Submission of evidence in relation to the Enterprise and Regulatory Reform Bill

Summary

1. This submission is on behalf of the UK Individual Shareholders Society ("ShareSoc"), representing over 2,000 private investors.

2. It addresses solely provisions to be introduced into the Enterprise and Regulatory Reform Bill ("the Bill") that relate to company director pay

3. This evidence relates to six key matters:

    - When shareholders are first allowed to vote on pay policy
    - Consultation regarding contents of the pay policy and implementation reports
    - Availability of information and voting rights to private investors
    - Applicability of the legislation to traded, as well as to listed companies
    - Voting on exit payments
    - Cross-directorships

About ShareSoc

4. ShareSoc represents and supports private investors who invest in the UK stock markets. We are the largest such UK organisation with over 2,000 members. We are a mutual association controlled by our members with "not-for-profit" articles and incorporated as a company limited by guarantee. The organisation is financed by member subscriptions, donations from supporters and by the services we provide to members. More information on ShareSoc can be obtained from our web site at www.sharesoc.org (our objects are fully defined on this page: www.sharesoc.org/objects.html).

About this submission

5. This submission relates to the "guide to Government reforms" published by the BIS on 20th June (http://www.bis.gov.uk/assets/biscore/business-law/docs/d/12-900-directors-pay-guide-to-reforms.pdf , "the Guide"), which states that the reforms described in that document will be introduced as amendments to the Bill.

Timing of initial vote

6. The Guide states that a vote on companies' pay policy will be required annually unless companies choose to leave their pay policy unchanged, in which case the vote will happen at a minimum every three years.

7. ShareSoc supports this proposal, but it is not stated when the first such vote must take place, following passage of the Bill. We advocate that such a vote should be required at the first annual general meeting of each company, as soon as is reasonably practical following passage of the Bill, so as to ensure that implementation of the stated policy is not unduly delayed.

Consultation regarding content of pay reports

8. The Guide, in Tables A and B, specifies outlines for content of pay policy and implementation reports ("the Reports").

9. We anticipate that the detailed content of the Reports will be specified in codes of practice or regulations ("Regulations") that are ancillary to and referenced in the Bill.

10. In the opinion of ShareSoc's members, it is essential that the information presented in those reports is precise, clear and concise, in order that shareholders will be able to base their votes on sound information.

11. We note that it has been suggested that pay policy, which is subject to a binding vote, should be principles based, rather than based on specifics of pay packages. Experience has shown that such a vote would be utterly ineffectual and would not fulfil the intention outlined in the Guide. There is ample evidence to show that where directors alone are allowed to define the details of pay packages, the results are unacceptable, both to shareholders and to wider society. If the pay policy is allowed to be defined in "principles only" terms, then it is easy for directors to define that policy to allow sufficient latitude to circumvent the aims of the Bill.

12. Giving shareholders the power to vote on pay packages has nothing to do with "micromanagement". Boards have repeatedly shown themselves to be incapable of acting responsibly in the very specific area of director pay. If the Bill is to be effective in this area, shareholders must be given the power to vote on the actual pay awards proposed.

13. ShareSoc has already been involved in consultations on these matters with the Financial Reporting Council ("the FRC") and with the BIS.

14. We request that bodies representative of private investors, such as ShareSoc, continue to be included in consultations relating to Regulations governing the content of the Reports. This will help to ensure that the Reports are fit for the purposes of private as well as of institutional investors.

Rights of private investors

15. Private investors can play an important role in ensuring that the Bill achieves the aim stated in the Guide of challenging excessive pay, for the following reasons:

    a. Most private investors are genuinely independent of the directors whose pay is to be determined.
    b. In ShareSoc's experience, many private investors in British companies are themselves experienced business people.
    c. It is not in private investors' best interests to either permit excessive pay, or to suppress pay to such a level that firms are unable to attract the best candidates for senior roles.
    d. Unlike some other shareholders, private investors are under no pressure to conform with peers or to gloss over this issue to avoid the spotlight being turned onto their own remuneration.

e. A significant proportion of shares in British companies are in private investors' hands. Therefore, if private investors are able to vote, they can, collectively, influence the outcome of binding votes. Organisations such as ShareSoc can represent them in negotiations with Boards on remuneration matters.

16. However, without specific legislative changes, many private investors will not be able to fulfil the role described above. That is because many private investors' shareholdings are held by their brokers in nominee accounts. Indeed, shareholdings held in ISAs and SIPPs are required to be held in nominee accounts. In theory, those whose shares are held in nominee accounts can enjoy the same rights as direct shareholders. In practice, however, whether they enjoy such rights is at the discretion of the brokers that operate the accounts. Most brokers either do not make information and voting rights available, make an extra charge for doing so, or make it onerous for shareholders to obtain their rights. In our experience, the vast majority of private investors whose shareholdings are held in nominee accounts find it difficult (or impossible) to exercise their information and voting rights.

17. Therefore, for the Guide's aims to be fulfilled by the Bill, it is necessary to ensure that private investors are able to exercise their rights, even if their shareholdings (beneficial shareholdings) are held in nominee accounts. Hence ShareSoc strongly feels that it is necessary for the Bill to include legislation imposing certain requirements on nominee account operators. The requirements that we believe are necessary are:

    a. All information that companies are required to distribute to registered shareholders must also be distributed to beneficial shareholders by nominee account operators in whose name the shares are registered ("Custodians")
    b. Custodians must provide a mechanism for beneficial shareholders to be able to vote their shares on any resolution that registered shareholders are permitted to vote on, that is no more complex than the direct and proxy voting facilities made available to registered shareholders.
    c. Custodians must provide the necessary documentation to share registrars to ensure that beneficial shareholders can attend shareholder meetings, speak, ask questions and vote in precisely the same manner as if the beneficial shareholding was registered in the beneficial shareholders' own name.
    d. Custodians must provide this documentation automatically and not require beneficial shareholders to request it in advance of attending meetings.
    e. Custodians must maintain a register of beneficial shareholders, in an analogous manner to the register of members defined in s113 of the Companies Act 2006 ("the Companies Act").
    f. Persons requesting to inspect or receive a copy of a company's register of members, for a proper purpose, as defined in s116 of the Companies Act, shall be able to request registers of beneficial shareholders from Custodians in a similar manner.
    g. Custodians must not make explicit charges to beneficial shareholders, in order to provide them with the rights conferred by subparagraphs a-d above. This implies that administrative costs of providing these rights will need to be recouped from other fees that Custodians charge beneficial shareholders (e.g. account maintenance fees). Without such a ban on explicit fees, shareholders whose holdings are held in nominee accounts will be deterred from exercising their rights by the fees.

18. The reason for registers of beneficial holders to be maintained and made available, as identified in subparagraphs e and f above, is to ensure that those that wish to communicate with shareholders for a proper purpose are able to do so with ALL shareholders, including the many private investors whose

shareholdings are held in nominee accounts. This is particularly pertinent to control of excessive director pay, which the Bill intends to address. When ShareSoc members bring an instance of excessive pay to our attention we, in turn, may wish to draw it to the attention of other shareholders. Whilst, under current legislation we can do so for registered shareholders, it is impossible for us to communicate with the many private investors whose shareholdings are held in nominee accounts.

Applicability of the legislation

19. ShareSoc strongly feels that it is important that legislation regarding director pay is extended to smaller companies whose shares are traded on public markets such as the AIM market. Such companies are identified as "traded companies" in the Companies Act.

20. Our members have frequently encountered excessive pay arrangements in such companies and director pay can sometimes constitute a significant proportion of company profits in such companies.

21. Under current legislation and regulations there is no requirement for traded companies to publish remuneration reports nor for shareholders to be offered a vote on those reports. Hence, holders of shares in traded companies have no practical mechanism to control excessive pay awards.

22. It may be argued that smaller companies cannot afford the administrative burden of producing the Reports. However, this burden will not be large unless pay arrangements are complex, requiring lengthy explanation. In our opinion, it is desirable that companies are deterred from introducing complex, opaque pay schemes, hence we do not accept that argument.

Voting on exit payments

23. ShareSoc applauds the proposals regarding exit payments made in the Guide. Incorporating the policy regarding such payments into the Pay Policy binding vote and making the payments themselves subject to an advisory vote will be effective. Similarly, a requirement to publish decisions regarding actual exit payments promptly is highly desirable.

24. Any concerns regarding delays to the removal of directors, as a result of the need for a vote should be addressed through amendments to service contracts, where necessary. Exit payments stipulated within a service contract should be expressed as being subject to shareholder agreement.

Cross-directorships

25. Our evidence is that many remuneration committees have proved ineffective in setting sensible levels of pay. Instead, they have rubber-stamped excessive awards.

26. The vast majority of pay policies published in current remuneration reports state that levels of basic pay and performance awards are set by comparison with "peer group" companies. Where a director of one company sits on the remuneration committee of another, it is often in their financial interest to favour increases,

which might be reflected in a peer group comparison and thus lead to the "ratcheting up" that has been observed.

27. Hence ShareSoc strongly favours a ban on current executives sitting on the remuneration committees of other companies.

On Behalf of The UK Individual Shareholders Society (www.sharesoc.org)

25th June 2012

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