SHARESOC REMUNERATION GUIDELINES – LARGE COMPANIES

Setting Pay in Public Companies

This document gives ShareSoc's guidelines for the remuneration of Directors in FTSE350, and Small Cap and AIM Companies with **market caps of more than £200 million**. ShareSoc have published separate guidelines for companies with market cap of less than £200 million.

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ShareSoc Remuneration Guidelines

SETTING PAY IN PUBLIC COMPANIES

FOREWORD

There has been substantial criticism of Director remuneration in public companies of late. Many consider current awards grossly excessive, with the pay of Directors continuing to rise disproportionally to that of other staff and officers. This tendency has been exacerbated by ever more complex pay schemes featuring multiple bonuses and long term incentive schemes. Such complexity can make it very difficult for shareholders to evaluate remuneration policies and to form a view as to whether payouts are reasonable.

This document attempts to provide simple guidance on what a suitable pay scheme should look like.

The Members of ShareSoc (the UK Individual Shareholder Society) have a right to expect fair and equitable returns on their investments. They look for the Directors to be reasonably, but not excessively, compensated for good performance and for their interests to be aligned with all the stakeholders in the business. Trust and respect in business stems from Directors doing “the right things” and we believe that companies that perform well and have a good Director Remuneration policy will gain the respect and admiration of a growing shareholder base.

There is a general consensus that pay levels need to be restrained, but existing mechanisms are not effective in doing so. Hence, ShareSoc has developed its own guidelines.

We hope this guidance will prove to be of use not just for investors when reviewing the remuneration of companies in which they have invested, but also the directors of such companies when they are considering pay structures.

Mark Northway

Chairman

May 2016

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Executive Summary

This document sets out ShareSoc's Guidelines for the remuneration of public company directors.

ShareSoc believes and recommends:

- Current levels of FTSE100 CEO pay are excessive. **An appropriate level of compensation should be less than half of the amounts currently being awarded.**
- FTSE 100 CEOs' **maximum bonus** should be **100%** of salary (currently 200% is typical) and **LTIP maximum** normal annual award should be **100%** of salary (currently 300% is typical). It may be necessary to offer more to externally recruited CEOs, in their first year.
- **Remuneration creep** needs to be reversed. Remuneration has tripled over the last 18 years, but the FTSE 100 share index has barely increased at all.
- To strengthen the executive board's focus on the company's long term performance, **shares or share options** should be a central element of the remuneration package, with the requirement that a meaningful portion of share incentives must be held throughout tenure.
- There should be clear **disclosure** of remuneration in the annual report and shareholders should asked to vote on remuneration and share schemes.

Manifest has agreed to allow ShareSoc to publish Manifest reports on its website. These reports contain a detailed analysis of remuneration for main market and larger AIM companies.

For **smaller companies** (those with market cap less than £200 million), ShareSoc has developed specific recommendations.

There should be clear **disclosure** of remuneration in the annual report and shareholders should asked to vote on remuneration and share schemes.

Objectives

ShareSoc's objective in promulgating these guidelines is to improve remuneration practices and to better align them with the interests of shareholders. In particular, we aim to help companies avoid bad remuneration practices and we look to provide a framework for good remuneration practice.

ShareSoc believes there should be an equitable balance between directors' personal interests and those of the company they direct and its shareholders, as a matter of good governance. We want remuneration committees to be truly independent and to balance those interests in a fair and reasonable manner.

We also hope that these Remuneration Guidelines will enable ShareSoc Members to monitor and engage with the Directors of the companies in which they invest and to critically assess their remuneration policies and practices.

ShareSoc's 5 Pillars of Good Remuneration

These Remuneration Guidelines have been developed in line with the following five principles or Pillars that support and underpin them:

1. **Performance Linkage:** There should be a demonstrable linkage between historic pay and performance (shown by 10 year TSR graph, Single Figure Remuneration and % of maximum pay-outs from bonus and options/long term variable pay).
2. **Pay Level:** Remuneration (salary, equity incentives, bonus and benefits) should be demonstrably reasonable. This is measured in terms of:

   i) £ amount.

   ii) % share of revenue, profits, cash flow, market cap, increase in market cap, dilution, etc.
3. **Share Ownership:** Management should own and retain significant amounts of shares in their company.
4. **Clarity and Transparency.** Remuneration policies should be clear and easily understandable by investors.
5. **Good Remuneration Governance** – independence, consultation, disclosure, voting and sound business practices.

The ShareSoc methodology looks at each of the 5 Pillars of Good Remuneration, but does not give weightings to each of them. We believe that in some cases that a particularly bad approach for any one of the pillars could result in a bad overall assessment for a company. We do not want companies to be able to trade off a good assessment under one pillar with a poor performance under another.

Our focus is on the CEO’s remuneration (or Executive Chairman or highest paid director as the case may be). In nearly all cases, if the CEO’s remuneration package and awards are reasonable, then this will be reflected acrss the board and management structure.

ShareSoc Remuneration Guidelines

Large companies are complex in terms of the scope and scale of their business operations. Their remuneration arrangements tend to be complex. They attract significant media attention. The remuneration numbers involved are very large in terms of absolute amount, even though they may represent only a small percentage of turnover, profits or market capitalisation.

There already exists a plethora of guidelines for large companies. The UK Corporate Governance Code provides best practice guidance for remuneration for large companies. In addition, there are best practice guidelines from the Investment Association (formerly the ABI) and the Pensions and Life Savings Association (formerly the NAPF), Manifest, PIRC, the IOD, the QCA and many fund managers including Hermes, Fidelity, F&C and many others.

There would be little value in ShareSoc developing its own remuneration guidelines for large companies, as this would add even more confusion to the current situation.

ShareSoc has therefore reached agreement with Manifest to publish Manifest's reports on the our website. These reports contain a detailed analysis of remuneration in main market and larger AIM companies. The availability of these reports is a very significant benefit to fully paid up ShareSoc Members.

ShareSoc members are also invited to write their own reports on investee companies and to make comments on the Remuneration Forum of the ShareSoc Members website (again accessible only by Full Members).
http://sharesoc.ning.com/forum/topics/remuneration-forum

The 5 Pillars provide a good framework to analyse the remuneration in large companies, and these are complemented by the following additional ShareSoc opinions:

- FTSE100 CEO pay is currently too high. Examples include WPP (£70m in 2015, Reckitt £23m in 2015, BP a 20% increase to £14 million against the backdrop of a £4.6 billion loss in 2015). ShareSoc has commented publicly on these and other cases.
- The FTSE 100 CEO pay policy model is also too high, with bonuses in many cases at 200% of salary and LTIPs at 300% of salary. These percentages should be less than half current levels.
- Remuneration creep needs to be reversed. CEO remuneration has tripled over the last 18 years, while over the same period the FTSE 100 share index has barely increased at all. Remuneration creep occurs in a number of ways and each of these should be identified and exposed, For example: –

  - Salary increases at greater than the rate for other employees. Over time modest-looking salary increases can compound to significantly increase remuneration, particularly as other awards tend to be set as a percentage of salary. There is a strong case for fixing the salary of the chief executive when he or she is appointed with no further increases; incentive pay will reward performance.

  - Increases in bonus maximum opportunity, or payment level for target performance, or setting easier targets, which mean that higher bonuses are paid than would have been in previous years for the same level of performance. Adopting additional performance measures which are easier to achieve than the previous measures, is another way of increasing the likely payout. The use of the balanced scorecard approach is often associated with soft targets and vigilance by shareholders is necessary in such cases.

  - Increases in the size of long-term incentive awards or setting targets which are easier to achieve than was the previous case. Adopting additional long-term performance measures which are easier to achieve than the previous measures, thus increasing the likely payout.

  - Making awards of long-term incentives at the same level of salary following a substantial decrease in the share price (e.g. Anglo American), which can produce windfall payouts for merely recovering to the previous level of share price.

  - Use of pension arrangements which hide the increase of value or potential value to the executive (e.g. BP where the chief executive has a pension based on salary and bonus).

  - Making large acquisitions that increase the volatility of future results. For example, the probability of the share price doubling or halving over three years may increase from 10% to 30% as a result of a large acquisition. The odds of achieving an EPS goal or ROCE goal may similarly improve.

    The effect on remuneration is to increase the potential value of the future remuneration plans, although the effect on shareholders is minimal and the alignment with shareholders is significantly reduced.

- Complexity in remuneration design is unhelpful. Simplification should be the goal where possible. However, there is a danger of further remuneration creep arising from over-simplification.

- Soft targets should be avoided. Remuneration Committees should be challenged to justify such targets. ShareSoc members are well positioned to challenge the board at AGMs.

- Generous use of discretion and interpretation of incentive scheme rules so as to boost incentive scheme payouts should similarly be challenged.
- The lack of disclosure of incentive targets, so that investors cannot see if the targets are easy or stretching, is unacceptable. The use of "the targets are commercially sensitive" excuse is in most cases self serving. If a measure is a KPI and if it is worth rewarding the CEO for the achievement of that KPI, the company must be able to explain what the target is and show that the threshold, target and maximum payout opportunities are stretching.
- Share options should be emphasised in remuneration packages, along with also strict share-holding requirements, so that a meaningful portion of stock incentives must be held to the end of a Director's tenure or beyond.
- The Remuneration Committee chair must be capable of standing up to the demands/requests of the executive board members. Historically, institutional investors have not provided the NEDs with adequate support. Shareholders should vote against the re-election of the director who is the Remuneration Committee chair where concerns exist, providing real pressure to resist excessive demands from the executive directors.
- Lastly and possibly most importantly, the appointment of a new CEO is a critical opportunity to control remuneration. To be effective, the CEO must work with a team of executives. Excessive remuneration to a new CEO is divisive and should be avoided. For most FTSE 100 companies, there are plenty of capable people able to do a good CEO job, so it is unnecessary to pay excessively to hire an external recruit. However, if, for example, it is necessary to provide a £5 million per annum package to hire a new CEO and a package that will pay out 25 million over five years and double that if the share price doubles, then the company should say so in simple language and justify it.

Conclusion

ShareSoc's objective is to improve companies' remuneration practices, so that ShareSoc Members and other shareholders receive fair and equitable investment returns.

The Guidelines in this document provide a framework for good remuneration practice, and can help companies avoid bad remuneration practices.

These Remuneration Guidelines will also enable ShareSoc Members to monitor and engage with the Directors of the companies in which they invest and to critically assess their remuneration policies and practices.

If you have any comments on the contents of this document please send them to ShareSoc using the Contact Information on the final page.

Glossary

LTIPs: Long Term Incentive Plans. LTIPs are operated by the majority of FTSE 100 companies and are sometimes called performance share plans, or performance restricted stock plans.

SIP: Share Incentive Plan. Schemes that allow employees to acquire shares in various ways. For SIP details see: http://www.mm-k.com/content/documents/201506SIP-summary.pdf

TSR: Total Shareholder Return. The percentage change in the share price plus dividends received by shareholders expressed as an annual return figure.

Value Creation Schemes. These give a share of the gain in the value of a company above a threshold to executives via a subsidiary company created for this purpose.

ShareSoc

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