Private & Confidential

Gemma Peck
Business Environment
Department for Business Innovation and Skills
1 Victoria Street
London
SW1H 0ET

24 November 2011

Dear Ms Peck

Discussion paper: Executive remuneration

PwC welcomes the Discussion Paper and the opportunity to engage with you on the 15 questions on which BIS is seeking views. As remuneration advisors to many of the UK's leading companies we support initiatives to drive improvements in remuneration governance but are keen to ensure that any changes in this area are both feasible and valuable.

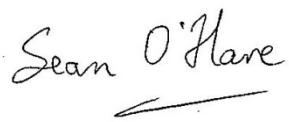
We hope that the consultation process will result in the identification of two or three key areas in which improvements could be made, in our view being:

- Simpler and more durable incentive arrangements;
- Greater alignment of performance metrics with strategic objectives; and
- More concise and transparent reporting of remuneration;

Our detailed written response is set out in Appendix I. We have kept these responses fairly short at this stage but would welcome further discussion on any or all of them should this be helpful.

We would be delighted to help with the furtherance of the objectives set out in this discussion paper. If you have any questions or would like to discuss any of the points in this letter in more detail, please contact me (on 020 7804 9264).

Yours sincerely



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APPENDIX I

Role of shareholders

Question 1: Would a binding vote on remuneration improve shareholders' ability to hold companies to account on pay and performance? If so, how could this work in practice?

The vote on remuneration is currently structured as an advisory vote on the entire remuneration report. We believe that this system works well and has a positive impact on the governance of remuneration.

For as long as the vote is on the remuneration report as a whole (which incorporates both historic and forward-looking information) it would practically impossible to make a binding vote enforceable. A negative binding vote on the historic elements of the report would give rise to a conflict between the contractual liability the company has to the executive and the legal implications of the negative binding vote.

We are not persuaded that a binding vote is necessary. Following the publication of the Stewardship Code, we have seen greater evidence of shareholders using the advisory vote to indicate concerns about remuneration. In our discussions with shareholders, it has not been evident that they want a binding vote; they would like Remuneration Committees to be more responsive to the signals they transmit when voting on the remuneration report. There is a risk that shareholders will be less inclined to cast a binding vote against the remuneration report than to give a strong signal through a negative advisory vote.

Greater accountability could be achieved by requiring a company which receives a 25% or greater vote against a remuneration report to explain in the subsequent remuneration report how shareholder concerns were addressed and, if not, the reasons why.

We consider that, together with the introduction of annual re-election of directors, this additional disclosure requirement would provide shareholders with sufficient power to hold the Board to account on remuneration.

Question 2: Are there any further measures that could be taken to prevent payments for failure?

As was evident from the DTI consultation in 2003, it is difficult to be prescriptive about what is "payment for failure" although the term is often used in a pejorative sense when individuals cease to be directors and receive termination payments. What is a "payment for failure" is largely a matter of perception which is almost entirely dependent on the communication in respect of the termination.

In our experience, prior shareholder approval for a termination payment is rarely sought. In practice, obtaining shareholder approval in the course of sensitive negotiations over a severance package would be fraught with difficulty, not least over the necessity of bringing the matter to public attention before agreement is reached.

The current disclosure of termination payments is generally adequate but if there is a view that greater disclosure would be valuable, this could include a requirement to disclose in the next remuneration report the full amount of the severance payment agreed (whether or not paid) with clear differentiation between:

- Payments arising under the terms of the service contract (eg twelve months' salary);
- Other payments in respect of which the individual would have a legal claim (eg bonus or other amounts earned); and
- Amounts determined to be payable by exercise of discretion (eg early vesting of share awards/ waiver of pension attenuation).

The disclosure should also state whether the payment is to be made in instalments and the extent to which mitigation is in point.

Question 3: What would be the advantages and disadvantages of requiring companies to include shareholder representatives on nominations committees?

The first point to note is that the historical reasons for the Swedish model, which did just this, were to deal with the risk that the company chairman might become too powerful or that authority may lapse into the hands of the controlling shareholder. Neither of these issues is currently considered to be a significant risk in listed UK companies.

The second point is that the Swedish corporate governance framework is based on a "two-tier" board system (ie a supervisory board consisting of "outside" directors and a management board consisting solely of executives). This model lends itself more to the inclusion of "outsiders" than the unitary board structure that is the foundation of the UK governance framework.

Although some commentators have referred to an improvement in the quality of management in Swedish companies as a result of the inclusion of shareholder representatives on nominations committees, we understand that most UK institutional shareholders would be unenthusiastic about taking on the role because of the restrictions on dealing deriving from being an "insider".

Role of Remuneration Committees

Question 4: Would there be benefits from having independent remuneration committee members with a diverse range of professional backgrounds and what would be the risks and practical implications of any such measures?

We are supportive of broader-based remuneration committee membership that could lead to greater fertility of ideas and more effective governance and believe that this is most likely to be achieved through the Government's initiative to widen the pool of prospective candidates for non-executive board membership and the requirement under the UK Corporate Governance Code for companies to disclose details of their approach to diversity.

As the pool of potential candidates from which remuneration committee members are selected is extended there will need to be greater emphasis on training and regular updates on relevant topics for committee members.

We consider that the inclusion of non-board members on the remuneration committee would suffer from the same legal and governance limitations as the inclusion of shareholder representatives on the nominations committee (discussed in the response to Question 3).

Question 5: Is there a need for stronger guidance on membership of remuneration committees, to prevent conflicts of interest issues arising?

The UK Corporate Governance Code ("the Code") already deals with the question of conflicts of interest arising from cross-directorships in the definition of independence (B1.1). This Code provision, (together with the Code provision for remuneration committees in FTSE 350 companies to consist of at least three independent Non-executive Directors (D2.1)), should be adequate guidance in this respect.

Question 6: Would there be benefits from requiring companies to include employee representatives on remuneration committees and what would be the risks and practical implications of any such measures?

We do not support introducing measures to require companies to include employee representatives on remuneration committees.

The presence of employee representation on supervisory boards in other countries is part of very different legislative and governance frameworks which extend far beyond the issue of executive pay. We question whether it would be appropriate to use this option on the single issue of pay otherwise than via primary legislation and the level of debate that route would involve.

There are a number of other circumstances in which, under UK law, employee representative have to be consulted on business issues affecting the workforce (for example, collective redundancies, the transfer of an undertaking). These models contain provisions to afford employees protection and to ensure confidentiality from the wider employee population.

We share the concern raised in paragraph 90 of the discussion paper in relation to the legal status of employee representatives. Remuneration committees are comprised of non-executive directors who have statutory duties as set out in the Companies Act 2006. These duties include a requirement to act in the way most likely to promote the success of the company for the benefit of its members as a whole and a requirement to exercise independent judgment. This means non-executive directors must be objective and not represent a particular interest. A director must also avoid a situation in which he or she has a direct or indirect interest that conflicts with the interests of the company.

On the assumption that the purpose of an employee representative would be to represent the interests of employees (unlike a non-executive director who is required to act for the benefit of the company as a whole), this raises the question of the legal standing of an employee representative on the remuneration committee. Even if legal difficulties in status could be overcome, there would be practical issue relating to the process for selecting the employee representatives, particularly in large companies with geographically diverse workforces.

We also share the concern raised in paragraph 89 of the discussion paper that employee representatives may suffer from information asymmetry in relation to the company's strategy, objectives and risks in comparison with other remuneration committee members who sit on the main boards, where there is no employee representation. This information asymmetry is inconsistent with corporate governance best practice which promotes equal access to information for all committee members. We therefore agree that employee representatives may suffer from a lack of influence.

Question 7: What would be the costs and benefits of an employee vote on remuneration?

We consider this proposal to be impractical in today's world of multinational companies. There are UK listed companies with tens of thousands of employees located worldwide for whom it would be impractical and costly to provide information regarding remuneration to all employees, to enable them to vote on proposals. In many jurisdictions there will be a requirement or best practice guideline to produce information in local language which adds cost. If information is disseminated in advance of remuneration committee members finalising proposals, there is a risk of leakage of confidential information in advance of adoption (or non-adoption if proposals are not carried out).

An alternative approach might be to include a provision in the UK Corporate Governance Code that listed companies should, at a specified point in the process of executive remuneration determination, enter into employee consultation. However, this has the disadvantage of being potentially very time consuming. There may be an opportunity to pursue a lighter touch approach, for example including questions in employee engagement surveys.

Question 8: Will an increase in transparency over the use of remuneration consultants help to prevent conflict of interest or is there a need for stronger guidance or regulation in this area?

In our response to question 26 of the narrative reporting consultation we express our support for the Remuneration Consultants Code which provides guidance to remuneration consultants to assist in the prevention of conflicts of interest in relation to client engagements.

We believe that remuneration committees are aware of the risks arising from perceived or real conflicts of interest and are putting in place processes to deal with these. However, the communication of these safeguards could possibly be improved, as outlined below.

We recommend that consideration be given by the Financial Reporting Council to amending the UK Corporate Governance Code (the Code) to increase the disclosure required in relation to the appointment and engagement of remuneration consultants. Remuneration Committees should be required to confirm in the remuneration report (or annual director's statement, if introduced) whether the remuneration consultants which they appointed support the Remuneration Consultant's Code and whether the remuneration committee took into account the provisions of the Remuneration Consultant's Code in regard to the consultants' appointment process.

Remuneration Committees should also be required to describe in the remuneration report (or annual directors' statement) the process they have used in appointing remuneration consultants, confirming, where relevant, that the remuneration committee has taken into account the potential for actual or perceived conflicts of interest in relation to the appointment.

Where conflicts have arisen, remuneration committees should be required to disclose how they were addressed and resolved. In addition remuneration committees should be required to confirm the conflict was resolved appropriately and that the appointment of the remuneration consultants was free from any undue influence.

Question 9: Could the link between pay and performance be improved by companies choosing more appropriate measures of performance?

Yes.

As the table below shows, there is evidence to show that companies are moving away from traditional performance conditions – principally TSR and EPS – towards more tailored, company specific measures. This is partly a result of recognition that these measures (TSR in particular) do not always provide the desired alignment between the executives' interests and the long term interests of shareholders. Nevertheless, it is still the case that many major shareholders still favour the traditional (and externally measurable) metrics.

Interestingly nearly 2/3rds of plans now use at least one "other" measure and 14% of plans rely *only* on "other" measures.

Long Term Incentive Plan performance conditions in use at CEO level within the FTSE 100

% plans using each measure			Other only
TSR	EPS	Other	
63%	48%	59%	14%

Source: PwC 2011 Executive Reward Survey

In response to this shift in focus many companies are beginning to look again at their performance conditions (as can be seen above) and a number of these have chosen to take a more strategic approach,. This involves holding executives accountable for delivering sustainable growth rather than focussing exclusively on short term financial outcomes. A more tailored approach to performance targets should lead to greater alignment between reward and corporate performance, something which we have been vocal in supporting for some time.

Question 10: Should companies be encouraged to defer a larger proportion of pay over more than three years?

In our experience, deferral practice amongst top tier companies is fairly consistent at present. Of those FTSE 100 companies with deferred bonus plans (79%), 84% defer for 3 years and 16% for 2. While there is some movement towards longer vesting and holding periods in long term incentive plans, this remains the exception rather than the rule.

From an executive's perspective, the deferral of receipt of a bonus over more than three years is unlikely to provide an incentive. Extended deferral is only currently being implemented typically within financial services companies. There may be some merits to this approach, where Remuneration Committees take a more holistic approach to fostering long term wealth creation for executives. One example of such a plan implemented recently is HSBC's 2011 LTIP which measures performance over the year prior to grant (against a balanced scorecard), has a 5 year vesting period and requires that shares be held to retirement.

Clearly there is a balance to be struck between incentivising through pay and ensuring long term alignment with the interests of shareholders. How this balance is struck should differ by sector and company and it is unlikely to be helpful to either executives or shareholders if a one-size-fits-all approach is implemented.

Question 11: Should companies be encouraged to reduce the frequency with which long-term incentive plans and other elements of remuneration are reviewed? What would be the benefits and challenges of doing this?

Incentive practice has developed over the past ten years as corporate strategy has evolved and companies have globalised. It is important that companies can respond to changing market conditions so that executives can be retained and incentivised. A good remuneration committee would typically review the operation of its plans each year with a view to replacing a plan on a five year cycle

It is difficult to envisage how this proposal might work in practice. Even best practice guidance is likely to be difficult to codify as there would always need to be flexibility to allow for unforeseen circumstances.

Question 12: Would radically simpler models of remuneration, which rely on directors' levels of share ownership to incentivise them to boost share value, more effectively align directors with the interest of shareholders?

We believe that there is merit in simplicity of plan design and advocate an approach of long-term incentives vesting solely on the basis of continued service. Alignment with shareholder interests is achieved through significant shareholdings which must be retained until retirement from the Board. Levels of award would logically be commensurately lower in recognition of the absence of performance conditions.

Areas worth further consideration include whether:

- The executive should be able to sell shares to settle tax liabilities arising from the awards ;
- consideration should be given to the possibility of allowing diversification once a certain threshold holding is achieved; and
- the executive should be required to hold the shares until at least one year after leaving the board.

Question 13: Are there any other ways in which remuneration, including bonuses, LTIPs, share options and pensions, could be simplified?

The pension regime will become simpler as defined benefit arrangements fall away and executives participate in defined contribution arrangements or receive a cash allowance in lieu of pension but it is difficult to see how other areas of remuneration are likely to be simplified in the short term, particularly with the emphasis on deferral of annual bonus.

Question 14: Should all UK quoted companies be required to put in place claw-back mechanisms?

We do not agree with the proposition that all UK quoted companies should be required to put in place claw-back mechanisms. The emergence of claw-back provisions within large UK companies can be clearly traced back to the financial services sector and its response to the fallout from the financial crisis of the late 2000s. Most companies have however implemented these provisions narrowly so that

they are only enforceable in instances of accounts restatement or gross misconduct, to comply with the UK Corporate Governance Code.

In general, claw-back provisions in the UK and US are slowing developing and not clearly disclosed. Although 45% of FTSE 100 companies have disclosed a claw-back arrangement, these in general apply to deferred incentive awards only (i.e. companies hold back the release of the deferred/ non vested element of annual bonuses or long-term incentives (LTIs)). In the US over 70% of S&P 100 currently operate a claw-back policy.

In order for claw-back to be meaningful and effective it should be implemented fully, with greater discretion given to Remuneration Committees to retract awards where the underlying financial health of the business is called into question as a result of past events. As well as accounts restatement and gross misconduct, this could also include circumstances in which there has been a regulatory breach or imposition of a fine by a regulator or similar body. There are however clearly a number of uncertainties which would need to be resolved regarding the practical implications of fully or partially retracting payments that have already been made.

Question 15: What is the best way of coordinating research on executive pay, highlighting emerging practice and maintaining a focus on the provision of accurate information on these issues?

There are already considerable resources available on good practices which are published by remuneration consultants. As a firm, we are involved in a number of groups which promote best practice reporting (for example Report Leadership, the Reporting Lab and the Corporate Reporting Users Forum).

We would support the development of a forum for non-executive directors (specifically, chairs of remuneration committees) to provide up to date and accurate information on remuneration policies and practices. We are already discussing the possibility of implementing a working party to research best practice, the role of remuneration committees and other areas.