RAILPEN Investments®

USS
UNIVERSITIES SUPERANNUATION SCHEME LIMITED

Submitted via email: rule-comments@sec.gov

November 18, 2010

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington DC 20549-1090

Re: File Number S7-31-10; Shareholder Votes on Executive Compensation

Dear Ms Murphy,

RAILPEN Investments (Railpen) and Universities Superannuation Scheme (USS) strongly support the proposed 'say on pay' rule but are submitting comments on specific issues where the rule could better reflect the intent of the Dodd-Frank legislation.

We expect remuneration committees to establish performance standards and executive remuneration arrangements that motivate management to deliver sustainable long-term performance. Therefore, executive remuneration should be aligned with long-term shareholder interests, which requires a pay for performance approach. From our experience in the UK, we believe an annual say on pay vote has had a number of benefits[1], including increased dialogue between compensation committees and major investors, a greater use of longer-term performance targets and an increased focus on alignment of performance targets with the strategy of the company. However, for say on pay proposals to add value for shareholders and issuers, there needs to be openness, transparency and better communication on a company's executive compensation policy and practices.

1. <u>Facilitating and Improving Investor/Corporate Dialogue on Governance and Remuneration Issues:</u>
   Given our experience with shareholder advisory remuneration votes in other markets, we expect that shareholders will have questions about remuneration packages regardless of what disclosure requirements are included in the rule. The resulting interaction that occurs in other markets between shareholders and the board can be extremely valuable to both sides and is an important benefit of such advisory votes. Legalistic responses to the rule's disclosure mandate could frustrate intent of the Dodd-Frank Act.

   Railpen and USS would like to see the rule modified to encourage issuers to conduct a meeting, conference call and/or internet forum (after release of the proxy but at least one week prior to the voting deadline) in order to respond to questions from shareholders on

[1] In September 2009, Railpen and Pensions & Investments Research Consultants, the UK proxy advisory firm, published a research paper entitled 'Say on Pay: Six Years On – Lessons from the UK experience', which is attached for reference. A key conclusion of the paper was the improved engagement and dialogue between directors and shareholders that an advisory vote on compensation facilitates.

company executive compensation policy and practices and other issues relevant to the proxy materials. Providing a specific vehicle for handling questions, with responses posted and available to all shareholders via the internet, would improve transparency and efficiency of the process[2]. This could be encouraged, for example, by providing for SEC consideration of bona fide supplemental disclosure vehicles as a mitigating factor in the context of determining SEC enforcement penalties for proxy disclosure violations.

2. No Change to the Board's Fiduciary Duty:
Section 951 of the Dodd-Frank Act provides that a shareholder advisory vote "shall not create or imply any change to the fiduciary duties" of the board or directors.

This is an important concept, and Railpen and USS would like to see an explicit reference included in the rule confirming that the outcome of a shareholder vote is not intended to decrease or otherwise relieve the board from the full extent of its fiduciary duties.

3. Disclosures:
   a. In order to assist shareholders in evaluating the complete extent of consideration received from the company, Railpen and USS believe disclosure requirements for the Compensation Discussion & Analysis section of the Proxy Statement should be revised to include a complete description and valuation of all related party transactions for named executive officers and their immediate family members. We are concerned that related party transactions could be substituted for, and are essentially the equivalent of, direct remuneration.

   b. To avoid hidden remuneration, the same level of related party transaction disclosure should be incorporated into golden parachute/change in control approval proxies. We believe that transactions with both the issuer and the acquirer are relevant to the vote and should be reported.

   c. In order to provide a full picture of remuneration being received in connection with a change in control, agreements for the acquirer to provide compensation or employment to named executive officers should be disclosed. Ongoing consulting or employment agreements, for example, can be very material to determining whether or not golden parachute/change in control provisions are reasonable. We think the rule should require such disclosures.

   d. It is necessary that companies are transparent in their policies and discussions regarding remuneration in order to assist shareholders evaluating compensation. Therefore, we support the required disclosure and discussion on the considerations by the company on the result of the shareholder advisory vote on executive compensation as a mandatory principles-based topic.

4. Allow Shareholder Resolutions on Vote Frequency After Material Changes:
We would encourage the SEC to create an exception to the proposed exclusion policy for submission of say on pay resolutions by shareholders at companies which implement shareholder vote frequency preferences in years following a material change in executive

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[2] As an extension of this, Railpen and USS are supportive of the idea of a conference call dedicated specifically to shareholder-director dialogue on corporate governance issues as set out in a company's proxy statement. This idea of a 'Fifth Analyst Call' is supported by other global investors representing approx. $2 trillion of assets under management and we attach a background proposal for information.

compensation policy or practices. When faced with the potential for a six year wait to vote again on frequency, regardless of changes in company practices, we expect that shareholders will tend toward shorter intervals between advisory votes. This could unnecessarily increase the workload for both issuers and shareholders. Therefore, Railpen and USS recommend that the SEC at least allow shareholders to file shareholder resolutions on frequency of the say on pay vote in years following a material change in executive compensation policy or practices.

5. <u>Votes Should be Held in the First Year Following an IPO:</u>
   We see no reason why shareholders of a company that has recently gone public should be accorded fewer rights than shareholders at more seasoned public companies. Railpen and USS object to allowing companies unilaterally to designate when (within three years) they will hold a say on pay vote when going public. Instead, companies should provide new public shareholders with a vote during the first year after going public.

6. <u>Treatment of TARP Companies:</u>
   We agree that TARP companies should be considered as to have met the requirements of Rule 14a-21(a) when such issuers conduct a shareholder advisory vote to approve executive compensation under the existing rule 14a-20 of the Emergency Economic Stabilization Act of 2008. However, we consider that TARP companies should not be exempt from the proposed rules once they have repaid their indebtedness. Therefore, we agree that TARP companies should be required to conduct shareholder advisory votes under Rule 14a-21(a) and Rule 14a–21(b) at the first annual meeting after they have repaid all the outstanding indebtedness under TARP. This is not only in shareholders' interests but is also very much in the broader public interest.

7. <u>Treatment of Smaller Companies:</u>
   We do not consider that the proposed rules are unduly burdensome on smaller companies and agree that smaller issuers should not be exempt. The interests of investors on these issues, in terms of disclosure and having a vote, are the same regardless of the size of the Company.

We hope that these comments from the perspective of an institutional investor with global experience regarding implementation of say on pay in other markets will be helpful. Feel free to contact us, if we can be of further assistance.

Respectfully submitted,

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Attached:
'Say on Pay: Six Years On – Lessons from the UK experience', Railpen Investments and PIRC

Request for Investor Dialogue: Fifth Analyst Call on Corporate Governance and the Proxy Statement

Railpen Investments (**Railpen)** is a subsidiary of rpmi. Railpen Investments is authorised by the FSA and carries out investment management for the Railways Pension Trustee Company Limited (RPTCL), the corporate trustee of the Railways Pension Scheme and other UK Railway industry pensions schemes with total assets of c. $27 billion. rpmi provides investment and pensions administration services to RPTCL for over 350,000 beneficiaries.

Universities Superannuation Scheme (USS) is the principal final salary pension scheme provided for academic and senior administrative staff in UK universities and other higher education and research institutions. The fund is the second largest pension scheme in the UK, managing c. $45bn in assets for over 400 participating employers and >260,000 members.

Say on Pay

Six Years On

Lessons from the UK Experience

A Report by
Railpen Investments
and PIRC Limited

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PIRC

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Executive summary

If shareholders need a vote on one issue, it is executive remuneration; as Sir Adrian Cadbury, author of the 1992 Cadbury Report on UK Corporate Governance: "Financial Aspects of Corporate Governance", observes:

"Say on pay promotes dialogue between investors and boards and encourages investors to engage with boards on a readily understandable issue, where interests may conflict. It is also a litmus test of how far boards are in touch with the expectations of their investors."

Shareholders in UK companies have had a mandatory resolution to enable them to vote on a company's remuneration policy since 2002. Shareholders in US companies are beginning to have experience of the same resolution, so-called 'Say on Pay', with the expectation of the introduction of legislation to require US companies to provide their owners with a vote on the compensation of their executives.

The discipline of going through the annual vote process, from the perspective of both companies and investors, is a valuable one. It enriches the understanding that investors have of companies due to the importance of remuneration within corporate governance risk analysis. It has required investors to develop expertise on pay structures, and this enhances both the quality of corporate governance evaluation undertaken, and the overall engagement with companies. Without doubt, the pay vote has created a challenge for investors, as it provides an extra resolution at each company on which they have to decide their voting position. In addition, there is a responsibility on investors to ensure that they inform companies of the reasons why they have voted a certain way on the remuneration report resolution.

Essentially 'Say on Pay' is part of a larger corporate governance process, and not an end in itself. It can provide a good insight into the relationship of board members with each other and how much ownership the remuneration committee has over the compensation process. If a chief executive answers questions from shareholders on compensation matters, one must question whether it is the remuneration committee which owns that process or whether it is the chief executive who is the ultimate decision maker. Such observations have wider implications for the underlying governance structures of a company.

The question of how shareholders can engage more effectively with the businesses that they own over issues of remuneration is not a straightforward one. However, with over six years of experience in dealing with a statutory advisory vote on remuneration, shareholders in UK companies can provide valuable lessons for the US market. Increasingly, with the globalisation of investment mandates, investors in UK companies are also investing in US companies, and will use the analytical techniques and experience gained from the UK when assessing Say on Pay proposals at US companies. Furthermore, investors with no experience of assessing Say on Pay proposals can learn valuable lessons from the UK experience.

In this paper, we discuss the impact the advisory vote on remuneration has had in the UK in terms of:

a) remuneration levels;

b) the relationship between shareholders and companies;

and

c) the importance of remuneration as an indicator of the governance structures that underpin a company.

Introductory Section considers the concept of 'Say on Pay' in the US market, and considers the other markets where shareholders do have a vote on remuneration.

Section 1 looks at the events in the UK in the lead up to the remuneration vote being introduced in 2002.

Section 2 considers what the vote sought to achieve in the UK.

Section 3 looks at the vote in practice in the UK and the reasons why shareholders vote against the remuneration resolution.

Section 4 evaluates the impact of the vote on executive pay overall.

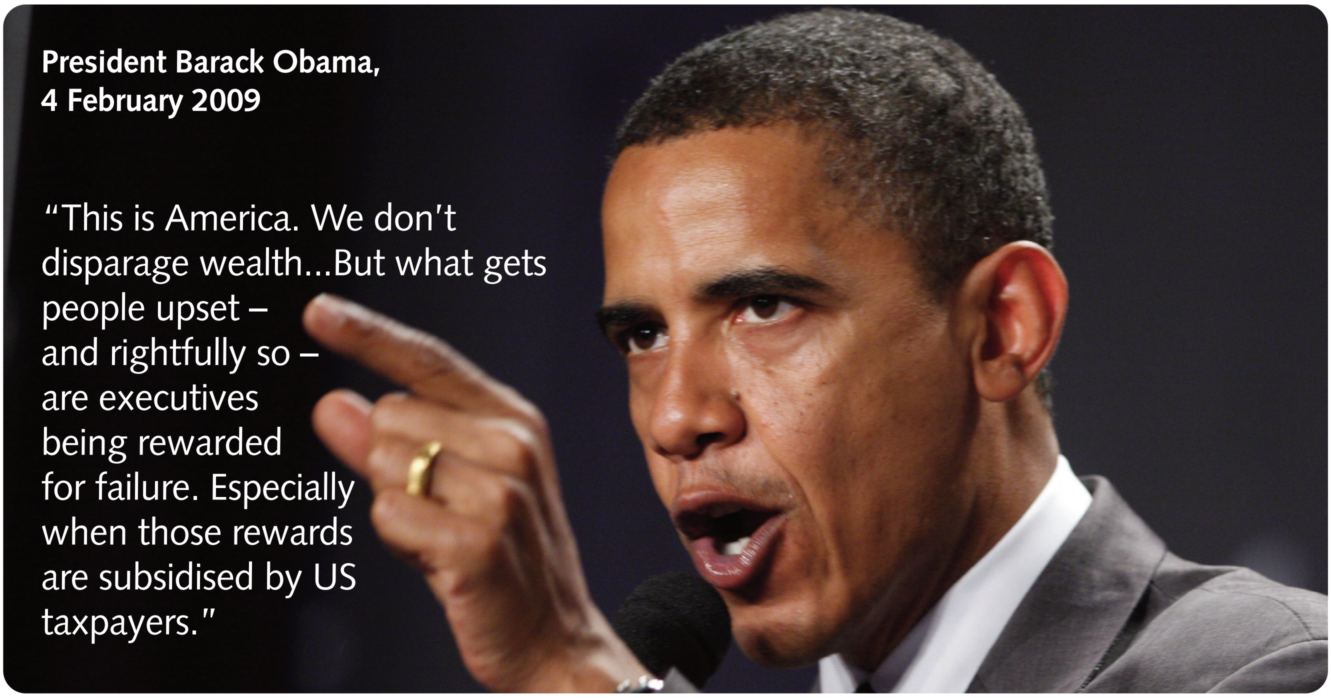
Section 5 considers whether the vote in the UK has met its objectives.

Section 6 concludes, and considers the remuneration report vote in the context of:

i) Pay for performance;
ii) Rewards for failure;
iii) Empowering remuneration committees; and
iv) Shareholder activism.

Section 7 poses considerations for UK investors in terms of the experience of the last six years, and going forward.

Introduction



1) The US debate

The expected implementation of an advisory vote on compensation at US companies comes at an important juncture in the debate about corporate governance in the USA, and globally. By extension, the responsibilities and actions of both shareholders, as principals, and board directors, as their agents, are under much scrutiny. The politicisation of the debate around executive remuneration, amidst the perception of a fundamentally flawed bonus culture and public hostility to banking executives, has only strengthened the need for a shareholder vote on compensation - a move that we believe will serve to enhance the rights of investors in US companies.

On 31 July 2009, the House of Representatives voted 237 to 185 to approve the Corporate and Financial Institution Compensation Fairness Act of 2009[1], which includes a proposal to give shareholders of US companies an advisory vote on compensation. At the time of writing, the bill had been referred to the Committee on Banking, Housing and Urban Affairs in the Senate.

In February 2009, as part of President Barack Obama's initiatives to curb executive pay, it was announced that companies participating in the capital access programs could waive the imposed compensation limit cap of $500,000 "only by disclosure of their compensation and, if requested, a non-binding 'say on pay' shareholder resolution."[2] This is an interesting quid pro quo. The message seems to be that giving shareholders a vote on remuneration is a sign that a company will adopt responsible remuneration policies and does not need the cap imposed. Effectively, the waiver of the cap can be taken to imply that the vote itself acts as a deterrent to egregious pay practices.

On 6 April 2009, in her speech to the Council of Institutional Investors Spring Conference in Washington, Mary Schapiro, Chair of the Securities and Exchange Commission (SEC), identified the areas of governance reform that would be the focus of the SEC's immediate agenda. On compensation, Schapiro commented that improved disclosure "is letting a company's owners know how their managers and directors ensure that compensation does not drive inappropriate risk-taking." She referred to a report from the Financial Stability Forum[3], which stated three principles for "sound compensation practices" – (i) effective governance of compensation; (ii) effective alignment of compensation with prudent risk taking; and (iii) effective supervisory oversight

[1] Corporate and Financial Institution Compensation Fairness Act of 2009 (H.R. 3269) http://www.govtrack.us/congress/billtext.xpd?bill=h111-3269.
[2] 'Remarks on the Economy and Executive Pay,' 4 February 2009, Washington, D.C.
[3] 'Principles for Sound Compensation Practices', Financial Stability Forum, 2 April 2009.

and engagement by stakeholders. It is within this "oversight" role for shareholders that having a vote on pay comes to the fore.

Commonly referred to as "Say on Pay", we believe that the advisory vote on compensation is part of a larger corporate governance reform exercise that is needed in the USA. Together with proxy access and underpinned by majority voting, Say on Pay will be an important factor in modernising the shareholder experience of investing in US companies. Given the scrutiny within which compensation is now regarded, the voices of dissent on Say on Pay are becoming increasingly diluted. As investors with several years of experience in the UK market, which introduced legislation on giving shareholders a vote on pay in 2002[4], we believe that these reservations are misplaced. Some opposition may stem from a misunderstanding of how the UK regime operates and we hope that this paper provides a comprehensive overview of the UK experience to inform the debate about Say on Pay in the US market.

By the middle of this year's US voting season, it was obvious the extent to which Say on Pay is now part of the US corporate governance landscape:

- AFSCME reported that, as at 4 May 2009, of the 29 Say on Pay shareholder proposals that had been voted on since the start of the 2009 proxy season, which asked companies for a vote on compensation, 10 received a majority of the votes cast, out of for and against votes, and the average vote across these ten proposals was 46%; and it was expected that around 80 Say on Pay shareholder proposals would be voted on in 2009.[5]
- On 5 May 2009, California State Teachers Retirement System (CalSTRS) launched their 'Principles for Executive Compensation' which set out model guidelines that they considered their investee companies should follow. CalSTRS requested 300 of its portfolio companies to develop these comprehensive executive compensation policies and to allow shareholders an advisory vote on these policies[6].
- On 7 May 2009, Senator Charles Schumer announced plans to introduce a corporate governance based bill called the Shareholder Bill of Rights Act 2009, which, amongst other enhancements to their ownership rights, would give shareholders a vote on executive pay. The bill's aim is clear: "to prioritise the long-term health of (their) firms and their shareholders"[7].

In fact, there have been ruminations about Say on Pay in the USA for some time and when AFLAC announced, in February 2007, their intention to give shareholders a vote on pay[8], this represented a watershed in terms of US corporations' general intransigence in providing their shareholders with a vote. The inaugural vote took place at AFLAC's 2008 annual general meeting where 93.1% of the votes cast supported the resolution.

In March 2007, Congressman Barney Frank, Chairman of the Financial Services Committee, introduced the "Shareholder Vote on Executive Compensation Act" in the House of Representatives. This proposed giving shareholders of US public companies an annual non-binding advisory vote on executive compensation packages, as well as an additional non-binding advisory vote if the company awards a new golden parachute package whilst simultaneously negotiating the purchase or sale of the company[9]. On 20 April 2007, this legislation was passed in the House of Representatives by a vote of 269-134. The very same day, then Senator Obama supported enactment of Say on Pay through his introduction of a companion bill in the Senate, which required a shareholder advisory vote on executive compensation. In 2008, in addition to AFLAC, five other companies gave their shareholders a vote on remuneration and all resolutions received over 90% support, except the vote at Jackson Hewitt Tax Services, which only received a slim majority of 53.6%.

Say on Pay is becoming a reality; and compensation has proved to be the dominating feature of the 2009 US proxy season, with increasing numbers of proposals on 'Say on Pay' either filed by investors or provided by companies to their shareholders.

In addition, there are ramifications from the US government's intervention in the financial sector. 555 US financial institutions received capital infusions via the US Treasury's Capital Assistance Program, a bank-share purchase program intended to restore confidence in banks and get them to lend[10]. This program is funded with $250 billion of the $700 billion Troubled Assets Relief Program authorized by Congress in October 2008 via the Emergency Economic Stabilization Act. One of the conditions of participation was restrictions on the compensation paid including: an annual advisory vote on compensation presented to shareholders; limits on compensation; a provision for the recovery of bonuses and awards for the top named executive officers (NEOs), and the next 20

[4] 'The Directors Remuneration Report Regulations 2002', Statutory Instrument 2002 No. 1986
[5] 'Say on Pay Shareholder Proposals Garner Record Support During Tumultuous Shareholder Season', 4 May 2009. Note that AFSCME filed the first shareholder proposals on giving shareholders a vote on pay in the USA.
[6] 'CalSTRS Guidelines offer Substance on Executive Pay', 5 May 2009 (www.calstrs.com)
[7] 'Support the Shareholder Bill of Rights Act 2009', letter from Senator Charles Schumer, 7 May 2009.
[8] 'Aflac Adopts Non-Binding 'Say On Pay' Shareholder Vote' 14 February 2007
[9] http://financialservices.house.gov/ExecutiveCompensation.html
[10] Participants in Government Investment Plan: http://online.wsj.com/public/resources/documents/st_BANKMONEY_20081027.html

most highly paid executives if the awards were based upon inaccurate statements; and a prohibition on 'golden parachutes' severance awards for the NEOs and the next five most highly paid executives.

2) Learning from other markets
This paper will explain the processes behind the remuneration report regulations that exist in the UK, which can serve as a model for the US and other countries considering the introduction of a vote on remuneration. Whilst the differences between the institutional landscapes of the US and the UK are well-known, this does not render the UK experience as irrelevant when considering the US model. However, the vote on remuneration is not unique to the UK; in fact, it is becoming a feature of governance models in many other countries.

In Australia, shareholders have had a vote on pay since 2005, introduced under the Corporations Act 2001 (Section 250R). The Australian experience was recently reviewed by the Business Roundtable in Australia, and Charles Macek, the chairman of the remuneration committee at Telstra, Australia's major telecoms provider, observed: "I think that what we are hearing is that communication with the institutional shareholders has actually improved as a direct consequence of the remuneration report and I think that's been without a doubt the major positive that's come out of that"[11].

In Europe, Sweden and Holland have a binding vote on executive pay and further to their initiatives in Switzerland, shareholder group Ethos (http://www.ethosfund.ch/) has had success in getting some major Swiss companies to enable their shareholders to have a remuneration vote (UBS, Credit Suisse, ABB and Nestle SA) and legislation is currently under consideration by the Swiss parliament. Other countries are also experiencing companies putting their pay to a shareholder vote of their own volition (Denmark, Finland and Canada). Shareholders in these markets are rising to the challenge of Say on Pay. For example, in April 2009, the Canadian Coalition of Good Governance (CCGG) announced the development of an "Engagement and Say on Pay" policy [12] which encourages shareholders to engage with companies on any concerns around the remuneration policies. In its statement, CCGG said that it "regards 'Say on Pay' shareholder advisory resolutions as an important part of [this] ongoing integrated engagement process between shareholders and boards"; clearly, an expected outcome of having the vote on pay is envisaged as an enhancement to engagement processes.

However, the UK provides the largest sample of data and anecdotal evidence of the experience of having a 'Say on Pay'. This paper sets out the background to the introduction of the vote and we explain some of the experiences of the UK in terms of having the vote. We hope that this paper will dispel some of the myths around the UK experience that are being used in the USA to downplay the significance, and achievements, of having a vote on compensation issues. This paper should be read as a contribution to what sort of structures should be in place to allow investors in US companies a proper voice in the debate on executive compensation.

But first, it is always helpful to go back to basics so let us remind ourselves what the purpose of compensation is, and why shareholders have an interest in it. One definition of the word 'compensate' is as follows:

"To make satisfactory payment or reparation to; recompense or reimburse."[13]

Compensation is money provided by the members of a company to remunerate the agents elected by the owners of the company, to provide safe and profitable stewardship over the assets of the principals. These principals are, ultimately, the beneficiaries of pension funds and other savings and investment schemes managed by institutional investors. It seems unequivocal, then, that shareholders should have an input into the process. This takes us to the crux of the matter; having a vote is not about shareholders having control over the process; what it is about is shareholders having input and influence over the process and for approving the compensation structures that are in place. This is a subtle, but very important, difference.

But why all this focus on compensation?

It is fair to observe that the corporate governance debate sometimes appears dominated by remuneration issues. After all, there are many other aspects of corporate governance (shareholder rights, audit issues, board structure and independence), that make up the corporate governance risk profile of a company. However, given the current economic climate, the focus on remuneration has only increased.

There are other reasons, apart from society's general concern at high levels of executive pay, why remuneration is a fundamental focus for corporate governance. Many shareholders take remuneration as a proxy for the wider corporate governance strengths and weaknesses of the company. If there is confidence that compensation plans facilitate true alignment between the interests of directors and shareholders, this may assure shareholders that other governance structures are in place and are working effectively. For some fund managers, remuneration is also often the one corporate governance issue that they will take a stance on. Whilst they might not necessarily take a view on quantum, they are very keen on alignment of directors' interests with those of shareholders and have used the remuneration vote as a way to raise concerns about any perceived lack of such alignment.

[11] Business Spectator/Mercer Roundtable, 3 February 2009 http://www.businessspectator.com.au/
[12] http://www.ccgg.ca/media/files/guidelines-and-policies/engagement-and-say-on-pay/CCGG%20SOPP%20Final.pdf
[13] http://www.thefreedictionary.com

1 The UK Say on Pay experience: the context and trends prior to the vote

The context
In the UK, the onus is very much on investors to provide oversight of companies in respect of corporate governance issues. The Directors' Remuneration Report Regulations 2002 are a good example of how investors have been encouraged by the UK Government to influence corporate behaviour. Prior to the regulations being introduced in 2002, the first reference to a shareholder vote on remuneration could be found in the 1948 Companies Act, Table A, where it is stated that:

"The remuneration of the directors shall from time to time be determined by the company in general meeting."[14]

Looking back at the history of the remuneration question in the UK, a report by PIRC in 1993[15] noted that appeals for pay restraint by directors had been made at that time by the Prime Minister, the CBI and the Archbishop of Canterbury. Issues included large golden handshakes, the structure of executive share option schemes and underlying pay increases that were outstripping inflation, company performance and general wage levels.

In 1999, the Department of Trade and Industry (DTI) - now the Department for Business, Innovation and Skills - appointed PricewaterhouseCoopers (PwC) to monitor compliance by listed companies with the best practice framework on directors' remuneration set out in the Greenbury Code of Best Practice and the Combined Code[16]. It is somewhat telling that only five per cent of companies analysed during that period disclosed, even in broad terms, how performance measures related to long-term company objectives. Only seven of the 270 companies monitored by PwC chose to put forward the remuneration report for shareholder approval at the annual general meeting, as recommended by the 1995 Greenbury Report[17]. As a result of the PwC report, the Government announced that it would be consulting on a number of possibilities for creating "an effective and more focused way in which shareholders could influence directors' pay".[18]

In 2000, much of the year was spent waiting for the Government's response to its consultation document issued in July 1999. This floated various ideas for improving shareholder oversight of the remuneration-setting process along with proposals to improve reporting. As frustration grew amongst shareholders over the slowness of the Government to report the outcome of its July 1999 consultation exercise, in the absence of any initiative from the DTI, various investor groups took matters into their own hands. In March 2001, PIRC wrote to all 800 companies within the All Share Index asking them to put forward a voluntary resolution seeking endorsement for remuneration reports and notifying them that PIRC would be advising clients to vote against senior members of remuneration committees where no such resolution was forthcoming. A few weeks later, a group of investment managers, co-ordinated by Hermes, wrote to companies with a similar request, suggesting also that they might propose a shareholder resolution on the matter at recalcitrant companies. Approximately 10% of FTSE100 companies complied[19].

Finally, the Directors Remuneration Report Regulations (DRRR) came into force on 1 August 2002 and applied to companies' financial years ending on or after 31 December 2002. The DRRR set out what was required of the remuneration report within the reporting documents of a company, and also introduced a mandatory annual vote for shareholders on the remuneration report for listed companies, in advisory form. Listed companies are required to put their remuneration report to shareholders in general meeting as a separate resolution. At the time the regulations were introduced,

[14] 1948 Companies Act, First Schedule, Table A, Part 1:"Regulations for Management of a Company Limited by Shares, not being a Private Company" Section 76 (http://www.companieshouse.gov.uk/about/tableA/comm1July48CoAct1948_P1.pdf)
[15] "Directors' Remuneration", PIRC Limited, London, 1993.
[16] "Monitoring of Corporate Governance Aspects of Directors' Remuneration" produced by PricewaterhouseCoopers for the DTI (1999)
[17] "Directors' Remuneration: Report of a Study Group chaired by Sir Richard Greenbury", 17 July 1995.
[18] Speech by Stephen Byers, then Secretary of State for Trade & Industry, to the ABI and NAPF Seminar on Institutional Investors and the Competitiveness of British Industry, 19 July 1999.
[19] PIRC Proxy Voting Review 2002, p.21

the Government made it clear that whilst it did not currently intend to regulate in this area, it would do so if necessary. In its response to the Trade and Industry Select Committee's 16th Report of Session 2002-03, on "Rewards for Failure", the Government stated that whilst it recognised best practice was the "preferred option" and that "legislation was considered an inappropriate route which would create unnecessary complexity and uncertainty as well as significant regulatory burden", there are consequences should the voluntary approach fail: "the Government will be monitoring the position closely and, if need be, will not hesitate to take the appropriate action".[20]

It is important to understand not only the political and social context that led up to the implementation of the remuneration report vote requirements but also the practice undertaken by companies which fuelled the concern and the need for a vehicle to allow shareholders a stronger voice on remuneration issues.

Here are some key examples:

At the turn of the millennium, **British Airways** angered shareholders by paying their departing chief executive, Robert Ayling, compensation equating to approximately 400% of base salary. Possibly in light of the controversy, the remuneration policy was put to a shareholder vote at the company's next AGM. In the same year, as the proposed merger between **Glaxo Wellcome** and **Smithkline Beecham** gained momentum, both companies were subject to shareholder scrutiny over the terms of the executive directors' share plans, which allowed accelerated vesting in the event of a merger such that awards that were not eligible for vesting on the merger date would become so. As a result, at **Smithkline Beecham Group**, an award worth approximately 20 times salary was granted to the chief executive. PIRC therefore recommended opposing the election of both chairmen of the respective remuneration committees.

In 2001, a £2.5m payout to directors at **Royal Bank of Scotland**, following the NatWest takeover, provoked a 17% vote against the chairman of the remuneration committee, Sir Angus Grossart.

This was eclipsed by the level of shareholder protest at **Schroders**, where the board tabled a resolution seeking approval for a payment of £5 million to the departing chairman and ex-chief executive, Sir Win Bischoff. The group compensation committee deemed the award a reflection of his outstanding contribution during the group's development and success over a 16-year period. However, shareholders questioned whether such a discretionary payment was justified given that company growth under Sir Win's guidance had been reflected in salary and previously established bonus and incentive schemes in which he had participated and been incentivised by. Coming after the sale of its investment banking business, many shareholders were dismayed by another transaction bonus which 40% of the non-family shareholders voted against.

Similar to prior shareholder protest at Smithkline Beecham, in 2001 **Billiton's** merger with **BHP** was overshadowed by concerns about the automatic vesting of share options, irrespective of whether performance targets had been met, on the completion of the merger.

During 2002, 30% of companies put their remuneration reports or policies for shareholder approval, up from 8% in 2001 and 3% the year before. These proposals were more prevalent among larger companies with 44% of FTSE100 companies bringing forward a resolution, compared to 17% of Small Cap companies.

For the first time in the UK, in 2002, two companies were forced to withdraw or amend their proposed share option schemes due to the level of opposition. The first of these was **Prudential** which, despite a prior consultation process, attracted 41% opposition for an overly complex scheme which could have paid the chief executive, Jonathan Bloomer, an award of between £3m and £6m (estimates varied) and around 90% of his salary for median performance. (PIRC's proxy voting analysis had highlighted **Prudential** and advised opposition to shareholders.) Given **Prudential's** role as an institutional investor of note, the scheme was also portrayed as setting a benchmark of acceptability for other companies. In the face of opposition fromvarious fund managers and other insurance companies, **Prudential** backed down the day before the AGM and withdrew the share scheme.

A week later, **Selfridges** amended its share scheme proposals in response to a Local Authority Pension Fund Forum campaign against its weak performance targets, a concern shared by other institutions. The amendment clarified the maximum award limit and introduced a 5% dilution limit, although the target remained unchanged. The resolution was passed but a substantial 25% vote was recorded against it. The company subsequently committed itself to reviewing the scheme.

A similar level of shares registered opposition against the **HBOS** share scheme brought to shareholders in 2002, which attracted attention in part due a perceived lack of appropriate challenging performance targets.

Whilst share schemes attracted dissenting votes, major controversies also emanated from other remuneration issues such as substantial increases in basic pay at **BP, Barclays** and **Schroders**.

[20] House of Commons, Trade and Industry Select Committee – Third Special Report, 2 March 2004 (http://www.parliament.the-stationery-office.co.uk/pa/cm200304/cmselect/cmtrdind/415/41504.htm)

The trends
In the years running up to 2003, and despite a backdrop of increasing regulatory pressure and general shareholder dismay, companies continued to increase all aspects of cash remuneration. Issues of concern were by no means limited to increases in cash-based remuneration, but also included insufficient levels of disclosure, the structure of remuneration packages, share-based incentive schemes and directors' contractual arrangements.

Specific concerns at the time related to the lack of an upper limit under numerous cash bonus arrangements; one-off share awards; inadequate disclosure of performance conditions whether under bonus arrangements or share-based incentive schemes; rolling retesting of performance conditions; cliff vesting; and, most of all, contract lengths and severance arrangements. Rolling retesting, a common practice of the time, meant that if a company failed to meet performance targets in the set timeframe (usually three years), the board would extend the test for one or more years while also adjusting the performance hurdle to maintain the same average annual performance target. For example, if the old hurdle called for growth in earnings per share of 9% over three years, the board would raise the new hurdle to 12% over four years. The consequence of such practices increased the likelihood that awards would become available, thus undermining the concept of 'pay for performance'.

Average executive director salaries (adjusted for inflation): 2000 - 2003

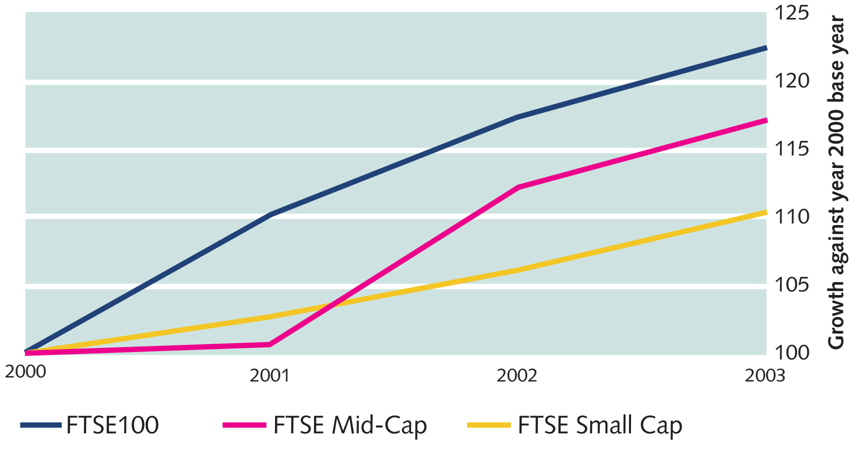


Figure 1 (Source: PIRC)

i) Trends in salary pre-remuneration vote
As Figure 1 displays, average executive directors salaries, when adjusted for inflation, increased in a rapid fashion for FTSE100 and Mid Cap companies in the years running up to the introduction of the remuneration advisory vote. When rebased to 2000, FTSE100 companies increased average executive salaries by 22.5% over three years.

Between 1999 and 2000, the average executive director's salary rose by 6.7% for the FTSE100, by 5.6% for the Mid Cap and by 8.0% for the Mid Cap.

Between 2000 and 2001, the average executive director's salary rose by 12.8% for the FTSE100, 3.4% for the Mid Cap and 5.4% for the Small Cap.

Pay continued to rise in 2002, with salary increases in the FTSE350 and a rise in the overall cash remuneration across all indices despite a decrease in annual cash bonuses and the value of exercised share option awards. Between 2001 and 2002, the average executive director's salary rose by 7.8% for the FTSE100, 12.6% for the Mid Cap and 4.6% for the Small Cap.

Salary rises in each index were well above inflation. Between 2002 and 2003, the average executive director's salary rose by 7.2% for the FTSE100, 7.4% for the Mid Cap and 6.9% for the Small Cap.

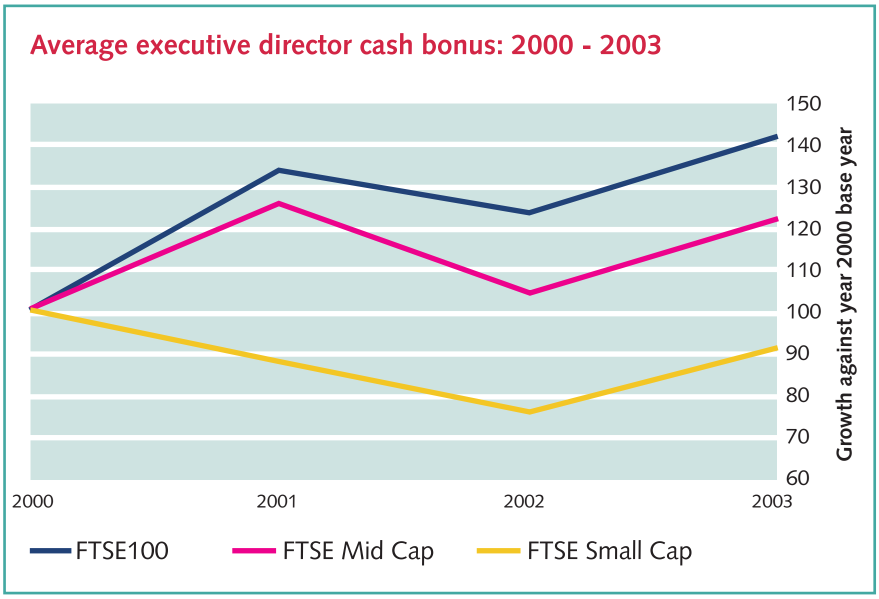


Figure 2 (Source: PIRC)

ii) Trends in bonus pre-remuneration vote

Whilst average salaries had increased in excess of inflation through the same period, the effect of the global market downturn in 2001/2 manifested a relative drop in the level of bonuses awarded to directors in 2002, as Figure 2 demonstrates. This resonated earlier for Small Cap companies that saw bonuses drop consecutively from 2000 to 2002. Notwithstanding the relative drop in 2002, average cash bonuses still increased through the three year period by approximately 40% and 20% for FTSE100 and Mid Cap companies respectively. As disclosure of targets for directors' bonuses was generally limited, it was not possible to assess whether the resumption of an upward trend reflected better performance by the companies or changes in the targets allowing them to be achieved more readily.

The increase in salaries and benefits meant that in spite of the drop in annual bonuses, overall cash pay continued to rise.

Total annual bonuses (excluding the value of share-based awards) increased by 34% for the FTSE100, 26% for the Mid Cap but decreased by 12% for the Small Cap during 2001.

On average, annual bonuses were worth 77% of salary for executive directors in the FTSE100, 52% of salary for the Mid Cap, and 34% of salary for the Small Cap.

In 2002, annual cash bonuses (excluding share-based awards and gains) for the average director decreased from 2001, reflecting overall poor market conditions.

-7.3% for the FTSE100, -17.0% for the Mid Cap and -13.9% for the Small Cap. On average, annual bonuses were worth 66% of salary for executive directors in the FTSE100, 39% of salary for the Mid Cap and 26% of salary for the Small Cap. Between 2002 and 2003, the average executive director's annual cash bonus rose in percentage terms by 14.5% for the FTSE100, 16.8% for the Mid Cap and 20.5% for the Small Cap.

When each element of cash remuneration is combined, ie, factoring in base salary, bonuses, and benefits, the escalation over a four-year period is striking. Using 2000 base data, Figure 3 exhibits the percentage increase in average combined cash remuneration running up to the first year of having a vote on remuneration in 2003. In addition, it is worth noting that this cuts across a significant market downturn in 2001.

In the three years running up to the remuneration vote, a 30% drop in the FTSE AllShare Index was accompanied by an inversely related 30-40% increase in average executive total cash remuneration for FTSE100 and Mid Cap companies.

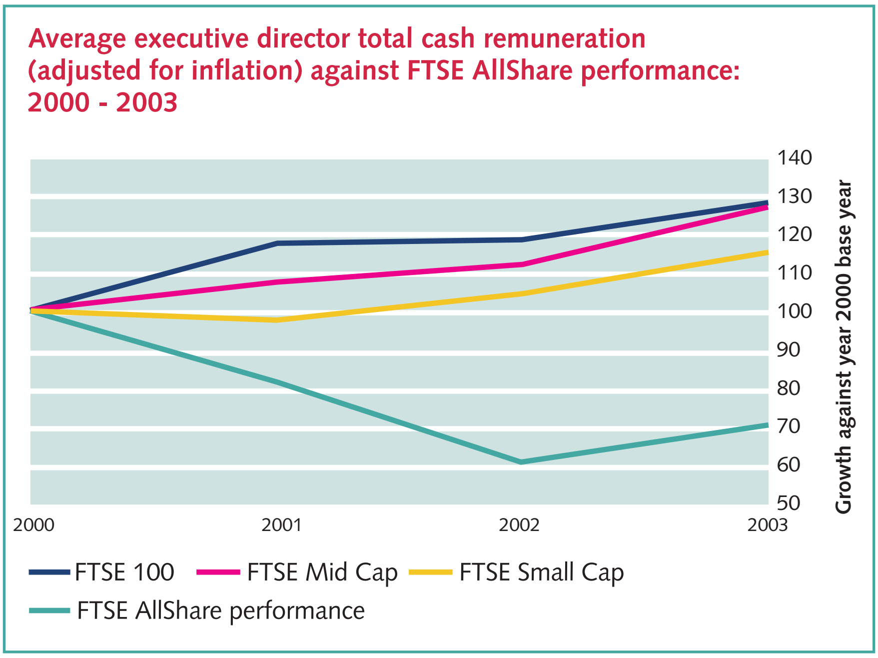


Figure 3 (Source: PIRC)

iii) Trends in contracts & severance payment pre-remuneration vote

PIRC first brought shareholders' attention to the potential consequences of long notice periods as far back as 1994 when over 40% of executives in the FTSE350 had contracts of three years or longer, compared to less than 30% of one year or less. One-year rolling contracts did not become the most common form of contract in the FTSE350 until 1998 when just over 50% of directors had one-year notice periods compared to approximately 45% on two-years' notice. The major change took place in 2001 when 75% of FTSE350 directors had one-year contracts, up from 56% in 2000[21]. Only 23% had a two-year contract down from 42% in the previous year.

In 2000, whilst contract lengths had been declining the cash value of compensation paid to departing directors had increased for all indices over the previous two years. Average compensation amounts stood at around 120% of salary and 90% of total cash remuneration. Among FTSE100 companies, 40% disclosed liquidated damage provisions in 2000, up from 34% in 1999. In the Mid Cap, 29% of companies had liquidated damage provisions, up from 23% in 1999. For the Small Cap, the percentage had fallen to 11% from 15%.

In 2001, average compensation amounts stood at around 130% of salary and 90% of total cash remuneration. The explanation for the increase in compensation at a time of shortening notice periods was that compensation was being paid for more elements of a director's emoluments package than simply salary. As the bonus element of packages was increasing, this pushed up compensation relative to salary.

The trend towards reducing executive contractual notice periods to one year or less continued during 2002. In 1994 notice periods in excess of one year were the norm, held by 70% of FTSE350 directors. This reduced to 43% by 2000 and in 2002, only 16% of executive directors still had a contract with a notice period longer than one year. However, despite the general reduction in contractual notice periods over these periods, with inclusion of 'unearned' cash bonuses in compensation payments, many paid out by companies were still considered excessive.

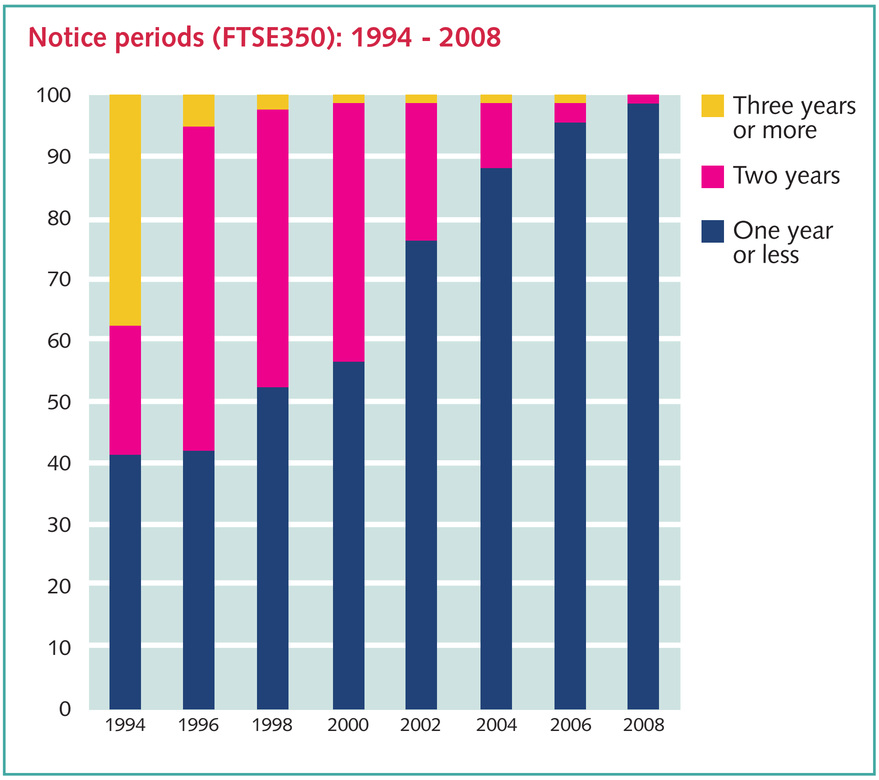


Figure 4 (Source: PIRC)

[21] The Greenbury Report first recommended the reduction of contract lengths to one year or less in 1995, *Greenbury Recommendations,* 1995, D2; B10. The Hampel Committee further emphasised that boards should set as their objective to reduce directors' contracts to one year or less, *Hampel Summary and Recommendations,* 1998, 24 and see 4.9 of the Hampel Committee deliberations. The Combined Code (May 2000), opined that directors' contracts should be one year or less and again reiterated that boards should set this as an objective, *Combined Code (May 2000)* B.1.7. In Schedule B, in the 2000 Combined Code, it is, in addition, specified that "Any service contracts which provide for, or imply, notice periods in excess of one year (or any provisions for predetermined compensation on termination which exceed one year's salary and benefits) should be disclosed and the reasons for the longer notice periods explained." Finally the Combined Code of 2003 established that service contracts should be set to one year or less and that "if it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period." This is the same rule included in the successive Combined Codes.

2 What did the UK Say on Pay vote seek to achieve?

i) Improving the linkage between pay and performance
One of the key aims of the remuneration vote was to improve the linkage between pay and performance. Many investors were not overtly worried about quantum in and of itself, if large rewards mirrored the creation of shareholder value. Such an approach reflected the desire to provide alignment of interests between shareholders and directors as a way to overcome the separation of ownership and control (the principal/agent problem). One way in which this would be achieved, it was argued, was calls for better standards in reporting and transparency in respect of remuneration arrangements.

ii) Empowering shareholders and improving shareholder democracy
A further aim was to empower shareholders such that they were in a more informed position on remuneration. By providing shareholders with a way to influence pay structures the remuneration report vote would improve shareholder democracy at companies as a consequence. Remember the UK Government's key aim when considering the introduction of a vote was to create "an effective and more focused way in which shareholders could influence directors' pay"[22].

The word *influence* is key here; in this view the aim of the vote was not that shareholders should micro-manage companies by setting pay levels and structuring compensation plans. Then, as now, few shareholders had the appetite to get involved in the minutiae of executive pay structures; indeed this was very much the role of the remuneration committee and what shareholders delegate to committee members and entrust them to do.

The aim of the vote was to allow companies to demonstrate how they could align the interests of directors with those of the owners by having transparent, effective pay policies that provide incentives to act in shareholders' interests over the longer term. Whilst shareholders typically do not want to set the detail of remuneration policy, they should have the right to a say on how effective they think remuneration policy is in achieving alignment of interests. Shareholders have the opportunity to *influence* pay policy towards best practice and away from poor practices, in order that such alignment is achieved.

iii) Remuneration committees
Although perhaps not an explicit aim, the introduction of the vote was considered to create greater focus by remuneration committees and for them to have more ownership of the compensation process. It would allow them the opportunity to demonstrate how they are carrying out their duties as agents of their principals.

As a consequence of this, having a vote on remuneration would provide shareholders with an alternative to voting against the remuneration committee members and focus concern in one area.

As an extension of this, the Say on Pay resolution can be considered as a way to 'contain' the concerns which are remuneration based to one resolution, which should be a positive for companies.

iv) Engagement
A final concern was the overall lack of engagement by shareholders on remuneration policies in general. Previously, engagement had been primarily driven through voting activity on individual share incentive plans. This proved somewhat restrictive for discussing remuneration generally, given that focus was on a specific scheme. Overall remuneration practices underpin these schemes but it was difficult to take a more holistic view on remuneration, or object to broad remuneration policy. Addressing incentive schemes in isolation was somewhat limiting and often necessitated taking a view on the scheme and ignoring other contributory factors such as salary sizes (a multiple of which forms the basis of incentive scheme awards). As an extension of this, it was difficult for investors not to let other remuneration practices influence their decision on the schemes themselves.

[22] Speech by Stephen Byers, then Secretary of State for Trade & Industry, to the ABI and NAPF Seminar on Institutional Investors and the Competitiveness of British Industry, 19 July 1999.

3 The UK Say on Pay vote in practice

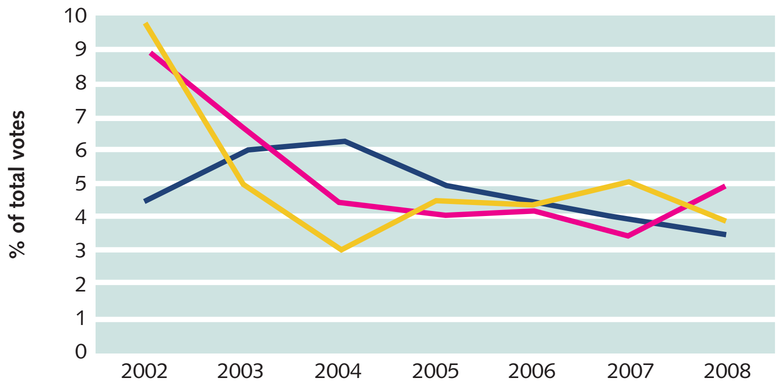
In this section of the report we review the evidence provided by PIRC's annual proxy voting reports to give a sense of how shareholders responded to their newly won voting opportunity.

1) How have investors used the vote?

i) Voting trends in remuneration

Until 2004 PIRC reported on increasing opposition votes on remuneration report adoption at FTSE350 company meetings relative to the level of support for share-based executive share option schemes (ESOSs) and long-term incentive plans (LTIPs). However, from 2005 to the present, the trend has been one of convergence on a stable level of opposition. Figure 5 shows that the average level of opposition for remuneration reports has fallen by 1.5% to 3.54%, whereas the average level of opposition for LTIPs has risen by 1% to 4.9%.

Average oppose vote, remuneration issues



	2002	2003	2004	2005	2006	2007	2008
Remuneration report	4.5	6	6.3	5.1	4.3	3.9	3.54
LTIP	9	6.8	4	4	4.2	3.5	4.9
ESOS	9.8	5	3	4.5	4.4	5.04	3.9

Remuneration report — LTIP — ESOS

Figure 5 (Source: PIRC)

ii) Top 5 remuneration issues year-on-year

Figure 6 (Source: PIRC)

	2002	2003	2004	2005	2006	2007	2008
1	Excessive payout potential	Excessive severance payout	Unchallenging targets	One-off award	Unchallenging targets	Lack of disclosure regarding performance targets.	Golden hello
2	Option scheme for non-executive director	Breach of US dilution limits	Lack of disclosure regarding performance targets	Excessive liquidation damages	One-off cash bonus	Excessive severance payout	Excessive severance payout
3	Breach of dilution limits	One-off option award	Excessive severance payout	Lack of disclosure regarding performance targets	One-off award	Unchallenging targets	Unchallenging targets
4	Breach of US dilution limits	Excessive severance payout	Unchallenging targets	Golden hello	One-off award	Unchallenging targets	One-off award
5	Breach of US dilution limits	Unchallenging performance conditions/excessive severance payout	Lack of disclosure regarding performance targets	Unchallenging targets	Breach of dilution limits	Excessive liquidation damages	Unchallenging targets

Excessiveness   One-off award   Disclosure   'Challengingness'   Contracts   Dilution

Please see Annex for the companies involved and a brief description of the issues.

From Figure 6, the following summary trends in shareholder voting on remuneration can be seen:

- Protest votes regarding the breaching of dilution limits have declined over time as a reflection of more compliant practice.
- There is an increasing focus on the disclosure and "challenging" nature of targets after 2004, most likely in light of increased company performance as economic conditions improved and higher disclosure expectations following the introduction of the remuneration vote in 2003.
- There has also been a growing intolerance towards one-off awards, although this could also be exacerbated by the increased use of one-off awards to retain and recruit talent during improving economic conditions.
- Particularly from 2005, there has been a growing level of opposition to both one-off awards and the level of potential and actual severance payments.
- In the wake of the financial crisis, early indications from the 2009 season suggest a significant upsurge in opposition to remuneration reports in general.

2) How have companies responded?
Companies have, in some cases, used the vote as an opportunity. It is worth noting that most firms do not have egregious pay practices and have a good story to tell in terms of their remuneration practices.

For these companies the vote has become an opportunity to gain shareholder endorsement of their pay practices. Such goodwill serves companies well when changes are proposed, or there is an issue of concern raised, in subsequent years.

Generally, anecdotal evidence suggests that there has been a more focused engagement process for companies and an increase in engagement activity with their owners. The role of the remuneration committee seems to have been enhanced as a result of the DRRR. From some investor experiences, it has forced members of such committees to take ownership of the remuneration policy and structures, and it is obvious when this is the case, and when it is not. Whilst remuneration consultants have their part to play in terms of structuring remuneration plans, it is the remuneration committees who should make the decision about whether or not a plan is acceptable. The remuneration consultants advise the committees, but of course the committees do not have to take their advice.

i) Consultation
Consultation with shareholders has been another positive outcome of the vote process. Companies have embraced consultation and, of course, used it to their advantage, though it should be clearly understood that undertaking consultation does not always mean a 'yes' vote. Sometimes, an incentive plan which does not meet best practice criteria is proposed as an opening gambit. There will be features within it that companies must know investors will object to. Therefore, shareholders have to be careful not to interpret a shift from this opening position towards best practice as a 'win'. The 'revised' scheme could be what the company wanted all along, but it had put forward a less acceptable version initially in order to 'manage' the consultation process.

As suggested above, some companies apparently think that simply because they have consulted, they are going to achieve shareholder endorsement for their remuneration policies and practices. In fact, some companies become quite aggravated when they have consulted with shareholders and still face disagreement. But this is the shareholders' prerogative. There may always be issues that shareholders object to, and if those elements are in the final plan arrangements, then we are always going to vote against.
A further point for consideration is that disclosing that a company has consulted with shareholders does not automatically infer that shareholders have given their consent to the proposals.
An additional point is to consider the representative nature of the bodies who have been consulted.

ii) Defeat of the remuneration report vote: GlaxoSmithKline plc
Whilst not the only company to have its remuneration report resolution defeated – witness the number and level of defeats in the 2009 proxy season alone[23] – the significance of the defeat of the remuneration report resolution at GlaxoSmithKline (GSK) in 2003 should not be underestimated. GSK was the first company to have its remuneration report defeated by its shareholders and this served to raise the profile of the remuneration report resolution and, by extension, the debate about executive pay in general. As a consequence, the remuneration report resolution was firmly established as a key aspect of the UK governance landscape.

The concerns at GSK related to the golden parachute provision within the pay arrangements for then chief executive, JP Garnier, with respect to the two-year contract provisions that GSK had agreed with him, and the US pay characteristics of the pay structure, such as a lack of performance linkage.

There was 50.7% opposition to GSK's remuneration report vote with another 10% of shareholders abstaining from voting. The total dissent of 61% made the GSK vote the highest opposition to a remuneration report at a UK company since the advisory pay vote was introduced.

In response to this vote result, and the concern expressed by a majority of the shareholders who voted, the company announced a fundamental review of all aspects of its remuneration policy and practices by Deloitte & Touche.

Subsequently, GSK overhauled its remuneration plan for 2004 after extensive consultation with shareholders and their pay consultants. The company continues to make changes to its remuneration policies as its business evolves and in 2009, prior to their 2009 AGM, a further review was undertaken by the company in order to implement changes to the company's remuneration practices, with a shift towards UK style packages for their new chief executive and their chief financial officer.

[23] 2009's proxy season is proving unprecedented in the frequency with which companies are facing strong opposition to their remuneration practices (for example, on 3 April 2009, Royal Bank of Scotland was defeated by 90.4% of shareholders voting against the resolution; and on 19 May 2009 Royal Dutch Shell saw its remuneration report resolution defeated when nearly 60% of its shareholders did not support the remuneration resolution. Two other companies have had the remuneration resolution defeated (Bellway plc and Provident Financial plc). The remuneration resolution at Amec plc and Tomkins plc have passed on minority support, ie, if abstention votes are included, the votes in favour were under 50% of the total votes cast.

4 What has been the impact on executive pay?

i) Post vote: general pay trends
Tracking levels of executive director salaries from 2000 to 2008, Figure 7 reflects a relatively sharp drop in fixed-base salaries from 2006 onwards. This is likely explained by an apparent increase in variable performance based bonus and share incentive remuneration (see Figures 8 - 12). The move to a higher proportion of performance dependant pay can be seen as a corollary of increased shareholder engagement since the introduction of the remuneration vote that had equipped shareholders with a portal to express concerns that remuneration should have a higher proportion of pay linked specifically to the performance of the company and its associated objectives.

The effect of the global market downturn in 2001/2 manifested a relative drop in the level of bonuses awarded to directors in 2002. This resonated earlier for Small Cap companies that saw bonuses drop consecutively from 2000 to 2002. Figure 8 also exhibits a sharp increase in bonus awards for Mid Cap companies from 2006, which corresponds with an associated decrease in base salaries from 2006. These caveats aside, over an eight-year period, the general trend has been for cash bonuses to increase significantly, with Small Cap awards increasing by 100%, Mid Cap companies a shade under 250% and FTSE100 companies by approximately 200%.

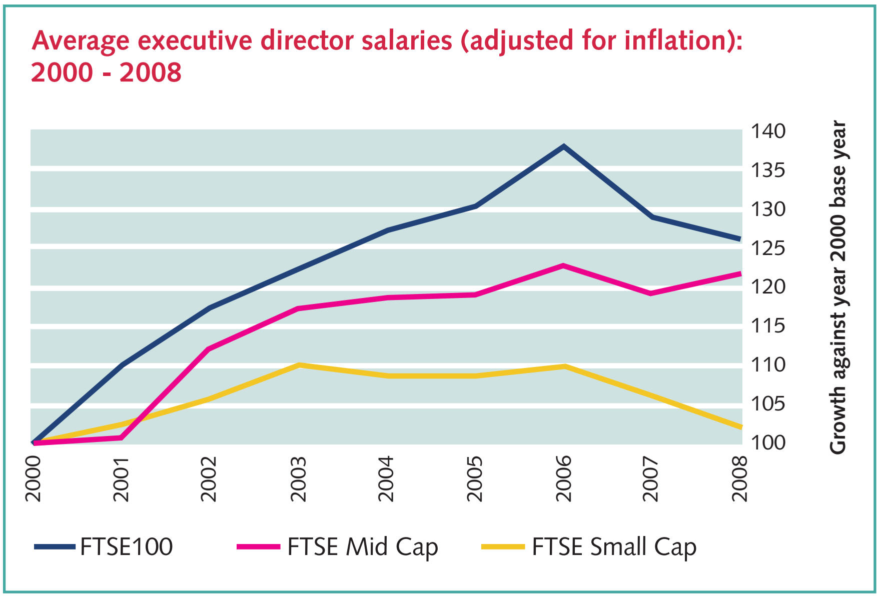


Figure 7 (Source: PIRC)

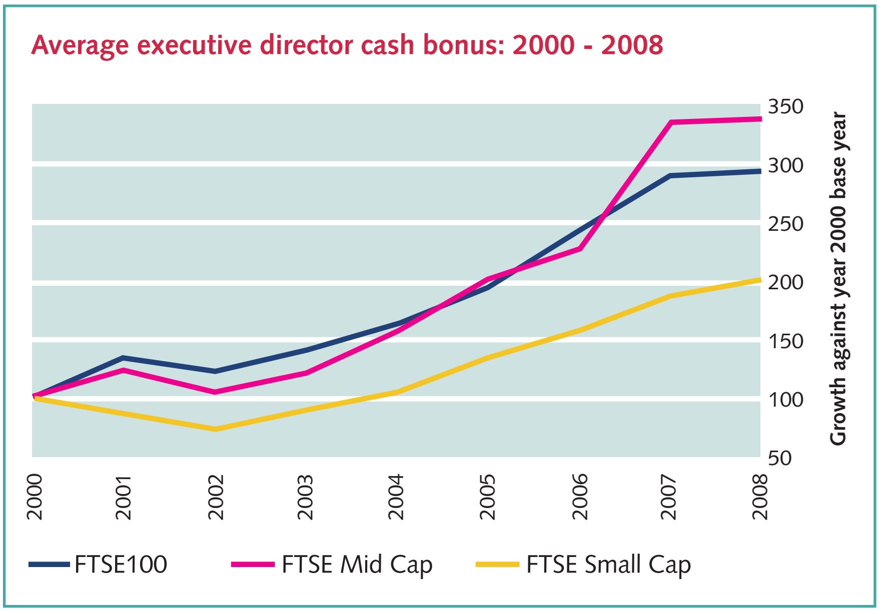


Figure 8 (Source: PIRC)

Average executive director total cash remuneration (adjusted for inflation): 2000 - 2008

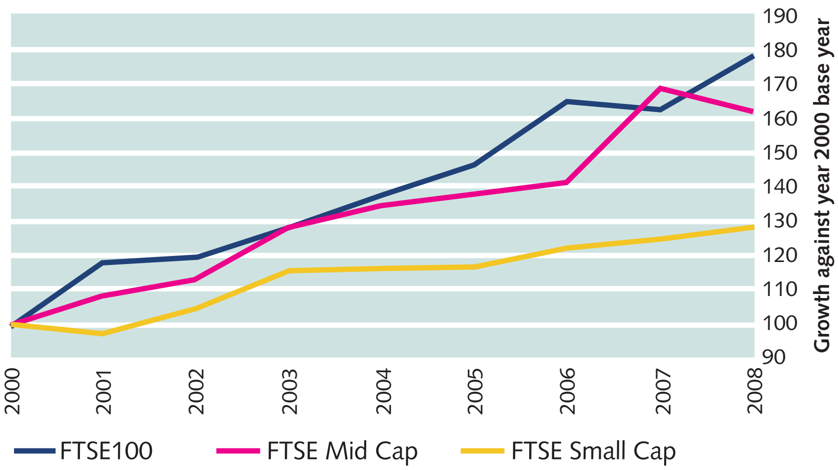


Figure 9 (Source: PIRC)

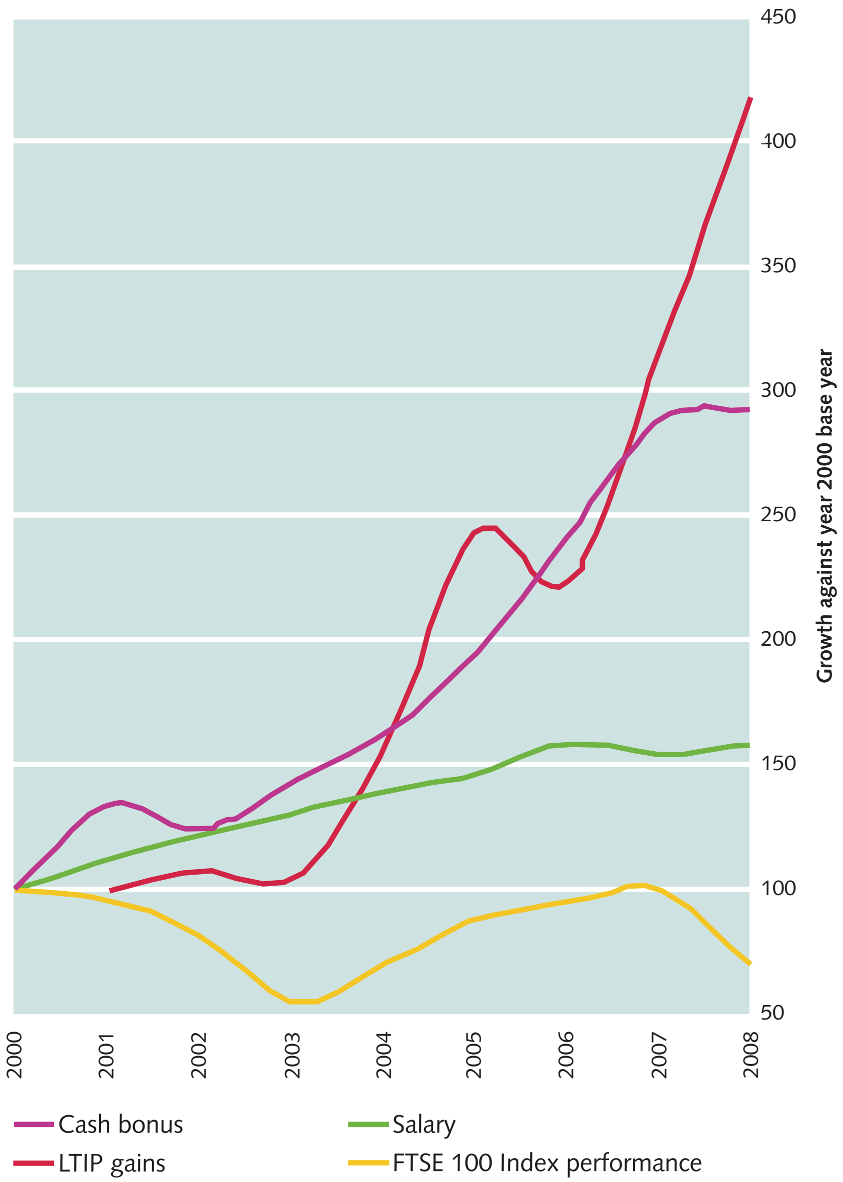
With the exception of Small Cap companies, Figure 9 reveals that total cash remuneration for the top 250 listed companies continued to increase through 2000 – 2002 despite the global market crash that had affected the economy. This occurred notwithstanding bonus payments dropping in the same period, indicating that companies increased the proportion of base salary and cash benefit payments in the same period.

Whilst a fractional drop in LTIP gains occurred concurrent to the nadir of the 2003 market crash, Figure 10 indicates that the preceding three years had seen salary, bonus and LTIP gains gradually increase as the FTSE100 index performance depreciated at its sharpest rate.

More intriguing perhaps is that LTIP gains grew significantly in 2004 and 2005, when the retrospective preceding three-year performance period would have included the downturn years of 2002 and 2003. The relatively steady 40% appreciation in index performance from 2003 up to 2007 saw LTIP gains and bonus awards grow approximately 300% from 2003.

Figure 10 (Source: PIRC)

FTSE100 - average executive director total remuneration against FTSE100 Index performance: 2000 - 2008



FTSE Mid Cap – average executive director total remuneration against FTSE250 Index performance: 2000 - 2008

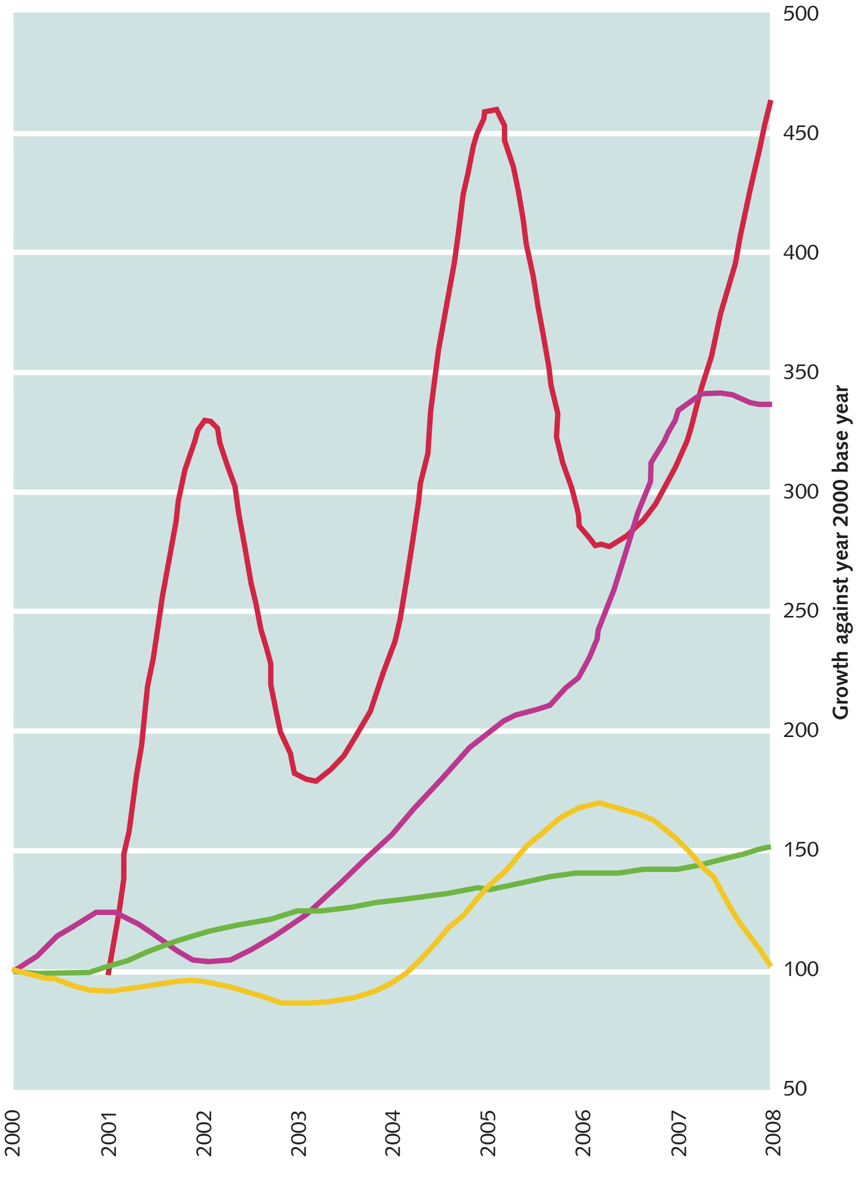


Figure 11 (Source: PIRC)

In a similar fashion to the FTSE100, we can see from Figure 11 that Mid Cap companies saw a drop in LTIP gains concurrent to the nadir of the 2003 market crash, although in the preceding year LTIP gains had spiked with a considerable 350% year growth. Mid Cap companies show some evidence of being more responsive to the market during 2002, during which bonus awards dropped in line with trend of index depreciation. The market turnaround from 2003 to 2007 which had seen the index appreciate approximately 80% was met with a partially correlated rise in bonus awards and LTIP gains. However, in a similar vein to FTSE100 companies, the 2005 spike in LTIP gains presents something of a misalignment between pay and performance, given that the preceding three-year performance period included the downturn years 2002 and 2003. Although perhaps the most striking performance pay misalignment occurred during 2008, in which LTIP gains rose approximately 150%, bonus awards held at 2007 levels and base salaries increased, over a year in which the index returned full circle to year 2000 levels.

FTSE Small Cap – average executive director total remuneration against FTSE250 Small Cap performance: 2000 - 2008

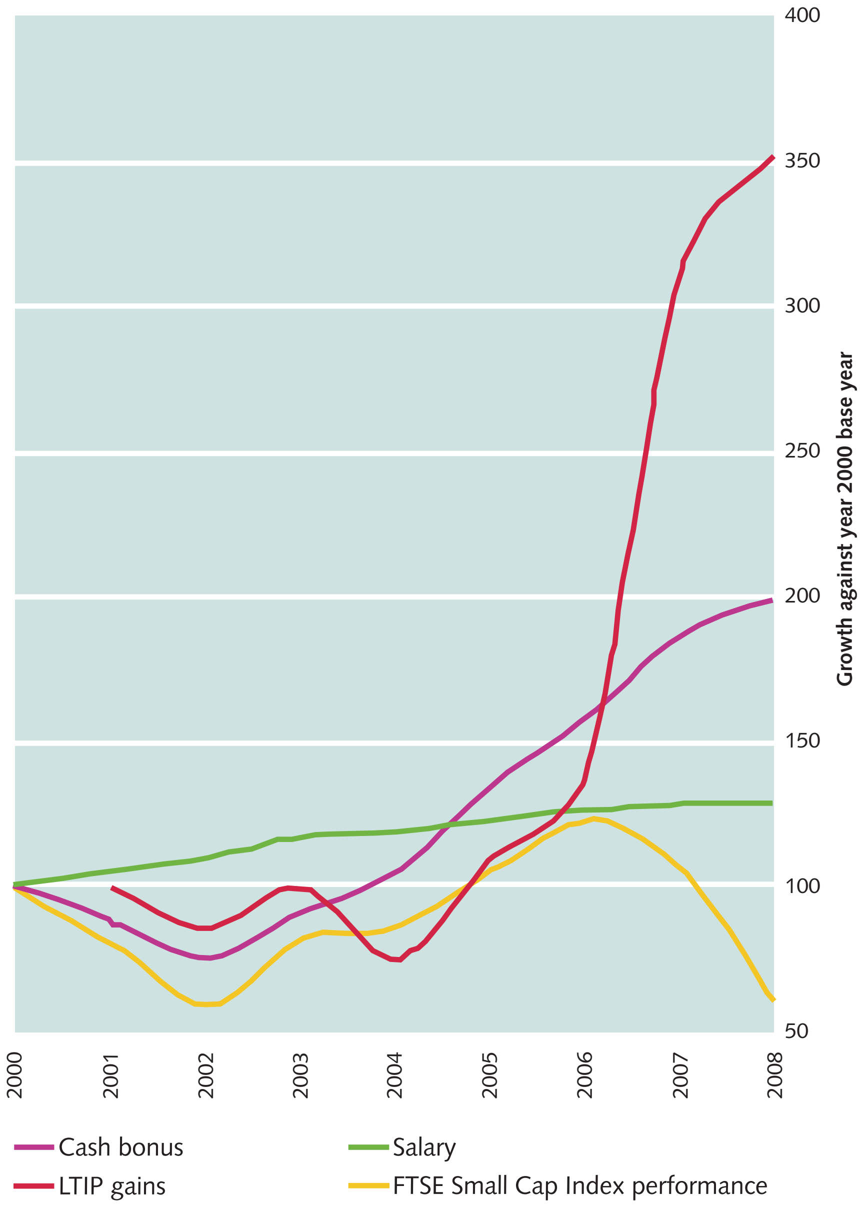


Figure 12 (Source: PIRC)

Relative declines in bonus awards and LTIP gains up to 2002 were positively correlated with the market crash of the time, which bottomed out a year early for Small Cap companies, per Figure 12. The significant market turnaround up to 2006, which had seen an approximate 60% appreciation in index performance, was matched with relatively modest growth in salary and bonus payouts.

However, the market turnaround was clearly recognised by the growth in vesting of LTIP awards in 2007 and 2008. The only major performance pay misalignment for Small Cap companies is recognised by the growth in bonus payouts during 2007 and 2008 over a period in which the respective index fell approximately 80%.

ii) Post vote: general pay trends plotted against index performance
Rebased to 2000, Figure 13 reveals an inverse correlation between the performances of the FTSE AllShare next to the level of total executive cash remuneration from 2000 – 2008. The disparity is particularly evident most recently in 2008. Across the eight year period, a 30% drop in the FTSE AllShare Index was accompanied by an inversely related 80% increase in average executive total cash remuneration for FTSE100 companies, 60% for Mid Cap companies and a 30% increase for Small Cap companies.

When the respective index performance is extrapolated and inserted next to each respective market cap, we are able to compare the levels of total cash increases next to their specific index performance.

The divergence is most evident for the FTSE100 (Figure 14), which saw companies increase total cash payments to executives by approximately 80% next to a corresponding 30% depreciation of the FTSE100 in the same eight-year period.

Average executive director total cash remuneration against FTSE AllShare performance

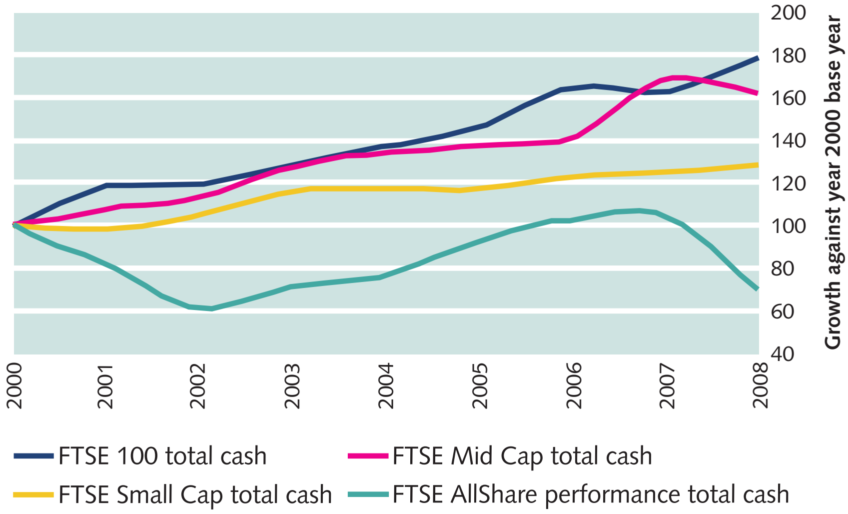


Figure 13 (Source: PIRC)

Average FTSE100 executive director total cash remuneration against FTSE100 performance: 2000 - 2008

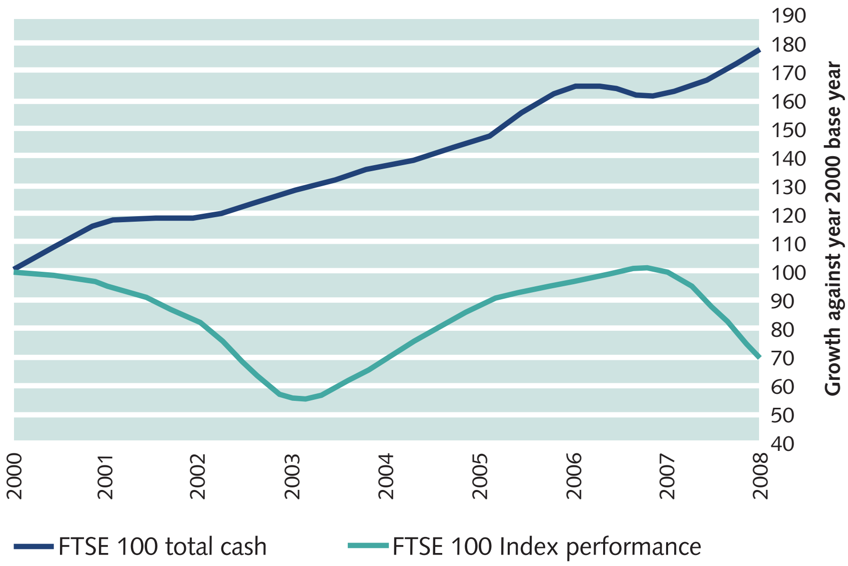


Figure 14 (Source: PIRC)

Average FTSE Mid Cap executive director total cash remuneration against FTSE Mid Cap performance: 2000 - 2008

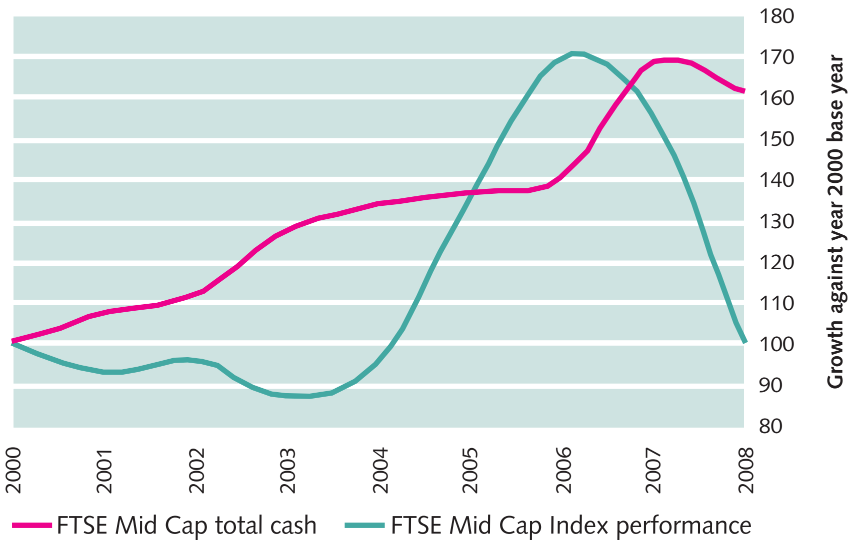


Figure 15 (Source: PIRC)

Average FTSE Small Cap executive director total cash remuneration against FTSE Small Cap performance: 2000 - 2008

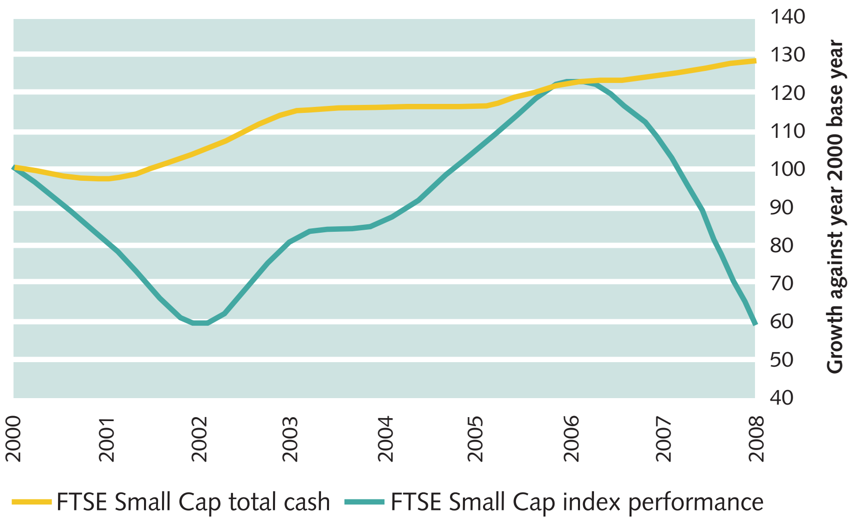


Figure 16 (Source: PIRC)

For Mid Cap companies (Figure 15), a general upward trend in total cash payments corresponded with a stagnant slide in FTSE Mid Cap index performance up until 2003, when the index outperformed and surpassed total cash increases for 2005 and 2006. This may explain the sharp increase in bonus payments from 2006 to 2007 for Mid Cap companies displayed in Figure 11. The depreciation of the Mid Cap index from 2006-2008 back to 2000 levels, saw total cash payments drop by 10% from 2007 to 2008.

A similar trend is exhibited by Small Cap companies (Figure 16), with the exception that total cash payments dropped in hand with the index from 2000, and increased just as the index turned in 2002. From 2002, significant outperformance of the Small Cap index up until 2006 was matched with modest growth in total cash payments. These caveats aside, total cash payments finished up 30% whilst the respective index finished 40% down.

iii) Post vote: trend in the level of incentive share schemes introduced

From Figure 17, it appears that although there is a declining trend between 2001 and 2003 in the number of schemes introduced, there is a positive spike between 2004 and 2006, before it returns to a steady rate of 65 schemes per year. The number of incentive share schemes introduced during the year can be explained by either the renewing of previous schemes that had expired, or by updating the remuneration structure to align further with best practice. Given that this sudden increase follows the introduction of the remuneration vote in 2003, this suggests that it was a result of updating remuneration structures, in order to meet any resistance that may have been expressed by shareholders in the previous year.

iii) Post vote: structure of remuneration: movement from executive share option schemes options to long-term incentive plans

As Figure 18 illustrates, between 2000 and 2008 there was a clear movement away from the use of option schemes towards LTIP share awards (or nil-cost options) and share matching schemes. This is partly explained by the growing unpopularity of share option awards following most company share prices becoming underwater after the slump in 2002, making options ineffective at incentivising directors. From 2003, more than half of all schemes introduced during the year were LTIPs as they became normal market practice. 2003 onwards also saw a small increase in the number of share matching (or bonus deferral schemes) that were introduced, which reversed by 2007, implying that following the introduction of the vote in 2003, companies were more innovative in considering their remuneration structure.

Number of incentive share schemes introduced each year – 2001 - 2008

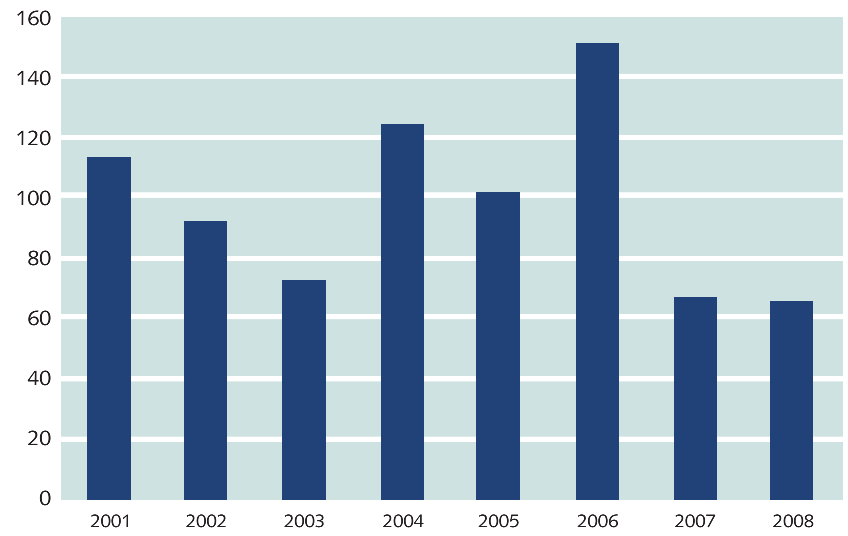
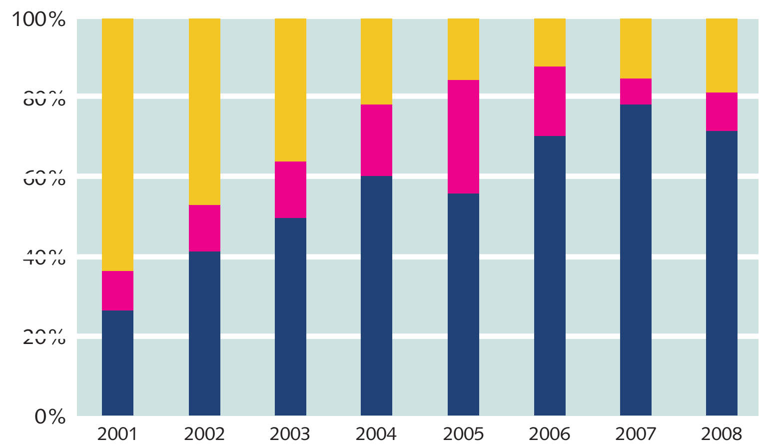


Figure 17 (Source: PIRC)

Incentive share schemes introduced during by year, by type



	2001	2002	2003	2004	2005	2006	2007	2008
ESOS	72	43	26	27	15	18	10	12
Matching shares	11	10	10	22	29	26	4	6
LTIPs	30	38	36	75	56	107	52	47

ESOS Matching shares LTIPs

Figure 18 (Source: PIRC)

5 Results

1) Has the introduction of the vote met its broad objectives?
The current economic situation has heightened concerns about egregious pay practices. It is important to note that the structures of investment banking pay, where bonuses play a very significant role, are different from the pay policies applied to executive directors of other companies. Nonetheless, it is certainly true at the time of writing that the question of executive pay in general is once again attracting much scrutiny.

This debate is an important one and has led to renewed focus on pay at different levels within companies, and a more general discussion about what are fair and equitable pay policies. One area of growing concern is the differential between pay of the CEO compared to pay for the average employee. Evidence demonstrates that this disparity has increased significantly in recent years. Therefore, a realistic appraisal is required of the successes and failures of shareholder engagement over pay spurred by the introduction of the advisory vote.

There have certainly been many positive outcomes from the introduction of an advisory, non-binding vote on remuneration:

- Having a vote has been valuable in terms of increasing and enriching the dialogue between investors and the company. There is now a more sophisticated debate taking place.

- Disclosure has improved such that shareholders now have more transparent information than before the regulations were introduced.

- The vote has provided a common platform to engage with companies. It has improved shareholder democracy in terms of taking a view on remuneration.

- It can be seen to have de-personalised the issue of remuneration, drawing the focus away from remuneration committee members generally, and votes against directors as members of the remuneration committee are now used in extremis.

- Having a vote has focused more attention on remuneration, and, as a consequence, executive compensation can be taken as a proxy for good governance generally. If the compensation policies and practices demonstrate a strong alignment of the interests between shareholders and directors, it can be generally inferred that other corporate governance structures support this alignment and facilitate the protection of the long-term interests of shareholders. It is also important to observe that there is now more focus on remuneration by financial analysts.

2) But pay continues to go up
However, we cannot ignore that overall pay levels continue to increase. Furthermore, in the current economic environment, even more emphasis is being placed on fair pay practices, the alignment of interests and performance linkage. Investors will expect awards to only become payable for performance that has created value and will not take kindly to rules being pushed to accommodate the different economic environment. Witness the defeat of the remuneration report at Bellway plc, in January 2009, where bonuses were paid out to executives despite performance criteria not being met; 59% of shareholders voted against the remuneration report, a resounding defeat of the resolution[24].

The quantum question is a difficult one; it has many facets to it, the first being that it is quite difficult to determine that a specific amount is too much money. For all the remuneration benchmarks in existence, few commonly-utilised metrics say simply: "this amount is too much." As an extension of this, an amount is 'too much' relative to what? Through experience, shareholders develop a sense of when an annual bonus of six or seven times salary on an annual basis is probably too generous. Companies, hopefully, appreciate that as well. Most shareholders do not have any issues with high levels of pay if those high levels have been generated through exceptional performance and shareholders have experienced high levels of value creation. Exceptional performance can justify exceptional pay, but the real question is whether performance is truly exceptional. Therefore, the focus has been on seeking performance linkage.

Quantum cannot be considered without a discussion on the sources of pressure on pay levels. One observation is that a key pressure on executive salaries is *other executives' salaries*; this goes back to one of the unintended consequences of remuneration reporting in that pay levels are now much more transparent, together with the structures that underpin and generate those pay levels.

[24] http://www.bellwaycorporate.com/pdf/RNS_AGM_results.pdf

If there is a well-functioning market, this determines the 'going' rate for an executive director.

Another feature is how remuneration at executive level is linked to pay in other parts of the organisation. There have been some changes to the Companies Act provisions in the UK, which now require remuneration committees to state 'how' they take into account other pay within the organisation when setting the pay levels for executives[25]. Certainly, when you have a pay freeze for most of the workforce, but the executive salaries continue to increase, that seems quite a disconnected way to provide incentivisation for executive directors.

There are also outside pressures, but UK shareholders have, by and large, managed to dismiss most of these arguments:

- A few years ago there was a perceived risk of UK executives going to work in the USA if they did not get US-style pay. The reality is that there are other reasons why people work in the UK apart from the fact that they do not get US-style pay packages.
- Subsequently, it was argued that UK public companies needed to offer private equity style pay packages, to provide enough incentive for directors to keep companies on the public market. Often, there was little acknowledgement of the major downside risks faced by executives in private equity-owned businesses, which can lead to personal bankruptcy if the business fails. In addition, employment prospects in the private equity world look slightly less attractive since the credit crunch.
- In 2008, companies argued that they needed to pay one-off retention payments to executive directors because none of the long-term performance schemes have paid out. It was recognised that such propositions fundamentally undermined two of the key purposes of effective remuneration systems: the concept of pay for performance and the alignment of interests of shareholders and directors.

Investors have a duty to work through the myths and realities of executive pay whilst being cognisant of the need to reward entrepreneurial talent and risk taking, and foster a culture of long-term wealth generation. It is a fine line, and there are certainly legitimate pressures on executive pay. However, in terms of retention payments in 2009, this seems quite a perverse argument now. It exacerbates the concern that companies are willing to overlook the most basic principle of performance-related rewards – if the performance criteria attached to awards has not been satisfied, then awards should not become payable, except in the truly exceptional circumstances.

3) Shareholders getting too involved

A final criticism of introducing a shareholder vote on remuneration is that investors will then be expected to get involved in the minutiae of executive compensation. However, this is misconception for two principal reasons:

- The advisory vote on pay covers a range of compensation issues above and beyond the structure of incentive plans, such as salary, pensions, and overall policy on compensation matters. For example, it is helpful to be able to take a view on the level of disclosure on all these matters Furthermore, the vote covers practices that have been undertaken in the year under review, as well as proposals for the future, so it is all-encompassing in terms of compensation practices.

  The remuneration vote is an effective vehicle to demonstrate general support for compensation policy whilst concerns about the actual mechanics of incentive plans can be voiced through the vote on the actual plan itself.
  As many incentive plans in the US do not have performance targets applied, shareholders may decide to vote against the plans because of the absence of performance linkage. Therefore, a vote on pay would allow shareholders in US companies to demonstrate to the company whether it is the overall pay policy they have concerns with, or whether the overall policy is generally good (and a vote in support is registered) whilst voting against pay plans themselves, and thus confining concerns to one area. This complementary approach also works vice versa.
- Not all companies demonstrate poor pay practices; and not all investors will have exposure to all companies in the USA. So it will not be necessary for investors to undertake detailed analysis of every single compensation plan, and certainly in the UK, we do not spend extended periods on every single FTSE company because for the majority of cases, there are no issues of concern. The egregious practices are what take up the time and effort, and this is merited.

[25] The new requirement for quoted companies to report in their directors' remuneration report on how they have taken pay and employment conditions elsewhere in the group into account when setting directors' pay (in paragraph 4 of Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008) will have to be included in reports for financial years beginning on or after 6 April 2009. See Schedule 8: Quoted Companies: Directors' Remuneration Report - Part 2, Section (http://www.opsi.gov.uk/SI/si2008/draft/ukdsi_9780110806303_en_26#sch8)

6 Conclusions

The UK's experience of having a resolution to enable shareholders to vote on remuneration provides many valuable lessons for the US market. Since the introduction of the vote, engagement has been based on a more rounded understanding of remuneration. This enriches both the company and the investor experience. It allows an informed debate to take place about the nature of compensation plans, their structure, the degree of alignment garnered through the plans and importantly, how it supports the company's strategy. It moves the engagement discussion from simply a vote on plan details to a more relevant debate about remuneration practices in the round. However, there is an important point to make here: the remuneration vote has facilitated better engagement with companies but the vote and engagement should not be seen as mutually exclusive. The vote is the first tool in the process. However, engagement without voting is engagement without teeth and cannot be taken as an alternative to voting. They must go hand in hand.

Pay for Performance
One of the main benefits of the vote is that it has strengthened the pay for performance culture; this was one of the major drivers of the vote's implementation. Previously, performance and pay had not been as closely related. Sir Christopher Hogg, Chairman of the Financial Reporting Council and Chairman of GlaxoSmithKline at the time of the defeat of their remuneration report resolution in 2003, observes:

"The vote forced a focus on pay for performance. It was definitely a step in the right direction. Even though the vote is only advisory, it does have an impact – boards are not insensitive to the consequences of a defeat or a high vote against and are very aware of the message that is being sent by shareholders."[26]

Rewards for Failure
The reduction in service contract lengths for executive directors has significantly reduced the risk of so-called 'rewards for failure'. It was somewhat galling for shareholders to witness executives being paid a contractual amount equivalent to their notice period in order that they no longer serve on the board of a company with immediate effect, when the stewardship of the company under that director's tenure had destroyed long-term shareholder value. However, the furore over the pension paid to Sir Fred Goodwin, previously the chief executive of Royal Bank of Scotland, has reinvigorated this concern and turned the spotlight on pension provisions for executive directors as a source of potential 'payment for failure'[27]. Focus will now turn on the disclosure of pension benefits and the practices endorsed by companies in terms of the pension provision for executive directors. Proposed UK tax changes on pension contributions for high earners may well have a further effect.

Empowering Remuneration Committees
Anecdotal evidence suggests that the vote can be used as a way for non-executives and remuneration committee members to refuse unreasonable or unrealistic demands from executives on remuneration matters. The vote has made the consequences of pay decisions more acute for companies, and the responsibilities and accountability of the remuneration committee have become more visible. Ishbel Macpherson, Chair of the Remuneration Committee of Speedy Hire plc, a UK Small Cap company, observes:

"As Chair of a remuneration committee, I value the fact that there is an annual advisory vote on the remuneration report at the annual general meeting. It has made companies more disciplined in their approach to the reward structure of senior executives. In certain companies it can provide a brake on demands from a domineering executive team and leads to greater engagement with shareholders."[28]

[26] Interview with the authors of this report, 2009.
[27] In early 2009, there was much public concern and debate over the arrangements for an annual pension amount of £703,000 a year to be paid to Sir Fred Goodwin upon his early retirement as chief executive of Royal Bank of Scotland at the age of 50. Royal Bank of Scotland is now owned predominantly by the UK Government after it was bailed out by taxpayers' money. Subsequently, on 18 June 2009, the company announced that Sir Fred Goodwin had agreed to a reduced amount of £342,500 per annum (http://www.investors.rbs.com/news/releasedetail.cfm?ReleaseID=397764).
[28] Ibid.

Aligning interest: the significance of remuneration
We see Say on Pay as an opportunity for companies to demonstrate how they are using compensation structures to achieve alignment of the interests of directors with shareholders. We expect that a further outcome of the introduction of a shareholder vote at US companies will be improved, and more transparent, disclosure within the Compensation Disclosure and Analysis section of annual reports and the Securities and Exchange Commission has already pressed for the use of plain English[29]. This would put shareholders in a more informed position to make effective and meaningful voting decisions. There are positive benefits for companies in such developments. Most firms do not have egregious pay practices and have a good story to tell. A vote on remuneration would provide US companies with the opportunity to gain shareholder endorsement of their pay practices. The value of the goodwill created in such cases should not be underestimated and often serves the company well, especially when they are proposing changes, or there is an issue of concern on compensation, in subsequent years.

Many investors see remuneration as a proxy for good governance generally. If there are well-structured remuneration practices in place which facilitate the alignment of interests between shareholders and directors, this can be an indication of a company that pursues good governance structures in the long-term interests of shareholders.

As Sir Adrian Cadbury observes:

"Say on Pay promotes dialogue between investors and boards and encourages investors to engage with boards on a readily understandable issue, where interests may conflict. It is also a litmus test of how far boards are in touch with the expectations of their investors."[30]

Shareholder activism: how active?
Given the low level of votes against remuneration reports prior to the current spike in opposition, we would query whether shareholders in UK companies have used the rights granted to them effectively. As discussed earlier, the vote is a core element of shareholders' engagement with companies. In our view, Say on Pay will only have an impact if shareholders are prepared to vote against companies; furthermore, the right to vote on remuneration is accompanied by obligations to engage with companies. As Ralph Barber, group company secretary at HSBC observes:

"Having a vote on the remuneration report each year underpins institutional shareholders' rights and obligations to engage constructively on remuneration issues in the interests of the ultimate investors they and the directors serve."[31]

Enshrining a right to vote on pay for investors in US companies will not end the debate about executive pay, and it will not end examples of egregious practice.

However, we firmly believe it will enhance shareholder oversight where it is currently weak, improve the dialogue between companies and their investors on remuneration, and help address the worst practices for the benefit of all concerned. There is nothing for companies to fear, and much for them, and their shareholders, to gain.

[29] Speech by then SEC chairman Christopher Cox: 'Plain Language And Good Business' Keynote Address To The Center For Plain Language Symposium, 15 October 2007.
[30] Ibid.
[31] Ibid.

7 A question for the UK: where do we go from here?

"Shareholders have had an advisory vote on companies' remuneration reports since 2002. However, our evidence suggests that this advisory vote has largely failed to promote enhanced scrutiny of, or provided an effective check on, remuneration policies within the sector. We believe the time is now ripe for a review of how institutional investors with holdings in the financial services sector have exercised these rights. We expect the Walker Review on corporate governance in the banking sector to examine this issue as part of its work."

Banking Crisis: reforming corporate governance and pay in the City, House of Commons Treasury Committee, Ninth Report of Session 2008-09, 12 May 2009

The banking crisis has forced a debate about the role of corporate governance within the financial sector, and specifically the impact of remuneration systems which may have perversely incentivised excessive risk-taking by banking executives. This leads, in turn, to a wider debate about how the vote on remuneration has been utilised since it was introduced in 2002, and the efficacy of the powers it has given shareholders. In this context, three notable observations are:

- The vote has not addressed the *appropriate* levels of pay for performance achieved, and we have shown that the total remuneration for directors of the UK's largest companies has continued to rise rapidly. Enhanced disclosure runs the risk of the so-called 'ratcheting' effect but increased transparency is nevertheless preferable to continuing opacity.
- The difference between pay at the top of a company and pay for others employed in the lower echelons of an organisation has generally not been debated. This is becoming a more pressing concern for some investors now, and a requirement for such consideration by companies was introduced in the Companies Act 2006[32].
- The format of the advisory vote on pay is being questioned; in a recent speech, Lord Myners, UK Financial Services Secretary, asked whether the vote should "continue to be advisory, or should it have some mandatory element?"[33]

These are important considerations; for if the purpose of the remuneration report in the UK is to remain relevant and current, debate must consider these matters. A key focus should be how the powers entrusted to shareholders and directors through the remuneration report vote translate into remuneration systems that provide true alignment of the long-term, and sustainable, interests, of these two parties. Real progress has been made in the UK since the vote on pay was introduced in 2002. However, recent events have indicated that the remuneration report vote must be underpinned by a more robust system of dialogue and engagement between shareholders and directors, where both are accountable for the actions they take.

[32] Ibid. Schedule 8: Quoted Companies: Directors' Remuneration Report - Part 2, Section 4
[33] Lord Myners, Association of Investment Companies Annual Conference, 21 April 2009.

Appendix A: Top UK remuneration-related oppose votes: 2002-2008

a) Top 5 UK remuneration-related oppose votes by company during 2002

	Company	Proposal	Opposition	Explanation
1	Prudential	Adopt Prudential executive share plan	41%	The scheme came in for considerable criticism in terms of its total potential payout, variously estimated at between £3 million and £6 million per annum for chief executive Jonathan Bloomer, for achieving top performance. PIRC regarded the scheme as overly complex, with a reward at median performance equivalent to 90% of the chief executive's salary. In the face of opposition the proposal was withdrawn.
2	TR European Growth Trust	Approve the share scheme for Stephen Peak	40%	Shareholders raised concern over the remuneration arrangement of Stephen Peak, a non-executive director at TR European Growth Trust, who was remunerated by the fund managers. The maximum award under the scheme was limited to 100,000 options each year with an overall maximum of 500,000. The options were subject to undisclosed performance conditions and were to be issued at a premium of 20% to the share price.
3	Anite Group plc	Approve the amendments to the LTIP performance targets.	41%	PIRC corporate governance analysis highlighted that a number of aspects of the schemes did not reflect best practice, notably a lack of information on performance targets and the breach of agreed institutional dilution limits.
4	BAE Systems plc	Approve BAE Systems SAYE share option scheme 2002	33%	Most investors support the operation of SAYE schemes that are within the accepted dilution limits of 10% in ten years because, in principle, they allow all employees to benefit from business success. However, the high oppose vote was largely due to US shareholders' opposition to the 'dilutive' nature of the proposals.
5	BAE Systems plc	Approve BAE Systems SAYE share incentive plan	32%	As above.

b) Top 5 UK remuneration-related oppose votes by company during 2003

	Company	Proposal	Opposition	Explanation
1	GlaxoSmithKline plc	Receive the remuneration report	51%	This was the first time a company's remuneration report had been voted down as a resolute of investor sentiment towards a policy which included a potential severance payment of up to $20m for the chief executive, Dr Garnier.
2	BAE Systems plc	Approve the remuneration report	49%	The bulk of the opposition came from shareholders following a US proxy agency's recommendation to oppose. The recommendation was followed despite BAE's employee plans being within UK institutional guidelines on dilution.
3	Emblaze plc	Approve the directors' remuneration	41%	The Israeli-based but UK-listed group put forward a resolution authorising the issuing of options to its chief executive of up to 2.9% of the issued share capital. Although not required to seek authorisation under UK rules, Israeli law requires one-off grants to be approved by shareholders.
4	Shire Pharmaceutical Group plc	Receive the remuneration report	40%	Contracts provided for a payment on termination of 12 months' salary, bonus, benefits' cash value and pension contributions. £4.3m pension compensation payment was made to Mr Stahel. Change of control provisions provided for 24 months' salary, bonus and full benefits (and a mitigation statement was not disclosed).
5	BSkyB plc	Approve the remuneration report	38%	Performance criteria for LTIP and the ESOS were deemed insufficiently challenging and Mr Ball had a two-year contract which included liquidated damage provisions as well as salary, bonus and benefits.

c) Top 5 UK remuneration-related oppose votes by company during 2004

	Company	Proposal	Opposition	Explanation
1	The Maiden Group plc	Receive the remuneration report	63.3%	Disclosure was considered poor as the maximum awards for the executive share option scheme and the discretionary bonus had not been disclosed. The executive share option scheme only had one performance criterion at a single vesting point, an EPS target of 6% real growth over three years, which was judged insufficiently stretching in light of brokers' consensus forecast.
2	The Maiden Group plc	Approve the restricted share incentive plan 2004	61.1%	Proposed performance targets were not specified, other than being based on the company's operating margin. There was an automatic vesting of awards on a takeover.
3	Aegis Group plc	Approve the directors' remuneration	49.2%	Shareholder concerns centred around the contractual termination provisions for the chief executive which would grant an annual salary and an additional amount of unearned bonus equal to prior years' annual bonus. Two other directors were also entitled to two years' pay upon change of control.
4	TT Electronics plc	Approve the TT Electronics plc 2004 Inland Revenue unapproved company share option plan	40.8%	The new scheme introduced a performance hurdle of 4% EPS growth per annum against brokers' consensus forecast of over 70% EPS growth per annum. The scheme also allowed full vesting at a single point. In addition, for each grant the target could be met in any consecutive three years in a six-year period.
5	Heywood Williams Group plc	Approve the remuneration report	40.2%	Performance criteria for LTIP and the ESOS were deemed insufficiently challenging and Mr Ball had a two-year contract which included liquidated damage provisions as well as salary, bonus and benefits.

d) Top 5 UK remuneration-related oppose votes by company during 2005

	Company	Proposal	Opposition	Explanation
1	United Business Media plc	Approve the directors' remuneration	77.11%	The opposition vote was a reflection of sentiment towards Lord Hollick's £2.5m bonus for handing over to the new CEO. Despite earlier protestations that he had "earned it" Lord Hollick offered to waive the payment following the vote.
2	MFI Furniture Group plc	Approve the directors' remuneration	60.47%	The points of contention in the committee's report, as acknowledged by the Chairman at the AGM, included the liquidated damages on a change in control provided for in executive contracts and the extension of the executive co-investment plan.
3	Goshawk Insurance Holdings plc	Approve the directors' remuneration	55.40%	At the AGM Phoenix Asset Management, holding over 28% of the company's stock, voted against three resolutions: the remuneration report and the re-election of the two non-executive directors standing from the remuneration committee. At the meeting, the remuneration report was passed on a show of hands even though a clear majority of proxy votes were cast in opposition.
4	Lonmin plc	Approve the 2004 remuneration report	54.05%	The remuneration committee paid compensation for the loss of incentive awards from a previous employer, to a director who joined the board during the year. In addition, an *ex-gratia* payment was made to a director who left the board during the year, in recognition of his work for the company.
5	George Wimpey plc	Approve the remuneration report	44.20%	Performance targets attached to the George Wimpey LTIP were not considered sufficiently challenging by PIRC and the combined awards during the year under review were deemed excessive.

e) Top 5 UK remuneration-related oppose votes by company during 2006

	Company	Proposal	Opposition	Explanation
1	Croda International plc	Approve the directors' remuneration	51.51%	The proposal met with heavy opposition due to concerns over the performance targets attached to a long-term incentive plan. The chairman failed to call a poll and the resolution was passed on a show of hands.
2	Amvescap plc	Approve the remuneration report	48.41%	Shareholders opposed the controversial US$9m bonus payment to Charles Brady, the outgoing chairman, who was awarded for 'exceptional leadership during a particularly difficult period in the history of the company, including managing an opportunistic hostile approach and the recruitment and transfer of succession to a new CEO'.
3	Abbot Group plc	Approve the remuneration report	46.10%	PIRC pointed out serious concerns over the large awards of free shares granted under a new executive share ownership plan, which did not have any performance conditions attached to it. Furthermore, the company provided directors with funds to cover their income tax and national insurance liability arising on acquisition of the beneficial interest in these shares.
4	Morgan Sindall plc	Approve remuneration report	41.19%	PIRC was concerned over the award of the discretionary bonus of 20,000 performance shares to chief executive, Paul Smith.
5	Psion plc	Approve the long-term share plan	39.84%	Specific concerns related to targets attached to the scheme, which were considered insufficiently challenging, and the 5% and 10% dilution limits for schemes were not adhered to.

f) Top 5 UK remuneration-related oppose votes by company during 2007

	Company	Proposal	Opposition	Explanation
1	Computacenter plc	Approve share option plan	26.72%	The degree of opposition reflected shareholder concerns over the fact that the specific performance targets operated under the scheme were not disclosed.
2	Hays plc	Approve the remuneration report	24.93%	The proposal met with relatively high opposition due to strong concerns over the guaranteed bonus, one-off restricted share award and bonus replacement award that the new chief executive, Mr Cox was entitled to.
3	Computacenter plc	Approve the remuneration report	23.48%	The focal point of concern related to the EPS targets attached to the PSP which were not considered challenging given the brokers' forecasts.
4	Rank Group plc	Approve remuneration report	14.68%	For Rank Group the same concern, as for Computacenter's remuneration report, arose in relation to the EPS targets attached to the PSP which were not considered challenging given the brokers' forecasts.
5	Compass Group plc	Approve the remuneration report	12.40%	Severance payments include, in addition to pay and benefits, an amount in lieu of the pension salary supplement and a notional bonus of 75% of salary. PIRC considered this to create an unacceptable possibility of substantial reward for failure.

g) Top 5 UK remuneration-related oppose votes by company during 2008

	Company	Proposal	Opposition	Explanation
1	Hays plc	Approve the remuneration report	45.99%	The proposal met with high opposition for the second year running. This reflected shareholder concerns with the 'golden hello' arrangements for Mr Cox and the compensation provisions for the departing chief executive Mr Waxman, which included a notional unearned bonus.
2	Chrysalis plc	Approve the remuneration report	43.25%	The proposal met with high opposition due to strong concerns over potential and actual compensation payments. Mr Riley who resigned in August 2007 received compensation payments amounting to approximately 355% of base salary during the year.
3	Paragon Group of Companies plc	Approve the remuneration report	35.87%	The principal concern related to the performance targets under the performance share and matching share plans which were considered insufficiently challenging.
4	BP plc	Approve the remuneration report	27.06%	The focal point of concern related to the special retention awards granted to Mr Inglis and Mr Conn. In addition, PIRC had significant concerns over the remuneration committee's decision to allow Lord Browne and Mr Manzoni, who left the board during the year, to participate fully in the 2005-2007 and 2006-2008 Executive Directors' Incentive Plan despite their departure.
5	Catlin Group plc	Approve the remuneration report	19.25%	Shareholder opposition related primarily to concerns over the operation of performance conditions, under the company's LTIP, which were not considered challenging. Additional concerns related to the disclosure of the performance conditions themselves, which precluded a definitive analysis.

Appendix B: Reasons for opposing, abstaining, or voting for a remuneration report vote

The points below indicate the typical factors that are taken into account when deciding how to vote on remuneration reports.

Voting against:

A variety of different issues that cause concern:

- Performance conditions have been changed which causes them to be easier to meet;
- High levels of pay and there is no real link to the performance achieved, or to be achieved;
- Annual bonuses continue to rise and salaries continue to increase, perhaps double digit salary increases become a pattern;
- Structural issues and overall lack of performance linkage;
- Performance targets do not align with the long-term strategy of the company.

Voting to abstain:

- No evidence of excess and a good level of disclosure; but salaries have been increased year on year and there is no justifiable reason as to why;
- Overall, there are no structural issues but there is a general lack of disclosure and there is scope for more information to be disclosed and for the company to be more transparent.

Voting in support:

- Clear disclosure of the main aspects of remuneration (ie, performance criteria, maximum awards, any departures from normal practices/scheme details);
- No evidence of excess;
- Clear link between pay levels and performance;
- Clear alignment of the interests of shareholders and directors through robust remuneration practices;
- Remuneration committee demonstrates behaviours that protect the interests of shareholders whilst offering pay packages and remuneration policies which allow incentivisation and retention;
- Performance targets for the long-term incentive plans do support the long-term strategic plan of the company.

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Designed by West Midlands Pension Fund 09/09 PAS 214

Request for Investor Dialogue: Fifth Analyst Call on Corporate Governance and the Proxy Statement

Background

In light of the recent trends to strengthen shareholder rights in the US, including revised SEC rules adopted in 2010 and the passage of the landmark Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), corporate governance responsibilities of both issuers and owners have increased materially. Among the most significant changes are the following:

- Beginning in 2011, shareholders will have the opportunity to vote on Say on Pay and to determine how frequently such votes take place going forward.
- Following recently revised SEC proxy access rules, investors are able to nominate directors directly to corporate boards without staging a proxy contest.
- Under new SEC proxy disclosure rules, boards are required to explain their board structure regarding the separation / unification of Chairman and CEO roles
- Beginning in February 2010, broker discretionary voting in connection with director elections and compensation was prohibited, resulting in increased value for directed shareholder votes.
- Going forwards, institutional investors will be required to disclose how they voted on all Say on Pay and golden parachute resolutions.

As a result of these enhanced rights and responsibilities, institutional investors with a commitment to good governance and responsible ownership believe there is now a unique opportunity to enhance dialogue and understanding around key governance issues between investors and companies.

Request for a Fifth Analyst Call on Corporate Governance & the Proxy

The undersigned institutional investors, representing approximately $2 trillion in assets under management as of September 1st 2010 are proposing that US companies host a dedicated conference call for institutional investors focused exclusively on corporate governance as reflected in the annual proxy statement. The “Fifth Analyst Call” would serve a purpose similar to standard quarterly results calls but follow the publication of the proxy statement and precede the annual shareholders meeting.

While the undersigned institutions believe that a majority of companies would benefit from this type of collaborative discussion with their shareholders, as a pilot project we have identified a number of companies that, in our view, would benefit the most from such engagement due to unique, company-specific circumstances.

The Fifth Analyst Call aims to:

- Utilise the rights and responsibilities embedded in the Dodd-Frank Act to encourage good governance by issuers and responsible ownership by investors;
- Enhance investor understanding of the company’s corporate governance strategies so as to better reflect governance in valuations;
- Improve company-investor dialogue so that corporate governance protects long-term value and enables sustainable business growth;
- Serve as a common platform of education and dialogue for both equity analysts and governance specialists within the institutional shareholder base, ensuring that voting decisions are made within the context of the company’s competitive environment and performance;
- Facilitate dialogue around the proxy statement so as to enable more informed voting of shares.

Participants
Proposed participants in a "Fifth Analyst Call" would be institutional investors who are shareholders in the company and have a commitment to actively vote their shares. Governance analysts and equity analysts are both encouraged to join the call. A full list of institutional investors and asset owners that have already agreed to support the 'Fifth Analyst Call' is included below:

APG Asset Management (The Netherlands)
Australian Council of Superannuation Investors (Australia)
BC Investment Management Corporation (Canada)
Cooperative Asset Management (UK)
DWS Investment GmbH (Germany)
F&C Asset Management (UK)
Florida State Board of Administration (US)
PGGM Investments (The Netherlands)
Railpen Investments (UK)
Standard Life Investments (UK)
T. Rowe Price (US)
Universities Superannuation Scheme (UK)
Walden Asset Management (US)

Investors request that the independent board chairman or lead director attend the call. The chairs of key board committees are also encouraged to participate although this is not a pre-requisite for conducting the call. It is assumed the Company Secretary would attend as well. It may be advisable for the General Secretary or Investor Relations to attend this call although the primary dialogue should be between investors and their board representative(s).

Agenda of the Fifth Analyst Call
We are proposing that companies participate in a conference call or other virtual meeting to discuss key corporate governance issues as reflected on the annual proxy statement, including the additional resolutions now required by the Dodd-Frank Act. The call itself would be hosted by issuers and co-chaired by the company and a 'lead investor'. The aim of the call will be for issuers to explain to institutional investors their corporate governance philosophy and strategy and for investors to ask questions and raise concerns prior to voting their shares at the AGM.

The meeting would be 60-90 minutes with the agenda being driven by and confined to the proxy statement. To this end, we would anticipate any meeting to cover the following basic governance points:

- Setting the Governance Framework and Philosophy including the board's role in setting and evaluating execution of strategy;
- Audit and/or Risk Committee Report Summary explaining annual achievements of the audit committee, including its review of internal controls and risk management;
- Compensation Discussion & Analysis including how compensation is linked to performance and to the core business strategy;
- Board Structure, Effectiveness, and Succession Planning including the company's approach to defining the roles and responsibilities of Chairman and CEO;
- Any other items on the ballot in need of discussion eg. change of auditors, capital raising, and board position on shareholder proposals;
- A response to any negative recommendations expected or received from proxy advisory firms, and a discussion of any additional or mitigating considerations.

An agenda, including allocated time slots, would be agreed between the company and the lead investor in advance of the meeting to ensure an effective and efficient meeting.

Timing of the Fifth Analyst Call
Investors are asking pilot program companies to host such a call 10-15 business days prior to the 2011 annual meeting.

More Information and Next Steps
Interested investors wishing to support the "Fifth Analyst Call" or issuers considering hosting such as call are invited to contact one of the following individual for more information. Signing on to this statement does not commit investors to participating in each call with issuers as participation will be based on shares held as of the record date:

Alexis Krajeski or Pat Tomaino, F&C Investments
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Pat.Tomaino@fandccom, (617) 426 9050 (US)

Deborah Gilshan, Railpen Investments
deborah.gilshan@rpmi.co.uk, + 44 207 220 5012 (UK)

Donna Anderson, T. Rowe Price
Donna_Anderson@troweprice.com, +1 410 345 3591 (US)

Meagan Thompson-Mann
UN PRI
meagan.thompson-mann@unpri.org

Frequently Asked Questions:

- *How would the call be hosted?* We envision a teleconference or virtual meeting hosted preferably by the company, although there may be potential for an investor to provide conference call facilities.
- *Would the call be secure?* Participation in the call would be by invitation only and would require pre-registration. Invitations will be limited to institutional investors with a holding in the company and a commitment to actively vote their shares.
- *Would proxy advisory firms be invited?* At this point, no. The aim of this call is to enhance dialogue between issuers and owners.
- *What benefit would there be for companies who already invest large sums in investor outreach?* While we expect there to be some initial costs to issuers of hosting a "Fifth Analyst Call", we believe these would be outweighed by the significant benefits such a call would bring. Key benefits include: 1) Efficiency in communicating with institutional investors and beneficial owners; 2) The ability for directors to interact directly with shareholders, not filtered through proxy advisory firms or solicitors; 3) Access to mid-sized investors on the share registry; and (4) General benefits of engagement.
- *What benefit would there be for asset owners and asset managers who already have an active voting and engagement program?* Such a forum would provide an opportunity for investors to speak directly to their independent board representatives. It would also provide a forum for the board to present key governance developments in a clear and concise manner prior to the vote and to field questions that could influence voting outcomes. We expect this to be particularly useful for investors prior to voting on contentious governance issues, including forthcoming Say on Pay proposals.

- *Wouldn't this essentially make the annual meeting irrelevant?* No, as this is only for institutional investors, the majority of whom vote their shares by proxy and cannot attend all AGMs in person given their large, diversified portfolios.
- *Wouldn't this require a lot of work and substantial institutional investor commitment before it would be worthwhile?* Given that the list of pilot program companies is limited and that the agenda will be driven by the proxy statement, we do not envision substantial additional work in preparing for the meeting (although some administration will be required). Gaining critical mass of investor support will be fundamental to the success of this proposal. This is why many institutional investors are supporting the effort and are reaching out to other investors to encourage greater participation. We would also welcome working with issuers to invite their other institutional shareholders to join such a call.
- *Doesn't this risk triggering Regulation FD or proxy solicitation rules?* We do not believe there is any greater risk of triggering Regulation FD or proxy solicitation rules during this call than during a standard financial results call. The call will focus on information already disclosed in the proxy statement and provide an opportunity for investors to ask questions and get clarification.