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Companies must innovate on remuneration, urges LAPFF

1. The Local Authority Pension Fund Forum (LAPFF) has urged companies, investors and remuneration consultants to strengthen the link between executive pay and long-term performance by making pay under long-term incentive plans (LTIPs) conditional on the achievement of non-financial performance targets.
2. This call follows on the heels of a LAPFF survey of FTSE 100 companies which concludes that companies currently face considerable obstacles to using performance targets based on non-financial measures.
3. 34% of respondents to the survey stated that the preference of their major shareholders was a primary factor in opting for an LTIP based solely on traditional financial metrics such as Total Shareholder Return or Earnings per Share.
4. 30% of respondents cited the difficulty in creating robust non-financial metrics for use in LTIPs, some stating that these have not been used long enough to guarantee that their use would not have unintended consequences.
5. The role of remuneration consultants also warrants a closer look: some respondents suggested that their remuneration consultants had not been supportive when the remuneration committee sought to introduce non-financial performance into their LTIPs.
6. Councillor Ian Greenwood, chair of the Forum, said: "The use of traditional financial metrics does not link pay tightly enough to performance. Investors in particular are in the hot seat on this one as they need to integrate environmental, social and governance considerations into their investment decisions to safeguard long-term returns – it does not make sense to then insist solely on financial metrics when it comes to long-term pay schemes."
7. The Forum has campaigned since 2007 for companies to consider including non-financial factors which influence a company's long-term outlook, as performance targets in their long-term incentive plans rather than in annual bonus schemes.
8. In 2007, research by the Forum into pay practices in the FTSE 100 identified only seven companies that used non-financial targets in their long-term incentive plans, compared to 51 companies that operated annual bonus schemes that

applied non-financial metrics. United Utilities plc emerged as a clear leader, employing 17 non-financial performance targets in its Share Matching Plan.

9. Councillor Greenwood added: “Traditional incentive schemes are failing to protect shareholders’ long-term interests. In the current crisis we see bonus schemes that would continue to pay out at bailed out banks, were it not for a Government ban. We need to address this worrying lack of long-term focus in pay schemes. Investors, remuneration committees and their consultants need to work together towards a reform of market practices in this area.”

About LAPFF:

The Local Authority Pension Fund Forum (LAPFF, www.lapfforum.org), which was set up in 1991, is a voluntary association of 48 public sector pension funds based in the UK. It exists ‘to promote the long-term investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate responsibility and high standards of corporate governance amongst the companies in which they invest.’ The Forum’s members currently have combined assets of over £75 billion.

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