PARLIAMENTARY DEBATES

HOUSE OF COMMONS
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GENERAL COMMITTEES

Public Bill Committee

ENTERPRISE AND REGULATORY REFORM BILL

Sixteenth Sitting

Tuesday 17 July 2012

(Morning)

CONTENTS

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Saturday 21 July 2012

STRICT ADHERENCE TO THIS ARRANGEMENT WILL GREATLY FACILITATE THE PROMPT PUBLICATION OF THE BOUND VOLUMES OF PROCEEDINGS IN GENERAL COMMITTEES

The Committee consisted of the following Members:

Chairs: † Hugh Bayley, Mr Graham Brady, Martin Caton, Mr Charles Walker

† Anderson, Mr David *(Blaydon)* (Lab)
† Bingham, Andrew *(High Peak)* (Con)
† Bridgen, Andrew *(North West Leicestershire)* (Con)
† Burt, Lorely *(Solihull)* (LD)
† Carmichael, Neil *(Stroud)* (Con)
† Cryer, John *(Leyton and Wanstead)* (Lab)
† Danczuk, Simon *(Rochdale)* (Lab)
Davies, Geraint *(Swansea West)* (Lab/Co-op)
Evans, Graham *(Weaver Vale)* (Con)
† Johnson, Joseph *(Orpington)* (Con)
† Lamb, Norman *(Parliamentary Under-Secretary of State for Business, Innovation and Skills)*
† Morris, Anne Marie *(Newton Abbot)* (Con)
† Mowat, David *(Warrington South)* (Con)
† Murray, Ian *(Edinburgh South)* (Lab)
† O'Donnell, Fiona *(East Lothian)* (Lab)
† Ollerenshaw, Eric *(Lancaster and Fleetwood)* (Con)
† Onwurah, Chi *(Newcastle upon Tyne Central)* (Lab)
† Prisk, Mr Mark *(Minister of State, Department for Business, Innovation and Skills)*
† Ruane, Chris *(Vale of Clwyd)* (Lab)
Simpson, David *(Upper Bann)* (DUP)
Smith, Julian *(Skipton and Ripon)* (Con)
† Wright, Mr Iain *(Hartlepool)* (Lab)
† Wright, Jeremy *(Lord Commissioner of Her Majesty's Treasury)*

James Rhys, Steven Mark, *Committee Clerks*

† attended the Committee

Public Bill Committee

Tuesday 17 July 2012

(Morning)

[HUGH BAYLEY *in the Chair*]

Enterprise and Regulatory Reform Bill

Written evidence to be reported to the House

ERR 39 PCS

ERR 40 Society of London Theatre and Theatrical Management Association

ERR 41 British Chambers of Commerce

ERR 42 Creators' Rights Alliance

Clause 57

DIRECTORS' REMUNERATION: EFFECT OF REMUNERATION REPORT

9 am

Question proposed, That the clause stand part of the Bill.

The Chair: With this it will be convenient to discuss the following:

Government new clause 5—*Payments to directors: members' approval of directors' remuneration policy*—

'(1) In section 421 of the Companies Act 2006 (contents of directors' remuneration report) after subsection (2) insert—

"(2A) The regulations must provide that any information required to be included in the report as to the policy of the company with respect to the making of remuneration payments and payments for loss of office (within the meaning of Chapter 4A of Part 10) is to be set out in a separate part of the report."

(2) After section 422 of that Act (approval and signing of directors' remuneration report) insert—

"422A Revisions to directors' remuneration policy

(1) The directors' remuneration policy contained in a company's directors' remuneration report may be revised.

(2) Any such revision must be approved by the board of directors.

(3) The policy as so revised must be set out in a document signed on behalf of the board by a director or the secretary of the company.

(4) Regulations under section 421(1) may make provision as to—

(a) the information that must be contained in a document setting out a revised directors' remuneration policy, and

(b) how information is to be set out in the document.

(5) Sections 422(2) and (3), 454, 456 and 463 apply in relation to such a document as they apply in relation to a directors' remuneration report.

(6) In this section, "directors' remuneration policy" means the policy of a company with respect to the matters mentioned in section 421(2A)."

(3) In section 439 of that Act (quoted companies: members' approval of directors' remuneration report), in subsection (1), at the end insert "other than the part containing the directors' remuneration policy (as to which see section 439A).".

(4) After that section insert—

"439A Quoted companies: members' approval of directors' remuneration policy

(1) A quoted company must give notice of the intention to move, as an ordinary resolution, a resolution approving the relevant directors' remuneration policy—

(a) at the accounts meeting held in the first financial year which begins after the coming into force of section (*Payments to directors: members' approval of directors' remuneration policy*) of the Enterprise and Regulatory Reform Act 2012 or at an earlier general meeting, and

(b) at an accounts or other general meeting held no later than the end of the period of three financial years beginning with the first financial year after the last accounts or other general meeting in relation to which notice is given under this subsection.

(2) A quoted company must give notice of the intention to move at an accounts meeting, as an ordinary resolution, a resolution approving the relevant directors' remuneration policy if—

(a) a resolution required to be put to the vote under section 439 was not passed at the last accounts meeting of the company, and

(b) no notice under this section was given in relation to that meeting or any other general meeting held before the next accounts meeting.

(3) A notice given under subsection (2) is to be treated as given under subsection (1) for the purpose of determining the period within which the next notice under subsection (1) must be given.

(4) Notice of the intention to move a resolution to which this section applies must be given, prior to the meeting in question, to the members of the company entitled to be sent notice of the meeting.

(5) Subsections (2) to (4) of section 439 apply for the purposes of a resolution to which this section applies as they apply for the purposes of a resolution to which section 439 applies, with the modification that, for the purposes of a resolution relating to a general meeting other than an accounts meeting, subsection (3) applies as if for "accounts meeting" there were substituted "general meeting".

(6) For the purposes of this section, the relevant directors' remuneration policy is—

(a) in a case where notice is given in relation to an accounts meeting, the remuneration policy contained in the directors' remuneration report in respect of which a resolution under section 439 is required to be put to the vote at that accounts meeting;

(b) in a case where notice is given in relation to a general meeting other than an accounts meeting—

(i) the remuneration policy contained in the directors' remuneration report in respect of which such a resolution was required to be put to the vote at the last accounts meeting to be held before that other general meeting, or

(ii) where that policy has been revised in accordance with section 422A, the policy as so revised.

(7) In this section—

(a) "accounts meeting" means a general meeting of the company before which the company's annual accounts for a financial year are to be laid;

(b) "directors' remuneration policy" means the policy of the company with respect to the matters mentioned in section 421(2A).".'.

Amendment (a) to new clause 5, in subsection (1), at end insert—

'(2B) The regulations must include information regarding the 10 highest paid employees in the company outside of the board and executive committee".'.

Amendment (b) to new clause 5, in subsection (4), leave out new section 439A(1)(a) and (b).

Amendment (c) to new clause 5, in subsection (4), leave out new section 439A(2) and (3).

Amendment (d) to new clause 5, in subsection (4), leave out new section 439A(5).

Amendment (e) to new clause 5, in subsection (4), leave out new section 439A(6)(b) and insert—

'(6A) The resolution under subsection (1) in respect of directors' remuneration policy must obtain the approval of 75 per cent. of members on the share register of the quoted company.'.

Amendment (g) to new clause 5, at end add—

'(5) In section 412 of the Companies Act 2006 (Information about directors' benefit: remuneration), after subsection (2)(e) insert—

(f) disclosure of fees paid to recruitment consultants in respect of recruitment consultancy work and non-recruitment consultancy work for the company in the last year.".'.

Amendment (i) to new clause 5, at end add—

'(6) The Secretary of State shall, within three months of the passing of this Act, make provision by regulations under section 1277 of the Companies Act 2006 requiring the provision of information about the exercise of voting rights in respect of directors' remuneration policy.'.

Amendment (j) to new clause 5, at end add—

'(7) After section 227 of the Companies Act 2006 (Directors' service contracts), insert the following new section—

"227A Appointment of remuneration consultants of public company

(1) Remuneration consultants may be appointed for each financial year of the company.

(2) For each financial year for which a remuneration consultant or consultants is or are to be appointed (other than the company's first financial year), the appointment must be made before the end of the accounts meeting of the company at which the company's annual accounts and reports for the previous financial year are laid.

(3) The directors may appoint a remuneration consultant or consultants of the company—

(a) at any time before the company's first accounts meeting;

(b) to fill a casual vacancy in the office of remuneration consultant.

(4) The members may appoint a remuneration consultant or consultants by ordinary resolution—

(a) at an accounts meeting;

(b) if the company should have appointed a remuneration consultant or consultants at an accounts meeting but failed to do so;

(c) where the directors had power to appoint under subsection (3) but have failed to make an appointment.

(5) A remuneration consultant or consultants of a public company may only be appointed in accordance with this section.

(6) In this section a "remuneration consultant" means a person who is appointed to advise on the terms of directors' service contracts.".'.

Government new clause 6—*Payments to directors of quoted companies.*

Government new clause 7—*Payments to directors: minor and consequential amendments.*

Government new clause 8—*Directors' remuneration reports and payments to directors: transitional provision.*

New clause 17—*Remuneration committees and non-executive directors.*

New clause 18—*High Pay Commission.*

Mr Iain Wright (Hartlepool) (Lab): May I say what a pleasure it is to serve under your chairmanship on the last day of the Committee's deliberations, Mr Bayley? We are now on the final lap, as it were, and I am sure that all Committee members will miss our Tuesdays and Thursdays—perhaps we can have a reunion during the recess.

Simon Danczuk (Rochdale) (Lab): Perhaps not.

Mr Wright: Perhaps not.

Andrew Bridgen (North West Leicestershire) (Con): I thank the shadow Minister for his opening remarks, but I point out that we seem to be missing most of the Labour Committee members this morning.

The Chair: Yes, and if we meet in the recess, you will miss the Chair as well.

Mr Wright: I think that my hon. Friends are probably stuck in the traffic chaos caused by the Government's incompetent—*[Interruption.]*

Chris Ruane (Vale of Clwyd) (Lab): On that exact point, I was texted not 10 minutes ago by my hon. Friend the Member for Leyton and Wanstead to say precisely that: he was stuck in Olympic traffic. There has been Olympic meltdown because, once again, the private sector has failed to fulfil its promises. That is why the Opposition Benches are much depleted.

Mr Wright: That is a fair point, but I do not want to test your patience on the last day, Mr Bayley. I want to move on to our consideration of clause 57, which is important and somewhat contentious. Thank you for grouping our amendments and the Government new clauses with this stand part debate. However, as in our debate on clause 56 on copyright on Thursday, I hope that, with your guidance and permission, I will have time to express and set out the context behind directors' remuneration, the shareholder spring, the Government's response to increased shareholder activism and the need, in our opinion, to go further, which is why we have tabled our amendments.

We are in the somewhat curious situation that we are debating this group of amendments and new clauses with clause stand part, even though, as I understand, the Government no longer intend to include clause 57 in the Bill. A range of Government new clauses have now been tabled to address some of the real concerns

[Mr Iain Wright]

regarding the very important matter of directors' pay. Our amendments are designed to push the Government further to ensure that we have a better and fairer system of executive remuneration—more transparent, simple and accountable.

During the last quarter of a century, corporate governance reforms have been attempted with the purpose—among such things as better accountability, transparency and reporting—of aligning shareholder interests with those of directors, which is entirely rational and understandable. If a company, and therefore its shareholders, does well thanks to directors' efforts, talent and ingenuity, it seems reasonable that those directors should be rewarded on a level that is commensurate with that success and improved performance. Such matters as share options and performance-related bonus schemes were specifically designed to show a closer alignment in remuneration between the owners and the managers of a business.

However, it has become increasingly apparent that some directors of quoted companies are often remunerated far in excess of what is earned in terms of corporate performance, and that executives continue to be very well rewarded even when the performance of those companies, which they are charged with running in the interests of shareholders, certainly does not warrant such rewards. Moreover, we are seeing greater inequality between the highest pay level and that of the average employee.

Let me use some evidence to illustrate my point. In 1980, the median pay of the highest paid directors in FTSE 100 companies was £63,000 and median wages were £5,400. By 2010, the median pay of this set of directors was £2.99 million, while median wages had risen to £25,900. The ratio of directors' to employees' median pay had therefore risen over that 30-year period from 11 to 116.

I am disappointed and upset that the hon. Member for Skipton and Ripon is not here to make my life much easier this morning. *[Interruption.]* Is he stuck in traffic, too?

The Government will wish to give the impression that the problem happened solely on our watch under the Labour Government, and that the problem is confined purely to the United Kingdom. However, if we are to have a mature, responsible and accurate debate about this serious matter, we must dispense with such myths here and now. Other countries have seen similar rises in executive remuneration packages over the past 20 or 30 years. In the United States, for example, the median remuneration package of a chief executive officer in the S and P 500 companies increased over a 15-year period from $2 million in 1993 to about $7.7 million in 2008—an annual increase of about 9.4%.

In 1993, chief executive officer pay in the US was about 100 times the median household income. By 2008, that differential had leapt to 200 times the average income. The issue of executive pay moving far ahead of general employee pay has affected both sides of the Atlantic. It has also continued beyond the life of the Labour Government. In 2011, the average compensation for a FTSE 100 chief executive rose by 12%, while average wages rose by 1.4 per cent.

Let us think back to last year: a deteriorating economic position, largely because of Government policy and the makings of a double-dip recession made in Downing street, but let us move away from that point; businesses holding on to cash; FTSE share prices stagnating; and the wider social problems of public sector cuts and rising unemployment. In such a context it is difficult, if not impossible, to see how such a large increase—an average of 12%—could have been justified by FTSE 100 chief executives.

As John Maynard Keynes once said:

> "The businessman is only tolerable so long as his gains can be held to bear some relation to what, roughly and in some sense, his activities have contributed to society."

On the basis of those figures, it is hard to see how executives have passed that test. Academic studies, such as that performed by the Centre for Economic Performance at the LSE, have shown overall inequality rising fastest in the late 1980s and slowing down from the mid-1990s, although still continuing to rise, albeit at a slow rate.

I will turn, if I may, to the heart of the matter regarding directors' remuneration: the link between pay and performance. The argument most often deployed for high levels of directors' remuneration is the need to attract the right calibre of candidate. A company needs to recruit talent, so the argument goes, and given the high mobility of such talent—the fact that the executives can go anywhere on earth if the right recruitment package is waved in front of them—and the small pool from which such talent is fished, it is therefore important that to add shareholder value and ensure high performance, companies need to pay a premium for such performance and talent. Rather like premiership footballers and the impact that they allegedly have on an average team, the superstars of the boardroom provide such improved corporate performance—so the theory goes—that they warrant high, excessive pay.

I have two things to say to that argument, and I will come on to a third when it comes to the grouping of amendments concerned with remuneration consultants. First, there is no evidence whatever to suggest a direct correlation between high executive pay and long-term shareholder value performance—quite the reverse, in fact. Secondly, there is a structural risk that pay will be ratcheted up without any real consideration of the link between pay and performance.

There is growing academic and industry evidence on the empirical link between pay and performance. Incomes Data Services has reviewed some 12,000 annual remuneration reports over the past 20 years. Over that period, there has been a marked shift in the remuneration of directors. First, there has been a shift from fixed salary towards variable performance-related pay to align shareholders' and directors' interests, although, despite that shift, basic pay has not been reduced as an absolute figure. Secondly, there is a growing complexity of incentive arrangements, with several schemes identified as having overlapping aims and targets.

Incomes Data Services and the High Pay Commission have summarised the data of FTSE 350 directors and corporate measures over the period 2000 to 2010, and they conclude that there is no correlation between high pay and high corporate performance. Indeed, the data reveal that nearly all the components of boardroom pay, with the exception of share options, to which I shall come shortly, "increased at a faster rate than corresponding measures of corporate performance."

I have a number of examples and statistics to back up that assertion. In the decade 2000 to 2010, basic executive salaries increased by 63.9%, the bonus element of remuneration increased by 187% and the total cash provided to directors went up by 133.4%. Long-term incentive payments increased by 253.5% over the decade and total earnings rose by 108%. In the same period, however, market capitalisation of FTSE 350 companies rose by only 8%, the year-end share price of those companies fell by 71.3% and pre-tax profits rose by an average of 50.5%. Earnings per share, a figure used by investors and accountants as a good indicator of a company's profitability, rose by only 73% during the period analysed.

I have mentioned the need for a link between pay and performance, but I also stress the need for a link between risk and reward. Opposition Members do not disagree that entrepreneurs who risk significant capital and assets should be entitled to commensurate reward. I had a sole trader in my constituency surgery on Friday who ploughed every penny he earned and his mortgage back into his business, and it is right that he can benefit from that. The risk—I stress that word—that directors of quoted companies undertake is often difficult to see, however. They face formidable challenges in running large, complex and often global organisations, and they need talent and skill to fulfil their objectives, but they are not members of unlimited liability partnerships who may lose their house in the event of a failed business decision.

That lack of risk is demonstrated by the decline of share options, which were popular 20 or 30 years ago. Over the past decade, the value and use of share options to remunerate directors has fallen by 40%. Share options, whereby directors are given the option to buy a block of shares at a certain price at a future date, give directors a clear, simple and direct incentive to work hard to raise the company's share price. That share options are not used to the extent they once were seems to reflect the lack of risk that directors face. Directors fail to have, to use the phrase coined by Warren Buffett, any skin in the game.

That is not the only empirical evidence available. An article by Michael Cooper, Huseyin Gulen and Raghavendra Rau in 2009 concluded that firms that pay their chief executive officer in the top 10% of pay earn negative returns of some -13% over the next five years. The effect is considered stronger for chief executive officers who receive higher incentive pay relative to their peers.

Jim Collins, author of "Good To Great," a study of how some companies make the leap to become truly outstanding organisations, considered the link between executive remuneration and company performance. His conclusion is stark. He said:

"We found no systematic pattern linking executive compensation to the process of going from good to great. The evidence simply does not support the idea that the specific structure of executive compensation acts as a key lever in taking a company from good to great."

9.15 am

Jim Collins also found no link between a firm that became great and the ability to make people redundant quickly. He concluded:

"Six of the eleven good-to-great companies recorded zero layoffs from ten years before the breakthrough date all the way through 1998, and four others reported only one or two layoffs…In contrast, we found layoffs used five times more frequently in the comparison companies than in the good-to-great companies. Some of the comparison companies had an almost chronic addiction to layoffs and restructurings."

Does that ring a bell? He continued:

"It would be a mistake—a tragic mistake, indeed—to think that the way you ignite a transition from good to great is by wantonly swinging the ax on vast numbers of hardworking people. Endless restructuring and mindless hacking were never part of the good to great model."

Chi Onwurah (Newcastle upon Tyne Central) (Lab): I thank my hon. Friend for his excellent points on remuneration and directors' pay. Linking that to the rate at which good-to-great companies fire people and make them redundant, does he think that that is an example of sowing a culture of long-termism, investing in people and wanting the right remuneration for reward and risk-taking, versus the short-term culture of getting the biggest buck that one can, as soon as they can, and firing at people at will?

Mr Wright: That is an important point. My hon. Friend touches on something central. Reading Jim Collins's book on the matter—it is an excellent book—he says—*[Interruption.]* Jim Collins. Regarding good companies moving to great, he says that executive remuneration is important; of course it is, as directors have talent and would not work for free. However, making a company the best it possibly can be is the big reward that people have, and that cannot be done overnight. It requires a long time, setting the values of an organisation and taking the people along to allow that to happen. The short-term, "let's take as much from the business as we can and make a fast buck" is not the way to have great long-term performance.

The second thing I want to mention is the structural tendency for companies to want to pay their executives the highest possible salary, as that may say something about a firm's ambition and its ability to compete at the highest level. Companies understandably want to be seen in the marketplace as being in the top quartile of performing organisations. They want to make a statement that they can attract the best talent, and therefore pay their directors in the top quartile. It would be unusual, even in light of the shareholder spring that we are currently seeing and the subsequent wave of shareholder activism, to hear a company announce that it wished to pay its directors below the average, or even in the bottom quartile, in overall remuneration. There will be a sense in the marketplace of "below average pay, below average performance." However, that gets us into a curious situation, where pay is ratcheted up in a vicious spiral that is then difficult to get out of. By the laws of mathematics, somebody has to be in the bottom quartile, so that results in higher and higher pay, as a consequence of companies wishing to pay their executives in the top quartile.

Let me quote from Jim Collins's book, "Good to Great", again.

The Parliamentary Under-Secretary of State for Business, Innovation and Skills (Norman Lamb): Why not?

Mr Wright: I am not getting commission for this. It is a shame to move away from the Minister's book.

Norman Lamb: I am glad to see that it is back again.

Mr Wright: Good.

Jim Collins said:

"The recent spate of boards enamored with charismatic CEOs, especially 'rock star' celebrity types, is one of the most damaging trends for the long-term health of companies. Boards should familiarize themselves with the charismatic of Level 5 leadership and install such leaders into positions of responsibility. Second, boards at corporations should distinguish between share value and share price. Boards have no responsibility to a large chunk of the people who own company shares at any given moment, namely the shareflippers; they should refocus their energies on creating great companies that build value for the shareholders. Managing the stock for anything less than a five-to-ten-year horizon confuses price and value and is irresponsible to shareholders."

Chi Onwurah: I thank my hon. Friend for the point he was making on the mathematical impossibility of all companies paying in the top 25%. Will he also note that the pay amounts are generally reported by recruiting companies, which have an obvious incentive to make the pay as high as possible, because that determines their return? That adds to the inflationary effect.

Mr Wright: My hon. Friend is exactly right and one of my concerns, which I will speak to at some length later, is the need to be able to regulate remuneration consultants and disclose the fees that they receive as transparently as possibly.

I thank you, Mr Bayley, for allowing me to set the context of what has happened over the past 30 years. It was important to do that. The Government, to be fair, have recognised the need to act, which is why they produced a consultation on the matter in March and again in June this year. The latter of those is still in its consultation phase, with a closing date for responses of 26 September. Despite the consultation not yet being finished, the Government have brought forward primary legislation, first with clause 57 and then with new clause 5 and other clauses.

New clause 5 amends section 421 of the Companies Act 2006 and requires several changes to the content of directors' remuneration reports. In particular, and relevant to these amendments, companies will be required to set out a policy for a vote to shareholders on remuneration policy only every three years. We believe that quoted companies should have an annual binding vote, and amendments (b), (c), (d) and (e) would remove certain elements of new clause 5 to require that.

In their shareholder voting rights consultation of March 2012, the Government's position seemed fairly clear. They set out their proposals for giving shareholders a binding vote on a company's remuneration policy. Companies would have to set out, at the start of the year, a proposed pay policy for the year ahead, which would then be put to annual shareholder vote. In the March document, the Government also set out a compelling reason for an annual binding vote, with which I fully agree. In paragraph 7 of the March consultation, the Government stated:

"The effect of introducing a binding vote on remuneration policy should be to encourage better quality engagement between companies and shareholders at an early stage in the process of devising remuneration policy."

We agree.

The Government have also stated that such a vote would be required only if a company wishes to change its policy on pay. That raises more questions than answers. New clause 5 inserts into the 2006 Act new section 439A, which is titled, "Quoted companies: members' approval of directors' remuneration policy". The new clause is somewhat vague on having a vote every three years. Subsection (1)(b) states that a resolution must be put to a vote

"at an accounts or other general meeting held no later than the end of the period of three financial years".

There is, however, no inclusion or explanation of the manner in which a vote could happen earlier. So, I ask the Minister: what constitutes change in pay policy?

The Secretary of State was unable to answer that simple question when questioned by the shadow Secretary of State, my hon. Friend the Member for Streatham (Mr Umunna), during the Secretary of State's statement to the House on this issue last month, so I hope that the Minister will be able to do so today. Will change be concerned with principles or actual numbers? Will an ongoing bonus of, say, 150% of salary be permitted if other circumstances change, for example if there is a fall in profits, the share price or market share, or if there are alterations to the regulatory regime in which the company operates? Who will decide what constitutes change? Will it be the shareholders, the board, the auditors, the management or a combination of all of those? Given those variables, would it not be simpler merely to have an annual binding vote?

Lorely Burt (Solihull) (LD): I have listened to the hon. Gentleman's comments very carefully and one might think that an annual vote would be preferable, but if they set a pay policy for three years would that not in fact encourage and enable companies to take a much longer view on their remuneration policy?

Mr Wright: I think the hon. Lady makes a fair point. We are trying to make sure that we have a longer-term perspective and responsible capitalism that looks to the long term rather than to the short term and extracting value as quickly as possible. That is a fair point.

Is an annual vote on this really that onerous given that there are annual reporting requirements elsewhere in companies legislation? Shareholders are used to carrying out certain tasks at an annual general meeting. It could be the appointment of the auditors; it could be a whole range of things, such as receiving the accounts and possibly re-electing and appointing the directors. On such a contentious issue as directors' pay, it is not onerous to have an annual binding vote. I cannot see that it provides complex or over-bureaucratic processes.

Norman Lamb: I am grateful to the hon. Gentleman for giving way. It is a pleasure, Mr Bayley, to serve under your chairmanship again, thankfully for the last time for the time being. That is no reflection on the pleasure it has been up until now: I just think we all need a break. On the question of one year versus three years, a pretty important player in all of this, the Association of British Insurers says:

"Having a vote on a three year remuneration policy should help the task of keeping executive pay proportionate and aligned to corporate strategy; having a fixed annual vote on pay has tended to drive up pay in practice rather than restrain it."

Is not the hon. Gentleman concerned that his proposition could have entirely unintended consequences as the ABI warns?

Mr Wright: The ABI is a moderate organisation and I consider myself to be a moderate shadow Minister. Let me quote a dangerous leftie organisation designed to bring down the shackles of capitalism, the *Financial Times*, which stated last month:

"the business secretary has missed a trick in not going for annual pay votes… His worthy hope is that this might encourage more medium-term thinking about pay."

I have some sympathy with my hon. Friend the Member for Newcastle upon Tyne Central on that point. The editorial continues:

"But an obvious worry is that such votes may degenerate into another exercise in box-ticking, with shareholders voting on boilerplate policies rather than specific deals."

Lorely Burt: I am afraid that I cannot agree with the hon. Gentleman. I think the reverse is true. An annual nod-through seems more of a box-ticking exercise than examining the pay policy and having a review every three years.

Mr Wright: I shall go back to that *Financial Times* editorial which is thoughtful and measured on this matter. The last paragraph sums it up:

"Executives will restrain their demands only when they perceive a real risk in flouting social norms on pay. Fund managers, who naturally shy from conflict with companies, still need to be encouraged to challenge bosses more—especially on this sensitive topic."

That will be a theme throughout today when we consider directors' remuneration. There is a need to challenge more. Doing so every three years is not sufficient. An annual binding vote is necessary. The editorial continues:

"Annual votes would at least put them firmly on the spot. Mr Cable's triennial polls, however well-meaning and thoughtful, may not."

I do not think this is particularly revolutionary, given what is required by company law already in terms of annual reporting. Given the significance and potential contentious nature of directors' remuneration, surely an annual binding vote, which the Secretary of State and, to be fair, the Minister are largely in favour of, is the right way to go. I should be interested to know why there has been this change of emphasis in the June consultation, when in the March consultation the Government's position seemed very clear that the annual binding vote was the way to go.

9.30 am

Norman Lamb: Because we listened to the consultation responses, and ultimately that is what a consultation should be for. The measure is about empowering shareholders and getting the relationship right between shareholders and the company. When shareholders make it clear that they think the Government's framework and settlement is right, I suggest that Opposition Members should listen to what the bulk of them are saying.

The hon. Gentleman asked about change and who decides on change. It would be for the board to decide that it wanted to change the policy, and it would put it to the meeting to seek to secure its support. Of course, if the shareholders rejected the change, it could not proceed. Indeed, if the board sought not to change a policy, but the shareholders at the annual meeting concluded that performance over the previous year had not been in accordance with policy, or they were not satisfied with the performance, they could vote down on the advisory vote looking backwards, which would automatically trigger the vote at the next annual meeting, securing the binding vote. The measure is about giving power to shareholders not prescribing, as Opposition Members seem to want.

Mr Wright: I understand, and I am grateful to the Minister for saying that. However, are we setting a new precedent here when it comes to reporting requirements for companies legislation, particularly for quoted companies? We are discussing an Enterprise and Regulatory Reform Bill, but is the Minister saying that to empower shareholders and to reduce reporting and regulatory burdens on companies, we will see a rise in three-yearly reviews of things as opposed to annual reporting? Because I still come back to the central point of my argument: annual reporting happens in quoted companies. That does not seem to be too onerous to me. It is not revolutionary. The measure just seems to be a development—an evolution—of what is going on already. As we have seen throughout the shareholder spring, given the importance and contentious nature of directors' pay, surely an annual binding vote is the way forward. I come back to the other point that I made: I think that the Government wanted this. Certainly, the Secretary of State and the Minister wanted this and are sympathetic to such a position. Will they reflect on the matter again?

Norman Lamb: The hon. Gentleman talks about whether the measure sets a precedent and reporting on a three-yearly basis. Of course, the report will be annual; it is the vote that has to be at least every three years. If shareholders want to trigger it earlier than that, they can do so. As I say, this is about empowering shareholders, but the report is every year.

Mr Wright: However, in many respects, they have got that power already. We have seen that to some extent with the shareholder spring, where shareholders have been unhappy with the disconnect between directors' pay and company performance. In many examples, they have wanted to vote down some chief executive and director pay packages. I can understand what the Secretary of State wants to do about this matter, and he has listened to consultation—largely, it has to be said, from many vested interests—but the point that was made in the FT editorial is a fair one. However well-meaning and thoughtful the Secretary of State's considerations are—I do not doubt the sincerity behind them—I come back to the central point that an annual binding vote is not too onerous and would empower shareholders still more.

Let me turn to amendment (e), which would require a super-majority of 75% to pass the resolution on remuneration policy. In tabling the amendment, I drew my inspiration, again, from the March consultation on executive pay from the Department. In a similar way in which the document advocated the need for close and early engagement between board and shareholders regarding the provision of remuneration policy, the

[Mr Iain Wright]

amendment is designed to ensure that the widest possible spread of shareholders are consulted for the purposes of agreeing the new policy.

Let me quote paragraph 12 from the consultation:

"Shareholders have expressed their frustration that companies are currently able to proceed with remuneration proposals even where a large minority of shareholders are opposed. The Government is therefore minded to consider the"—

the text then moves to bold—

"requirement to secure a higher level of shareholder support, beyond the current majority threshold, on votes cast on future remuneration policy."

Paragraph 13 goes on to explain, again very compellingly, the rationale behind such a super-majority. I absolutely agree with the following points:

"The benefit of increasing the level of shareholder support required, beyond a simple majority, would be to encourage companies to improve their engagement with shareholders on the issue of pay, so as to secure sufficient support to pass the vote. This measure would also give more power to those shareholders that are engaged on the issue of pay and may in turn encourage more shareholders to play an active role."

Such a stance is supported by Dominic Rossi, the chief investment officer of equities for Fidelity Worldwide Investment, which has about £165 billion worth of investments.

Ian Murray (Edinburgh South) (Lab): How much?

Mr Wright: A hundred and sixty-five billion pounds. He has argued that directors' pay is over-generous and over-complex, that remuneration reports should be backed by 75% of shareholders, and that any vote should be taken before pay is awarded. Mr Rossi concludes by saying something so sensible and moderate that I cannot see why the Government would want to move away from it:

"Companies have nothing to fear if what they propose is fair and reasonable and clearly aligned to what is good for long-term shareholders."

Our amendment (e) would merely try to encourage companies to obtain as much consensus as possible from shareholders in their pay policies.

I turn to amendment (i). In all of the amendments, our ultimate objective is to increase and improve transparency and accountability.

Norman Lamb: The hon. Gentleman referred to Fidelity, but does he concede that Fidelity is the only shareholder group arguing the case for a 75% vote? The consensus beyond Fidelity was for a 50+% vote.

Mr Wright: Equally, should an important institutional investor with £165 billion of assets under its management not be taken into account at least?

Norman Lamb: Absolutely, but it is the only one.

Mr Wright: Fidelity is an important player in the City and we should be mindful of what it says. Going back to the March consultation, surely it is not ideal to have no discussion and contemplation of remuneration policy until the annual general meeting, with it then coming as a shock to shareholders. Having active, early engagement and consultation, and trying to secure a consensus on directors' pay is the right way forward. It is reasonable to consider establishing that by having a super-majority.

Andrew Bridgen: The shadow Minister rightly stated that an investor with a £165 billion portfolio to invest should have its views listened to. Surely they will be, because an investor of that size will have a considerable holding in companies that they have taken a position in, and the level of that holding will be represented in the share of the vote that they have at the shareholders' meeting. The £165 billion will therefore be represented in every company that they hold.

Mr Wright: I do not follow the logic of £165 billion being represented in every company that they hold, but I understand the hon. Gentleman's broader point. Although I do not know this with a great degree of certainty, given Mr Rossi's comments, I imagine that he ensures that, in terms of his holdings in companies, he plays an active role in their strategic direction and policies, particularly with regard to directors' pay, which he has heavily criticised.

That brings me back nicely to amendment (i). As I said, we want to try and improve transparency and accountability. That principle should also be upheld in respect of the disclosure in which institutional investors, such as Fidelity and others, have opted to exercise their voting rights regarding pay. It seems fair to say that that would prompt significant downward pressure on executive pay, as greater scrutiny would be given to the manner in which institutional investors have voted, and such investors would be required to explain their stance. I think that the matter is simple enough. Section 1277 of the Companies Act 2006 allows the exercise of voting rights to be disclosed. Amendment (i) would merely stipulate that section 1277 of the 2006 Act be switched on within three months of the Bill's becoming law.

Amendment (a) is a straightforward addition to new clause 5. In many industries, employees who are not directors of the company may be the most remunerated people in the firm. The most obvious example is financial services, particularly investment banking, where traders' remuneration packages far exceed those of directors. Such a practice may also occur in the entertainment sector, and in the past 24 or 48 hours we have seen that the BBC pays about half a dozen of its talent more than £1 million, which is in excess of the director-general's salary.

I appreciate that the BBC is a different type of company with different corporate governance, but the principle still stands. In the interests of transparency and accountability it would be helpful for shareholders to be able to make decisions on remuneration policy for the 10 highest paid employees in the company, regardless of whether they are directors, in full light of the widest possible range of facts. Other countries, including the United States, have such a provision, and it would not be particularly oppressive to have a similar provision here.

I now turn to the amendments concerning remuneration consultants. It is becoming increasingly clear, as my hon. Friend the Member for Newcastle upon Tyne Central mentioned, that remuneration consultants have played a role in hiking up directors' pay in recent years. An academic study carried out by Professor Martin Conyon and published last year found a correlation between higher than average executive pay and the use of remuneration consultants. The clear conclusion was that chief executives of UK firms that use remuneration consultants receive higher pay than those of firms that do not. Studies show that CEO pay is, on average, 26% higher in companies that use remuneration consultants. Academic studies also demonstrate that the level of cash pay or salary is lower than average, but that remuneration consultants design inherently riskier and more complex remuneration packages such as long-term incentive payments.

In the US, the Congress inquiry led by chairman Henry Waxman into conflicts of interest among compensation consultants, as they are called in the States, found that remuneration consultants to Fortune 250 companies were paid almost 11 times as much for providing other services to the company as they were paid for providing executive compensation advice. That calls into question the consultant's impartiality, or the perception of impartiality, in the provision of advice on executive remuneration, because the consultant and his or her firm may derive further, larger fees from work commissioned by the company's executives.

That problem is not confined to the United States. In Canada, the ratio of fees for the provision of executive remuneration to fees for the provision of other services was 1:13. The impression, which is backed up by quantitative evidence, is that the use of remuneration consultants raises directors' pay and increases the complexity of the remuneration package. Remuneration consultants obtain more lucrative fees as a result of their close involvement with executives, which calls into question their independence and raises the question of who actually commissioned the work on directors' pay; was it shareholders, through the remuneration committee, or management, which will have a direct interest?

In many respects, that scenario is similar to the problems faced by audit firms in the past 10 or 15 years. Audit firms in the 1990s provided lucrative consultancy advice, which called into question the independence of the audit opinion that they provided to shareholders. In a nutshell, there was a perception that because auditors did not want to rock the boat and compromise their consultancy fees, they would allow lapses in statements of financial control or in whether the accounts provided a true and fair view of the company's financial position. Perception is important as well as reality. In many respects, at an extreme level, that resulted in huge corporate failures, such as that of Enron, and led to improvements and changes in the corporate governance framework, especially in the US, with Sarbanes-Oxley and other things.

9.45 am

Chi Onwurah: My hon. Friend is making an important point regarding the transparency of the activities of remuneration consultants. An example in the world of audit is Arthur Andersen, an old company whose closeness to Enron led to its being fined £500,000 by the US investigation and to its demise.

Mr Wright: Absolutely. When I worked for Deloitte, we merged with the UK firm of Arthur Andersen. I could see the effect that it had on former Arthur Andersen employees. Not only should auditors be clean, they should be seen to be as clean, as independent and as impartial as possible. Although audit stands alone in its importance to allow shareholders the confidence to invest and have faith in the numbers, the issue of directors' pay is important enough to ensure that we have the highest possible degree of transparency, accountability and disclosure of all relevant information.

There is a voluntary code of conduct on executive remuneration consulting in the UK, produced by the remuneration consultants group. We believe that such provisions need to go further, backed up by statutory force where possible.

Amendment (j) would amend section 227 of the Companies Act 2006 regarding directors' service contracts to ensure that shareholders can approve the remuneration consultants. The amendment is necessary to ensure that it is members of the board who appoint the consultancy from whom they will seek advice regarding the pay package of directors, rather than the management, who will have a vested interest in ensuring the commissioning of such work.

Amendment (g) would require an insertion into section 412 of the 2006 Act, dealing with information about directors' remuneration to ensure the disclosure of fees paid to recruitment consultants in respect of recruitment consultancy work and non-recruitment consultancy work. That is important. Such disclosure would provide a degree of transparency to allow shareholders and others to see what fees are being derived from particular firms. I do not think that there is a particular problem with that, and I would use the analogy with audit firms that I provided earlier. I would be interested in what the Minister has to say on that.

Norman Lamb: Shareholders clearly want more transparency about how remuneration consultants are used by a company. That is why we have proposed that quoted companies' remuneration reports should set out who provides advice about remuneration of directors, including on recruitment; whether they provided other services to the company; whom they were appointed by and how they were selected; the total cost of advice; and the basis on which they were paid. Ultimately, the remuneration committee and the board of directors have to be accountable for their decisions, after they have received advice from whatever source.

Mr Wright: Absolutely, and I welcome what the Government have done on the matter. They have gone a considerable way towards where we need to be, but our amendments would go a little bit further, and I would like to probe the Minister on the matter. I hope the Government will accept what I think are reasonable amendments.

The Minister mentioned remuneration committees and the board. That brings me on quite nicely to—I am sure the Committee will be relieved to hear this—my final comments. [Hon. Members: "Shame."] Actually, I am not sure that the Committee has heard all my comments. With your permission, Mr Bayley, I will start from the beginning again.

The Chair: Permission refused.

Mr Wright: Very wise, Mr Bayley. Let me get my notes back in order.

Ian Murray: I am delighted that my hon. Friend the former Minister has given way. If he feels that the Committee should be refreshed or more informed by his comments, perhaps he could put them in a hardback book and sell them on Amazon for us to buy in future years.

The Chair: I can assure the Committee that *Hansard* will be publishing his remarks in an affordable softback.

Mr Wright: Thank you.

The Minister of State, Department for Business, Innovation and Skills (Mr Mark Prisk): As a stocking filler.

Mr Wright: The Minister says, "As a stocking filler". That is certainly true—for all one's enemies, a *Hansard* copy of the proceedings of the Enterprise and Regulatory Reform Public Bill Committee. I think the Minister will be reading "Fifty Shades of Grey" over Christmas. We could be talking about stocking fillers in a rather different way.

Norman Lamb: Move on, move on.

Mr Wright: Would the Committee like me to talk about stocking fillers or new clause 17? I think it is new clause 17. I will move on because I think the attention of the Committee is waning.

Corporate governance is one of the most important aspects of business and organisation theory. It is not merely about structures and processes; nor should it be a box-ticking exercise. Board members have to perform a balancing act. Perhaps we will come on to that; it is vital to the success or failure of an organisation. Board members should support management in what they are trying to do, but equally challenge. That balancing act is the key test of what a non-executive director can provide. Searching questions at board level are absolutely invaluable and may not only allow organisations to thrive, but may allow them to survive. If only somebody on the board of a bank had said a couple of years ago, "What happens if these securitised American mortgages are not paid back?" we might have been spared a lot of grief.

The Secretary of State for Business, Innovation and Skills wrote about the issue of who makes up boards and remuneration committees in an article in the *Evening Standard* yesterday. It is interesting, although it provides very little in the way of tangible proposals going forward. In a very telling and important point he mentioned the

"shallow and stagnant, unrepresentative of wider society"

pool from which boards are selected. I strongly believe that such homogeneous boards will, by the theory of group dynamics, fail to effectively challenge and scrutinise.

Group thinking—even the herd mentality—could become the order of the day. As I stressed, the essential role of boards to challenge and ask searching questions would therefore not be fulfilled. Greater diversity will in all likelihood result in better performance. As the CBI has said:

"An organisation that recruits from the widest pool of talent ensures a diversity of experience and perspective in the boardroom that broadens discussion. Diverse views promote debate and challenge group mentality. Diversity of thinking is an essential driver for innovation."

We agree; that is an important point. I do not see diversity on the board or remuneration committee as tokenistic. To use a phrase that the Minister mentioned last week, this is not motherhood and apple-pie stuff: it would be nice to have a different type of non-executive director and to have more women on the board, for example. I am not looking at this from a woolly—dare I say it?—liberal point of view. I am looking at this purely as an objective hard-nosed business matter, because all the facts show that greater diversity on boards improves company performance. It is as simple as that.

Lorely Burt: Speaking as a woolly Liberal, I totally agree with the hon. Gentleman. The coalition Government are making great strides to improve the diversity of boards. I agree with the hon. Gentleman that that can only be a good thing.

Mr Wright: I thank the hon. Lady for that. I cannot think off the top of my head whether there are any female Liberal Democrat Cabinet members. I do not think there are. There is a great need for actions rather than words.

Norman Lamb *rose—*

Mr Wright: Before I allow the Minister to intervene, I want to set out an important point. Let us strip it to the bare essentials.

Norman Lamb: He is back on "Fifty Shades of Grey".

Mr Wright: If there is greater diversity on a board, there is greater performance. Companies with three or more female board members have a better return on equity, sales and invested capital. More specifically, companies with women on their boards have a 42% higher return on sales, a 66% higher return on invested capital and a 53% higher return on equity. Given that we all have pensions invested in the stock market, it is in all our interests to encourage boards to have more women because it ensures better corporate performance.

Norman Lamb: I completely share the hon. Gentleman's view about the value of diverse boards. In October, a new provision in the UK corporate governance code comes into force that will require companies to report on their policy on boardroom diversity. That is an important innovation.

Specifically with regard to women on boards, would the hon. Gentleman concede that the position under the previous Government was woeful throughout the past decade? In the last year, for the first time we have seen 26% of new appointments to boards of FTSE 100 companies being women. We of course need to get that higher, but that is a dramatic increase on what went on before. Does he applaud, with me, the work that has been done to get companies to think about the value of diversity and do something about it?

Mr Wright: I think it is a bit cheap of the Minister to descend into party politics on this.

Norman Lamb: I would never be cheap. *[Interruption.]*

Mr Wright: I am shocked at the reaction. This matter goes beyond a particular Government or country. We have seen problems with directors' pay and a lack of diversity in the boardroom for the best part of 30 years —certainly on that latter point. A certain type of non-executive director has arguably been in place for ever. I can understand why the Minister wants to make a party political point. To be fair, the Secretary of State has recognised the issue and some of the work carried out by the Lord Davies study is important and we encourage that. As part of that encouragement and support, we believe that proposed new clause 17 would push that a bit further.

Chi Onwurah: I thank my hon. Friend for giving way, and do not wish to descend into making cheap party political comments. [HON. MEMBERS: "Never!"] Would my hon. Friend agree that leadership in this area must be given from the top? Contrasting the Cabinet with the shadow Cabinet, the lack of diversity in this Government becomes all too apparent.

Mr Wright: That reiterates my intervention on the hon. Member for Solihull. The Prime Minister and, to some extent, the Deputy Prime Minister have spoken about the matter but actions speak louder than words. I understand that there is an imminent reshuffle of the Government's ranks. We might see some greater diversity and maybe, given the Minister's performance, he will be promoted.

Ian Murray: That would not increase diversity, though.

10 am

Mr Wright: Well, we have not got enough employment lawyers. That notion—that to improve corporate performance we would like to see greater diversity—is the basis of proposed new clause 17. It would build on the work that the Government are doing—to be fair to the Minister—and require the Secretary of State to provide for a requirement that companies must demonstrate that non-executive directors on boards and on remuneration committees are drawn from diverse backgrounds. Companies must also demonstrate in their annual report how they are widening their search for non-executive directors.

Subsection (1) of the new clause also provides an important requirement that an employee representative should be a member of the remuneration committee. Again, that is not tokenism. It is designed to improve diversity and challenge the closeted, closed shop mentality. As my right hon. Friend the Leader of the Opposition rightly said, it is important for a director to be able to look a worker in the eye and argue why they are worth additional remuneration while perhaps presiding over a faltering share price, falling market share and possible redundancies. The inclusion of employees on remuneration committees works elsewhere—most notably in Germany— and I see no reason why it should not work in the UK.

I am about to use a word that I think the whole Committee will lament. Finally—[HON. MEMBERS: "Oh."] I know. New clause 18 establishes the High Pay Commission on a statutory basis. We believe there is a need, given what is going on in boardrooms and elsewhere in corporate life, to have a body established by law to consider and make recommendations about high pay in society. We see this as the counterpoint to the Low Pay Commission, which was established by the National Minimum Wage Act 1998. The High Pay Commission should examine and monitor the level of directors' pay, both absolute and relative to the average pay of employees. It should also look at the nature of remuneration packages provided to directors—whether packages are becoming more complex and inherently risky—as well as the relationship between pay and performance, which we have discussed this morning.

The shareholder spring has been activated to some extent by wider involvement in the issue. We therefore believe that the public should also provide their opinion on pay. We also believe that the High Pay Commission should report to the Secretary of State on such issues and make recommendations on high pay, so that we can have a wider debate in society about the level of pay of those who run our businesses. This point is not particular controversial, and I think that the Minister would be interested in the High Pay Commission's inclusion on the statute book.

On that basis and given your indulgence in allowing me to roam freely around the issue of directors' remuneration, Mr Bayley, I commend the amendments in my name and those of my hon. Friends.

Chris Ruane: I thank my hon. Friend for providing the Committee with such important statistics today. I had not come across them before, and they are so important that I want to reiterate them. The Minister said that in 1980—I have it written down here in my own longhand—the average board member was on £63,000 and the average worker on £5,000. By 2010, that had gone up to £2.99 million for the board member and £25,000 for the worker. In 1980, the board member was on 11 times as much as the average worker and that increased to 116 times as much in 2010.

Those figures are truly fascinating and tell a tale of more than just remuneration. They tell a tale of what has gone wrong with society. It has been chronicled by such eminent researchers as Richard Wilkinson that the more unequal a society becomes, the more it feeds into society itself. All the indicators that are important to us as politicians, such as crime, obesity, drugs, violence and the prison population, become worse in unequal societies. In more equal societies, they become better. We are talking about big issues, not just about remuneration and what happens at the top of the pyramid. Such issues affect the whole of society. That is the view of not just a Labour MP, but also of billionaires with hearts and minds, such as Warren Buffett. He is probably one of the most successful business men the world has ever seen and his perspective on taxation is that those at the top are not paying enough compared with those at the bottom. He thinks remuneration must be earned rather than given as a right.

Recently, shareholders have taken their responsibility more seriously by questioning those at the top—the directors, who have awarded themselves huge increases,

[Chris Ruane]

not just in pay, but in pensions, share options and all sorts, as performance is worsening. Over the past couple of months, shareholders in five, six or seven companies have challenged such increases by saying, "No. You do not deserve this and you are not going to get it."

We are not only seeing that with shareholders. Local authorities are thinking of switching from Barclays, which needs to be punished for its own good. There have also been all-party representations in Parliament. I received an e-mail this morning from MPs from both sides of the House that said, "Please consider taking your personal account away from Barclays and putting it in another bank." The captains of some industries have misruled for 30 years, and they have got away with that to such an extent that Bob Diamond, 18 months after the world's banking system nearly collapsed in 2008, said that the time for remorse is over. What did he learn from 2008? Those people have not learned their lesson, and we have to hit them where it hurts, which is in their pockets. I say that not for the sake of being mean-spirited or mean-minded, but for the good of the companies.

I apologise to my hon. Friend the Member for Hartlepool for interrupting him and mentioning Jim Cousins, who was, of course, a famous Labour MP. Jim Collins wrote the book "Good to Great," which I have read, and it has some lessons. When Jim Collins researched those companies that shone in America, he went round and spoke to the captains of industry. The biggest thing for them was not remuneration, nor how much they were paid, nor a flash car. Quite often they had small offices, lived in small houses and drove smaller cars. The important thing to them was not pay, but a belief in what they were selling—not what they were selling, but why they were selling it. They believed in their work force. We need to get back to that type of capitalism.

The leader of the Labour party, my right hon. Friend the Member for Doncaster North (Edward Miliband), had it right last year when he coined the term "predatory capitalism." Predatory capitalism is in no one's interest, not even the predatory capitalists'. Predatory capitalism might suit them in the long term, but it suits no one if the banking system collapses. We have seen arrogance in certain industries, rate-fixing in banks, businesses going under and mortgages and houses lost. GlaxoSmithKline was fined $3 billion in America, which would never happen in the UK, for selling to children antidepressants that had not been properly tested. In America, 29% of children have a mental illness. Those are big issues that the Bill must reflect.

There are many sensible amendments before the Committee: a pay review for top directors once a year, rather than once every three years; a requirement for 75% of shareholders to approve increases in remuneration; and a requirement that the earnings of the 10 highest-paid employees are made publicly available. An employee representative would have a seat on the remuneration board to question those who determine the remuneration, the experts brought in from outside, and to question the amount that top directors are awarded. He who pays the piper picks the tune. Who will those outsiders truly be serving: the shareholders or the directors? The shareholders should appoint those people and monitor them carefully.

If the amendment were accepted by the Minister, it would serve the British economy and the British worker well. We are in the final day of this Bill Committee. We started by discussing tribunals and making it easier to sack workers. We are finishing it today by talking about how to pay directors better with less scrutiny.

I will finish with a few lines from a Christy Moore song, which encapsulates the Bill.

Norman Lamb: Which amendment is this relevant to?

Chris Ruane: All of them. The lyrics to "Ordinary Man" go:

> "I never missed a day nor went on strike for better pay,
> For 20 years I served them best I could,
> With a handshake and a cheque it seems so easy to forget,
> Loyalty through the bad times and the good,
> The owner says he's sad to see that things have got so bad,
> But the Captains of industry won't let him loose,
> He still drives a car and smokes a cigar,
> And still he takes his family on a cruise,
> He'll never lose."

That is what it is about. We have a chance to fix the system by putting these measures in place. The amendments would rein in that remuneration and only give remuneration to those directors doing a proper job, delivering growth, jobs and prosperity, not just for themselves but for the whole country. Some directors may say, "If you cut back on this, I will fly. I will leave this country and go somewhere else." If they want to do that, let them go.

Fiona O'Donnell (East Lothian) (Lab): It is a delight to see you back in the Chair, Mr Bayley. I am even more delighted to follow my hon. Friend the Member for Vale of Clwyd and his passionate but reasonable contribution to the debate. We as the Opposition are saying to the Minister that this is an opportunity to make the Bill one that meets the mood and expectation of the public. We are not talking about some fringe movement, such as the Occupy movement. This is about people whose whole lives become about equality. Everyone in the street has an opinion on this issue.

The Government do not quite get what a seismic change there has been in our society. People are no longer willing to let these obscene payments be made to people at the top of many companies without questioning them and holding them to account. People are asking the question, "How can anyone make a contribution to our society that is worth 100 times the contribution of a nurse, a teacher, a janitor in a school or a community worker?" People are particularly asking that question in these difficult times.

Andrew Bingham (High Peak) (Con): I hear what the hon. Lady is saying and I have heard it from the Opposition a lot, but this has all grown up over the past 13 years and the Labour Government did nothing about it. The Opposition are quoting from 1980 but not from 1997.

Fiona O'Donnell: I think that is further evidence of just how out of touch the Government are. There has been a change since the global crisis in the banks. People in this country have been losing their jobs. I am trying to establish a food bank in my relatively affluent constituency because so many people are going to bed hungry. That is the situation we are in and the latest briefing that I had from the Trussell Trust told me that it is now opening three food banks a week. That is the scale of the problem.

It is not just those who are suffering who are now saying, "Enough." Those who benefited from a period of growth and the boom and bust—certainly the boom—are now saying, "You know what? We are not comfortable living in a society that is so unequal." The idea that it will not come home to people's doors and not affect them is simply untrue. That is why the public mood has changed.

There have always, of course, been people who have fought for equality and justice and wanted to see a greater redistribution of wealth, but this Government do not get that something very different has happened. I am sure that all of us as MPs are receiving e-mails and other communications from people calling for the Government to do more and to intervene. I know that goes against the grain for many Conservative Members, but I thought we shared with the Lib Dems that vision of a fairer, more equal, more just society, where it was okay for the state to intervene.

Coalition Members are out of touch if they do not get just how much people are saying, "This is unacceptable. This is not the kind of country I want to live in, where I walk down the street and increasingly see more examples of poverty—more people living rough. That's not the kind of UK I want to be part of."

10.15 am

The Government were out of touch on Leveson; they dragged their heels and eventually, after mumping and grumping, agreed to a judge-led inquiry. They have not listened to the public. I think they will change their minds about an inquiry on the banking crisis. As the Committee begins its investigations and the scale of illegal and obscene practices in the banks becomes more public, that change will be achieved not by Labour Members, but by the public, who will tell the Government, "This is not good enough. The scale of abuse of power must be addressed, and it is not even within Parliament's grasp to do it."

Norman Lamb: Surely the hon. Lady will concede that the culture of sometimes irresponsible capitalism, and irresponsible behaviour, did not emerge recently. It developed over many years and, indeed, under Labour Governments. Her colleague Lord Mandelson coined the phrase that he was

"intensely relaxed about people getting filthy rich".

Is not that the culture that the present Government, with the biggest and most comprehensive reform of the area in question for a decade, are getting to grips with?

Fiona O'Donnell: I agree with the Minister, and with Lord Mandelson. I have no problem with people getting rich, as long as they do it in a fair, legal and responsible way. Lord Mandelson did not say it was okay to play around with LIBOR to make more money, or that it is okay to avoid paying taxes.

Mr Wright: I feel I must defend my predecessor as MP for Hartlepool. What Lord Mandelson actually added—people tend not to finish the quotation—was,

"as long as they pay their taxes".

There have been many examples where that has not happened.

Fiona O'Donnell: To be fair to the Minister, I will not pretend that our record in government was free of blemishes; but now there is an opportunity for the Government to do something, and for the Lib Dems and Labour to ensure that the values that we share will be at the heart of the Bill. I appeal especially to Lib Dem Members to take the opportunity to make the Bill one that is in touch with the public, and that reflects their mood of disgust. Then I will be able to return to my constituency and say, "Parliament is doing something about this situation."

Norman Lamb: Just as the shadow Minister's early performances in Committee were clearly inspired by a performance by the Stone Roses in Manchester, I have been inspired by a performance by the great Paul Simon, in Hyde park on Sunday. Indeed, when the great, brilliant and wonderful Hugh Masekela—that 73-year-old trumpeter from South Africa, who was given his first trumpet by the wonderful Bishop Trevor Huddleston—instructed us to shake our booty, we duly obliged.

Chris Ruane: On the issue of Paul Simon, does the hon. Gentleman agree that when this matter is put to the vote, if he and his Liberal colleague do not join us, we will experience the sound of silence?

Hon. Members: Oh.

Norman Lamb: The groans say it all. Hearing Paul Simon perform "The sound of silence" was a wonderful moment—slightly more wonderful than that intervention.

In his speech to the Committee, the hon. Member for Vale of Clwyd said that this is the opportunity to fix it. Indeed, that is exactly what the Government intend to do. There is clear evidence of a market failure here in linking top pay to performance and our amendments seek to rectify that failure. Last month the Secretary of State for Business announced the Government's final policy proposals. I am sure the Committee will have noted that they were widely well received. Indeed, we heard positive endorsement of them when the Committee took evidence from stakeholders.

On 20 June Standard Life said:

"Today's announcement is a watershed in the governance of executive pay. It provides a framework for flexibility with accountability."

Otto Thoresen, the director general of the Association of British Insurers, said:

"Dr Cable's proposals are practical, workable and should help tackle excessive executive pay."

David Paterson, the head of corporate governance at the National Association of Pension Funds, said:

"The reforms should help bring about much-needed cultural change. They present a challenge to companies and investors as there will be a need for better communication by both."

John Cridland, the director-general of the CBI, said:

[Norman Lamb]

"This substantial package of measures strikes a balance, by giving shareholders increased transparency on pay and providing ways to hold Boards to account, without getting them bogged down in day-to-day micro-management."

Sir David Walker, the author of a major report on corporate governance and adviser to Morgan Stanley, giving evidence to us on 21 June, said,

"my view is that if what he"

—the Secretary of State—

"was proposing yesterday is incorporated into the Bill in some way, that is just about right for what is needed in the remuneration area."—[*Official Report, Enterprise and Regulatory Reform Public Bill Committee,* 21 June 2012; c. 135, Q289.]

Finally, Simon Walker, the director general of the Institute of Directors, said:

"The level of executive pay at the UK's largest companies has become unjustifiable over the last decade and it's right that the Government recognises that it is shareholders who have the power to control it."

There has been a lot of support for what the Government are seeking to do. May I also reflect briefly on the nature of the market failure that we have identified and which the shadow Minister also referred to? The average total remuneration of FTSE 100 CEOs saw a fourfold increase between 1998 and 2010. The hon. Gentleman chose two decades. I chose the period 1998 to 2010 to see what happened while the previous Government were in office. That increase is faster than the increase in the FTSE 100 index, retail prices or average remuneration levels across all employees for the same period. In 1998, FTSE 100 CEOs earned on average 47 times the amount earned by the average employee. By 2011, that figure had risen to 139 times the earnings of the average employee.

The previous Government introduced advisory votes in 2002 and they were right to do so. There was growing evidence—not just anecdotes—of a mounting market failure. The gap between performance—this is the critical point, because I suspect all of us in the room accept that there can be high pay to reward success—and pay was mounting from 2002 onwards. Yet nothing further happened. It is this coalition Government who are taking action with the most comprehensive reform package for a decade.

Mr David Anderson (Blaydon) (Lab): If the Minister agrees that it is right that high performance should be rewarded, why are his Government supporting the move in the south-west health authorities to reduce the pay of clinicians?

Norman Lamb: I understand that there was a report in *The Sunday Times* about the number of trusts looking to tackle pay levels in their hospitals. That is not directly related to the issue of regional pay. None the less, the previous Government did introduce regional pay for court staff. The Opposition fail to recognise that we have a massive deficit problem in this country—£150 billion a year when this Government took office. Although the Government—unlike the Opposition—promised to protect funding for the health service, we have a genuine problem in this country. As the population ages, we see rising costs of health care. Even protecting the health budget leads to challenges. I suspect that if we continue down this route, we will get chastised by the Chair.

Mr Anderson: Will the Minister give way so that we can see whether the Chair chastises us?

Norman Lamb: Let me move on. *[Interruption.]* I am nervous of that; I accept that. I can see by the Chair's body language that his patience is rapidly disappearing. I believe that Opposition Members fully support the case for reform in this area and the need to strengthen shareholder power. However, I am conscious of the amendments they have tabled and I will deal with them later.

The clauses that we have put forward would replace clause 57 with a more comprehensive package of reform. The clause would repeal section 439(5) of the Companies Act 2006, which currently prevents the statutory requirement for a resolution on the directors' remuneration report from having the effect of making a person's entitlement to remuneration contingent on the outcome of the resolution. It is that that makes the current vote on pay advisory in nature. Removing subsection (5) of the Act would make it easier for quoted companies to make payments to directors contingent on the resolution should they choose to do so, and should shareholders agree. However, we want to go further than that. In the light of the proposed new clauses 5 to 8, which would introduce a binding shareholder resolution on directors' remuneration policy in all quoted companies, clause 57 is no longer necessary. We will therefore oppose the motion that the clause stands part of the Bill.

New clause 5 introduces a new requirement for a shareholder resolution on the policy part of the director' remuneration report. In accordance with the proposed section 421(2A), the remuneration policy will be set out in a separate part of the remuneration report. That will contain information about performance measures and maximum possible pay-outs if targets are achieved as well as details of how the company would compensate a director in the event of loss of office. The contents of the report will be prescribed by regulation. The Committee will be aware that we have published a draft of the regulations to aid its consideration of the Bill, and consultations on those draft regulations are continuing through to 26 September. Companies will need to put to a shareholder meeting a resolution on the directors' remuneration policy in the first year these provisions come into force and at least every three years thereafter. That will require the support of a simple majority of those shareholders voting in order to be approved.

10.30 am

If a company wants to make changes to its remuneration policy, it will need to put it back to shareholders for approval at a general meeting. That will promote a longer-term approach to pay policy and, far from watering down the original idea of an annual vote, when it was put to consultation the large majority of shareholders who responded—the hon. Gentleman mentioned one dissenting voice—believed that it was the right way forward. It is important, by the way, that if someone consults they listen to the responses.

Mr Iain Wright: Will the Minister answer a question that the Secretary of State could not answer in his oral statement to the House last month? In that context, what constitutes change?

Norman Lamb: A whole series of issues could constitute a change from the stated policy voted on at the AGM. As I have said, the draft regulations will prescribe in detail the issues that have to be covered by this part of the remuneration report. If during the currency of the policy the directors believe that some change is necessary, they have to go back and get approval. It could be a change to exit payments, because particular circumstances mean that a payment the directors intend to make does not come within the policy. They might not get approval—it is a binding vote—but it is impossible to prejudge the whole range of changes that could be made, because the level of prescription of the topics covered in the policy is significant.

Mr Iain Wright: Let me tempt the Minister down the path of prejudgment as much as possible. I do not want to get into individual remuneration packages—that would be unfair—but to look at the matter in broad policy terms. We have seen the scandal of the LIBOR setting, which will run and have huge implications for the banking sector. How does the Minister think the two issues will run together? If criminal prosecutions take place and further revelations come out, what will happen to directors' contractual obligations with regard to exit payments and other things? How will the measures help to ensure a fairer response regarding directors' and executives' pay, within the narrow prism of the Libor scandal?

Norman Lamb: If a director has either committed a criminal offence or breached his or her contract, the whole contract potentially falls. That is a contractual law issue. Committing a criminal offence in the course of one's employment would be a fundamental breach of the contract of employment, and would result in any entitlements under the contract to pay-offs at the end falling away.

It might well be that up to now some companies have not been sufficiently robust in questioning whether a departing director should be entitled to a payment. The culture, in both the private and the public sector, has been to make substantial payments. Earlier in our deliberations, I railed against some of the pay-offs to NHS chief executives that were massively in excess of what they ought to have been, and often paid in return for a vow of silence about things that had gone wrong. That can happen in both the public and the private sector. We want to engender a culture in which people are not entitled to more than the policy allows, and a fundamental breach of the contract or a criminal offence might well result in a director having no entitlement to pay on leaving.

Mr Iain Wright: The Minister is going down an important path. May I again provide a theoretical example, and in doing so question the extent to which current contractual obligations will be revised in the face of the Government's proposals? He mentioned exit payments. If a director of a company is entitled, through his or her contract, to be allowed two years' base salary as an exit payment, how will the Minister's proposals in new clause 6 and elsewhere help to revise that downwards to ensure greater accountability and scrutiny?

Norman Lamb: The proposals will work by forcing companies to consider whether the existing contractual payments are consistent with the forward-looking policy that they believe they can get through their annual general meeting. They will have to focus their minds on having to win a vote in an annual general meeting on their future policy and, as I have said, that policy will include details of exit payments.

To give details of what will be covered, the forward-looking policy report will contain a table setting out key elements of pay and supporting information, including how each element supports the achievement of the company's strategies. That will force companies to think about getting incentives right and about how payments lead to improved performance, because many people are concerned that existing incentives are wrong and do not achieve sustainable long-term value. The report will also cover the maximum potential value, performance metrics and scenarios for what directors will get paid for performance that is above, on or below target. It will include information on employment contracts and on the percentage change in profits, dividends and the overall spend on pay. It will contain the principles on which exit payments are made, including how they are calculated, whether the company distinguishes between types of lever or the circumstances of exit, and how performance is taken into account. It will also cover material factors, specifically employee pay and shareholder views, that are taken into account when setting pay policy.

That is a significant degree of detail. To be clear, it is set out in draft regulations, but if Parliament approves something in accordance with those draft regulations, a substantial degree of detail will be required to be given in the report. Indeed, there will be every opportunity for shareholders to seek to engage with the company and to ensure sufficient granularity for them to hold it to account. Vague details will not satisfy anyone, and the report will give power to shareholders to hold companies to account in ways that they could not use in the past.

Mr Iain Wright: On this very important point, I want to seek clarification from the Minister and to press him on one specific point. He mentioned reforms, with which we agree, and the forward-looking remuneration policy. As I have asked in previous interventions, will the Minister clarify the relationship between the proposed forward-looking remuneration policy and current contractual obligations on directors? Will the forward-looking plan supersede contractual obligations, and if not, how can boards extract themselves from such contracts?

Norman Lamb: I am grateful to the hon. Gentleman for reminding me to deal with the impact on existing contracts. Contracts that were in place before the new clauses were tabled on 27 June and that remain unchanged will be protected. Companies will be able to honour any payments that they legally have to make, without coming into conflict with the new restrictions on pay in proposed new sections 226B and 226C of the Companies Act 2006. However, all payments made under contracts entered into, amended or renewed on or after 27 June will be caught by the new rules. Contracts will need to be written to take that into account. The restrictions on payments will not come into force until 2014, at the

[Norman Lamb]

earliest, giving companies plenty of time to prepare. Most contracts are rolling contracts, so it should be possible for companies to adjust those contracts by agreement with the director, if they are minded to introduce a pay policy that has the effect of reducing some of those elements of the remuneration package that may have become excessive.

As for the greater transparency that will be engendered by the Government's reforms, the implementation report on what has happened already will have to give a single total figure of remuneration for each director, and details of performance against metrics for long-term incentives. That is again part of the draft regulations that are being consulted on. There will be far greater transparency.

The hon. Member for Hartlepool talked about the increased complexity of remuneration packages. For the first time, the total value of the package will have to be reported. That gives much greater transparency than has ever existed. I am sure the hon. Gentleman supports what we are trying to do in that regard.

Companies will continue each year to put to the AGM an advisory resolution on the remainder of the remuneration report, which is the backward-looking part on the actual payments I have just referred to, made to directors in the last financial year. If in any year they fail to get that vote, companies will have to bring forward a resolution on the remuneration policy at the next AGM. That triggers a vote at the next AGM.

The advisory vote can achieve that trigger, calling companies to account if shareholders are unhappy with the way the remuneration policy is being implemented. That is a substantial strengthening of shareholder power.

New clause 6 would place new restrictions on remuneration payments and payments for loss of office that may be made to directors of quoted companies. So for the first time, there will be real, binding limits on what companies can pay. In future, all payments will need to be consistent with the approved policy in place at the time. That legislative provision is what makes the remuneration policy binding on a company; it will be binding once it has been approved by the shareholders at the AGM.

If the company wishes to pay beyond the levels approved in the policy, that will need to be approved in a separate, specific shareholder resolution. There will be sanctions if companies ignore the remuneration policy, so it has teeth. Any unauthorised payments made will need to be held on trust for the company, and the directors responsible will be liable for any costs incurred.

The new clause also makes it clear that any legal obligation that gives rise to a payment to a director that would be deemed unauthorised, is unenforceable. In other words, contracts cannot be used to trump the provisions in the legislation. That will ensure the remuneration policy cannot be undermined.

New clause 7 would make important, consequential amendments to various sections of the Companies Act 2006 to ensure that the proposed new clauses are consistent with existing provisions in that Act. For example, it excludes quoted companies from the existing provisions in chapter 4 on payments for loss of office, because those companies will instead have to comply with the provisions set out in new clauses 5 and 6.

It also introduces a new requirement for companies to publish on their website, details of payments for loss of office made to departing directors. That will mean that shareholders no longer have to wait months to find out that information, again significantly increasing the power of shareholders. Shareholders can only exercise power if they have the information available on which to base judgments. It will cause companies to think more carefully about how exit payments will be perceived, which should help prevent the most egregious cases.

Finally, new clause 8 deals with the transitional arrangements to help companies understand how and when these new rules will affect them and so that they can prepare. In particular, it makes clear how existing contractual provisions will be dealt with.

These few clauses represent a major strengthening of the corporate governance of directors' remuneration. The Government have engaged extensively with stakeholders in developing the proposals and the result is a balanced package that can make a real difference, without overburdening companies or shareholders with unnecessary regulation. As a result, these proposals are publicly supported by business leaders and—critically—by investors alike.

10.45 am

Let me turn to the amendments that the Opposition have tabled. The first of them—amendment (a)—seeks to require that high pay below board level is also reported on. We know that high pay outside the board room is most prevalent in the financial services industry. For that reason, the Treasury is currently considering the responses to its recent consultation on extending pay disclosure in large banks to highly paid non-board executives. If it is enacted, this proposal will ensure that the UK has the most comprehensive disclosure regime of any major financial centre, exceeding the practices of many other countries. However, we do not believe that extending this regime to other sectors or to the whole economy, where high pay below board level is much less of an issue, is necessary.

Mr Iain Wright: When I tabled this amendment, I cited the example of the creative and cultural sector, which is the other obvious example of a sector in which there is high pay below board level, as shown by what has been done this week regarding the BBC. Leaving the BBC to one side, does the Minister not think that there is a public interest in shareholders who invest in a particular media company finding out whether the talent—the entertainment element—is being paid more than the executives? Surely that is also relevant to what we are considering, is it not?

Norman Lamb: Of course there is an interest, and my instinct is to encourage transparency both in Government and outside Government. Transparency has great benefits; it focuses people's minds on what can be justified. Someone has to think, "Can this actually be justified to the wider public?"

However, a balance must be struck between introducing measures that achieve an objective and address a specific mischief that has developed—the loss of the connection between performance and pay—and other factors. The response that the Government have received from across the board has demonstrated that we are getting those measures right, but we must strike the right balance between the introduction of those measures and avoiding the introduction of excessive burdensome regulation.

After all, banks are a special case, because there is the potential systemic risk with banks that is, of course, not present in the type of media company that the hon. Gentleman was perhaps referring to. In terms of the impact on people's daily lives, irresponsible behaviour in the financial services industry and particularly in banks can have, as we have seen, a direct impact on the entire community and on the economy as a whole. That is not the same in the creative industries and this process is about getting the balance right, addressing the additional requirements on disclosure that the Government are already consulting on through the Treasury to ensure that they are targeted at the sector where the mischief is at its greatest and has the greatest impact on the public and on the economy.

We consulted on this issue last year and found that there was no demand from investors—this whole package is about empowering investors to hold companies to account—for this extra information with regard to areas outside financial services. Indeed, it would be an unnecessary extra reporting burden on companies. Furthermore, as the regulation-making power in section 421 of the Companies Act 2006 relates to the content of the directors' remuneration report, it is unclear whether we could legitimately require the inclusion of information about the pay of non-directors without also extending the original power. So the amendment is based on a power that relates to directors and yet it is addressed to non-directors. With respect, that is a potential flaw in the drafting of the amendment. I therefore ask hon. Members to withdraw the amendment.

The intention behind amendment (b) is to require that the resolution on the directors' remuneration policy be put forward at every accounts meeting, although that is not entirely clear from the drafting of the amendment, which simply seeks to remove the three-yearly requirement. As we have debated, that is something we considered very carefully when developing our proposals. We discussed the idea at length with investors and businesses, and concluded that companies should have the option of setting out a pay policy that can be approved by shareholders for up to three years.

The hon. Member for Hartlepool said that we should take note of the comments of one investor group, and that is right. However, I suspect that he would accept on that basis that he should take note of the comments of the Association of British Insurers that the provision will,

"help the task of keeping executive pay proportionate and aligned to corporate strategy".

The measure will promote a longer-term approach to pay setting and discourage companies from making unnecessary annual tweaks and adding to the complexity of pay packages. Investors also agree that it will help to put a brake on annual upward pay ratcheting.

Again, I come back to the point I made in an intervention. Because companies will have to address the issue every year in a vote, I urge the hon. Gentleman to consider that the amendment may have the unintended consequence of seeking to justify some upward ratcheting of the pay package.

Mr Iain Wright: Will the Minister give way?

Norman Lamb: I appreciate that the hon. Gentleman is about to quote again from the *Financial Times*. We have already heard extensively from it, but I will hear again.

Mr Wright: It is an important article. I understand that the Minister is making full and reasonable points, as he has done throughout the Committee. I am grateful to hear what he has to say, and I certainly have to take into account the views of different stakeholders, particularly the ABI and others. I fully accept that, but how does he respond to the editorial opinion from the *Financial Times* of 21 June, which states, on the point to which the Minister has been referring:

"annual votes would at least put them"—

in other words, executives—

"firmly on the spot. Mr Cable's triennial polls, however well-meaning and thoughtful, may not."

How does the Minister respond to what the *Financial Times* has to say on such an important matter?

Norman Lamb: I suppose that all I would say is that even though it is the *Financial Times*, we should not necessarily accept everything that it says. Indeed, I am quite sure that one will find other supportive comments about what we are seeking to do in that edition, if that was the edition that followed immediately after the announcements. I urge the hon. Gentleman to reflect on the fact that although that leading article clearly represents a dissenting voice—I accept that—none the less, the mass of responses was highly supportive, as I indicated from the quotes I gave earlier.

If the hon. Gentleman thinks about it, is the idea of trying to encourage some more longer-term thinking not a good thing? Is it not sensible to be planning pay for the three years and to have a strategy, rather than lurching from one year to the next? Companies will set a longer-term strategy for three years, but shareholders will have the right to bring the matter back earlier if they are not satisfied, and if they choose to vote against the performance of the company in the previous year, it will trigger a binding vote in the following year. That seems to us to be the right package, and it is genuinely ingenious and smart. The measure achieves greater longer-term focus, gives shareholders the power to come back sooner and empowers shareholders to hold the company to account.

Mr Iain Wright: The Minister makes an important point that an annual binding vote may ratchet up the pay on a yearly basis, but will he not accept the converse point? Looking at the medium term—say, over a three-year period—directors might be tempted to negotiate with the board and say, "Well, three years is a long time. There are a lot of uncertainties there. On that basis and factoring in that risk, instead of a 10% increase year on year, I think I should have a 15% or 20% increase," totalling a 60% increase over three years. Is there not a risk that pay will increase disproportionately as a result of that three-year period?

Norman Lamb: Absolutely not, because the shareholders would have to be convinced that the package was worth supporting. If the shareholders decided that such a dramatic percentage increase could not be justified against projections for the company's performance and pay for the rest of the company's employees, they would vote it down. Again, this is about giving power to shareholders to hold their companies to account. That is what makes the package so powerful.

If a company wants to make any change to policy, it will have to refer back to shareholders, but if the policy remains totally unchanged, it is an unnecessary burden on both companies and shareholders to require a vote on it. If a company is keeping the policy exactly the same over a sustained period, what on earth is the point of going back and having another vote on it when they had a vote the previous year? If changes are made, the company must come back and justify them. That seems to get the balance right.

We have, however, built in a safety net. If shareholders are not happy with how the pay policy is working out, they will be able to use the annual advisory vote on the report on pay to trigger a compulsory vote the next year. It is an important trigger, to which Sir David Walker referred —oh, look—as "ingenious" when he gave evidence to this Committee. It means that shareholders could force the annual binding vote on remuneration policy should they wish to. Given the wide support for the Government's approach to the issue, we suggest gently that the amendment should be withdrawn.

Mr Anderson: The Minister keeps quoting wide support. I have listened carefully to what he has said. The bodies that support it appear to me to be the same insiders who over the past 20, 30 or 40 years have seen huge increases, such as the insurance brokers, and the CBI, which said, "That's okay. If we don't give these people what they deserve, they'll all run away and leave the company." Is that not exactly what he is suggesting?

Norman Lamb: No, I do not think that that is the case. Many groups within the shareholder community have become highly critical. It is fair to say that they have not used the power already available to them. They have some power, under the—with the benefit of hindsight—inadequate reforms by the hon. Gentleman's Government in 2002, which introduced the advisory vote. That is all that the previous Labour Government did.

Shareholders have not even exercised as much power as they could have to send a strong message through the advisory vote. The shareholder spring that we witnessed this year has indicated that at last, a change in that culture appears to be happening, but I think that shareholders recognise that things must change, and indeed that it is not in their interest, as owners of the company, to allow the mismatch between performance and pay to continue. As I said, this is about getting incentives right. If we get incentives right so that they drive strong performance by directors in the long term, the company owners will benefit. That is not what has been happening in the past decade, and it needs to change.

11 am

Amendment (c) would remove the requirement for a company to propose a resolution on its directors' remuneration policy in the event that the advisory resolution on the remuneration report failed at the previous AGM. That is the trigger mechanism, which I have discussed. The amendment is tied to amendment (b), which seeks to require that the resolution on remuneration policy take place annually—although, as I said earlier, I do not think that the amendment's wording is entirely clear—regardless of whether the policy has changed. I have elaborated on why the Government do not believe that that should be the case, and also on how investors support the notion that it should be possible for the remuneration policy to last for more than a year. I therefore ask Opposition Members to withdraw the amendment and maintain the effective, ingenious trigger mechanism that I have discussed.

I must admit that I do not know why amendment (d) has been tabled. Lines 57 to 62 of new clause 5 ensure that the appropriate process is followed when a company gives notice that the directors' remuneration policy is to be put to a resolution at a meeting. In doing so, it mirrors provisions applied under the Companies Act to the existing resolution on the remuneration report. The previous Government drafted those provisions, which we are reflecting entirely. The remuneration policy will form part of the remuneration report, so it is desirable that the same processes apply to both resolutions. It is standard practice to give notice to people attending the meeting of what is on the agenda, so why remove that requirement? It seems counter-productive, and I urge Opposition Members to withdraw the amendment.

As I see it, amendment (e) would do two things. First, it would remove the provisions in subsection (6)(b) that allow companies to propose a remuneration policy at a meeting other than the accounts meeting. The purpose of those provisions is twofold: in the event that the policy resolution fails at the accounts meeting, it allows the company to propose a revised policy at an extraordinary general meeting; it also allows a company to propose a revised policy mid-year after a takeover or demerger, for example. Those essential measures ensure that companies can respond to circumstances. Without them, companies and their shareholders could be restricted by a remuneration policy that is no longer suitable, which would be bad for businesses and those who invest in them. The amendment would create gridlock, with a policy that has either been rejected or needs changing, without the ability to bring about that change. That outcome would be wholly undesirable.

Secondly, the amendment would insert the provision that the remuneration policy should be approved by 75% of the total share register—that point is important, because the Opposition's proposal would not apply to those who vote, but to the total share register. Earlier this year, we consulted on the level of support required for remuneration resolutions. We asked whether it should be increased beyond a simple majority; for example, whether the resolution should be "special" rather than "ordinary".

Following that extensive consultation, our conclusion was that an ordinary resolution is most appropriate, which was a view held by the vast majority of investors. They had concerns that a minority of shareholders could overturn the majority's views, using it as a means of causing disruption. A special resolution normally only applies when shareholders are voting on critical matters, such as recapitalisation or changing the articles of a company. They are very rarely used.

In all cases in public companies, resolutions are measured as a proportion of those voting at a meeting, and never as a proportion of the total voting rights. Moving towards the latter system would be a major reform and would effectively remove shareholders' rights to abstain. Turnout in such votes tends to be about 70%. If a 75% vote from all those entitled to vote were required, one would effectively be saying that there has to be a 75% turnout and 100% would have to vote in favour. That again is a recipe for complete gridlock and if the hon. Gentleman thinks about it, he will see it as simply unworkable. We consulted on whether there should be a special resolution of 75% or an ordinary resolution of 50%, but his proposal goes massively further. If he is minded to go for a majority of all those entitled to vote, would he like the same provisions to be introduced for trade unions?

Mr Wright: The Minister has obviously been listening to the hon. Member for Skipton and Ripon.

Norman Lamb: I know; I feel sure that he would have made an interesting contribution. If the hon. Member for Hartlepool thinks that that principle should apply to shareholders of a company, surely it should apply to trade unions, which would cause him enormous difficulty with his trade union paymasters.

Ian Murray: The Minister has raised an incredibly interesting point, but is it not far easier for shareholders to exercise their vote than for trade union members when it comes to balloting?

Norman Lamb: The hon. Gentleman makes an interesting, desperate defence of the system. We are discussing a sensible level of majority in a vote, and the important point is that because turnouts are generally about 70%, the amendment would, in effect, require a 100% vote. Any dissension at all would completely block things. I am sure that the Opposition do not seek to achieve such gridlock.

Mr Wright: The Minister is making sensible comments, and I understand the limitations of the amendment. He has mentioned the level of support, however, and the principle behind the amendment has been: to what extent do the directors and the board work together with the widest possible range of shareholders to achieve some degree of consensus on remuneration policy? We may agree or disagree with the distilled principle, but what will the Minister do to encourage consensus and early consultation on the rudimentary remuneration policy, to ensure that the level of support reflects the wider shareholder register?

Norman Lamb: The hon. Gentleman raises an incredibly important point, to be fair to him. We absolutely want to encourage early engagement. There is already good engagement in well run companies, but we want to make that the norm so that the report that goes before an AGM is the result of good engagement. We want everybody to feel confident that the report will be supported because that good engagement has happened. The smartness of the reforms is that they create the culture, the space and the incentives to allow a genuine revolution in the relationship, without imposing an excessive or bureaucratic burden on companies.

Mr Wright: If I withdraw the amendment and table something on Report requiring 75% of those who vote, would the Minister agree with me and vote accordingly?

Chris Ruane: Compromise!

Norman Lamb: That is not much of a compromise, to put it politely. The point I am making is that we consulted on the more modest proposal of 75% of those voting, and we listened to the consultation responses. That is critical, and I think we both agree that if we do a consultation, we must not just ignore its outcome. The clear voice of the investor community said that 75% would not be sensible, and that the proposal that has emerged from the process gets the balance right.

Fiona O'Donnell: Will the Minister inform the Committee what percentage of shareholders responded to the Government's consultation? That might indicate the activity that we are likely to see in future.

Norman Lamb: All the major shareholder organisations responded to the consultation, so it was a significant and substantial response. The overwhelming view was that 50% was the right level, and that that gave them the power that they needed to hold their companies to account. Investors, as I have said, have publicly welcomed our decision to maintain an ordinary threshold. Importantly, they have shown this year that if they are unhappy with the performance of the company's executives or the board and there are issues with pay, they can muster a 50% vote against. The Government agree, however, that companies should sit up and take notice when a large minority of shareholders reject a remuneration resolution, even if it has technically been passed. We welcome the Financial Reporting Council's commitment to examine whether companies should formally respond when a significant number of shareholders vote against a pay resolution and to consult on whether that should be in the corporate governance code.

Mr Anderson: In an intervention on the shadow Minister, the Minister mentioned trade union paymasters. Does the Minister accept that his party's paymaster is actually languishing in jail? When will he get his party to pay back the £2.5 million that it received from that gentleman?

The Chair: A brief response to that, Minister.

Norman Lamb: Mr Bayley, you have allowed me a brief response, but I feel obliged not even to take up that invitation. I will focus in a disciplined way on the amendments before us and not be tempted, much as I am, by the invitation.

Regarding amendment (g), Opposition Members will be reassured to hear that the Government share their desire for greater transparency around the use and payment of remuneration consultants. The behaviour of some remuneration consultants has been a major cause for concern. We looked at that matter last year as part of the consultation on improving company reporting. Shareholders told us that they wanted more information on how remuneration committees use the services of consultants when making decisions about pay. That is

[Norman Lamb]

why we proposed in the draft regulations that quoted companies' remuneration reports set out, first, who provided advice about the directors' remuneration, including recruitment, secondly, whether other services were provided to the company, thirdly, who the consultants were appointed by and how they were selected, and, finally, the total cost of advice and the basis on which consultants were paid. That will focus the minds of those on remuneration committees on justifying their use of remuneration consultants and on how much they are paid, because there will be that transparency that helps to hold them to account.

That will be part of the regulations made under section 421 of the Companies Act 2006, which sets out the required content of remuneration reports. That section already gives the Secretary of State the power to prescribe what information about consultants may be included. Therefore, there is no need to add that into primary legislation. We have, as hon. Members know, published a draft of the regulations for comment, and both Houses will have the opportunity to debate them at a later stage. I reassure hon. Members that the intention behind amendment (g) is already being taken forward. No further amendments are required to the 2006 Act, so I suggest that the amendment be withdrawn.

Amendment (i) concerns investor voting disclosure. As did the previous Government, we have committed to using the power under section 1277 of the Companies Act 2006 if market practice on voting disclosure fails to show sufficient signs of improvement. As my right hon. Friend the Secretary of State said to the Business, Innovation and Skills Committee on 28 June and in his subsequent letter to the Committee, institutional investors are showing greater signs of both voting and disclosing how they vote. Several recent surveys of fund managers by organisations such as the Investment Management Association and the TUC acknowledge a steadily increasing rate of disclosure over recent years.

Furthermore, and as those and other surveys have recognised, the Financial Reporting Council's stewardship code has been making a difference since its introduction in July 2010. Principle 6 of the code requires signatories to have a clear policy on disclosure of voting activity or to explain why they do not. That is the "comply or explain" principle. Most of the major investors in UK equities have signed up, and that is important. The latest Investment Management Association survey of institutional investors shows that 73% of those surveyed now publish their voting records, up from 21% in 2004. There has been a significant change in behaviour.

11.15 am

The non-legislative route seems preferable to the legislative one. However, as with the rest of the reforms, the Government are committed to reviewing how behaviour evolves. If it does not produce the transparency that we all believe is necessary, we can return to it. We will closely monitor the trend in investor disclosure and take further action if appropriate. Currently, given the significant trend that we are already seeing, we do not believe that it is necessary. Therefore we reject the amendment.

Regarding amendment (j), I have already made clear our commitment to greater transparency on how remuneration consultants are appointed, used and paid. Our proposals for the new remuneration reporting regulations will address shareholders' concern that it was not always clear how a remuneration committee's decisions have been informed and what role consultants played in that.

We have heard a small number of people arguing that remuneration consultants are the root cause of escalating and ever-more complex pay packages. Those people, including hon. Members, seem to favour tighter regulation of consultants. Remuneration consultants and, for that matter, recruitment consultants, clearly have an input in the pay-setting process, but they do not in the end decide. It is people who place their votes—the remuneration committee and then the board of directors—who ought to be ultimately accountable. Let us not forget the roles and responsibilities of the board and the shareholders who hold the board to account.

Chi Onwurah: Does the Minister not acknowledge that by providing the information on which that decision is made, for example, "To attract a certain level of talent or executive quality, one must pay at a certain rate", the role of remuneration consultants is critical in the decision-making process?

Norman Lamb: It is important. That is why we are requiring, in the draft regulations, companies to disclose where the advisers come from and how much is paid for that advice. We are seeking to address the concerns raised by the Opposition. We share the concern; this is a debate just about the appropriate response. Ultimately, responsibility and accountability lie with the people who vote, who are the board of directors. The policy that emerges from the board has to be approved by shareholders, the owners of the company.

Mr Iain Wright: Does the Minister think that the measures regarding the disclosure of fees paid to remuneration consultants for providing consultancy advice on executive pay should go further? For example, if the nature of the contract between a firm and a consultancy is that a percentage of the executive salary will be paid as the fee, there is obviously a vested interest for the consultancy firm to try to boost as much as possible directors' remuneration. Should there be some sort of disclosure about whether remuneration consultancies are provided with a flat fee or with a percentage of the remuneration package?

Norman Lamb: Clearly, the incentives there are important as well. We are consulting on such things at the moment. I would encourage the hon. Gentleman to participate in the consultation process.

During our consultation process, we have not had calls from shareholders for tighter controls on how consultants are appointed or for them to have a direct role in the process. It would be unnecessary and unwelcome regulation that would add an extra burden on companies and shareholders. However, we are requiring information to be disclosed as part of the report, as I have already indicated. There is no evidence that this would contribute to improving the link between pay and performance and tackling rewards for failure.

I note with some amusement that the proposed new section would actually make it a legal requirement for directors to appoint a remuneration consultant. That is a bizarre turn of events. I am not sure whether institutionalising and requiring the use of recruitment consultants is what the Opposition really want, but that is what their amendment proposes, which seems somewhat bizarre. Whereas there is an obvious case for requiring this of auditors, I can see no reason for compelling companies to pay for advice on directors' salaries from people whom the Opposition assert have behaved irresponsibly, which is a view shared by many people. For all those reasons, I am afraid we have to oppose amendment (j) and I invite the hon. Members to withdraw it. I suspect it would achieve unintended consequences.

The substance behind new clause 17 has been debated in both Houses many times over the past few months. A successful company needs to have a board of the highest quality with the right mix of skills, knowledge and experience. The Government have been very clear about their commitment to board diversity as one critical way of promoting effective boards. The Secretary of State has spoken on numerous occasions about his desire to see directors recruited from a far more diverse range of backgrounds. This is not just about gender, but also about bringing in people with a wider range of professional experience as well.

Companies should be looking outside the usual pool for recruitment. We have already taken steps to promote this. In October, a new provision of the UK corporate governance code comes into force requiring companies to report on their policy on boardroom diversity and what progress they have made. That is an important innovation that the Government have been keen to see. It is the first time that it has happened. This sits alongside a new ground-breaking code of conduct for executive head-hunters, which encourages them to recruit directors who are not currently on boards.

Investors, too, are doing their bit to promote greater diversity. The Association of British Insurers has issued a report on board effectiveness, highlighting good examples of board diversity and succession planning and putting forward recommendations for how companies can improve. The appropriate way to deliver this objective is through the corporate governance code, by sharing best practice and through industry-led initiatives such as the excellent work led by Lord Davies. I pay tribute to him for the fantastic leadership that he has shown with regard to women on boards. That is the appropriate way to deal with this, not through company law.

Lorely Burt: As a Liberal Democrat Member of this excellent coalition Government Public Bill Committee, does my hon. Friend agree that it is not appropriate to force companies to have, for example, workers on boards in the Bill, but we could adopt a policy of diversity as a mark of a more ethical and successful company that would meet with the approval of shareholders? We could reserve the right to legislate to prescribe greater diversity on boards in future, as we have already in relation to women on boards.

Norman Lamb: I am grateful to my hon. Friend for that intervention. Focusing on the business case as well as the ethical case for diversity is important. Companies with more diverse boards tend to perform better. The evidence on women on boards shows a close relationship between gender diversity on boards and the economic and financial success of the company. We will do everything to promote that. The view of the Government is not to prescribe, but to encourage. Indeed, the initiative this October to encourage greater diversity is the way in which one changes the culture. It is important to take people with you, rather than seek to impose change against hostile opposition.

11.25 am

The Chair adjourned the Committee without Question put (Standing Order No. 88 and Order of the House, 5 July).

Adjourned till this day at half-past One o'clock.