Directors' Pay: consultation on revised reporting regulations. Response form.

The closing date for this consultation is 26 September2012

Please return completed forms to:

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I am responding on behalf of (please tick):	
	Quoted company
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✓	**Business representative organisation**
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Questions

Question 1: The Government seeks comments on how well the draft regulations attached at Annex B give effect to the policy set out in this consultation document.

Whilst we recognise the Government's concerns in this area, we remain of the view that a binding vote on remuneration policy is not necessary for small and mid-size quoted companies. It is our view that these requirements should not extend to them and/or that policy for these companies could be in much simpler form.

We are therefore of the opinion that the Government should limit the application of these rules to the largest listed companies, for example, to companies within the FTSE 350. As the FTSE 350 is revised quarterly, we suggest that companies which have been within the FTSE 350 for two quarters in the financial year prior to the financial year being reported on are subject to these rules. This will enable companies to know at the start of the reporting year whether they are subject to these rules for that year.

Alternatively, a threshold based on an average market capitalisation over the previous three years could be used. For example, the revised Prospectus Directive (Article 2 (1)(ii)(t))uses the following definition determining whether or not a company qualifies to use the proportionate disclosure regime for SMEs/companies with reduced market capitalisation:

> *"a company with an average market capitalisation of less than EUR 100,000,000 on the basis of end-year quotes during the last three calendar years"*

We believe that a robust dialogue on remuneration already exists between institutional investors and small and mid-size listed companies. Institutional investors tend to hold large stakes in small and mid-sized listed companies and therefore it is important for both companies and investors to engage in a dialogue on remuneration to ensure that their interests are aligned.

We are also of the opinion that requiring a binding vote on remuneration policy for small and mid-sized listed companies will have little practical effect except increased costs and reduced flexibility in setting remuneration policy for these companies. In addition, as the draft regulations currently require commercially sensitive information to be disclosed, these companies will be at a disadvantage to their unlisted competitors who may not be subject to the same levels of disclosure.

Notwithstanding that we believe that these regulations should not apply to small and mid-sized listed companies, we have a number of specific comments on the draft regulations (in addition to those made elsewhere in this response), as follows:

- **Part 1 (Introductory)** – Paragraph 1(3) allows the policy part of the report to be omitted from the directors' remuneration report and to be found instead on the company's website or other place. As the intention is that the report should be easily accessible for stakeholders, it would make sense for it to be on the website, rather than an alternative location. All companies which are subject to the regulations should have a website.

- **Part 2 (Summary statement)** – Although companies normally include a statement from the Remuneration Committee Chairman at the start of the directors' remuneration report, we consider it too prescriptive to require the contents of the report to be summarised. As it is not clear what companies are expected to summarise in the statement, most companies are likely to summarise a large proportion of the report in order to ensure that all material points have been covered. Accordingly, there is likely to be significant repetition, increasing the cost for companies.

- **Paragraphs 5 – 9** – please see our comments on Question 7.

- **Paragraph 11 (loss of office payments)** – it is not clear why payments for compensation for loss of office – which require additional information about how the payment was calculated – are treated differently from other payments on termination of office (for example payments in lieu of notice) which do not require further information. If all termination payments are to be treated in the same way, this should be clarified in the legislation.

- **Paragraph 12(b)(iii) (performance conditions)** – we assume "face value" should normally be the number of shares times the price per share at the date of grant of an award or option, but this should be clarified.

- **Paragraph 12(b)(iv) (performance conditions)** – it is unclear what is meant by the "maximum value of the an award at vesting ". We assume it means 100% of the face value, otherwise it will be difficult to state what the maximum is for options and awards because this will be dependent on the value of the shares at a future date. What is required should be clarified.

- **Paragraph 15 (consideration by the directors of matters relating to directors' remuneration)** – we understand that this is targeted at requiring companies to provide information about advice provided by remuneration consultants. However, it is very widely drafted and so may catch other advisors. For example, it may catch the company's accountants or legal advisors if they have provided advice which has materially assisted the remuneration committee. This could include, for example, drafting share scheme rules or explaining how the share schemes apply to a departing director. Whilst their advice has materially assisted the remuneration committee it is not what we understand this regulation to be targeted at. This is not a new point as the legislation has not changed here from what has applied since 2002. However, given the disclosures now required, this has achieved new importance. Requiring disclosure of such information will require the company to disclose the total fees paid to such advisors beyond merely advice on remuneration. Obtaining accurate information may be a significant, and disproportionate, exercise for the company and of little actual value to shareholders.

- **Paragraph 16 (statement of shareholder voting)** – we do not support this proposal. Section 431 Companies Act 2006 already requires listed companies to post poll results on their websites and we see little benefit of also including this in the directors' remuneration report. This proposal also requires companies to outline, where known, the reasons for any substantial shareholder votes against the report. Whilst companies may know the reasons why some shareholders have voted against the resolution they will not know why all shareholders voted against it. It is not clear what level of enquiry companies are expected to make of shareholders to be able to fulfil this requirement. Further, the reasons for shareholders voting against the resolution may be very different and contradictory, resulting in a lengthy and unhelpful disclosure. We are not sure how it will facilitate shareholder engagement – it is best practice for companies to engage with their shareholders about a failed advisory vote as soon as possible and up to shareholders to put pressure on companies to do so. We do not believe that such measures should be provided for in legislation.

- **Paragraph 19 (future policy table)** – companies are required to provide details of the performance conditions to be applied to future awards. Whilst the consultation paper, on page 17, states that the Government does not expect companies to be forced to disclose performance metrics where doing so would harm shareholders interests, this is not reflected in the draft regulations. Companies will be concerned about publishing sensitive information regarding the company's strategy. Companies will be very reluctant to include information which could be advantageous to competitors, particularly where they might not be subject to the same reporting requirements.

- **Paragraphs 21-24** – please see our comments in Question 4.

As a general comment, we would point out that the quality of drafting of these regulations (using

definitions etc but also more generally) does not meet normal Parliamentary standards and so we feel the final version needs to be much improved.

Question 2: What costs will companies face in adjusting to these revised reporting regulations?

Requiring a vote on remuneration policy for small and mid-sized listed companies will result in a significant increase in the cost of preparing the directors' remuneration report. This is primarily due to the limited resources available to these companies and the concern about the loss of flexibility in developing and applying their remuneration policy.

Many larger companies will have a secretariat HR function which will be able to deal with the matters covered by these regulations. Many of our members, small and mid-sized listed companies, will have to arrange for outside consultants to help draft these on their behalf given the legal consequences of an erroneously drafted or sufficiently inflexible policy. On an ongoing basis, the extra audit costs will also be considerable (see our answer to Q15).

Question 3: The Government intends to introduce a table which sets out the key elements of remuneration and supporting information on the pay policy. The Government does not propose to prescribe the specific disclosures that are required for each element of pay. Is this a practical and informative approach?

Yes. This seems sensible.

Question 4: The Government intends to introduce reporting requirements on service contracts, what remuneration directors can receive in different scenarios and the percentage change in profit, dividends and overall expenditure on pay in the reporting period. Is this a practical and informative approach? If an alternative disclosure would be useful, please give details.

Our comments on the proposals, as set out in the draft regulations, are as follows:

- **Paragraph 21 (service contracts)** will require companies to provide detailed information about directors' remuneration covering all benefits. This is likely to be a lengthy disclosure and will contain a significant amount of information which is not of interest to most shareholders. This will be a costly exercise for companies. Companies are already required to have directors' service contracts available for inspection by shareholders and it is difficult to see what benefit this additional disclosure will have.

- **Paragraph 22 (scenarios)** requires a graphical representation of what directors are expected to receive if the performance criteria threshold is met, exceeded or not met. In practice, there may be different performance criteria applying to different awards. It will, therefore, be difficult to produce one clear graph showing this information. If a number of different graphs are included, this may significantly add to the length of the report and the cost to companies of preparing the report and at the same time result in a lack of clarity for shareholders. We consider that the regulations should only prescribe that this information is provided for the CEO and should leave it for companies to decide whether to include it for other directors.

- **Paragraph 24 (relative importance of spend on pay**) requires the report to set out the percentage change in profit, dividends and pay over the period. However, we suggest that there is further clarity on what is meant by profit for these purposes – for example, should it be profit before tax?

We also consider that it would be preferable to include this information in the implementation report rather than the future policy report.

Question 5: The Government proposes that a company's statement on its approach to exit payments sets out the principles on which the determination of the payment will be made. If additional information would be useful, please give details.

In line with our general approach that the regulations are already providing too much legislation in this area, we do not think any further prescription is required.

Question 6: The Government would welcome views on the proposal for the policy part of the remuneration report to include a statement on whether and if so how a company sought employee views on the remuneration policy.

We believe that giving employee views on director remuneration is not likely to be a helpful insight for shareholders. No employee survey is ever likely to produce satisfaction with executive pay and a survey itself is likely to exacerbate tensions. We still maintain that this proposal should be dropped.

Question 7: The Government's intention is that the single total figure includes remuneration that becomes receivable as a result of the achievement of conditions relating to performance in the reporting year where the reporting year is the last year of the performance cycle. Do the specific disclosures set out in the table below correctly give effect to this intention?

We consider that the specific disclosures in the table, in principle, cover the elements necessary for a single total remuneration figure. However, we are concerned that there is a lack of clarity on certain aspects – for example it is not clear that each element of remuneration should only appear once and where, when there is overlap, it should appear. In addition, it will be important for there to be consistency in how the single total figure is calculated to avoid unhelpful comparisons between companies.

We also believe that the Government is overly optimistic that a single table will allow meaningful comparisons between companies when the long list of disclosures will in effect only show how complicated the position behind single figures is.

In relation to the specific drafting of the draft regulations covering the table and single remuneration figure, we have the following comments:

- **Paragraph 5 (single total remuneration figure)** – it would be helpful to clarify that each element of remuneration should only appear in one column, as, in practice, certain items could fall into more than once column.

- **Paragraph 5(d)** – it is unclear what is intended to be caught here. The regulation refers to money or assets "awarded in the reporting period as a result of the achievement of performance conditions which relate to that period…". However, in practice, awards will normally be made following the end of the reporting period – for example an award made in respect of performance in the year ending 31 December 2014 will be made during the 2015 reporting year.

- **Paragraph 7 (benefits)** – to avoid uncertainty and duplication, it would be helpful to clarify that amounts included in paragraph 5 are not also included in paragraph 7 and explain which paragraph takes precedent.

- **Paragraph 7 (benefits)** – it is possible that a departing director will receive payments and

benefits following the reporting year in which he ceases to be a director. It is not clear whether those payments and benefits should be included in respect of the year of departure (and, if so, how they are measured at that time) or the year of receipt.

- **Paragraph 8 (variable pay – additional disclosures)** – While we support the aim of improving narrative around LTIPS, we are concerned that there are practical issues with these proposals. In particular, we are concerned by the requirement in paragraph 8(2) to provide details of performance conditions and the relative weighting of each and the targets set when the performance condition was agreed. In most circumstances, performance conditions relate to confidential internal performance measures. We are concerned that too much information will be released concerning the company's strategy which could be advantageous to competitors who may not be subject to the same reporting requirements.

Question 8: The Government proposes the application of the HMRC methodology to work out the value of defined benefit pension schemes. Is this a practical and informative approach?

We have no comment on this as it is outside the scope of the representatives on our various Expert Groups.

Question 9: The Government proposes that claw-back is recorded as part of the single figure. Is this a practical and informative approach?

We believe a disproportionate amount of time is being spent on discussions regarding clawback, which is likely to play only an exceptional role outside the financial services industry.

That said, we agree with the approach in respect of awards vesting i.e that it should not be a financial adjustment, but a footnote. If clawback occurs in relation to a vested award, we agree it should be referred to, though it may require a separate column as it may be difficult to relate the amount clawed back to any particular head(s) of remuneration. However, if shares are forfeited as the means by which clawback occurs, how would they be valued?

Question 10: The Government would welcome views on whether it would be commercially sensitive to require companies to publish full details of performance against metrics. If so, how can an appropriate degree of flexibility be achieved?

We consider that it will be commercially sensitive to require companies to publish full details of performance conditions as well as full details of actual performance against metrics. Companies will be very reluctant to disclose such sensitive information. In particular, this may be advantageous to competitors who might not be subject to the same reporting requirements.

We suggest that companies are instead required to include a very formal description of the nature of the performance targets required and include an indication of what actual performance against them has been.

Question 11: Will the Government's proposed disclosure requirements on pensions lead to reporting of sufficient information on the benefits received by directors?

We have no comment on this as it is outside the scope of the representatives on our various Expert Groups.

Question 12: The Government proposes that scheme interests awarded to directors during the reporting year are disclosed at face value. Is this a practical and informative approach?

Yes.

Question 13: The Government proposes to simplify the reporting requirements regarding directors' interests. What are the costs and benefits of this approach? If an alternative disclosure would be more useful, please give details.

Any effort to simplify any aspect of the report is to be welcomed from both a cost and a presentation perspective. However, the existing regime for directors' interests disclosure has always appeared one of the more sensibly framed disclosures.

Question 14: The Government proposes that the remuneration report includes a graph that plots total shareholder return, as a proxy for company performance, against CEO pay. Do you agree that this graph would be useful? If so, do you agree that total shareholder return and CEO pay are the best proxies for company performance and pay? If not, what measures would be more appropriate?

If a comparison is required, this seems as useful as any and a TSR graph is one with which shareholders are familiar.

Question 15: The Government proposes that the single figure, detail of performance against metrics, total pension entitlements, exit payments made and detail on variable pay are all subject to audit. Are there any other sections of the report that should be subject to audit?

The audit costs of checking the report will be considerable. We suggest that, as one way of reducing the cost for companies, the Government should suggest removing the need for companies to have this report audited, particularly as directors already have a legal obligation to ensure that the report is accurate.