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Trade Union Voting and Engagement Guidelines

Contents

Section one

Introduction

This document sets out voting and engagement guidelines for trade union funds with investments in equities to use at company AGMs.

Under the UK's system of corporate governance, shareholders have important rights and responsibilities in relation to the companies whose shares they hold. Shareholders elect the directors of the board, both executive and non-executive, now on an annual basis; they vote on shareholder resolutions; and recent changes have made company policies on future executive pay subject to a binding vote by shareholders. Other significant decisions such as company mergers and takeovers are also subject to shareholder control.

Pension funds, the retirement savings of working people, generally hold a significant proportion of their holdings in UK and global equities. Thus many trade union members have an interest in the success of companies both as employees and as investors. It is the TUC's view that shareholder engagement with companies must be linked back to those with an economic interest – pension fund trustees, and scheme beneficiaries.

It is important for trade unions to play an active role in corporate governance because the way companies are run is inextricably linked to other important areas of our work such as labour standards, job security, social and environmental responsibility and the development of the relationship between finance and industry. It is our view that good governance requires the balancing of the interests of all stakeholders in a company.

Many pension funds delegate decisions on voting and engagement to their fund managers. Successive TUC Fund Manager Voting Surveys have shown the divergence between different fund managers in their positions on voting. They have also documented how few fund managers have supported union-sponsored shareholder resolutions and other shareholder resolutions on labour standards and other social and environmental issues. For trade union pension funds and other funds, this presents a risk that their fund could inadvertently be voting against the union's own policies and the interests of its members through delegating its voting and engagement to its fund manager.

To address this situation, the TUC and some of its affiliated unions have decided to establish a trade union group to collaborate on voting and engagement with companies. This collaboration is being launched with the participation of funds from the TUC, UNISON and Unite. All union funds are welcome to join the collaboration at any stage in the future.

Introduction

Collective action is the basis of trade unionism: the fact that people are stronger working together to defend their shared interests than they are alone is the fundamental reason why unions were established and why they still play a vital role. Trade union collaboration over voting and engagement with companies reflects this tradition of collectivism, and enables its participants to put trade union values at the heart of corporate governance.

The participants of this collaboration believe that it is their fiduciary duty to take account of environmental, social and governance (ESG) issues in how they manage their funds' investments. We believe that this not only desirable from a trade union and ethical perspective but also contributes to the long-term success of the companies whose shares we hold.

Research over recent years has provided convincing evidence that investors that take account of ESG issues in terms of how they manage their investment generally out-perform those who do not[1]. This has led to a reappraisal of the concept of fiduciary duty, including in relation to consideration of ESG issues. A report[2] by the legal firm Freshfields Bruckhaus Deringer for the United Nations Environment Programme Finance Initiative (UNEP FI) concluded that because of the increasing evidence of a link between ESG factors and financial performance, consideration of ESG factors was clearly permissible and arguably required of investors. It also argued that ESG factors should be taken into account where a consensus, express or implied, exists amongst beneficiaries. This reflects the situation of trade unions, whose staff will generally have a strong commitment to the aims and values of the union movement.

These guidelines are also aimed at member-nominated pension fund trustees throughout the labour movement. The TUC has a network of over 1,000 trade union member-nominated trustees, which is the largest trustee organisation in the UK.

The financial crisis highlighted significant weaknesses in the way that investors had exercised their oversight and governance role in relation to investee companies. To address this, the Financial Reporting Council has put in place the Stewardship Code for Institutional Investors, which sets out the responsibilities of investors towards the companies whose shares they own. The Stewardship Code encourages asset owners to communicate their policies on stewardship to their managers and to hold their managers to account for their stewardship activities. This trade union collaboration on voting and engagement with companies provides a means for its trade union participants

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[1] See Demystifying Responsible Investment Performance, A joint report by The Asset Management Working Group of the United Nations Environment Programme Finance Initiative and Mercer, 2007 and Shedding Light on Responsible Investment, Mercer 2009 for discussion and summaries of studies and research on the topic.

[2] A legal framework for the integration of environmental, social and governance issues into institutional investment Produced for the Asset Management Working Group of the United Nations Environment Programme Finance Initiative, October 2005

to fulfil their obligations under the Stewardship Code while promoting trade union values.

The trade union voting and engagement guidelines below reflect a trade union perspective on corporate governance. They set out trade union policies on issues ranging from the composition of the board of directors and executive pay to employment relationships and tax avoidance. Where possible, guidance on how these policies should be reflected in voting at AGMs is included. However, this is not always possible, as the narrow nature of the votes that take place at company AGMs means that votes cannot be used as referenda on every aspect of a company's performance. While shareholder resolutions can be used to raise specific issues of concern, the high bar for laying a shareholder resolution in the UK limits their use (in contrast, for example, to the US).

While some areas of policy are unlikely to be reflected directly in votes in most instances, they would be relevant to engagement activities. Over time, we aim to engage collaboratively with companies whose shares we own to raise standards of corporate governance and corporate practice.

Section two

The Board

Board balance and structure

Models of governance

In the UK, a unitary board, comprised solely of executive and non-executive directors, is the norm. However, experience in other major European countries demonstrates that companies including large multinational enterprises operate effectively with supervisory boards including worker representatives.

This trade union collaboration believes that shareholders should give UK-listed companies the freedom to adopt alternative governance arrangements. Therefore companies which, for example, seek to include worker representation in their governance structure will be supported, provided that their selection by the workforce is democratic and the representation is meaningful and does not come at the expense of adherence to other principles of good governance.

That said, for the foreseeable future UK-listed companies are expected to adhere to the unitary board model. Therefore this section of the guidelines is intended to inform voting decisions at companies following this approach to governance.

Board balance

In assessing a company's governance structure, we will take account of the overall structure of the board in terms of composition, separation of powers, relationship between executive and non-executive directors and membership of board committees.

Analysis may also focus on those aspects of directors' appointments which can be clearly assessed: the process by which individuals are appointed, their contractual terms, their independence (in the case of non-executives), and the provision of sufficient information to allow a clear judgement on calibre, experience and potential conflicts of interest.

Boards should have a balance between executive directors and non-executive directors with broader experience who are in a position to act independently and hold executive management accountable for their actions. The ratio of different types of director is important. Independent non-executive directors should comprise at least half of the board, excluding the chair, at FTSE 350 companies. In addition there should be at least three non-executives on the board.

It is important that boards comprise the full range of experience they need to manage and lead the company effectively. In addition to financial expertise and knowledge of the company's products and commercial activities, this includes managing employee and other stakeholder relationships and environmental impacts. We will take account of whether boards include sufficient experience of managing stakeholder relationships and environmental impacts in our assessment of board composition and performance.

Board committees

In line with the recommendations of the UK Corporate Governance Code, boards should establish separate nominations, audit and remuneration committees. We consider that the audit and remuneration committees should be comprised solely of independent non-executive directors and that the nomination committee should comprise a majority of independent non-executive directors. Some boards may decide to put board-level leadership for corporate social responsibility into effect through setting up a CSR committee, which would usually comprise a mixture of executive and non-executive positions. Where there have been significant failings relating to the responsibilities of a given committee, active consideration will be given to opposing the re-election of the chair of the committee. Other members of the committee may also not be supported.

The role of the chair

The role of the chair should be distinct from that of the chief executive. The chair has responsibility for leading the board and for ensuring that the board runs effectively. The chair should also ensure effective communication with shareholders. Placing these responsibilities in the hands of the person responsible for running the company's business can lead to unfettered powers of decision-making and as such the roles of chair and chief executive should always be separated. Unless sound reasons for the need to abrogate this principle temporarily are given, we will oppose the re-election of individuals who, either explicitly or de facto, combine these roles.

We support the position of the Corporate Governance Code that the Chair should be independent on appointment.

The senior independent director

The UK Corporate Governance Code attaches considerable importance to the position of the senior independent director (SID). In particular much emphasis is put on their role in soliciting shareholder views and feeding them back to the board. The role of the SID can also be important where shareholders have concerns about the chair. Where there is a demonstrable failure to address shareholder concerns, we will consider not supporting the SID's re-election.

Diversity and recruitment

Public recruitment and equal opportunities

We believe that boardroom diversity is not only a desirable social outcome but also a business advantage for the future. In order to widen the basis of experience on boards and improve their accountability and effectiveness, companies should extend their search for non-executives beyond the boards of other listed companies to include individuals with a greater diversity of backgrounds. International candidates, those with relevant experience in the public, academic or voluntary sectors, or at divisional level in other companies may well be suitable.

The TUC strongly supports the recommendations of the Davies Review that FTSE 350 companies should aim for 25% of board positions to be held by women. Where boards fail to meet this target without a satisfactory explanation, we will oppose the election of the chair of the nomination committee.

To comply with best practice on equal opportunities, and to ensure that those with a broad range of experience are considered for board opportunities, it is essential that companies advertise all executive and non-executive board positions publicly. Currently, most companies rely on a head-hunter approach to filling board positions. This 'by invitation only' method of selecting a shortlist excludes many with relevant experience from putting themselves forward for positions, and perpetuates representation from a very narrow range of backgrounds on Britain's boardrooms. In addition, it significantly strengthens the hand of executives to negotiate even higher pay (since there is not open competition for the role).

Where a recruitment company is used, the terms of reference should stipulate that the post must be publicly advertised in an appropriate range of media, and that candidates for interview or shortlists are not selected by head hunting alone.

Unless it is clear that recruitment for board positions has involved posts being publicly advertised, we will oppose the election of the chair of the nominations committee and may oppose the election of all the members of the nominations committee.

We expect all our investee companies to adhere to equal opportunities best practice.

Whenever seeking to recruit a non-executive director, the nomination committee should:

- promote themselves as an equal opportunities employer;
- draw up a job description and person specification, which reflects the need of the board to have a broad range of experience among its members;

- ensure that an advert for the position is publicly advertised in an appropriate range of media designed to attract the attention of a wide range of candidates;
- when a search firm is used, the committee should ensure that its terms of reference stipulate that the position should be publicly advertised, and should apply the principles of the voluntary code of conduct launched in 2011[3];
- ensure that training is available to enable a candidate from a non-commercial sector background to familiarise themselves with key boardroom practices.

Independence

Independence is determined partly by an individual's character and integrity. These factors cannot be objectively assessed by shareholders on a consistent basis and are therefore not an appropriate area for written guidelines.

However, there are a number of criteria identified by the UK Corporate Governance Code that may be assessed in an objective fashion. For example, personal, financial and commercial links between the non-executive and the company raise obvious potential concerns about independence. Similarly, tenure should be taken into account, although we do not believe that length of tenure necessarily impedes the ability of non-executives to challenge executive directors effectively. We will form our own view of a directors' independence using these criteria together with any other factors we believe to be relevant.

Where there is insufficient independent representation on a board, active consideration will be given to opposing the re-election of non-executives who are not considered independent.

Worker representatives

In the case of worker representation, either on the board or on committees, the TUC believes that a different approach should be taken. Unless the worker is a full-time executive director of the company, the TUC does not consider that they should be included in an assessment of the level of independence on the board or its committees. Unless there are extraordinary reasons for not doing so, the TUC recommends that, where they face election by shareholders, worker representatives should be supported.

Number of positions and time commitments

Directors should be able to assure investors that they have sufficient time to carry out their board duties. This inevitably must limit the number of board

[3] http://www.prnewswire.co.uk/news-releases/executive-search-firms-launch-voluntary-code-of-conduct-in-response-to-the-davies-review-of-women-on-boards-145049045.html

positions they can hold. In general, an executive director should have no more than one external directorship, and non-executive directors should have no more than three additional directorships, although the varying time different positions require must also be taken into account.

Where there is evidence that a director is not able to devote sufficient time to their roles, for example if they have missed a number of board or committee meetings without adequate explanation, we will give active consideration to opposing their re-election.

Annual election of directors

Voting on the appointment of the directors is one of the most important routine issues for shareholders to consider at general meetings. The composition and effectiveness of the board is a crucial element in determining corporate performance. In line with the UK Corporate Governance Code, all directors should seek re-election on an annual basis. The TUC does not believe that this should be limited to the FTSE350.

Succession planning

Forward-planning for orderly succession is important, although there will always be unforeseen circumstances. The board should disclose how it goes about planning for succession, the factors considered and with whom responsibility lies. Succession policy should form part of the terms of reference for the nominations committee.

Risk and Accountability

Internal controls

The TUC concurs with the Turnbull Committee's conclusion that "a sound system of internal control contributes to safeguarding the shareholders' investment and the company's assets"[4] and that it is the board's responsibility to set internal control policies. The role of poor risk management in the financial crisis and the importance of sound procedures for the governance of risk were highlighted by Sir David Walker's Review of corporate governance in UK banks and other financial industry entities.

Risk control policies and processes should be fully described and should include an explanation of non-financial as well as financial risk management systems. Relations with investors will benefit where companies decide to go beyond the basic requirements and identify the significant areas of risk and how the company manages these.

[4] *Internal Control: Guidance for Directors on the Combined Code (1999*) published by the Turnbull working party under the auspices of the institute of Chartered Accountants in England and Wales (ICAEW)

Accountability for failures in corporate responsibility

There are numerous recent examples of companies suffering significant financial losses as a result of failing to adhere to high standards of corporate social responsibility, notably from the oil and banking sectors. In such cases it is important that shareholders use their ownership rights to hold the board to account. For example, in cases of significant health and safety failures, we will give active consideration to opposing the re-election of any board director with responsibility for this area. If there is no board director with specific responsibility, we may oppose the re-election of the CEO.

Section three

Directors' Remuneration

The gap between directors' pay and employee pay

The union movement has long been concerned about the scale of executive remuneration in the UK. We are particularly concerned about the gap between executive remuneration and average employee pay, both within companies and throughout the economy as a whole. We believe that the current gap between executive and average employee pay is much too high. It is of deep concern to us that the gap continues to grow.

Differentials within companies have grown steeply year on year, as remuneration committees ratchet up reward in order to pay 'top quartile' or 'upper median'. Although increases in base salary have slowed in recent years, they still outpace increases for the wider workforce. The explosion in performance-related rewards has ensured that the total package available to directors has increased far quicker than employee pay.

The High Pay Commission found that in 2010 the average FTSE 100 CEO total pay was 145 times the average salary for UK workers and was projected to reach 214 times by 2020[5].

Pay differentials of this scale have far-reaching economic and social consequences, both for society and for companies themselves. We believe they are socially corrosive and economically inefficient.

There is clear academic evidence that a high wage gap between executives and other company workers is damaging to company performance. For example:

- A study of 4,735 companies between 1991 and 2000 found that within-firm pay inequality is significantly associated with lower firm performance[6].
- A second study that used compensation data from Standards and Poor's ExecuComp (covering around 1,500 companies per year) found that firm productivity is negatively correlated with pay disparity between top executive and lower level employees[7].
- A third study of over 100 companies found that low pay differentials were

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5 Cheques With Balances: why tackling high pay is in the national interest Final Report of the High Pay Commission November 2011

6 Pedro Martins, Dispersion in Wage Premiums and Firm Performance, Centre for Globalisation Research Working Paper No. 8 April 2008

7 Olubunmi Faleye, Ebru Reis, Anand Venkateswaran, The Effect of Executive-Employee Pay Disparity on Labor Productivity, EFMA, Jan 2010

associated with higher product quality[8].

Given this clear evidence, we believe company shareholders should use their votes and influence to encourage companies to reduce the gap between executive pay and average employee pay.

Excessive levels of executive pay also contribute to wider inequality across the economy as a whole. The High Pay Commission found that over a third of the top 0.1% of highly paid individuals were company directors[9].

There has been raft of compelling research published in recent years, notably the Spirit Level by Richard Wilkinson and Kate Pickett, that clearly demonstrates the social and economic costs of inequality. Countries with high levels of inequality also have higher rates of ill-health and mortality, including infant mortality. Crime, especially violent crime, is higher in more unequal societies, while social mobility and trust in fellow citizens are lower. As union investors, we support the creation of a more equal society and are committed to taking the impact on wider inequality into account in our consideration of executive pay.

If shareholder engagement is to have any impact on runaway executive pay, robust positions must be adopted on all elements of executive pay. These are addressed in turn below.

In addition, we believe that worker representation on remuneration committees will be an important element of executive pay restraint in the future. Whilst this is not recognised as yet by the UK Corporate Governance Code, we encourage companies to adopt such representation voluntarily.

Pay differentials and ratios

We believe that remuneration reports should include the distribution of pay throughout the company by grade and should provide for each company director the ratio between his or her total remuneration and median and lowest employee pay. In the absence of such disclosures, we will use the information on total wage bill and employee numbers provided in annual reports to calculate a ratio between each director's total pay and average (mean) employee pay.

We support an aspirational goal of a 20:1 maximum pay ratio within companies and indeed within all organisations. However, in consideration of current information requirements, which do not make it easy to calculate a top to bottom pay ratio, and the fact that a top to average pay ratio of 20:1 still

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8 Douglas M. Cowherd and David I. Levine, Product Quality and Pay Equity Between Lower-Level Employees and Top Management: An Investigation of Distributive Justice Theory, Administrative Science Quarterly, Vol. 37, No. 2, Special Issue: Process and Outcome: Perspectives on the Distribution of Rewards in Organizations June 1992

9 More for Less: what has happened to pay at the top and does it matter? Interim report of the High Pay Commission May 2011

requires very considerable reform of current practice, we are setting a maximum 20:1 top to average pay ratio as a benchmark for our support for remuneration reports.

Where the top to median pay ratio disclosed or the top to mean pay ratio calculated as described above for more than half the directors at a company exceed 20:1, we will vote against the pay policy, using the forward-looking binding vote and/or the advisory vote on the remuneration report as appropriate.

Rates of pay increase

Rates of increase in directors' pay that are significantly higher than those offered to other employees in the same company cannot be justified, and are detrimental to staff morale and productivity. Therefore increases in total pay for directors should be in line with those offered to ordinary employees within their company. Where this is not the case we will vote against the pay policy, using the forward-looking binding vote and/or the advisory vote on the remuneration report as appropriate.

Lowest employee pay

We encourage all companies to become living wage employers. As well as helping to discharge their moral responsibility to their workforce, adopting the living wage can also bring valuable reputational and personnel benefits. The benefits of paying all workers the living wage include lower staff turnover and absence rates and better motivation and work performance. Reduced turnover of contractors has also been reported[10].

Information on the distribution of pay across the company by grade will show whether or not companies are paying the living wage to direct employees but would not include the position in relation to contractors[11]. We believe that remuneration reports should state whether or not the company is an accredited living wage employer[12]. Where they are not, we believe that reports should state what proportion of company employees and contract workers are paid below the living wage and set out a corporate action plan to address this.

Performance-related pay

We believe that arguments in favour of executives receiving a sizeable element of performance-related reward as part of their overall package are flawed. For

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[10] Findings from research looking at the business effects of implementing a living wage – see http://www.livingwage.org.uk/about-living-wage

[11] A living wage employer will ensure contracted workers are paid a living wage if the worker is on the employer's premises for two or more hours per week, for eight or more consecutive weeks in the year.", Living Wage Foundation, "Living Wage: a guide for employers", 2012, p6.

[12] Information about becoming accredited as a living wage employer can be found on the Living Wage Foundation website: http://www.livingwage.org.uk/

complex tasks, the available evidence suggests that incentive pay is not effective at increasing motivation and performance[13]. In addition, the focus of many shareholders on the structure, rather than scale, of pay has allowed overall reward to balloon.

We believe that the repeated failure to design schemes that do not create perverse incentives, or reward directors inappropriately, combined with emerging evidence about the ineffectiveness of performance-related rewards, should lead to a more fundamental review of such schemes. Millions of ordinary working people perform effectively at their jobs every day without the need to be incentivised through bonuses or share schemes. We would argue that UK companies need to be led by people motivated not by financial greed but by commitment to their company, their job, a set of values that include honesty and integrity and respect for stakeholders, and the ability to do the job well.

If performance-related pay is to be used, in our view, directors should participate in no more than one incentive scheme, and the maximum award under it should not exceed 10% of salary. Where the remuneration policy exceeds this limit, we will use our voting rights to challenge this. Where companies are recommending potential incentive awards that amount to more than 10% of basic salary, we will use the binding vote on pay policy to address this. Where an existing policy already in operation is unacceptable, we will use the advisory vote on the remuneration report.

In addition, we will only support incentive schemes for directors including share schemes that are open to all staff on the same basis.

Where incentive pay is used, it should be linked to long-term indicators that reflect stability, risk management and wider corporate goals and values (including good employment relationships, which are known to correlate with future profitability) and not just to bald profit numbers. They should also avoid rewarding directors for relative performance that is beyond their control.

Long-term incentive schemes should genuinely be long-term, with a vesting period of at least five and preferably ten years. If shares allocations are used, shares should be held for the long-term, and directors should not be able to sell their shares until they leave the company at the earliest. Annual bonuses should be ended.

Directors' contracts and severance pay

It is unacceptable for those at the top of the company, who have most influence over its direction and management, to have greater protection from failure than those they employ. To address this, the TUC believes that directors' notice periods should be brought into line with those offered to other employees in their company, which will generally mean notice periods of

[13] Frey, B (1997) *Not Just For the Money: An Economic Theory Of Motivation,* Edward Elgar Publishing

between one and three or six months. We will oppose notice periods that are longer than those offered to other staff in the company. If no information is given on staff notice periods, we will assume that staff notice periods do not exceed three months and will oppose directors' notice periods of over three months.

In addition, companies that continue to use incentive related payments should introduce clawback provisions in order that any awards made on the basis of illusory or unsustainable performance can be reclaimed.

If a director is actually working out his or her notice, it is acceptable for the performance-related elements of remuneration to be paid during the notice period. In practice, however, this is very rare. If the director has in fact left the company, it is not acceptable for severance pay to include payments for performance that is not being worked for, and makes a mockery of the whole notion of setting targets, the achievement of which should trigger the payments. In these circumstances, severance pay should consist of the requisite amount of basic salary only. No performance elements of remuneration – not bonuses, nor share options, nor long-term incentive plans – should be included in the package. This principle should be reflected in liquidated damages clauses, if they are used. Phased payments should be used, and remuneration committees should make full use directors' duty to mitigate.

Where companies are proposing to allow termination provisions beyond the minimum pay and benefits set out above, we will oppose this using the binding vote on remuneration policy.

Pensions

The pensions of executive directors should be in line with the pension offered to staff. Directors should be members of the same pension schemes as their staff on the same terms.

Directors' pension entitlements must be clearly disclosed. In defined benefit schemes the transfer value of accrued benefits, the accrued annual pension, the normal retirement age and the accrual rate should be disclosed. In defined contribution or personal pension schemes, company contributions should be disclosed, both in cash terms and as a percentage of salary. Where payments in lieu of pension are provided the cash amount and percentage of salary should be disclosed. The TUC believes that guidance produced by the Local Authority Pension Fund Forum and National Association of Pension Funds provides a good model for disclosure in this area.[14]

[14] http://www.napf.co.uk/PressCentre/Press_releases/0024_061510_Investors_want_greater_transparency_0610.aspx

It is also essential that there is full disclosure of staff pension schemes so that the pensions offered to executive directors can be compared with those offered to their workforce.

Thus the information on pensions that companies should report is as follows:

Disclosure of company pension schemes for all directors and staff

- Full disclosure of all company pension schemes and details of who is entitled to join each scheme on what terms
- Numbers of employees and percentage of workforce not in a company pension scheme, including the number of employees who have opted out following auto-enrolment".

Disclosure on all company DB pension schemes

- Transfer values for each director
- Accrued benefits for each director
- Accrual rates for each director and accrual rates for employees; where these differ, an explanation should be given
- Normal retirement or pension age for directors and for employees; where these differ, an explanation should be given

Disclosure on all company DC pension schemes

- Contribution amounts for each director and average contribution amount for employees
- Contribution rates as a percentage of salary for each director and average contribution rate for employees; where these differ, an explanation should be given
- If provision is contract-based, whether or not governance arrangements include a workplace management committee
- Whether or not any company pension schemes are in master trusts, and if so which one.

Disclosure on cash payments in lieu of pensions

- Contribution amounts for each director and average contribution for any employees receiving equivalent benefits
- Contribution rates as a percentage of salary for each director and average contribution rate for any employees receiving equivalent benefits; where these differ, an explanation should be given
- Who is entitled to receive such benefits.

In addition, details of any company pension schemes that have closed to new entrants or to accrual over the last five years should be included. The company should make clear whether schemes that have closed to employees are also closed to directors, or whether directors are allowed to join closed schemes in certain circumstances.

Given that directors are already paid significantly more than other employees, there is no justification for providing enhanced retirement provision to directors. Therefore, where directors are offered preferential treatment in respect of pension provision, either in terms of the benefits or access, we will vote against the remuneration report and the pay policy. We will also vote against the remuneration report and pay policy where payments in lieu of pension are excessive.

Remuneration consultants

We believe that the use of remuneration consultants has fuelled both the levels and complexity of executive pay. We believe that remuneration committees should take full responsibility for policy and implementation of executive remuneration themselves and should not rely on remuneration consultants to generate proposals.

Where remuneration consultants are used, they should be employed directly by the remuneration committee and not by executive directors or any other employee of the company. There should be full disclosure of fees paid.

We believe that in order to avoid conflicts of interest, remuneration consultants should not undertake any other consultancy work for same company. Where this is not adhered to, it is essential that there is full disclosure of the value of the non-remuneration related work the consultants have carried out for the company. Where remuneration consultants are being paid more in non-remuneration work than for their work for on remuneration, we will oppose this using the binding vote on remuneration policy.

Director responsibility

Where there are particular concerns relating to executive remuneration, active consideration will be given to opposing the re-election of the chair of the remuneration committee.

Executive remuneration: best practice policy

- Total pay: total remuneration for each director should be no more than 20 times the median employee pay in the company.
- Basic salary: should comprise at least 90% of total pay.
- Performance-related pay: all schemes should be open to all staff on the same

terms and performance-related pay for directors should comprise no more than 10%of total pay.

- Living wage: all employees and contract workers should be paid at least the living wage.
- Notice periods: notice periods for directors should be in line with those for staff.
- Pensions: directors should be members of the same pension schemes as their staff on the same terms.
- Remuneration consultants: where used, remuneration consultants should be employed only by the remuneration committee. In order to avoid conflicts of interest, remuneration consultants should not undertake any other consultancy work for same company

Section four

ESG and company reporting

Introduction

The behaviour of quoted companies is a matter of public interest. Public companies lie at the heart of our economy and we all have a stake in their success or failure – either directly as employees, as members of a community in which a company operates or as investors in the business through pensions and savings.

We consider that a responsible company will recognise that their long term development will only be sustainable if they maintain the trust and support of stakeholders. This trust is contingent on transparent reporting of all social and environmental impacts.

The business case for taking an inclusive approach to the management and reporting of risk was recognised by the Turnbull[15] working group in 1999, which widened the definition of risk management to include non-financial in addition to financial risks. The same approach to risk management is also inherent in successive studies that have provided evidence of a correlation between an inclusive approach and financial performance.

The TUC considers that in developing and implementing effective policies on CSR issues, investee companies should follow a basic process model. This involves: identification of relevant stakeholders (which must include employees and their representatives) with whom to engage over policy development and performance; the development and publication of comprehensive policies; clear accountability at senior executive level for implementation of these policies; measurement and reporting against key performance indicators and target setting based on an analysis of this data; and independent auditing and accreditation of performance and progress together with independent verification of reporting.

A company's reporting should demonstrate that processes are in place to implement appropriate CSR policies, including policies on the treatment of employees and other stakeholders, responsible supply chain management, environmental impacts and community involvement. We will consider withdrawal of support for resolutions seeking approval of the directors' report and financial statements where this is not the case.

[15] Turnbull guidance, ICAEW, September 1999

Company reporting

Reporting is a fundamental element of accountability to shareholders. Reporting should be objective and comprehensive. Financial reporting should be as transparent as possible, with results represented in a way that captures all material issues. Accounting policies and judgements that have a material impact on results should be clearly identified.

However, non-financial reporting is also critical. A company's management of its stakeholder relationships has a direct impact on its performance, and are also an important part of its 'license to operate'. Directors should identify all key stakeholders, develop appropriate policies for managing their stakeholder relationships and should report on and be held accountable for the quality of these relationships since they are an important part of a company's long-term competitive position. Financial success in the long term can only be achieved where employees are properly regarded as stakeholders.

Therefore, as well as reporting on financial performance, companies should provide additional information on a range of issues which reflect the directors' management and stewardship of the company. These issues include information on a company's relationship with its employees and other stakeholders, its commitment to society and its impact on the environment. Such information should appear in the Business Review. (These issues are explored further in the section on corporate social responsibility.)

Where there are concerns about financial reporting or the quality or veracity of the Business Review, we will actively consider voting against the resolution seeking to receive or approve the annual report and accounts.

The audit process

It is vital that the audit process is objective, rigorous and independent if it is to provide assurance to users of accounts and maintain confidence in reporting in the capital markets.

Investors' confidence is reliant on the objectivity of the audit process. Confidence may be undermined where the audit firm has also undertaken consultancy for a company, particularly in areas with a direct impact on those financial statements subject to audit.

We believe that in order to avoid compromising their independence, it would be preferable if auditors undertook no non-audit work for any company for whom they are serving as auditor. If they do carry out non-audit work, there should be full disclosure of the nature of work done by the auditors during the year, accompanied by fees charged and the existence of any material links between company and audit firm. Where the value of non-audit work undertaken exceeds that of the audit, consideration will be given to opposing the re-appointment of the auditor.

The role of the audit committee

The provisions of the UK Corporate Governance Code, which deal with the role, responsibilities and composition of the audit committee, are minimum requirements[16]. Best practice in this area goes beyond regulatory compliance and it is up to each company to disclose the extent to which its own arrangements offer a meaningful and effective contribution to the governance of the company and the protection of investors and other stakeholders. Such disclosure should be included in a separate audit committee report within the annual report and accounts.

As an additional comfort to investors and in order to enable audit committee members to fulfil their duties effectively, reports could include confirmation that committee members receive copies of formal communications between the external auditor and the company. Companies should also include details of attendance at audit committee meetings, with particular reference to attendance by staff other than committee members. Any direct or indirect involvement by reporting auditors in the company's internal audit function should also be reported. Companies with formal procedures for recording audit or accounting related grievances by internal audit or accounting staff should be encouraged to confirm the existence of such procedures.

Employees

There is considerable evidence of the significant contribution that positive employment relationships make to company performance[17]. Based on this evidence, there is a compelling business case for companies developing long-term, committed relationships based on respect and trust with their workforce. In addition, a company's employment record is one of the most important aspects of its contribution to society more broadly, and there is a strong social case for developing good relationships with its workforce.

There are many elements to being a good employer and in some areas there may be a range of ways in which companies can implement best practice; in other words, there is not always only one 'right' way of doing things. However, as trade union organisations, we consider that the following areas will always be critical to good practice in employment relationships:

- Diversity and work life balance – policies and practice;
- Training and development - policies and practice;
- Employee representation and involvement – policies and practice on information, consultation and negotiation with employees and their representatives;

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[15] *The UK Corporate Governance Code:* Code provisions C3.1 to C3.7

[17] A range of research on this is included in Engaging for success: enhancing performance through employee engagement A report to Government, David MacLeod & Nita Clarke, 2009

- Health and safety – policies and practice;
- Pay levels and increases; and
- Pension provision.

In annual reports, public companies often repeat the mantra that their employees are 'their greatest asset' and key to their success. Despite the truth of this assertion, the detail and clarity of reporting on the treatment of employees does not match the rhetoric.

The TUC believes that the duty to report should include information relevant to each of the dimensions set out above. The following information will help shareholders to assess company performance on employment issues:

- Diversity and work life balance: at each level of the organisation a breakdown of staff numbers by gender, race, age and disability, supported by a description of policies on equal opportunities and work life balance and their implementation. This should include information on whether an equal pay audit has been undertaken.
- Training and development: the role of employee training and development in delivering the company's strategic objectives, supported by training resources per employee and their distribution across the company.
- Employee representation and involvement: the extent to which employees and their representatives are (a) informed (b) consulted and (c) involved in decisions about changes to their own jobs and wider strategic issues. This should include the percentage of the workforce covered by collective bargaining arrangements.
- Health and safety: health and safety budget resources and details of RIDDOR accident, disease and incident reports and all safety enforcement action and penalties.
- Pay: at each grade, pay scales and the most recent pay increases, including whether or not the company is an accredited Living Wage employer, and, where they are not, the proportion of employees and contract workers paid less than the Living Wage and what plans the company has to address this. The TUC encourages all investee companies to undertake equal pay audits, and to publish the results.
- Pensions[18]: what type/s of pension scheme the company offers; numbers and proportion of staff not in a pension scheme, including the number of employees who have opted out following auto-enrolment; for defined benefit schemes, the accrual rate and normal retirement age; and for

[18] Please note this is already covered above in the section on executive pay, but is included here as well for completeness of this section

defined contribution schemes, the average employer contribution amount and rate and whether or not any company pension schemes are in master trusts and if so which one. If provision is contract-based, whether or not governance arrangements include a workplace management committee.

In addition, we believe that companies should report on any employment tribunal claims that have been upheld or where a compromise agreement has been reached over the reporting period.

Companies may then additionally identify employment risks and opportunities that are sector specific. However, the key focus of all reporting should be to enable investors and others to satisfy themselves that companies are managing their employment issues in a way that adds value to the company in the long-term.

We regard such reporting as consistent with a properly constituted business review and do not accept the argument that a legal duty to report would be an unbearable bureaucratic burden. There is a growing consensus that superior performance is linked with good practice in these areas.

Supply chain management

Responsible management of supply chains and in particular the protection of human and labour rights within them is an essential part of responsible corporate practice. We believe that companies should report on their supply chain management in their annual reports. It is essential that this includes a full list of suppliers used to source and/or make products sold by the company.

Section five

Other strategic and financial issues

Share capital and shareholder relations

Shareholders need to have clear information about their rights and those of other shareholders. The company's share structure should be disclosed, including the voting rights and other rights attached to each class of shares.

Share issuance authorities are among the routine items which shareholders are asked to approve at general meetings. We support the pre-emption rights principle and consider it acceptable that directors have authority to allot shares on this basis. Resolutions seeking authority to issue shares with and without pre-emption rights should be separate and should specify the amounts involved, the time periods covered and whether there is any intention to utilise the authority.

We generally prefer straightforward dividend payments to share buybacks, as in practice share buybacks can be disadvantageous to remaining shareholders. In addition, the linkage between buybacks, earnings per share enhancement and remuneration scheme targets creates a conflict of interest, and amplifies complexity in remuneration schemes. We therefore may not support share buybacks.

Rights issues

Where companies are undertaking rights issues due to significant financial pressures it is important that directors are not rewarded for carrying them out as this is essentially a transfer of wealth from shareholders to the board.

Where rights issues are necessary within a relatively short period of time following an AGM where the accounts were signed off on a going concern basis, this will inevitably raise questions about the auditor's opinion, and the oversight exercised by the audit committee.

We will judge proposals for rights' issues on the basis of whether they will support a viable long-term business plan based on organic growth for the company.

Intervention in strategic and operational issues

Decisions taken by directors on strategic or operational issues can clearly have a major impact on the financial interests of shareholders. When engagement with a company on a strategic issue is undertaken the highest priority must be placed on the interests of key stakeholders and employees. Failure to focus sufficiently on the impacts on key stakeholders has been a significant factor behind the poor results that have followed many company restructurings.

Many board decisions on strategic issues are subject to shareholder approval, usually at an EGM. Examples include specific corporate actions such as takeovers, mergers and capital reorganisations. They are required either by law or under the Listing Rules to be put to shareholders because they are deemed to be of such importance, and to have such significant implications for the rights of shareholders, that shareholders specifically need to approve them.

In the long-term, we do not consider that our beneficiaries benefit from a takeover system whereby shareholders decide whether or not to sell their shares on the basis of price rather than what is in the long-term good of the company in question. Our beneficiaries and (indeed other long-term investors and the economy as a whole) would benefit from a takeover system that made the long-term success of the company its priority rather than the short-term interests of shareholders.

We will judge proposals for mergers and takeovers on the basis of whether we consider them to be in the long-term interest of the company whose shares we hold. In this context, we will take into account any corporate governance or social responsibility issues surrounding shareholder approval of relevant corporate actions, including whether such actions impact on the terms and conditions of employment or are predicated on the loss of jobs. Full information should be provided together with an assessment of the likely financial and strategic impact on the company and its stakeholders.

In practice, given the evidence[19] that much merger and acquisition activity not only fails to create value, but in fact actively destroys it, we will err on the side of caution when voting on such proposals.

In cases where a proposed deal is not completed there are often significant costs incurred. Where this is the case we will consider not supporting the re-election of those directors responsible.

We are particularly concerned about conflicts of interests in the context of mergers and takeovers. We do not believe that any board member should benefit financially from a merger or takeover as this may undermine their ability to act in the long-term interests of their current company. There should be full disclosure of all fees and other payments made relating to a merger or takeover including all financial arrangements relating to the board of directors

[19] Eg Magnus Bild, Andy Cosh, Paul Guest and Mikael Runsten, Do Takeovers Create Value? A Residual Income Approach on UK Data, ESRC Centre for Business Research, University of Cambridge, Working Paper 252, December 2002

Shareholder resolutions

Shareholders have the right to put forward a resolution for consideration at a company's general meeting, and this can be used as a way to address issues in relation to the company's strategic direction not included on the meeting agenda. The TUC strongly supports the right of shareholders to raises issues in this way. In a small number of cases resolutions have been used to raise shareholder awareness of workplace issues, and the TUC welcomes such initiatives.[20] In general shareholder resolutions will be judged on their individual merits.

Tax and governance avoidance

We believe that companies must contribute their fair share of tax revenue. Corporate tax avoidance is incompatible with a commitment to corporate citizenship and risks causing serious reputational damage which in turn may harm the company's prospects.

A number of large listed companies have de-listed in recent years and have been registered or listed in low tax overseas jurisdictions with subsequent loss of tax revenue. Such moves can also compromise governance where new codes or regulations then apply. Companies should provide explanations for such decisions, and commit to maintain UK standards of governance even if these are not required in its new jurisdiction. Failure to do so may be interpreted as an attempt to weaken shareowner rights or protection.

Where a company fails to meet these requirements, or make such disclosures, the TUC recommends that shareholders oppose the report and accounts and the election of the directors responsible.

Companies should avoid the use of tax havens and include details of the amounts of tax paid in all the different countries in which they operate. The following information should be included in annual reports to enable shareholders to assess company behaviour on tax:

1) UK turnover, profit before tax and current tax charge as well as those for the group as a whole to enable comparison of the two.

2) A list of all the places where the company trades, their main activities there and what their subsidiaries based there are called.

3) The accounts of all tax haven subsidiaries that would otherwise be secret on their website.

4) If they are not paying the UK tax rate, explain why in detail; if it is because of deferred tax, explain when that deferred tax might be due.

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[20] Resolutions on labour issues were filed at First Group in 2006 and 2007 and at Tesco in 2009.

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