The Ethics of Executive Remuneration:

A Guide for Christian Investors

Richard Higginson and David Clough
A report commissioned by the Church Investors Group
March, 2010

The full report is available to download from
www.churchinvestorsgroup.org.uk

Summary

1 Executive remuneration: The current situation
Current levels of executive pay in the UK are strikingly high: a 2008 survey showed the highest earner as being paid £23m annually, with 34 receiving packages valued at more than £5m. The average Chief Executive Officer (CEO) package in the FTSE 100 was £2.9m. The average salary of a FTSE 100 employee is £26,000, so the pay of FTSE CEOs is on average over 100 times that of average salaries in these companies. In 1970 this differential was approximately 10:1. The UK is reckoned to be second only to the US in executive pay.

2 A cause for concern
2.1 General ethical objections
Critics of these levels of executive pay judge them unfair because they overvalue the contribution made by chief executives. Defences of high executive pay on the basis of market rates fail to recognise the ways in which the market differs from free market conditions. Shareholders are disadvantaged by competition between companies on levels of top executive pay and this competition also risks attracting candidates more strongly motivated by their own financial interests than the interests of the company or its shareholders. It is unclear that high pay is a significant motivator for top executive performance. Extreme economic inequality may well also have damaging social consequences.

2.2 Particular crisis-related concerns
The global financial crisis heightened public concern about excessive executive remuneration, especially in relation to banking and financial institutions seen as bearing some responsibility for it. Such institutions seem to have been cavalier regarding the risk of their strategies and this approach may well have been encouraged by remuneration policies. Market mechanisms were not successful in limiting the adverse effects of remuneration policies on risk management and executives have often escaped the consequences of their mistakes.

2.3 Church investment
Church investors have been active in voting against excessive pay packages, but the theological and ethical basis for this stance has not yet been made clear.

3 Theological considerations
3.1 Distributive justice
The Bible makes economic justice a central focus of its moral concern. Biblical accounts of justice include four elements: impartiality between persons, rendering to each what is their due, respecting proportionality between labour and its reward, and recognising the normativity of judgements rooted in God's moral law.

3.2 Wealth
The Old Testament sees wealth as a good gift for God's people to enjoy, but it is stern concerning the misuse of wealth and its dangers. The wealthy are expected to be generous and are warned of the potential for wealth to make them greedy and turn them from God. The prophets condemn the rich who oppress the poor, love luxury and flaunt their wealth. In the New Testament, Jesus warns against the idolatry of serving Mammon in place of God, tells the rich young ruler to sell his possessions and makes clear how hard it is for rich people to enter the kingdom of God, though some of his followers and members of the early church are among the wealthy. Christian attitudes to wealth in the later history of the church include medieval ideals of monastic poverty and a Reformation emphasis on the legitimacy of using God's gifts in business. 19th century Christian entrepreneurs who founded successful businesses were often generous with their wealth and careful to treat their employees well. The rich in the twenty-first century seem to be less generous.

4 Investors' responsibility
Shareholders have a responsibility to exercise proper stewardship of the companies in which they invest, but often fail to do so. Even serious long-term institutional investors suffer from the 'agency problem' of the gap between shareholders and the board and their respective interests. Several of Jesus' parables relate to the stewardship of resources and picture stewards being judged on long-term performance, with attention to both financial and inter-personal behaviour. Recent reports on remuneration policies emphasise non-financial measures of performance and advocate that such policies should promote effective risk management.

The full report is available to download from www.churchinvestorsgroup.org.uk

5 Conclusions

5.1 Theological values

Four theological values arise from the analysis of the report:

1. Concern for the poor. Investors should be more concerned with helping the poor than restraining the rich, and therefore even more vigilant about levels of pay at the bottom of an organisation than those at the top.

2. Just pay. Market arguments for unrestricted pay policies should be rejected on the grounds of distributive justice and in recognition that the markets in question are not sufficiently free to set remuneration appropriately. Pay differentials are more important than outright value, and attending to differentials makes clear that some companies have fairer policies than others. Investors should examine the ratio between top executive pay and the average pay of the lowest 10% of employees, and set an appropriate rule of thumb for engaging with companies. The authors suggest 75 times as an upper limit for this ratio, reduced over time through engagement with companies. It is also crucial that remuneration packages be made simpler and more transparent in order to judge whether they are proportionate.

3. The dangers of wealth. Attracting candidates with high levels of pay means they are disproportionately likely to put their own financial interests ahead of those of the company and its shareholders. Companies seeking to enhance their prestige through competitive remuneration policies are operating in clear opposition to shareholder interests.

4. Good stewardship. Remuneration for those such as CEOs responsible for stewarding the resources of others should be based on long-term performance and appropriate attitudes to risk. Investors should object to overly generous severance packages and encourage 'claw back' mechanisms to recover remuneration that proves to have been awarded on the basis of mistaken estimates of performance.

5.2 Recommendations

1. Investors should be most concerned about pay for the poor.

2. Investors should consider corporate pay differentials as more important than absolute pay packages. A maximum multiple of the ratio between the pay of the top executive and that of the average pay of the lowest 10% of employees should be identified, and over time the ratio should be set on a downward trajectory. In the opinion of the authors, it would be difficult to justify a ratio in excess of 75 times.

3. Investors need to hold executives to account over performance – with an emphasis on sustained performance.

4. Investors should discourage companies from seeking to compete with one another through levels of executive remuneration, recognising the disadvantages of motivating senior executives primarily through concern for their personal wealth.

5. Investors should dissuade companies from offering pay packages which encourage high-risk behaviour.

6. Investors should encourage companies to adopt simple and transparent packages of executive remuneration in order to facilitate accountability.

7. Where companies operate executive remuneration policies at strong variance with these recommendations and investor engagement with a company does not lead to any change of policy, disinvestment should be considered.

The full report is available to download from www.churchinvestorsgroup.org.uk

The Church Investors Group represents many mainstream Church denominations and organisations in Britain and Ireland. Each member has its own investment policy but members work together on issues of common concern. It has 37 members with combined assets of around £12 billion.

It has four key aims:

- to encourage the formulation of investment policies based on Christian ethical principles;
- to assist each other in putting such policies into practice;
- to encourage responsible business practices through engagement with company managements;
- to share information and views on ethical matters related to investment.

The re-formed CIG took effect from 1 January 2005, building on an informal ecumenical ethical investment network that had existed since 1973. It is a collaborative ecumenical venture that seeks to empower and inform members as they pursue their own independent views and policies. Membership is open to investment or trustee bodies representing the charitable and pension funds of denominations, dioceses (or their equivalent), religious orders and Christian-based charities. Members of the CIG include:

The Dominican Council
Congregation of Jesus Charitable Trust
Diocese of Hallam
Society of Catholic Medical Missionaries
Diocese of Birmingham
Servite Friars
Diocese of Arundel & Brighton
CIG South Africa
Catholic Trust of England & Wales
Diocese of Salford
Christian Aid
Diocese of Middlesbrough
Methodist Church in Ireland
The William Leech Foundation Limited

URC Trust
USPG
Diocese of Plymouth
BMS World Mission
Diocese of Southwark
URC Ministers' Pension Trust
Joseph Rowntree Charitable Trust
Methodist Ministers' Pension Scheme
Trustees for Roman Catholic Purposes (SJ)
Church in Wales
The Church of Scotland Investors Trust
The Salvation Army
The Baptist Union of Great Britain
CFB Methodist Church

To fulfill its aim of encouraging responsible business practices, the CIG commisions papers that provide theological insight for the business and investment communities to help them find practical ways of addressing issues of public concern.

Any opinion and recommendation contained in this report are those of the authors and may not reflect the views of CIG members. Neither should the conclusions of the report be seen as representing those of the CIG consensus.

Further information is available on the website
www.churchinvestorsgroup.org.uk
or from the CIG Secretary at: info@churchinvestorsgroup.org.uk

The CIG secretariat
is provided by
CCLA