

Executive Remuneration: Discussion Paper. Response form

Please send your response by: 25 Nov 2011

About You	
<p>Name:</p> <p>Lord Sharman – Chairman, Aviva plc</p>	<p>Organisation (if applicable):</p> <p>Aviva is the world’s sixth largest insurance group. It provides 44.5 million customers with insurance, savings and investment products with total worldwide sales in 2010 of £47.1 billion.</p> <p>Aviva is the UK’s largest insurer with over 14 million customers. The combination of life, health and general insurance is unique in its scale and breadth in the UK market.</p> <p>Aviva plc is in the top 10% of socially responsible companies globally in the Dow Jones Sustainability World Index.</p> <p>Aviva Investors is the global asset management business of Aviva. The business delivers investment management solutions, services and client-driven performance to clients worldwide. Aviva Investors operates in 14 countries in Asia Pacific, Europe, North America and the United Kingdom with assets under management of £269 billion at 30 June 2011.</p>
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I am responding on behalf of (please tick)	
X	Yourself : Quoted company
	Other company
X	Investor or investment manager
	Business representative organisation
	Investor representative organisation
	Non governmental organisation (NGO)
	Trade Union
	Lawyer or accountant
	Other (e.g. consultant or private individual)

Introduction:

We welcome the opportunity to respond as we understand and share the concerns of many that directors' remuneration is being heavily criticised for being excessive and not closely linked to the performance of their firms.

You will note from our response that we believe there is sufficient guidance for remuneration committees and sufficient rights for shareholders to hold remuneration committees to account; we believe the major problem is that shareholders are not exercising those rights. Our view is that more focus should be put on the stewardship of companies by investors and investors themselves should be made accountable for how they hold remuneration committees to account.

This will explain our opposition to having employees and/or shareholders on remuneration committees or nomination committees. We are not convinced this will work in practice and believe that in the first instance; we should make shareholders accountable for their stewardship of companies. We have suggested some structural changes to plans and process. It would be reasonable to review and potentially revisit the issues in a few years time.

It is important to bear in mind that high levels of remuneration exist outside the quoted company environment, in private companies, private equity, hedge funds and partnerships for example. We should take care that disclosure requirements applying only to quoted companies do not discourage talented individuals from taking senior positions in these companies.

Our answers to the questions are as follows:

Questions

Role of shareholders

1. Would a binding vote on remuneration improve shareholders' ability to hold companies to account on pay and performance? If so, how could this work in practice?

Yes	No
	X
Comments	
<p>We consider that the practical difficulties would outweigh any real benefits. For instance, how would remuneration that had already paid need to be treated? How would a binding vote interact with contractual obligations? Would shareholders always have the time to give a binding vote sufficient consideration? Paradoxically, we consider that a binding vote could discourage shareholders from voting against remuneration reports for fear of potentially serious consequences should a resolution be voted down.</p> <p>Shareholders have various existing rights and mechanisms to hold companies and directors to account and we consider that these are generally adequate if used by shareholders to back up their views on inappropriate pay arrangements. For example, voting against the re-election of directors where it is believed they have failed to adequately respond to shareholder concerns. We believe the problem therefore is that shareholders are not using the rights they already have rather than not having enough rights.</p> <p>An overall binding vote would not engender or enhance constructive dialogue between a company and its shareholders; not least because any vote is retrospective and shareholders may be even more reluctant to vote against the remuneration report for fear of destabilising the company.</p> <p>As the main aim of this proposal is to ensure that voting and engagement lead to better remuneration arrangements, the important thing is for investors to inform the company of their concerns and for Boards to consider and act upon shareholder concerns. This can be achieved by requiring all investors to disclose their voting decisions together with the reasons for that decision. There should also be much more encouragement for clients of asset managers to require them to consider governance and pay issues at the companies in which they have invested.</p> <p>That said, Aviva Investors do see merit in considering the potential for a gradual escalation of the remuneration report vote; where (1) more than 50% of shareholders have opposed the advisory vote on remuneration and (2) where directors are not up for re-election each year. This could encourage those companies who do not put their directors up for re-election each year</p>	

and who currently fail to respond to shareholder action, despite significant votes against over successive years, to make changes. There could also potentially be a case, again as a last resort, for the advisory vote on the remuneration report becoming binding for a period of time, once a remuneration report has been voted down.

We have also suggested in our response to the Narrative Reporting consultation that it is worth looking at a mechanism whereby companies would inform shareholders when the Report & Accounts is available and at the same time open a “forum” which would allow shareholders to communicate with the company specifically on AGM/voting issues. This would enable shareholders who have concerns or queries to raise this before the AGM. It will also give companies the opportunity to rebut the conclusions of proxy voting agencies prior to the voting deadline. This is something which at Aviva we already attempt to do, notifying and responding to shareholders in advance of the AGM.

2. Are there any further measures that could be taken to prevent payments for failure?

Comments

Whilst we believe that it is appropriate to minimise payments for failure, exit payments often are made, for example, in respect of contractual entitlements which have been previously negotiated and agreed (and perhaps implicitly endorsed by shareholders). In this respect, good corporate governance is sometimes at odds with contractual or employment law.

Aviva Investors would see continuing use of “contractual entitlements” as an excuse for ‘payment for failure’ as no longer acceptable. Instead, companies should take a more robust line against such payments when they occur and ensure that when negotiating contracts provisions allow sufficient flexibility in times of failure.

We would also emphasise that in cases of payment for failure, the collective responsibility of the Board, including the executives, should be recognised by shareholders, and not solely focused on the remuneration committee members.

We believe there would be value for shareholders, in the introduction of a prohibition on directors voting on their own reward packages, as, for example, currently required by Australian law. We believe the principle of a prohibition is sensible one; however, acknowledge that the practicalities would need to be worked through carefully.

Finally, the growing incidence of large recruitment packages is also an issue which requires further consideration, particularly where such payments crystallise awards which may not otherwise have vested. The ability to make such payments may also promote a culture of “buying in” executives rather

than incentivise long term succession planning. Aviva Investors would favour any such “golden hellos” being required to be aligned to shareholder interests and subject to meaningful performance conditions.

3. What would be the advantages and disadvantages of requiring companies to include shareholder representatives on nominations committees?

Yes	No
	X
Comments	
<p>We believe that the concept of shareholder representatives on nomination committees is, in practice, far too difficult to implement. We agree that the dispersed and internationalised nature of the UK shareholder base would challenge adoption of the Swedish model of shareholder representatives in the UK where non-executive directors already fulfil this role. Shareholders currently elect directors to act in the best interests of shareholders as a whole. If directors are ineffective, it is up to shareholders to vote against their re-election when the time comes. We do not believe that further, specific shareholder representation on particular issues is necessary.</p> <p>Advantages:</p> <ol style="list-style-type: none"> 1. Potential for better shareholder involvement, with more diverse influence and scrutiny over nominations to the Board. <p>Disadvantages:</p> <ol style="list-style-type: none"> 1. Elected directors work within a clear legal framework and are clearly accountable to shareholders. It is not clear how shareholder representatives could be chosen - who would select them? Would they also be elected? Nor to whom they would owe allegiance or how they would be held accountable. 2. Institutional shareholders may be unwilling or unable to participate in nominations committees due to the risk of becoming an “insider” and therefore restricted in buying or selling the company’s shares. 3. Given the diversity of shareholdings in UK companies, it is unclear just how truly representative such individuals could be. <p>Aviva Investors however, do believe that nominations committees should be required to disclose, within the nomination committee report, much better information to shareholders on the processes they have undertaken and of the key criteria considered in the selection process. In particular, a meaningful explanation of what the committee considers the nominated director will bring to the Board, and how this is expected to contribute to overall Board</p>	

effectiveness.

Role of remuneration committees

4. Would there be benefits of having independent remuneration committee members with a more diverse range of professional backgrounds and what would be the risks and practical implications of any such measures?

Yes	No
	X
Comments	
<p>In principle, we believe there should be a diverse range of professional backgrounds on remuneration committees. However, this is already expected of Boards today.</p> <p>The UK Corporate Governance Code already requires that the Board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively. We consider that there is significant benefit in a Board and its committees being constituted of individuals from a wide variety of backgrounds, with a diverse range of skills and experience.</p> <p>As with many areas of corporate governance, the effectiveness of the Remuneration Committee will be determined by the individuals involved in the decision making, and therefore will vary from company to company. The best way to ensure the effectiveness of Boards is through an active and engaged shareholder base and Boards engaging in high quality Board evaluations. Aviva Investors believe this does not happen often enough.</p> <p>However, the discussion paper indicates that the question is about extending membership to independent people who are not full non-executive directors of the company. We consider this would blur the lines of responsibility of the Board and reduce accountability to shareholders, and we would consequently not support it. We consider that remuneration committees are, and should remain a direct extension of the Board and that executive remuneration is a fundamental Board responsibility with clear accountability to shareholders. If remuneration committee members are not sufficiently independent and diverse, this is a wider Board issue that should instead be addressed by improving Board composition.</p> <p>Aviva Investors believe institutional investors should take a more active interest and fund managers should disclose their voting records and the reasons for their vote decisions. It would be helpful if, for example, the Financial Reporting Council (FRC) were to have a page on their website that records the voting decisions of all those who have signed up to the</p>	

Stewardship Code. That way we can track more easily those investors who are acting on these issues through voting activity and those who are not. Those investors that vote in favour of all resolutions and at all company meetings should explain what else they do to demonstrate they are good stewards of their clients/policyholders money.

5. Is there a need for stronger guidance on membership of remuneration committees, to prevent conflict of interest issues from arising?

Yes	No
	X
Comments	
<p>We believe that the current guidance is generally sufficient and is capable of being supported by a number of other factors which are already in place, namely, the regulatory duties of directors and the ability of shareholders to vote against directors' re-elections. Conflicts can appear in many guises and are difficult to prevent. It should be down to shareholders who perceive a conflict to raise this with companies. At the end of the day, it is the outcome of the remuneration deliberations that counts and we should focus more on the outcomes of remuneration arrangements.</p> <p>From Aviva Investors' own experience, it is apparent that the failing is often in the rigorous application of the guidance and in the lack of support in practice. We consider therefore that ultimately shareholders should recognise that the entire Board and not just the remuneration committee are responsible for executive remuneration, and that more pressure should be put on shareholders to hold both remuneration committees and executive directors to account.</p> <p>Whilst executive experience undoubtedly brings an important perspective to remuneration committee considerations, there may still be potential inherent conflicts of interest when non-executive directors are also current executive directors elsewhere. For that reason, Aviva Investors would suggest that consideration is given to recommending limits on the proportion of such directors on a remuneration committee, thereby ensuring that there is not a majority of members who are currently executives elsewhere.</p>	

6. Would there be benefits of requiring companies to include employee representatives on remunerations committees and what would be the risks and practical implications of any such measures?

Yes	No

	X
Comments	
<p>We believe that remuneration should already be aligned with the interests of shareholders and other key stakeholders, including employees. However, from our experience as investors, we agree that this is not always the case.</p> <p>While we understand the desire to make some remuneration committees more effective and more aware of the negative impact of their decisions, we believe that including employee representatives would not necessarily achieve the desired outcomes due to issues of confidentiality, and the time commitment required.</p> <p>We believe that employee representatives would be in a very difficult position judging their executive's reward on behalf of fellow employees, and would predict that pressures would tend to move these representatives either towards acquiescence or towards perpetual and probably ineffective dissent, neither of which would benefit discussions around remuneration practices.</p> <p>We do however, support remuneration committees taking employee views on executive remuneration into account, albeit not via an employee vote. See question 7.</p>	

7. What would be the costs and benefits of an employee vote on remuneration proposals?

Comments
<p>We are not supportive of an employee vote on remuneration proposals. We believe that this would not provide constructive input or insight into the process; instead creating undue pressure on management to agree a populist agenda rather than a practical and commercial one.</p> <p>That said, we do see merit in Remuneration Committees being encouraged to receive input into their deliberations from the employees, not least because Boards will work best with the confidence of their employees.</p> <p>This input could potentially be formed via an employee survey which would be used as a two way conversation - to both increase understanding amongst employees of how reward packages are made up and determined and to provide input to the remuneration committee on the views of the workforce. We would expect Remuneration committees to disclose how they have used such information in their deliberations and decision making when developing pay for directors.</p>

8. Will an increase in transparency over the use of remuneration consultants help to prevent conflict of interest or is there a role for stronger guidance or regulation?

Yes	No
X	
Comments	
<p>We believe that an increase in the transparency of the use of remuneration consultants would be of benefit both to shareholders and to companies. There are obvious conflicts of interest that are possible - for instance, if the consultants used by the remuneration committee are also used elsewhere in the company at the behest of the executive - and appropriate transparency about the roles played by consultants and the controls and monitoring of potential conflicts of interest would help to prevent such conflicts occurring.</p> <p>We would recommend that the Remuneration Consultants Group Code of Conduct is kept under review, and that monitoring adherence by signatories is transparently reported</p>	

Structure of remuneration

9. Could the link between pay and performance be strengthened by moving away from TSR and EPS as the key measures of performance?

Yes	No
Yes and No	Yes and No
Comments	
<p>Performance measures should be set in light of the long-term strategy of the company and appropriate measures will therefore vary widely between different companies and sectors. Long term sustainable shareholder return is what all Boards should be seeking to maximise and long-term Total Shareholder Return (TSR) is an appropriate measure in this regard. Aviva Investors' preference is that at least some part of a director's incentive arrangement is based on TSR.</p> <p>Earnings Per Share (EPS) on the other hand will not always be relevant as a measure of value creation for various reasons, not least because there may be little long-term correlation between EPS and long-term returns to shareholders, it can be easily manipulated and it does not incorporate any allowance for the capital used to create those earnings.</p> <p>We consider that companies should have long-term performance measures that are appropriate to their business and strategy, In this regard, a model that</p>	

is seen to impose TSR and EPS only is wrong, but either or both measures may be appropriate in a given set of circumstances.

10. Should more companies be encouraged to adopt vesting periods of more than three years?

Yes	No
Yes and No	Yes and No
Comments	
<p>We note that there is a disparity between the question in the Consultation document and the question posed in this response Form. The Consultation question is “Should companies be encouraged to defer a larger proportion of pay over more than three years?” which is a very different question to the one we are answering. We shall attempt to answer both.</p> <p>On the question of vesting periods of more than 3 years, Aviva Investors view is that the length of performance and vesting periods should attempt to correlate with companies' strategic plans. This very much depends upon the business and the sector and as such no one policy should be applied arbitrarily across the market. For long term plans, the minimum vesting period should be 3 years but where companies have strategic objectives that go beyond 3 years then the incentive arrangements should align with the longer period.</p> <p>On some occasions we would even support more focus on shorter periods than 3 years - for example, in rescue situations where the next year is critical. However, we would stress that this is only in the most exceptional circumstances</p> <p>On the original question in the consultation paper which asks about deferrals, we agree that companies should be encouraged to defer a larger proportion of pay over a longer period. In particular where the long term vesting period is three years, there should be a longer deferral period at the end of the vesting period in order to encourage Boards to look through to a longer period and through their business cycle.</p>	

11. Should companies be encouraged to reduce the frequency with which long-term incentive plans and other elements of remuneration are reviewed? What would be the benefits and challenges of doing this?

Yes	No
X	

Comments
<p>We are of the view that long term incentive plans and other elements of remuneration should not be reviewed annually. The plans should be able to stand the test of the time for which these were designed. This would reduce their costs, monitoring and voting costs for shareholders and others and increase consistency over time.</p> <p>In particular, stability of performance measures over time is important to ensure that cyclical factors (such as company business cycles and market cyclicality) are fairly reflected in incentive reward.</p> <p>The counter argument would likely be that strategy will change over time so the LTIPs should be adjusted to reflect this. Where this happens, the company may have a case for review but so far as business as usual is concerned, the plans should not be constantly changed. Shareholders will, of course, assess the change in strategy in conjunction with the change to remuneration arrangements. Where plans remain the same but potential reward is increased, Aviva Investors considers this to be an issue that should go to shareholders for a vote.</p>

12. Would radically simpler models of remuneration which rely on a directors' level of share ownership to incentivise them to boost shareholder value, more effectively align directors with the interests of shareholders?

Yes	No
X	
Comments	
<p>In principle, we are in favour of simpler arrangements and the prospect of radically simpler models of remuneration is very attractive. Simplification would generally strengthen alignment with shareholders, reduce the “casino” element, improve the incentive element (complexity is not conducive to effective incentivisation), and reduce the costs for both companies and shareholders of assessing and monitoring complex incentive schemes. However, we believe there is a balance between making things too simple and/or too complicated. Our view is that plans are currently too complicated.</p> <p>Meaningful share ownership by executives is an important alignment factor, ensuring that directors suffer and benefit in the same way as shareholders. Simpler pay arrangements are also important and aid both better understanding by everyone, including shareholders and directors and better incentivisation. Important as these factors are however, we do not believe that, on their own, they will always be sufficient as incentivisation.</p> <p>There have been discussions as to whether significant shareholding and long</p>	

retention times can replace performance conditions. As investors, we are not yet convinced of the case for this but where these plans are put in place, we believe the incentive should be paid in market priced (not nil priced) options. In this way, at least the share price has to increase before the options vest. Having said this, when the markets rise, all stocks rise with it, so we would still prefer to have a measure which reflects management action rather than just the movement of the markets.

In order to avoid directors reducing negative impacts of poor performance, Aviva Investors would suggest that consideration be given to banning directors from any kind of hedging against their shareholdings or unvested awards in the company.

13. Are there other ways in which remuneration - including bonuses, LTIPs, share options and pensions – could be simplified?

Yes	No
X	
Comments	
<p>We believe the disclosure proposals in the Narrative Reporting consultation will significantly simplify the understanding of remuneration arrangements. In our response to the Narrative Reporting consultation we support in principle a single number for total pay based upon an agreed prescriptive methodology for calculating the value of pay and incentives for ease of comparison with other companies. We believe a clear explanation of the guiding philosophy and how pay practices serve to align with company strategy in the Strategic Report is welcome.</p> <p>From a structural point of view, it would be much simpler if some individual companies had fewer and less complex incentive plans. Also, the alignment with clear measures of long term value creation and measures of performance that are easily assessed and understood. This would mean less reliance on complex calculations. Where complicated calculations are used, companies should give a clear explanation of how this works and the assumptions applied. However, if plans are too complicated, Aviva Investors may not support the arrangements.</p> <p>In addition, we consider that better disclosure of incentive award values should be required, with both face values and expected values disclosed, and companies should also present illustrative scenarios on what would be paid out at differing levels of performance. We do not see this as contrary to the desire for simplicity, its object would be to improve understanding.</p>	

14. Should all UK quoted companies be required to put in place claw-back mechanisms?

Yes	No
X	
Comments	
<p>Yes, we believe that all UK listed companies should be required to put in place claw-back mechanisms.</p> <p>We also believe that claw-backs should be in relation to net and not gross reward given the complications involved in recovering taxable elements.</p> <p>It should be ensured that the use of claw-back mechanisms is not overly restrictive (i.e. they will be virtually unusable) and that remuneration committees have some discretion as to how and when to invoke them, with shareholders holding remuneration committees responsible for using or not using their discretion as appropriate.</p>	

Promoting good practice

15. What is the best way of coordinating research on executive pay, highlighting emerging practice and maintaining a focus on the provision of accurate information on these issues?

Comments
<p>If research needs to be coordinated, it needs to fall under the remit of one organisation. The Association of British Insurers may be able to provide such a service or academia</p>