FTSE 100 SAY ON PAY VOTING INSIGHT

DirectorInsight

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This report summarizes the UK FTSE 100 Director remuneration proxy voting results from 2011 to May 2016. It strives to provide corporations, their boards and other stakeholders, information on how shareholders voted on pay proposals across the 100 largest listed companies in the UK. Ultimately to better understand the pitfalls, shareholder revolts and how this can be mitigated through effective company engagement.

"Executive pay proposals in the FTSE 100 companies have the highest active absentations among other shareholder proposals on the proxy sheet"

Introduction

Over the last 5 years, the landscape has significantly changed with shareholders being very active on executive pay proposals. The 2011 AGM showed a spike in shareholders scrutinizing pay proposals disclosed in companies' remuneration reports. From 2012 till 2014, companies received more "votes for" relative to 2011. However, the 2016 proxy season, using a threshold of 10% votes against, is already showing that the 2015/16 remuneration reports received one of the highest votes cast against. While we are still in the middle of the proxy season, 23.61% of the FTSE 100 companies' shareholders have already voted against remuneration reports.

"Now more than ever, there is more focus on stewardship in the FTSE 100"

Key findings

- U.K. FTSE 100, Shareholder revolt on executive pay is already higher than 2012 shareholder spring.
- Shareholders have been increasingly engaging with their portfolio companies on governance matters, to understand the drivers and risks, for sustainable performance, and protect the long term value and interest of their investments.
- Corporations and their board are expected to be better equipped to already obtain buy in at an early stage.
- Institutional investors have been building in-house governance research capabilities for an independent screening and proactive company engagement.
- Recommendations given by proxy advisors were not always aligned and investors were willing and able to make independent and different decisions.
- Some of the corporations and their boards did not anticipate any shareholder revolt. This led to intensified engagement, high public attention and reputation risk exposure. These revolts were mainly driven by shareholders being dissatisfied with company's proposals for the following reasons:
  - Lack of transparency and strong rational.
  - CEO's Pay showing a hike and perceived as excessive and socially irresponsible.
  - Misaligned with company performance over multiple years.
  - Change in performance metrics as part of new pay policy were not linked to long term value creation.
- Increased responsibility for the Remuneration Committee, which is being held accountable. The same applies to the associated remuneration advisors. The latter is being challenged on level of independence.
- Same companies receive year on year more than 10% votes against on their pay practice

THE UK STEWARDSHP CODE

Under the Companies Act, listed companies are required to announce their AGMs and release meeting materials, at least 20 working days before the meeting date. The quorum requirement for an AGM is generally subject to the company's articles of association. All UK companies generally provide shareholders with the opportunity to actively abstain on a resolution. This is an option shareholders can use to note their dissatisfaction with a management proposal without voting against it outright. It must however be noted that abstentions do not comprise votes in law and only votes that are cast are counted in resolutions settlement.

Some of the important resolutions that are found on the proxy include pay proposals and director elections. The UK corporate governance code does not recommend the use of staggered boards and so under the corporate governance code, all directors must stand for reelection annually during AGMs subject to satisfactory performance. Remuneration reports are submitted for voting at AGMs which are normally advisory votes. Shareholders have a binding vote on companies' remuneration policies (CG code 2014).

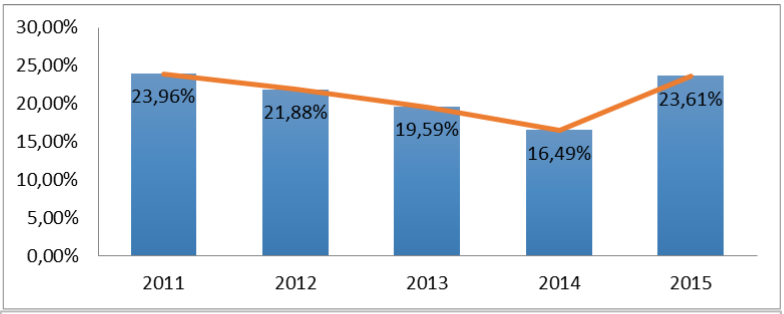
PROXY VOTING STATISTICS

AGMs in the UK Financial market are not unnoticed in global markets. Interesting trends and governance developments are initiated year on year which influences other markets. To identify these trends, we analyzed the proxy results of all FTSE 100 companies (using the FTSE composition at the end of 2015), over the period 2011 till May 2016, and identified the companies which received more than 10% 'against' their remuneration reports. So far, in this proxy season of the 72 companies who conducted their AGM's, 23.61% received more than 10% against. The previous year out of 97 companies, 16.49% voted against. For the year 2013, 19.59% voted against and 21.88% for 2012.

During the 2012 AGM season, the UK financial market witnessed perhaps the biggest level of shareholder revolt on executive pay proposals for several FTSE 100 companies. In what was seen as protest votes, these companies saw their remuneration reports voted down which were all advisory votes. Industry players began calling on the need for the remuneration reports votes to be binding for boards. For example at the time, Central Rand Gold received as much as 75% of votes cast against its remuneration report. Aviva PLC also received 54.41% of votes against its remuneration report whiles Barclays Bank and BP also received 26.9% and 11.79% votes cast against their remuneration report. It is believed that these events set the precedent for the introduction of binding remuneration policies in the 2014 CG code. Analysts are of the opinion that this was due to the backlash issuers received at the 2012 AGMs for 2011 remuneration reports.

The 2016 AGM season is already showing proxy voting results are back at the same level as 2012 AGM season, with the remaining 30% of the FTSE 100 companies AGM's still to be conducted.

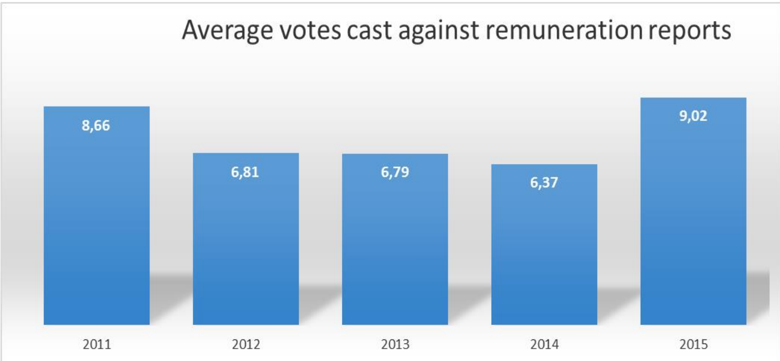
The table below shows the percentage of companies in the FTSE 100, which received a voting of more than 10% 'against' their remuneration reports from 2011 till May 2016.



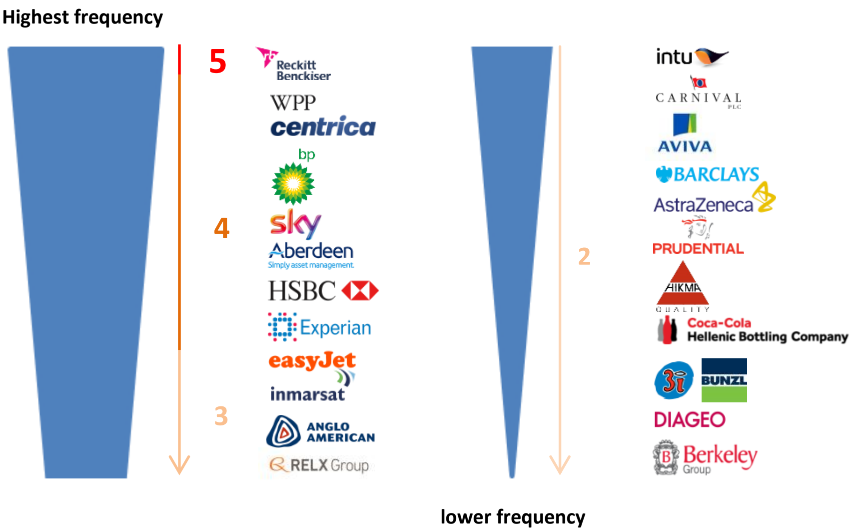
Total companies	96	96	97	97	72

2015 AGAINST 2014

43.4%



WHEN TAKING ALL VOTES CAST FOR THE PROXY YEAR 2015/2016, THE AVERAGE VOTES THAT WERE CAST AGAINST REMUNERATION VOTES WERE 9.02%. WITH THE 2016 AGM SEASON STILL ONGOING, IT IS RECORDING THE HIGHEST AVERAGE VOTES CAST AGAINST REMUNERATION REPORTS IN THE FTSE 100 OVER THE LAST 5 YEARS.



THE 24 COMPANIES ENCOUNTERING TWICE OR MORE, THAN 10% SHAREHOLDER VOTES CAST AGAINST, ON THEIR REMUNERATION REPORT FOR THE LAST FIVE YEARS **(2011 – MAY 2016)**

Note: The results for some companies that have conducted their AGM's after May 2016 are not included.

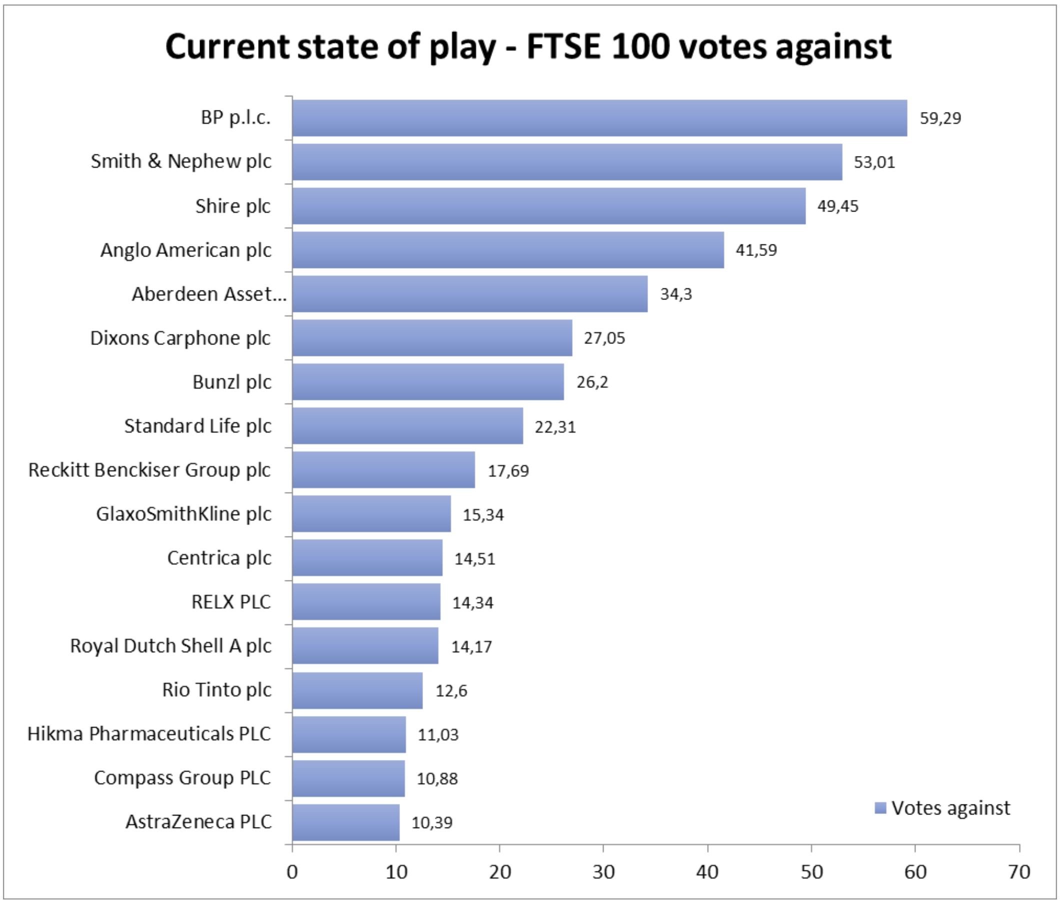
HIGHLIGHTS OF THE 2016 AGM SEASON

This proxy season faced an all-time record shareholder revolt on executive pay proposals. It signifies that the landscape is changing and there are more active shareholders in the FTSE 100, who are taking governance and executive pay matters seriously.

Shareholders have shown issuers the hostile response for rubber stamped pay packages for executives without any corresponding performance. Furthermore, shareholders voted against when no dividend payments or cut in dividend payments were proposed while the company CEO is getting a pay increase and bonus. In addition, change in performance metrics, as part of new pay policy, which were not tied to performance hurdles that are linked to long term value creation, were rejected. Finally, CEO's pay proposals showing a hike were perceived as excessive and socially irresponsible.

"Shareholders who voted on governance and remuneration resolutions significantly increased"

British Petroleum's shareholders showed discontent. The board received 59.29% of valid votes cast against the remuneration report, which is believed to been caused by the ballooned CEO's remuneration for a company who had recorded major losses in the year under review. Not long after that, shareholders of Medical equipment group Smith & Nephew showed the board their displeasure. The board received approximately 53.01% against its decision to allow a long-term incentive plan to pay out £2.1m to 60 senior executives even though the performance hurdle had not been met by these executives. Drug making giants Shire Plc received investors' activism on executive pay. It barely escaped a defeat over its pay proposals to shareholders. CRH plc received approximately 40.85% against its remuneration policy, which will see the group's CEO Albert Maniford pocket a maximum annual bonus payment of up to 225% of his basic salary, as well as a share plan of more than 250% of his pay. At the end CRH plc annual remuneration report received 91.35% backing from shareholders. Anglo American received only 58.36% votes cast in favor for its 2015 remuneration report. In addressing the situation, Legal and General Investment Management, which owns 2.9% of Anglo American, said it voted against the remuneration report because of a *"lack of discretion exercised by the remuneration committee to scale back long term incentive awards to executive directors at a low share price".*



Source: DirectorInsight

How are issuers responding to shareholder activism?

Boards that have had worse run started reacting to shareholders. The Chairman for the board of BP, Carl-Henric Svanberg, promised to address the concerns of their shareholders concerns and return with better pay proposals. Shire PLC acknowledged shareholder concerns through the company's spokesperson. Smith and Nephew, who received significant % of votes against its remuneration report, responded to their shareholder concerns. They noted that its remuneration committee will be taking an in-depth look at its remuneration arrangements with shareholders. A revised policy in consultation with shareholders will be designed to align executive's pay with shareholder's interests. Intertek plc, who received 51.68% of votes cast against their remuneration report for 2014, received a high approval from shareholders for this year's remuneration report at 96.49%. The board submitted a revised remuneration policy, which will see annual incentive based solely on financial performance (Revenue growth, operating profit growth, Return on Invested Capital performance). The board, acknowledging the push back they received on their 2014 remuneration report, believes that this new policy is more aligned with the growth strategy of the company. At the previous AGM season, HSBC notably received 23.71% against their remuneration report. This season, they received more support from their shareholders, as 96% of investors voted in favor of their remuneration policy and 90.5% also accepted the bank's 2015 remuneration report. This is in the light of the Bank's willingness to change its pay policy, by telling shareholders that it would overhaul its policies first, by cutting the amount of cash given to executive directors in lieu of a pension from 50% to 30% of their base salary. The company also addressed the need to make its Long Term Incentive Plan (LTIP) subject to three-year performance period in accordance with their peers in the FTSE. Aberdeen Asset Management who received 34.30% against its remuneration report promised to make its remuneration report more "transparent" for shareholders.

Shareholders shaping the landscape for good governance

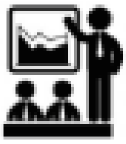
Companies such as Legal & General, Fidelity, BlackRock, Aviva Investors, BMO, F&C Asset Management and Royal London have been identified as being very active owners on governance and executive compensation matters. For example, it was reported that Fidelity Worldwide voted against 32.9pc of pay policies, followed by Aviva Investors. Blackrock's 2016 first quarter voting engagement report on its EMEA investments portfolios showed that almost half of their voting engagements were on governance practices, with a strong focus on executive compensation. This in itself is an interesting finding and there is the need to understand how much of interest these investors have in the FTSE 100, as they could influence the voting behavior of other investor.

"Shareholders are becoming more sophisticated in their understanding of pay policies"

Shareholders are adopting more themes in their proxy voting guidelines for good corporate governance. These themes include identifying pay for performance misalignments, excessive pay, policy not aligned with long term value creation and in the interest of their assets.

Furthermore, shareholders have recently turned their frustrations away from the recipients of these executive pay to remuneration committee heads. For example, Dame Ann Dowling, remuneration chair of BP, came under fire by shareholders, who argued it was under her watch that the company suffered the rebellion on executive pay.

PROXY ADVISORS AND THEIR INFLUENCE



It is not uncommon for institutional investors to make use of proxy advisors in making their voting decisions. The ICSA published in its review that during the 2015 AGM season, 18 FTSE 100 companies received at least one against or abstain recommendation from the proxy advisory firm ISS, for a total of 23 resolutions. Additionally, 85 FTSE 100 companies received at least one against or abstain recommendation from proxy firm Glass Lewis, for a total of 120 resolutions.[1] These recommendations have impact on voting outcomes.

For example, investors of shire plc received a recommendation from ISS and Glass Lewis to vote against its remuneration report. The concerns of these institutions were a 25% fixed pay rise for the group's CEO Flemming Ornskov. One of the proxy advisor firms advised clients and shareholders of Smith and Nephew to reject its pay proposal given that performance hurdles had not been met by the company. The performance hurdle for receiving a bonus by the executives was when TSR was at or above median of the company's peer group. ISS and PIRC were perhaps instrumental in the show down Standard Plc's board received against its remuneration report. Both recommended shareholders to vote against the remuneration report as they criticized the size of the CEO's Long term incentive award and the bonuses paid to former chief executive David Nish after

[1]https://www.icsa.org.uk/knowledge/governance-and-compliance/features/december-2015-agm-season-in-review

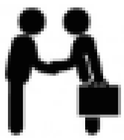
his resignation, along with a "golden handshake" payment made to board member Colin Clark. Standard PLC received 22.31% of votes against the remuneration report.

In a related development two of the biggest institutional advisers Glass Lewis and Pensions & Investment Research Consultants (PIRC) recommended shareholders to vote against the remuneration report of Royal Dutch Shell PLC. Industry watchers and analysts believe that Shell's senior executive pay award did not justify its performance. Both argued that the peer group for benchmarking its executive pay was extremely "narrow"[2]. The leading advisory company with the largest market share ISS recommended shareholders to approve the remuneration proposal. At the end, despite these conflicting recommendations, Shell's shareholders gave the board 85.83% of the votes cast in favor. It is possible to say that these recommendations impacted the remuneration report vote for Royal Dutch Shell. Looking at the company's remuneration vote's history, the company consistently received above 90% of votes cast in favor for the past five years.

Another example, the shareholder advisory firms PIRC and Manifest advised shareholders to reject executive payouts that saw CEO Antonio Horta- Osoria of Lloyd Bank receive GBP 8.7M for the 2015 annual year. Both argued that the payout was excessive. Shareholders shot down these recommendations and the AGM held on May 12, 2016 saw the board receiving 97.67% votes cast in favor of its remuneration report. The board also received 97.81% backing for its Long Term Incentive Plan 2016. Lloyds was not the only target by these proxy advisors. ITV's shareholders also received recommendations from PIRC to abstain from remuneration vote for what they describe as "excessive" for the CEO's take home pay. Although the remuneration report received quite a significant number of votes withheld, it was not the largest votes withheld on resolutions presented for their AGM votes.

Institutional investors have increasingly started to create their own governance research capabilities that are tasked with conducting independent screening on governance practices, which are integrated in their investment decision making process. This enables investors to be more proactive and to form their own view on pay proposals, ultimately to establish proactive direct engagement with the companies for decisions regarding their votes in an early stage.

THE REMUNERATION CONSULTANTS



The use of remuneration consultants by boards of corporations in the FTSE 100 has a high prevalence. According to the Remuneration Consultants Group (RCG), 97% of FTSE 100 companies have named remuneration consultants as their advisers in their remuneration report with 95% of this being registered members of the RCG. Over the last years, pay consultants have come under harsh criticisms, as some of them have been linked to the most controversial pay packages that sparked shareholder outcry. In addition, criticism has been that these consultants are not truly independent as they also provide other services to these companies.

The consultants who were most named as advisor to companies who received more than 10% votes against over the last 5 year were: Towers Watson Willis, New Bridge Street, PWC and Kepler Asscociates. In addition, we found

[2]The telegraph: top investors vents anger at boss pay; http://www.telegraph.co.uk/business/2016/05/11/top-shell-investor-vents-anger-at-boss-pay/

that some companies named two advisory firms in their remuneration report for the same year.

OUTLOOK

This proxy season has unleashed some very interesting engagements. Shareholder activism on pay proposals increased, with shareholders continuously demanding a strong link with company performance and holding board of directors liable for remuneration proposals.

A significant number of companies in the FTSE 100 will have to present their remuneration policies for adoption at the 2017 AGM season.

With shareholders scrutinizing now more than ever company's remuneration policies and proposals, boards and their remuneration committees will need to go back to the drawing board to mitigate activism risk, their personal and company's reputation.

We anticipate that institutional investors will independently perform their own research to form their voting decision, which can differ from the recommendations they receive from the proxy advisors.

With investors getting increasingly more sophisticated in assessing pay proposals, boards and their corporations will most likely change the way they engage with shareholders. A constructive dialogue supported with powerful intelligence will be needed for obtaining shareholder support pre-AGM. Being able to clearly demonstrate good corporate governance on themes such as pay aligned with performance, using appropriate peer groups, sustainable and socially responsible pay practices will be critical for effective company engagement.

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Company description

DirectorInsight is a one-stop, interactive online corporate governance data and analytics solution. It provides a new way for corporations, their boards and investors, to independently analyze data and obtain unparalleled insight on pay, performance and governance practices for informed decisionmaking and company engagement. DirectorInsight provides an easy to access on line platform with comprehensive governance analytics, fundamental company financial performance and executive compensation data from 2008 and onwards, providing highest quality statistics and data for assessing executive compensation levels, pay for performance alignment, board and corporate governance practices. Data covers over 31 indexes, +1200 listed companies with more than 35.000 executive profiles, drawn from leading European equity indexes. DirectorInsight provides a fully integrated governance solution where boards, remuneration committees, investors and professionals in the field of HR and research, have access to the same data, to make informed decisions and engage effectively.

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