Council of Institutional Investors®
The voice of corporate governance

Via Email

February 9, 2017

Corporate Governance Reform Team
Department for Business, Energy & Industrial Strategy
3rd Floor Spur 1
1 Victoria Street,
London
SW 1H 0ET

Re: Green Paper, Corporate Governance Reform[1]

Dear Sirs/Madams:

I am writing on behalf of the Council of Institutional Investors (CII), a Washington, D.C. based, nonpartisan, nonprofit association of largely U.S. employee benefit plans, foundations and endowments with combined assets under management exceeding $3 trillion. Our voting member funds include major long-term global shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate (non-voting) members include a range of U.S. and non-U.S. based asset managers with more than $20 trillion in assets under management.[2]

As a leading voice for long-term investors, CII appreciates the opportunity to provide comments on the Department for Business, Energy & Industrial Strategy (BEIS) Corporate Governance Reform Green Paper. We would defer on most specific questions to the views of UK investors and their associations. In particular, with reference to executive pay, we acknowledge the useful work of the Executive Remuneration Working Group, including discussion of concerns that executive pay has become too complex, which also is a concern for some of our members with reference to U.S. pay schemes.[3]

We also note the sensible letter of January 24, 2017, to Prime Minister Theresa May, from leaders of the International Corporate Governance Network, the Institute of Directors, ICSA: The Governance Institute, and Trades Union Congress.[4] Among other things, the letter urges creation of a mechanism for those whose interests should be protected by Section 172 of the Companies

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[1] Department for Business, Energy & Industrial Strategy, Corporate Governance Reform, Green Paper (Nov. 2016), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf.
[2] For more information about the Council of Institutional Investors (CII) and its members, please visit CII's website at www.cii.org.
[3] Executive Remuneration Working Group, Final Report (July 2016), *available at* http://www.theinvestmentassociation.org/assets/files/press/2016/ERWG%20Final%20Report%20July%202016.pdf.
[4] Letter to The Rt Hon Theresa May MP, Prime Minister, 24th Jan. 2017, from Kerrie Waring, Simon Walker, Frank Curtiss and Frances O'Grady, *available at* https://www.icgn.org/sites/default/files/170124_Letter%20to%20PM.pdf.

Act to make complaint and find appropriate remedies, and to encourage frameworks for executive pay that require long-term focus.

Notwithstanding our deference to UK investors, we do appreciate the observation of BEIS that a large portion of UK equity is held by investors in other markets. We respectfully offer general perspective from CII on some of the issues raised in the Green Paper in the hope that we can be helpful.

Executive Pay

CII believes that executive remuneration should be transparent and tied tightly to corporate performance, create value for the long-term and advance a company's strategic goals. Executive compensation is a critical and visible aspect of a company's corporate governance. Directors' decisions about CEO pay speak volumes about the board's accountability to shareowners. CII Corporate Governance Policies cover executive compensation, and are consistent with the UK Corporate Governance Code's statement that executive pay policies and awards should be transparent, promote the long-term success of the company and be sensitive to pay and employment conditions in the wider workforce.[5]

Shareholder Voting and Other Rights

CII believes that all public companies "should provide annually for advisory shareowner votes on the compensation of senior executives." We believe an annual say-on-pay vote is critical to investors because it provides shareowners with the ability to communicate their views on the most recent payouts stemming from the policies used to administer executive compensation practices. Those payouts may change in unforeseeable and unexpected ways due to a policy's complexity, reliance on forward-looking factors, and accommodation of board discretion.

In the U.S. it is now widely acknowledged that the advisory vote on executive compensation, which was mandated some years later than in the UK, has resulted in a number of ongoing improvements to the process in which corporate boards determine and disclose executive pay, including:

- U.S. boards are more actively and more frequently reaching out to shareowners to solicit their concerns about, and their approval of, executive pay practices;[6]

[5] CII, Policies on Corporate Governance, § 5.2 Advisory Shareowner Votes on Executive Pay (Updated Sept. 30, 2016) (expressing the view that "[i]t is the job of the board and the compensation committee to ensure that executive compensation programs are effective, reasonable and rational with respect to critical factors such as company performance, industry considerations, risk considerations and compensation paid to other employees"), *available at* http://www.cii.org/files/policies/09_30_16_corp_gov_policies.pdf.
[6] *See* Stuart R. Levine, Huge Regulation Cuts In 2017: Directors Beware, Forbes.com, Jan. 25, 2017, at 2, *available at* http://www.forbes.com/sites/forbesinsights/2017/01/25/huge-regulation-cuts-in-2017-directors-beware/#41a1f8f8a793 ("Almost 75% of directors believe it is 'somewhat' or 'very' important to discuss executive compensation with shareholders vs. 65% in 2013"); *see also* Mintz Levin, Preparation for 2016 Fiscal Year-End SEC Filings and 2017 Annual Shareholder Meetings 1 (Jan. 23, 2017) (on file with CII) ("issuer engagement with institutional shareholders has become an integral part of the say-on-pay process, with many companies reaching out to their largest shareholders in the months following the annual meeting to discuss pay practices").

- U.S. boards are increasing the proportion of executive compensation linked to company performance, leading to potentially greater alignment between compensation and long-term value of the company;
- U.S. boards are eliminating executive compensation perks such as club memberships that they are unable to rationalize, and[7]
- U.S. boards are continuing to reevaluate and improve their compensation-related disclosures in their proxy statements.[8]

More generally, we agree with Steve Seelig, senior regulatory advisor at Willis Towers Watson, who recently said:

> The more global question on say-on-pay is whether it's had a beneficial effect – not necessarily on tamping down on CEO pay, but rather if it's improved the process by which companies engage with their shareholders. I think the answer to that is an unequivocal yes.[9]

The UK presently provides an annual say-on-pay advisory vote, and goes beyond it with the requirement for shareholder approval of directors' remuneration policy at least once every three years. The UK policy approval requirement, which is binding, is broadly analogous, if arguably more direct and therefore better formulated, to U.S. requirements for approval of equity compensation plans and of executive bonus plans if they are to be tax deductible.

In general, CII policy at present does not envision making all or some elements of the executive payouts in a given year contingent on shareholder approval, except for ratification of employment contracts, side letters or other agreements providing for excessive severance, change-in-control or other special payments. While many of our members have substantial criticisms of U.S. executive pay practice, we have not seen a significant push at this date from our members or other investors for mandatory votes in the U.S. market. It is possible that differences in U.S. and UK market dynamics on this point exist because the U.S. was late to say-on-pay, and still is in a period of figuring out how to make maximize effectiveness of shareholder/board engagement. However, many of our members believe that voting on board members is a backstop, providing a method to escalate concerns that are ignored by a board of directors, even within a U.S. context that provides weaker shareholder rights (as compared with the UK) in election of directors.

With reference to paragraph 1.32 on views of investors outside the UK on quantum of executive pay and relation to wider UK society, we would note that opinions among our members vary even within the U.S. context, although consensus-driven CII Policy does speak to the broader

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[7] *See, e.g.*, Paul Hodgson, Surprise Surprise: Say on Pay Appears to be Working, Fortune.com, July 8, 2015, at 2 ("'Say on Pay has increased this pressure, forcing companies to retain only those perks that they can rationalize'"), *available at* http://fortune.com/2015/07/08/say-on-pay-ceos/.
[8] *See* Mintz Levin at 1 ("The advent of say-on-pay continues to cause companies to reevaluate their compensation-related disclosures in their proxy statements, in particular the Compensation Discussion & Analysis . . . section").
[9] Jena McGregor, How Much More Do CEO's Make Than Workers? With Trump's Election, It Could Be Harder to Know, Wash. Post, Nov. 18, 2016, at 2, *available at* https://www.washingtonpost.com/news/on-leadership/wp/2016/11/18/how-much-more-do-ceos-make-than-workers-with-trumps-election-it-could-be-harder-to-know/?utm_term=.9e97838e1e99.

human capital management implications of internal pay inequity and potential impacts on morale. U.S. investors, particularly those who are cautious on making judgments on quantum and social effect within the U.S. context, are likely to be even more circumspect on these questions in other markets.

We defer to UK investors, including members of the Executive Remuneration Working Group (who have brought forth a number of good ideas) on the specific new policy options on executive remuneration presented in the Green Paper.

Transparency in Executive Pay

CII supports strengthening requirements to disclose the performance targets that trigger annual bonus payments.[10] We have long taken the position there is a need for more and better disclosure about the quantitative measures used to design and determine executive incentive pay, including disclosure of bonus targets.[11]

As we stated in our comment letter to the SEC in response to its proposal for new disclosure on Pay Versus Performance:[12]

> The continued absence of disclosure of this information, remains a major impediment to investor's and the markets' ability to analyze and understand the compensation programs awarded [to executives]. Consistent with our membership approved policies, we believe requiring such quantitative information may be the single most important improvement the Commission could make to this Proposal.[13]

As in the UK, U.S. investors generally would prefer to know specific targets to help formulate views on how challenging are the metrics for the award of large performance-based awards. We are concerned that that too many companies hide behind the view that disclosure is "commercially sensitive", and we are encouraged by the progress reported in paragraph 1.58 of the Green Paper, attributable at least in part to pressure from the Investment Association and corporate governance advisors. We believe that retrospective disclosure of all bonus targets within some specified timeframe would be a sensible reporting requirement.

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[10] Green Paper ¶ 1.56.
[11] Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing Before the S. Subcomm. on Securities, Insurance, and Investment of the Comm. on Banking, Hous., & Urban Affairs, 111th Cong. at 14 (July 29, 2009) (testimony of Ann Yerger, Exec. Dir. of CII), *available at* http://www.banking.senate.gov/public/_cache/files/e64b1840-5e6e-4a88-a8f6-3f01b2462404/33A699FF535D59925B69836A6E068FD0.yergertestimony072909.pdf.
[12] Pay Versus Performance, Exchange Act Release No. 74,835, 80 Fed. Reg. 26,330 (proposed May 7, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-05-07/pdf/2015-10429.pdf.
[13] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Brent J. Field, Secretary, Securities and Exchange Commission 7 (June 25, 2015), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2015/06_25_15_letter%20to%20SEC%20on%20953(a).pdf.

Disclosure of Fund Manager's Voting Records

CII does not have a position on the mandatory disclosure of fund managers' voting records.[14] Our membership approved policies, however, include the following best disclosure practices for institutional investors:

> In order to foster an environment of transparency and accountability, institutional investors—including pension funds, hedge funds, private equity firms and sovereign wealth funds, among others—should make publicly available in a timely manner:
>
> - Proxy voting guidelines;
> - Proxy votes cast;
> - Investment guidelines;
> - Names of governing-body members; and
> - An annual report on holdings and performance.[15]

Many of our members have a fiduciary duty to monitor the proxy voting performance of investment managers. Good corporate governance matters to shareholders and proxy voting is the most direct means for shareholders to exercise oversight in relation to the corporations they own.

We note that our members are now demanding even more information from their external managers in their approach to corporate governance, putting pressure on fund houses to increase resources in this area.[16] As Rakhi Kumar, head of corporate governance at State Street Global Advisors, recently stated, "client demand for more information on the company's approach to this issue had 'gone up significantly.'"[17]

Corporate Governance in Large Privately-Held Businesses

CII generally supports strengthening the corporate governance framework for large privately-held businesses through a voluntary approach.[18] Our membership approved policies state:

> Publicly traded companies, *private companies* and companies in the process of going public *should* practice good governance. General members of venture capital, buyout and other private equity funds should encourage companies in which they invest to adopt long-term corporate governance provisions that are consistent with the Council's policies.[19]

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[14] Green Paper ¶ 1.35.
[15] CII, Policies on Other Issues, Best Disclosure Practices for Institutional Investors (adopted May 1, 2009), *available at* http://www.cii.org/policies_other_issues#disclosure_practices_inst_invest.
[16] Madison Marriage, BlackRock, Vanguard and State Street Bulk Up Governance Staff, Fin. Times, Jan. 28, 2017, at 2 (subscription only) (on file with CII).
[17] *Id.*
[18] Green Paper ¶¶ 3.10-.16.
[19] Governance Practices at Public and Private Companies § 1.7 (updated Sept. 30, 2016) (emphasis added).

We agree that good corporate governance is beneficial to both public and privately-held businesses because it:

> [P]rovides confidence not just to shareholders but to other key stakeholders that a company is being well-run. In particular, it can help build and sustain the confidence of banks, investors and suppliers giving businesses better access to external finance at a lower cost and on a longer term basis than would otherwise be the case. It can help build a company's reputation and ensure its long-term success.[20]

CII appreciates the opportunity to express its views on this matter. Please feel free to contact me at 202.822.0800 or jeff@cii.org.

Sincerely,

Jeff Mahoney
General Counsel

[20] Green Paper ¶ 3.3; *see* Value of Corporate Governance ("CII believes that shareowners, other investors and other stakeholders benefit when rules and regulations provide adequate protections to owners and ensure that important information is promptly and transparently provided to the marketplace").