PIRC

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PIRC ALERTS

UPCOMING MEETINGS

Governance issues at upcoming meetings:

NEWS

QUOTE OF THE WEEK

"With pension fund liabilities that are therefore stretching out for many decades, surely the current focus on "quarterly capitalism" is increasingly unfit for purpose?"

Prince Charles calls for a more long-term approach from pension funds.

1 Daily Mail (17.10.13)

The voice of responsible shareowners

Oracle Corp AGM 31st October

Remuneration and director independence are issues at Oracle Corporation.

We have concerns over disclosure, balance of performance and rewards, and the terms of executive employment at Oracle. Its Executive Compensation Committee seems to have discretion in awarding additional bonuses, stock options vest in less than three years, and change-in-control automatically triggers accelerated vesting of all outstanding equity awards. It is noted that the remuneration report only received support of 41% of votes cast in the previous year, but the company has not made amendments to their remuneration policy.

It is recommended shareholders oppose the remuneration report.

It is proposed to amend the Oracle Corporation Amended and Restated 2000 Long-Term Equity Incentive Plan to make an additional 305,000,000 shares available for use under the plan. The plan allows for the award of stock options to non-executive directors, employees, consultants, etc. There is a double trigger provision in the case of change in control. No employee may be granted in any year stock options and SARs on more than 25,000,000 shares of common stock or granted stock bonus awards, stock unit awards or stock purchase rights on more than 10,000,000 shares of common stock.

No performance conditions apply other than share price. There are concerns over the excessiveness of stock option awards made to executive officers. In the current year, the CEO earned $76.8 million in stock option awards. Together with the shares already available for use under the plan, this would represent a dilution of 10.75%, which is considered overly dilutive.

Opposition to the approval of amendment to the long-term equity incentive plan is recommended.

A "withhold" vote is also recommended for the re-election of Bruce R. Chizenm, independent non-executive director and chairman of the Compensation Committee. The compensation report received a 59% vote against at the last AGM and there was sizeable opposition to the pay package which awarded the CEO over $70 million for each of the last three years, yet the committee has stated that no change will be made to their compensation policy.

There is also insufficient independence on the board and shareholders are recommended to withhold the election of four non-executive directors - Jeffrey S. Berg, H. Raymond Bingham, Michael J. Boskin and Hector Garcia-Molina - because they are not considered to be independent.

We recommend shareholders withhold support from the election of Executive Chairman Jeffrey O. Henley. There is no independent Non-Executive Chairman, contrary to best practice guidelines. As there is also no Lead Director and insufficient independence on the Board, a withhold vote on his re-election is recommended.

Rabobank scraps board bonuses

The Dutch bank plans to voluntarily abolish bonuses for its executive board.[2]

Rabobank, which is owned by 1.9m retail customers and farmers, bowed to its owners and public opposition to variable pay and came to a new wage agreement for its 35,000 staff that will abolish bonuses for all but a small number of traders and IT personnel. The move comes despite the fact that Rabobank has not received state aid during the financial crisis and was not forced to stop paying executive bonuses.

The cooperative bank has had strict bonus rules already in place which limit variable pay for executives to 30 per cent of salary. However, Wout Dekker, Rabobank's chairman said: "The supervisory board has concluded that variable remuneration for our executive board is no longer compatible with the economic role Rabobank plays in Dutch society."

The Dutch government also plans a law that would limit bonuses for bankers to 20 percent of their salaries, which would be one of the strictest rules on executive pay in the world. In comparison the EU's cap on bankers' bonuses that will be introduced next year will limit variable pay to two times the base salary, with shareholder approval or 100% of salary without.

Research from the Institute of Leadership & Management published this week highlights the limited role incentive pay plays in motivation. Just 13% of staff felt that the prospect of receiving a bonus or other financial incentive motivated them to do more or try harder in their role.[3]

Shareholders want new Fox chair

Two out of three minority shareholders have backed a resolution seeking the appointment of an independent chair at 21st Century Fox.

The resolution, co-filed by Christian Brothers Investment Services and British Columbia Investment Management Corporation, and supported by the Local Authority Pension Fund Forum, was voted on at the company's AGM last week. The headline voting results show that the vote in favour was approximately 29%.[4] However when the voting power of the Murdoch family's shares is taken into account, it appears that approximately 64% of the remaining shareholders voted in favour of the resolution.

The level of support for the resolution is almost unchanged from last year, when it was filed at the pre-split News Corp last year. Following the division of the company into 'new' News Corp (covering the publishing business) and 21st Century Fox, Rupert is combined chair and chief executive only at the latter. News Corp has a separate chief executive, although Murdoch is the executive chair, which still raises governance concerns for investors.

Julie Tanner, Assistant Director of Socially Responsible Investing at CBIS, said: "The level of family control – Mr. Murdoch owns 40% of voting shares – and the dual class share structure was engineered to keep power in the hands of Mr. Murdoch. While it is virtually impossible for a shareholder resolution to "pass," at Twenty-First Century Fox, this strong result compels the board to take action. Until then, shareholders will continue to voice their disapproval through the few channels available to them."

Notably the 21st Century Fox AGM results also show that Lachlan Murdoch appears to have received a vote against his re-election from the majority of non-Murdoch shareholders. James Murdoch also received a large vote against.

Representing the beneficiaries

A hard-hitting report on the distribution of wealth in the UK will has called for a new not-for-profit body to represent the interests of savers.

The University of Birmingham Policy Commission report, entitled: Sharing our good fortune: understanding and responding to wealth inequality urges policy makers to do more to help people avoid problem debt. The report states: "In terms of debt prevention, increased levels of saving would clearly help to avoid the need to borrow. Saving is clearly difficult for those on very low incomes but if people can afford to repay a loan, this suggests that they could afford to save."

One of the more interesting ideas in THE report is that a new organisation be created to represent the interests of savers, something it argues is missing in the finance system as it stands. It says: "There is currently no organisation which solely represents the interests of savers and this is something which could be established, for example, using the fees which savers pay to the financial services industry and which are currently used to fund trade bodies and regulators."

It's a good point that also extends to corporate governance. Currently the interests of 'shareholders' are too often seen as the preserve of trade bodies like the ABI and IMA who have other interests. A body representing the interests of beneficiaries could provide an interesting new voice.

2 Financial Times (17.10.2013)
3 Daily Telegraph (21.10.13)
4 21st Century Fox AGM results
5 University of Birmingham press release

Enhancing auditor accuracy

Research suggests a way around auditor's conflict of interest by way of linking auditing fees to the accuracy of their reporting.[6]

An academic study examining pollution across the state of Gujarat found that auditors routinely reported misleading information to favour the interests of their clients. The field analysis pinpoints a universal conflict of interest that is at the heart of the third-party auditing industry. Researchers from Harvard and Massachusetts Institute of Technology who prepared the study argue that the relationship between companies and their auditors is fraught with conflicts of interest or "poor incentives to tell the truth". The study shows that in the Gujarat case close to 30 per cent of audit reports on environmental standards falsely reported that companies met required standards.

The researchers concluded that auditors often bend to the will of senior managers, suppressing information that might damage their clients in order not to lose the work. Michael Greenstone, an MIT economist, said: "Every single third-party auditing market in the world has a fundamental conflict at its core. The person being audited is paying the Auditor."[7]

To address the situation in Gujarat researchers introduced a new method by which auditors' pay is linked to the accuracy of their reporting. The results were positive as the auditors received fees from a central pool and not directly from companies and their fees were defined in advance at a flat rate.

NAPF stewardship framework

The National Association of Pension Funds (NAPF) has launched the Stewardship Disclosure Framework.[8]

The framework, which is based around the seven Principles of the UK Stewardship Code, seeks to provide pension funds with greater transparency around the stewardship policies and activities of the 206 asset managers who are signatories to the Stewardship Code.

The framework will allow an "at a glance" comparison between the approaches of different asset managers. This could be a useful resource to pension fund trustees and their advisers who could better understand the stewardship approaches of current and prospective asset mangers. This information will be publicly available on the NAPF website.

Mark Hyde Harrison, NAPF Chairman, said in press release: "The Framework allows managers to demonstrate their commitment to good stewardship. I am delighted to announce that JP Morgan, Aviva, Newton and LGIM have already completed the Framework. [...] We hope to see many more asset managers completing the Framework in the coming weeks."

Departing FTSE 100 female CEOs

With Angela Ahrendts leaving Burberry as the company's chief executive, only two female FTSE 100 CEOs remain.

The news about Angela Ahrendts, CEO of Burberry, moving to Apple to become senior vice-president of its retail and online stores triggered a renewed debate about the progress towards greater gender diversity at the executive level of FTSE 100 companies. Ms. Ahrendts is one of only three remaining female CEO's of the biggest UK listed firms after Marjorie Scardino, ex-CEO of Pearson, and her counterpart at Anglo American, Cynthia Carroll, left office within the last year.

While the number of women FTSE executives is everything but encouraging, attention should shift from looking at departing female CEOs to the real causes of the gender gap. The core of the problem is the continuing lack of a 'pipeline' of female talent, which would allow women in management roles to move to top positions. More direct intervention may still be required from companies to achieve this.

On the positive side, Ann Francke, the head of the Chartered Institute of Management had a more optimistic view on Ahrendts departure in suggesting that Ms. Ahrendts is "being lined up to be the CEO of Apple".[9]

Woodford looks to the long term

Neil Woodford is leaving Invesco Perpetual to pursue long-term investment opportunities on his own.[10]

After a quarter of a century, Neil Woodford, one of the biggest names of British fund management, is to leave Invesco Perpetual to set up his own fund management company. He is known for his critical stand on short-term trends in the asset management industry. The Kay Review of UK equity markets 2012 singled him out as the ideal fund manager because of his low portfolio turnover and long holding periods.

With £33bn Mr. Woodford has more under management than any other British fund manager. He has been an activist investor who "takes corporate engagement very seriously" and also has one of the best records. After the news of his departure shares of Invesco, the US parent company, fell 6.4% and experts predict his departure will trigger significant outflows of his funds at Invesco Perpetual and consequently force selling of some positions.

6 report
7 Financial Times (13.10.13)
8 NAPF press release
9 The Telegraph (15.10.2013)
10 Financial Times (15.10.)

Working with activists pays off

Research finds that boards that compromise with activist investors perform better than those which do not.[11]

Research conducted by Activist Insight, an activist investor research firm, suggests that US companies with activist shareholders experienced bigger improvements in their share price if they compromised with demands made by activist shareholders. The compiled data shows that thirty instances of US companies reaching a settlement agreement since 2010 produced an average annualised share price increase of 60 per cent. The findings are based on the analysis of 476 activist actions in the US between 2010 and 2013. Out of these activist investors were successful 211 times and partly successful 42 times. A total of 131 activist actions were unsuccessful, or resulted in the activist withdrawing its demands.

The US companies where activist actions where successful saw their share price increase 26 per cent, while partial success brought gains of 32 per cent. By comparison companies in which activist investors were defeated saw it share price grow by an annualised average of 15 per cent. Even worse performed companies where activists withdrew their board nominations as their share price went up only 7 per cent.

JP Morgan's $13bn mortgage bill

JP Morgan looks set to agree to a $13bn deal with the US Justice Department, in relation to the bank's involvement in the sale mortgage-backed securities.[12]

JP Morgan is under pressure due to claims that investors were misled about the quality of loans underpinning mortgage bonds. According to the Wall Street Journal, the deal includes $4bn to settle claims by the Federal Housing Finance Agency that the bank misled Fannie Mae and Freddie Mac. The paper also says that $4bn of the settlement will take the form of relief for struggling homeowners. JP Morgan recently agreed to pay out over $1bn to regulators in the UK and US over the 'London Whale' scandal.

Prince Charles vs short-termism

The pensions industry should focus on long-term sustainable returns or risk condemning future generations to a "miserable future", Prince Charles has said.

In a pre-recorded message shown at the National Association of Pension Funds annual conference last week, the Prince said that investors they had responsibility to create a sustainable financial system.[13] He said that the current system of "quarterly capitalism" was "unfit for purpose".

This is not the Prince's first foray into long-term investing. He was also involved with the 'P8' group of public pension funds which met to discuss how they could tackle issues like climate change.[14]

PIRC seminar on executive pay

PIRC will be holding a seminar on 30th October on the new regime covering executive remuneration.

With a new reporting regime and the introduction of a binding shareholder vote on remuneration policy coming into force, it is important that both shareholders and companies understand the changed landscape. This seminar will explore the new regime, and PIRC's approach to it.

Rick Di Mascio, chief executive of Inalytics, will also speak on the exciting new collaboration with PIRC to embed our governance risk ratings in its analysis of asset manager skill.

For more information contact janiceh@pirc.co.uk

11 Activist Insight report
12 Wall Street Journal (19.10.13)
13 Evening Standard (17.10.13)
14 P8 Group

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

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