



ABI updates guidelines on executive remuneration

Background

The Association of British Insurers (ABI) has played an active part in influencing executive remuneration since the 1970s when the organisation published its first guidelines on the subject. These efforts were bolstered in 2002 when the UK Government approved The Directors' Remuneration Report Regulations, which have had a significant influence over executive remuneration since then, principally by improving disclosure. This is because the Regulations require quoted companies to produce a detailed annual directors' remuneration report and to hold an advisory shareholder vote on the remuneration report.

Launch of revised guidelines

Members of the ABI's Investment Committee review the ABI's guidelines on an annual basis ahead of the proxy voting season. On 14 December 2006, the ABI launched its revised executive remuneration guidelines (www.ivis.co.uk/pages/gdsc2_1.html). The guidelines focus on total remuneration and include recommendations on issues such as basic pay, bonuses, share options, share incentive schemes, contracts and pensions. The revisions are intended to assist remuneration committees to deliver proposals acceptable to shareholders.

Changes to the guidelines

The guidelines have been restructured to provide a clearer format with five core principles, seventeen main provisions and more detailed guidance than in previous versions. (See Box 1). As a result, they are more informative and easier to read.

As a member of the ABI Investment Committee, Insight was consulted on the guidelines. We particularly

encouraged the ABI to focus on pensions and severance, and to address our unease that current contracts sometimes entitle directors to big pension increases as part of their severance packages (see our article on "Inflated Pensions – rewards for failure?" published in November 2006). We are pleased that the new guidelines reflect our concerns and state that "remuneration committees should demonstrate that the route taken on severance represents the lowest overall cost to the company".

We believe that the evolution of the guidelines has changed executive remuneration schemes in the UK for the better. Because they have strong backing from investors, they send a strong message to companies to seek to comply with the best practice the guidelines set out. In the spirit of the Combined Code's 'comply or explain' philosophy, if companies do not comply with them, they should discuss their proposals and present the reasoning behind them to the ABI and its members, in order to work together to find a mutually acceptable solution.

Examples of improvements in remuneration schemes

In recent years, a number of positive outcomes have resulted from companies' implementation of the ABI's executive remuneration guidelines:

1. The removal of rolling re-testing of performance targets

Rolling re-testing is where a company measures the performance of directors over an initial period usually three years, but provides unlimited opportunities for performance to be re-tested, using different parameters, in the event of continued failure to meet the initial targets set. The result is that

bonus payouts are virtually guaranteed at some point and the link between payment and performance is severed. We therefore see the removal of rolling re-testing as a positive step forwards.

2. Focus on the size of base salaries

Shareholders have increasingly focused their attention on the size of directors' base salaries – the building blocks for other elements of the total remuneration package.

3. Disclosure of targets for annual bonuses

In Insight's view, the overall disclosure of targets for annual bonuses has improved, even though disclosure may occur after the performance period, due to the commercial sensitivity of the targets. Insight encourages companies to set non-financial metrics for directors and allowing remuneration committees to use their discretion about when that is appropriate. Although such softer targets can be more difficult to report against, this should not prevent companies from using them.

Finally, although the guidelines apply to companies with a main market listing, we believe they are useful for others too. All companies are encouraged by the ABI to observe the guidelines because they represent a strong consensus about what constitutes best practice in this area of corporate governance. Although Insight and other investors welcome consultation on individual firms' remuneration proposals, the guidelines provide companies with a clear indication of what shareholder views are likely to be. Insight welcomes the role that the ABI has played in contributing to improving remuneration practices among UK companies.

Box 1: ABI Guidelines on Executive Remuneration 2006

The five principles emphasise the following key points:

- Long-term value creation and alignment of shareholder and company interests.
- The importance of remuneration committees and transparent dialogue.
- Avoidance of upward ratchet of remuneration levels.
- Clear and understandable policies.
- Reward justified by performance.

Guidance for base pay, bonuses, pensions, contracts and severance

- Justification is needed for base pay at median or above.
- Strong reservations about ex-gratia payments, especially transaction bonuses.
- Emphasis on the way pensions boost fixed remuneration.
- Review of pension arrangements, preventing large payments on severance – recommend no automatic entitlement to bonuses.

Guidance for share-based incentive Schemes

- Encouragement to vesting period of longer than three years.
- Share dilution limits retained.
- Concerns over chairmen and independent directors receiving share incentives which might jeopardise their independence.
- Support for shareholding requirements.

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