PIRC

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PIRC ALERTS

UPCOMING MEETINGS

Governance issues at upcoming meetings:

NEWS

QUOTE OF THE WEEK

"You can't have a system where people don't know what they are paying for."

Gina Miller, head of the True and Fair Campaign which lobbies for full disclosure of investment costs, criticising hidden pension fees.

1 Financial Times (10.11.2013)

The voice of responsible shareowners

British Sky Broadcasting Group AGM 22nd November

Remuneration and board composition are issues at BSkyB.

There are concerns over board composition at the media and telecommunications company. James Murdoch who is standing for re-election is not considered independent as he was the Chief Executive of the Company prior to his appointment as a Non-Executive Chairman. He is also the son of Rupert Murdoch, the ultimate controlling shareholder of the Company through Twenty-First Century Fox and he has been on the Board for more than nine years. There are concerns over his fitness to serve. OFCOM, the regulator for the UK broadcasting industry, in its report on the "phone hacking" scandal stated: " We consider James Murdoch's conduct, including his failure to initiate action on his own account on a number of occasions, to be both difficult to comprehend and ill-judged. In respect of the matters set out above, in our view, James Murdoch's conduct in relation to events at NGN repeatedly fell short of the exercise of responsibility to be expected of him as CEO and chairman."

Investors are advised to oppose the re-election of James Murdoch.

The remuneration policy does not go beyond 'attract, retain and motivate'. Disclosure of policy includes a statement on pay elsewhere in the Company and there is evidence that internal pay ratios are used in order to determine aggregate executive pay. However, the disclosure of share-based awards is not adequate as there is no indication of expected values of awards.

The use of a non-financial criterion (product net growth) for the vesting of awards under the annual bonus scheme is welcomed. However, LTIP awards vest solely based on financial criteria and none of the non-financial KPIs disclosed in the Annual review 2013 are taken into consideration. It is also of concern that all metrics operate 'adjusted' versions of the underlying figures. There are concerns that this raises the possibility of misalignment of executive interests with those of shareholders, as executives are shielded from costs incurred by the company whilst shareholders are left to carry the burden of these costs. It is noted that adjusted metrics have not been utilised in this manner, thus far.

Combined awards under the annual bonus and long term incentives are again considered excessive in the year under review and considered highly excessive on a potential basis, particularly in light of the lack of an upper limit on the LTIP share scheme. Based on share price at grant date, the CEO received a combined award under the bonus scheme, the LTIP and the Co-Investment Plan representing approximately 8 times his base salary and the CFO received awards equalling approximately 6 times salary.

It is recommended that shareholders oppose the remuneration report.

ABI's new pay principles

Last week, ABI made its latest pronouncement on executive pay. This was perhaps inevitable given the important legal changes which apply to UK companies with FY ends from 1st October 2013.[2]

A complaint often heard from company secretaries is that their reporting is expected to comply with a plethora of often conflicting or incongruous best practice expectations. In respect of the latest ABI Principles of Remuneration it appears that company secretaries and their boards can relax.

Companies will of course need to be compliant with the disclosure requirements of the Large & Medium Sized Companies and Groups (accounts and reports) regulations 2013. In meeting the minimum disclosure expected by the regulations companies can be sure of meeting expectations of the ABI's members.

For example, the ABI guidance encourages remuneration committees to "look at" executive remuneration in terms of the pay policy of the company as a whole. In contrast the law now requires a tougher disclosure hurdle of whether, and if so, how, the company consulted with employees when drawing up the directors' remuneration policy.

Elsewhere the guidance calls upon boards to ensure that pay for failure cannot occur. As with the majority of the principles stated in the guidance this is a laudable sentiment. However the new regulations explicitly give this responsibility to shareholders. Other than for older legacy contracts boards will not be able to make payments unless they align with the policy approved via a binding shareholder vote.

The ABI's principles based approach allows remuneration committees a good deal of room for interpretation, however there are a small number of issues where the ABI expresses the unambiguous view that a particular practice will not be tolerated. One such area is transaction related bonuses. While ABI states that shareholders do not support such practices, proxy voting results compiled by PIRC suggest the contrary.

For example this years' vote at Old Mutual's AGM showed almost unanimous approval for a remuneration report that included vesting of awards approved by shareholders in 2010. PIRC's advice at the time was to vote against the awards on the grounds that "An explicit statement is made that directors will benefit directly from transactions according to the relative value of the transactions against a benchmark".

The ABI's claim that shareholders do not support executive pay linked to transactions will be tested again at the forthcoming Punch AGM. The pay policy up for approval on the 27th November features an incentive for the finance director linked to negotiations with creditors over re-financing. PIRC will watch the result with interest.

Tighter listing rules in the City

The FCA has strengthened its listing rules to protect minority shareholders, who will get additional voting rights and greater influence over key decisions.[3]

The Financial Conduct Authority (FCA) has published a proposal to reform share listings in the UK. The aim is to improve the reputation of London as a financial centre after scandals related to the poorly governed and tycoon controlled mining groups ENRC and Bumi tarnished the City. New listing rules thus seek to prevent premium floatation of companies with poor corporate governance and to stop majority shareholders from destroying a company's reputation and value.

According to David Lawton, the FCA's director of markets, the proposed changes are designed to safeguard minority interests from abuse by controlling shareholders and intend to promote market integrity and empower minority shareholders to hold investee companies to account. "Active engagement by all shareholders is essential to make markets work well", he said.

The proposed reforms follow a consultation by the FCA's predecessor, the Financial Services Authority, from October 2012 which was a response to concerns from investors over the governance of premium listed companies with a controlling shareholder and the rights of minority shareholders. The new rules are thus a response seeking to strengthen the voice of minority shareholders.

The main changes to the proposed premium listed regime are:

- Ensuring listed companies are run independently of their controlling shareholders, including measures that give independent shareholders a veto over transactions between listed companies and a controlling shareholder when this independence is threatened.
- Requiring separate approval of independent directors by independent shareholders, in addition to gaining approval from shareholders as a whole.
- Requiring greater transparency for listed companies to ensure shareholders have the information they need to exercise their voting rights.

The effectiveness of some of the reforms is, however, questionable. An exemption allows a simple majority of votes by all investors to prevail over the veto of independent shareholders. The new rules are nonetheless a step forward for corporate governance standards at premium listed corporations on the London market and will make it harder for controlling shareholders to cancel a listing. The FCA intends to implement the full package of measures in mid-2014.

2 ABI Principles of Remuneration
3 FCA press release

Hacking cases multiply

Trinity Mirror announced last week that subsidiary MGN has failed to have civil claims alleging phone hacking struck out. A linked application to challenge the basis on which two other claims were made was also unsuccessful.[4]

The claims against MGN represent the first significant legal action over phone hacking affected publications which are not part of the News International stable. What is more, there is speculation that more civil claims could be in the pipeline. According to The Independent, there could be a further 55 new claims relating to Trinity Mirror titles.[5] The company had already disclosed in September that police were investigating whether MGN is criminally liable for the alleged unlawful conduct by previous employees in relation to phone hacking on the Sunday Mirror.[6]

Meanwhile the ongoing trials of former News of the World journalists have already resulted in some interesting developments. A number of former NOTW staff, Neville Thurlbeck, Greg Miskiw and James Weatherup, have pleaded guilty to phone-hacking charges. Glenn Mulcaire, the individual often tasked by NOTW staff to hack phones, has also pleaded guilty.[7] However both Andy Coulson and Rebekah Brooks maintain their innocence. Brooks, along with her husband and other News International staff, also face charges linked to perverting the course of justice.

The fact that Neville Thurlbeck has pleaded guilty is particularly interesting, and may remind some readers of the infamous 'for Neville' email. Exactly who was familiar with that email, and what it meant, remains an unresolved issue.[8]

Investors demand lower capex

Shareholders press oil majors to improve capital discipline and return more cash to investors.[9]

Over the past years global oil companies have been investing lavishly to sustain growth and fund new explorations. A study by EY of 75 oil companies found their global capex increased 13 per cent in 2012, to $541bn. This rise however does not reflect the sector's better performance. EY found that profits actually fell by 16 per cent between 2011 and 2012 while revenues remained flat.

In times of high industry costs, stagnating oil prices and climate change risk with potential danger of stranded carbon assets many investors believe the current levels of capex are no longer acceptable. As pointed out Martijn Rats, of Morgan Stanley the critical debate among equity investors is "what is the right balance these companies should be striking between retaining cash to reinvest in the business and distributing it to shareholders".

The biggest oil companies, Royal Dutch Shell, ExxonMobil and Chevron, have so far resisted investor pressure for higher dividends and share buybacks. Simon Henry, Shell's chief financial officer, warns of long-term consequences and says it would be "too easy to get cheap headlines and a cheap boost in the stock price just by cutting investment". Other oil corporations, such as Total, BP, ENI, BG Group, on then other hand, have already announced their intention of lowering capex in the coming years. Total, after announcing falling capex in 2014, became the best-performing stock among the major oil companies this year.

FCA fails to fine fund groups

FCA refrained from punishing fund groups despite their breach of regulatory rules on corporate access.[10]

The Financial Conduct Authority (FCA) has found that investment companies have broken UK rules by using client commissions to pay brokers for arranging meetings with company executives. However, the fund groups will not be punished the FCA said, even though the firms have acted against their clients' best interest.

The UK regulator estimates that up to $500m of dealing commission was spent on corporate access last year. According to Ed Harley, head of the FCA's asset management division, many firms did not put enough attention on getting value for money. But for him this did not constitute a "blatant disregard for the rules in place", which is why the FCA did not feel incentivised "to take strong action". Will Amos, director of wholesale banking and investment at FCA, argued the scandal "is not a case where there is a clear detriment to investors".

There seems to be a lack of uniformity around this issue. In contrast to the above statements, Martin Wheatley, FCA chief executive, namely recently clearly pointed out that paying for corporate access with client commission "transfers the firm's costs to the client, which clearly works against clients' interests". The failure of enforcement action by the FCA came as a surprise to many market participants who believe that the regulator took an unacceptably soft stance on asset managers.

4 Investigate
5 The Independent (6.11.2013)
6 Investigate
7 The Guardian (30.10. 2013)
8 The Guardian (22.7.2011)
9 Financial Times (5.11.2013)
10 Financial Times (3.11.2013)

Lagging fund activism in Europe

Hedge fund activism is much more prevalent in the US as in Europe due to various cultural and regulatory reasons.[11]

While hedge fund activism is widespread in the US, similar investor campaigns seeking corporate change face many more hurdles in Europe. According to figures from Activist Insight only 34 companies were targeted by public activist campaigns in Europe this year, in comparison with 149 in the US over the same period. It seems that in the European investment culture activism is much less acceptable and mostly takes place behind closed doors in contrast to the well publicised campaigns in the US.

Maarten Wildschut, lead portfolio manager at RWC, believes it is harder to be an aggressive activist in Europe than in the US: "The regulatory landscape in Europe is much more complex, the remit of company boards is broader and more opaque, [and] lots of European companies have dual shareholder structures." Added to this is also Europe's fragmented market structure, the prevalence of powerful family shareholders and widespread corporate hostility towards press involvement in shareholder disputes.

Shareholders should also be wary about widely believed but unfounded assertions about the negative impact of investor activism on company performance. A new study conducted by scholars from Harvard Law School, Duke University and Columbia Business School examined 2,000 interventions by activist hedge funds during the period 1994 – 2007 over a long time window of five years following the intervention. The evidence shows that interventions by activist shareholders, including hedge funds, do not have an adverse effect on the long-term interests of companies and shareholders and that companies' operating performance actually improved after activist interventions.[12]

Ill informed claims about the negative effects of investor activism can have a negative impact on legitimate shareholder rights. European fund managers should step up on profit driven activism while companies ought to become more receptive to investor oversight for their own good.

More women on company boards

A new report on board diversity reveals a slight increase of the number of female directors on boards of UK companies.[13]

The Cranfield School of Management has published a report titled "Women on Boards, Benchmarking adoption of the 2012 Corporate Governance Code in FTSE 350", which presents the latest figures on the number of women on boards of UK's 350 biggest listed companies and the pace of change over the past six months.

The report suggests that since the Davies Report in March 2011, the percentage of female-held directorships on FTSE 100 boards has increased to 18.9 per cent and on FTSE 250 boards to 14.9 per cent. Despite this encouraging trend the percentage of new director appointments going to women will need to increase substantially if Lord Davies' target of 25 per cent by 2015 is to be hit. The analysis of companies' annual reports also showed that 65 per cent of the FTSE 100 companies and only 18 per cent of FTSE 250 companies had stated a clear policy on board diversity.

11 Financial Times (10.11.2013)
12 Article: "The Long-term Effects of Hedge Fund Activism"
13 Women on Boards report

PIRC advises institutional investors with assets in excess of £1.5 trillion.

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