

Debate over 'say on pay' gathers momentum



As job losses mount and economic suffering worsens, anger at highly-paid bank executives is rising on both sides of the Atlantic. The meltdown in the credit markets has sparked the ire of political leaders, media commentators – and above all taxpayers, who are saddled with costly bail-outs. Most importantly, it has been confirmed that the unprecedented pay packages of the past few years at some financial institutions were driven by extraordinary risk-taking rather than real, sustainable profits. With share prices plunging and banks scrambling for bailouts, shareholders have faced extreme dilution – and now they expect to see executives who profited in the good times take responsibility in the bad ones. Yet while a few high-profile banks have reacted to the public outcry by announcing zero bonuses for their top executives in 2008, much has yet to be done by banks to convince shareholders and the public that banks are serious about reforming their remuneration practices.

In the US the debate on pay restraint has fully reached the political level, as President Obama imposes a \$500,000 cap on salaries of top executives at banks receiving support from the federal bail-out package – a move that has whetted public appetite for further restraints, including at institutions not directly involved in the bail-outs. In Europe, politicians in Germany, the UK and France have also expressed concerns about the amount of both salaries and bonuses to be paid to executives at bailed-out financial institutions.

F&C remains concerned about government-mandated controls on pay that may create unintended consequences and incentives that are not always aligned with shareholder interests.

"Companies have made a grave strategic error by allowing the controversy over pay to

enter the realm of legislators," said Boston-based Elizabeth McGeeveran, Senior Vice President for Governance & Sustainable Investment. "We have been urging voluntary action by companies for some years. Some of the worst pay excesses might have been avoided if shareholders had been able to demand greater accountability on pay from our board representatives."

"Most US companies do not put executive pay up for a shareholder vote, meaning that there are few constraints on runaway pay. We are encouraged by leadership companies such as Hewlett Packard and Occidental Petroleum that have voluntarily agreed to submit their executive compensation report to an advisory shareholder vote on pay following dialogue with F&C. But it may be too late for companies to shut the barn door now that the horse is loose – and we expect US companies are going to have a one-size fits all solution imposed upon them by regulators." In the meantime, F&C will continue its engagement with US companies directly to encourage boards to adopt so-called "Say on Pay" provisions. Currently, it is sponsoring a shareholder resolution at consumer finance giant Capital One, having withdrawn its proposal from Hewlett Packard.

Euro bond market rally brings opportunities

The European High Yield market has rebounded strongly from lows in November of last year, according to Andrew Lake, co-manager of the award-winning F&C European High Yield Bond Fund. Surprisingly, the riskier end of the spectrum, such as CCC-rated bonds, has significantly outperformed the rest of the market whilst BB-rated issues only returned 6.84% in January. Lake explains "The size of the European market means that large issuers have a disproportionate affect so much of the CCC move can be explained by the rally in Autos, particularly GMAC and GM. Whilst there have been inflows into the asset class, much of the price activity is not reflective of actual trading. Inventory is scarce as a result of paring back risk during 2008 and investors are reluctant to sell bonds that they have held down to current levels.

Additionally, most investors are focussing on the same companies and sectors, adding to the liquidity problem that the market is facing at present".

However, Lake believes that the current rally is not sustainable based on worsening economic data, the prospect of increased defaults and continued problems in the finance sector.

Lack of a strong new issue calendar could result in the market continuing to tighten in the short term as investors do have cash to spend. However, there will be significant market volatility this year and one should not be complacent over the current rally. Lake's view is that there will be some recovery/stabilisation towards the end of the year and any market widening will lead to buying opportunities.

Lake concludes "Despite the bleak economic backdrop, there are still attractive opportunities at these levels. Telecom continues to be a good solid sector and telecom company Wind remains one of my top picks in Europe. I also like German cable companies as a core holding and remain positive on consumer non-cyclical stock. My focus is on companies at depressed prices that I believe will survive the downturn, in-keeping with our strategy of gradually increasing risk in the portfolio for 2009".

Please be aware that these are the manager's own views and do not constitute financial advice.

Last call: Responsible Investor Report

F&C is hosting a press briefing at 9:30am on Wednesday 24th February to launch its annual Responsible Investor Report. The report will disclose the key trends in how we cast shareholder votes globally both in totality and in specific areas such as remuneration, board elections and capital structures. The presenters will be Karina Litvack, Head of Governance & Sustainable Investment (GSI) and George Dallas, F&C's Director of Corporate Governance. For more details and to register to attend, please email jennifer.donohoe@fandc.com.

Save the date - 4 March

We are holding informal drinks for UK personal finance and trade press journalists at Piccolino's, Exchange Square on 4 March. A number of fund managers will be present. For details please contact jennifer.donohoe@fandc.com

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