This submission is made by PricewaterhouseCoopers LLP (PwC), the UK member firm of the PwC network. Our submission is limited to the area of the inquiry relating to executive pay. PwC UK’s Chief People Officer, Laura Hinton, is separately giving oral evidence to the Committee on the gender pay gap on 15 May 2018.

As a leading advisor to clients in relation to executive pay, we are fully aware of the increase in the amount of remuneration delivered to senior executives over the past ten years. The reasons for this were presented in our submission to this Committee’s earlier inquiry on this subject\(^1\) and include:

- the increased size and complexity of organisations; and
- the international pay environment.

As our Building Public Trust\(^2\) initiative illustrates, we are committed to encouraging open dialogue between companies and their shareholders supported by comprehensive and candid disclosure. Consistent with the provisions of the draft 2018 UK Corporate Governance Code, we are supportive of the move to ensure that companies implement fair pay policies across their workforces, and that they are able to demonstrate their communication of this approach to all stakeholders.

Through our work with clients, and the work of our survey team, we have observed that the upward pressure on executive pay has receded and overall reward opportunity at the most senior levels is beginning to reduce, particularly at the highest paying companies, over the past couple of years. However, there are still some examples of arrangements put in place several years ago that are delivering remuneration that is significantly outside normal parameters. Where seen as unjustified, investor, media and public pressure has had a significant impact on amounts actually paid. In addition, this pressure is beginning to have a positive impact, reducing the incidence of less justifiable examples of executive pay practices.

We are wholly supportive of the Government’s investigation into the area of pay fairness, but consider it may be premature given our understanding that it was motivated by public concern about remuneration of executives in businesses that have entered severe financial difficulty or where the payout appears excessive or unwarranted. We question whether waiting until after some of the changes introduced as a result of the Government’s Green Paper on Corporate Governance and Executive Pay had been implemented and had the opportunity to have an influence on executive pay, may have led to more meaningful findings.

Our response to the executive pay questions in the inquiry are set out in the Appendix to this letter. If you have any questions or would like to discuss this further, please do not hesitate to contact Roz Crawford\(^3\).

Yours faithfully
For and on behalf of PricewaterhouseCoopers LLP

8 May 2018

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\(^1\) As set out in PwC’s written submission to the Commons Select Committee inquiry on Corporate Governance, dated 20 October 2016.

\(^2\) Information regarding PwC’s Building Public Trust initiative is available online at www.bptawards.com.

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Executive Pay

Q1: What progress has been made on implementing the recommendations on executive pay by the previous Committee in its 2017 report on Corporate Governance (the “2017 Report”)?

The recommendation, made by the previous Select Committee, that long-term incentive plans (“LTIPs”) should be discontinued has not been taken up by companies. Most investors regard LTIPs as important in ensuring executives take a longer-term view of performance. In our experience, this, coupled with the international nature of business and the wide spread use of LTIPs internationally, means that the majority of stakeholders do not support the Committee’s view that these plans are no longer appropriate.

The Government has declined to introduce a further binding vote on directors’ pay (either on pay outcomes or on a “two strikes” basis). However, the Investment Association has set up a register of companies receiving 80% or lower support for a resolution at a General Meeting (a “significant vote against”), and the draft 2018 UK Corporate Governance Code includes provisions for further shareholder consultation when a company receives a significant vote against a resolution. We note that, in our experience, this is having the unintended consequence of making companies less willing to pursue pay simplification.

As noted below in the response to Q2, a number of companies have started to report on how their remuneration policy applies across all employees. Moreover, the draft UK Corporate Governance Code has extended the oversight responsibilities of remuneration committees, and re-emphasised the board’s role in providing governance oversight of pay and other human resource practices across the company.

The Government is implementing the requirement to disclose a CEO: median employee pay ratio, which we understand will be required with effect from 1 January 2019; some companies have early-adopted this disclosure. There is currently no indication of Government intent to introduce a CEO: median senior executive pay ratio, although certain investors have made this a feature of their guidelines.

Q2: What improvements have been made to reporting on executive pay in the last 12 months?

We have observed a reduction in the number of companies relying on the commercial sensitivity opt-out from immediate retrospective disclosure of performance targets, and consequent improvement in annual bonus outcome disclosure. Last year, fewer than a third of FTSE 350 companies withheld this information on the basis of commercial sensitivity and early disclosures in 2018 suggest only a small monitoring of companies not disclosing bonus targets retrospectively.

The area where there remains scope for improvement is the disclosure of the assessment of performance against a director’s personal objectives. We note that this is an area of close investor scrutiny for the current AGM season and a common reason for a negative voting recommendation by advisory services such as the Institutional Voting Information Service, Glass Lewis or the Institutional Shareholder Services.

Whilst some companies have greatly improved their description of how the remuneration committee takes into account pay and conditions across the company, few companies seek to provide insight by going significantly beyond the minimum regulatory requirements.

An increasing number of companies provide clear evidence of the alignment between the performance conditions for executive incentives and their corporate strategic objectives but our research suggests that this is an area where there is room for improvement. However, we note that those companies committed to best practice in corporate reporting are continuing to make their remuneration reports more transparent and accessible by:
• increased use of “at a glance” sections which allow the reader to access quickly the most important information in the remuneration report;
• improved content of the Chairman’s Statement, typically providing an open and discursive summary of directors’ remuneration over the financial year; and
• better recognition of when discretion has been exercised and, consequently, a more insightful narrative description of the rationale and impact.

Q3: What steps have been taken by Remuneration Committees and institutional investors to combat excessive executive pay in the last 12 months?

In our experience, remuneration committees are readier to exercise discretion to reduce incentive pay outs where there has been a significant negative event that is not reflected in the performance condition outcomes, or where company performance does not justify the level of payment.

As noted above in the response to Q2, the increased rigour in the disclosure of performance targets means that any unexpected outcomes need to be accompanied by a robust explanation.

Investors have made it clear that salary increases for executive directors that are in excess either of inflation, or those provided to the wider employee population, are unacceptable except in very limited circumstances. Investors are also placing downward pressure on executive directors’ pension contributions or allowances that are higher than those provided to employees more generally.

There is a clear reduction in the overall quantum of potential reward where remuneration committees have introduced simpler long-term remuneration structures, such as those where performance is assessed on grant, deferred shares or restricted awards of shares (typically with the only forward-looking condition, other than continued employment, being a performance under-pin).

Investor pressure on the highest paying companies has resulted in some reduction in award quantum, with the maximum long-term incentive plan (LTIP) opportunity at the median for CEOs in FTSE-100 companies falling from 290% of 270% of salary based on data year to date in 20174.

Q4: What further measures should be considered?

In our opinion, there is a need for further momentum to be put behind simplification of pay, as recommended by the BEIS Committee and the Investment Association Executive Remuneration Working Group, to allow companies to implement incentive models that are most appropriate to their strategy and business, rather than prescribing a “one size fits all” approach.

Although there has been some progress in this area, few companies have felt emboldened to adopt the recommendations, in part because of the diversity of investor views, but also due to the stance taken to date by proxy voting agencies (although there is some sign of change in 2018).

Coupled with the implication, evident in the draft UK Corporate Governance Code and the establishment of the Investment Association’s Public Register, that a 20% vote against a resolution is to be avoided, this diversity of view on simplifying pay structures is dulling companies’ appetite to alter the current predominance of the standard long-term incentive plan (“LTIP”).

4 [Preliminary findings from PwC’s Mid-Season AGM Update 2018, to be published in May 2018.]
We believe that the Government has strong signaling power that can be used to encourage investors and other market participants to be more open-minded about less traditional incentive structures, where there is a strong commercial rationale for their use.

In our view, the FRC could be more explicit in the new UK Corporate Governance Code in recognising the validity of other incentive models as an alternative to LTIPs. We suggest that the FRC, within the Board Effectiveness Guidance, could promote the potential validity, with the appropriate commercial rationale, of all of the models set out in the report of the Executive Remuneration Working Group, which included:

- LTIPs;
- deferred share awards (whether or not linked to the annual bonus);
- performance-on-grant type awards; and
- restricted stock.

It would also be useful for the Investment Association to follow up on the Working Group’s conclusions from their review two years ago, to identify, and seek resolution to, continuing barriers to pay simplification, including engaging with proxy voting agencies.