leading to an erosion of trust within companies and amongst wider society.

Executive pay

A – Shareholder voting and other rights

Q1) Do shareholders need stronger powers to improve their ability to hold companies to account on executive pay and performance? If so, which of the options mentioned on the Green Paper would you support?

As the Government has cited, executive pay is of significant public concern with surveys consistently showing it to be a key factor in public dissatisfaction with large businesses.

This sentiment is shared by a growing number of institutional investors[1], ourselves included, who invest and manage money contributed by predominantly low to median income earners.

We welcome options set out in the Green Paper to give shareholders stronger powers. We also believe consideration of additional measures to address the level of executive pay and the growing disconnect between pay at the top and pay at the bottom of companies[2] may also have a role in addressing the challenge. One of our concerns is how to incentivise shareholders, in particular the largest fund managers who are usually delegated with investment and stewardship responsibilities, to exercise their powers effectively and hold companies to account on their pay policies and annual remuneration reports.

There is already a strong sense by institutional investors, particularly pension funds, that asset managers tend to take a shorter term view. It is felt that the interests of long term shareholders and beneficiaries[3] may not always be at the forefront of voting decisions or company engagements. High levels of pay and particularly variable pay is a common theme in the asset management industry. If high and variable pay within asset management circles is normalised, this may mean asset managers see less of an issue in high and variable pay at companies they invest in and vote on, on behalf of their clients[4]. Alongside other institutional investors we would argue that greater plurality and diversity in the voices heard by investee companies over issues such as pay and reward would be beneficial for the companies themselves. We believe it would lead to a better alignment between the interests of long term shareholders and the corporations they are investing in. We address this further in our response to question two.

When addressing the options presented in the Green Paper we would like to emphasise that providing shareholders with more powers may not alone improve all of the issues that the consultation paper highlights. As noted in the introduction to the consultation, the UK is recognised as having a world leading corporate governance framework. This supports the UK being an attractive and trusted place to invest. Initiatives such as the executive pay reforms which were introduced in 2013 to give shareholders more control over companies' pay policies were welcome developments. However in terms of moderating the size of executives' pay packages and the growing disparity between pay at the top and the rest of the workforce, the effects to date have been disappointing. We believe this is in part due to shareholders not using their increased powers effectively, and an ongoing issue of many asset managers having too short an investment time horizon. These are issues that have been well rehearsed in reports such as the Kay review.

Turning to the specifics of the question and the options presented.

<u>Option (i): Make all or some elements of the executive pay package subject to a binding vote. This could be the full remuneration report or refer only to variable pay elements of</u>

---

[1] PLSA member survey 2016 – 87% of respondents felt executive pay was too high and 85% of respondents were concerned by the pay gaps between executives and their workforce

[2] Data from the High Pay Centre in 2017 shows the average pay ratio between FTSE100 CEOs and the average total pay of their employees in 2015 was 129:1

[3] A report by Shareaction found that many of the world's best-known Asset Managers side too often with company management on controversial votes at company AGMs, even when there is a clear case for challenging company management on a vote: http://action.shareaction.org/page/-/AssetManagerVotingPracticesFinal.pdf

[4] FTfm analysis cited that variable pay for some CEOs of the largest asset managers were 30 times their salary in 2015

the pay award (such as the annual bonus, the Long-Term Incentive Plan and any proposed increase in basic salary). It could be applied annually to all companies or only to companies that have encountered significant shareholder opposition to the remuneration report.

We would welcome a binding annual vote on the full remuneration report making it consistent with the triannual binding vote on the pay policy.

Option (ii): Introduce stronger consequences for a company losing its annual advisory vote on the remuneration report

As mentioned above we would prefer to see the introduction of a binding vote rather than stronger consequences for company that loses its annual advisory vote.

Option (iii): Require or encourage quoted company pay policies to (a) set an upper threshold for total annual pay (from all elements of remuneration), and (b) ensure a binding vote at the AGM where actual executive pay in that year exceeds the threshold.

The consultation's suggestions for an upper threshold for total annual pay have merit in terms of simplicity and transparency. However the setting and implementation of such a threshold would need careful consideration. The principle of 'comply or explain' as is used throughout the Corporate Governance and Stewardship codes could lead to a healthy dialogue between companies and their owners as to what constitutes appropriate pay and under what circumstances agreed pay thresholds should be set aside.

The consultation notes that 'setting a pre-determined limit on share awards could disincentivise executives from maximising long-term performance' we believe this illustrates some of the challenges of share awards being used as a key measure for reward. In our discussions with boards and the literature on what drives good corporate performance we are consistently presented with evidence that what drives senior executives is rarely just pay. Remuneration structures should reflect the general desire that senior leaders wish for long term success for their organisation. Linking this success to measures such as share price can muddy the waters of performance and reward.

Option (iv): Require the existing binding vote on the executive pay policy to be held more frequently than every three years, but no more than annually, or allow shareholders to bring forward a binding vote on a new policy earlier than the mandatory three year deadline.

We do not support the existing binding vote on the pay policy to be held more frequently than every three years. We would prefer to see companies take a longer term view when setting pay policy and discourage them from spending time tinkering with pay policies every year.

Option (v): Strengthen the Corporate Governance Code to provide greater specificity on how companies should engage with shareholders on pay, including where there is significant opposition to a remuneration report

Strengthening the Corporate Governance Code to include expanded guidance around wider employee pay and conditions we believe would be a helpful addition. We would caution though as to whether this would necessarily lead to improved stewardship by all asset owners. The Code currently states that:

"The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in corporate and individual performance, and should avoid paying more than is necessary. They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases."

From discussions with other institutional shareowners there are times when it appears the spirit of the Code is not always what happens in practice among some publicly listed companies.

Where there is regulation, for example Section 172 of the Companies Act, which requires directors to have regard for the interests of workers, consumers and other stakeholders in promoting the success of companies, the mechanism for policing this law appears unclear. The incentive for some companies to integrate this requirement into their remuneration policies or deliberations appears weak. Shareowners could do more to ask for greater detail as to how companies are interpreting this duty within their pay considerations.

B - Shareholder engagement on pay

Q2) Does more need to be done to encourage institutional and retail investors to make full use of their existing and any new voting powers on pay? Do you support any of the options mentioned? Are there other ideas that should be considered?

We strongly agree with the consultation's analysis that stronger shareholder voting rights on pay will only have an impact if shareholders are prepared to cast their votes and use them where necessary to vote down pay awards they consider are unjustified. We also agree that the record on this approach is mixed. We again agree with the consultation that the reasons for this are a mixture of the cost of performing in-house research - so that investors are reliant on a small number of proxy advisors - and an element of disconnect between the fund managers and the beneficial owners. As has been observed in previous reports such as the Kay review, the longer the 'investment chain' the harder it is for corporations to 'hear' the voice of the ultimate beneficiary. We also believe that the increase in the use of large indexed funds leads to an inevitable decrease in the variety of views that can be expressed. For large asset managers who may have many clients we would argue it is difficult for the views of all their clients to be reconciled into a single vote for or against on a particular issue. As Chris Philp MP eloquently puts it *"Shareholders have become highly fragmented and fund managers are often focused on the short term, which means shareholders often fail to exercise proper oversight of the companies they own"*.[5]

[5] Restoring responsible ownership: Ending the ownerless corporation and controlling executive pay, Chris Philp MP

NEST has tried to address this challenge in a number of ways. Firstly when appointing fund managers we focus attention on our fund managers' commitment to active and responsible ownership. We expect to have a dialogue with our fund managers about voting and corporate engagement, to ensure they understand our views and the interests of beneficial owners. In our developed market equity mandates we also have an agreement to override the voting decisions of our fund managers in order to vote in accordance with NEST's voting policy in situations where our views are not aligned and neither side has been persuaded by the other's arguments. This is not necessarily because we think our fund manager is incorrect in their assessment of the vote. It means only that in some instances our views differ because we are acting on behalf of the economic interest of our membership who may be investing with us for decades, whereas the fund manager may have a different investment horizon when considering their approach. To our mind this demonstrates a mature accommodation between two investors whose views are unlikely to be aligned on every issue.

On the specific options the consultation sets out as a means of addressing this challenge our response is a follows:

<u>Option (i) Mandatory disclosure of fund managers' voting records at AGMs and the extent to which they have made use of proxy voting.</u>

We agree with the sentiment of this proposal. Fund managers should be transparent about their voting activities, particularly when they are acting on behalf of beneficial owners. Our experience has been many fund managers do this already, and it is a requirement for fund managers working with NEST to provide on a quarterly basis their voting records, which we then publish on our website. Once a year we also produce an analysis of how all our fund managers have voted and how their votes compare to our voting policy. We use this information to probe and challenge our fund managers on a regular basis as to why they voted in a particular way, and what their overall approach has been to performing an active and responsible ownership role.

We are agnostic about whether this should be a mandatory requirement. NEST's example would suggest that those fund managers who don't do this will not be asked to manage money on behalf of NEST members. We would suggest that if the demand and expectation from institutions such as pension funds is greater transparency, it would make little market or business sense for fund managers not to do this.

One suggestion we would make would be about a greater standardisation of how voting reports are compiled and presented. NEST is invested in thousands of companies globally, and even our UK holdings run to many pages of votes cast. For beneficial owners to navigate this level of data and to understand how votes were cast for one company or another on their behalf is a daunting prospect. An example of best practice in this sphere is the Norges Bank Investment Management (the Norwegian sovereign wealth fund). They provide an easily navigable database that contains all the voting records of their huge international portfolio, allowing interested parties to find quickly the records of millions of votes cast.

https://www.nbim.no/en/responsibility/our-voting-records/

Option (ii) Establish a senior shareholder committee to engage with executive remuneration arrangements

We think this is an interesting idea, and the rationale for its existence is well argued in the High Pay Centre's September 2016 paper. Our concerns are similar to the theme running through our response, mainly that fund managers are representing potentially hundreds of clients who all may have competing interests not least because of often very different investment horizons. We are concerned that these beneficial owners' voices are not well heard by fund managers, and are not well transmitted to the corporations themselves. Below we set out a number of suggestions that we have developed in consultation with our proxy voting agency, fund managers and through discussions with other large pension funds. The aim of these suggestions is to try and bring beneficial owners' views and needs closer to the end investee company. We believe this would provide something of a virtuous circle. Corporations would hear more from savers and investors with long term investment horizons and a real desire to see long term and sustainable profit for the companies they invest in. This will provide senior leaders more confidence that they can take genuine long term decisions, without being overly focussed on short term performance, or sometimes unhelpful metrics like quarterly share price.

We make the following suggestion, which we would be interested in discussing with Government and the investment industry as to how this idea could be developed further.

Enable beneficial owners to have a greater say in voting their economic interests on executive remuneration

As we have seen from the evidence presented in the consultation, high voting approval by fund managers has been a long-standing feature of the UK corporate governance world. As the consultation recognises, some reform of corporate governance is needed. One element of this jigsaw would be - in our view - a greater recognition of the different expectations of beneficial owners compared to fund managers and proxy voting agencies. Finding ways to ensure a diversity of views and investment horizons by encouraging beneficial owners (or agents on their behalf, such as trustees) to vote their economic interests we believe would help end the cycle of high voting approval by the fund management sector. We think this could be a contributory factor to improving executive remuneration.

A different voting outcome would be expected by giving beneficial owners the right to vote. When beneficial owners buy shares a small part of the purchase value is the right to vote, so they are the natural ones to exercise that vote rather than a fund manager.

The steps could involve:

- Identify beneficial ownership of shares. The majority of shares by value are held in multiple-ownership pooled accounts, where information about the beneficial owner is not held centrally. The name recorded on the shareholder register is usually the fund manager or a nominee and not the beneficial owner. ONS calculates that in 2014 multiple ownership pooled accounts accounted for 59 per cent of the total value of holdings of UK quoted shares. Multiple-ownership pooled accounts are voted by fund managers, usually in a block with no differentiation between the many different beneficial owners whose interests may be widely divergent. A single vote for or against does not capture the multiplicity of views.

- Enable beneficial owners to vote
- Categorise beneficial owners according to their type. The Office for National Statistics (ONS) already does this. The ONS quantifies the main beneficial owners of UK shares in UK domiciled companies. The main categories are: pension funds, insurance companies, individuals, public sector, sovereign wealth funds, and a group together comprising charities, churches, endowments, and foundations.
- Employ preponderance voting. For example if a majority of beneficial ownership categories have a simple majority, the vote outcome would be binding. In other words, if there are 5 beneficial owner categories and 3 categories vote more than 50 per cent the vote would be binding. This would not be dissimilar to the 'two-strike' rule introduced in Australia 2011, whereby the voting approval of the remuneration report needs to pass multiple gates. One could alternatively think of this as a double majority. Table 1 below provides an example. The process would stop voting outcomes being dominated by fund managers, who predominantly vote with management, or by investors who do not vote.

Table 1:

Type of Owner	For	Abstain	Against
Pension funds			52%
Insurance companies			35%
Charities, churches, endowments, foundations			57%
Individuals			60%
Fund managers			35%
Outcome: Against Note: numbers are for illustration only			

Below we set out a potential way that would allow better identification of beneficial owners, and facilitate a closer alignment between beneficial owners and corporations.

An electronic beneficial ownership register

The development of an electronic beneficial ownership register above a certain holding of shares would in our view facilitate company knowledge and improve accountability and cooperation between real owners. Issues about privacy can be dealt with by the beneficial owner delegating to the fund manager if so desired, and the fund manager voting that portion of the pool. Registration should carry a low burden. There could be automatic registration for medium and large beneficial owners. The registration of small shareholder owners would be on an opt-in basis. The law requires clients' investments to be segregated from those of the custodian and for simplicity it's usual for custodians to aggregate together shares held by multiple pooled funds within an omnibus account and give the account a generic name. Electronic registration of shares within a central depository would by-pass any responsibility on custodians and sub-custodians who generally do not maintain real time records of ownership and reconcile positions in omnibus accounts relatively infrequently. The depositary or the fund manager could be asked to deliver a certificate of entitlement enabling the beneficial owner to take part in any general meeting and vote by electronic proxy in advance of the meeting.

The Financial Action Task Force (FATF) would like clearer beneficial ownership to facilitate higher level of transparency to combat money laundering and terrorist financing. We believe companies themselves would also benefit from beneficial ownership identification because they could:

- Make contact with their real owners
- More readily hear, distil, collate, and reflect on communications with owners
- Build trust with owners and secure long-term investment
- Monitor changes in the evolution of ownership structure for signals about approval or disapproval of corporate strategy and corporate performance
- More efficiently identify owners when organising and convening shareholder meetings.

C – The role of the remuneration committee

Q3) Do steps need to be taken to improve the effectiveness of remuneration committees and their advisors in particular to encourage them to engage more effectively with shareholders and employee views before developing pay policies?

We agree with the consultation's analysis that the role of the remuneration committee is a challenging one having to balance a number of competing interests. In our response to this question we would make one general point before addressing the specific options suggested.

The general point is our concern that there is an enormous amount of focus from stakeholders, investors and commentators about the levels and structure of executive pay. We understand this focus because of the crucial role senior executives play in the strategic direction of the companies they run and the leadership they provide to their employees. However we would also like to see remuneration committees take a much more holistic view of the level of executive pay in the context of the individual, the company overall, and in respect of all employees. Broader still, the remuneration committee should be attuned to pay elsewhere and the concerns of society – increasingly made up of beneficial owners - more widely when setting pay.

We would like to see remuneration committees focussed on ensuring that the remuneration policies and structures in place serve to reinforce the right corporate culture. This should discourage executives from taking excessive risk and encourage them to make decisions in the long term interests of the company.

Turning to the specific options set out in the consultation paper:

Option (i) Require the remuneration committee to consult shareholders and the wider company workforce in advance of preparing its pay policy

We think this would be a sensible proposal. We also believe that providing shareholders and other stakeholders with evidence that the committee has considered overall worker pay and their views when setting pay for executive directors would be a helpful step. Whilst we would encourage more engagement between shareholders and company boards, we think it would be helpful if the discussion is broadened to encompass wider company pay and not just executive pay. Boards should also be supported to reach out to and hear the views of a wider range of shareholders and stakeholders in order to get a more holistic view from employees, customers and savers.

We would like to see more guidance on how remuneration committees should engage in constructive dialogue with the wider work force. Companies and shareholders should also be guided on the information that should feed into the pay policy and the disclosures that should be made on wider pay in the annual report. We discuss the merits of pay ratios in the next question.

Option (ii) Require the chairs of remuneration committees to have served for at least 12 months on a remuneration committee before taking up the role

We think this could be a sensible and pragmatic step to ensure the chair of the committee has enough knowledge and experience of pay in the company to lead and oversee the committee. As with an earlier answer, we would not want this to be too onerous an expectation, so making this mandatory would seem heavy handed. An assumption that the chair has served for 12 months on the committee, unless there are compelling reasons (significant churn on boards for example) why this wouldn't be an appropriate course of action, would probably be enough.

D- Transparency in executive pay

Q4) *Should a new pay ratio reporting requirement be introduced? If so, what form of reporting would be most useful? How can misleading interpretations and inappropriate comparisons (for example, between companies in different sectors) be avoided? Would other measures be more effective? Please give reasons for your answer.*

We believe the arguments presented in the consultation as to why this is a sensible way forward are compelling. Of particular note is that this is already a requirement for US listed companies.

Option (i) Pay ratio reporting

We believe pay ratio reporting would be a helpful development. What the inputs should be to calculate this company level Gini coefficient will need to be defined. We would be willing to take part in the debate as to how this could be set and monitored over time. The key value of the ratio is that if boards believe their ratio to be correct then they will be able to justify them publicly.

We agree with the thrust of the question that a pay ratio in isolation is only helpful so far. Disclosure of pay principles would help guide how ratios are applied across the workforce and significantly help investor understanding. This is currently absent from most remuneration committee reports.

A ratio of senior management hires would also be useful to indicate retention, training, development, and promotion of internal talent versus external appointments coming in to the business.

Also important would be a ratio that captures progression of employees on lower pay scales through a 'where are they now within the workforce' metric. The aim of the metric would be to move away from a focus on financial incentives to a measure of how companies are promoting staff through the business and whether they experience a positive and progressive culture. This would involve taking those who've remained with the company during the past 12 months and showing their progression in some way.

Our experience is that companies are not yet providing much meaningful information on pay across the workforce. Most companies say very little, making it hard to link director pay back to what other employees are paid, or to understand how the benefits of performance are shared by staff. We think greater transparency and reporting would be really helpful for shareholders and stakeholders, We believe it's likely that is would improve trust in the rationale for pay awards, and how a corporation is rewarding, incentivising and developing its talent.

Q5) *Should the existing, qualified requirements to disclose the performance targets that trigger annual bonus payments be strengthened? How could this be done?*

<u>Option (ii) Disclosure of bonus targets</u>

As the consultation sets out, since 2013 the disclosure of bonus targets and performance measures is already a requirement in the annual remuneration report. We are heartened by the evidence presented by the Investment Association that use of the 'commercially sensitive' exemption has rapidly decreased in recent years. We think there is a case therefore to strengthen the FRC's remuneration guidance to make reporting consistent amongst all companies. We also support the proposal to make retrospective disclosure of all bonus targets within a specified timeframe a reporting requirement. We think 12 months would be a reasonable period.

In our view it is an important point of principle that shareholders are aware of the conditions under which bonuses have been awarded particularly where there has been a change in control provisions triggering earlier and/or larger payments and rewards.

E- Long-term executive pay incentives

Q6) How could long-term incentive plans (LTIPs) be better aligned with the long-term interests of quoted companies and shareholders? Should holding periods be increased from a minimum of three to a minimum of five years for share options awarded to executives?

We agree with the evidence presented in the consultation that long term incentive plans do not appear to be providing the right incentives to board directors, and make it difficult for shareholders to understand how performance is being measured and rewarded.

Long-term incentive plans (LTIPs) may have a part to play in reward but there is a balance to be struck. Too much emphasis on incentives and too short-term a pay-off will have the effect of over emphasising share price performance. That would not be warranted for Directors' duty under Section 172 of the Companies Act, which is to act in the way believed to most likely to promote the success of the company for the benefit of its members as a whole. Executive directors may be encouraged to strike the right balance of company performance for all its members by LTIPs that vest a sufficiently long period after the director has left the company, so that behaviour does not become driven by the short-term.

However Figure 1 below highlights little correlation between executive pay and economic profits for FTSE 350 companies, showing profit to be a poor measure for performance related pay. The use of LTIPs make pay packages more inflated than necessary, complex, less aligned with the interests of the company and contribute towards increasingly large income disparities in a company. The Government has already provided examples in the Green Paper on how incentive plans in their current form can lead executives to make decisions that are not in the long term interests of the company in order to boost the share price and in turn their own share awards. We do not believe or have seen any evidence that giving away shares and share options as part of executive remuneration is aligned to the interests of long term shareholders, employees and the wider society.

Executive remuneration in the form of shares, particularly share options complicates the calculation of executive pay and makes it very difficult to know how much executives are really making. If directors believe in the long term vision and sustainability of the company they are running they are able to buy their own shares.

Whilst we would like to see incentive plans provide better long term incentives we certainly do not believe that such plans should be linked to short term measures like total shareholder return and earnings per share. Both the Kay Review and CFA UK's response to it highlighted serious concerns over the ability of these widely used performance metrics to reflect fundamental value creation for companies, and hence to serve as a reliable basis for incentivising and rewarding senior executives[6.]

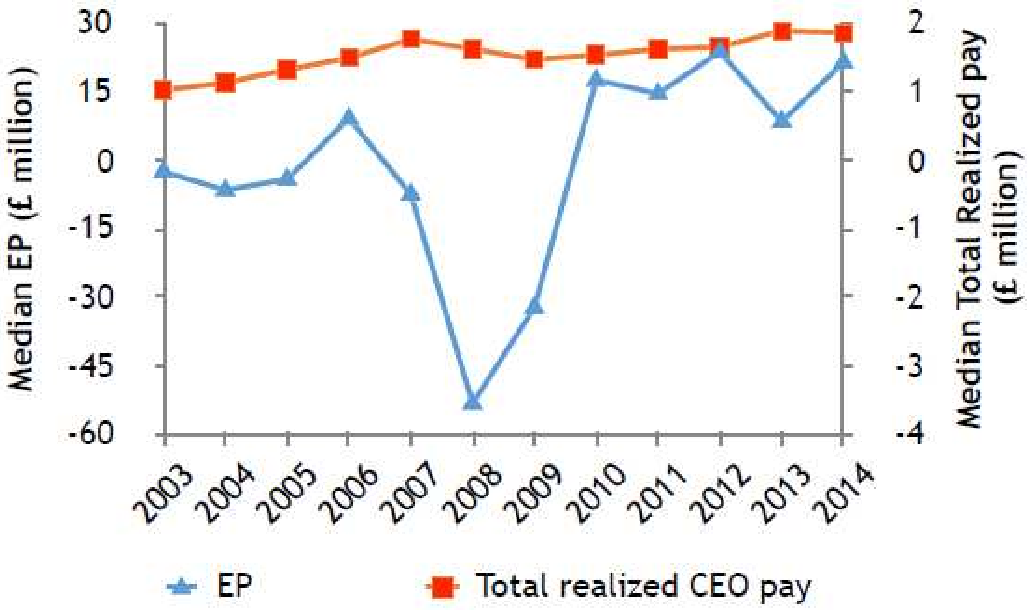
If the industry feels the need to continue with incentive plans there has to be more attention on linking incentives and rewards more directly to performance metrics that reflect sustained value creation for the company in the long term. By long term we mean at least three years but more usually five.

We would prefer to see reward metrics linked to key performance indicators that help executives meet agreed corporate strategic objectives and business aims. These would align executive director behaviour with real performance rather than share price and similar measures, which may encourage excessive risk taking or poor decision making.

[6] CFA Society UK: An Analysis of CEO Pay Arrangements and Value Creation for FTSE-350 Companies 2016

We agree with the CFA's call to redirect the spotlight from CEO pay levels and performance-related pay arrangements towards a more refined discussion about the type of performance measures that should be employed by companies. We would welcome further consideration from the Government on this and a move away from the current approach to incentives.

Figure 1: Median realised total inflation-adjusted CEO pay and economic profit (EP) by calendar year for FTSE 350 companies



Strengthening the employee, customer and wider stakeholder voice

Q7) How can the way in which the interests of employees, customers and wider stakeholders are taken into account at board level in large UK companies be strengthened? Are there any existing examples of good practice that you would like to draw to our attention? Which, if any, of the options (or combination of options) described in the Green Paper would you support? Please explain your reasons.

We believe boards should publicly feedback once a year on how they have been influenced by the efforts of wider stakeholders.

Investors, employees, trade associations, lobby groups, standard setters, customers, and the third sector constantly reach-out to companies to put their views across and enter into dialogue. In addition, companies formally receive the views of shareholders through comments and votes at General meetings.

These inputs constitute a significant effort by stakeholders to influence how directors lead companies and promote success. Companies could do much more to report the role that this variety of stakeholders can play to contribute to promoting the success of their businesses. The lack of acknowledgement makes it difficult to understand the extent that companies' attitude, behaviour, and operation has been influenced by stakeholders.

Formally feeding back to stakeholders as a collective would help companies demonstrate how they move with changes in societal norms, where they have listened, contemplated, and adapted their business and behaviour to stakeholders, and the ways that they are approaching matters differently because of the efforts of stakeholders.

We believe a specific company annual disclosure to stakeholders would go a long way to show how stakeholders' collective input has shaped and influenced companies during the past 12 months. This could include concrete examples of how companies have taken that input on board when discharging Section 172 of the Companies Act. We think such an approach would:

- Demonstrate a more inclusive business sector.
- Show the extent that companies are being run for the long-term through visible and forward-looking leadership.
- Provide important evidence about how companies discharge Section 172 of the Companies Act.
- Provide a counterweight to the ill-perceived wisdom that maximising shareholder value symbolises all one needs to know about company performance.
- Build greater trust between business and the public.
- Provide incentives to stakeholders that communicating with companies is worthwhile.

Government could also consider an annual general meeting vote on this disclosure as a means through which companies can become directly accountable on Section 172 of the Companies Act.

Q8) Which type of company do you think should be the focus for any steps to strengthen the stakeholder voice? Should there be an employee number or other size threshold?

We believe this should be the FTSE 350. These are medium and large UK companies that are the most heavily invested in by institutional investors.