

Lord Myners
Financial Services Secretary to the Treasury
HM Treasury
1 Horse Guards Rd.
London SW1A 2HQ

12 February 2010

Dear Paul,

Thank you for your letter dated 28th January. We welcome the opportunity to share with you our efforts to engage with UK banks to promote the adoption of more sustainable remuneration policies. We are also pleased to have the chance to provide feedback on the challenges we continue to face. We detail both below.

First, however, we would like to stress that we generally do not seek to engage with companies on their bonus schemes in isolation. We view the bonus as part of a larger remuneration package that should be looked at in its entirety. In most cases we look to the bonus scheme to reward past out-performance, while the LTIP is targeted at incentivising sustainable future outperformance. In both cases it is vital that performance is measured over a sufficiently long time to ensure it is durable and not the result of excessive short term risk taking.

Actions USS has taken in the past

- **Internal framework for analysis:** Over the years, USS has developed a set of guiding principles for evaluating director and executive remuneration schemes. This guidance emphasises the need for performance to be evaluated over sufficiently long periods, to discourage short term and risky behaviour, and is measured against performance metrics that are closely tied to the company's long term strategy. The policy will be assessed against a company's individual circumstances.
- **Voting:** USS has demonstrated its willingness to vote against remuneration schemes that fail to comply with our internal guidance on numerous occasions. Any vote against a company is followed with a letter explaining our position and invitation to engage in further discussion. In 2008, USS voted against management at six of the seven largest UK banks with regard to their remuneration schemes. In 2009, USS voted against approving the remuneration report at 4 of the remaining 5 largest UK banks. Each vote against management was followed by a letter to the company or direct discussions with the board. We are happy to provide further rationale for our voting decisions upon request.



- Engagement: USS has been engaging with banks for a number of years on a variety of different governance, operational and strategic issues, including remuneration. Meetings have been held with directors of the major banks in which USS had a holding, in conjunction with our portfolio managers, to ensure an holistic and integrated approach is applied towards engagement.

Actions USS is currently taking:

- Company engagements:
 - RBS: RBS has been consulting shareholders in recent weeks about its proposed long term incentive plan (LTIP). USS has offered its views about the scheme in two letters as well as in phone conversations.
 - Lloyds: Lloyds held a consultation with NAPF members, in which USS participated, in January regarding their LTIP proposals for 2010. Members fed back a number of concerns regarding the proposals, which the remuneration committee will consider at their next meeting. We expect additional information from the company at the end of February.
 - HSBC: USS has scheduled a meeting to discuss HSBC's proposed remuneration plans in the next couple of weeks
- *Proposed sector wide dialogue*: USS has developed a proposal for a sector wide dialogue on remuneration between large long term investors and bank directors. We are currently consulting with potential participants.


Barriers to influence

- *Company openness*: USS's ability to provide feedback to banks on proposed remuneration policies is limited if companies do not share full details of their proposals with us. To take RBS as a recent example, shareholders have been provided with details of the proposed LTIP, but without any indication of quantum or how it will complement the bonus scheme. Moreover, specific targets for performance metrics have not been provided. This makes it difficult for us to evaluate the proposals or provide our support.
- *Company responsiveness*: Even where details are shared, this does not mean directors will take on board our recommendations or address our concerns. A common reason companies provide for not adopting our suggestions is that they are faced with numerous and opposing views from shareholders and the final proposal reflects a compromise. It is very difficult for us to verify this claim, or insist on change, even when we do work in conjunction with other pension funds.
- *Government ownership*: Ironically, for banks which are majority owned by the government, we have found that long term investors' interests may be at odds with the government's objective of ensuring a profitable exit. Indeed, in these situations it appears that the government's objectives are not always in line with its own advice embodied in the FSA's remuneration guidance. For instance, UKFI favours an absolute TSR criteria for performance evaluation at RBS which gives no weight to the risks the bank may have had to take on to achieve an increased share price.

While USS has been addressing remuneration practices with company boards for several years, the financial crisis and public furore over bankers pay has meant these matters are now receiving far greater attention by directors. This should, in turn, mean investors like USS have a greater opportunity to influence remuneration policies set by boards than in the past. While this is certainly the case for some banks, as we have highlighted, there remain impediments to the influence large shareholders can exert.

If you would like to discuss any of the points raised in this letter in more detail, we would be happy to arrange a meeting. Please also let me know if you would like us to send you any of the aforementioned documents.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'D Summerfield', with a long horizontal flourish extending to the right.

Dr Daniel Summerfield
Co-Head of Responsible Investment