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Marks & Spencer
Directors’ Pay: consultation on revised reporting regulations. Response form.

The closing date for this consultation is 26 September 2012

Please return completed forms to:

Barry Walker
Executive Pay Consultation
Department of Business, Innovation and Skills
1 Victoria Street
SW1H 0ET
020 7215 3930
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection

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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.

We welcome that the proposed regulations will replace the existing regulations in their entirety, rather than adding to the current reporting requirements. Our comments on the specific draft regulations giving effect to the policy are set out below:

Part 3 Item 4.
We suggest that the letters a, b, c, etc are replaced with the appropriate headings e.g. salary, benefits & dividends, pension, etc. We suggest that companies should have flexibility to add additional columns or break down items further. For example, M&S typically separates different taxable benefits and identifies different LTIP awards. We believe the current proposal would result in extensive footnotes which may be confusing.

Part 3 Item 5. (d)
This refers to ‘money or other assets awarded in the reporting period’, however, bonuses are typically awarded after the end of the financial year. We therefore suggest this is amended to ‘money or assets awarded in respect of the reporting period’.

Part 3 Item 5. (e)
It is not clear where any elements of bonus that are paid in shares should be disclosed. It is assumed they would fall into (d), however, are they excluded from (e) on vesting? Clarification is required for the treatment of awards where performance is assessed from date of award to date of vesting or where awards are subject to performance conditions over a set period (e.g. three years) but are not released to participants until a later date.

Part 3 Item 6. (e) (iii)
This states ‘the value of the benefit will be calculated on the basis of an average market value over the last quarter of the financial year’. However, the consultation document suggests a three month average should be used (page 71). Clarification is required since this will not necessarily always be the same period.

Part 3 Item 6. (e) (iv)
This states ‘the cash amount the individual was required to pay to purchase the share’, however, share options may not necessarily have been exercised or any gain realised at this time. If options are underwater at the time of vesting, how is this accounted for? Would this be disclosed as 0 or a negative amount that is offset against the total figure?

Part 3 Item 11.
We assume that this does not include share awards that vest at a date following cessation – these would not normally be regarded as ‘compensation for loss of office’.

Part 3 Item 12.
We would expect this to also include number of shares awarded, share price award date and exercise price if share options. We are unclear how to illustrate the maximum value at vesting since this would be dependent on the share price at vesting.
Question 2: What costs will companies face in adjusting to these revised reporting regulations?

We are likely to incur additional costs in terms of the time required to produce and review the revised reporting requirements. In addition, we may incur additional remuneration consultant fees and audit fees in ensuring that we fully meet our obligations.

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?

We agree that a table setting out the key remuneration elements is helpful but believe that companies should have flexibility to identify the appropriate level of detail. This is already adopted at M&S – please refer to page 56 of the 2012 Annual Report. In addition, we agree it is useful to provide further detail of the rationale for the senior remuneration framework including performance measures. M&S also already provides this explanation within the Remuneration Report.

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.

In line with current requirements, M&S already discloses current service contracts and terms of employment for directors. M&S has extensive disclosure for new directors which we believe already satisfy the new proposals. Should the disclosure requirements be extended we do not believe this would be particularly onerous.

Service contracts
In line with current requirements, M&S already discloses current service contracts and terms of employment for directors. M&S has extensive disclosure for new directors which we believe already satisfy the new proposals. Should the disclosure requirements be extended we do not believe this would be particularly onerous.

Scenario analysis
We believe that disclosing remuneration based on different scenarios could be useful, however, it will be necessary to clearly state all assumptions used (e.g. share price assumptions) in each scenario. However, we do have significant concerns over this type of disclosure given that if the company built in share price forecast this could have a material impact on investor views. Any assumptions are likely to differ for different companies so we do not believe that specific scenarios or assumptions should be prescribed by the Government. M&S currently includes charts within its Remuneration Report that illustrate the total remuneration package split between pay at risk and fixed pay for ‘on-target’ and
‘maximum’ performance.

Relative importance of spend on pay
It is unclear whether this relates to the company’s total paybill or director pay only. If total pay, we are unclear how this disclosure would add value for our shareholders since an organisation’s total pay can change for a number of reasons which are not necessarily related to value creation. For example, outsourcing certain activities would reduce the company’s total pay cost. We believe absolute spend is more helpful than change in spend and this information is already disclosed elsewhere in the Annual 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.

We agree that this is useful and M&S already sets out the current service contracts and terms of employment for directors in its Remuneration Report. It should be noted, however, that exit situations can vary significantly and we believe companies should have flexibility to ensure they can act appropriately and in shareholder interests in such circumstances.

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.

Fairness and relativity to overall staff pay is an issue the Committee already reviews and considers when discussing Executive remuneration. We do not believe it therefore necessary for companies to consult with employees on remuneration policy for executive directors in order to develop fair and equitable remuneration policies that are aligned with shareholder interests.

Many companies, including M&S, operate within a number of different countries so this proposal would be difficult to implement in practise. However, we do believe it is important that our Remuneration Committee understands the remuneration arrangements for the wider employee population and how arrangements for our executives compare as noted in the Remuneration Report. In addition, M&S also asks questions about remuneration as part of its annual all-employee engagement survey.
**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 believe that a single figure that is calculated consistently for all companies will enhance shareholder understanding. However, this should be considered in conjunction with additional context about the company’s performance during the year.

Further consideration is given in our response to Question 1

**Comparative data**

We believe it would be useful to have an additional column showing the comparative figure from the previous year.

**LTIP**

M&S operates a number of different LTIPs, therefore we believe it would be helpful to set out details of each plan separately.

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**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 believe this is the most straightforward approach, however, it would not necessarily meet all our future needs, for example, international pensions. M&S currently discloses this information using the IAS19 and transfer values methodologies so the HMRC methodology would require a separate calculation.

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

We agree that any amounts clawed back should be included in the single figure (where the amount being clawed back has been included in the figure for a previous year or included in the single figure in another column for this year). However, to avoid confusion, we believe that any amount clawed back should be documented as a separate item. Amounts clawed back should be included in the year the clawback occurs based on the original value that was included in the single figure to allow for a like for like comparison. In addition, an explanation of the reason for the clawback should be provided.
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 understand the desire for companies to provide details of payout levels or vesting under STIPs and LTIPs and associated performance levels. However, in many instances M&S targets are commercially sensitive and therefore full disclosure would not be in the interests of our shareholders.

M&S currently discloses the following information which we believe is sufficient for shareholders to assess whether awards are reasonable in the context of the company’s performance:

- Performance conditions and their relative importance;
- Company performance against each target (e.g. below threshold / threshold / on-target / above target / outstanding);
- Degree of discretion exercised by the Remuneration Committee (if applicable);
- Resulting award level.

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

It is not clear whether this proposal replaces or is in addition to the existing Listing Rule requirements (paragraph 9.8.8R(12)).

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?

We agree that showing awards at face value is the most straightforward approach for shareholders; the use of expected values is complicated and involves a number of differing assumptions.
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.

We welcome the desire to simplify the information on directors’ interests, however, we believe it is important to be able to easily identify all outstanding awards i.e. relevant share plan; vesting date; exercise price, etc. We agree with the proposed approach on the basis that this information is already disclosed elsewhere.

For information, M&S currently discloses the following information in the Remuneration Report (as appropriate):

- Ordinary shareholdings;
- For each share plan:
  - Maximum receivable at start and end of year;
  - Movements during year (including grants, exercises, lapses)
  - Option price;
  - Share price on date of award;
  - Share price on date of exercise;
  - Option period.

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?

We agree with the desire to illustrate how remuneration relates to shareholder value, however, we do not believe that the proposed graph is the most appropriate way to do this. Although TSR is easily comparable between companies and ultimately reflects shareholder value, it may be impacted by factors that are outside a company’s control therefore making a direct comparison with CEO payout challenging. Furthermore, CEO remuneration will normally comprise fixed and variable pay with both short and long-term incentives so a direct comparison of CEO pay to TSR will not always be meaningful.
**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?

We agree that the areas set out above should all be subject to audit to ensure consistency across different organisations.

**Further Comments (not response to specific questions):**

We do not believe it is appropriate to require companies to disclose fees paid to remuneration consultants. Companies should not be discouraged from gaining external advice since the aim is to seek independent opinion and follow best practice.
Mercer Ltd
Directors’ Pay: consultation on revised reporting regulations.
Response form.

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**I am responding on behalf of (please tick):**

- [ ] Quoted company
- [ ] Other company
- [ ] Investor or investment manager
- [ ] Business representative organisation
- [ ] Investor representative organisation
- [ ] Non governmental organisation
- [ ] Trade Union
- [ ] Lawyer or accountant
- [✓] Other (e.g. consultant or private individual)
### 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.

The draft regulations appear to be reasonably drafted. No further comments.

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

Many of the proposals have been drawn from existing companies’ reports and are deemed best practice therefore for some the costs will be minimal.

Inevitably there will be transition costs to the new reporting regime including internal preparation and external advice. This is likely to be less than £50,000 initially in total.

On-going additional audit costs will be necessary; however the majority will be captured in the existing audit process therefore we do not envisage this to be significant.

**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?

The proposed pay policy table mirrors the form of summary tables that many companies produce already. This is a useful format to identify and assess pay policy in a clear and concise manner especially to inform the binding vote on pay policy every three years.
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.

Again the majority of the additional disclosures are being disclosed by companies as emerging best practice.

The scenarios will give a general indication of the pay in different situations however we understand that there is no valuation methodology for this and therefore we can see there will be difficulties as comparisons across companies will not be possible but likely to occur nonetheless.

We acknowledge that the spend on pay calculations could be practical additions to the disclosure due to the relative ease in applying the wages and salaries figure in the accounts. However, we question the purpose and whether it is actually informative to the reader. This does not appear to be relevant for the directors pay policy section of the report since it encapsulates all-employees.

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.

The exit payments policy proposed disclosure is good practice and will help readers form a view of what would happen with an executive leaver. This policy will likely need to be quite prescriptive to limit the potential legal claims in the cases of discretion.

US style exit payment calculations for different scenarios would add further clarity to see how the policy is actually implemented however the relevance of this is questionable. Only when the exit is determined should the full calculation occur to prevent misunderstanding of all the relevant figures within the report.

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.

Given the current executive remuneration landscape, internal relativities should always be considered when setting executive remuneration.
However, we are unsure why the Remuneration Committee would consult with employees on issues relating to executive pay policy. This is the Committee’s responsibility and it is questionable whether the outcome from consulting with general employees would result in proportionate benefit.

We consider that the information required in the Policy Part about differences in approach to setting executive and general employee pay are likely to provide useful content for shareholders to form a view of how the Remuneration Committee has carried out its governance responsibilities. A disclosed statement as to whether consultation took place seems less informative.

**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 are of the opinion that the methodology set out in the table gives an appropriate definition of total remuneration.

However, we note that is a distinct difference between pay ‘earned’ and pay ‘received’. We believe total remuneration should be calculated on the principle of pay ‘earned and received’. This is akin to the proposed methodology for the LTI calculations. The short-term incentives proposal is to include bonuses that are deferred and not paid; this does not align with the above principle.

The concept of deferral in an STI programme is to adjust or remove pay which has been earned over the short-term to align with what should have been earned over the long-term. Therefore including deferral within the single figure is inconsistent.

We recommend that only pay received in the year is recorded therefore removing deferred compensation (that could potentially disappear or increase accordingly).

**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 agree that using HMRC’s methodology is likely to be a practical solution. However, it is not that informative, since it will rarely, and only coincidentally, give an accurate reflection of the value of the benefit. Using the single factor
means, for example, that:

- Younger directors will appear over remunerated relative to older directors;
- The remuneration of Directors in schemes with low pension ages (likely to be the majority with defined benefit accrual) will be understated;
- Similarly, Directors in schemes with relatively high pension increases, or high dependents pensions will be understated.

A cash equivalent approach as currently, or the accounting basis, will respect these differences, but we agree that it will become harder to compare remuneration between companies. A useful additional piece of information to set along side the disclosures about the benefit structure, which would not be expensive to calculate, might be to determine the age at which the factor provides a true reflection of the cost in the scheme, using the cash equivalent basis, to make it easier to compare remuneration within the company.

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

Yes.

To align with the principle of determining pay earned and received it is logical to also include any amounts that have been clawed-back.

This disclosure will also further highlight to readers that issues have occurred and the reasons for this. Disclosure in this way will help improve the credibility and power of such a mechanism. This will usually be evident for departing executives.
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?

There is always a potentially sensitive issue surrounding disclosure of annual performance measures. Currently the retrospective disclosure of measures appears to have not been widespread in the level of detail.

From our experience, the majority of STI measures are not overly sensitive however flexibility regarding disclosure is desirable.

We do not see there to be any issues with disclosing current year – generic financial measures (e.g profit / revenue growth) and targets.

Strategic/personal measures are potentially more sensitive, therefore we would acknowledge that non-disclosure would be desirable.

Ultimately, unless it becomes clear that the spirit behind the regulations is being ignored, the level of detail should be a matter of judgement and there should not be onerous statutory requirements. The corporate governance code could be used to indicate what is expected from different sorts of firms.

A comply or explain approach could be adopted, whereby the reason for non-disclosure should be disclosed.

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

See our answer to question 8, about the additional information that might be helpful if HMRC’s factors are adopted.

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?

We agree with the issues of using the expected value approach to valuing LTI awards.

Mercer agrees with the approach to use the face value methodology as this can easily be applied consistently across all companies. However, the fair value is likely to mislead readers to the amount the executives will actually receive. Clear disclosure of the expected level of vesting should be made. This should be alongside the face value calculation to act as a sensible comparison.
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.

Repetition of information in different parts of the report is undesirable since it confuses the reader and can complicate.

Summary information in respect to shareholdings is a logical addition and should not prove costly to prepare. Disclosure should be made clear and concisely in the form of a chart, outlining the number of shares owned outright, those deferred and those subject to performance. This should also correspond with an illustration of the value of the shares owned outright as a percentage of base salary.

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?

Companies are under increasing pressure to justify remuneration policies. Tying these policies in some way to overall corporate performance is therefore desirable. However, whilst TSR is a useful indicator of relative performance it is not the only measure of corporate performance.

Further, Mercer has previously raised the issue that TSR is not the most appropriate metric for measuring executive performance (measures of economic profit – such as return on invested capital – are preferable).

Having a direct comparison between pay levels and TSR may distort perception, with the unintended consequence that companies continue to pin executive pay to TSR performance and lose sight of the other factors.

That said, and given that the objective of this proposal is to put pay into some kind of context relative to company performance, TSR may provide a simple means of doing so. However, in light of the short average CEO tenure (less than 5 years) a 10 year time horizon will be skewed by potentially two or more CEOs at different stages of their careers. This will need additional disclosure for readers to understand the spikes or dips in remuneration.

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 shareholding disclosures should also be audited.
MITIE Group
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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.

The draft regulations appear to meet the objectives of the proposed government legislation; however these significantly increase the company’s reporting burden for information which up till now hasn’t been requested by our shareholders. Whilst there is general agreement amongst remuneration experts that greater transparency would be beneficial, including it to the degree set out in Schedule 8, seems to us to be another example of bureaucratic red-tape.

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

We envisage incremental costs in terms of additional resources to collate and analyse the information both internally and externally (professional services).

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?

We don’t foresee any issue with this approach - simplifying the information to be provided is in general a good idea. However we would draw the line at revealing any data which in our view were commercially sensitive.
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.

We have no objections in principle to a chart showing the mix of remuneration to explain the upside potential of a package should executives over-perform. However, the value of showing the increase against the % change in profit etc is not clear to us. Where long term incentives in particular are concerned, there may be a lag between company performance and pay-out – which without understanding the context, risks being misconstrued.

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 our opinion, the company should retain the right to exercise flexibility over the approach to exit payments. There may be different reasons why an executive needs to be exited and if the principles are too specific, these may constrain the organisation from moving forward.

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.

Whilst it is appropriate that the remuneration committee should take into consideration the broader company context in setting remuneration levels, there is a real question about the value of seeking employee views given that they will lack the broader strategic information to be in a position to assess properly if a policy is appropriate or not.

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?

Yes – if there is to be a single number, it is important that companies should calculate this using the same methodology.

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?

In principle we have no issue with using the HMRC methodology. We would however want the multiple to be set at 16, being the HMRC’s multiple used to calculate the annual allowance.

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

We have no issue with this approach.
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 providing this level of detail would certainly be commercially sensitive. It should be sufficient for a company to give an overall percentage achieved against the performance criteria.

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

The annual value of the accrued pension should provide shareholders with sufficient information on benefits received.

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?

In principle, we have no issue with this approach.
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.

We welcome any move towards greater simplification.

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?

TSR as a sole measure has been found to be somewhat flawed. It can work well where an organisation has a discrete set of peer companies which operate on a similar geographic scale. Outsourcing companies tend to be very different both in terms of the types of services outsourced and the organisational reach (geography). Comparing CEO pay against TSR based on a sample of such disparate companies could not therefore be particularly meaningful.

Given that the government is proposing multiple additions to the Remuneration Report, it is questionable whether this particular analysis is really required or wanted by our shareholders.

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?

We have no suggestions regarding other sections of the report that should be subject to audit.
26 September 2012

Executive Pay Consultation
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

By email to: executive.pay@bis.gsi.gov.uk
FAO: Mr Barry Walker

Dear Sirs,

**Directors’ Pay: consultation on revised reporting regulations**

MM & K Limited (“MM & K) is an independent firm of remuneration consultants.

We think you have done a very good job. The creative approach of combining additional voting and better disclosures will force companies to re-think their approach to remuneration. We just hope the 10 year graph does not get buried in the depths of the remuneration report. It should be the headline story that underpins the whole logic of why the company is paying the way it is.

We support the thrust of your suggested changes in respect of remuneration. We attach your response form as Appendix 2 to this letter.

Our main observations are as follows:

1. The removal of the requirement to state all previous long term incentive awards would be a huge backwards step. It would add to complexity and reduce transparency as investors would have to plough through many years of old reports to see what awards had been made, which had vested and when and which were still live.

   Remuneration is not just the awards made or received in the year. It is the cumulative effect of all awards made over the lifetime of the executive that are currently unexercised, plus the impact of share ownership and share sales rules that are a condition of the director’s employment. Your proposals fail to recognise the importance of this point.

   **The current requirements of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 Schedule 8 Paragraphs 9 to 12 should be retained.**

2. We think that para 14 should be audited. It would be extraordinary if shareholdings and changes in shareholdings were no longer audited.

3. The problem of excessive pay as perceived by most politicians, the media and the general public is limited almost entirely to banks and the FTSE 100. Therefore these proposals are disproportionate to smaller and medium sized quoted companies. We would prefer proposals that reflect this and are proportionate. It would be best to trial
these proposals for 5 years with larger companies (eg FTSE 350) before forcing smaller companies to adopt them.

4. It is already apparent that many companies are adopting many of the new proposals as best practice before the new proposed legislation is enacted. We are confident that most smaller companies would adopt proportionate responses that meet their shareholders’ needs, without this legislation.

5. It seems to us that main criticisms of pay are:

   a. Pay is too high (although we have noted that this does not appear to be a policy objective. We assume that as the document is silent on this key issue that the Government/BIS has no view other than it is for shareholders to approve pay levels.)
   b. Payments for failure are too high
   c. Payments for mediocre performance are too high

6. The proposals are unlikely to reduce pay, to any significant extent. Pay is driven by:

   a. The supply and demand of talented people and the attractiveness and challenges of different roles. Accordingly, pay levels and structures in UK listed PLCs will need to compare and compete with the levels of pay available including:
      i. other companies both in the UK and abroad
      ii. private equity backed businesses and private equity investment partnerships
      iii. privately owned professional services firms
      iv. investment banking.
   b. The power of the CEO and the executive team to influence the Board and the Remuneration Committee.
   c. The preference of NEDs to keep the CEO and the executive team happy and the lack of incentive in the system for them to do anything else. Annual votes on re-election of directors have helped in this regard, but few NEDs have left as a result of being too generous in the pay they awarded executive directors.
   d. For FTSE 100 and most FTSE 250 companies the costs of remuneration for CEOs and executive directors are only a small proportion of shareholder value. As a result there is little or no economic constraint on their remuneration. For smaller companies, pay is very much constrained by affordability.

7. We agree there is a problem of perception in respect of large payments to executives who leave when past performance has been mediocre or poor. We believe that a maximum termination payment of six months’ salary should be enough for most good senior executives, who should be able to find another job within that period if they want one. Anything more is likely to generate negative PR when the executive leaves and this is an increasing problem with the age discrimination legislation.

   A key way to meet your policy objectives of improved linkage of pay and performance would be to change the Companies Act to limit the maximum contractual termination payment to six months’ salary, except for new hires and those cases where shareholders have formally approved a length in excess of six months.

8. We think that the requirement to produce a ten year graph of TSR performance and CEO pay will highlight those cases where high pay is being made for mediocre performance. We expect that companies will choose to disclose their KPIs as well as TSR over the ten year period so they can explain the linkage of pay and performance. The votes on policy and implementation will allow shareholders to exercise their power to control pay in cases where it is necessary to do so. This will encourage the adoption of many of the good ideas in the Kay Review and of the Narrative Reporting proposals.
9. We congratulate you on forcing a consensus on the definition of a single figure of total remuneration. Nevertheless you should note that using a single figure is a gross oversimplification and it is important that disclosures enable shareholders and their representatives to be able to see and/or calculate:

   a. the expected value of remuneration awarded (as has to be disclosed in the USA)
   b. the amounts that the executive receives when he/she exercises their options
   c. the amounts that the executive receives when he/she sells their shares.

10. The public debates have tended to be on individual companies where pay is perceived as egregious. In practice, the engagement between shareholders and companies tend to produce a compromise, so that shareholders can say that their intervention has been successful in reducing the remuneration proposals. However another interpretation of this process is that the resulting compromise has increased the norm and subsequent benchmarking (which will include the egregious case, albeit slightly reduced in value from its original proposition) will further fuel the inflationary pay spiral.¹

11. Historically there has been too much short termism in pay. We believe this is beginning to change. These proposals will assist this, which is one reason we support them.

Detailed answers to your consultation questions are attached. We have only responded in relation to remuneration matters, upon which we regards ourselves as experts.

Yours faithfully,
For and on behalf of MM&K

Cliff Weight
Director

Attachments:
Appendix 1 About MM&K
Appendix 2 Consultation response form

¹ The issue of benchmarking and its inflationary impact is described well in a recent paper “Executive Superstars, Peer Groups and Over-Compensation – Cause, Effect and Solution” by Charles M. Elson and Craig K. Ferrere see http://irrcinstitute.org/pdf/Executive-Superstars-Peer-Benchmarking-Study.pdf
Appendix 2 - About MM&K

MM&K is a leading independent consultancy specialising in the planning, design and implementation of executive pay and reward strategies.

Founded in 1973, MM&K focuses on directors’ and senior executive remuneration, but we have added other services to support our clients’ needs through the acquisitions of Independent Remuneration Solutions and The Share Option Centre and the launch of higher talent, our specialist recruiter of HR professionals. MM&K is owned by its employees and directors.

Our consultants’ expertise areas include HR, share schemes, law, accountancy, tax, corporate governance, business management and statistics. Our multi-disciplinary approach to remuneration is always tailored to individual client requirements.

MM & K Limited is owned by its employees and directors.

MM & K Limited is authorised and regulated by the Financial Services Authority.

Who We Are

Paul Norris, Chief Executive

Masters graduate in Law and Barrister. Paul started his career with MWP Incentives Limited, and then spent a period in merchant banking before joining the buy-in team that created MM & K in 1985. He advises a number of remuneration committees on business-linked remuneration strategies and is experienced in the design and implementation of cash and share based incentive plans.

Nigel Mills, Director

PPE graduate and chartered accountant. Nigel joined MM & K in 1985 having spent 6 years at Price Waterhouse after graduating from Oxford. He is an authority on executive and all employee cash and equity based incentive schemes for public and private companies. He also leads the Private Equity business of MM & K and is an expert on carried interest and co-investment plans for Private Equity houses.

Cliff Weight, Director

Graduate in Mathematics and Statistics from Cambridge. Cliff has over 20 years’ experience as a remuneration consultant. He was a Director of Independent Remuneration Solutions, who merged with MM & K in November 2006. He specialises in advising companies on executive directors’ remuneration, annual and long term incentives and non-executive directors’ fees. He is a regular speaker at conferences and is co-author of Tottel’s Corporate Governance Handbook, for which he wrote the chapters on directors’ remuneration.

Damien Knight, Executive Compensation Director
Graduate in Physics from Oxford. After a period in construction management, Damien has followed a career in human resources and remuneration consulting, spanning 30 years. Damien was a director of the Hay group where he worked for over 20 years and most recently Damien was a Senior Consultant with Watson Wyatt. For the past 20 years he has specialised in executive remuneration and has advised the remuneration committees and management of a wide range of companies in the UK and elsewhere in Europe, including several FTSE 100 and other major corporations.

**Mike Landon, Executive Compensation Director**

BA in Economics & Politics and MBA from London Business School. Mike has 25 years of experience as a remuneration consultant and over this period has been at the forefront in developing innovative share and cash-based incentive arrangements for executives and employees generally. This has included assisting with the design and implementation of all types of tax-favoured “approved” share plans, executive and “phantom” plans, as well as extending share plans around the world. Mike plays an active role in ifsProShare, the ESOP Centre and the Quoted Company Alliance and is a member of the Consultative Committee for the Office of Tax Simplification’s Employee Share Schemes Review. He previously worked for Mercer, PricewaterhouseCoopers and Watson Wyatt.

**Ian Murphie, Share Plans Director**

Graduate in Economic History, Law and a qualified Barrister. Ian heads the share plan design and administration teams within MM&K and has over twelve years’ experience in advising quoted and unquoted companies in the area of share plan design, affiliated employee trust structures, share valuation, employee communication and share plan administration. Ian has worked both in private practice and in-house, as head of legal services at a specialist remuneration consultancy and most recently as reward director at a top-10 audit and accountancy firm. Ian is currently Chairman of the ifsProshare SME Sub Focus Group, member of the ESOP Centre's International Steering Committee and attending member of HMRC's Fiscal Valuation Forum Group.
Directors’ Pay: consultation on revised reporting regulations.  
Response form.

The closing date for this consultation is 26 September 2012
Please return completed forms to:

Barry Walker  
Executive Pay Consultation  
Department of Business, Innovation and Skills  
1 Victoria Street  
SW1H 0ET  
020 7215 3930  
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection
In the interests of transparency, the Department may choose to publish the responses to this consultation. **Please state clearly if you wish your response to remain confidential.**

Please note also that information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.
### About You

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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.

The policy objectives are not clear.

On page 10, Policy objective para 15 seems to list 5 goals:

1. The Government believes that these measures will give shareholders more leverage on executive pay and encourage improved pay discipline.

2. Shareholder empowerment lies at the heart of the UK’s corporate governance framework and these reforms are consistent with that approach.

3. They will enable shareholders to promote a stronger, clearer link between pay and performance in order to prevent rewards for mediocrity or failure, while still allowing for exceptional performance to be rewarded.

4. Companies will be encouraged to be proactive in designing long term pay policy that is clearly linked to the company’s strategy and which is acceptable to shareholders.

5. Companies will respond appropriately to shareholder challenge on remuneration issues.

However in two other parts of the document other objectives are listed:

1. Better, lasting engagement (see Executive summary para 3)
2. Stronger link between pay and long term performance (see Executive summary para 3)
3. As part of an effective framework (see Foreword on page 5).

Exec summary para 3 says:

Through these reforms the Government is seeking to increase the power of shareholders and promote better, lasting, engagement between shareholders and companies to encourage a stronger link between pay and long term performance.

In the Foreword on page 5 it says:

These revised regulations must be assessed in relation to the framework announced by the Secretary of State for Business, Innovation and Skills announced a far reaching package of measures to address failings in the corporate governance framework for executive remuneration. This included:

1. Giving shareholders more power through binding votes, so they can hold companies to account.
2. Boosting transparency so that what people are paid is clear and easily understood.
3. Working with responsible business and investors to promote good practice and ensure reforms have a lasting impact.

We note that the document is “silent” on the levels of pay. The Secretary of State mentions the ratcheting up of pay in his Foreword, but this is not a policy objective.

We believe that these regulations will not directly affect pay levels and the problem with rising executive pay which is not linked to performance.

UK - 73625180.3
The impact when combined with the voting proposals will be longer term and cultural in its effect. We are strongly supportive of the intentions behind these proposals which should create much more clarity about directors’ pay. In particular we congratulate you on:

1. The proposals for a single figure which has forced an agreement of how the individual elements can be defined in a consistent basis.
2. The proposal for 10 year comparison of CEO pay and performance which will illustrate the long term approach and logic in each company’s approach and expose any flawed approaches where pay is not linked to performance and where increases have been arbitrary.

The problem of excessive pay as perceived by most politicians, the media and the general public is limited almost entirely to banks and the FTSE 100. These proposals are disproportionate to smaller and medium sized quoted companies. It would be best to trial these proposals for 5 years with larger companies before forcing smaller companies to adopt them.

It is already apparent that many companies are adopting many of the new proposals as best practice before the new proposed legislation is enacted. We are confident that most smaller companies will adopt proportionate responses that meet their shareholders’ needs, without this legislation.

A key way to meet your policy objectives of improved linkage of pay and performance would be to change the Companies Act to limit the maximum contractual termination payment to 6 months’ salary, except for new hires and those where shareholders have formally approved a length in excess of 6 months) – see answer to question 5.

As a general comment, we would point out that the quality of drafting of these regulations does not meet normal Parliamentary standards and so we feel the final version needs to be much improved.

Tables are easier to understand than draft legislation and it would be useful if more of these were included in an explanation of the legislation. Using tables also enables you to indicate what might be best practice, where it is felt inappropriate to legislate at this moment in time.

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

Many larger companies will have a secretariat HR function which will be able to deal with the matters covered by these regulations. Many 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).

As noted in our answer to question 1, the problem of excessive pay as perceived by most politicians, the media and the general public is limited almost entirely to banks and the FTSE 100. These proposals are disproportionate to smaller and medium sized quoted companies. It would be best to trial these proposals for 5 years with larger companies before forcing smaller companies to adopt them.

It is already apparent that many companies are adopting many of the new proposals as best practice before the new proposed legislation is enacted. We are confident that most smaller companies would adopt proportionate responses that meet their shareholders’ needs, without this legislation.

The use of XBRL formats and technology will reduce costs of companies, remuneration
consultants, fund managers and proxy advisers. Time saved could be better spent on more value added activities. Government should move towards XBRL formats as a long term approach.

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. The table is not sufficient. Supporting narrative will be required, particularly in narrative reporting of KPIs and why they have been chosen and why weightings have changed.

The pay policy table ought to be in the remuneration report every year (not only when the pay policy changes). If shareholders have to cross refer to previous remuneration reports this adds complexity and reduces transparency.

It may be better to have an explicit policy for new hires. There are pros and cons for more requirements in this regard.

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. Can there be a degree of materiality? We also think a requirement to have a table showing the potential payments in £s as well as descriptive words will be clearer and more easily understood by shareholders and others reading the report. See example - Table 5 below.

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. The regulations should only proscribe this for the CEO. We suggest you leave it to companies to decide whether and if so how to do it for others.

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. Surely this ought to be in the implementation report? It ought to be shown for several years (see Table 12 in answer to question 14).
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| Dir 2 etc. |                   |               | any contractual provision agreed prior to the commencement of these regulations that could impact on the quantum of the payment. | }
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.

Companies should be required to state the average termination payments paid to employees in the group and to explain why the executive director is being given more than the average employee.

Any termination payment of more than 6 months’ salary should require shareholder approval. We suggest you to change the Companies Act to limit the maximum contractual termination payment to 6 months’ salary, except for new hires and those where shareholders have formally approved a length in excess of 6 months).

Most of the dissent about the fairness of directors’ pay (apart from the 5 quoted banks) arises in cases when a director leaves with a large payoff. The above proposals would reduce the frequency of such problems and switch the responsibility to shareholders who approve such a policy.

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 see no harm in this and it might even be beneficial.

It would also serve as warning that failure to take account of this issue might lead to even more extreme measures from the Government such as employee representatives on remuneration committees or on the Board.

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 believe that the Government is right that a headline single table will allow meaningful comparisons between companies even when the long list of disclosures will in effect show how complicated the position behind single figures is.

1. The proposal for a single figure will use a definition of Total Remuneration which includes:
   - the estimated value of deferred bonuses awarded in the year (i.e. it ignores the change in value of share price between date of award, vesting and sale of shares)
   - the realisable value of share options, which is the notional gain at the date of vesting (i.e. it ignores the gains or losses from the vesting date until the date the option is exercised and the date the shares are sold)
   - defined benefit pension, which is valued at 20 times the increase in accrued pension in the year (i.e. it ignores the impact of changes in the cost of funding the pension obligation, makes no allowance for the age of the director or their prospective widow,
2. You ought to encourage the use of two figures. Both MM&K and Manifest in separate submissions to government consultations have argued that a single figure of total remuneration is over-simplistic and likely to lead to misleading analyses. Publication of both “total remuneration awarded” and “total remuneration realised/realisable” would be a better approach:
   - Awarded measures remuneration committee decisions made in the financial year and
   - Realised/Realisable measures the outcomes of performance based on decisions which may have been made several years earlier.

3. The following example shows what happens when somebody is recruited and shows the amount of disclosed total remuneration in each year:

   New CEO appointed
   Salary £1 million p.a.
   Bonus £1 million p.a. (target)
   Share Award of £10 million of shares which vest in 5 years’ time, with “easy” 5 year performance condition
   Disclosed Total Remuneration
   - Year 1 = £2 million (assumes bonus is at target level)
   - Year 2 = £2 million
   - Year 3 = £2 million
   - Year 4 = £2 million
   - Year 5 = £12 million

   Using only the proposed single figure is a nonsense. The average remuneration in the above example is £4 million p.a. The total remuneration awarded, would be £12 million in year one and then £2 million for each of years 2 to 5.

   The example shows why both figures are needed, as a minimum.

4. From the shareholders point of view, what they’re interested in is the total cost of employing a person not the value of the package to the individual and therefore a comment on page 7 about benefits is irrelevant.

5. On page 8 the consultation document does not mention pictures or tables. A picture paints 1000 words.

6. We think there should be a Disclosure Aid 3 which is the total remuneration awarded. This is required in the US, and will therefore be required for all large companies with a dual listing. This needs to be shown a full three-year period, as in the US, and we think that arguably this should be five years for chief executives. (see below – Table 6)

7. 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.

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

   - Paragraph 5a Salary– it would be helpful to state the salary for someone appointed in the year and the number of months that the reported salary reflects.
• **Bonus** – the table wording should read “Full bonus awarded for performance in the relevant performance year.”

• Deferred bonus is often paid in shares and the value of these shares will reduce or increase in the period until vesting. Executives are not allowed to hedge positions in shares in their company so are exposed to changes in the share price. Therefore this is remuneration and it should be measured. A footnote of explanation might be appropriate.

• Options. We think you should define the value of options as market price at date of vesting minus the exercise price times number of shares vesting.

• **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 one 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.

• For example an LTI with 50% of the award made on 20 February 2012 based on EPS in respect of performance in the year ending 31 December 2014 and 50% based on TSR in the 3 year period to 20 February 2015, would be in different years (unless the draft legislation is changed and an estimate of the TSR outcome is made).

• **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 required concerning the company’s strategy which could be advantageous to competitors who may not be subject to the same reporting requirements or in the alternative to sub-optimal remuneration design to avoid such disclosure. (See answer to question 8).

We have identified a number of potential consequences that may arise from this drafting. These include the swap of deferred bonus into long term incentive (which reduces the amount of disclosed single figure of total remuneration as deferred bonus is counted in the year it is awarded and long term incentive in the year it vests) and increases in the performance period of long term incentives (as this delays the inclusion of the amount in the single figure of total remuneration until the final year of the performance period). Another consequence is that new hires will appear to have lower total remuneration than those who have been in comparable roles for several years.
Table 6: Suggested best practice format to show 5 years of CEO and 3 years of other Directors.

List the executive directors above the Chairman and NEDs; and show sub totals at the bottom.

### Table 6: Single Total Pay Figure (£’000)

<table>
<thead>
<tr>
<th>Salary</th>
<th>Benefits</th>
<th>Pension</th>
<th>Sub-total</th>
<th>Bonus</th>
<th>LTI Received</th>
<th>Sub-total</th>
<th>Total Received</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>d</td>
<td>e</td>
<td>f</td>
<td></td>
</tr>
<tr>
<td>CEO 2012 (current year)</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
<td>50%(S)</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>CEO 2011 (previous year)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>CEO 2010</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>CEO 2009</td>
<td></td>
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<tr>
<td>CEO 2008</td>
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<td>Director 2</td>
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<td>Director 3</td>
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<td>Etc.</td>
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<tr>
<td>Sub totals executive directors</td>
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<tr>
<td>Sub totals Non-Executive Directors (state if including or excluding Chairman)</td>
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<td>Total of all directors</td>
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<td>2010</td>
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</tr>
</tbody>
</table>

NOTE re Bonus % deferred: this is a requirement of paragraph 9 and it seems sensible to put it in here. Enter C or S to show whether deferred in cash (C) or shares (S).

UK - 73625180.3
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?

It is more important that all companies use the same method than we continue to haggle over the different approaches. However all parties should be aware of the deficiencies of the proposed approach.

The 20x increase in accrued benefit is a rule of thumb which understates the value of DB pension for older executives and overstates it for younger ones, particularly with short service (although few of the latter now accrue DB benefits).

The disclosure is inadequate and does not reflect the NAPF/LAPFF recommendations.

Although not a legal requirement, it should be noted that the NAPF and LAPFF\(^1\) in 2010, called for greater transparency in disclosures on:

“Accrual rates in defined benefit pensions, which include ‘final salary’ schemes. Some directors benefit from a rapid accrual rate, such as 1/30th, when other employees may typically be on a rate of 1/60th or 1/80th.

Company contributions to defined contribution pension schemes. Recent studies have shown that contributions for directors are often far higher than those made for other staff.

Payments in lieu of pensions. An increasing number of firms offer cash payments instead of a pension contribution. These can be sizeable – in some cases over 50% of salary.

The retirement ages of directors. The reasons for any differences between the boardroom and other employees should be explained.

Special early retirement provisions. Firms should make it clear that an unreduced pension on early retirement is usually inappropriate.”

The following should be proposed as best practice. How much should required by legislation needs further thought.

---

\(^1\) Local Authority Pension Fund Forum
UK - 73625180.3
**Recommended Best Practice: see Table 9a and 9b below**

**Table 9a: Pension components**

<table>
<thead>
<tr>
<th>Name</th>
<th>Total Pension Benefit £00 as shown in Table 6/6a</th>
<th>Cash in lieu of pension £00</th>
<th>% of total pension</th>
<th>Money purchase scheme benefit achieved in year £00</th>
<th>% of total pension</th>
<th>Defined benefit scheme benefit achieved in year £00</th>
<th>% of total pension</th>
<th>Defined benefit scheme additional value if retires early</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Director 2</td>
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<td></td>
</tr>
<tr>
<td>Director 3</td>
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</tbody>
</table>
Table 9b: Additional defined benefit disclosures

| Name   | Retirement age | Age | Length of service | Accrual rate | Individual’s contribution to DB plan | Accrued Pension as % of final pensionable salary | Accrued pension at end of year | Increase in accrued pension in the year | Increase in accrued pension net of inflation | Transfer value of accrued pension at start of year | Transfer value of accrued pension at end of year | Increase in transfer value of accrued pension net of individual’s contributions | Benefit achieved in year from participating in a defined benefit scheme (HMRC value of 20x increase in accrued benefit) |
|--------|----------------|-----|-------------------|--------------|-------------------------------------|-----------------------------------------------|-------------------------------|------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| CEO    |                |     |                   |              |                                     |                                               |                               |                                          |                                               |                                               |                                               |                                                                                                                                  |
| Director 2 |            |     |                   |              |                                     |                                               |                               |                                          |                                               |                                               |                                               |                                                                                                                                  |
| Director 3 |            |     |                   |              |                                     |                                               |                               |                                          |                                               |                                               |                                               |                                                                                                                                  |

Notes:
1. If retirement age is different for any director and other employees the reasons for any differences should be explained.
2. Personal pension contributions to company pension plans should be disclosed the reasons for any differences to other employees should be explained.

Tables 9a and 9b also include the items required by the NAPF/LAPFF policy on pension disclosure.
Question 9: The Government proposes that claw-back is recorded as part of the single figure. Is this a practical and informative approach?

Yes.

We do not 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. There are numerous examples in other industries with large tail risk, Consider oil exploration, Pharmaceuticals, eg Thalidomide, Manufacturing/Chemicals eg Bhopal, PIP breast implants, Perrier (benzene), Newspapers and Media (phone tapping), Electricity (Fukushima), Retail (Ronson’s Crap comments about jewellery), Automobiles (Ford Pinto), Tobacco (cancer effects), Food & Beverages (Coca-Cola also had water problems). There may be a backlash on high fat, high sugar products which cause obesity and can be linked to diabetes.

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?

The approach proposed seems ok and will rarely occur, so it is not worth debating too much. Footnotes will cover it and there will be bigger issues to be addressed if it occurs.

As noted above, there is currently no true-ing up or down for deferred bonus awarded in shares and if you plan to true up for clawback then we think deferred bonus should be treated similarly.

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 description of the nature of the performance targets required and include an indication of what actual performance against them has been.

It is also important that the measures link in with the KPIs, the narrative reporting and the description of the business model.

Analysts’ reports on companies typically contain much information on the company and what is important. We think the question of commercial sensitivity of publishing data is overblown by some commentators.
Question 11: Will the Government's proposed disclosure requirements on pensions lead to reporting of sufficient information on the benefits received by directors?

See our answer to Question 8.

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, but it would be even better if the expected value is also required (as it is in the US).

The removal of the requirement to state all previous long term incentive awards would be a huge backwards step. It would add to complexity and reduce transparency as investors would have to plough through many years of old reports to see what awards had been made, which had vested and when and which were still live.

Remuneration is not just the awards made or received in the year. It is the cumulative effect of all awards made over the lifetime of the executive that are currently unexercised, PLUS the impact of share ownership and share sales rules that are a condition of the director’s employment. Your proposals fail to recognise the importance of this point.

The current requirements of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 Schedule 8 Paragraphs 9 to 12 should be retained.

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.

As noted above, a move to XBRL would be helpful.

The current drafting is:

Statement of directors’ shareholding

14. The directors’ remuneration report must, in respect of each person who was a director in the financial year, set out—
   (a) any requirements on a director to own shares in the company and state whether or not those requirements have been met;
   (b) total numbers of shares and share options in respect of that director—
      (i) of which the director is the legal owner,
      (ii) which have been awarded subject to deferral on satisfaction of conditions other than performance conditions,
      (iii) the award of which are subject to performance conditions.
We think this would be much easier if it were specified in tabular format, e.g.

**Minimum Disclosure, see Table 13**
**Best Practice, see Table 13a**
### Table 13: Directors’ shareholdings

<table>
<thead>
<tr>
<th>Name</th>
<th>Requirement to own shares</th>
<th>Whether requirement met</th>
<th>Shares owned</th>
<th>Deferred shares without performance conditions</th>
<th>Deferred shares subject to performance conditions</th>
<th>Options without performance conditions</th>
<th>Options subject to performance conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>

### Best practice disclosure

### Table 13a: Directors’ shareholdings

<table>
<thead>
<tr>
<th>Name</th>
<th>Salary</th>
<th>Share ownership guideline (as multiple of salary or as number of shares)</th>
<th>Shares owned at year end, including vested awards</th>
<th>Value as multiple of salary</th>
<th>Whether requirement met</th>
<th>Shares owned</th>
<th>Deferred shares without performance conditions</th>
<th>Deferred shares subject to performance conditions</th>
<th>Options without performance conditions</th>
<th>Options subject to performance conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO</td>
<td>£750,000</td>
<td>5 x salary</td>
<td>800,000, 2,400,000, 500,000</td>
<td>2.0</td>
<td>No</td>
<td>400,000, 1,200,000, 250,000</td>
<td>100,000, 300,000, 62,500</td>
<td>50,000, 150,000, 31,250</td>
<td>100,000, 300,000, 62,500</td>
<td>50,000, 150,000, 31,250</td>
</tr>
<tr>
<td>Dir 2 etc.</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

1. Value is at end of the last financial year. For options it is the notional gain if the option were exercised at the end of the last financial year.

2. If any shares have been sold during the year then this should be explained in notes to the above table.

There should be a cross reference to performance conditions or a description of them, including the latest estimate of their outcome, unless judged commercially sensitive.
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?

We think this is a wonderful idea. We attach below an example of what may become best practice.

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

Companies will be free to add other measures as well as TSR. This proposal will encourage companies to do so and merge their remuneration reporting with that on narrative reporting on KPIs.

The line graph comparison, of overall performance and pay of Single Total Figure and Performance over 10 years as required by paragraph 13, will seem to some readers the most logical place to start when explaining the linkage of pay and performance.

The **minimum disclosure** is shown in the chart below:

Comparison of TSR and CEO pay for last 10 years
We question whether this is the right format. Statisticians will question whether it is right to join up the points and whether bars are more appropriate for pay figures. More important is whether the TSR figure should also be an index. For example:

![Comparison of company performance and average FTSE 100 CEO pay](chart)

The use of TSR rather than the cumulative returns over the 10 years will lead to sensationalist headlines and fails to reflect the policy goal of linking pay to performance over the long term. Inevitably there will be reasons for pay being high in particular years, but it is the long term picture which validates whether the pay policy has been effective.

However, best practice would be to include the index of the components of pay and the actual amounts in a table. (See Table 12) In addition, the requirements of paragraph 24 could usefully be included in this table.

The commentary would explain why the Remuneration Committee had adopted the policy and why it had paid out the amounts it had, noting the performance of the company and the linkage of pay and performance and other material factors.
Table 12: Detailed comparison of company performance and CEO pay and profit, dividends and overall compensation costs

<table>
<thead>
<tr>
<th>Year</th>
<th>-10</th>
<th>-9</th>
<th>-8</th>
<th>-7</th>
<th>-6</th>
<th>-5</th>
<th>-4</th>
<th>-3</th>
<th>-2</th>
<th>-1</th>
<th>0</th>
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</thead>
<tbody>
<tr>
<td>TSR</td>
<td>100</td>
<td>77</td>
<td>86</td>
<td>93</td>
<td>109</td>
<td>121</td>
<td>123</td>
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<tr>
<td>Total Pay</td>
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<td>215</td>
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<td>Salary</td>
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<td>Other Benefits</td>
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<tr>
<td>sub-total not performance related</td>
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<td>130</td>
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<td>288</td>
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<td>93</td>
<td>109</td>
<td>121</td>
<td>123</td>
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<td>115</td>
<td>129</td>
<td>164</td>
<td>164</td>
<td>234</td>
<td>245</td>
<td>256</td>
</tr>
<tr>
<td>Overall expenditure on pay</td>
<td>100</td>
<td>100</td>
<td>107</td>
<td>109</td>
<td>117</td>
<td>138</td>
<td>108</td>
<td>151</td>
<td>157</td>
<td>163</td>
</tr>
<tr>
<td>Average employee pay</td>
<td>100</td>
<td>100</td>
<td>102</td>
<td>107</td>
<td>113</td>
<td>128</td>
<td>106</td>
<td>128</td>
<td>135</td>
<td>141</td>
</tr>
</tbody>
</table>

CEO remuneration in £000

| Salary | 525 | 620| 659| 672| 716| 711| 755| 810| 818| 825| 850|
| Other Benefits | 83 | 75 | 84 | 87 | 91 | 91 | 99 | 74 | 92 | 78 | 96|
| Pension | 347 | 427| 494| 504| 537| 534| 566| 467| 642| 499| 581|
| sub-total not performance related | 954 | 1,122| 1,237| 1,262| 1,344| 1,336| 1,421| 1,351| 1,552| 1,402| 1,527|
| Bonus | 372 | 573| 708| 859| 922| 990| 1,178| 1,127| 1,177| 1,345| 1,597|
| LTI | 479 | 904| 841| 966| 1,038| 983| 1,178| 1,177| 1,480| 1,167| 1,497| 1,647|
| sub-total performance related pay | 851 | 1,477| 1,549| 1,825| 1,960| 1,973| 2,456| 2,607| 2,344| 2,842| 3,244|
| Total Pay | 1,806| 2,600| 2,786| 3,087| 3,305| 3,309| 3,877| 3,958| 3,896| 4,244| 4,721|

annual % change (profit, dividends and overall expenditure on pay are required by Para 24)

| Profit | 11% | 0% | 8% | 1% | 8% | 18% | -22% | 39% | 4% | 4% | 35%|
| Dividends | 5% | 0% | 8% | 1% | 8% | 18% | -22% | 39% | 4% | 4% | 35%|
| TSR | -15% | -23% | 12% | 7% | 17% | 11% | 2% | -29% | 21% | 9% | -5%|
| Overall expenditure on pay | 3% | 35% | -3% | -10% | 3% | -5% | -16% | 25% | 15% | 1% | 24%|
| Average employee pay | 0% | 0% | 2% | 5% | 5% | 13% | -17% | 21% | 5% | 5% | 1%|
| Total Pay | 29% | 44% | 7% | 11% | 7% | 0% | 17% | 2% | -2% | 9% | 12%|

Note: Minimum disclosure is only latest year.

UK - 73625180.3
Other possible KPIs and remuneration figures

(Note these are examples. Each company should choose its own KPIs.)

<table>
<thead>
<tr>
<th>KPI</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO Pay - Total expected value of awards</td>
<td></td>
</tr>
<tr>
<td>CEO Pay - Total received</td>
<td></td>
</tr>
<tr>
<td>Total Shareholder Return – absolute value</td>
<td></td>
</tr>
<tr>
<td>Total Shareholder Return – relative to an index e.g. FTSE 100, 250, All Share etc. and/or comparator index or group of companies</td>
<td></td>
</tr>
<tr>
<td>Share price growth (as the make-up of TSR is useful to see)</td>
<td></td>
</tr>
<tr>
<td>Dividends – yield as % share price</td>
<td></td>
</tr>
<tr>
<td>Market Capitalisation (Note: It is suggested this is included as well as TSR and share price. It is not quite the same as share price as, by issuing new shares, a company might increase market cap but reduce the price per share. Pay is correlated to size of company so this is an important piece of background)</td>
<td></td>
</tr>
<tr>
<td>Net Debt</td>
<td></td>
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<tr>
<td>Enterprise Value</td>
<td></td>
</tr>
<tr>
<td>Turnover</td>
<td></td>
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<tr>
<td>Profit (EBITDA)</td>
<td></td>
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<tr>
<td>Profit margin</td>
<td></td>
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<tr>
<td>Profit growth / Turnover relative to peers</td>
<td></td>
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<tr>
<td>Cash flow</td>
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<tr>
<td>ROCE</td>
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<tr>
<td>WACC</td>
<td></td>
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<tr>
<td>Debt/ EBITDA</td>
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<tr>
<td>EPS</td>
<td></td>
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<tr>
<td>P/E ratio (share price/ EPS)</td>
<td></td>
</tr>
<tr>
<td>Other KPIs</td>
<td></td>
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<tr>
<td>E.g. ARPU (average revenue per user), key strategic goals, Customer satisfaction, staff effectiveness, Health and Safety, CSR measures</td>
<td></td>
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<tr>
<td>CEO Salary</td>
<td></td>
</tr>
<tr>
<td>CEO Bonus</td>
<td></td>
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<tr>
<td>CEO shares and options – expected value of awards made in the year</td>
<td></td>
</tr>
<tr>
<td>CEO share awards and options realised – total of gains from options exercised in the year and restricted shares that vested in the year</td>
<td></td>
</tr>
<tr>
<td>Pension – transfer value of increase in accrued benefits</td>
<td></td>
</tr>
<tr>
<td>Benefits – taxable value of benefits received</td>
<td></td>
</tr>
<tr>
<td>Average Remuneration of employees</td>
<td></td>
</tr>
<tr>
<td>Ratio of CEO (expected/realised) pay to average employee</td>
<td></td>
</tr>
</tbody>
</table>

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?

We think that para 14 should be audited. It would be extraordinary if shareholdings and changes in shareholdings were no longer audited.

The audit costs of checking the report will be considerable and disproportionate for smaller companies. We suggest that, as one way of reducing the cost for companies, the Government should remove the need for companies to have sections of this report (other than shareholdings) audited.

The directors already have a legal obligation to ensure the report is accurate.
National Association of Pension Funds
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About the NAPF

The NAPF is the leading voice of workplace pensions in the UK. We speak for 1,300 pension schemes with some 16 million members and assets of around £900 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.

Introduction

The NAPF welcomes the opportunity to respond to the government’s consultation on revised remuneration reporting regulations.

We are supportive of the Government’s proposals to revise the remuneration reporting regulations in order to restructure remuneration reporting to increase transparency to shareholders. The NAPF and its members have long urged for restraint in setting directors’ pay along with transparency and simplicity. If we are to make progress on executive remuneration, it is critical that companies explain clearly how their remuneration policy is structured, how it is linked to performance and how that impacts shareholder value.

Companies at present do not consistently disclose remuneration information in a format which is clear, transparent and comparable. The proposals for such information to be displayed in a standardised table will aid understanding on how the company’s pay policy supports its strategy and performance.

Institutional shareholders such as pension funds will expect to see companies set out sufficient and specific detail within both this table and the accompanying narrative in order that they can judge the policy’s appropriateness and vote on it accordingly. We have set out in response to some of the questions additional areas of disclosure that investors such as pension funds would welcome.

We are happy to work with other investor bodies, investors, company preparers and other interested and relevant stakeholders to agree on initial best practice guidance in this area ahead of its introduction next year.

David Paterson
Head of Corporate Governance
NAPF

Will Pomroy
Policy Lead: Corporate Governance
NAPF
Response to consultation questions

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.

We do not feel in a position to comment on the effectiveness of the drafted regulations.

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

From an investor perspective, we perceive the likely costs incurred in adjusting to the revised reporting requirements to be small in relation to the benefits to be derived from greater transparency.

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?

Companies at present do not consistently disclose remuneration information in a format which is clear, transparent and comparable. The proposals for such information to be displayed in a standardised table will aid understanding on how the company’s pay policy supports its strategy and performance.

Companies do and should design their pay policy to suit their own unique business model and strategy; as such it is right that the Government is not proposing to prescribe required detail, beyond the suggested headings.

Institutional shareholders such as pension funds will expect to see companies set out sufficient and specific detail within both this table and the accompanying narrative in order that they can judge the policy’s appropriateness and vote on it accordingly.

In addition to those items of remuneration which are already included, NAPF members would welcome the addition of:

- A row setting out the company’s policy with regards to service contracts, including any provisions contained within such contracts.
- The company’s policy with regards to recruitment, this should set out the expectations for recruitment under ‘normal circumstances’ and an indication that any recruitment which would require the company diverging from this due to ‘exceptional circumstances’ would involve shareholder consultation in advance.
- Any policy the company may have with regards to the management of individuals’ tax exposure and hedging of variable pay and shareholdings.
- A catch all category for any other material elements.
Whilst we agree that companies should not be forced to disclose performance metrics where doing so would harm shareholder interests, we believe that companies should be required to at least disclose the performance criteria for annual bonuses in retrospect the following year if advance disclosure is not possible.

We are happy to work with other investors, company preparers and other interested and relevant stakeholders to agree on initial best practice guidance in this area. We’d expect this best practice to evolve and refine itself on a regular basis as investors and companies adapt to the new requirements.

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.

Service contracts

Transparency around the content of directors’ service contracts is very important and at present it is often difficult and impractical to get hold of them. We therefore welcome the proposed requirement that the policy report set out all existing contractual provisions that relate to directors remuneration. We also believe that Directors’ contracts should be made available for shareholder scrutiny online.

Scenarios

As described in the consultation document some preparers already set out in graphical form expectations of what directors may receive at below, on and above target. We agree that this can be a beneficial disclosure.

However, the objective should be to foster a more trusting relationship between remuneration committees and shareholders. To this end, what investors want to be reassured about is that remuneration being awarded is reflective of performance, and thus aligned with their interests. We would therefore welcome disclosure which shows the single figure plotted over five years, compared to the TSR of the shares and a single measure of performance drawn from the remuneration KPIs.

Relative importance of the spend on pay

We would welcome preparers setting out in graphical form the relative share of the spend on pay, although we would question the appropriateness of the use of profit in all cases.

As investors we see considerable merit in this “share of the pie” approach; companies should be able to illustrate to shareholders the percentage of profit or cash flow being: a) retained for capital investment, b) paid out in dividends, c) being paid to staff in annual bonuses – split between directors and the rest of the employees, and d) being contributed to the company’s pension scheme. While in of itself this disclosure will be of limited interest, the movement of
the percentages over time should be most illuminating and allow investors to judge whether decisions are being taken in the long-term interest of the company and its shareholders.

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.

We welcome the move to include within the binding policy details of the company’s approach to exit payments. Inclusion here will keep the structure simple, provide a link to recruitment (where the problems often start) and provide a policy framework for termination payments which is practical and allow companies to complete negotiations in a timeframe which is in the interests of all.

Disclosures in this area should include how the company defines a ‘good leaver’, the effort to mitigate against payment for failure and how the remuneration committee is able to use its discretion.

We see merit in the Australian model of setting out the likely circumstances of termination and the payments they would trigger; it might be further beneficial if the potential outcomes were illustrated for the CEO.

In the short term we would also welcome companies ensuring that such disclosures cover current contracts and indicates when they were last reviewed.

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.

On employee involvement, we believe it helps companies to focus on these issues if they have to communicate their general remuneration policy to staff and report to shareholders on that policy. Consultation on that policy will take place at different places in a company but we do not think it appropriate that all employees should be consulted on the policy for executive remuneration. It also adds to shareholder understanding of the culture of the company.

We do not see the need for this requirement to be any more detailed than is suggested.

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 on page 24 correctly give effect to this intention?
We welcome this proposal, however, the FRC’s Financial Reporting Lab’s proposal for this table also included a third column for the related disclosure, we see merit in this being included in addition to the definition and measurement to aid understanding of any unusual numbers as well as navigation of the report.

We would also welcome the inclusion of the comparative figures from the previous year.

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?

Yes, while there is no right answer to calculating this figure, the HMRC methodology is transparent, simple and understandable. It will provide sufficient practical information to be useful to shareholders. It is important that as far as is possible, disclosures should endeavour to aid understanding, the volatile values produced via IAS 19 would make comparability very difficult and thus reduce the usefulness of this disclosure to shareholders.

Given that the companies’ policy in relation to pensions, including specific details, is to be set out within the new policy report, there is no need for this calculation to be any more complicated than is suggested.

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

We agree that where claw back occurs, the circumstances and factors that affected the decision should be disclosed and the values included within the disclosures for the single figure. We would also expect an explanation of the circumstances around such an occurrence to be set out within the Chairman’s Statement.

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 believe companies should be required to disclose the performance metrics for annual bonuses, recognising that in some cases deferral of disclosure may be appropriate.

Investors would be concerned if the size of reward available under variable pay is high and are being asked to these support plans without being aware what the targets are. As stated in our Policy and Voting Guidelines, insufficiently demanding performance targets or insufficient disclosure on the scope of annual bonuses and performance conditions would likely cause concern to investors and trigger a voting sanction.
BIS Executive Remuneration Discussion Paper: NAPF response

Where metrics are commercially sensitive, as investors, we would welcome companies explaining to shareholders, at a minimum, the nature of such metrics and attached targets and how they relate to the company’s strategic objectives.

Where the actual metrics and targets in bonus plans are deemed too difficult to disclose there may be ways around this such as utilising a range of acceptable targets. It is important that if metrics are not disclosed for the year ahead that these are disclosed retrospectively soon after.

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

We would also welcome disclosure of any differences in the arrangements offered to directors and the rest of the staff. Generally we see little justification for the often significant disparity in these arrangements and investors may have important questions about fairness if the pensions of directors are disproportionately more generous than those of other staff.

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. Shareholders welcome the transparency offered by face value disclosures as opposed to expected values. We would also welcome increased narrative to explain why the performance measures are deemed to be stretching.

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.

We welcome this simplified disclosure. We are encouraging companies to require directors to build up a significant shareholding within the company in order to align their interests with those of their shareholders. Given our desire for companies to move in this direction it will be important for investors to easily understand the total number of shares that each director owns or may potentially own.

We would also welcome a requirement to disclose any hedging undertaken by directors against risk within their variable pay.

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?
We agree it is important that the remuneration report enables investors to be able to easily assess the relationship between remuneration and performance over a long period.

We have sympathy with the suggestion of a graph which plots CEO pay against TSR given that this will be easily attainable from the single figure calculations and if operating correctly should be aligned with performance. We are conscious that the average tenure of a UK FTSE-100 CEO is approximately 5 years and as a result the suggested graph will likely cover a period of more than one CEO. We do not see this as a problem and will in itself be a useful graphical illustration of any jumps in pay, the value of which can thus be assessed.

We agree that the chosen metric used as a proxy for performance needs to be one that is easily understood and comparable. Given that long term sustainable shareholder return is what all Boards should be seeking to maximise, long-term absolute Total Shareholder Return (TSR) is an appropriate measure in this regard.

This information might usefully be combined with the disclosures described under Question 4.

We also believe that companies should include their estimated projections over at least the next three years, we do not believe that this should be too difficult to include given that remuneration policies are to be set on three year cycles.

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?

We agree that all historical elements such as the single figure, detail of performance against metrics, total pension entitlements, exit payments made and detail on variable pay should all be subject to audit.

We welcome the additional proposal to disclose the provision of advice from any consultant that provided advice to the company on remuneration. We also support the proposal to require disclosure of information about how the company engaged with their shareholders, including how shareholders voted on both the binding vote and advisory vote at the previous year’s AGM and the action taken by the Committee to respond.

Finally, we believe that adherence to these new requirements should be included within the UK’s listing rules in order to ensure that UK listed but not UK incorporated companies are also covered.
Directors’ pay – Consultation on revised remuneration reporting regulations
A response to the Department for Business Innovation & Skills (BIS) consultation

About us

Starting from October 2012, employers in the UK will have a statutory duty to automatically enrol some or all of their workers into a pension scheme that meets or exceeds certain legal standards. They will have to make minimum contributions for these workers.

NEST is an occupational contribution pension scheme that UK employers can use to meet their new legal duties. NEST is an easy to use, low charge scheme that has a public service obligation to accept employers of any size or sector that want to use NEST.1

NEST Corporation is the trustee body responsible for NEST. It’s a non-departmental public body (NDPB) that operates at arm’s length from government and is accountable to the UK Parliament through the Department for Work and Pensions (DWP).

NEST Corporation has a Chair and 10 Trustee Members. Together they form the Trustee of the scheme. As the Trustee they have to act solely in the best interests of the members of NEST when taking investment decisions.

NEST invests and owns stakes in hundreds of UK-listed companies and is likely to be among the very largest institutional asset owners in the UK. How these companies are governed and run is a concern for the members of NEST as it will affect the performance of NEST’s funds and therefore members’ incomes in retirement.

About NEST’s interest in responding

Since launch, NEST has been committed to developing evidence-based policy and delivery solutions to provide a suitable investment approach for its members. To support this we’ve conducted an extensive investment consultation, published an international benchmarking report on ownership best practice, forged links with pension schemes across the EU and conducted ground-breaking primary research into the characteristics and aspirations of NEST’s target group.

The evidence we’ve gathered has led the Trustee of NEST to firmly believe that paying attention to issues such as corporate governance in its investment process improves long-term outcomes. This will result in better and more sustainable returns for NEST members and more robust global markets.

Based on this evidence-led belief, NEST works with fund managers, other pension funds, trade bodies and social partners to influence regulators and policymakers to provide the best regulatory environment to support economic growth and sustainable corporate performance.

NEST has also signed the FRC’s UK Stewardship Code, which aims to improve the way companies and shareholders work together in the long-term interests of shareholders.

1 More information about NEST can be found at: http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/key-facts-myths,PDF.pdf
In our published statement as a signatory of the Financial Reporting Council’s Stewardship Code (http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/Stewardship-code-statement.PDF.pdf), we say:

‘To us, being a good steward means understanding how the companies we invest in, on our members’ behalf, affect the societies and environments around them, and encouraging them to operate appropriately day in day out, year in year out. We believe that corporate governance will remain sound if owners of shares take a strong interest in the long-term health of companies.’

Responding to consultations like this is an appropriate and expected means of delivering on this commitment to good stewardship. By participating in policy debates – in our capacity as a Trustee of a pension scheme with considerable assets under management – we have the chance to make a significant impact on the way companies are run.

This consultation comes at a time when average pay increases for workers in the private sector have been running significantly behind inflation. This contrasts to the very significant real terms increases in the pay of those leading Britain’s companies. The growing pay gap between top and bottom at Britain’s companies is a concern to many, particularly where the growing rewards at the top don’t reflect increased productivity or performance of the companies in question.

Responsibility for better corporate performance

NEST Corporation welcomes BIS’s consultation on revised remuneration reporting regulations for directors’ pay.

This consultation places shareholders at the heart of solving failings in the corporate governance framework for executive remuneration.

It does so by proposing improvements in transparency and accountability in directors’ pay and introducing a binding vote on companies’ executive pay policy.

We’re pleased to see the debate and consultation placing shareholders at the heart of reforms on executive remuneration. However, we believe there is a limit to what shareholders alone can do. They need support from strong and vocal non-executive directors – particularly independent ones – better constituted remuneration committees and improved succession planning so that the remuneration committee does not feel beholden to its current board composition. It’s also vital that the remuneration committee has clear and transparent terms of reference and is attuned to pay elsewhere and the wider concerns of the public, whose interests large shareholders often represent.

In recent years it has become apparent that boards meet and talk about their own pay frequently. In 2009 remuneration committees at FTSE All-Share companies generally met twice as many times as the audit committee met and three times as often as the nomination committee. In only one-third of companies did the audit committee meet more times than the remuneration committee.2

Meeting to discuss directors’ pay 13 times a year, as the data says some companies do, has the potential to distract from the principal purpose of the board: to discuss, set and execute a strategy to grow and develop the business while ensuring the company remains financially sound.

We believe that boards must look to change this balance. Pay should not take priority over other corporate matters. We have some concern that further disclosures on pay, metrics and a new binding vote on remuneration policy could move remuneration to centre stage at companies, displacing more important corporate governance and business matters. While we welcome shareholder empowerment, we’re mindful that a considered and principled approach to share ownership will ultimately deliver the best outcomes.

Six principles inform NEST’s approach to executive remuneration as a shareholder.

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2 Pensions Investment Research Consultations, corporate governance database, 2009
NEST principles on executive remuneration

An independent and considered process

We believe in an independent and transparent procedure for developing, recommending and monitoring director remuneration and payout. The committee’s remit should include the remuneration of individual directors and senior management. This committee should be wholly comprised of independent directors, including the company chairman, who we would expect on appointment to the company to meet independence criteria. We believe that the committee is more able to remain neutral and objective when the company chairman is not the chair of the remuneration committee.

The 2009 Walker Review on Corporate Governance sounded the right note in highlighting a growing disconnect between how remuneration for executive directors was arrived at and how things work further down the organisation. We support recommendation 28 of the Walker Review:

‘The remuneration committee should have a sufficient understanding of the company’s approach to pay and employment conditions to ensure that it is adopting a coherent approach to remuneration in respect of all employees. The terms of reference of the remuneration committee should accordingly include responsibility for setting the over-arching principles and parameters of remuneration policy on a firm-wide basis.’

Pay only what is necessary

Companies should pay no more than is necessary for the purpose of attracting, retaining and motivating directors of the quality required to run the company successfully. We believe that executives should not be paid more than is necessary to support these goals.

A healthy succession programme will help to keep control over remuneration and other terms and conditions. To us, succession planning is at the heart of long-term board effectiveness.

We believe the remuneration committee should consider the level of executive pay in the context of the individual, the company overall, and in relation to all employees. Broader still, the remuneration committee should be informed of pay levels in equivalent sectors and industries both private and public - and wider societal concerns.

Contract design should avoid excessive payments to departing directors regardless of their reason for leaving. Contracts should not entitle executives to significant compensation for early termination of their contract, including pension contributions. The compensation of independent directors should not risk compromising their independence or aligning interests too closely with those of management.

Aligned to shareholders’ interests

The remuneration committee should aim to align the interests, incentives and behaviour of directors with the interests of shareholders.

This should be a long-term approach that encourages sustained shareholder value and sustainable value creation. Doing so will help to ensure that the interests of shareholders and executives don’t become misaligned and that the company remains financially sound.

As a long-term investor we’re interested in safety and financial stability alongside performance so we can see no reason why a company’s credit rating, or other similar measures, should not be used in board pay structures, especially regarding clawback. We believe too that remuneration policies and structures should serve to reinforce the right corporate culture and moral compass.
A significant element of our asset allocation is invested in equities as we’re seeking inflation-plus returns on investment. However, we wouldn’t want to see that ‘plus’ pursued to such an extent that it endangers the ongoing financial soundness of the company. It’s the remuneration committee’s task to mitigate the risk of directors focusing on equity price performance at the expense of long-term shareholder return on capital and arrive at appropriate performance targets and metrics that encourage the right risk-taking and decision-making.

Nothing should encourage inappropriate risk taking at the expense of longer-term performance. For this reason we’re not in favour of annual bonus arrangements where the size is generous compared to longer-term performance arrangements. By long-term performance we mean at least three years and more usually five. All variable aspects of pay should be weighted towards sustained performance over the long term.

Incentive plans, where they are used, should clearly link to execution of the agreed corporate strategy. Performance metrics should link to key performance indicators (KPIs) identified to facilitate meeting the agreed strategic objectives.

We believe that a substantial proportion of remuneration should be paid on a deferred basis (a minimum of three years and preferably five). We’d welcome further research on the specifics but it feels right for over half of variable remuneration to be deferred when paid to executive directors. In cases where variable remuneration represents a particularly large part of total remuneration we believe that the portion deferred should be even higher.

A clawback policy is essential for cases such as performance rewarded in previous years later found to be based on erroneous financial reporting, or found to be as a result of regulatory infringement. We would expect to find clawback terms within the rules of the company bonus plan, long-term share schemes, and/or executive contractual terms.

We think executive directors and senior management should be encouraged to build up meaningful personal shareholdings in the companies they run. However, this should be just one part of any package and should be done in a way that does not incentivise directors to attempt to inflate the price of the stock. We support the idea of the remuneration committee setting a target level of share ownership for key senior employees. Unvested share-based incentives should not count towards any calculated number.

Externally and internally audited

External audit provides shareholders with the assurance that all information audited is fair, reliable and free from material error. It follows that external audit should also sign-off remuneration reports, including benchmarks used, the suitability of metrics and the calculation of performance.

Informatively disclosed

Disclosure provides assurance to shareholders. We believe that annual disclosures on remuneration should be meaningful, relevant, clear, transparent and understandable.

Dense and cluttered reports don’t serve shareholders or other users of reports and accounts. Good disclosure explains the link between remuneration and value-creation, performance, risk management and alignment with shareholders. Disclosure should include advisers used by the remuneration committee and their relationship and independence. We expect companies to explain the circumstances when they have applied clawback.

Approved by shareholders

We believe that companies should give shareholders an annual vote on remuneration. We believe too that there is more to the conversation than just a binary yes or no vote. Companies need to communicate with major shareholders on remuneration as an ongoing process. We would expect dialogue to cover policy development, the design of pay schemes and metrics, performance against metrics, major changes and the level of pay.
A significant weakness in the voting chain is that a vote withheld is not a vote in law. Investors casting an abstain vote often do so with meaning, yet an abstain vote remains a withheld vote in law. It’s regrettable that the meaning of an abstain vote is, to a large degree, lost.

We raise the issue here because several major shareholders cast votes to abstain on executive pay more than they vote for or against.3

The consideration of legislation to require companies to count abstentions as a vote in law would be welcome.

The introduction of similar recognition within the UK Corporate Governance Code would in our view be a positive step forward. The Financial Reporting Council could consider introducing a best practice recommendation for companies to recognise abstentions based on a comply or explain approach. The Stewardship Code could then call on signatories to consider not using an abstain vote at companies that fail to attach meaning to withheld votes cast.

**Our response on consultation questions**

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.

The introduction of a binding vote on a company’s pay policy is most welcome and we congratulate BIS for taking this step. We believe a binding vote will empower shareholders to vote intelligently and encourage companies to discuss remuneration more widely with shareholders before company AGMs. We’re generally supportive of a triennial vote, unless there are changes to the policy in intervening years, which will encourage companies and investors to think longer term.

The draft regulations set out by the government look to bring simplicity, succinctness and transparency to what are often dense, cluttered and complex remuneration reports. We’re particularly pleased to see the introduction of a standardised approach so shareholders are able to make comparisons across companies more effectively.

We’re in favour of seeing a single total figure of remuneration for each director annually and see merit in the table format highlighted on page 23 of the consultation document that depicts a breakdown of this information. A table of standard measures will make it easy for companies to regularly divulge this information and for shareholders to understand how each director is remunerated and track progress over time.

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?

We consider that introducing a table will be useful to clearly set out key elements of remuneration. There are significant benefits for shareholders in seeing a familiar format and accepted standards in disclosing the basics of the remuneration strategy.

The ‘Purpose – Operation – Opportunity – Performance Metrics – Changes’ rubric is welcome and will help shareholders make clearer comparisons, especially at the height of AGM season.

We generally support a principles-based reporting framework. We agree that there should not be specific disclosures prescribed for each element of pay as we recognise that each company’s pay policy will differ to suit their own business model and strategy.

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3 TUC Fund Manager Voting Survey 2011, pg 54
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.

We think the style of the graph on page 18 of the consultation document is a good approach. We expect that proxy service providers will lift the style and set it against a peer group and sector context for their clients to further illustrate relative positioning.

The percentage breakdown of total remuneration is a useful marker that will enable shareholders to easily analyse remuneration reports and the amount awarded from one year to another. This is especially relevant during the spike of the AGM voting season when the resources of investors who are keen to apply high standards of stewardship to their investee companies are stretched.

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.

We see merit in companies setting out their approach to exit payments in the policy report. We see a need for shareholders to have sight of the exit payment approach in the policy report and how these are calculated for each director.

Often when a director suddenly leaves there is little transparency around exit payments regardless of the reasoning behind the departure. Shareholders should have access to how exit payments are calculated in all circumstances. The most common examples of payments for failure relate to the application of discretion, usually in an upwards direction, by the remuneration committee and event-driven payments such as those triggered by contractual termination or a change in control.

The levels of discretion non-executive directors have in determining whether an executive is a good leaver or otherwise can be problematic. Given the uncertainty regarding the nature of the circumstances prevailing when a director leaves a company there is tremendous potential for significant reward for failure as things stand.

We support greater disclosure relating to the nature of departure and how this equates to the payments made with a view to offering comfort to shareholders. Additionally, further information on how discretion has been applied in relation to mid-cycle-performance share awards when pro-rating is applied for time and performance would aid transparency.

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 consider the involvement of employees in the decision-making process of remuneration policy to be an interesting concept and would be interested in seeing examples of how this would work in practice.

We expect the remuneration committee to understand the pay levels of employees and set the policy for the company in a holistic way. Directors’ pay is just one part of a company’s remuneration policy and we believe that this should be put in context. If operating effectively the remuneration committee should take into account all data and be mindful of excessive pay differentials across the company.
We think that employee salaries should be considered when setting directors’ pay, especially against the backdrop of companies that have adopted the living wage and the High Pay Commission’s work on pay ratios. This is a method already implemented by some remuneration committees, but which could be given greater value in order to attune remuneration packages more to the business and its employees.

We believe that the remuneration committee should be populated by fully independent legally accountable non-executive directors. An employee remuneration committee that reports to the board might be one way of implementing employee opinion.

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 believe the specific disclosures set out in the table are appropriate measures to help determine a single total figure. MM&K/Manifest Total Remuneration Survey includes the measures in question in their methodology and we’re very much in favour of it.

The key is detailing the total amount realised in the relevant financial year against the potential total that could have been awarded based on scheme caps. The multiple elements that comprise total remuneration can be open to creative interpretation and a standardised approach accompanied by justification would help investors making comparisons.

The current position is that estimating total remuneration can be an extremely protracted and demanding exercise and figures are rarely comparable between companies. A logical distinction is between fixed and variable elements of remuneration. ‘Golden hellos’ received or ‘golden goodbyes’ should be detailed in the same section.

The inclusion of historical pay and projected pay for upcoming years would also be a useful addition here and could help companies explain their remuneration policies.

Overall, we feel that the specific disclosures set out in the table are acceptable. It’s important to bear in mind that companies are not being capped on the amount of information they can provide, but should include further explanation or definition if necessary to explain their individual remuneration schemes.

9: The government proposes that clawback is recorded as part of the single figure. Is this a practical and informative approach?

Clawbacks impact pay, and therefore we believe they should be recorded as part of the single figure on remuneration and agree they should be subject to the same levels of transparency as other elements of pay. To avoid confusion and limit discrepancies we’d prefer to see actual values that have vested before the date on which the remuneration report needs to be signed off.

Where clawback does occur companies should be encouraged to set out the circumstances and factors that affected the decision in supporting disclosure.
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?

It’s important that shareholders are able to see a clear link between the pay awarded to directors in the reporting period and previously agreed performance measures. However, we’re concerned that greater annual disclosure of performance against metrics may lead to more focus and time spent on performance numbers giving increased weight to performance-related pay, which we don’t necessarily advocate.

We appreciate the benefits that increased transparency brings, but encouraging companies to publish full details of performance metrics could detract shareholder attention away from other important aspects of the board or business strategy. In any case, major shareholders will be talking about performance metrics in their broader discussions with the company.

As long-term investors, we’d like to be able to see performance metrics that help us form a long-term view of businesses. These metrics could also help demonstrate a stronger alignment between remuneration and the sustainability of the company.

On the topic of discretion, details of how often discretion has been used in the past would provide further context for shareholders.

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. Scheme interests awarded to directors during the reporting period should be disclosed at face value. To clarify, we understand face value to mean share price at grant date multiplied by number of shares granted expressed as percentage of salary.

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?

We have concerns about the use of total shareholder return (TSR) as a proxy for executive pay. We don’t believe TSR graphs are an effective way of communicating to shareholders how effectively pre-agreed strategies are delivered as good financial and strategic measures.

In addition, TSR is affected by drifting valuations and external economic and industry factors that distort the measurement of management’s added value. The use of TSR as a proxy encourages short-term thinking and does not solve the issue of excessive executive pay.

An article in the Rotman International Journal of Pension Management identifies the complex issues associated with the ‘unconsidered use’ of TSR as a metric to represent the gains (or otherwise) in shareholder wealth. Not all TSR is created equal. The article suggests that other measures, such as economic profit (EP), return on invested capital (ROIC), and future value (FV), need to be introduced to effectively interpret the quality of TSR.

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4 Total Shareholder Return (TSR) and Management Performance: A Performance Metric Appropriately Used, or Mostly Abused? Rotman International Journal of Pension Management, Roland Burgman and Mark Van Clieaf, Fall 2012
We believe many of the metrics used in determining remuneration policies disregard the safety and stability of the company and focus solely on the upside.

We believe that the credit rating of the company should also be considered alongside its growth and development to help determine CEO pay. Including bondholder perspectives within the thinking process of companies’ corporate governance arrangements heralds an important restoration of interest in prudence, strength and security.

As a long-term investor we’re interested in safety and financial stability alongside performance. We wouldn’t want to see performance encouraged at the expense of financial soundness, which is conceivable where performance-related pay is a large portion of total remuneration. We also support including other non-financial performance metrics in setting long-term executive pay, such as customer satisfaction, decision-making, reputation, diversity and board composition.

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?

We believe that audit and assurance has an underpinning role to play in ensuring that the information disclosed by companies to shareholders is fair, reliable and free from material error.

That said we believe there is scope for some of this information around remuneration to be audited internally. This will allow for the measurement and monitoring of performance against metrics designed by the remuneration committee. This would make the audit and remuneration committees more directly accountable to shareholders.

By having all performance metrics externally audited there is a concern that audit work could become overly preoccupied with remuneration and will only serve to move performance-related pay to the top of priorities to be discussed by boards.

As long-term investors we are keen on companies integrating sustainability metrics into executive incentives and welcome the growing number of companies that choose to instil such measures at the highest levels. Audit and assurance of these measures will make sure that pay is based on measures that are verified and reliable.
New Bridge Street
Executive Pay: Revised Remuneration Reporting Requirements Consultation Response Form

Name of respondent

Jonathan Hutchings, Andrew Page and Helen Mussen
New Bridge Street (an Aon Hewitt company)

Please state whether you are responding as an individual or representing the views of an organisation by ticking the appropriate box below:

| Business or business representative organisation |
| Investor or investor representative organisation |
| Government or regulator                           |
| Lawyer                                           |
| ✓ Remuneration consultant                        |
| Other professional advisor                       |
| Trade union or employee organisation             |
| Individual                                        |
| Other (please describe)                          |

We set out below our response to the questions posed as part of the Government's consultation on proposals regarding the reporting of directors' remuneration. At the end of this response, we address the questions of interim regulation and 'anti-forestalling'.
QUESTION 1: The Government seeks comments on how well the draft regulations give effect to the policy set out in this consultation document

The stated policy objective of the Government is to give shareholders more leverage on executive pay and encourage improved pay discipline. It is designed to enable shareholders to promote a stronger link between pay and performance in order to prevent rewards for mediocrity or failure, while still allowing for exceptional performance to be rewarded.

We believe that the draft regulations generally represent a workable approach to reporting and shareholder voting on executive pay. We believe that, as they currently stand, they represent a more practical and flexible set of rules than previous iterations of the consultation, helping to address some of our previous concerns about trying to apply a 'one size fits all' approach to an area which is as variable as the companies which will be subject to it.

We believe that, at least in theory, the proposals regarding shareholder voting rights are suitable to empower shareholders whilst not overly restricting companies’ ability to act commercially and adapt to future developments. However, this will very much depend on the extent to which investors are willing to tolerate some flexibility over the pay policy – we suspect that this may vary from house to house, with significant influence being exerted by large investor representative bodies such as the ABI and RREV. In our view, a pay policy should inherently allow for some potential future unknowns, and we would hope that shareholders will allow for companies to set policies which are not be too restrictive or rigid, the unintended effect of which could be for a frequent need to return to shareholders to seek approval for changes to the policy to cater for various 'one-off' issues arising.

We hope that, in response to the increase to their voting powers, investors will take their new voting rights seriously and will not be inclined to apply a rigid set of voting rules to the inherently diverse set of circumstances which may shape a company's policy. We note that due to the high level of additional workload that this will place on investors (see response to question 2) – for example in the inevitable increase in advance shareholder consultation, that this could pose a risk, particularly in the first year or two of the regulations when every company will be required to put their policies to a binding vote.

As regards the draft reporting regime, we consider that the spirit of the draft legislation will generally help to improve the clarity of remuneration reporting. We welcome the additional transparency over two key areas in particular, namely (i) the link between corporate strategy and pay strategy and (ii) a much stronger justification of the link between pay and performance achieved. We note that in both these areas, the quality of the disclosure currently varies widely between companies. We welcome the lack of a proposed single prescriptive approach in certain areas, which helps to recognise that it will not always be possible to apply a 'blanket' approach to an inherently diverse area.

We note that there are some points of detail within the covering commentary and the draft regulations which are not internally consistent or which may not, as currently drafted, give practical effect to the
Government's intention. Where we feel that this is the case, we have identified the key points within our response to this document. We also feel that there are areas which could be clarified further, and where this is the case we also flag these.

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

In the first couple of years following the introduction of the new legislation, there will inevitably be a cost to companies (we interpret 'costs' to include both financial and non-financial such as time, administration and resource constraints). We do not aim to quantify such costs, but some of the areas in which we anticipate that there will be increased time and expense include:

- There will be a significant time and financial cost to companies in redrafting their directors' remuneration reports.

- There are likely to be additional audit fees in respect of the revised audited sections of the implementation report. We also note that whilst not formally audited, the bulk of the narrative content within a DRR is also reviewed by the company's auditors, and this will also incur additional time during the transitional period.

- We anticipate that most companies will wish to carry out a prior consultation with their major shareholders in advance of the first binding vote in 2013. Given the high number of companies which are likely to be doing this, we would expect each consultation will need to be submitted with around two months to complete, so this will likely involve a significant time burden on both companies' and investors' resources.

- Many companies are likely to either partially or fully attempt 'early implementation' of the proposals in 2013, and so we would expect that the additional work will begin virtually immediately. Whilst this may help companies to manage the time and expense of the process over a longer period of time, it should also be noted that in this transition phase, there will also be a period in which the reporting will straddle two sets of legislative requirements, which may also compound the work required somewhat.

- There will be additional administration involved with the changes to the shareholder voting process. As well as the modest changes required by all companies in ensuring that the AGM resolutions are amended suitably, the main costs would be born by companies which either fail one or both of their votes or receive a 'significant' number of votes against.

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?
We support the format of the summary table, variants of which are already produced by many companies. We consider that including this as a required disclosure will help to make the communication of remuneration policies simpler and more transparent. That said, we suspect that most companies will wish to continue to provide a supporting explanation of their remuneration policy, and that this level of detail will be expected by investors in order to make an informed voting decision.

We note that this table is likely to be an important reference point for investors when they are considering their vote on the Policy Report, providing as it will a concise summary of the policy. We therefore consider that it is appropriate for the legislation not to prescribe the specific disclosures relating to each element of pay, on the basis that each company is likely to have a different rationale for following a particular policy and it is important to allow flexibility around which to communicate this to investors.

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 profits, 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.

Taking each item referred to in the question in turn, our comments are as follows:

- **Service contracts disclosures**: we believe that the proposed disclosures will be significantly more transparent than currently, and will enable shareholders to gain a much more informed view on the potential termination payments which could be received by executives. We feel that including this disclosure as part of the vote on policy is significantly more practical than the previous proposal to have a separate shareholder vote on actual termination payments as and when they occur.

- **Pay scenarios**: we feel that this type of chart can be very informative in showing how the remuneration package varies by different levels of performance, albeit with the caveat that rarely will all scenarios pay out in line with the theoretical levels (for example due to factors such as share price and the timing of rewards between short-term and long-term elements). We also note that many companies present similar charts currently, so for many companies this will not be a new disclosure. However, we suggest that some clarification is provided to the draft legislation and covering commentary, as there are some practical questions which arise, including:

  1. The terminology is rather 'loose' in places. In particular, on page 17 of the consultation document, and in the draft legislation itself, the reference is to showing payouts at 'below-threshold, threshold and maximum' performance. However, in the draft chart on page 18, the chart shows 'below-threshold, target and maximum'.
2. Companies generally do not consider 'threshold' and 'target' to be the same thing. In general, companies define 'threshold' as the point at which variable pay may start to pay out (so, for example, the 'start to earn' point for a bonus might be zero so a chart showing threshold payout under the bonus might indicate zero payout here). 'Target' typically represents a level of performance which is higher than this – i.e. a good level of performance. Therefore, the final legislation needs to be clear whether 'threshold' or 'target' is intended, as otherwise there could be considerable confusion and differences in the comparability between companies. (Our view, for the record, is that on-target performance would be more meaningful than threshold as this is likely to represent 'good' performance for an average company).

3. The draft chart (page 18) is technically misleading as it suggests that (i) that the proportions of the package would not vary with each level of performance, which is clearly not the intention (as generally performance pay percentages would increase with improved performance) and (ii) absolute levels of salary and pension would increase in line with performance, when these should, in fact, be 'fixed' elements.

- **Percentage change in profit, dividends and overall expenditure on pay**: we question how insightful this disclosure will be given that the definition of 'pay' within the draft legislation appears to be total employee costs in the company, of which directors' pay is normally only a very small proportion (with that proportion varying by company type and size). We would also suggest that an analysis of how these figures have moved over, say, a three to five year period, may be more meaningful rather than looking at a single year's changes in isolation which might be misleading. Finally, we would also raise the point that the proposal to include this within the Policy Section of the report seems rather odd, and it would seem more logical to place this in the Implementation Report, seeing as it is based on actual outcomes.

**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.

Taken together with the extra information on termination provisions within service contracts, we consider that disclosing principles-based guidance is more palatable than the previous proposal requiring shareholder approval for amounts above a certain percentage of salary cap (which we were concerned could be both practically unworkable and could have given rise to unintended consequences).

That said, we consider that, for many companies, this disclosure is likely to be the one which they will find the most challenging to adapt to. The key challenge will be to set out with any meaningful precision the potential principles on which they will determine exit payments given the vast range of potential exit reasons which might actually arise. In our experience, the circumstances surrounding terminations are
rarely capable of simply classification, and in many cases the company will wish to balance commercial considerations (e.g. restrictive covenants) alongside its legal obligation. However, this will always be highly specific to the circumstances of any termination.

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 it is appropriate that the legislation refers to whether employee views were sought, rather than actually requiring employee consultation to be conducted in every company. We note that many remuneration committees use a range of different reference points to determine remuneration policy, and this appears to give more weight to one.

Whilst the principle of employee consultation is admirable, the actual process may be very difficult to execute effectively and could be potentially very costly to companies (for example, in devising ways to engage with an internationally diverse group of employees, and how to interpret and use the results which are obtained) which may not necessarily lead to any particularly insightful conclusions.

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 cycles. Do the specific disclosures set out in the table on page 24 of the consultation document correctly give effect to this intention?

There is no 'perfect' way of calculating the single total figure, and believe that provided a consistent approach is taken from company to company, this is broadly acceptable. However, the method could give rise to some potentially anomalous outcomes, for example where companies operate two performance targets within a long-term incentive plan, both of which end in different financial years (this is quite common, for example, where companies operate a plan with a financial target ending in the reporting year and a total shareholder return target ending on the vesting date).

We also note that the use of an estimated share price in cases where the performance period ended in the year under report may not reflect reality.

An alternative possibility could be to all value long-term incentive payouts based on their value on the vesting date, which would mean that all scheme interests relating to a particular award would be captured in the same year, and also that the share price would reflect the actual value which could crystallise to the executive at the point of vesting (rather than using an estimated share price).

QUESTION 8: The Government proposes that the application of the HMRC methodology to work out the value of defined benefit pension schemes. Is this a practical and informative approach?
Please refer to the separate response submitted by our colleagues within Aon Hewitt pensions.

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

In the event that companies invoke a clawback clause, the proposal to include the clawed-back amount as a deduction to remuneration in the single figure in the year that the claw-back is taken (with appropriate explanatory notes), appears to us to be the most appropriate approach.

**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 note that it is already a matter of best practice for companies to retrospectively disclose the performance targets which were set for the bonus, and how executives performed against these. We do not think that full retrospective disclosure should pose particular problems for most companies. Indeed, we note that many companies already disclose sufficient information so as to fully comply with this requirement.

In some unusual cases, companies may feel that even retrospective disclosure of the performance targets may be commercially sensitive (for example, if the targets are highly bespoke and form one part of a company's long-term strategy). Flexibility could, perhaps, be provided by allowing a 'comply or explain' approach within the legislation, under which companies would need to justify why they felt the targets were too commercially sensitive to retrospectively disclose in full. In such instances, we suggest that companies should still be encouraged to disclose as much detail as possible on those targets which are not as commercially sensitive.

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

Please refer to the separate response submitted by our colleagues within Aon Hewitt pensions.

**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?

We consider that this is a suitable approach, noting that this method is consistent with the current reporting requirements and that other elements of the remuneration report should make clear how scheme interests may vary with performance. For the audited parts of the report, we believe that it would be misleading to disclose anything other than face value (for example, whilst using expected values can be very useful in certain circumstances, such as a benchmarking tool to compare from company to company, it is inherently an estimate which is unlikely to reflect what an executive will ultimately receive from that award).
We would, however, suggest that the definition of 'face value' is clarified. For the majority of companies, face value is defined as the maximum number of shares over which awards are made, which are then subject to performance. However, a few companies use a different terminology under which the maximum potential number of shares may be above the 'face value'. In order to make reports more comparable from company to company, it would seem sensible to have a single definition of 'face value' as being the maximum number of shares which would vest if all performance conditions are met, which may help to avoid any confusion.

**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.

We think that the proposed approach to disclosure of directors’ interests appears sufficiently clear and informative, and is an improvement on the current approach in which directors may have interests in their company’s shares across a range of different arrangements, all disclosed within different parts of the directors’ remuneration report.

**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 TSR and CEO pay are the best proxies for company performance and pay? If not, what measures would be more appropriate?

Whilst we appreciate the rationale for such a chart, we believe it would be more appropriate for the Remuneration Report to form a clear and detailed analysis of pay and leave the question of performance to the other parts of the annual report. To attempt to produce a single condensed figure of ‘performance’ within one measure is to unduly simplify a complex picture and is potentially misleading. Assuming such a comparison remains, however, we have the following observations:

- **Total Shareholder Return as a proxy for "Performance":** Due to TSR's 'all encompassing' nature, it is used by many companies to measure performance within their share plans, and is generally seen by investors as being a more rounded measure than financial performance. That said, some companies may also elect to voluntarily present other internal measures of performance over time (e.g. their main KPIs used within the business), in order to supplement the ‘performance summary’, which may help to support the link between pay and performance.

- **CEO pay as a proxy for "Pay":** We think that although this is theoretically the best proxy for pay, in practice there may be numerous underlying inputs to the CEO pay figure which could distort it and may make it less insightful than hoped. For example, where there is a change in the CEO, it may well be that there are one-off items of pay which are not reflective of on-going policy (e.g. termination or joining payments). Whilst we accept that the objective of the legislation is to reduce the incidence of these, it should be noted that they likely relate to legacy contract negotiations when
the incidence of such items was commonplace and we would be concerned if this influenced shareholder votes on the current year implementation of policy. Furthermore, when a new CEO joins there will also likely be a time lag in their total pay due to not having any long-term incentive awards vesting in their first few years at the company.

Since no measure will be perfect to capture the essence of the Government's intention, it may well be that companies will wish to provide explanatory notes to the chart setting out reasons for any significant movements.

Some additional comments and points of detail that we have in relation to this chart are:

- In our view, ten years is a very long retrospective time period to look back on. We question how informative this would be in helping shareholders make a judgment on the current year's implementation of policy. Presumably the intention of the graph is to demonstrate how pay and performance are aligned over a period of time, but in our view, a five year analysis should be sufficient for this. The executive remuneration landscape has changed very significantly over the last ten years, and to judge companies based on what may include a range of pay policies over this period, when in fact the aim of the directors' remuneration report is to assess a future pay policy and the implementation thereof in the last financial year, could in our view be misguided.

- From a technical perspective, we do not consider the draft chart shown in the consultation document is particularly meaningful. In order to effectively show a comparison between two measures (both of which are measured in different 'currencies' (i.e. TSR is a percentage return and CEO pay is an absolute figure) over a period of time, the start point for the chart should rebase both items to the same point, as illustrated by our example below:
When first producing this chart, it may be very time consuming for companies to gather the data to produce retrospective ‘single figure’ CEO data for ten historic years given that the calculation of the single figure has not previously been required. This could particularly be the case where executives are or have been members of defined benefit pension arrangements. Not all companies may be well equipped to prepare this volume of data (e.g. due to legacy record keeping).

**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?

We do not think it would be necessary to audit any other sections of the report, although would expect that most companies would wish to have external assurance that the figures produced in their charts (e.g. the TSR versus CEO pay chart) are correct.
Supplementary response points outside of consultation questions

Request for clarification of the application of the transitional provisions set out in Section 64 of the Enterprise Regulatory Reform Bill.

1. Section 64(2) disapplies the provisions of the new Chapter 4A inserted into the Companies Act 2006 (provisions establishing the need for shareholder approval of remuneration payments to directors), to payments made before the earlier of two dates. For a company with a year end of 31 December, that date will be 1 January 2014.

Section 64(3) gives a similar disapplication for remuneration payments made pursuant to obligations arising under an agreement entered into before 27 June 2012 (provided it has not been amended since that date).

Using the example of a company with a 31 December year end, the apparent result of these two subsections is that agreements made during the period from 27 June 2012 to 31 December 2013, may or may not be subject to the provisions for shareholder approval in Chapter 4A, depending on whether the payments have been 'made' before 1 January 2014.

'Remuneration payment' is defined in the legislation as:

'any form of payment or other benefit made to or otherwise conferred on a person as consideration for the person being, or agreeing to become, a director of a company, other than a payment for loss of office.'

It is not clear to us whether, in the context of Long Term Incentive Plan (LTIP) Awards comprising a right to acquire shares after several years and which are subject to performance conditions and continued employment, this definition captures the grant of the award or the time when the shares are delivered to a director. Clarification of this is important for understanding the transitional provisions.

Continuing with our example of 31 December year end, the legislation should clarify the following points:

- Where a director is granted an LTIP award between 27 June 2012 and 31 December 2013 and the award is due to vest after 31 December 2013, is that award subject to shareholder approval of the directors’ remuneration policy:
  1. before the year in which the award will vest – because the vesting represents payment and therefore can only vest if it is consistent with the approved directors’ remuneration policy; or
  2. not at all – because the ‘remuneration payment’ was at the time of grant?
Where a director has been granted an LTIP award before 27 June 2012 but the performance conditions attaching to the award are changed after that date either:

a) on or before 31 December 2013; or

b) after 31 December 2013

are the new performance conditions subject to shareholder approval in either or both of these scenarios by virtue of section 64(4)?

We have a concern that LTIP awards being made now are caught by the new Regulations even though granted as binding contracts before the Regulations came into force.

We would suggest that the principles for LTIP awards should apply equally to any deferred payment of cash or shares.

2. There seems to be some uncertainty over the position where a company fails to obtain shareholder approval of its remuneration policy. If there has not been any previous approved policy to fall back upon, such as before the Act comes into force, can the company continue to determine the policy applied as it sees fit, until such time as approval is obtained? The legislation should clarify whether in this scenario remuneration payments made to directors after the date fixed by section 64(2) will be repayable to the company if they are not approved by shareholders at some future date?
Directors’ Pay: consultation on revised reporting regulations. Response form.

The closing date for this consultation is 26 September 2012

Please return completed forms to:

Barry Walker
Executive Pay Consultation
Department of Business, Innovation and Skills
1 Victoria Street
SW1H 0ET
020 7215 3930
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection

In the interests of transparency, the Department may choose to publish the responses to this consultation. Please state clearly if you wish your response to remain confidential.

Please note also that information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.
# About You

<table>
<thead>
<tr>
<th>Name: Jo Chattle</th>
<th>Organisation: Norton Rose</th>
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<tr>
<td></td>
<td>Norton Rose is a leading international law firm. With more than 2900 lawyers, we offer a full business law service to many of the world’s pre-eminent financial institutions and corporations from offices in Europe, Asia, Australia, Canada, Africa, the Middle East, Latin America and Central Asia. We are strong in financial institutions; energy; infrastructure, mining and commodities; transport; technology and innovation; and pharmaceuticals and life sciences.</td>
</tr>
<tr>
<td></td>
<td>Norton Rose is the business name for the international law firm that comprises Norton Rose LLP, Norton Rose Australia, Norton Rose Canada LLP and Norton Rose South Africa (incorporated as Deneys Reitz Inc) and their respective affiliates.</td>
</tr>
<tr>
<td>Email: <a href="mailto:jo.chattle@nortonrose.com">jo.chattle@nortonrose.com</a></td>
<td>Address: 3 More London Riverside London SE1 2AQ</td>
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# I am responding on behalf of (please tick):

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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.

Generally we consider that the proposed approach requiring that companies disclose and seek shareholder approval of the directors’ future pay policy and the implementation of such policy will provide shareholders with greater leverage on executive pay.

We welcome the objective of seeking to make disclosures consistent across different companies and consider that the requirement to produce an implementation report in the manner specified in the draft regulations will facilitate this. However, we doubt that the proposed implementation report, combined with the future pay policy, is going to lead to less information being produced or more concise disclosure. In particular with regard to the future pay policy, companies will be concerned to provide sufficient detail on the basis that they will need to be able to demonstrate that they are acting within the parameters of their policy. In some areas the exact parameters for the information required to be included in the future pay policy are not entirely clear. For example is it sufficient for a company simply to acknowledge that they have not sought any employee input into the pay policy? This would seem to be sufficient under the draft regulations. It will be helpful to see the best practice guidance that is to be developed setting out the level of detail and information to be reported as early as possible so that companies and their advisers have as much notice as possible of what should be incorporated into their remuneration reports.

However we are concerned that the new voting regime, under which shareholders either approve or do not approve the future pay policy, is a fairly blunt conduit for shareholder influence and will not necessarily facilitate effective influence at the detailed level required when dealing with complex structured remuneration packages which comprise many different elements some of which may be supported by shareholders and some of which may be a cause of concern. It is also not entirely clear from the draft regulations (and the proposed amendments to the Companies Act 2006 in the Enterprise and Regulatory Reform Bill) which pay policy will apply if the shareholders fail to approve the pay policy put before them. Will the company be able to fall back on an existing pay policy even if it is one which has not been previously approved? This could be the case if the first pay policy put to shareholders is rejected - at that point there will be no “approved” pay policy to fall back on. Will companies be expected to revise that pay policy quickly and call another general meeting to approve it so that the company has an “approved” pay policy in place? In addition we are not clear from the draft legislation what would constitute a revision to the pay policy such that it would require further shareholder approval within the three year period. Who will determine whether there has been such a revision?
Question 2: What costs will companies face in adjusting to these revised reporting regulations?

There will be initial increased costs, in particular with respect to producing the future pay policy, however we would anticipate that year on year unless companies are changing their pay policy their costs will remain relatively level.

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?

We understand that the table is a framework within the future pay policy and as such companies will be required to operate their remuneration strategy in accordance with the parameters of the framework.

Our concern is that a table setting out information at a high level may leave companies in an uncertain position with regard to their flexibility. For example, does the table need to set out discretions or policy with regard to exceptional circumstances?

As companies will be obliged to operate within the parameters of their stated future pay policy (or otherwise they will need to seek separate shareholder approval), there will be a desire to include a level of detail which we believe is at odds with the requirement for only a high level summary table. We anticipate that in practice companies may adopt a summary table but include lengthy and detailed notes.

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.
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.

Other than in respect of long term incentives, it is unusual and indeed commercially undesirable for companies to pre-determine good and bad leaver scenarios since it is difficult for companies to anticipate every leaver eventuality. For example, an employee may fall within the concept of a “bad leaver” and yet it may be in the company’s interests to ensure a good settlement to secure post termination restrictive covenants and protect the company’s business interests. This may prompt companies to adopt a very broad and generic exit payment policy to retain flexibility and thereby defeat the objective of this disclosure provision.

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.

As drafted we believe that it would be possible for a company to state that no employee views have been sought on the remuneration policy and that there will be no further obligation on the company to seek employee views. Whether a company will do so is therefore likely to depend on existing work force representation and how that is accommodated by the company in any decision making process.
**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?

Including deferred bonus awards at face value is contrary to the principle that the figure reflects actual pay earned since these awards represent potential pay receivable subject to conditions which may or may not be achieved in the future. These amounts should be included at the time of eventual vesting and at the vested value at that time.

**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 agree that it is difficult to choose a methodology to calculate the cost to a company of providing defined benefit pensions to directors. This is because the true cost depends on factors including the investment performance of the pension scheme’s assets and will vary according to factors such as when the benefits are paid or secured. This is an issue which arises regardless of the chosen method of calculation. However for the purposes of simplicity the HMRC methodology appears preferable primarily due to it avoiding the need for further detailed administrative calculations to be carried out each year in respect of each director.

Despite this it should be noted that the application of the annual multiplier of 20 to the accrued benefits is a very simplistic way to assess the value. This method only takes account of the “basic” benefits accrued by the director over the course of the year so would not take account of other benefits such as spouse/dependant pensions deferred pension revaluation increases to pensions in payment and enhanced early retirement or ill health pensions. We note that the use of 20 as the annual multiplier rather than 16 is intended to go some way towards mitigating this issue. However the multiplier should be kept under review particularly in light of the on-going worsening of annuity rates (and the resultant increasing true cost to companies to provide these benefits).

In addition the inability of the HMRC methodology to take account of these “other” benefits could give rise to the possibility (indeed likelihood) of directors being remunerated significantly more than is disclosed. For example deferred pension revaluation and increases to pensions in payment could be set at rates which are significantly higher than those required by pensions legislation. Whilst a director’s basic pension would be as disclosed this gives rise to the potential for the pension to increase significantly once the director has left office or retired.

To address this issue we suggest that companies be required to disclose
these “other” benefits where they exceed certain levels. For example the policy report could include statements setting out (i) the levels of deferred pension revaluation and increases to pensions in payment where these are greater than 2.5 per cent per year or (ii) the level of the spouse’s pension where it exceeds 50 per cent of the director’s pension. This information could be included in the supplemental information to be provided alongside the single figure table.

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

Clarification is needed as to whether the amount is disclosed on a gross or net of tax basis. On the basis that the value of benefits received is disclosed on a gross basis the clawback amounts disclosed should reflect the original gross benefits to which they relate and regardless of whether or not the actual clawback amount is net or gross of the related income tax on the original benefit.

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 understand from our clients that in most cases of short term awards this would be highly commercially sensitive.

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

As set out above in our response to Question 8 it is likely that the disclosed pensions figure will not take account of pension benefits other than a director’s “basic” pension. This issue would not be addressed by the additional statements that it is proposed be made alongside the single figure table. As also set out above our recommendation in relation to this issue would be for additional benefit information to be provided in the event that the “other” benefits exceed certain levels.

We do not consider that the requirements of paragraph 10(2) of the Schedule to the draft regulations is clear in relation to the additional pensions information that must be provided. This paragraph requires disclosure of the director’s “accrued benefits under a scheme as at the end of that year assuming a normal retirement date”. It is not clear whether this figure should take account of deferred pension revaluation between the end of the year and actual normal retirement date (and at what assumed rate this should be) or
whether the figure should represent the pension that would become payable if the director’s normal retirement date was at the end of that year.

In addition paragraph 10(3) of the schedule requires disclosure of “the total value of any additional benefit that will become receivable to a director in the event that that director retires early”. We assume that this is intended to include any enhancement payable on a director’s early retirement pension (such as non-reduction or limited reduction of the pension to reflect the longer period over which it will be paid) although this is not clear. On the basis that this is the intention it would be useful for this paragraph to include an indication of the basis on which it is anticipated any such enhancement should be valued. This would be consistent with the requirements relating to the disclosure of the value of pension accrued over each year which sets out the method of valuation.

**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?

We believe that disclosure at face value is most likely to achieve consistent and comparable reporting between different companies.

**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.

**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 total shareholder return (TSR) is the performance measure against which the company determines its long term incentives then this is an appropriate proxy. However, for those companies whose shareholders approve performance targets relating to other indicators such as earnings per share, it would be more meaningful and helpful to plot pay against the achievement of
these measures.

Absolute TSR is also a simplistic measure of performance and companies which use TSR almost always elect to measure on a comparative basis within relevant peer groups.

**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?

We believe not.
Old Mutual plc (Remuneration Committee)
Directors’ Pay: consultation on revised reporting regulations. 
Response form.

The closing date for this consultation is 26 September 2012

Please return completed forms to:

Barry Walker
Executive Pay Consultation
Department of Business, Innovation and Skills
1 Victoria Street
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Confidentiality & Data Protection

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<tr>
<td><strong>Name:</strong> Russell Edey - Chairman of the Remuneration Committee</td>
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<tr>
<td><strong>Organisation:</strong> Old Mutual plc</td>
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<tr>
<td><strong>Email:</strong> send via <a href="mailto:Kevin.stacey@omg.co.uk">Kevin.stacey@omg.co.uk</a></td>
</tr>
<tr>
<td><strong>Address:</strong> 4th Floor Old Mutual Place, 2 Lambeth Hill, London EC4V 4GG</td>
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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.

Regulations seem be generally reasonable and to practically give effect to the policy other that where indicated otherwise to questions below.

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

Given that there is reasonable lead time to the change, and as Remuneration Reports have evolved and changed over time, we do not see any substantial problems or cost implications to these proposals.

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?

This is similar to what we already provide in our remuneration report but with some added requirements. We do not see anything in this that is overly onerous or difficult to provide.

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.

This information is reasonably practical and not difficult to provide, however comparison of pay to a single profit number in a complex long term (life Insurance) business may lead to simplistic interpretations of performance. Some additional measures of profitability such as a return on capital may be needed for different types of business or where there have been changes to the capital of the company and longer term trend would probably be more relevant to the analysis than a single year result.

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.
This seems a fairly straightforward requirement for Old Mutual which currently only has UK based Executive Directors. If Directors were employed in other countries the implications of local norms and legislation would make this more difficult and challenging.

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.

For an internationally dispersed group of around 50,000 employees, mostly not in the same country as the executive directors, general consultation with employees on executive pay is impractical. Some level of assessment could be undertaken by subsidiary remuneration committees or by adding questions to employee surveys but it seems unlikely that this will elicit meaningful reliable information.

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?

The proposed disclosures reflected will give effect to the intention but, although it provides simplicity and consistency, this approach does not fully correlate pay outcomes to the period to which performances was determined. Getting a better correlation with long term outcomes would require a more complicated approach, such as averaging (say over 3 yrs) the value of LTIP vesting.

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 do not use defined benefits pensions so have no strong view on this. It seems practical to align with HMRC though. That having been said the current reporting requirement is very different and looks at transfer values which may be a better reflection than a fixed multiple used by HMRC. Also HMRC uses three multiples for different purposes!
Question 9: The Government proposes that claw-back is recorded as part of the single figure. Is this a practical and informative approach?

It seems practical and informative that the impact of any claw-back should be recorded as part of the single figure of the year but for there should in addition be a requirement to set out the rationale for any claw-back to be footnoted as it is not like other elements of pay where the basis has been set out in advance.

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 do not believe it is sensitive to publish financial metrics and targets in arrears i.e. in the remuneration report following the annual performance cycle. To do so at the start of the year would be commercially sensitive, as it is our practice to fully align these to business plan so it would be a forecast.

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

We do not use defined benefit pensions, so have no specific comment on this.

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?

This is consistent with our existing practice and is practical and informative provided there is also full disclosure on metrics and targets that apply to future vesting periods.

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.

This revised approach seems to be clear and less onerous than the current approach, so is supported. We assume that disclosure of interests of PDMRs to the Stock Exchange will be aligned with this change.
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?

CEO pay and overall TSR are reasonable proxies for pay and performance but peer group TSR should be added as performance based should also take into account relative TSR should impact. There are in addition timing issues in looking at the annual receipt basis of CEO pay, averaging of LTIP vesting values could provide better alignment to reflect longer term alignment between pay and value creation, where spiky LTIP vesting is highly likely to lead to misinterpretation. In particular when a new CEO is appointed there will typically be no visible LTI for three to four years while the first award vests. There will also be anomalies as a result in looking at CEO pay on a pro-rata basis where there is a changeover of a CEO within a year. It may be useful therefore to add another line to the analysis to show CEO pay over the period based on the “target” or expected value of compensation.

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?

We are comfortable with this proposal and suggest that the historical figures of pay for the year reported are subject to audit as at present
Directors' Pay; Consultation on revised reporting regulations (BIS).

Response by One Society
Contents

About One Society

Introduction

Recommendations

General points:
- Empowering shareholders is necessary but not sufficient. The myth of the shareholder spring.
- Reporting the relationship between director's pay and workforce pay, as well as the relationship between director's pay and company performance.
- Reporting by investors as well as reporting to investors. Filling the accountability gap.

Responses to consultation questions
About One Society

One Society draws on a wealth of research which shows that large divides in income at the top and bottom of society - beyond ‘proportional rewards’ - are damaging to our economy and society.

One Society works with policy-makers, employers, and other decision-makers and influencers who have significant power to affect rates of income inequality.

One Society was established as an Equality Trust project in 2009. The Equality Trust is working to build a movement for change to reduce the income gap and improve the health of society. The Equality Trust does this by analysing and sharing the latest research and supporting a network of local campaign groups across the UK and beyond.

The Equality Trust, established in 2009, was inspired by findings set out in the internationally best-selling book, The Spirit Level, which looks at the link between income inequality and the health of society.
Introduction

We very much welcome that the government proposes to revise the remuneration reporting regulations and are pleased to see measures to improve the transparency of pay reporting and to enhance shareholder power being proposed. We know that executive pay reporting is too often ambiguous, over-complicated and does not allow for comparison between companies. We also know that shareholders are not sufficiently empowered to engage in pay policy matters in a meaningful and timely manner. And we know that remuneration committees are insufficiently diverse and are advised by people such as remuneration consultants, who may have adverse vested interests in advising higher rates of pay.

We applaud Government’s intent to require companies to publish clearer and more informative information about how executives are being rewarded. However, we fear the requirements set out in the appendix to the consultation, may result in companies producing bland statements designed to meet the letter of the law, rather than the spirit.

We are disappointed that Government has not taken this opportunity to look again at the composition of remuneration committees and feel that this omission undermines laudable Government intentions.

We feel that the proposals set out in this consultation do not sufficiently address the evidence that excessive pay differentials are damaging to the performance of both companies and the economy.

In order to ensure the best long-term performance for the company - and wider economy - we believe it is necessary to introduce measures which recognise and address the importance of the pay and performance levels across the whole workforce spectrum. We also believe that Government has a role in setting out regulation that recognises the relationship between productivity and pay dispersion.

We believe companies should report and manage pay ratios and give greater consideration to whole-workforce pay and performance.

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1 Hansard 24 Jan 2012: column 7WS BIS Written Ministerial Statements on executive pay
Recommendations

- Remuneration consultant(s) should report to and to be appointed solely by the remuneration committee, as opposed to the executive.

- The maximum tenure of the remuneration consultant(s) - both company and individual consultant should be set at three years for any one organisation.

- A requirement should be introduced to ensure that all remuneration consultants be bound the Remuneration Consultants Group (RCM) code of conduct.

To ensure clarity of calculation:

- When calculating the total value of a remuneration package, data should relate to director preference in a given year rather than items received/vested in that year.

- Valuation of non-cash awards should be standardised.

- Where currency values need to be converted, a standardised conversion rate should be used.

- Where pension contributions are to defined benefit schemes, companies should show the transfer value - less director's contributions - of the increase in accrued pension.

- All institutional investors should be obliged to disclose their voting records and make these available on public websites as allowed for by s1277 of the Companies Act 2006.
General points:

Empowering shareholders is necessary but not sufficient. The myth of the shareholder spring.

- The chief executive of WPP, Sir Martin Sorrell, suffered significant embarrassment in June 2012 when the company’s remuneration report was rejected by 60 per cent of the company’s investors. This is the latest in a series of widely-reported so-called rebellions. It would be easy to get the idea that shareholders are now tackling the soaring levels of executive pay and that robust government action is unnecessary. That idea would be wrong.

- The WPP ‘rebellion’ was unlike other rejections of remuneration reports that have recently taken place, because WPP has actually been performing well. Other votes against hikes in CEO pay have taken place in companies where performance was poor. In other words, votes against remuneration reports are an indication of discontent about company performance. They have not been used to express disquiet about ever-increasing remuneration for the highest paid executives. In actuality, there is less to the ‘shareholder spring’ than meets the eye. The vast majority of companies still have their remuneration report approved.

Number of FTSE 350 pay defeats between 2003 and 2012 (until 25 Sept 2012)

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source: PIRC

The low level of shareholder rebellion strongly suggests that solutions to excessive directors’ pay cannot rely on investors alone.
Reporting the relationship between director’s pay and workforce pay, as well as the relationship between director’s pay and company performance. The business case.

- Pay throughout the workforce is important, not just that of the highest paid. The disparity between the highest paid and the lowest paid impact upon company performance.\(^4\)

- The assertion that pay levels reflect risk and responsibility is not supported by the evidence. Using their Monks Job Evaluation System (JES) - an analytical job evaluation system widely used in both the private and public sectors - PwC found that the risk, responsibility and complexity of the jobs performed by those at the head of public sector organisations is on a par with that of those that lead private sector organisations. Despite this, private sector CEO reward package values are around twice as much as those of comparable local government CEO reward packages.\(^5\)

- Pay inequality is a major contributor to the overall income inequality, of which the UK now has one of the highest rates in the developed world. High levels of income inequality are associated with a range of health and social problems, for example lower life expectancy, poor educational attainment, criminality, mental health problems and obesity, which are themselves expensive to address and/or reduce economic performance.

- High income inequality is also associated with low levels of social mobility. This denies opportunities to latent talent and denies that potential returns were that talent realised. The IFS believe that “it is likely to be very hard to increase social mobility without tackling income inequality”. The Sutton Trust estimates that low social mobility could cost up to £140 billion a year by 2050.

- Excessive top pay and excessive pay inequality may harm perceptions of business: Most people think the gap between the rich and the rest is too wide, even though they significantly underestimate how much the highest paid are actually getting.\(^6\) Almost two thirds (64 per cent) say FTSE CEOs should get paid less than £500,000pa. Only one per cent think FTSE CEOs should receive the £4m and more they’re typically paid. Almost three quarters (72 per cent) of people think that


\(^5\) www.ukmediacentre.pwc.com/content/detail.aspx?releaseid=3267&newsareaid=2 (accessed 11/09/12)

those running public and private sector organisations should be paid about the same.\(^7\)

We are aware that the Business Secretary rejected the proposal that companies should report on the ratio between the pay of directors and that of the workforce, because ratios will be more affected by workforce structure than whether the company is attempting to moderate levels of pay dispersion. A good response to this has been made by investment advisors PIRC, who say “It is true, as some have argued, that investment banks may look like they have a ‘better’ ratio than supermarkets, because the latter have a large number of low-paid workers. But why would anyone compare an investment bank and a supermarket in the first place? On a whole range of issues that are analysed investors know they need to take account of factors such and industry sector, company size etc. Why would they do any different in respect of pay dispersion? It is a poor argument against greater transparency”\(^8\).

**Reporting by investors as well as reporting to investors. Filling the accountability gap.**

Requiring institutional investors to report on their voting record would allow asset owners to more easily assess the level of activity of their asset managers and individual clients to assess the activity of asset owners. We note that although the argument most frequently advanced against the exercise of these powers is that voluntary disclosure is sufficient, such voluntary disclosure has in fact been far from universal and of variable quality.\(^9\)

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8  PIRC: “Pay ratios aren’t that difficult” (website http://www.pirc.co.uk/news/pay-ratios-aren%E2%80%99t-difficult)
Responses to Consultation 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.

We regard the requirement for three-yearly reporting as insufficient, given that changes to pay practices, personnel, performance and other contextualising elements change frequently.

BIS should also make clear what constitutes pay policy, to mitigate against the risk that companies will seek to describe what are effectively policy changes as changes in practice or process, to avoid these changes appearing in pay policy reports and therefore to avoid investor scrutiny on these issues.

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

Whilst we cannot comment on the specifics of the cost of this, we believe that, given the sophistication of modern payroll software, these costs will in no way be onerous.

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?

We believe that the provision of these proposed regulations offer the perfect opportunity to learn from the mistakes of the Localism Act provisions on the reporting of pay policy statements. Due to a lack of clear guidance on what should be reported and how it should be reported, the data presented in local authorities’ pay policy statements are confused and inconsistent. This means it is impossible to fulfil the intention behind the Localism Act provision, namely to enable comparison of levels of pay between different local authorities. With this in mind, we recommend that all key element of remuneration is indeed set out in table form and that Government require that the following elements be set out in that table:

- All target-dependent elements, such as performance-related pay. In this case, the maximum that could be gained should be listed, as should the targets that need to be attained.
- Any inducement payment
- All non-target dependent elements, such as salary
- Any severance package
- Total remuneration
For a given year, figures should be for both amounts awarded and amounts vested should be given. This avoids the outcome whereby options which are realised after a director is no longer in the relevant employer’s employment are not recorded as part of their remuneration package.

Non-cash remuneration value should be standardised. For example, share value for reporting purposes could be set at that which applied at the close of London trading on the last working day of the company’s year.

Conversion of payments made in currencies other than sterling should standardised. For example, the exchange rate used could be that which applied at the close of London trading on the last working day of the company’s year.

Companies should show the transfer value (less director’s contributions) of the increase in accrued pension where pension contributions are to defined benefit schemes.

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.

We very much support inclusion of service contracts in companies’ pay reporting duties. As in the case for employee remuneration discussed above, we believe that, if government’s ambition to empower shareholders is to be realised, the type and form of data to be disclosed by companies, as well as the format in which this information should be displayed, should be set out by government.

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.

Statements on exit payment policy for the whole workforce, and not just directors, should also be published. Companies should also be obliged to report where exit payments are made that do not comply with stated exit payment principles and an explanation of deviation given.

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 the most effective way to reflect the views of employees on director remuneration is to include two or more employees on remuneration committees. We fear that a non-prescriptive injunction to seek employee views may result a cursory assessment of employees’ views.
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 believe it would be more appropriate for the industry specialists, that is, the Institute of Actuaries, to develop a methodology for this purpose.

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 that where proposed bonuses are withdrawn or reclaimed if the premise for the bonuses is not fulfilled, these amounts and the fact that they may be withdrawn/reclaimed should be listed separately for full clarity.

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?

We support this proposal, but stress that “CEO pay” must be interpreted to mean total remuneration rather than just salary.

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?

We believe companies’ statements as regards staff consultation should also be subject to audit to mitigate against the risk that seeking of employees' views become a mere 'paper exercise'.
Patterson Associates
Directors’ Pay: consultation on revised reporting regulations.  
Response form.

The closing date for this consultation is 26 September 2012

Please return completed forms to:

Barry Walker  
Executive Pay Consultation  
Department of Business, Innovation and Skills  
1 Victoria Street  
SW1H 0ET  
020 7215 3930  
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection

In the interests of transparency, the Department may choose to publish the responses to this consultation. Please state clearly if you wish your response to remain confidential.

Please note also that information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

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### About You

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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.

Part 4, point 19 – to what extent will companies have to explain how each remuneration element is tied to the long-term strategic objectives of the company? In some cases this may be sensitive information – where this is true is it appropriate for this to be enforced?

Part 4, point 30(1) – requires a comparison of the % increase in director pay and that of all employees generally. It is unclear what director pay comprises, but if it is to include the variable elements then we consider such a comparison to provide little insight for shareholders. Shareholders should be aware of those elements that ensure accountability (pay tied to changes in share value), and those that offer ‘line-of-sight’ (performance that management can control directly).

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

Both direct and indirect costs. The direct cost of changes to annual reporting, and increased controls at the Company Secretariat and HR level, are likely to be considerable. The indirect cost is that increased scrutiny leads remuneration governance to become over-cautious so that pay programmes are not tailored to the company’s strategic objectives. As a result, the company is likely to over-pay for talent.

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 leaves some room for flexibility and allows companies to tailor disclosures to reflect shareholder demand. Companies should be encouraged to develop policy alongside shareholders and where shareholders feel that insufficient detail has been provided then they may voice this opinion in the binding policy vote.
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.

Service Contracts
If all new contracts must be consistent with shareholder approved policy then inclusion of this would be of limited value. However, in terms of contracts enforced prior to the new legislation then it will ensure shareholders have easy access to this information.

Scenario Payouts
Yes, this would be a useful addition – although how does a company define target and above target performance and does this align with shareholder opinion.

% Change in Profit, Dividends
This would also be a useful addition in terms of providing all relevant information in one place

Overall Expenditure on Pay
This could be useful although it would be useful to put the figure into perspective. For example, historical expenditure on pay vs performance over the same period.

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.

None.

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 do not believe that this would either add value to or simplify the remuneration report. In addition seeking employee views would require some level of communication and education on executive remuneration followed by gathering employee views. It is questionable whether this is a productive use of time and money and also poses the question - how employees would be selected?
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?

Yes. Although it will be beneficial to have a single figure highlighting variable pay received in year alongside the ‘one number’ to encourage a high variable to fixed pay ratio.

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?

The most important thing is that a consistent methodology is applied. The HMRC methodology is likely to give the lowest result but is a comparatively simple calculation widely used throughout the UK.

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

Claw-backs should be reported as a separate figure and should not be captured in the current period.
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 believe strongly that Long term Incentives (LTIs) should be encouraged, and that a proportion of the performance conditions on such LTIs must be operating metrics (not simply Total Shareholder Returns (TSR). As such, given its importance, publication of the measures chosen should be immediate, but publication of the actual goals to be at the end of the performance cycle. This has been achieved successfully by a number of UK listed companies already.

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

Likely, yes.

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?

Likely to be most practical solution.
**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.

Whilst details of directors’ shareholdings will be embedded within the single figure and details on variable pay awarded we believe that these shareholdings and how they have changed throughout the year should continue to be reported separately including, as suggested, share ownership requirements and the extent to which these have been met. It is important that shareholdings are treated as a distinct entity and that shareholders are fully aware of the potential liabilities that companies have to their directors.

**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?

This is an important area of confusion by many commentators.

We review performance of CEOs over periods longer than one year. One year is not a sufficient length of time to judge (i) a CEO’s performance, and (ii) to review pay vs performance

Performance measures must balance **Accountability** and **Line of Sight**

Total Shareholder Returns (TSR) is an effective measure of performance over the long-term, and makes executives accountable to shareholders. However, it is an ineffective measure as a form of incentive compensation.

Please also note that there is a common misconception that ‘Beating Median TSR vs an Index [or set of Peers]’ is average. It is far from average. It is very nearly impossible for CEOs to beat the median more than 6x out of 10. So, for 40% of the time, a CEO can be almost certain that a 3-year TSR-based LTI will not pay out. That is why many executives are wary of LTIs, and why metrics other than TSR are vital.

**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?

No.
Peter Tompkins
Directors’ Pay: consultation on revised reporting regulations.
Response form.

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### About You

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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?

May I declare my interest in this subject. I chaired a committee of the Institute and Faculty of Actuaries in 1995 following the Greenbury Report which had asked us to report on disclosure of pensions. The methodology of using transfer values was adopted, but unfortunately the Stock Exchange rules implemented it correctly (the transfer value of the increase in benefits) but the Companies Act regulations had it differently (the increase in the transfer value of benefits, which is a different piece of maths). Some companies disclose both, making it impossible for shareholders to understand!

I still believe transfer values of the increase in benefits to be the right sum. In some companies, a pension paid from 60 with two-thirds paid to a widow and with inflation increases is worth a lot more than a pension from 65 with 50% to a widow and limited price inflation. The transfer value corrects for such differences.

However, I do agree that a simple approach of a multiple of 20 and then adding the value to the matrix of directors’ remuneration would be easy to do and have low implementation costs.

If you do decide to stick to using transfer values, can I please ask that you make sure that your regulations refer to the transfer value of the increase in benefits (so a pension of 10000 one year going up to 11000 the next is valued by multiplying 1000 by a factor (20 say) making 20000).

The alternative which is in current companies act regulations is the increase in the transfer value, so that might be 10000 times 20 going up to 11000 times 22 (if financial conditions change) making 242000 – 200000 = 42000 for instance. This is
confusing because the director has not had this much benefit from the company; most of the increase is the effect of investing the previous year’s pension rights.

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

The draft regulations are, in our view, a significant improvement upon the original proposals. Certain matters do, however, require clarification. Those matters are:

(a) How should companies proceed if they lose the first binding vote on their remuneration policy? Should they revert back to their pre-existing policy (which will only have been subject to an advisory vote by shareholders as part of the existing non-binding vote on the directors' remuneration report)? If not, then how will they be required to proceed?

(b) Most companies will seek shareholder approval for their remuneration policy for the first time in Q2 2014 (as most companies financial year ends on 31 December with general meetings being held in April/May the following year) it needs to be clarified whether such approval, if obtained, is effective for 3 years from (a) the date of the relevant shareholder meeting; (b) 1 January 2014 (assuming a calendar year financial year) (although if this is the case how will awards granted in March/April 2014 in line with a company's usual grant cycle be treated?); or (c) 1 January 2015 (assuming a calendar year financial year).

(c) Payments made pursuant to pre-existing commitments (i.e. those entered into before 27 June 2012) need to be adequately grandfathered where those commitments are amended prior to value being delivered to a director. For example, it needs to be made clear that if a share award granted before 27 June 2012 is amended before vesting/exercise then, so long as that award (as amended) falls within the scope of a company's remuneration policy, the award as amended can be satisfied without further recourse to shareholders.

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

There will be upfront implementation costs in relation to the revised reporting regulations, including in relation to company secretary and directors' training and taking external advice on the new requirements. Companies will need to invest a certain amount of time in becoming familiar with the revised regulations, and it is likely that they will seek a greater level of input from advisers during the period of adjusting to the new regime.

There will be additional work – and therefore costs– for some companies in relation to some of the requirements of the revised regulations, for example in setting out the remuneration which directors might receive in different scenarios. Some companies may already have been compiling such data but will need to work on the way in which it may be presented as part of the remuneration report.

Additional costs could also potentially be incurred if companies are unable to meet pre-existing contractual commitments and have to "buy-out" such commitments. It is hoped that companies will be able to draw their remuneration policies
sufficiently widely to enable them to meet their pre-existing contractual commitments but if, either as a result of the final form regulations or investor pressure (or otherwise), they are unable to do so then this could result in additional costs for them.

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?

An over-prescriptive regime could present practical issues for companies – due to the wide degree of variation in remuneration structures between listed companies, it would be difficult to come up with a set of provisions which would cover all circumstances. Over time, new approaches may develop, and a very prescriptive set of rules might require frequent updating in order to remain appropriate, which would involve unwelcome time and cost.

A more flexible approach to reporting requirements, within an overall framework, is therefore a practical approach. However, there needs to be sufficient structure so that the nature of the supporting information provided is sufficiently detailed, and consistent between companies. In order to achieve transparency of disclosure, companies will need to provide a suitable level of detail to enable informed conclusions to be reached about the way in which a remuneration package has been structured. In addition, investors and other stakeholders need to be in a position to draw sensible comparisons between remuneration packages in different companies.

So a practical approach of flexibility around the detail of disclosure needs to be balanced with the need for a truly informative approach. For the most part, companies will want to present a report which is user-friendly and does not attract negative feedback from shareholders. Where there are less prescriptive rules over content therefore, suitable guidance for companies would be useful at least during the period of adjustment to the new regime, whilst a “best practice” approach is still emerging.

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.

Comparisons between remuneration potentially received in different scenarios will potentially be informative where those scenarios are relevant and properly presented. This will act as a suitable check and balance to the provision requiring disclosure of the face value of awards made in the reporting year (see question 12) which may overstate the actual level of remuneration a director may reasonably expect to receive.

The comparison between overall spend on pay and percentage change in profit and dividends can also be seen as a useful tool for investors looking at the link between pay and performance. However, it may be too simplistic an approach in some circumstances, and companies should have the flexibility to provide further
information and notes to explain where appropriate why particular figures have changed year on year in the way that they have. The draft regulations (paragraph 24) also need to be amended to clarify which “previous years” a comparison should be drawn with. We assume that companies will be required to disclose year-on-year changes rather than draw multi-year comparisons and, if this is the Government’s intention, the draft regulations should be amended accordingly.

Questions will arise in relation to valuing overall expenditure on pay and information on this will need to be available so that interested parties can confirm whether or not they are comparing like with like when looking at the position for a number of different companies.

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.

Disclosure of the principles upon which determination will be made is as much as could be disclosed in relation to exit payments which will depend in each case on the relevant facts and circumstances, as well as often being the subject of sensitive negotiations.

For UK listed companies, payments to leavers under arrangements such as long-term incentive plans will be made pursuant to the terms of the relevant plan rules, or award contract, which will have been approved by shareholders and so to require further detailed disclosure would be an additional burden for those companies.

It is noted that in the event of a director leaving companies will be required to immediately issue a statement setting out how his/her exit payment has been calculated. It needs to be clarified what companies will need to do to satisfy this disclosure requirement where a director leaves and at the point of termination the exit package has not been finalised.

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.

Companies are currently required to state whether pay across the organisation as a whole has been taken into account in setting directors’ pay. This disclosure acts as a prompt for many companies to consider group-wide pay.

It is a further step for companies to seek employee views on the policy for directors’ remuneration. It will be easier and more informative for some companies to do this than for others, depending upon the size, profile and location of the workforce. There is the potential in relation to the proposal to include a statement on this, for companies which can in practice take meaningful account of employee views to be viewed as having a “better” approach than others. If the reality of a particular situation is that the employee body is not in a position to give informed feedback on remuneration policy, then will investors prefer that a company says that it has taken views into account – but ignored them – or that the company states it has not taken these views into account.
The risk is that remuneration committees may come to be harshly judged for taking a pragmatic approach based on the particular facts and circumstances of the company in question.

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 on page 24 correctly give effect to this intention?

The fact that bonus amounts subject to mandatory deferral will be included in the figure for full bonus awarded in relation to a performance year may cause some discrepancy. Although no longer performance-related, such amounts will continue to vary in value (e.g. because the deferral may be in shares and the value of shares obviously fluctuates) and may remain subject to service conditions and other adjustments, depending upon the terms of the awards.

This differs slightly from the situation where an LTIP award which is structured as an option has vested but remains unexercised, as the time of exercise is within the individual’s control.

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?

There are likely to be some queries and areas of uncertainty, but to develop a methodology which can be applied consistently is in our opinion the most practical approach to an otherwise difficult issue. Over time, the approach may become more informative as it becomes more familiar and as a history of disclosures becomes available which can act as a basis for comparison and benchmarking. Consideration will, however, need to be given as to how to appropriately disclose the pension entitlements of non-UK directors whose arrangements differ from those found in the UK.

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

Claw-back should be the subject of full disclosures in relation to the circumstances and quantum.

Where claw-back or "malus" provisions have applied to reduce the amount of unvested awards, this will be reflected within the single figure for those awards which would under normal principles be reported within that figure.

In relation to "true" claw-back of vested awards, any amounts clawed-back should be put through the single figure calculation.

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?
In some cases detailed disclosure of performance against metrics will be commercially sensitive. Where performance targets are based on measures which are not publicly available information, then generic disclosures should be permitted in cases where the remuneration committee considers there could be a material disadvantage to the company in disclosing details to potential competitors, or in the case of personal performance metrics, if there is any question around employee confidentiality or data protection. It would be desirable for the regulations to explicitly provide that generic disclosures can be made in circumstances which the company considers appropriate.

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

- 

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?

Disclosure of face value is a simple approach but is less informative than an "expected value" disclosure. High levels of face value award may be subject to very stretching performance targets and the probability of awards paying out, and at what percentage of face value, is an integral part of assessing how a remuneration package has been structured.

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.

Focus on the key information, and streamlining the disclosures required to prevent duplication would be a welcome change. Whilst a simpler reporting regime will be beneficial for companies, it will be important to ensure that information which is of interest to shareholders is still easy to locate and is suitably referenced where appropriate.

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?

It is acknowledged in the consultation paper that in relation to company performance, "there does not appear to be a consensus on the preferred measure". Total shareholder return has the advantage of being well-understood, but there may be times when the appearance of the graph may represent a deviation between pay and performance, for example as a result of a fall in share price. This may reflect market conditions overall rather than CEO performance. It might be helpful to include average directors’ pay, although companies will prefer the least onerous reporting requirement.
CEO pay as derived from the single figure may include pay-outs of awards made several years previously, and for this circumstance, as well as any other exceptional factor affecting the graph, it will be important that further explanatory notes are read alongside the graph itself.

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?

These are the key financial disclosures and are therefore the main areas which it is expected would be subject to audit.
Mr Barry Walker  
Executive Pay Consultation  
Department for Business, Innovation and Skills  
1 Victoria Street  
SW1H 0ET  

24 September 2012  

Dear Mr Walker  

**Consultations on revised remuneration reporting regulations**  
PwC welcomes the opportunity to comment on this consultation document.  

**Overall message**  

We are supportive of the need for change. We consider that the government’s proposals are an improvement on the current regime and go some way towards improving the transparency of remuneration reports while providing companies with the opportunity to report in a more concise fashion. The split of the report into two clear parts is also a reasonable step and is of course necessary for consistency with the legislative changes to voting in the Enterprise and Regulatory Reform Bill (‘ERR’) currently going through Parliament.  

However, in our view not all of the proposed disclosures will be valuable in every case and we believe that some will seldom be valuable, such as the comparison of the change in CEO pay to the change in pay of the workforce as a whole, or the information on the ‘relative importance’ of the spend on pay. Nevertheless, we can see the benefits of the package of measures taken together.  

In setting reporting requirements there is always a balance to be struck between being so prescriptive that disclosures become standardised and allowing flexibility for companies to exercise judgement and develop ‘good practice’. However, as they stand, the draft regulations (‘the Regulations’) need to be clarified in a significant number of areas if they are to be consistently workable across all companies. The additional guidance that the Government calls for in paragraph 10 of the consultation document (‘the CD’) will be important in ensuring consistency of approach and that the disclosures meet users’ needs.  

**Main points**  

**Alignment with other Government reporting initiatives**  

It is a difficult task to consider the role of the remuneration report in advance of the future reporting framework being finalised. In due course, we might have a strategic report, a remuneration report and an annual directors’ statement, in addition to the financial statements, and it is unclear how these will fit together to complement each other and benefit users. While remuneration is considered by some to be a higher priority, we do need to understand the full picture of the future reporting framework, especially as it is stated in the CD that the Government intends that all changes to the reporting framework should take place at the same time. For example, the Regulations require a summary statement from the chairman of the Remuneration Committee setting out key messages on remuneration and the context in which decisions have been taken. It seems that this might be located...
within both the remuneration report and the strategic report, which may lead to duplication or inconsistent practice.

**Single source of remuneration reporting requirements**

In paragraph 36 of the CD, the government states that it will work with the UK Listing Authority ('UKLA') to consider whether the Listing Rules need to be changed. We appreciate that the difference between 'listed' and 'quoted' companies often makes it difficult to achieve a single source of disclosure requirements, but in the context of remuneration disclosures the relevant Listing Rules apply only to those UK companies with listed equity shares. Accordingly, we can see no significant barrier and, in our view, it is important that this opportunity is taken to create a single source for remuneration reporting requirements, which should be within the Companies Act.

**Defined terms**

A central feature of the Regulations is the 'single total figure of remuneration' for each director. They include a number of disclosures which require disclosure of 'pay' or 'remuneration' which appear to be used interchangeably although neither is a defined term. Similarly, throughout the Regulations, there is inconsistent use of the terms 'performance condition', 'performance metric' and 'performance target'. More clarity around the terms used would be helpful to ensure consistency of understanding.

As a separate matter, in the ERR, the term 'remuneration payment' is defined as a payment for being a director rather than a payment in respect of qualifying services (a term used in the current legislation). We believe that it is important that the nexus of remuneration for qualifying services is a clear pre-requisite for disclosure (as under the current regime).

**Audit responsibility**

The split of the remuneration report into two parts has implications for auditors that are not addressed in the Regulations. Auditors will clearly have a 'read' responsibility for the policy part of the remuneration report when it is included within the annual report. They will also apply this 'read' responsibility in respect of the policy part in years when it is not included within the annual report, consistent with other information that is referred to from the annual report. The Regulations should be clarified on this point, and on the restricted scope of the auditors' responsibilities in respect of the policy part of the report, bearing in mind its importance as the subject of a binding vote by shareholders.

We have set out detailed responses to the specific consultation questions in Appendix 1 to this letter.

If you have any questions or would like to discuss any of the points raised in this letter in more detail, please contact Peter Hogarth (tel: 020 7213 1654) or Sean O'Hare (tel: 020 7804 9264).

Yours sincerely

PricewaterhouseCoopers LLP
Appendix 1

Responses to consultation 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.

As noted in our covering letter, the Regulations and the terms used therein need to be clarified in a significant number of areas if they are to be consistently workable across all companies. Without the CD to support them, the Regulations would be very difficult to interpret as they stand.

The government should also add an explicit requirement for comparative information to be provided for all relevant disclosures, and the single total figure table in particular.

Single source of requirements for companies

We support the government in its efforts to work with the UKLA towards achieving a single source for remuneration disclosure requirements. However, there are also improvements that could be made within the Regulations themselves.

There appears to be no proposal to exempt quoted companies from Schedule 5 of SI 2008/410. To create a single source of requirements for both quoted and unquoted companies, it would be preferable if quoted companies complied with Schedule 8 only while Schedule 5 applied only to large and medium-sized unquoted companies. This would avoid the need for a cross reference from the ‘back half’ of the annual report to the directors’ remuneration report. Schedule 5 requires different disclosures in respect of certain elements of the pay package from those required in the current directors’ remuneration report (for example, the disclosure of the aggregate gain on exercise of share options for directors); it would be helpful to avoid inconsistencies of this kind when finalising the Regulations.

Content of statement by chairman of remuneration committee

It is not clear what should be included in the ‘summary’ statement suggested in paragraph 23 of the CD and section 2 of the Regulations. We consider that it would be difficult to define the content of this statement and that it should be up to the company (aided by market practice) to determine its content. However, this ought to be addressed in the guidance that the CD calls for.

As regards the location of the statement, while it is evident that it forms part of the remuneration reporting package, it is not clear whether it is part of the policy statement, the implementation report or potentially a ‘strategic report’ produced under a future narrative reporting framework. This should be made clearer.

Definition of ‘performance metrics’

Throughout the Regulations, there is inconsistent use of the terms ‘performance condition’, ‘performance metric’ and ‘performance target’. It appears that the Regulations could be proposing a reduction in the level of forward-looking disclosure of performance conditions (see response to Q3), but this is unclear currently because of the use of differing terminology. For instance, under section 19(d) of the Regulations, in the policy part of the remuneration report there is a requirement to disclose performance ‘metrics’, but section 5(d) refers to performance ‘conditions’ in this context in the implementation report. (Section 20(b) in the policy part then refers to performance ‘conditions’ in respect of the amount in the policy table.)
We believe it is critical that these terms are clearly defined and consistently applied. If the measures are to be applied differently in different contexts, the reasons for this also should be clearly explained as we believe this is an area of reporting that will attract close scrutiny.

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

We do not have sufficient specific information to enable us to respond to this question in detail. However, we believe it is inappropriate to assume that many of the proposed disclosure requirements are already best practice so that there will be no additional cost from implementing them. For the many companies for which these proposals do not represent current practice they may well add cost. For virtually every company covered by the Regulations there will also be a cost implication of splitting the report into two parts.

**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?**

We consider that the proposed table will encourage more consistent and concise disclosure of remuneration policy which will assist shareholders in their assessment of the appropriateness of policy when determining whether to support the binding vote. However, in order to be useful it is important that the alignment with strategy is clear and relevant to the company and that reduction to 'boiler-plate' disclosures is discouraged. This could be achieved by effective guidance.

**Performance targets or metrics – impact on the policy report**

In our response to Q1 under *Definition of ‘performance metrics’,* we comment on the apparently inconsistent use of the terms ‘performance condition’, ‘performance metric’ and ‘performance target’ in the Regulations. The point below assumes that the terms have been used as intended to make a distinction between the policy and implementation parts of the remuneration report.

Section 19 (d) of the Regulations requires disclosure in the policy part of the remuneration report of performance *metrics* but not *targets.* In the implementation part of the report performance *targets* for annual bonus and long-term incentives will be disclosed for the financial year in which values are included in the single figure (subject to the debate over commercial sensitivity – see Q10) and a summary of the performance *criteria* will be included for long-term incentive awards that are granted in the financial year.

If companies are only required to disclose metrics (not targets) for long-term incentives when setting the remuneration policy, this would be a less detailed disclosure than is currently required and we believe it may not provide sufficient information for the binding vote on the remuneration policy.

Remuneration committees typically review their performance targets each year (to ensure they are consistent with expectations of future performance), so in our view the policy part of the remuneration report should include these targets (as we understand the phrase to be used) and not just the metrics to which they relate. Inevitably, this would mean that many companies would need to have a binding vote on policy every year, but this would be in line with the position set out in paragraph 14 of the CD which states that 'shareholders will get a binding vote on...pay policy. This will happen annually unless companies choose to leave their pay policy unchanged'.

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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.

Risk of clutter and lack of clarity in service contract disclosures

The proposal in paragraph 46 of the CD and section 21 of the Regulations for the policy report to include 'all existing contractual provisions that relate to directors' remuneration' does not seem appropriate. This disclosure could be lengthy, complex and unpenetrable or, alternatively, of little value. Surely a summary or explanation setting out any changes to an individual's employment contract would be more useful.

Scenarios graph – needs to be corrected

While we do not disagree with the ideas it is intended to communicate, the graph in paragraph 47 of the CD is clearly wrong in the way it presents base pay as increasing in different performance scenarios. It is also questionable to have incentives vesting for performance that is below target. The percentages are clearly wrong. The whole point of variable pay is that it represents an increasing proportion of total reward as performance improves.

It is not clear from the CD whether this disclosure is intended to be given for each director, in aggregate or as an average (representing policy). The most appropriate approach would be to give the graph for each director; any other approach risks hiding significant information. However, in view of the number of graphs that may need to be produced, we believe that non-executive directors should explicitly be excluded from the requirement. In our view, given the nature of most non-executive directors' remuneration, such graphs would not include useful information for the policy vote and would clutter the remuneration report.

It is also not clear how companies are expected to reflect potential share price increases in the scenarios shown. If an assumption of zero share price growth is made, no value will be included in respect of market value options. To avoid assumptions on share price growth being treated as share price forecasts, it would be preferable to include pre-determined growth factors in the Regulations. If share price growth assumptions are not included in the Regulations, the only alternative is to include expected values for market value options, which would make the graphs inconsistent and harder to interpret.

The example in the CD refers to three scenarios: below target; on target and maximum but section 22 of the Regulations specifies performance achieved that meets; exceeds or falls below threshold. The scenarios in the Regulations could be interpreted in different ways and will not give shareholders any real clarity over the maximum payments available under any remuneration arrangement. In our opinion, the scenarios should be defined by reference to the minimum (or threshold), target and maximum payments under any particular arrangement. Where a company's incentive arrangements do not specify a maximum level of payment, there should be disclosure (for these purposes) of the expected maximum payment and, as a note to the graph, of the fact that there is no maximum level.

Change in profit, dividends and overall expenditure – clarifications needed

It is unclear to us why this disclosure is included in the forward-looking policy statement rather than the implementation report as it is historical information that has more relevance to the year under review.
Paragraph 49 of the CD and section 24 of the Regulations refer to the percentage change in 'profit' and the 'overall expenditure' on pay, and the Regulations state that these phrases have the same meaning as is relevant in respect of the preparation of the accounts. There is no such definition under IFRS, which is the accounting framework that the relevant companies will be using. To address this, the Regulations should include specific definitions:

- 'Profit' should be profit after taxation, which is the only profit measure that will be found in every set of IFRS financial statements.
- 'Overall expenditure' should include all expenditure (including finance costs, and both cash and non-cash items); all items will need to be reported on an 'accounting' basis, for instance with the cost of pension commitments measured in accordance with IAS 19 and share-based payment under IFRS 2.

The Regulations provide for the disclosure of the percentage change in profit, dividends and overall expenditure on pay 'compared to previous years' (although there is no indication of how many years). We would expect readers to be more interested in understanding the absolute amounts for each of these metrics and recommend that companies should be required to disclose the current and previous year's actual cost as well as the percentage change.

**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.**

We recognise that companies need a degree of flexibility to deal with the often challenging circumstance of exit payments in practice and section 26 of the Regulations aims to strike a balance between allowing for such flexibility at the time of setting the remuneration policy and providing shareholders with sufficient explanation of the policy to make the binding vote meaningful. The Regulations appear to require only disclosure of *whether* the company will distinguish between different types of leaver. To ensure that sufficient information is available for the binding vote in respect of *how* different types of leavers will be dealt with, section 26(b) of the Regulations should be amended to read 'whether and how the company will distinguish between – (i) types of leaver...'. This explanation could, where applicable, refer to the ultimate discretion of the remuneration committee.

We note that the Regulations do not include a provision for disclosure of payments made to former directors (currently paragraph 15 of Schedule 8). We consider this to be an important feature of the compensation disclosure framework and recommend its addition to the Regulations.

**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.**

*Risk of boilerplate disclosures on employee consultation*

The suggested disclosure of employee consultation is likely to result in boilerplate text that adds little value for users. It is in practice difficult for companies to include any disclosures in their reports that are meaningful.
Also, section 28 of the Regulations refers to employee consultation in 'drawing up this policy part', which could be read as drafting the report and not setting the policy. This wording should be clarified.

*Comparison between increases in CEO pay and the pay of the workforce as a whole may not be meaningful*

In our response to earlier consultations on remuneration disclosure, we provided feedback on the limitations of a disclosure of the comparative ratio of CEO pay to average or median employee pay. We note that the disclosure requirement in the Regulations refers to a comparison between increases in the CEO's pay and changes in the pay of the workforce as a whole. It is not clear whether this is intended to compare base pay or the 'single figure' of total remuneration. If the latter, this could lead to very volatile ratios being disclosed as the CEO's pay will be materially affected by the quantum of long-term incentive awards vesting in the year.

For multinational groups, factors such as exchange rates or local inflation rates will potentially distort comparison. On the other hand, we believe that the option to identify an appropriate comparator group could be easy to manipulate. This disclosure requires further consideration if the information is to be meaningful and not subject to abuse.

*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 support the intention of the table but believe that the Regulations should address the following points:

*Cut-off point for awards included in the table*

Under the Regulations, awards that have performance conditions measured over periods that are not coterminous with the financial year and vested within a short period of the year end will be included in a subsequent year's 'single figure', notwithstanding that the performance is all but achieved by the end of the financial year. This could create a disconnect between the disclosures of reward and performance, which could in turn make the advisory vote less meaningful (for example, awards that vested on the basis of good performance in 2012 may not be voted upon until the AGM in 2014, by which time performance may have changed).

To address this, it is important that the status of such awards is made clear in the implementation part of the report. Our proposal under *Tracking of the value of awards held* below would assist with this by setting out the intrinsic value of awards held at the end of the financial reporting period. We believe that disclosure should also be made of any other circumstances that may be relevant to the advisory vote, and particularly any gains made on the exercise of awards between the end of the reporting period and a specified date shortly before the accounts are signed.

*Cash dividend received over the vesting period*

The Regulations imply that cash dividends will be received over the vesting periods for long-term incentives. This would be an unusual design feature as most long-term incentives will only release accrued dividends to the executive at the time and to the extent that the shares vest. Similarly, if cash amounts are paid in lieu of dividends, these would only be paid at the time the awards vest in respect
of the shares vesting. We suggest that the wording be amended to refer to ‘cash payments in lieu of dividends accruing over the vesting period’.

Tracking of the value of awards held

Although (subject to the comments above) we support the inclusion in the single figure of the value to the director of awards vested during the performance period, we believe that additional transparency would be provided by the addition of the following disclosures for each director:

- At the end of each financial reporting period within the performance period, the value of awards held based on the intrinsic value of the award at the end of the financial reporting period.
- At the end of the financial reporting period, the gain made on the exercise of options (including those options that vested in previous periods).
- (As and when the information becomes available) the difference between the amount included in the single figure in respect of awards and the cash received when the options are exercised.

See the table included in Appendix 2 for an illustration of such disclosures.

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 believe that the rejection for the purposes of the Regulations of market-based measures of pension benefit is reasonable and support use of the HMRC methodology in principle. Discount rates are volatile and such changes should not affect directors' remuneration. The proposed use of a multiple of 20 to the HMRC number seems somewhat arbitrary, but at least it would be consistent across all companies.

There may be merit in referring (in paragraph 6(c)(iii) of the Regulations) to schemes that are unfunded rather than ‘where there has not been a contribution to the scheme in respect of the person by the company’.

Where the HMRC methodology is being used for unfunded defined contribution pension arrangements, there is a risk that the disclosures are misleading if notional returns are volatile (for example leading to large increases some years and large decreases in other years without any overall movement in value).

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

We agree that it is important that BIS fully consider the implications of claw-backs for the disclosure of the single figure. We consider that it is reasonable to deduct any amounts clawed back from the single figure of remuneration in the year that claw back occurs providing it is explained in a footnote to the table.
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?

Dealing with commercial sensitivity

We consider that companies should be required to publish sufficient detail of performance against targets after the end of the financial year(s) to which the targets relate to make the advisory vote meaningful; it should be for shareholders to decide if they have received adequate information and no exemption for commercial sensitivity should be included in the Regulations. Such transparency would put small shareholders on a similar footing with institutional investors who have more regular access to company forecasts.

Use of ‘value’ rather than percentage

Paragraph 8(2)(b) of the Regulations requires disclosure for long-term incentive awards of the targets set when the performance condition was agreed and the corresponding ‘value’ of the award achievable. As this disclosure relates to share awards, the inclusion of a value implies an assumption as to share price. It is easier (and arguably clearer) to disclose the percentage of the award vesting at target.

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

Yes, we believe so.

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, they should continue to be disclosed and the use of face value can be a sensible approach. However, we have concerns about the timing of disclosure.

It may be more valuable to shareholders to have disclosure of the awards that will be made shortly after the year end (by reference to individual performance during the year) rather than the historical awards made in the financial year under review.

If this is an historical disclosure, shareholders will have no opportunity to vote on the performance targets that are set for long-term incentives if the policy disclosure is limited to performance metrics (see also our comments under Q3).

See also our response to Q7 for comments on tracking awards across their performance period.

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.

Provided that user needs are satisfied, we support the simplification of reporting requirements regarding directors’ interests. However, we believe it would be helpful to include some additional information to allow understanding of the potential value that may accrue to directors – see our comments under Tracking of the value of awards held.
in Q7 above. There may also be merit in providing some analysis of the number of awards that are due to vest in each of the years.

**Single source of requirements for companies**

We consider that the proposed disclosure requirement will be more valuable to investors than the current numerous tables. However, consistent with our covering letter, UK companies should be bound only by the Act’s disclosure requirements and should not need to look to the Listing Rules for additional disclosure of directors’ interests, including post-year end changes in those interests, regardless of whether those Rules ‘do not contradict’ one another (see paragraph 88 of the CD).

**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?**

The problem with using pay of the CEO (ignoring changes in the post-holder) and disclosing a graph showing total shareholder return (‘TSR’) from a point ten years ago is that it will not clearly demonstrate the impact of a new CEO. Consideration could be given to total executive director pay plotted against TSR or another performance metric.

It may be more relevant to use a measure of performance on which the CEO’s pay or executives’ pay is based (that is, one of the key performance metrics). This could provide a clearer reflection of the company’s performance than TSR which could be heavily affected by market sentiment (particularly when used in isolation from a broad equity market index).

The production of an historic ten year chart for the first few years after the implementation of the Regulations will be extremely onerous (if not impossible) for most companies. Transitional arrangements should be added.

**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?**

We agree with the government’s proposal for the auditable parts of the implementation report.

Under ISA (UK&I) 720, auditors read the other information in the remuneration report for consistency with the financial statements and (currently only in the Application Material to the ISA) for consistency with their knowledge gained from the audit. We assume that auditors will also apply this ‘read’ responsibility to the policy report in the years when it is not included in the annual report.

In both cases, the ‘read’ responsibility is a restricted scope of work that includes no form of verification and this should be made clear in section 32 of the Regulations.
## Appendix 2

### Tracking of the value of awards held

<table>
<thead>
<tr>
<th>Name</th>
<th>Y/E 31.12.12</th>
<th>Held outright</th>
<th>Deferred</th>
<th>Subject to performance</th>
<th>TOTALS</th>
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<tbody>
<tr>
<td></td>
<td>Shares</td>
<td>Options</td>
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<tr>
<td>A Jones</td>
<td>Number</td>
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<td>Value at year end</td>
<td>£162,500</td>
<td>£60,000</td>
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Notes:
- Share price at 31.12.12 was £2.50
- 2010 share awards are expected to vest in full
- 2010 options are expected to vest at 50% (exercise price of £2.00*)
- 2011 share awards are expected to vest at 25%
- 2011 options are expected to vest in full (exercise price of £2.75)
- 2012 share awards are expected to vest in full
- Weighted average exercise price of A J's options held outright is £1.50
- Weighted average exercise price of B S's options held outright is £1.70

Gain on exercise of share options
- A J exercised 10,000 options during the year realising a gain of £10,000; Ex has been included in the single total figure at the time these options vested**.
- B S exercised 25,000 options during the year realising a gain of £30,000.
- Ex has been included in the single total figure at the time these options vested**.

*Where there several exercise prices, the weighted average should be used.
**This disclosure should be added where the single total figure was disclosed in respect of the period when these options vested.
Quoted Companies Alliance + letter
Barry Walker  
Executive Pay Consultation  
Department of Business, Innovation and Skills  
1 Victoria Street  
SW1H 0ET  

executive.pay@bis.gsi.gov.uk

2 October 2012

Dear Mr Walker,

**BIS – Consultation on Revised Remuneration Reporting Regulations**

**Introduction**

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of EuropeanIssuers, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Corporate Governance and Share Schemes Expert Groups have examined your proposals and advised on this response. A list of members of the Expert Groups is at Appendix A.

**Response**

We welcome the opportunity to respond to this consultation. Whilst we recognise the Government’s concerns on executive pay, we remain of the view that a binding vote on remuneration policy is not necessary for small and mid-size listed companies.

We believe there is no significant evidence to suggest that there is a problem with excessive remuneration and company and investor engagement on remuneration within small and mid-cap listed company sector. It is our view that these requirements should not extend to them.

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. 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.

We have outlined this in more detail in the responses to the individual questions, which is enclosed. If you have any queries, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward  
Chief Executive
List of Expert Group Members

Corporate Governance Expert Group

Edward Beale, Western Selection Plc
Tim Bird, Field Fisher Waterhouse
Dan Burns, McguireWoods
Anthony Carey, Mazars LLP
Louis Cooper, Crowe Clark Whitehill LLP
Edward Craft, Wedlake Bell LLP
Victoria Dalby, Capita Registrars Ltd
Kate Elsdon, PricewaterhouseCoopers LLP
Nicola Evans, Hogan Lovells International LLP
David Firth, Penna Consulting PLC
David Fuller, CLS Holdings PLC
Clive Garston, DAC Beachcroft LLP
Tim Goodman, Hermes Equity Ownership Services
Nick Graves, Burges Salmon
David Isherwood, BDO LLP
Nick Janmohamed, Speechly Bircham LLP
Colin Jones, UHY Hacker Young
Dalia Joseph, Oriel Securities Limited
Doris Ko, Aviva Investors
Claire Noyce, Hybridan LLP
James Parkes, CMS Cameron McKenna LLP
Julie Stanbrook, Hogan Lovells International LLP
Eugenia Unanyants-Jackson, F&C Investments
Melanie Wadsworth, Faegre Baker Daniels LLP
Cliff Weight, MM & K Limited

Share Scheme Expert Group

Barbara Allen, Stephenson Harwood
Simon Allum, Lewis Silkin
Fiona Bell, Memery Crystal LLP
Martin Benson, Baker Tilly
Danny Blum, Eversheds LLP
Ian Brown, Hewitt New Bridge Street
Anika Chandra, Stephenson Harwood
Stephen Chater, Postlethwaite & Co
Christopher Connors, Charles Russell LLP
Karen Cooper, Osborne Clarke
Jared Cranney, Interior Services Group plc
John Daughtrey, Equiniti
Michael Deeks, Olswang
David Firth, Penna Consulting PLC
Philip Fisher, PKF (UK) LLP
Amanda Flint, Grant Thornton UK LLP
David Fuller, CLS Holdings PLC
Andy Goodman, BDO LLP
Paula Hargaden, Burges Salmon
Daniel Harris, Ernst & Young LLP
Colin Kendon, Bird & Bird LLP
Michael Landon, MM & K Limited
Nigel Mills, MM & K Limited
Peter Mossop, Sanne Group
Isabel Pooley, CMS Cameron McKenna LLP
Robert Postlethwaite, Postlethwaite & Co
Colum Spillane, Sanne Group
Nicholas Stretch, CMS Cameron McKenna LLP
Paul Twist, KPMG LLP
Nick Wallis, Smith & Williamson Limited
RBS (Remuneration Committee)
Directors’ Pay: consultation on revised reporting regulations.  
Response form.

The closing date for this consultation is 26 September 2012
Please return completed forms to:

Barry Walker  
Executive Pay Consultation  
Department of Business, Innovation and Skills  
1 Victoria Street  
SW1H 0ET  
020 7215 3930  
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection
In the interests of transparency, the Department may choose to publish the responses to this consultation. Please state clearly if you wish your response to remain confidential.

Please note also that information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.
## About You

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</thead>
<tbody>
<tr>
<td>Penny Hughes</td>
<td>The Royal Bank of Scotland Group plc</td>
</tr>
<tr>
<td>Chair of the Remuneration Committee</td>
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<table>
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<tr>
<td></td>
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</tr>
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</tr>
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<td>RBS Gogarburn</td>
</tr>
<tr>
<td></td>
<td>PO Box 1000</td>
</tr>
<tr>
<td></td>
<td>Edinburgh EH12 1HQ</td>
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</table>

I am responding on behalf of (please tick):

<table>
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<tr>
<th>Quoted company</th>
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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.**

Broadly speaking, the draft regulations appear to meet the Government’s objective of creating a two-part remuneration report. Overall, the latest proposals offer a more practical solution for shareholders and companies than some of the earlier initiatives. There are some points to consider on the draft regulations as follows:

In the comparison of overall performance and pay provisions (para 13), it would be helpful to clarify if the ten year “relevant period” period starts when the new requirements come into force and is built up thereafter or whether this is a retrospective disclosure of performance over the last ten years. Given the regulations are largely forward looking, including historic data may result in retrospective judgement of pay practices which may not be relevant to current pay practices. Additionally the risk profile and structures of many companies will have changed over the period undermining the relevance of comparisons.

The statement of directors’ shareholding provisions (para 14) references the total number of shares and share options of which the director is the legal owner. Presumably the intention is to show all share interests held, i.e. shares owned beneficially as well as conditional share awards and share options? Whilst simplifying this part of the disclosure requirements is to be welcomed, it may be appropriate to include other information to assist shareholders such as option prices, which would differentiate between market value and nil-cost options, and vesting dates where appropriate. There has also been debate as to whether some of the share information could be facilitated through disclosure on the company’s website but it is not clear from the draft if this will be permissible.

The Policy section of the regulations, Part 4 (para 24), includes the ‘Relative importance of spend on pay’. This relates to the percentage change in profit, dividends and overall expenditure on pay in the reporting period compared to previous years. If this information is to be included, it would seem more appropriate for this to be included in the Implementation Report rather than the Policy Report. This appears to relate to the distribution of past profits and spend on pay rather than a forward-looking policy statement for future distributions, which companies may find difficult to include in percentage terms. It would also seem odd that shareholders may only see this information once every three years under the Policy Report requirements.

A general comment is that there are parts of the regulations that are not prescriptive in terms of the level of detail that should be included. For example, the directors’ service contracts provisions (para 21) state that the remuneration report must contain a statement setting out all the provisions that relate to remuneration. Whilst flexibility for companies in some areas is helpful, there may be a benefit in being more prescriptive on some elements.
in order to ensure consistent and concise disclosure by companies. Alternatively, disclosure on service contracts could be one of the areas that companies and investors look to agree as part of best practice guidelines.

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

There will be additional time taken, particularly in the transitional years, in re-drafting remuneration reports into the required two parts. There may also be extra work and costs in ascertaining detail to support new disclosures, such as the graph of TSR / CEO pay over ten year period. This will be exacerbated if the ten year period requires building an historic record.

Additional engagement with shareholders will be necessary in explaining the new disclosures and the elements that are subject to binding and advisory votes. It is difficult to quantify the exact costs that will be incurred by companies in making the transition as the impact will be felt across a number of internal departments.

Once the new regime is established, it is not anticipated that the costs will be materially different to complying with the current reporting regulations.

The costs could be increased for firms if there is inconsistency between the HM Treasury Bank Executive Remuneration disclosure proposals or any additional reporting required by the FSA over and above the current reporting requirements.

**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, companies will need some flexibility in how they wish to set out each element of pay and disclose information such as performance metrics. If the approach is too prescriptive, this may restrict the ability of the Remuneration Committee to implement policy over a reasonable period, e.g. three years.

It is helpful that the Government acknowledges companies should not be forced to disclose performance metrics where doing so would harm shareholder interests. It is up to companies to consult and agree the level of detail shareholders expect to see in order to make an informed judgement of the Policy Report. Shareholders will still have the ability through voting on the Implementation Report to influence behaviour if they have concerns with the practical application of the policy.
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.

Much of the information relating to the proposed scenario reporting is already disclosed in terms of potential threshold and maximum vesting levels but any graphical representation of total remuneration will need to make it clear that these figures do not represent value received at this stage. It should be stressed that these are only potential payments, subject to the achievement of targets over time and, in terms of share awards, linked to the future share price. There is a risk that investors may view the scenario disclosure as some form of cap on the potential value that will be received in future.

As mentioned in our response to Q1, if there is a desire to disclose the percentage change in profit, dividends and overall expenditure on pay in the reporting period, this would seem to sit better in the Implementation Report rather than the Policy Report. However, it is questionable whether this disclosure adds much value for shareholders. Expenditure on pay will be influenced by the business mix and model so comparisons across companies may be difficult. Greater flexibility for companies to choose measures which are more appropriate to their particular circumstances, for example the retention of capital rather than just changes in profit and dividends, may allow for more meaningful disclosure.

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.

Many companies already provide information in relation to potential exit payments under current reporting including any agreed contractual provisions. Overall, the latest proposals represent a more workable solution than the earlier proposal for a separate binding vote on exit payments that exceed 12 months salary.

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.

RBS already seeks employee views on remuneration generally through an annual survey and this could be a source of information for the Remuneration Committee to consider. Whilst it remains to be seen whether this information is of particular interest to stakeholders, it is encouraging that employee consultation is not proposed to be a mandatory requirement.
In terms of the proposed disclosure on the percentage increase in pay of the workforce against the percentage increase in pay of the CEO, it is not clear from the draft regulations whether this relates to salary or total pay for the CEO. The latter will include a much higher variable component that will only be earned based on performance. Therefore companies should be able to supplement this disclosure with a statement setting out the rationale for any changes in CEO base pay relative to the wider workforce.

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?

Yes. Companies need to have flexibility where performance targets, either in whole or in part, do not strictly follow the reporting year cycle, e.g. where they run up to the vesting date. However, the suggested disclosure provides for estimations to be used and this should be a workable solution for companies along with caveats to explain any estimations where necessary.

Although recruitment payments are not related to performance in the financial year, such awards are clearly of interest to shareholders. However it is not clear why recruitment payments are included within the benefits column of the single figure on remuneration. Typically such payments would relate to amounts awarded in lieu of deferred remuneration forfeited as a result of changing organisations. As such these amounts would better fit within the bonus or LTIP columns with appropriate footnotes.

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?

The use of the HMRC valuation methodology does have the advantage of being a simple and consistent approach. However, it is not clear why a 16x multiplier would not be used as is normal practice.

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

The principle of disclosing this amount is understandable in order to recognise that directors have suffered financial loss, but claw-back can happen at any time and may not relate to the year being reported on. It may also be implemented in different ways, e.g. reduction of current year remuneration and/or the forfeit or reduction of prior year unvested deferred awards that had already been included in the single figure, so there would need to be a methodology for valuing the amount to be disclosed on a consistent basis.
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?

Where the disclosure relates to awards that have vested, it should be less of an issue for companies to publish full details of performance metrics without impinging on commercial sensitivities, i.e. as a retrospective disclosure. There are more likely to be concerns relating to disclosure of performance metrics at the time of grant and during the time that awards are still part of the performance cycle. There may also be greater sensitivities in relation to annual bonus targets.

Many companies are facing this issue already and provide as full details as possible in their annual reports. This may include the framework under which performance will be assessed but with greater detail on actual targets disclosed retrospectively once the awards have vested. Similar flexibility should be provided for under these proposals. We note the Government does not expect these provisions to require companies to disclose performance metrics where doing so would harm shareholder interests. It is not clear as yet how the Government proposes to implement such an exemption but a “comply or explain” approach may be appropriate.

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

We agree that a consistent approach should be adopted in disclosure on pension benefits. Amounts should be included in the single total remuneration figure whether they are paid as cash in lieu or as arrangements under defined contribution and defined benefit schemes.

It is not clear how useful shareholders would find the disclosure of the accrued value of the pension were the director to retire at the end of the year. The value of a defined benefit pension is dependent on a number of factors including salary and pensionable service which may limit the ability for shareholders to compare value across firms and directors.

Another approach would be to disclose the accrued pension at the start and end of the year, which formed the basis of the HMRC calculation in the single figure, as this would provide a more transparent view of the change in a director’s pension.
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?

Information that allows shareholders to calculate face value is typically available to shareholders already in the remuneration report. It is important that shareholders understand that directors may not receive face value where performance conditions apply. Disclosure of the performance conditions will allow shareholders to judge the level of stretch and likelihood of the targets being attained.

It may be helpful if companies can supplement this disclosure if they wish, for example via a footnote of expected value rather than just disclosing face value. This would assist shareholders in judging the potential payout, recognising that it would be subject to a number of assumptions.

Care will also be needed in terms of the explanation of this disclosure and avoiding any potential confusion with the single total remuneration figure.

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.

Given the new requirements to disclose under the single total remuneration figure and variable pay awarded during the year, the proposed simplification of reporting directors’ interests in shares and share plans as at year end is to be welcomed. This may offset some of the additional work required for new disclosures.

Disclosing shareholding guidelines alongside share interests may be helpful to shareholders though it should be stressed that directors typically have a period of time over which to build up shareholdings to meet guidelines.

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?

No, RBS believes the five year TSR graph under current reporting requirements has been of little value and can see no benefits in extending this to a ten year TSR graph against CEO pay.

Different strategies may well have been in place over the period and what constitutes good performance can vary significantly between companies at
different times. Similarly, as is the case with RBS, the CEO and the business plan may have changed over the specified period, making comparisons between performance and pay more difficult.

TSR is only one measure of company performance. Rather than solely focussing on TSR, allowing companies a greater degree of flexibility, for example comparing performance against CEO pay based on measures that relate to the Company’s strategic plan and the CEO’s objectives for that period, would provide a more meaningful comparison.

**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 proposed approach seems reasonable although it may also be helpful for directors’ shareholdings and interests in shares / options to be part of the report subject to audit on the basis this is factual information of interest to shareholders.
19 September 2012

Barry Walker
Department of Business, Innovation and Skills,
1 Victoria Street
London
SW1H 0ET

Sent by email to: Executive.pay@bis.gsi.gov.uk

Dear Mr Walker,

Directors' pay: Consultation on revised remuneration reporting regulations

We previously submitted our views during the last consultation round and were pleased to see that our more substantive concerns had been taken on board for the purposes of the draft regulations. Notwithstanding this, some areas of concern remain, in particular relating to the proposed disclosure regime around annual bonus plans. To this end, we feel it important to share our views in relation to question 10 of the consultation document:

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 support the objective of transparency of reporting to show how companies operate pay for performance. Nevertheless we have strong reservations around the proposal to disclose individual targets and performance against these targets. This information remains commercially sensitive even after the financial year in question has closed as it would enable competitors to gain a level of insight that is inappropriate and it could be commercially damaging. Instead of disclosing specific targets, we believe the year-end disclosure could take the form of a narrative description and a qualitative assessment of progress made in the context of the environment in which the company operates.

Finally, we would like to take this opportunity to reiterate that it is important to ensure that the role, responsibilities and accountability of the Remuneration Committee to shareholders is not being undermined and thus we would urge BIS to refrain from being too prescriptive in relation to the final regulations on the content and operation of remuneration policy. We strongly believe that the content and level of detail contained within the remuneration policy section, including any discretion afforded to the Remuneration Committee, should be a matter for companies and their shareholders to agree between themselves.

Yours sincerely,

Anthony Habgood
Chairman of Reed Elsevier Group plc

Mark Elliott
Chairman of the Reed Elsevier Group plc
Remuneration Committee
Rio Tinto
### About You

<table>
<thead>
<tr>
<th>Name:</th>
<th>Ben Mathews, Company Secretary</th>
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<tbody>
<tr>
<td>Email:</td>
<td><a href="mailto:ben.mathews@riotinto.com">ben.mathews@riotinto.com</a></td>
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<table>
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<tr>
<th>Organisation:</th>
<th>Rio Tinto plc</th>
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<tbody>
<tr>
<td>Address:</td>
<td>2 Eastbourne Terrace, London, W2 6LG</td>
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### I am responding on behalf of (please tick):

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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.

Rio Tinto has some concerns over the proposed method of representing the following item in the “single total figure of remuneration” and believes that unless these anomalies are resolved they risk distorting what has actually been earned by the executive in the annual reporting year.

5.e.(i): final vesting is determined as a result of the achievement of performance conditions that end in the year being reported on

Rio Tinto believes that it would not increase transparency or stakeholders' understanding of pay reporting to include the value of LTIP awards which have vested during the year being reported on in column "e" of the “single total figure” table. The inclusion of a monetary value for LTIP awards, which may have been made between one and five years previously, is in our view erroneous since these values would have little or no relationship to the reporting year in question. This problem is increased when multiple awards vest in the same year.

Instead, we propose that the ‘fair’ or ‘expected’ value of LTIP awards made in the reporting year be adopted as the best way of representing the value for the single total figure of remuneration provided to an executive for the reporting year in question.

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

Rio Tinto has contributed to and endorses the response made by the GC 100 to this question. In their response, the GC 100 indicates that the transition to the new regulations is estimated to cost between £100,000 and £250,000 for FTSE 100 companies.

In this regard, the timing of the implementation of these regulations is significant. In practice, the first binding shareholder vote in respect of the remuneration policy will be at shareholder meetings in 2014. The implementation report with respect to that policy will then be submitted to shareholders in 2015 in respect of the 2014 financial year. It is clear, therefore, that 2013 - 2015 will be a crucial period of transition for companies and will be the years during which most cost will be incurred in complying with the new requirements.

We would also highlight that in addition to the costs mentioned by the GC 100, companies with a dual listed company structure (“DLC”), such as Rio Tinto, will face extra costs compared to companies which are listed in the UK. This arises from the need to align two different reporting frameworks.
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?

In addition to the input provided by the GC 100, Rio Tinto welcomes the introduction of a table which sets out the key elements of remuneration as it will reduce the duplication of information with regards to long-term incentives. This difficulty is more acute in companies which have a number of long-term incentive plans/schemes.

Rio Tinto also feels that given that the table is key to understanding a company's remuneration policy and provides the context for the implementation report, it should be produced annually.

Whilst we would welcome guidance, we recommend that such guidance that is issued makes it apparent that it should be for companies to construct their tables in a way they believe best fits and that they explain why it is appropriate for their particular circumstances. The final form of the proposals should, in our view, embrace this principle.

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.

We question the use of the same comparability measures (profits and dividends) for all companies. This will not, for example, be appropriate for companies such as Rio Tinto operating in the mining sector which is a cyclical industry, where price setting - which drives a significant part of profit levels - are not in the control of the management team.

We propose that companies be provided with the flexibility to determine their own reporting methodology for this purpose, e.g. the use of share price growth, dividends, profits, earnings per share etc. and therefore permitting companies to use two or three of the measures which are most appropriate to their particular circumstances. This allows sector differences over longer time periods to be more fairly reflected when comparing performance against total spend on pay.

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.

The approach to exits for executives will vary across different companies in different sectors. Companies need to have the ability to draft their policy on exit provisions with sufficient flexibility to ensure that they can react appropriately.

A flexible approach is particularly important for Rio Tinto as a DLC with listings in
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.

In addition to supporting the position taken by the GC 100, Rio Tinto notes that many FTSE companies already provide employees with opportunities to provide their views on remuneration policy through participation in all employee share plans which allow them to vote as shareholders on the remuneration report. It also encourages employees to comment on relevant remuneration policy and practices through its regular employee engagement surveys.

Rio Tinto further believes that a process of quasi consultation with employees on the remuneration policy may raise expectations among certain employees over them playing a more significant role in influencing executive pay and outcomes when, in the context of international rewards, they are not necessarily best placed to do so. We would suggest therefore that there is sufficient flexibility afforded to the boards of FTSE companies and, in particular, their remuneration committees not to comply with these provisions if they so choose.

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?

As mentioned in our response to question 1 with regards to the proposed remuneration regulation 5.e.(i), Rio Tinto believes that the approach of adopting a “fair” or “expected” value in respect of awards made in the reporting year is the best way of representing the value provided to an executive in the “single total figure” table.

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?

The proposed HMRC methodology using a factor of 20 does not reflect the actual value of the defined benefit pension being provided. Differences in retirement age, spouse’s pension and increases in payment are ignored if adopting this approach and it does not necessarily represent an accurate value where a director is based outside the UK and does not participate in UK pension arrangements.

We would point out that many international companies employ executive directors in London, Australia and New York and with executives based in various jurisdictions. This footprint requires us to take into account the legal and regulatory requirements of those jurisdictions, which may in turn impact on the approach taken to the disclosure of exit payments. The same considerations apply to multi-listed and other global/international companies.
different countries. Defined benefit arrangements can vary significantly from country to country and the UK specific HMRC methodology may well not be appropriate in these circumstances and provide an anomalous figure which could mislead readers of a remuneration report.

We would also highlight that the UK Listing Authority’s Listing Rules still require pension disclosures that are very similar to the requirements under Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) that these draft regulations are proposed to replace. The introduction of a further methodology for valuing a defined benefit pension may not therefore achieve its aim of increasing transparency and we would welcome clarification and alignment between the Listing Rules and remuneration report regulations in respect of pension disclosure.

DLCs have the additional consideration that the executive directors are paid under the statutory superannuation scheme operating in Australia. Any regulation of disclosure requirements needs to accommodate differences such as this.

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

Companies have differing nomenclature and approaches to malus (the cancellation of unvested awards) and claw back (the reclaiming of vested awards), not least because of the jurisdictions in which executives are employed, which will make it practically impossible to make informed comparisons between companies.

While we do not diminish the importance of transparency regarding malus and claw-back, we are not convinced that it should form part of the single figure and would suggest that if and when it is applied (which may in the case of malus before the vesting event, and claw back some time after the vesting event) it be subject to a separate disclosure.

**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?

Rio Tinto supports the GC100’s comments in respect of this question.

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

We support the proposed disclosure and consider that it gives sufficient scope for companies to explain their approach to the pension benefits received by directors, particularly if the pension disclosure required under the Listing Rules is retained. We are of the opinion that further prescriptive regulations on pension disclosure would not achieve the aim of increasing transparency.
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?

For the avoidance of doubt, as mentioned in questions 1 and 7 above, we propose that the approach of adopting a “fair” or “expected” value in respect of awards made in the reporting year is the best way of representing the value provided to an executive for the reporting year in question in the ‘single total figure’ table.

If the decision is taken to use the face value of the award in the reporting year, we wish to clarify that, for share options, the face value should be stated net of the subscription cost and/or that the option price should be clearly indicated.

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.

Rio Tinto supports the GC100’s comments in respect of this question.

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?

In addition to the GC100’s comments, we propose that companies be provided with the flexibility to determine and justify their own proxies and time periods for linking performance and pay, given their industry, geographical spread, appointment of senior executives, etc. This will lead to greater chance of genuine comparison between industries and to look at linkage between pay and performance over time.

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?

Rio Tinto supports the GC100’s comments in respect of this question.
RPMI Railpen
Executive Pay Consultation: Revised Remuneration Reporting Regulations

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.

We would observe that there is a risk that the policy is too wide and generalised and that it may permit too wide a discretion to the Remuneration Committee.

We would stress in passing that Remuneration Committees should only pay what is necessary which is not necessarily the same as paying the theoretical maximum amount available. We also welcome the requirement for a statement from the Chairman of the Remuneration Committee. This should have no cost implications as many progressive companies already provide this anyway but it might be helpful to have guidance on the content and for the statement to be reviewed by the external auditor as part of the assurance process (see response to question 15 below).

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

We consider this question is more for companies to answer. However, from our perspective, we do not envisage that the cost implications would be material given the level of reporting that is already required currently. However, costs may be material if the binding vote or the advisory implementation vote is lost, and not just in monetary terms, but also a cost in terms of the reputational damage.

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, it seems a reasonable balance between consistency and the minimum of prescription. The challenge will be for shareholders to set parameters and then trust the Remuneration Committee to work within those parameters. This is where engagement and honest communication between boards and shareholders will be vital. However, for effective application, key concepts should be clearly defined. For example, there should be a definition for ‘performance metrics’ preferably linking the achievement of strategy and pay.

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.

Yes, we consider the proposed requirements to be practical and informative which should provide a wider context to the cost of pay compared to other distributions. However, there needs to be consistency in relation to the definition of the profit figure and also the dividend payments to aid comparability across companies.

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.
Yes, the proposals seem comprehensive in terms of providing an overview to the general approach but we note that no information on exit payments will be provided on an individual basis. We also noted the absence of any reference to "mitigation". This is a key element of the negotiations between a leaver and the Remuneration Committee and can often work to limit the amounts to be paid by the Company from which the executive is departing. We would also welcome more transparency around the definition of “good” and “bad” leavers.

**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.**

This would be helpful, and we expect unionised workforces and their representatives would make their views known in any event. However, the value of this exercise is that it will make Remuneration Committees more fully aware of the broader issues in relation to pay across the company. It would also be helpful for the future policy report to indicate how shareholder views were taken into account.

We also envisage that the inclusion of a statement on the extent if any of consultation with employees on the remuneration policy might also lead to greater demand for the publication of the pay ratio of the CEO to the average employee.

We do not foresee this being an onerous cost on companies as the information will be available via personnel records. If an enormous pay gap was revealed, this would need careful explanation and justification by the Remuneration Committee. There should be an expectation on compliance rather than explanation in terms of the Remuneration Committee should be aware that a large differential would send signals of concern externally, including to shareholders. It is not enough just to take the ratio into account, it must be an influencing factor on decision making and outcomes.

Also informative would be information on ratios between CEO pay and the rest of the executive team. This would not be hindered by considerations around firm-specific factors that could lead to obfuscation of the information.

**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 on page 24 correctly give effect to this intention?**

We agree that the single figure should reflect the value the director becomes entitled to unconditionally in relation to the performance for the year. However, as drafted, we are not convinced that the specific disclosures will necessarily provide this. This is particularly relevant where performance and the vesting of the award are not coterminous as it could lead to disclosures in the subsequent year for bonuses vested shortly after the reporting year end based on the performance during the year. In some cases this could become very complex and detract from the clarity of a single figure.

**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?**

Yes, with reservations. We participated in the debate conducted by the Financial Reporting Lab on this issue and gave our qualified support to this approach. We consider that the HMRC methodology, although actuarially flawed in that it undervalues the cost of early
retirement, is better than the alternative bases such as transfer values or the more volatile IAS 19 approach that were also considered. Its chief merit is its simplicity and consistent applicability that is well understood by executives, companies and investors which is obviously helpful if it is to be used in compiling a single figure for overall pay.

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

Transparency dictates that any amount clawed back be included in the single figure, but it will serve to reduce the overall amount and therefore should be explained carefully by the Remuneration Committee as well as being indicated in a separate column within the overall disclosures.

**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 note that companies are more sensitive in relation to the disclosure of bonus targets as they may be visible to competitors. Whilst we are sympathetic to this concern, we consider that the bases for which bonuses are determined can be disclosed as well as retrospective disclosure of decision making once results are known.

It should be noted that current best practice for the disclosure of long term incentive performance targets is voluntary. The proposed legal requirement falls somewhat short of the status quo. It would be disappointing if disclosures under the new regime were to become less full. More generally, we do not consider disclosure of performance targets, whether retrospectively or prospectively would be commercially sensitive. We consider it puts the onus on Remuneration Committees to justify payments made.

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

Yes and we welcome the intention to extend disclosure to cover unfunded as well as funded defined benefit schemes. Current disclosure on pensions is insufficient and particularly for unfunded liabilities and the true cost may not be visible even to Remuneration Committees. Improved disclosure will give greater clarity on the quantum which in some cases may be so high that Remuneration Committees will need to review potentially excessive pension provision for executives. This would be a beneficial outcome from our perspective.

**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?**

If there is consistency across reporting, this would be an improvement on the existing arrangements. We support the use of face value provided that the term ‘face value’ is clearly defined in the proposed Regulations to enable consistent calculation.

**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.**

We are generally supportive.
**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?

We have already had this graph under the existing regulations and there is scepticism about its utility. We also would not want to see an unexpected outcome of this to be a disproportionate focus on total shareholder return. A more appropriate graph would be CEO pay tracked against the targets applying under the company specific incentive plans.

**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?

We agree that the five sections of the report identified in paragraph 97 of the consultation paper on assurance should be subject to audit. However, we would expect that the external auditor should also review the statement from the Remuneration Committee chair to ensure that it is consistent with the audit findings on the five specific sections. There is also a general expectation that the auditor should read the entire narrative report to see that it is consistent with the financial statements.

We hope that in reviewing various sections, the auditors also look at the financial accounts to satisfy themselves that management have not attempted to game the system to ensure they have met the performance criteria for incentive plans. For example, we are aware the EPS can be manipulated and indeed this is one of the reasons why shareholders are often wary of this performance metric. Accounting policies and practices should not be used to game performance targets and we consider the auditor has a role to play in ensuring management are making prudent decisions in the long term interests of stakeholders. For example, a company may pull back on spending on research and development, which is vital for the long term sustainability of the company to ensure they meet the targets of the short term incentive plan. This type of oversight by the auditors would assure the Remuneration Committee that the numbers upon which they have made pay decisions are robust.
SAB Miller
26 September 2012

Dear Mr Walker

Consultation on Revised Remuneration Reporting Regulations

I am writing on behalf of SABMiller in response to the consultation paper issued by the Department of Business, Innovation and Skills on the revised Remuneration Reporting Regulations. SABMiller is one of the world's largest brewers, with brewing interests and distribution agreements in over 75 countries and some 70,000 employees worldwide across six continents. SABMiller is listed on the London and Johannesburg stock exchanges with a market capitalisation of approximately US$70 billion (£43.2 billion), and in the year ended 31 March 2012, the group reported revenues of US$31,388 million with earnings before interest, tax, amortisation and exceptional items (EBITA) of US$5,634 million.

We welcome this opportunity to respond to the consultation paper, and we sincerely hope that our comments on the drafting deficiencies set out in response to question 1 will be considered seriously, but before setting out our responses to your specific questions, we have a number of general observations:

A. Generally, a number of the new requirements in the draft regulations appear to be predicated on the somewhat parochial assumption that all of the directors and employees of UK companies are in the UK, and ignore the fact that a significant number of larger UK companies have the majority of their business outside the UK. Making comparisons of relative pay or of percentage pay increases in multi-national companies with businesses across numerous countries in developed and emerging markets (as required for example by paragraph 30 of the draft regulations) is like comparing underpants with apples.

B. The regulations also appear to betray a lack of understanding of the global marketplace in which UK companies compete, not just for business but also for executive talent. We believe that there is a significant risk that the new regulations, if not applied flexibly and in a way that allows remuneration committees to exercise appropriate discretion, will have the potential seriously to limit UK companies' flexibility in remuneration and will adversely impact their ability to compete with non-UK companies to recruit talented executives. The costs of this are unquantifiable but...
may be substantial in the longer term, and may result in the UK ceasing altogether to be an attractive place for multi-national companies to base their operations.

C. We believe that there is a significant disconnect between the government’s approach to companies and its approach to investors. The government’s proposals rely upon a mis-applied point of pressure on companies, in the hope that greater transparency (or in some cases, the presentation of non-standard information in a standardised format) will result in more alignment between companies and shareholders. In our experience, most shareholders (with a few honourable exceptions) show no particular interest in engaging with companies on complex remuneration issues, and far too many shareholders are much more likely simply to delegate (or abdicate) their decision making to proxy advisory services and to vote in accordance with their recommendations, rather than analysing the explanations put forward by companies, engaging with management, and forming a deliberative view on companies’ reasons for adopting particular remuneration structures. We do not believe that the standardised reporting encouraged by the draft regulations will improve the alignment between companies and shareholders unless shareholders are willing to engage. Unfortunately, we see no evidence as yet that the new Stewardship Code is having the intended effect.

D. Global businesses are complex, and reducing remuneration to simple or simplistic standardised measures presented in prescribed tables will not necessarily be in the interests of shareholders, who expect (rightly) that management will manage complexity. Selecting the right measurement is more important than simplicity, and this should be supported by shareholders’ actions in encouraging and supporting company-specific performance metrics. And, as appropriate measurements may evolve over time, this can naturally increase complexity. Setting targets which deliver value to shareholders, and incentivising management to meet those targets, will clearly bring alignment. The art and science is in setting the right targets, hence the link to the strategy of the specific company, and not to the lowest common denominator. The regulations do nothing in our view to advance this cause.

E. Finally, there remains the main practical difficulty of a binding vote on the Directors’ Remuneration Report, which is how to identify what shareholders are voting on and what the implications are of a sizeable minority vote against, given that different shareholders may object to different aspects of the remuneration policy. For example, in relation to the advisory vote on SABMiller’s directors’ remuneration report at the annual general meeting in 2012, six shareholders were good enough to communicate before the meeting their intentions to vote against the report and their reasons why. Unfortunately, these six shareholders had four different reasons between them for objecting to different aspects of the report. Unless all shareholders communicate exactly what they are objecting to, it would be impossible to decide whether the will of the shareholders was for example that salaries should be reduced, bonuses cut or repaid or LTIP performance measures altered. It would be wholly impractical to propose a separate vote on each element of each director’s remuneration package, and in any event remuneration packages are structured as balanced packages combining a number of elements, to deliver a blended outcome designed to meet the needs of both executives and shareholders. A process where some elements, but not others, would be cherry-picked for approval or not would in practical terms be impossible to manage.
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.

We have the following specific drafting points on the regulations, which in some cases reflect specific points made below in response to the questions set out in the consultation paper, and on other cases reflect drafting errors or infelicities.

Paragraph 5(b)(ii):

We do not think that it is appropriate that cash dividends received over the vesting period of long term incentives are consolidated into a single figure (by being included as “taxable benefits” in column “b”). We suggest that they should more appropriately be included in column “e” which details the vesting of long term incentives. In any event, as drafted, there is the potential for double counting dividends received in the final year of vesting of long term incentives, as column “e” must include the value of accrued dividends received. If column “b” remains as drafted, there needs to be a specific proviso to exclude double counting of accrued dividends that would fall to be included in the final year under column “b” (or which have already been included under column “b” in respect of an earlier year).

Paragraph 5(c):

The consultation refers in paragraph 70 to the intended inclusion of “unfunded pension schemes”, and their valuation as if they were defined benefit schemes. The regulations as drafted do not in fact pick up "unfunded pension schemes" at all. See the response to question 8.

If the regulations are amended to include unfunded schemes, then we strongly suggest that any notional credits to such arrangements are valued in the same way as contributions to money purchase schemes. In legal form, such notional credits are most typically unsecured "promises to pay" by the company, and the amounts which might be paid to the director on retirement are referenced only to the amounts notionally credited (either by reference to salary or to notional interest on the notional balance), and not to the director’s final or averaged salary. They are therefore much more akin to a money purchase scheme. Of course, if the unfunded scheme does promise to pay an amount referenced to a percentage of final salary (which is theoretically possible, but extremely unlikely), then it would be appropriate to value it in the same way as a defined benefit scheme.

Paragraph 5(e)(ii):

As noted in more detail in response to question 7 below, the requirement to include the value of awards granted in the reporting year which are not subject to performance conditions is inappropriate, unless the awards are capable of immediate exercise. Such awards will almost always be subject to a three or five year vesting period, and their value should therefore only be taken into account when they have vested and are capable of exercise.

There also appears to be some confusion in the drafting, as paragraph 5(e)(i) refers to "final vesting", whereas 5(e)(ii) refers instead to "final value", which does not make sense in context, and should also refer to "final vesting".
Paragraphs 5, 6 and 7:

Generally, there are a number of instances throughout paragraphs 5, 6 and 7 of different words and terminology being used for the same concept in different places, which obfuscates the intentions of the regulations and makes their interpretation difficult and confusing. For example, instead of consistent references to a "director", the various paragraphs and sub-paragraphs sometimes refer to "director", sometimes to "person" and sometimes to "individual" for no obvious reason. Similarly, in some places there are references to payments or awards being "granted" and in other cases to being "awarded", with no obvious reason or consistency, or any clue as to whether the terms are being used inter-changeably or with the intention that they should have different technical meanings.

The same is true throughout paragraph 10, and also arises later, in paragraph 14, where the relevant sub-paragraphs appear to be talking about the same types of awards as to those covered by paragraphs 8 and 12 but use completely different terminology for no apparent reason.

Paragraph 6(e)(ii):

The drafting of this sub-paragraph just does not make sense. As written, it requires you to take a number of shares (being the number expected to vest — line item "(X)"); then to add to that number of shares, the amount of accrued dividend received (if any), which is a cash amount (to yield "XY"), and then to multiply that sum (which is the sum of a number and a cash amount, and hence not actually possible to add together) by the "market value of shares" at the date of vesting (which is presumably meant to refer to the market value of a share). The presumed intention is to multiply the number of shares vested by the sum of the market value of a share at vesting and the dividend (if any) accrued on a share during the vesting period (i.e. to multiply line 1 by the sum of lines 2 and 3, rather than multiplying the sum of lines 1 and 2 by line 3), but the drafting needs to be fixed.

Paragraph 7(5):

The cross-reference to paragraph 7(4)(a) is incorrect. There is no such paragraph.

Paragraph 8:

The additional disclosures required for annual bonuses and long-term incentives set out in paragraph 8(2) apply, as drafted, only to "any shares that have become receivable". Where shares are awarded as part of an annual bonus, this would therefore require disclosure of short term performance conditions, some of which may be commercially sensitive. For example, if they related to market share targets or the degree of success of new product launches, it would not be in the interests of the company or its shareholders for those targets to be disclosed to the company’s competitors. The consultation recognises this in a number of places, including on page 17: "The Government does not expect companies to be forced to disclose performance metrics where doing so would harm shareholder interests." and page 27: "We do not expect these provisions to require companies to disclose performance metrics where doing so would harm shareholder interests."

Accordingly, paragraph 8 needs to include a proviso which allows the company not to disclose performance conditions or the degree of performance achieved where in the board's opinion it would not be in the interests of the company to make those disclosures.
Paragraph 12:

This paragraph is predicated on the assumption that all "scheme interests" are structured in the same way. It assumes that all schemes specify a "threshold" performance, which may not always be the case. It is not clear what implicit assumptions are required to be made in order to determine "the maximum value at vesting if above [face value]" as the maximum value at vesting will be wholly dependent upon the degree to which performance conditions have been met, and on the share price at the time of vesting — is it to be assumed that the performance conditions are met in full (presumably) and that the share price has stayed the same, or risen by a hypothetical percentage, or something else? It is not clear that this has been sufficiently thought through.

Paragraph 14:

These provisions as drafted are inadequate to meet the stated intention.

(a) Paragraph 14(b)(i) refers to shares of which the director is the legal owner. We suspect that the intention is to refer to beneficial owner, which is quite a different legal concept, although we suggest that it would be much more appropriate to follow the existing language and terminology relating to the disclosure of interests of directors and their connected persons as set out in the Listing Rules and the Disclosure and Transparency Rules, rather than creating a separate new parallel confusing disclosure regime.

(b) Paragraph 14(b)(ii) and (iii) as drafted would require disclosure of all share awards and share options ever granted to a director, even if subsequently lapsed or exercised, and would double count any shares retained by the director following exercise (which would fall under paragraph 14(b)(i)). The intention presumably is only to count share awards or share options which have not vested, and share options which have vested but have not yet been exercised, but the drafting does not do this.

(c) It is not clear what is meant by paragraph 14(b)(ii). It would be helpful if it used the same terminology as paragraphs 8 and 12.

(d) In paragraph 14(b)(iii), the reference should be to shares or options the "vesting" of which is subject to performance conditions, rather than the "award" of which is so subject.

Paragraph 15(1)(c)(iii):

As drafted, this would require a company to disclose the remuneration of employees such as the head of compensation, or the head of HR, or the company secretary if those individuals are not directors but provided services to the remuneration committee. We doubt if this was the intention, and suggest that paragraph 15(1)(c) be amended by inserting the words "or an employee of a company in the group" after the words "director of the company" in the first line.

The word "who" in paragraph 15(1)(b) is superfluous.

Paragraph 19(c):

As with paragraph 12, it is not clear what implicit assumptions are required to be made in order to determine "the maximum potential value" as the maximum value of any variable share based payment
will be dependent upon the degree to which performance conditions have been met, and on the share price at the time of vesting — is it to be assumed that the performance conditions are met in full (presumably) and that the share price has stayed the same, or risen by a hypothetical percentage, or something else? Again, it is not clear that this has been sufficiently thought through.

**Paragraph 24:**

This requires a report on actual historic financial information in the reporting period. This report should therefore logically appear in the implementation report, and not in the future policy report. However, as noted below in response to question 4, we do not believe that this new report is either useful or informative to anyone.

**Paragraphs 27 to 30:**

Similarly, these paragraphs require backward looking reports on historic information and processes, and are not appropriate for a forward looking policy.

We suggest that paragraph 24 (if retained) and paragraphs 27 to 30 inclusive therefore need to be moved into Part 3 of the Regulations.

**Paragraph 30**

This paragraph requires the report to state the percentage increase in pay of the total workforce as a whole and the percentage increase in pay of the chief executive. This information is of course already required to be stated in a company's annual report, albeit that the chief executive’s pay is dealt with in the remuneration report and the total wage bill appears in the relevant note to the accounts. More importantly, the comparison will produce another meaningless statistic which in most cases will yield no useful insights into anything, let alone the relationship between pay and performance. A change in the total wage bill is most likely to be function of an increase or reduction in the total number of employees, which can itself be a function of numerous factors, including the acquisition or disposal of businesses, the launch of new businesses or the closure of existing businesses. Changes in the rates of pay, especially for global companies, will be much more a function of local market conditions, including local price inflation, which have nothing to do with the chief executive’s circumstances. Any spurious comparability between companies will therefore be the result of random coincidence than any meaningful similarities.

As noted in the introductory observations, this is one of the paragraphs which appear to be predicated on the somewhat parochial assumption that all of the directors and employees of UK companies are in the UK, which ignores the fact that a significant number of larger UK companies have the majority of their business outside the UK. Making comparisons of relative pay or of percentage pay increases in multi-national companies with businesses across numerous countries in developed and emerging markets is like comparing underpants with apples.

**Paragraph 33(1):**

Share awards may vest on a day which is not a business day. The definition of "value" should refer to the market price on the day of vesting or on the previous trading day if the vesting day is not a trading day (although we note that this is an existing definition in the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410)).
Question 2: What costs will companies face in adjusting to these revised reporting regulations?

We expect that the costs of adjusting to the revised regulations will be significant, in terms of the additional management time and resources which will be required in the collation of additional information for disclosure, preparation of the required reports, analysis of voting information, engagement with shareholders to understand which aspects of the report they did not support, and then preparing and publishing explanatory statements which try to reconcile different shareholders' reasons for voting against. In addition, we expect that companies will incur significantly higher external advisers' fees (remuneration consultants, legal advisers and auditors), which will reduce profits available for distribution to shareholders.

More specifically, audit costs will increase as a result of the regulations as drafted, as in a number of places new disclosures are required, on a new basis, of information which is already required to be disclosed under other legislative or regulatory requirements on a different basis. See our responses to questions 7(c), 11 and 13 below for specific examples. Additionally, companies IFRS 2 costs will continue to have to be audited, and it will add further audit cost to have to audit a different set of valuations based on the same underlying facts. It would be preferable for all remuneration disclosures to be consistent and to avoid having two different disclosure regimes for the same matters, both of which are subject to separate audit requirements and costs.

More importantly, we expect that the new regulations, if not applied flexibly and in a way that allows remuneration committees to exercise appropriate discretion, will have the potential seriously to limit UK companies' flexibility in remuneration and will adversely impact their ability to compete with non-UK companies to recruit talented executives. The costs of this are unquantifiable but may be substantial in the longer term, and may result in the UK ceasing altogether to be an attractive place for multi-national companies to base their operations.

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?

We agree that it is not practicable to prescribe specific disclosures in relation to each element of pay, as companies inevitably will differ in their approaches to remuneration and in the relative importance of different elements of pay. However, we believe that the amount of information required to be included in the table is excessive, and various elements seem to require statements of the blindingly obvious, such as in relation to base pay. We expect that the explanations of each element and the rationale for selecting particular performance measures will result in reports that are just as lengthy as at present, and that these tables will either be very large and hard to follow, or will become standardised and meaningless, containing the absolute minimum amount of information. Standard “tables” are more likely to formalise reporting and actually make it more difficult for companies to explain, and shareholders to understand, directors’ remuneration.

We suggest that companies be allowed to use appropriate narrative description, possibly under prescribed headings, rather than having to "dumb down" reporting by having to present information in a
summarised tabular format. At the very least, companies should be free to construct their tables in a way they think fit and explain why that is appropriate for their particular circumstances.

We also note that under the draft regulations and draft legislation, payments cannot be made which are inconsistent with the current approved policy. This could, for example, prevent the vesting of an award which was granted in accordance with the approved policy at the time, but may vest some years later when a different policy has been introduced which may be inconsistent with the old one. This will make it difficult for companies to make medium to long term commitments to executives, and result in companies being at a competitive disadvantage, and is likely to have the unintended consequences of driving up base pay and short term pay to compensate executives for the uncertainty. This problem could be addressed by including a specific provision in any new policy that any payments made in accordance with a previously approved policy are also permitted, but it would be helpful, and provide additional clarity, if the regulations made it clear that a company’s policy can indeed include giving effect to any commitment made before the current policy came into effect and which was consistent with any remuneration policy in effect at that time, even if not consistent with the current policy.

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.

(a) Companies are already required to make copies of service contracts available, as the consultation notes. We do not accept that it is “difficult to get hold of them”, as anecdotally alleged. In any event, the suggestion that the report should include remuneration extracts from employment contracts will increase the length of reports without providing useful information, especially as contractual remuneration provisions will not be understandable without also publishing the accompanying definitions. It would be much more sensible to give companies the option to discharge this obligation by making the service contracts available on their website.

(b) We are not convinced that the proposed scenario analysis will be terribly useful to anyone. Detailed scenarios will involve significant amounts of additional work for companies in compiling them and for investors in reading them, and will add additional clutter to the report, rather than conciseness. The proposal is also overly simplistic, as it assumes that all performance measures governing various elements of pay will move in the same direction at the same time, which is not always the case. It also assumes that all companies structure the variable elements of short and long term remuneration by specifying a threshold level of performance, which again is not always the case for all elements. For scenario analysis to provide any transparency or comparability between companies and between years, it needs to be clear how each component in the scenario analysis would be valued and what assumptions are required (e.g. salary increases, level of bonus award, level of long term incentive awards, share price performance, etc.). It is also not clear what implicit assumptions are required to be made in order to determine
what level of performance "exceeds" or "falls below" any given threshold, which could be anywhere between maximum and zero. In addition, even with those assumptions being clarified, the value at vesting will depend in the case of share based payments on the share price at the time of vesting — is it to be assumed that the share price has stayed the same, or has risen by a hypothetical percentage, or something else? It is not clear that this has been sufficiently thought through.

(c) In addition, the table of expected performance notably omits any reference to the inclusion of the impact of shareholding guidelines (or actual shareholdings) on remuneration levels. If a table of performance is required to be included, then logically the impact of an executive’s contractually required shareholding should also be shown. For example, if a CEO is required to hold 200% of base pay in shares, and the scenario (for impact on bonus, LTI, etc.) is a 10% fall in share price, then it would be more transparent for the table to show the total impact, *including* the impact on the value of the CEO’s required shareholding. Logically, the same principle should of course operate for scenarios which include an increase in share price.

(d) We see no particular utility in separate disclosure of the change in total pay compared with the change in dividends and profits, and we suggest that this requirement be removed, because:

(i) while there may be some value in highlighting the relationship between profit, dividend and pay in industries such as financial services where pay is a very large part of the company’s costs and is, to some extent, controllable from year to year, it has very little value in capital intensive industries where pay is largely a fixed cost and not one of the larger costs faced by the company. A total expenditure figure for those companies will reveal very little about decisions they have taken on remuneration;

(ii) A company’s expenditure on pay will vary by reference to the kind of industry it is in, where its employees are located and the extent to which work is contracted out, so the information will not be comparable across companies; and

(iii) These figures are already required to be stated in the accounts, and so do not need to be restated.

An alternative approach would be to give companies the ability to select their own reporting methodology for this purpose, depending on which metrics are most appropriate to their particular circumstances, rather than prescribing a one size fits all template. This might at least allow sectoral differences over longer time periods to be more fairly reflected when comparing performance against total spend on pay.
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.

We do not believe that any additional information would be useful.

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 do not think this should be included. What is the advantage and how do shareholders benefit from a statement to the effect that employee views on the remuneration policy have or have not been solicited?

In any event, there are many practical difficulties in organising an employee consultation on the remuneration policy. The logistics would be challenging, particularly where a company operates in many countries. The cost for companies, and hence for their shareholders, of organising a consultation would be significant, especially for companies with thousands of employees overseas who are unable to read English. Documents would need to be translated, concepts explained, and employees would have to be educated on the basics of remuneration. Large multinational companies with 100,000s of employees would probably have to engage third parties to manage the process. It is not clear that shareholders would welcome the company’s money being spent on such an exercise.

However, provided companies are able simply to state that they did not seek employee views on remuneration, the additional clutter in reports should be limited.

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 on page 24 correctly give effect to this intention?

No. We believe that the drafting has a number of flaws.

(a) The requirement in paragraph 5(e)(ii) to include the value of awards granted in the reporting year which are not subject to performance conditions is inappropriate, unless the awards are capable of immediate exercise. Otherwise, amounts will be included which the director may never receive (e.g. because he leaves employment before the awards vest or because of claw-back), which is misleading. It is of course very rare for directors of UK quoted companies to receive share options which are not subject to performance conditions, but in those rare instances where they are awarded, they will almost always be subject to a three or five year vesting period, and their value should therefore only be taken into account when they have vested and are capable of exercise (or alternatively, and more appropriately, as summarized in paragraph (c) below, their projected value over each year of the vesting period should be tracked and included, and then reconciled to the actual deemed gain in the final performance year).
(b) In addition, the reporting in the year of grant of awards with no performance conditions would produce quite ridiculous results. As drafted, 10-year share options, with no performance conditions and an exercise price which is set at market price on the date of grant, would be valued and disclosed as £nil under paragraph 6(e)(ii)! Clearly they would have some value, but they would be disclosed at nil value, which is a bizarre outcome and certainly not thought through.

(c) We also believe that it is conceptually wrong to record the whole value of the LTIP vesting in the final performance year, notwithstanding the Financial Reporting Lab’s recommendations. We suggest that it would be more appropriate to value and disclose the increase or decrease in the projected value of the LTIP over each year of the performance period, and then to reconcile to the actual pay-out in the final performance year. This is the approach adopted under IFRS2 (non-market conditions) and also similarly for the disclosure of defined benefit pension accruals in the current regulations governing the Directors’ Remuneration Report. This approach would ensure closer alignment between the 12 months being reported upon and the impact on the projected LTIP pay-outs. In the case, for example, of a 5-year LTI award, great performance in the first 4 years and flat performance in the 5th year might generate a good LTI pay-out, but the current drafting of the proposal would mean this is “hidden” for 4 years, and then disclosed only in the final year against flat 5th year performance. It would be more transparent for shareholders to see how the LTI projected pay-outs were being impacted by performance over each year of the performance period, and then reconciled to the actual pay-out in the final year.

(d) A number of companies require directors to take a portion of their bonus in the form of a share award which is not subject to performance conditions (as the performance condition has by definition already been met). It is clear in paragraph 5(d) that deferred bonuses not subject to performance conditions have to be included in the single figure for the year to which the bonus relates, but they also seem to be disclosable in the report for the following year as awards granted in that year with no performance conditions (paragraph 5(e)(ii)). It should be made clear that no amount is required be counted twice in the same single figure or in the single figures for one director in more than one year.

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?

It is a rough and ready approach which is not likely to yield an informative figure. The HMRC methodology will also not cater for executive directors employed in different countries, with local pension arrangements which vary from country to country, and may well produce an anomalous figure. A more refined and more meaningful approach would be to adopt the transfer value of the increase in accrued benefit, given that there will inevitably be a range of different retirement ages and benefit structures.

If it is to be used, we do not believe that it is appropriate to use the multiple of 20 (which is used for lifetime allowance purposes) to represent the value of one year’s defined benefit accrual. The annual allowance conversion factor (which would mean multiplying by 16, rather than 20) would be preferable.
as it gives the deemed value of a year’s accrual on which a member is taxed (to the extent that it exceeds the amount of the annual allowance).

As noted in response to question 1, the consultation refers in paragraph 70 to the intended inclusion of "unfunded pension schemes", and their valuation as if they were defined benefit schemes. The regulations as drafted do not in fact pick up "unfunded pension schemes" at all.

However, if the regulations are amended to include unfunded schemes, then we strongly suggest that any notional credits to such arrangements are valued in the same way as contributions to money purchase schemes. In legal form, such notional credits are most typically unsecured "promises to pay" by the company, and the amounts which might be paid to the director on retirement are referenced only to the amounts notionally credited, and not to the director’s final or averaged salary. They are therefore much more akin to a money purchase scheme. Of course, if the unfunded scheme does promise to pay an amount referenced to a percentage of final salary (which is theoretically possible, but extremely unlikely), then it would be appropriate to value it in the same way as a defined benefit scheme.

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

No. We believe that this is inappropriate, and that clawback should be subject to separate disclosure.

**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?**

As noted in response to question 1 above, the additional disclosures required for annual bonuses and long-term incentives set out in paragraph 8(2) apply, as drafted, only to "any shares that have become receivable". Where shares are awarded as part of an annual bonus, this would require disclosure of short term performance conditions, some of which may be commercially sensitive if, for example, they relate to market share targets or the degree of success of new product launches, and it would not be in the interests of the company or its shareholders for those targets to be disclosed to the company's competitors. The consultation recognises this in a number of places, including on page 17: "The Government does not expect companies to be forced to disclose performance metrics where doing so would harm shareholder interests." and on page 27: "We do not expect these provisions to require companies to disclose performance metrics where doing so would harm shareholder interests."

Accordingly, paragraph 8 needs to include a proviso which allows the company not to disclose performance conditions or degree of performance achieved where in the board’s opinion it would not be in the interests of the company to make those disclosures.

Shareholders will have the additional comfort of knowing that these figures will have been audited.
**Question 11:** Will the Government’s proposed disclosure requirements on pensions lead to reporting of sufficient information on the benefits received by directors?

The degree of disclosure will certainly be sufficient, but it would be helpful if these disclosures were harmonised with the disclosures required by LR 9.8.8R(11) and (12) of the Listing Rules, and if the Government were to consult with the UKLA to ensure that the two sets of rules are consistent and do not result in duplication or omissions. It would be preferable for all remuneration disclosures to be consistent and to avoid having two different disclosure regimes for the same matters, both of which are subject to separate audit requirements and costs.

**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?

No. We do not believe that face value disclosures are particularly helpful to any understanding of remuneration policy. The face value of an award alone will lead to misleading disclosure, and to a focus on hypothetical maximum remuneration levels that will only rarely materialise in practice, and is more likely to result in a ratcheting up of awards over time. We therefore suggest that disclosures should either be of expected value, or should at least include both face value and expected value. In any event, a remuneration committee’s rationale for selecting a particular level of award will take into consideration the benefits ultimately intended to be conferred on the executives, which will be a function of expected value, not face value.

**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.

Simplification of these disclosures is welcome, but given that (i) these details are already disclosed to the market through announcements made pursuant to the Disclosure and Transparency Rules, and (ii) there are existing annual report disclosure requirements contained in the Listing Rules (see LR 9.8.6R), it is questionable (and indeed has long been questionable) whether there is any value in repeating the totals in the remuneration report. Again, it would be preferable for these disclosures to be consistent and to avoid having two different disclosure regimes for the same matters.

It would also be much simpler for everyone involved if companies were allowed to maintain and update this information monthly on their corporate websites, so that shareholders are able to review the most up to date figures, rather than repeating out of date information in the remuneration report.
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?

We do not think that this will result in shareholders being any better informed, or any the wiser. The search for comparability across companies in different sectors and in different countries is a hunt for the chimera.

We see little value in tracking these measures retrospectively. A graph showing performance over the past 10 years, during which companies have had different CEOs, different board members, and policies and strategies will illustrate very little about a forward looking remuneration policy. If a CEO has been incentivised on, for example, absolute return on capital and paid for meeting targets set for him, subsequently comparing his pay against another measurement and judging performance on that basis is really pretty pointless.

In addition, any chart with CEO pay could end up being completely meaningless (irrespective of the performance measure that it is tracked against), as the way the “single figure” is proposed to be calculated will inevitably cause “spikes” as LTIs vest, or not, from year to year. However, if the single figure were to adopt an approach of valuing projected increases in unvested LTI pay-outs, as suggested in response to question 7, these “spikes” would reduce, making longer term comparisons more appropriate.

In practical terms, it will involve a lot of work for companies to go back and calculate the single figure for the CEO for the past 10 years. Such a graph will also be riddled with anomalies, as in perhaps the majority of cases where there have been a number of CEOs in the period, the pattern of remuneration will typically dip in the early years of a new appointment, as new CEOs remuneration packages will include share awards which do not vest in the early years of their tenure in the early years, and only flow through into “pay” in later years.

If the government decides to press ahead with this, at the very least the period should be reduced to 5 years, to reduce the wasted resource implications for companies and shareholders.

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?

No.

Yours sincerely,

John Davidson
General Counsel and Group Company Secretary
Severn Trent plc
Executive Pay: Revised Remuneration Reporting Requirements Consultation Response Form

Name of respondent
Andy Duff
Chairman, Severn Trent plc

Please state whether you are responding as an individual or representing the views of an organisation by ticking the appropriate box below:

| ✓ | Business or business representative organisation |
|   | Investor or investor representative organisation |
|   | Government or regulator |
|   | Lawyer |
|   | Remuneration consultant |
|   | Other professional advisor |
|   | Trade union or employee organisation |
|   | Individual |
|   | Other (please describe) |
26 September 2012

Barry Walker
Executive Pay Consultation
Department of Business Innovation and Skills
1 Victoria Street
London
SW1H 0ET

Dear Barry

Re: Consultation on revised remuneration reporting regulations

Thank you for providing us with the opportunity to respond on the above consultation document. I write on behalf of the Board of Severn Trent plc.

Severn Trent is a FTSE 100 utility, providing water and sewerage services in the UK and internationally through our two complimentary businesses — Severn Trent Water and Severn Trent Services. Our group turnover is in excess of £1.7bn and we have over 8,200 employees.

Overview
As a general principle, Severn Trent takes seriously the issue of setting a remuneration policy that links closely to the Company’s strategy, and does not differentiate in its policy between senior executives and other employees.

Accordingly, we support the objective of the proposed legislation, and believe that increased transparency in certain areas of remuneration reporting will, at least in theory, help shareholders to make a more informed decision when voting on directors’ pay. We believe that the revised proposals on voting rights, whereby issues such as termination payments are included within the policy vote rather than requiring their own separate resolution, are significantly more practical than previous iterations of the consultation.

To this end, our main concern will be to ensure that institutional investors are adequately prepared for the increased workload that will inevitably be placed upon them, as the effectiveness of the changes will depend upon shareholders exercising their voting rights diligently and taking into account the merits of each individual company’s circumstances. This will require shareholders to be willing to engage pro-actively with companies, including dedicating sufficient time and resources to the process.

The role of proxy advisors in this process will also be critical — already they wield significant influence and this is only likely to increase as the workload on shareholders rises. If shareholders and their proxy advisors do not appear to take sufficient time to understand a company’s pay policies and ensure that their decisions are made on their merits rather than applying a ‘black box’ approach (which is already a problem with certain shareholders and their proxy advisors), companies may in turn gravitate to a standardised set of pay policies which are not tailored towards each organisation’s strategy and challenges.
Costs
From a cost perspective, there will inevitably be a fairly significant financial and administrative burden on companies during the transition period, as they adjust to the new reporting and voting requirements. We believe that the key points in this regard are:

1. Most companies will, we expect, seek external advice from remuneration consultants to help redraft their reports in order to ensure that they are compliant with the legislation and sufficient to meet shareholders' expectations.

2. Many companies may use this time to review their remuneration policies completely – for example, if their policies were due to be reviewed in the next 2 to 3 years, they may bring this forward in order to avoid a 'policy change' soon after the new regulations are introduced. Furthermore, there are some areas of remuneration policy, such as having a pre-defined policy on exit payments, which many companies may not currently have in place. Therefore, as well as the explicit reporting changes there will likely be significant background work on remuneration policy being carried out alongside these changes.

3. There will also be a substantial amount of work required in communicating remuneration policies to shareholders in advance of the first binding vote – this will mean that shareholders themselves will likely be very stretched over this period and, as stated above, we believe a key risk could be that they do not have sufficient capacity to make a judgment on each company's policy.

Key changes to the reporting regime
In general, we think that most of the proposals are sensible and workable. We note that, of itself, the legislation does not appear to encourage excessive disclosure, but hope that on implementation of the legislation, the trend will be towards quality of disclosure rather than quantity. The expectations of shareholders and their representative bodies will likely shape the direction that companies take in this regard.

There are some areas of disclosure around which we have a few comments, namely:

• **Policy on exit payments:** Whilst we think this is preferable to holding a vote each time a termination payment exceeds a certain threshold, we feel that it may be very challenging for companies to determine in advance of any potential exit, what the termination payments would be. This is a key area of policy in which we anticipate that remuneration committees will value flexibility (taking account of the vast range of different scenarios which might lead to a termination), and will be interested to note the attitude that shareholders take to building in some flexibility here.

• **Employee views on remuneration policy:** Severn Trent is a unionised company with a large workforce. We value engagement with our employees very highly, although views on the issue of executive remuneration are not an area in which we have previously sought feedback. One concern is that employee engagement exercises can potentially be costly and it may be difficult to derive meaningful conclusions from the results. In this regard, we think it is likely that many companies will await developments in the wider market before carrying out their own employee engagement exercise.

• **Single figure of remuneration:** We believe that this is a suitable alternative to the current emoluments table and should enable a like-for-like comparison to be made between companies. We feel that the approach to claw-back (should this be invoked) as a deduction to the single figure is suitable. That said, one drawback with the single figure approach is that vested long term incentive plans will relate to performance over a number of years and therefore has a built in "lag" which when combined with salary,
short term bonus and benefits may give a misrepresentative correlation between performance and pay (in both directions) – this will particularly show up in the graph of pay versus performance (see separate comments on this below). Companies will wish to have the flexibility to relate disclosure of long term pay to the relevant performance period.

- **Disclosure of performance against targets:** For several years, Severn Trent made full disclosure of retrospective performance against its bonus targets. In the last reporting year we removed some of this, not due to commercial sensitivity but because we felt that the disclosure risked becoming too lengthy. We do not believe that, for most companies, a backward looking disclosure should be problematic from a commercial sensitivity perspective. However, we note that for some companies the disclosure could become quite cumbersome due to the nature of their bonus structures.

- **Graph showing comparison of TSR versus CEO pay:** We feel that the preparation of the data for this graph (i.e. in compiling ten years of retrospective CEO pay under a different methodology than previous reporting required) will be potentially very time consuming for some companies. In addition, we question how much value such a long backward-looking time scale would provide as the figures would relate to previous remuneration policies and, in many cases, former CEOs. We therefore wonder how useful this graph would actually be in practice in helping demonstrate to investors the alignment between pay and company performance.

I hope that these comments are helpful.

Yours sincerely

[Signature]

Andy Duff
Chairman of Severn Trent plc
Society of Pension Consultants
Dear Mr. Walker,

DIRECTORS’ PAY: CONSULTATION ON REVISED REMUNERATION REPORTING REGULATIONS

We welcome the opportunity to contribute to the above consultation.

INTRODUCTION TO SPC

SPC is the representative body for a wide range of providers of advice and services to work-based pension schemes and to their sponsors. SPC’s Members’ profile is a key strength and includes accounting firms, solicitors, insurance companies, investment houses, investment performance measurers, consultants and actuaries, independent trustees and external pension administrators. SPC is the only body to focus on the whole range of pension related services across the private pensions sector, and through such a wide spread of providers of advice and services. We do not represent any particular type of provision or any one interest - body or group.

Many thousands of individuals and pension funds use the services of one or more of SPC’s Members, including the overwhelming majority of the 500 largest UK pension funds. SPC’s growing membership collectively employs some 15,000 people providing pension-related advice and services.

The consultation document has been considered by members of our Legislation Committee. This committee comprises representation from actuaries and consultants, insurance companies and pension lawyers.

COMMENTS ON THE CONSULTATION

Our comments are restricted to the reporting of the pension element of directors’ remuneration.

1. GENERAL

We strongly challenge the proposal to move away from the current cash equivalent approach. The proposed new policy of using the HMRC method has been developed in isolation from the pensions industry (on the basis of just the one FRC research paper), but it seems fundamentally misplaced if one is concerned to disclose the value of directors’ pensions in an accurate and transparent way.

We therefore do not support the suggested approach.

Additionally, we have the following comments on its practical implementation.
2. **VALUING A DEFINED BENEFIT PENSION**

Where the pension is on a defined benefit basis, the proposal is that the benefit achieved in the financial year is to be calculated "using the HMRC method and where the value of the annual pension is capitalised using a multiplier of 20". The “HMRC method” is defined in the draft regulations as that under section 234 of the Finance Act 2004, namely the method used for the purposes of the Annual Allowance assessment. (As an aside, we note that, in the definition of the HMRC method, the words “lump sum” should instead read “pension related benefit”. In addition, whilst the draft regulations simply refer to s.234 of the Finance Act 2004, we assume that sections 235 and 236 would also be applicable.)

We have two major concerns, discussed below:

(i) **The s.234 method**

Firstly, the s.234 methodology does not produce sensible results for the additional benefit accrued during a year where the promised pension on retirement at normal retirement date (NRD) is unrelated to the length of service. The following provides an illustration of the issue:

**Example**

Director ‘A’ is aged 40 and is appointed at the start of the financial year on a salary of £300,000. She is promised a pension from age 60 of 2/3rds final salary if her service continues to that age, which is her normal retirement date (NRD). However, if she leaves service before her NRD she will become entitled from age 60 to a pro-rata deferred pension from age 60, reflecting the ratio of actual service to total prospective service.

At the end of the financial year, her actual accrued pension is:

\[ \frac{1}{20} \times \frac{2}{3} \times £300,000, \text{ namely } £10,000pa (\text{reflecting the fact that the } 2/3\text{ds pension accrues uniformly over the 20 years to her } 60^{th} \text{ birthday}). \]

Using a multiplier of 20 this would give a capital value of £200,000.

Ignoring for illustrative simplicity future salary increases, the additional pension actually accrued in each subsequent financial year would also clearly be £10,000pa.

However, the s.234 methodology would result in this director instead being treated as having fully accrued the entire 2/3rds pension in the first year of service, solely because the pension on retirement at NRD is non-service related. In other words, the total remuneration figure for the first year of service would include a pension component valued at £4m (20 x [2/3 x £300,000]), rather than the ‘true’ figure of just £200,000.

Moreover (again for simplicity ignoring future salary increases), each future year’s pension accrual using the s.234 methodology would be nil.

This clearly presents a misleading picture, on two counts. Firstly, the remuneration report for the first year of directorship would show a vastly overstated pension value (£4m rather than £200,000, in this example). Secondly, the reports in all future years would include no pension component of remuneration at all.

(ii) **The 20 multiplier**

Whilst using a single fixed multiplier has the appeal of simplicity, it will mask important differences between pension schemes. For example, it would result in £1pa of pension payable from age 60 having the same disclosed value as £1pa payable from age 65.

It will also mask the fact that the capitalised value of a pension varies with the age of the director. In particular, a multiplier of 20 is arguably too high, especially for younger directors.

We suggest, therefore, that consideration at least be given to a simple multiplier matrix, giving different multipliers for perhaps three age ranges (say up to 45, 46 to 55, and 56 and over).

3. **TOTAL PENSION ENTITLEMENTS**

We refer to paragraph 10 in Part 3 of the draft directors' remuneration report.

(i) In paragraph 10(2), the meaning of the phrase “assuming a normal retirement date” is unclear. We believe what should be disclosed is simply “…the accrued benefits under the scheme as at the end of that year, and the normal retirement date.”
(ii) Paragraph 10(3) would require “the total value of any additional benefit that will become receivable to a director in the event that that director retires early”. The following aspects are unclear:

(a) Would this exclude any additional benefit that would only be payable with employer and/or scheme consent? The use of “will” implies an automatic entitlement.

(b) Is one meant to consider all possible future early retirement dates?

(c) If the quantum of additional benefit depends on the date of early retirement, what should be valued?

(d) How should any additional benefit be valued? In other words, what capitalisation factor should be used?

Associated to (d), how should effect be given to the situation where early retirement may only occur at an age sometime in the future (because the director is some years from the earliest possible early retirement age), compared to the position of an older director who can immediately retire early?

Yours sincerely

John Mortimer
Secretary
Strategic Remuneration
Directors’ Pay: consultation on revised reporting regulations.
Response form.

The closing date for this consultation is 26 September 2012
Please return completed forms to:

Barry Walker
Executive Pay Consultation
Department of Business, Innovation and Skills
1 Victoria Street
SW1H 0ET
020 7215 3930
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection
In the interests of transparency, the Department may choose to publish the responses to this consultation. Please state clearly if you wish your response to remain confidential.

Please note also that information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.
### About You

<table>
<thead>
<tr>
<th>Name: Alan Judes</th>
<th>Organisation: Strategic Remuneration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Email: alan.judes@Strategic Remuneration.com</td>
<td>Address: 2 Hampstead Heights, London, N2 0PX</td>
</tr>
</tbody>
</table>

### I am responding on behalf of (please tick):

- Quoted company
- Other company
- Investor or investment manager
- Business representative organisation
- Investor representative organisation
- Non governmental organisation
- Trade Union
- Lawyer or accountant

- ✓ Management Consulting firm advising Remuneration Committees of FTSE 100 companies
- Other (e.g. consultant or private individual)
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.

Reasonably well. There are some drafting errors that need to be tidied up.

1. The information required by paragraph 24 Relative importance of spend on pay is not a policy matter, rather it is a disclosure of what happened in the year just ended and prior reporting year.

2. Paragraph 15(1)(b) is not well drafted – I suggest deleting the word “who” which will help the meaning of the regulation

Consideration by the directors of matters relating to directors’ remuneration

15.—(1) If a committee of the company’s directors has considered matters relating to the directors’ remuneration for the relevant financial year, the directors’ remuneration report must—

(b) state whether any person who provided to the committee advice, or services, that materially assisted the committee in their consideration of any such matter and name any person that has done so;

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

There will be costs in reframing the existing Remuneration Reports, and in obtaining advice confirming that the new regulations have been complied with. There will be costs in getting the ten-year history of CEO pay and calculating it in accordance with the regulations and having it audited.

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, many companies already have such tables even though it is not a requirement of the current disclosure regulations.
**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.

It is more a theoretical than a practical approach. The figures set out in each scenario are unlikely ever to be delivered in practice.

**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.

Not applicable

**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.

There could be unintended consequences of such a proposal. It is not the job of employees to give their views on pay of the directors, and could cause employees significant difficulties in the workplace if their views could somehow be attributed to them.

**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?

There is a key connection between this question and question 14 below. In isolation the reporting of remuneration only on vesting may not be a problem. However, the amounts disclosed will not be regular or smooth especially when a new CEO is recruited and there is a three or four year period without any vesting of LTI and then a large spike. Where performance is measured over a three or four year period it is hard to say that reporting the pay only in the last year gives a fair picture of the pay earned over the performance period. When comparisons are made either with CEOs from other companies or with TSR delivered to shareholders then the problems with this methodology become evident, and they are significant. In my opinion a better methodology would be to require the use of a cash-settled liability accounting approach. In this manner the remuneration shown would be reflective of share price performance year by year and would be cumulatively accurate in the final year of vesting.
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?

HMRC uses three different multiples (10, 16 and 20) for different times and purposes. Pension costs of defined benefit pension schemes are affected by interest rates and longevity predictions and these cannot be predicted precisely. BIS should choose its own arbitrary rate for disclosure purposes rather than linking it to a capricious and ever changing methodology posited by HMRC and the current Chancellor of the Exchequer.

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

Not if the shares never vested and therefore were not included in the income figure in the first place.
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?

For long-term incentives this should not be a problem. For annual incentive plans it is difficult to get the balance right. However, disclosure should be required.

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

As most companies are moving towards a defined contribution approach it most probably will not be possible to know what pension benefits are received by individuals. Also, once the director has left employment only unfunded arrangements need to be disclosed.

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?

Not really, as face value ignores the time value of an option. There is a possible unintended consequence of paragraph 6 (d)(4) that will see companies granting market value options without performance conditions which then are not reported as remuneration as there is no intrinsic value at the time of grant. There will, of course, be an accounting expense and questions could well be asked why the accounting expense should not go into a calculation of the remuneration figure.
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.

I do not know enough to answer.

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?

As presently drafted this graph will be of no use whatsoever. I understand where Vince Cable is coming from and can offer the following suggestion. The share-based component of pay in the graph must be an annual accrual of the change in value to the director using the cash settled liability method of accounting for share-based payments. In this way there is a relationship between the share price performance and the calculation of the remuneration figure. Without such an approach the comparison is spurious.

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?

Yes, the details of the share-based entitlements that have not vested.
Stuart Brown
Dear Sirs,

I am in favour of greater regulation of executive pay. However I oppose the Government's proposals because they assume that the basic economic model (i.e. free market, reward according to results, corporate self-determination) remains in place. I oppose the basic economic model, therefore I oppose the legislation.

To put in context what I would like to contribute to this discussion, it might be worth noting that I am presently on long-term contract to the UNDP and acting as EU High Level Policy Adviser to the Minister of Environment of the Republic of Moldova. Therefore questions of social justice, economic drivers and so on are a routine part of my work. I see this from both sides of the fence, being at the same time the sole director of my own company in the UK and a one-time associate member of the Institute of Directors. (I left it because it ceased to be relevant to my business.) I am neither a socialist nor a capitalist. I see in practice what makes societies tick, what tends to destabilise them or encourage stability, and what promotes economic "health". I use the word "health" rather than "growth" for a very specific reason, which I trust will become apparent.

A person has a right to be rewarded in proportion to something. The question is what that "something" should be.

The question of motivation

Any person needs the motivation of knowing that if they work harder and achieve more, they will be rewarded accordingly. There comes a point, however, at which a person is receiving so much money that it becomes for them a matter of practical indifference whether they succeed or fail. I hesitate to cite names, but Bob Diamond, for example, has been paid so much money that he need never work again. I see no justice in that. No person is worth so much as to merit being granted a lifetime exemption from all the cares with which normal people have to deal. In short, the expectation of additional reward provides motivation; the assurance of excessive reward promotes a careless disregard of consequence.

Economic distortion

If you were to come to Moldova, you would see very clearly what is the outworking of a free market economy. An increasingly small group of increasingly (and in Moldova unethically) rich people drive up the prices of basic commodities for which they are able to pay, placing them beyond the reach of ordinary folk. One month's average salary here will buy you 120 double espressos, while drivers prowl the streets in BMWs, Mercedes,
Hummers, Aston Martins and so on. Is that really how you would like the UK to develop?

The "worth" of people

When a person's head hits the pillow each night, the work that they do impacts upon them in some way. Some people are better able to deal with that than others. People should be rewarded in proportion to the burden that their work places upon them, not as some function of the profits that they generate for other people.

Economic "health"

The health of the world's economy will be determined by worldwide social justice and as much equality as can realistically be engendered while maintaining economic incentives for success. Worldwide economic growth is in fact not possible, given that resources are fixed, the population is growing and many countries survive only at subsistence level. We should be aiming for health based on social justice, not for growth based on an economic model that promotes greed, envy and resentment.

As I say, I am not a socialist. In fact I twice voted for Margaret Thatcher and in many ways I am still a preacher of monetarist policies with regard to development in places like Moldova. (You need only ask the UNDP if you require proof of that.) However, my experiences in the developing world have convinced me that the UK is pursuing a self-destructive policy: no person on the planet is so different at birth from others as to deserve being rewarded to the tune of 7,286 times more than someone else: that is the ratio of Bob Diamond's basic salary to the national average wage in Moldova, without bringing countries like Ethiopia into consideration. Is it any wonder that a growing proportion of the world's population resents us and what we stand for?

Regards,

Stuart Brown
Director
SB VisionConsult Ltd
Tesco
Dear Mr Walker

Tesco PLC response to the Consultation on Revised Reporting Regulations

Tesco PLC welcomes the opportunity to respond to the above consultation paper. Before we respond to the specific issues raised in the consultation, we wish to highlight the following principles which underlie our responses:

- We are concerned about the potential negative impact of over-regulating remuneration practices and disclosure. We believe the best outcomes will be achieved through companies and shareholders engaging more so that shareholders have trust in the directors they have elected to safeguard their interests. In our experience, we find that an open and regular dialogue with our shareholders is the most productive way of managing executive remuneration.

- We believe that remuneration should be fair. In testing fairness, companies and their Remuneration Committees should be expected to consider, among other things, external market practice; the pay and benefits provided throughout the wider workforce; the individual’s contribution to the performance of the business; and the value created for shareholders. However, we are not convinced that such considerations can be simply translated into a ratio, chart or a table. Even if it could, it may be of little value to external stakeholders as it would not be easily comparable to other companies.

- We think there is an opportunity to clarify and align the requirements in relation to remuneration practices and disclosures.

We have set out below our views in relation to the questions you have raised in the consultation:

**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.**

There are a number of areas that we believe need to be amended or clarified and we have set out details of these in Appendix 1.
Question 2: What costs will companies face in adjusting to these revised reporting regulations?

Additional costs will be mainly in the form of additional time to draft, review and approve the disclosure required under the revised regulations and in time and resources for companies and their shareholders as a result of the increasing level of engagement.

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?

As noted above, we are not convinced that a single table will be an effective way to communicate all of the relevant information. We agree that presenting information in the form of a table can be a clear and informative approach where this is accompanied by relevant supporting information. Consideration will need to be given to establishing the appropriate level of detail to be included in this table in order to balance the requirements of shareholders to have sufficient information but not to provide so much information that the disclosure loses its effectiveness. We agree that it is not appropriate for this to be achieved via further regulation and that companies and shareholders should work together to create appropriate guidance to deliver consistency and comparability.

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.

Under current legislation companies are already required to disclose the notice period and termination provisions in respect of executive contracts which provide information on the key areas of interest for shareholders. Extending the disclosure requirements to include all provisions that relate to remuneration would therefore not be particularly onerous.

We believe that scenario analysis disclosure would be more useful than the current requirements to disclosure the balance of fixed and variable pay. Companies will need to consider the assumptions used in this analysis carefully to ensure that it is an appropriate reflection of each potential scenario. Given that different assumptions are likely to be appropriate for different companies, we agree that it is right that a methodology is not prescribed but the assumptions used should be disclosed.

We do not believe that the disclosure on the percentage change in profit, dividends and overall expenditure on pay would add value for shareholders. It is unclear how considering the change in the total level of pay helps shareholders better understand the dynamic of the relationship between executive pay and performance. The total employment cost of an organisation can change for a number of reasons which may not necessarily be aligned with shareholder value creation. If numbers are included, we believe absolute spend or average spend per employee, rather than the change in spend, would be more appropriate and this information is already disclosed in other
places in the annual report or, in the case of average per employee, can be easily calculated from
the available data.

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.

We agree that companies should agree principles for exit payments and provide transparency
around payments that have been made. However, situations around exits are varied and unique
and we think that companies should have the ability to draft their policy on exit provisions with
sufficient flexibility to ensure that they can react appropriately in the prevailing commercial
circumstances without having to seek approval from shareholders.

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 do not agree that it is necessary for companies to consult with employees on remuneration
policy for executive directors in order to develop an appropriate remuneration policy that is both
equitable throughout the organisation and creates alignment with shareholder value. We do not
therefore believe that this requirement would provide useful information and add value for
shareholders. In addition, many companies operate across many countries and this requirement
would be practically very difficult to implement.

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 believe that a single figure, calculated on a consistent basis for all companies, could provide
useful information for shareholders, particularly when considered in the context of information
regarding the performance of the business during the year. We generally agree with the proposed
methodology put forward for calculating the single figure as we believe this number would best
represent what has been paid in respect of the performance that has been delivered up to and
including the financial year that is being reported on.

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

We agree that any amounts clawed back should be included in the single figure where the amount being clawed back has been included in the figure for a previous year or included in the single figure in another column for the year being reported on. Disclosures, however, should make it clear what has been paid and what has been clawed back.

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 generally support the disclosure of targets and performance achieved for long-term incentive plans. We have significant concerns around applying the same approach to annual bonus plans and we do not support the requirement for companies to disclose the actual targets originally set for each metric. We believe this information is commercially sensitive and its disclosure could be detrimental to the interests of the company and its shareholders.

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

We support the proposed disclosures on pensions. It is not clear from the consultation document whether the Listing Rule requirements would continue to apply. If not, then it may be necessary to continue to disclose some additional details such as the transfer value of pensions which is helpful for shareholders in assessing the pension benefit.

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?

We agree that showing awards at face value is the simplest and most informative approach. The alternative approach of using expected values is overly complex and relies heavily on the particular assumptions made by each company.

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.

We appreciate the desire to simplify the information on directors’ interests, however we are concerned that the draft legislation removes information that is vital for understanding the outstanding awards held by executives. The aggregation of all outstanding awards which remain subject to time and/or performance into a single figure would provide little value for shareholders.

It is not clear from the consultation document whether the Listing Rule requirements would continue to apply. If not, then we believe that it would be helpful for the detail of outstanding share interests of executives to continue to be disclosed.
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?

We agree that shareholders may find it helpful to compare company performance against CEO pay. Total shareholder return may be the best proxy for many companies but other measures of performance may be more relevant for some and we would welcome the flexibility for companies to take a different approach where appropriate and provide an explanation for this. If TSR is used we think that the measure should be the three year TSR to the end of the financial year as it would provide a more meaningful snapshot of a company's performance each year and would be more consistent with the timeframe of incentives for directors.

We agree that it is better for CEO pay to be used rather than a total or average of all directors. Although this places a lot of focus on one role, the alternative approach would make year on year comparisons meaningless given that the number of individual directors on the board will often change from year to year. We believe that a graph covering a five year period, rather than the ten year period proposed, would be more useful as it would align better with the typical tenure of a CEO and would better reflect the current remuneration committee's decisions around pay.

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?

We agree that the areas set out above should all be subject to audit.

If you would like to discuss any of these points further, we would be happy to do so.

Yours sincerely

Jonathan Lloyd

Company Secretary
Tesco PLC
### Appendix 1 – Comments on draft regulations in Annex B

<table>
<thead>
<tr>
<th>Regulation</th>
<th>Comment</th>
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<tbody>
<tr>
<td><strong>Part 2 - Summary Statement</strong> &lt;br&gt;2. The DRR must contain a statement by the director who fulfils the role of chairman of the remuneration committee summarising the contents of the report</td>
<td>The purpose of the letter is intended to “summarise the key messages on remuneration and the context in which decisions have been taken”. We think that the regulations should be amended as follows: “The directors’ remuneration report must contain a statement by the director who fulfils the role of chairman of the remuneration committee summarising key messages on remuneration and the context in which decisions have been taken”</td>
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<tr>
<td><strong>Part 3 – Single total figure of remuneration</strong></td>
<td>As currently drafted, only salary and fees are specifically defined as being in respect of qualifying services. This definition should apply to all of the elements of pay in the single figure table.</td>
</tr>
<tr>
<td><strong>Part 3 – Single total figure of remuneration - 5 (d)</strong></td>
<td>In practice, bonuses are not awarded during the financial year as bonus decisions and the actual payment are made after the year end. The regulations should be amended as follows: “money or other assets awarded in respect of the reporting period”</td>
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<tr>
<td><strong>Part 3 – Single total figure of remuneration - 5 (d) and 5 (e)</strong></td>
<td>The drafting of these clauses is not clear and could be further clarified.</td>
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<td><strong>Part 3 – Single total figure of remuneration - 6 (e) (iii)</strong></td>
<td>This paragraph states that the “value of the benefit will be calculated on the basis on an average market value over the last quarter of the financial year”. The consultation document states that a three month average should be used. For companies where the financial year is not a full calendar year these periods might not be exactly the same. Either approach is fine but there should be a single definition.</td>
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<td><strong>Part 3 – Single total figure of remuneration - 6 (e) (iv)</strong></td>
<td>This paragraph states that where share options have been included in the single figure the amount shown should be net of the exercise price. Share options may be included in the single number before they have actually been exercised so this should be amended to: “was or would have been required to pay to purchase”</td>
</tr>
<tr>
<td><strong>Variable pay – additional disclosures - 8 (2)</strong></td>
<td>We do not believe that the intention is to limit this disclosure to just share based payments and therefore the word “shares” should be replaced with the word “remuneration”.</td>
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<tr>
<td><strong>Variable pay awarded during the financial year where the value will be determined according to the achievement of performance condition in future periods - 12</strong></td>
<td>If awards are made in the form of share options the option exercise price should be disclosed.  &lt;br&gt; If shares are awarded without performance conditions but subject to continued employment then these should also be disclosed under this paragraph and the section title should be amended to reflect this. More guidance should be provided on how to interpret “threshold”.</td>
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26th September 2012

Barry Walker
Executive Pay Consultation
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

Dear Barry,

I attach Towers Watson's response to the consultation on directors’ pay and please don’t hesitate to contact me if you have any questions.

You may know that the team here, particularly Tamsin Sridhara, have been in contact with Gemma Peck over the last few months and our remarks are predicated on the basis that we have already given our views on the pitfalls that aspects of the regulations and new approach entail.

We have also tried to make our comments (and mark-up of the regulations) as practical as possible.

Yours sincerely,

Katharine Turner
Executive Compensation UK
Directors’ Pay: consultation on revised reporting regulations. Response form.

The closing date for this consultation is 26 September 2012

Please return completed forms to:

Barry Walker
Executive Pay Consultation
Department for Business, Innovation and Skills
1 Victoria Street
SW1H 0ET
020 7215 3930
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection

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In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.
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<th>About You</th>
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<tr>
<td><strong>Name:</strong> Katharine Turner</td>
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<tr>
<td><strong>Email:</strong> <a href="mailto:katharine.turner@towerswatson.com">katharine.turner@towerswatson.com</a></td>
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<td><strong>Lawyer or accountant</strong></td>
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<td><strong>✓ Other (e.g. consultant or private individual)</strong></td>
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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.

- In broad terms, they give effect. Positive aspects include:
  - The necessity for remuneration committees to review policies and practices and take a total pay perspective;
  - The greater focus to the remuneration reports; and
  - The encouragement for greater dialogue between companies and their shareholders.

- However, we understand that the draft regulations were published in haste and they are, in many cases, unclear and inconsistent with the guidance and the policy intent outlined in the consultation document. For completeness, we have attached a manuscript mark-up of the draft regulations setting out our comments and suggested amendments, as well as some questions.

- Our major concern centres on the operation of the proposed Companies Act provision that any payment to a director inconsistent with the latest approved policy shall have no effect and authorising directors will have a liability. This places great emphasis on the relevant policy disclosures (and the level of detail) and we urge that, in reviewing the drafting of the relevant sections of the regulations (s.19, 25 and 26), the right balance is struck between ensuring companies provide investors with sufficient guidance on their overall approach to directors’ remuneration but remuneration committees are left with sufficient flexibility to respond appropriately to changing business environments and unforeseen events. The remuneration policy requirements in the regulations should therefore be high level (as currently) but more clearly drafted, with further details being left to guidance either from BIS or investors.

- We are also concerned about the adviser fee disclosures. The draft regulations do not match up to the stated intention in the guidance. We are not convinced that the policy intent captured in Para 85 (that for each adviser the total cost of advice to the remuneration committee on directors’ remuneration should be disclosed) is helpful for shareholders. It is more helpful for other remuneration consultancy firms for marketing purposes.

- We are not supportive of the additional requirement in the draft regulations (s.15(1)(c)(iii)) that the total fees earned for all services provided to the client should also be disclosed. The latter will not provide any meaningful insight into remuneration committees’ decision-making and is a flawed barometer for judging the objectivity of advisers’ assistance. A more valuable measure, if required, would be in respect of the relative importance of the fee stream to the adviser rather than the absolute amount. For example, the requirement might be that, in cases where the advisers were paid more than a specified threshold of their total prior year’s revenues by a client (e.g. at least one-half of one per cent), that percentage should be disclosed. We suggest that it might even be more useful for shareholders to know what steps the remuneration committee has taken to ensure that...
the advice received was objective and independent.

- In addition, the proposed combination of separate votes on the policy and implementation sections and the fall back to latest approved policy may have some perverse (although admittedly unlikely) outcomes, for example:

  - Shareholders may be comfortable with a policy in Year 1 (and approve it by a binding vote), but may be surprised by its implementation as disclosed in Year 2’s implementation report (resulting in a failed non-binding vote). This would lead to a compulsory binding vote on policy in Year 3, which may then be failed. However, even if it were failed, the “fall back” policy would be the Year 1 policy report (which may, for example, have been too wide / flexible, leading to the objectionable implementation). The company and shareholders are therefore being thrown back on the policy which led to the objectionable outcomes. Practically, we would anticipate the company taking whatever steps were necessary to rectify the situation.

  - A further potential problem is that implementation reports in the first 2-3 years of the new regime will contain details of LTI awards granted under the current regime and which may benefit from the transitional arrangements. The vesting outcomes of these LTI awards may be objectionable, leading to a failed implementation report. However, even if the company modifies its future grant policy, it will not affect the outstanding awards. Companies that fail the first implementation report under the new regime may therefore also fail the second and third reports for the same reason (as historic awards will continue to vest on the same basis).

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

- From working with clients who want to be early adopters, we can already see the additional time and resource costs in preparing for the new regime. Preparation is taking an additional two/three months longer compared to the current report – at least for the first year. We would expect these additional costs to reduce over time, as they did when the current regulations were introduced in 2002.

- A significant part of the additional time commitment relates to reviewing all aspects of directors’ remuneration arrangements and related contractual entitlements (current and forward looking) to ensure that they are adequately addressed in the policy report and to remove the risk of inconsistent payments.

- Other additional time and resources costs include collating data for the 10 year CEO/TSR chart (not beneficial) and engaging further with institutional shareholders (beneficial).

**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?**
We think that the regulatory requirements should remain high level, but should be clearly stated and thought through. In the current draft, the requirement to show how an element “operates” is ambiguous without reference to the mock up table. Likewise, the requirement to show “maximum value” is inappropriate (i.e. it does not work) for base salary and benefits, although the mock up table offers an interpretation.

We are supportive of there being further guidance from BIS, but on the understanding that this is guidance. If BIS is to issue an updated mock up table, we suggest it also covers non-executive directors.

Neither the regulations nor the mock up table cover payments related to new hires, payments to newly-promoted directors relating to prior commitments or other one-off events, yet these will clearly need to be captured in the policy table if different from “regular” policy.

**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.

- The provisions in respect of pay scenarios appear sensible and informative.
- The requirement with respect to service contracts may lead to duplicative disclosure, given that all such provisions will need to have been reflected in the policy table if they are to take effect (unless benefiting from transitional provisions). We suggest that the requirement be restricted to remuneration provisions under service contracts that are inconsistent with the policy disclosures.
- We understand the topical concerns on distribution, but given that this requirement relates to overall executive pay, question whether it should be in the remuneration report at all. If it is, we suggest that it should be in the implementation report but note that simply showing a single year’s % increase will not be informative and may give false indications.

**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.

- The requirements are reasonable and it is helpful to specifically require disclosure with respect to long-term incentives as these are not specifically covered by the current disclosure requirements and disclosure has been patchy. This will, however, lead to longer disclosures.

**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 understand that this was included to reflect current political concerns. We agree with the Government that seeking employee views on directors’ pay should not be a requirement. There are many instances of main market listed companies where this would be particularly difficult and unfeasible. Even where companies have a workforce based wholly in the UK, employees’ views on directors’ pay may be highly subjective. We anticipate that much of the disclosure around this requirement will be uninformative to shareholders and boiler-plate in nature.

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 accept that, if the single figure approach is adopted, specific rules will be required to ensure compliance and consistency. We also accept that, if the intention is to link disclosure as far as possible to the performance period (as is currently the case with annual bonuses), the proposed approach is appropriate. There are, however, a few aspects that require further consideration, in particular:

- How to disclose the vesting of LTI awards that have two performance conditions, one ending at the end of the financial year, and one ending after sign off of the remuneration report for that year;

- How to recognise that some of the awards that will be captured in the single figure may be subject to additional service requirements and/or clawback;

- How to deal with the clawback of an amount that has already been recorded in a prior single figure table;

- How to reconcile the disclosures in the single figure table related to share-based interests (which will be disclosed as if vested when legally this may not have been the case at the time the remuneration report is signed off) with the disclosures required under s.14 and by the Listing Rules under which have to disclose interests according to proper legal status.

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?

In our previous submissions, we offered various alternative approaches to valuation but accept that in the context of trying to provide shareholders with an illustration of the value of the directors’ current pension rewards in a way that is comparable with previous years and other directors, then the HMRC proposal has some merit.

There are weaknesses to the HMRC approach that still have to be ironed out and, as acknowledged in the consultation document, there is even more variation in overseas pension schemes, so it is likely to be less accurate for executives based outside the UK.
For these purposes, its use would be improved if the methodology could take into account the impact on the value of different pension ages and employee contributions, for example.

- The increase in DB value over the financial year may have been part-funded by employee contributions. This part would be included in the HMRC calculation but would be (a) inconsistent with the treatment of defined benefit schemes, where only employer contributions will need to be shown in the single figure table, and (b) lead to double counting (as the employee contributions would also be included in salary).

- For the same reason, we suggest that salary sacrifice-related contributions are also excluded for the purposes of calculating defined benefit and contribution values, as these will already have been disclosed in the salary disclosure and will result in double counting.

- It would also help to have clarification on:
  - Whether the pension benefit disclosures relate simply to qualifying services or other services, and
  - How cash balance benefits are to be valued (neither the valuation of money purchase benefits or defined benefits would appear to be appropriate for cash balance benefits).

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

- It is unclear how this is currently reflected in the draft regulations (if at all)? Should claw-back also be recorded as a negative in calculating the single figure?
- As noted above, it will be important to make clear what elements within the single figure remain conditional, subject to forfeiture and/or subject to ‘malus’ or claw back.

**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?**

- It is important to distinguish between metrics (measures), targets (performance standards) and out-turns (performance against standards). Although many companies already choose to disclose performance metrics, including performance against those metrics (sometimes as an indicative range), it is not appropriate for companies to be required to disclose all metrics, targets and performance out-turns, even retrospectively.
- These can all be commercially sensitive, particularly annual bonus metrics. It is easier for some companies than others – regulated businesses are not in the same position as FMCG companies for example. If more disclosure is deemed to be desirable, we would recommend that this be introduced on a comply or explain basis and/or for companies to be required to indicate in narrative terms the overall level of achievement of each performance measure (threshold, target, indicative range etc). This would enable
Question 11: Will the Government’s proposed disclosure requirements on pensions lead to reporting of sufficient information on the benefits received by directors?

- This depends on the purpose and objective. Increasingly, executive directors receive cash in lieu of pensions and shareholders can, as now, see the cost to the company.
- Likewise, there is and will continue to be clear visibility on ‘cost’ with respect to defined benefit contribution arrangements.
- As for defined benefit promises, the values that have been disclosed in detail for at least ten years have not been well understood and some shareholders may be further confused by the new numbers presented by the HMRC approach which do not represent the ‘cost’ to the company.
- The combination of the policy table disclosures on pension, exit policy disclosures proposals and the supplementary provisions on pension in respect of early retirement (s.10) should combine to draw out most other pension related entitlements.
- We note, however, in relation to s.10, that under the current drafting it is unclear to us exactly how the accrued benefits at the end of the year “assuming a normal retirement date and the date the benefit becomes payable” should be calculated. For instance, what is meant by “the date the benefit becomes payable”, is this normal pension age or the earliest age that benefits can be drawn? It also unclear how “the value of additional benefit if the director retires early” should be calculated.

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?

- We consider this to be a practical and informative approach. However, we would suggest that this information is supported with accounting values (to confirm, not expected values), which is often much more informative.
- Whether or not our suggestion is adopted, it will be important to highlight that the face value of shares awarded in the year should not be confused with the realised value which will depend on a number of factors including share price growth and whether vesting conditions are met.
- As with a number of aspects of the new proposals, it will also be necessary to ensure consistency with the equivalent reporting requirements under the Listing Rules.

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.

- Simplification is welcomed as the proposals would lead to the current extensive tables on outstanding LTI awards no longer being required.
- However, this may not simplify the reporting requirements for the largest companies, who will still have to adhere to Listing Rule 9.8.6 which requires listed companies to disclose...
the total interests of a director and his or her connected persons as at the end of the period under review unless, of course, the Listing Rules are also modified.

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?

- While we recognise the Government’s intentions, we do not consider this graph will provide the type of meaningful disclosure required. We have already worked with several clients on the preparation of this graph and find that:
  - The results are uninformative given that TSR performance is typically such a small determinant of total pay received; and
  - A change of CEO can lead to meaningless results for a number of years.

- It would be much more helpful to allow companies freedom to make the business case for their pay outcomes for the CEO over the last five years (being the average tenure of CEOs in the UK) or over the tenure of the CEO in post as they see fit (i.e. not necessarily using a prescribed format graph).

- We would also suggest that comparison on a relative basis (as with the current TSR graph) would be much more informative, rather than just absolute performance.

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?

- We would not suggest that any other sections of the report should be subject to audit.
Annex B: Draft regulations

Draft Regulations laid before Parliament under section 473(3) of the Companies Act 2006 for the approval by resolution of each House of Parliament.

DRAFT STATUTORY INSTRUMENTS

2013 No. XXXX

COMPANIES

The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2012

Made - - - - ***

Coming into force - - ***

The Secretary of State makes the following Regulations in exercise of the powers conferred by section 421 of the Companies Act 2006(25).

In accordance with section 473(3) of that Act, a draft of this instrument was laid before Parliament and approved by a resolution of each House of Parliament.

Citation and commencement

1. These Regulations may be cited as the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 and come into force on .........

Amendment to regulation 11 of the principal Regulations

2.—(1) In these Regulations, “the principal Regulations” means the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008(26).

(2) Regulation 11 of the principal Regulations is amended as follows.

(3) For regulation 11(2) substitute—

“11.—(2) In Schedule 8—

Part 1 is introductory,

Part 3 relates to information relating to the financial year in respect of which the report is required to be made,

(25) 2006 c. 46.

(26) S.I. 2008/410.
Part 4 relates to the policy part,
Part 5 identifies which parts of the report are subject to audit,
Part 6 is interpretative and supplementary.”.

(4) In regulation 11(3) for “Part 3” substitute “Part 5”.

Substitution of Schedule 8 to the principal Regulations

3. For Schedule 8 to the principal Regulations substitute the provisions set out in the Schedule to these Regulations.

SCHEDULE

“DIRECTORS’ REMUNERATION REPORT

PART 1

INTRODUCTORY

1.—(1) In the directors’ remuneration report for a financial year (“the relevant financial year”) there must, subject to sub-paragraph (2), be shown the information specified in Parts 2, 3, and 4.

(2) The policy part of the report, as specified in Part 4, may be omitted from the directors’ remuneration report for a financial year, subject to paragraph (3), if that part of the report is not to be subject to a resolution at a general meeting in accordance with section 439A of the Companies Act 2006.

(3) Where the policy part is omitted from the report, there shall be set out in its place an indication of where on the company’s website or other place the policy part which was last approved at a general meeting can be found.

(4) Information required to be shown in the report for or in respect of a particular person must be shown in the report in a manner that links the information to that person identified by name.

PART 2

SUMMARY STATEMENT

2. The directors’ remuneration report must contain a statement by the director who fulfils the role of chairman of the remuneration committee summarising the contents of the report.

PART 3

REPORT RELATING TO THE FINANCIAL YEAR IN RESPECT OF WHICH THE REPORT IS REQUIRED TO BE MADE

Single total figure of remuneration

3. The directors’ remuneration report must, for the relevant financial year, for each person who has served as a director of the company at any time during that year set out in a table in the form set out in paragraph 4 below the information prescribed by paragraph 5 below.

4. The form of the table required by paragraph 3 is—

<table>
<thead>
<tr>
<th>Single Total Figure Table (£’000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>a</td>
</tr>
<tr>
<td>----</td>
</tr>
<tr>
<td>Director 1</td>
</tr>
<tr>
<td>Director 2</td>
</tr>
</tbody>
</table>

5. In the table in paragraph 4, the sums that are required to be set out in the columns are—
(a) in the column headed "a", the total amount of salary and fees in respect of qualifying services;

(b) in the column headed "b"—
   (i) all taxable benefits;
   (ii) all cash dividend received over the vesting period of long term incentives;
   (c) in the column headed "c"— all pension related benefits including—
   (i) cash in lieu of pension;
   (ii) benefit achieved in year from participating in money purchase schemes;
   (iii) benefit achieved in year from participating in a defined benefit scheme;
   (d) in the column headed "d", money or other assets awarded in the reporting period as a result of the achievement of performance conditions that relate to that period other than—
   (i) payments which are awards granted in a previous period and where final vesting is determined as a result of the achievement of performance conditions relating to the year being reported on (or shortly thereafter), or
   (ii) payments which are awarded in the reporting period but whose vesting is subject to achievement of performance conditions in a future reporting period;
   (e) in the column headed "e" awards under schemes (as defined in paragraph 7 below) where—
   (i) final vesting is determined as a result of the achievement of performance conditions that end in the year being reported on and (or shortly thereafter)
   (ii) awards granted under schemes (as defined in paragraph 7 below) where the final value is not dependent on the achievement of performance conditions;
   (iii) the column headed "f", the total amount of the values set out in columns "a" to "e".

6. The measurement methods to be used to calculate the sums specified in paragraph 5 are—
   (a) for column "a", cash paid to or receivable by the person in respect of the year,
   (b) for column "b", the value at which they would have been taxable if the director was subject to tax,
   (c) for column "c", the cash value;
   (d) for column "d", the total cash equivalent including any amount deferred,
   (e) for column "e", either—
   (i) the cash value of any monetary award or
   (ii) the value of any shares or share options awarded, calculated by—
   (X) multiplying the original number of shares granted by the percentage that will vest based on current year performance (or best estimate)
   (XY) adding to the total arrived at in (X) the amount of accrued dividend received or receivable
   (XYZ) multiplying the total arrived at in (XY) by the market value of shares at the date of vesting
   (iii) for the purposes of the calculation in subsection (XYZ) where full vesting is not achieved by the date on which the remuneration report is signed off, an estimate of the value of the benefit will be calculated on the basis of an average market value over the last quarter of the financial year
   (iv) where the award was an award of share options, the cash amount the individual was required to pay to purchase the share will be deducted from the total arrived at in subsection (ii).

What happens when you lose an LTI with 2 condition; one ends at end of financial year, the other three months later. Do you disclose payment you unpart the rest (which life my suggest) or can you disclose both in following year.
Definitions applicable to the table

7.—(1) "Benefits" in paragraph 5(b) includes—
   (a) sums paid by way of expenses allowance that are—
      (i) chargeable to United Kingdom income tax (or would be if the person were an individual), and
      (ii) paid to or receivable by the person in respect of qualifying services; and
   (b) any benefits received by the person, other than salary, (whether or not in cash) that—
      (i) are emoluments of the person, and
      (ii) are received by the person in respect of qualifying services.

(2) Benefits received in advance of a director commencing qualifying services are to be treated as if received on the first day of the contract under which the person is employed, or under which the payment is to be made.

(3) “Scheme” in paragraph 5(e) means any agreement or arrangement under which money or other assets may become receivable by a person and which includes one or more qualifying conditions with respect to service or performance that cannot be fulfilled within a single financial year, and for this purpose the following must be disregarded, namely—
   (a) any payment under paragraph 5(d) the amount of which falls to be determined by reference to service or performance within a single financial year;
   (b) compensation in respect of loss of office, payments for breach of contract and other termination payments; and
   (c) retirement benefits.

(4) “HMRC method” means the amount of the increase in the value of the lump sum that the individual is entitled to under the pension scheme as calculated under s234 of Part 4 of the Finance Act 2004 whether the scheme is a defined benefits scheme within 5(c)(iii) or a money purchase scheme within 5(c)(ii).

(5) For the purposes of 7(4) as it applies to paragraph 6(c)(iii) the assumption applies that all of the rights that the individual is entitled to would be used to provide a lump sum.

Variable pay – additional disclosures

8.—(1) For every element of variable pay included in the columns headed "d" and "e" of the table required by paragraph 3, there shall be set out after the table the relevant details (see sub-paragraph (2)) of any award that has become receivable in respect of the interest.

(2) In sub-paragraph (1) "the relevant details", in relation to any shares that have become receivable in respect of a scheme interest, means—
   (a) details of performance conditions and the relative weighting of each;
   (b) within each performance condition, the targets set when the performance condition was agreed and corresponding value of the award achievable; and
   (c) for each performance condition, how the company performed against the targets set for that condition measured over the relevant reporting period.

(3) Where the company had a discretion in respect of an award, there shall also be set out—
   (a) whether the discretion was exercised;
   (b) if so, at what stage in the performance cycle and how, that discretion was exercised.

(4) There shall also be set out what was the resulting level of award.

9. For each item in column "d" of the table in paragraph 4 the company will report the percentage deferred and whether it was deferred in cash or shares, if relevant.

Total pension entitlements

10.—(1) The directors’ remuneration report must, for each person who has served as a director of the company at any time during the relevant financial year, contain the information in respect of pensions that is specified in sub-paragraphs (2) – (4).
(2) Where the person has rights under a pension scheme that is a defined benefit scheme in relation to the person and any of those rights are rights to which he has become entitled in respect of qualifying services of his, the details of the person’s accrued benefits under the scheme as at the end of that year, assuming a normal retirement date and the date the benefit becomes receivable.

(3) The total value of any additional benefit that will become receivable to a director in the event that that director retires early.

(4) Where a person has rights under more than one type of pension benefit identified in column “c” of the table in paragraph 4, the relative weighting of each type of benefit.

**Loss of office payments**

11. The directors’ remuneration report must for the relevant financial year show, for each person who has served as a director of the company at any time during that year, the total amount of—

(a) any compensation for loss of office paid to or receivable by the person, broken down into what element of pay made up that compensation and the value of each element;

(b) an explanation of how the payment was calculated;

(c) any other payments paid to or receivable by the person in connection with the termination of qualifying services;

(d) an explanation of how discretion allowed for within the policy on exit payments was exercised.

**Variable pay awarded during the financial year where the value will be determined according to the achievement of performance conditions in future periods**

12. The directors’ remuneration report must contain a table setting out—

(a) details of the scheme interests awarded to the person during the relevant financial year; and,

(b) for each scheme interest—

(i) a description of the type of interest awarded,

(ii) a description of the basis on which the award is made,

(iii) the face value of the award,

(iv) the maximum value at vesting if above that set out under sub-paragraph (iii),

(v) the percentage that would vest at threshold performance,

(vi) the end of the period over which the qualifying conditions for that interest have to be fulfilled (or if there are different periods for different conditions, the end of whichever of those periods ends last); and

(v) a summary of the performance criteria if not set out elsewhere in the report.

**Comparison of overall performance and pay**

13.—(1) The directors’ remuneration report must contain a line graph that shows—

(a) a line drawn by joining up points plotted to represent, for each of the financial years in the relevant period, the total shareholder return on a holding of shares of that class of the company’s equity share capital whose listing, or admission to dealing, has resulted in the company falling within the definition of “quoted company”, and

(b) a line drawn by joining up points plotted to represent for each of the financial years in the relevant period, the total pay for any director fulfilling the role of chief executive officer as calculated under the provisions of paragraph 3.

(2) For the purposes of sub-paragraph (1), “relevant period” means the ten financial years of which the last is the relevant financial year.

(3) Where the relevant financial year is—

(a) prior to the company’s tenth financial year, sub-paragraph (2) has effect with the substitution of “two”, “three” or “four” and so on (as the case may be) for “ten”; and

(b) the company’s first financial year, “relevant period”, for the purposes of sub-paragraphs (1) and (4), means the relevant financial year.
(4) For the purposes of sub-paragraph (1), the "total shareholder return" for a relevant period on a holding of shares must be calculated using a fair method that—
   (a) takes as its starting point the percentage change over the financial year in the market price of the holding;
   (b) involves making—
      (i) the assumptions specified in sub-paragraph (5) as to reinvestment of income, and
      (ii) the assumption specified in sub-paragraph (7) as to the funding of liabilities, and
   (c) makes provision for any replacement of shares in the holding by shares of a different description.
(5) The assumptions as to reinvestment of income are—
   (a) that any benefit in the form of shares of the same kind as those in the holding is added to the holding at the time the benefit becomes receivable; and
   (b) that any benefit in cash, and an amount equal to the value of any benefit not in cash and not falling within paragraph (a), is applied at the time the benefit becomes receivable in the purchase at their market price of shares of the same kind as those in the holding and that the shares purchased are added to the holding at that time.
(6) In sub-paragraph (5) "benefit" means any benefit (including, in particular, any dividend) receivable in respect of any shares in the holding by the holder from the company of whose share capital the shares form part.
(7) The assumption as to the funding of liabilities is that, where the holder has a liability to the company of whose capital the shares in the holding form part, shares are sold from the holding—
   (a) immediately before the time by which the liability is due to be satisfied, and
   (b) in such numbers that, at the time of the sale, the market price of the shares sold equals the amount of the liability in respect of the shares in the holding that are not being sold.
(8) In sub-paragraph (7) "liability" means a liability arising in respect of any shares in the holding or from the exercise of a right attached to any of those shares.

Statement of directors' shareholding

14. The directors' remuneration report must, in respect of each person who was a director in the financial year, set out—
   (a) any requirements on a director to own shares in the company and state whether or not those requirements have been met;
   (b) total numbers of shares and share options in respect of that director—
      (i) of which the director is the legal owner,
      (ii) which have been awarded subject to deferral on satisfaction of conditions other than performance conditions,
      (iii) the award of which are subject to performance conditions.

Consideration by the directors of matters relating to directors' remuneration

15.—(1) If a committee of the company's directors has considered matters relating to the directors' remuneration for the relevant financial year, the directors' remuneration report must—
   (a) name each director who was a member of the committee at any time when the committee was considering any such matter;
   (b) state whether any person who provided to the committee advice, or services, that materially assisted the committee in their consideration of any such matter and name any person that has done so;
   (c) in the case of any person named under paragraph (b) who is not a director of the company, state—
      (i) the nature of any other services that that person has provided to the company during the relevant financial year;
      (ii) by whom that person was appointed, whether or not by the committee and how they were selected;
      (iii) the amount of fee or other charge paid by the company to that person for the provision of the advice or services referred to in (b) and the other services referred to in (c)(i) and the basis on which it was charged.

(See formal response)
(2) In sub-paragraph (1)(b) "person" includes (in particular) any director of the company who does not fall within sub-paragraph (1)(a).

(3) The above provision also applies to a committee which considers remuneration issues during the consideration of an individual's nomination as a director.

Statement of shareholder voting

16. The directors' remuneration report must contain a statement setting out in respect of the annual general meeting held in the financial year to which the report relates—

(a) in respect of the resolution to approve the report on the previous financial year, of the votes cast, the number of votes for, against and abstentions:

(b) in respect of the resolution to approve the report on remuneration policy for the coming financial year, of the votes cast, the number of votes for, against and abstentions:

(c) where in either (a) or (b) there were substantial shareholder votes against the resolution, where known to the company, the reasons for that vote and any actions taken by the directors in response to that.

PART 4

THE POLICY PART

17. The directors' remuneration report must identify the date of commencement of the financial year or other date on which it is intended that this part of the report shall take effect.

Future Policy table

18. The directors' remuneration report must contain in the form of a table a description of each of the elements comprised in the remuneration package for the directors of the company.

19. In respect of each of the elements described in the table there shall be set out the following information—

(a) how that element supports the short and long-term strategic objectives of the company (or group):

(b) an explanation of how that element of the remuneration package operates including whether there are any provisions for the recovery of sums paid or the withholding of the payment of any sum by reference to the performance or behaviour of a director;

(c) the maximum potential value;

(d) what performance metrics, if any, are used, the relative weighting of each and the period of time over which they are measured;

(e) whether that element formed part of the remuneration package in the last policy part and if so, whether there have been any changes to that element and if so why.

20. There shall accompany the table notes which—

(a) explain the differences (if any) in the policy on the remuneration of directors from the remuneration of other employees generally (both within the company, or where the company is a parent company, the group);

(b) in respect of any scheme falling within paragraph 5(e) above, explain why any performance conditions pay were chosen, and

(c) if any entitlement of a director in respect of any scheme falling within paragraph 5(e) above is not subject to performance conditions, an explanation of why that is the case.

Service contracts

21. The directors' remuneration report must contain a statement setting out all the provisions that relate to remuneration contained in the directors' service contracts.
The term "threshold" is used to describe the minimum level of performance. Based on this information, if we assume the reference should be to 'target,' we advise you to use typical terminology.

22. The directors' remuneration report must set out in graphical form what remuneration the company expects the directors to obtain if, in respect of the threshold set for performance criteria, the performance achieved (a) meets, (b) exceeds or (c) falls below the threshold.

23. For each scenario it must show—
(a) the total amount of remuneration; and
(b) the proportion of pay made up by each element of pay in that scenario.

Relative importance of spend on pay

24.—(1) The directors' remuneration report must set out the percentage change in—
(a) profit;
(b) dividends, and
(c) overall expenditure on pay (as a whole) in the reporting period compared to previous years.

(2) "Profit", "dividend" and "expenditure" shall have the same meaning as is relevant in respect of the preparation of the accounts of the company.

Exit payment policy

25. The directors' remuneration report must summarise and explain the company's policy on—
(a) the duration of contracts with directors, and
(b) notice periods, and termination payments, under such contracts.

26. The directors' remuneration report must also state the policy on which the determination of the termination payment will be made including—
(a) how each element of the payment will be calculated;
(b) whether the company will distinguish between—
   (i) types of leaver or
   (ii) the circumstances under which a director left;
(c) how performance will be taken into account; and
(d) any contractual provision agreed prior to the commencement of these regulations that could impact on the quantum of the payment.

Statement of consideration of conditions elsewhere in company and group

27. The directors' remuneration report must contain a statement of how pay and employment conditions of employees of the company and of other undertakings within the same group as the company were taken into account when setting the policy for directors' remuneration.

28. The statement must also set out whether, and if so, how, the company consulted with employees when drawing up this policy part.

29. The statement must also set out—
(a) whether any comparison metrics were taken into account and if so, what those metrics were, and how that information was taken into account;
(b) how these specific items of information were taken into account when determining directors' remuneration.

30.—(1) The directors' remuneration report must also set out the percentage increase in pay of any director fulfilling the role of chief executive officer and that of all of the employees generally, or if this is considered by the directors as an inappropriate comparator, such other comparator group of employees identified by the directors, with a statement setting out why that group was chosen.

(2) Where the company is a parent company, the statement shall relate to the group and not the company.
Statement of consideration of shareholder views

31. The company shall state whether, and if so how, any views expressed by shareholders either at the previous annual general meeting or during the financial year were taken into account in the formulation of the policy.

PART 5

PROVISIONS OF THE REPORT WHICH ARE SUBJECT TO AUDIT

32.—(1) In Part 1 of the report the following paragraphs are subject to audit.
(2) Paragraphs 3 - 9 and 10 – 12.

PART 6

INTERPRETATION AND SUPPLEMENTARY

33.—(1) In this Schedule—
“amount”, in relation to a gain made on the exercise of a share option, means the difference between—
(a) the market price of the shares on the day on which the option was exercised; and
(b) the price actually paid for the shares;
“company contributions”, in relation to a pension scheme and a person, means any payments (including insurance premiums) made, or treated as made, to the scheme in respect of the person by anyone other than the person;
“defined benefit scheme”, in relation to a person, means a pension scheme which is not a money purchase scheme in relation to the person;
“emoluments” of a person—
(a) includes salary, fees and bonuses, sums paid by way of expenses allowance (so far as they are chargeable to United Kingdom income tax or would be if the person were an individual),
(b) and any profit achieved but
(c) does not include any of the following, namely—
(i) the value of any share options granted to him or the amount of any gains made on the exercise of any such options;
(ii) any company contributions paid, or treated as paid, in respect of him under any pension scheme or any benefits to which he is entitled under any such scheme; or
(iii) any money or other assets paid to or received or receivable by him under any long term incentive scheme;
“money purchase scheme”, in relation to a person, means a pension scheme under which all of the benefits that may become payable to or in respect of the person are money purchase benefits in relation to the person;
“pension scheme” means a retirement benefits scheme within the meaning given by section 150(1) of the Finance Act 2004 which is—
(a) operated on behalf of the company or
(b) one to which the relevant company paid a contribution during the period of account;
“qualifying services”, in relation to any person, means his services as a director of the company, and his services at any time while he is a director of the company—
(a) as a director of an undertaking that is a subsidiary undertaking of the company at that time;
(b) as a director of any other undertaking of which he is a director by virtue of the company’s nomination (direct or indirect); or
(c) otherwise in connection with the management of the affairs of the company or any such subsidiary undertaking or any such other undertaking;
“retirement benefits” means relevant benefits within the meaning given by section 612(1) of the Income and Corporation Taxes Act 1988;

“shares” means shares (whether allotted or not) in the company, or any undertaking which is a group undertaking in relation to the company, and includes a share warrant as defined by section 779(1) of the 2006 Act;

“share option” means a right to acquire shares;

“value”, in relation to shares received or receivable on any day by a person who is or has been a director of the company, means the market price of the shares on that day.

(2) In this Schedule “compensation in respect of loss of office” includes compensation received or receivable by a person for—
   (a) loss of office as director of the company, or
   (b) loss, while director of the company or on or in connection with his ceasing to be a director of it, of—
      (i) any other office in connection with the management of the company’s affairs, or
      (ii) any office as director or otherwise in connection with the management of the affairs of any undertaking that, immediately before the loss, is a subsidiary undertaking of the company or an undertaking of which he is a director by virtue of the company’s nomination (direct or indirect);
   (c) compensation in consideration for, or in connection with, a person’s retirement from office; and
   (d) where such a retirement is occasioned by a breach of the person’s contract with the company or with an undertaking that, immediately before the breach, is a subsidiary undertaking of the company or an undertaking of which he is a director by virtue of the company’s nomination (direct or indirect)—
      (i) payments made by way of damages for the breach; or
      (ii) payments made by way of settlement or compromise of any claim in respect of the breach.

(3) References in this Schedule to compensation include benefits otherwise than in cash; and in relation to such compensation references in this Schedule to its amounts are to the estimated money value of the benefit.

(4) References in this Schedule to a person being “connected” with a director, and to a director “controlling” a body corporate, are to be construed in accordance with sections 252 to 255 of the 2006 Act.

34.—(1) For the purposes of this Schedule emoluments paid or receivable or share options granted in respect of a person’s accepting office as a director are to be treated as emoluments paid or receivable or share options granted in respect of his services as a director.

(2) Where a pension scheme provides for any benefits that may become payable to or in respect of a person to be whichever are the greater of—
   (a) such benefits determined by or under the scheme as are money purchase benefits in relation to the person; and
   (b) such retirement benefits determined by or under the scheme to be payable to or in respect of the person as are not money purchase benefits in relation to the person,

the company may assume for the purposes of this Schedule that those benefits will be money purchase benefits in relation to the person, or not, according to whichever appears more likely at the end of the relevant financial year.

(3) In determining for the purposes of this Schedule whether a pension scheme is a money purchase scheme in relation to a person or a defined benefit scheme in relation to a person, any death in service benefits provided for by the scheme are to be disregarded.

35.—(1) The following applies with respect to the amounts to be shown under this Schedule.

(2) The amount in each case includes all relevant sums paid by or receivable from—
   (a) the company; and
   (b) the company’s subsidiary undertakings; and
   (c) any other person,

except sums to be accounted for to the company or any of its subsidiary undertakings or any other undertaking of which any person has been a director while director of the company, by virtue of section 219 of the 2006 Act (payment in connection with share transfer: requirement of members’ approval), to past or present members of the company or any of its subsidiaries or any class of those members.
(3) Reference to amounts paid to or receivable by a person include amounts paid to or receivable by a person connected with him or a body corporate controlled by him (but not so as to require an amount to be counted twice).

36.—(1) The amounts to be shown for any financial year under Part 3 of this Schedule are the sums receivable in respect of that year (whenever paid) or, in the case of sums not receivable in respect of a period, the sums paid during that year.

(2) But where—

(a) any sums are not shown in the directors' remuneration report for the relevant financial year on the ground that the person receiving them is liable to account for them as mentioned in paragraph 35(2), but the liability is thereafter wholly or partly released or is not enforced within a period of 2 years; or

(b) any sums paid by way of expenses allowance are charged to United Kingdom income tax after the end of the relevant financial year or, in the case of any such sums paid otherwise than to an individual, it does not become clear until the end of the relevant financial year that those sums would be charged to such tax were the person an individual,

those sums must, to the extent to which the liability is released or not enforced or they are charged as mentioned above (as the case may be), be shown in the first directors' remuneration report in which it is practicable to show them and must be distinguished from the amounts to be shown apart from this provision.

37. Where it is necessary to do so for the purpose of making any distinction required by the preceding paragraphs in an amount to be shown in compliance with this Part of this Schedule, the directors may apportion any payments between the matters in respect of which these have been paid or are receivable in such manner as they think appropriate.

38. The Schedule requires information to be given only so far as it is contained in the company's books and papers, available to members of the public or the company has the right to obtain it.”.

Missing sweep up clause requiring significant awards paid to former directors to be disclosed.
EXPLANATORY NOTE
(This note is not part of the Regulations)

These Regulations are made under section 421 of the Companies Act 2006 (c.46) (“the Act”) and substitute for Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (S.I. 2008/410) (“the 2008 Regulations”) a revised Schedule.

Regulation 3 substitutes the provisions of the Schedule to these Regulations for Schedule 8 of the 2008 Regulations and regulation 2 makes consequential amendments to regulation 11 of those Regulations.

The provisions of the Schedule contain the requirements for the content of the directors’ remuneration report required to be prepared in accordance with section 420 of the Act. It provides that the report shall contain a summary statement by the chairman of the remuneration committee, a report in respect of the past financial year and a statement of the future remuneration policy of the company.
Trades Union Congress TUC
Directors’ Pay: consultation on revised reporting regulations. Response form.

The closing date for this consultation is 26 September 2012
Please return completed forms to:

Barry Walker
Executive Pay Consultation
Department of Business, Innovation and Skills
1 Victoria Street
SW1H 0ET
020 7215 3930
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection
In the interests of transparency, the Department may choose to publish the responses to this consultation. Please state clearly if you wish your response to remain confidential.

Please note also that information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.
### About You

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### I am responding on behalf of (please tick):

- Quoted company
- Other company
- Investor or investment manager
- Business representative organisation
- Investor representative organisation
- Non governmental organisation
- Trade Union
- Lawyer or accountant
- Other (e.g. consultant or private individual)
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.

Comments on the detail of the draft regulations will be given below in the relevant sections.

More broadly, the TUC believes that the Government has missed an important opportunity to go beyond the current discredited approach of relying on shareholders to tackle executive pay. Shareholders have had an advisory vote on remuneration reports since 2004, but until this year had defeated only 18 out of the thousands of reports they had voted on over this period. Investor responses to recent BIS consultations on executive pay show that a majority of investors did not support being given a binding vote on remuneration reports, arguing in many cases that having a binding vote would discourage them from voting against remuneration reports.

The consultation policy notes that “Shareholder empowerment lies at the heart of the UK’s corporate governance framework and these reforms are consistent with that approach.” However, given shareholders do not want additional powers in relation to executive pay and have failed to make good use of their already substantial powers in this area, continuing to make shareholders the focus of Government policy in relation to executive pay is in the TUC’s view misguided at best.

The Government has missed an important opportunity for introducing wider stakeholder involvement in the setting of directors’ remuneration. Worker representation on remuneration committees would bring a fresh perspective and a common sense approach to discussions on remuneration, which, as evidence from other countries shows, would help to tackle excessive executive rewards.

The draft regulations focus on reporting, but an obvious question is how much difference they will make in practice. The TUC has set out in detail elsewhere its key concerns on executive pay: namely, that executive pay has become too high both in absolute terms and critically that the gap between executive pay and employee pay in the same companies as well as across the economy as a whole has become too large. There is clear academic evidence that large intra-company pay gaps have a detrimental impact on company performance. Reporting is important in its own right in terms of boosting transparency and accountability, but its main significance is in its effect on practice. It is on their impact on directors’ remuneration levels, components and rates of increase, and in particular how these relate to those for ordinary workers, that the TUC will judge the effectiveness of these new reporting regulations. The Government has acknowledged the importance of changing practice on executive pay; it is essential that the impact on practice of the Government’s package of reforms in this area is systematically monitored.
Question 2: What costs will companies face in adjusting to these revised reporting regulations?

While adapting to a new reporting regime may generate minor one-off costs, these should be more than offset by the benefits of improving transparency relating to executive pay. Improving the quality of disclosure on executive pay should reduce monitoring costs for shareholders. On a broader level, if improved disclosure feeds into improved decision making on executive pay, this could generate broader economic benefits. For example, as noted above, there is clear academic evidence that lower intra-company pay differentials are associated with better company performance than companies with high intra-company pay differentials.

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?

The TUC supports the introduction of a requirement to set out the elements of remuneration in a table as set out in draft regulations 18, 19 and 20. There is an apparent discrepancy between the consultation text and the draft regulations, in that the former refers to 'key elements of remuneration' while the draft regulations refer to 'each of the elements [of] remuneration'. It is essential that this table is comprehensive, as is required by the draft regulations, as if some elements of remuneration were not included the table would become meaningless.

As the Government has itself argued, one reason that reforms are needed in the area of reporting on directors’ remuneration is to improve comparability between companies and over time. Given this, the TUC has some concerns about the Government’s intention not to prescribe the specific disclosures that are required for each element of pay. There is a danger that this will lead to disclosures that are based on different methodologies and which therefore do not aid comparability. Another point of concern is that the usefulness of the future pay policy report depends on the extent to which reports comprise concrete amounts and figures, rather than vague assertions of policy.

However, there may also be a case for allowing best practice to develop over the next couple of years, rather than introducing detailed prescription at this stage. To balance these concerns, the TUC believes the Government should keep this area under review with a view to introducing guidance on specific disclosures based on best practice as it emerges in the next two years.
Much of the usefulness of the table will depend on the quality of the explanatory notes (as set out in draft regulation 20). The TUC supports all of the explanatory requirements and in particular (a) on the differences in policy on the remuneration of directors from the remuneration of other employees. However, there is a danger that companies respond to this requirement with boilerplate statements - for example, stating that remuneration policy across the company reflects market practice - without setting out the specific differences in policy and explaining them. The TUC believes that setting out clear guidance on what is expected of companies would greatly improve the quality of disclosure in this important area. This should be included in the guidance that the Government is proposing will be in place before the proposals take effect.

The consultation paper says that the Government intends to work with business and investor groups to develop this guidance (paragraph 31). However, as the debate around executive pay in the last few years had made extremely clear, directors’ pay is of direct concern to other company stakeholders and in particular to workers. The TUC trusts that in view of this, the Government will not limit its discussion on guidance to business and investor groups but will include other organisations representing stakeholders including the TUC in its deliberations.

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.

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.

We will respond to these questions together as this better reflects the proposals as set out in the draft regulations.

Distribution statement

The TUC welcomes the proposal for a ‘distribution statement’; however, there are major flaws in the proposal as set out in draft regulation 24 that need to be addressed.

Firstly, the proposal requires the percentage increase in spending on pay, dividends and profit, but does not require that the actual amounts are set out comparatively. While the percentage change in these areas is of interest, this should supplement a requirement to show a simple comparison of the relative spend in absolute amounts on the different areas. Otherwise there is a danger
that the disclosures mask very different starting points between companies in these areas.

The finance sector provides a good illustration of why this amendment is needed. There has been widespread criticism of the fact that top-end pay and bonuses in the banking sector have outstripped dividend payments in recent years. Yet a distribution statement that looked only at percentage changes in the different categories would not necessarily pick this up – if pay and bonuses went down slightly as a percentage of the total but still outstripped dividend payments, this would not be captured by the requirement. If this requirement is to work effectively, it is essential that this is addressed. (Given that pay and dividends are all paid out of profits, it would be necessary to replace profits with ‘retained earnings’ or similar for the comparison of actual amounts).

Secondly, the requirements should separate out spending on executive pay from spending on workforce pay more broadly. Some sectors are much more labour intensive than others; for example, retail is more labour intensive than engineering. It is therefore important to separate out the pay of ordinary company employees from the pay of company executives in order to provide meaningful information about executive pay in relation to other areas of company spending.

Finally, there is evidence that investment in skills, research and development and other drivers of long-term organic growth are squeezed by pressures to pay high levels of both dividends and executive remuneration even when company performance is poor. The TUC would therefore welcome the inclusion of spending on research and development and skills development in the distribution statement.

Scenarios

We have the same concern about comparability of information in relation to the Government’s proposal not to set a standard methodology for calculating performance-related pay in different scenarios. We would recommend that this is included in the guidance and kept under review in light of practice in the first few years of implementation.

Service contract and termination and exit payments

The requirements relating to exit payment policy should include a requirement to set out the policies in relation to staff exit payment policy and explain any differences between the policies for directors and those for other staff.

Company directors are given far more protection against redundancy or exit than the rest of the workforce. Given that directors’ much higher remuneration packages also make it much easier for them to save for a rainy day, this is impossible to justify. Employees are entitled to just one week’s notice for each year worked, up to a maximum of three months - a far cry from one year’s salary plus other benefits that directors receive.
Draft regulation 25 should therefore include an additional clause: ‘(c) the notice periods and termination payments under such contracts for other company employees; where these differ from those for company directors, an explanation should be given.’

Similarly, draft regulation 26 should also include an additional clause requiring disclosure of the policies on termination payments to other company employees and, where these differ from those for directors, an explanation.

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.

Remuneration committees have been required to take into account pay and conditions elsewhere in the company in setting directors’ pay since the Greenbury Report of 1995. It has been a legal requirement for the remuneration report to report on how they have done this since 2002; yet throughout this whole period companies have failed to provide meaningful information on how their policies in relation to workforce pay have affected their decisions on directors’ remuneration.

The TUC welcomes the improvements in reporting in relation to this area that are proposed in this consultation. While we regret that the Government has decided not to require the publication of pay ratios, we strongly support the requirement for companies to report on the percentage increase in chief executive remuneration and the percentage increase for employees generally.

Employee buy-in should be an important consideration for remuneration committees in determining remuneration policy. The reason that high company pay differentials are correlated with poorer company performance is because of the impact on employee engagement, which is a major contributor to company performance. The TUC supports the proposal to require a statement on employee consultation on remuneration policy. However, we believe that the regulations should require a statement on how, not whether, a company sought employee views on the remuneration policy, to give a stronger signal to companies that they should engage with their staff on this issue.

As already noted, poor quality reporting has dogged this area over the years. We believe that it will be very important to monitor the quality of reporting in relation to draft regulation 29 (on comparator metrics) to ensure that companies are reporting full information on metrics and not responding with meaningless platitudes.

We would suggest that 29 (a) is clarified thus:
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?

The TUC supports the proposal for a single figure of total remuneration. As this is a new requirement, we believe that implementation will need to be carefully monitored to ensure that the policy works as intended. Other than the comments on pensions below, we believe that the draft regulations should produce clear information on total remuneration, but, as already noted, monitoring of implementation will be essential.

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?

It is somewhat surprising that the Government has chosen to use the HMRC methodology to express the value of defined benefit schemes for the purpose of the single figure of total remuneration, given that the other measures considered such as transfer value and IAS 19 are currently much more common measures used by pension schemes.

If the HMRC methodology is to be used, it is essential that the multiplier used correctly reflects the value of the pension; a multiplier of 20 is too low and will systematically underestimate the value of defined benefit pensions for older workers, who are those most likely to be member of defined benefit pension schemes.

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

Comprehensive disclosure of performance targets is essential if the Government wishes to ensure a tighter relationship between executive pay and company performance. Without full disclosure of targets, it will be impossible to verify the extent to which companies are setting stretching targets for variable pay.

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

The TUC believes that the proposed reporting requirements on directors’ pensions are inadequate. The introduction of new reporting requirements on directors’ pay provides the ideal opportunity to address the lack of disclosure in relation to directors’ pensions, which comprise an important aspect of directors’ overall remuneration package.

As the consultation document notes, many companies offer much more generous pension provision to company directors than to other company staff, despite the fact that directors already have much higher pay and are therefore much more able to save. Requirements for companies to report on differences between pension schemes for directors and for staff would be a vital first step towards addressing the scandal of two-tier pension provision.

It should also be noted that NAPF and LAPFF have published a joint statement setting out the information that they believe companies should provide on directors’ pension provision, which the proposed requirements do not fulfil.

The TUC believes that the following information on pension policy across the company should be required:

For all 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 who are not in a company pension scheme

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

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.

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?

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.

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?

There is a danger that requiring a graph that shows total shareholder return against CEO pay will encourage companies to pay high dividends when not justified by company performance and to take measures to boost the share price when these are not in the interests of promoting long-term, organic
growth.

We believe a graph that includes other measures that are better correlated to long-term company value creation would be a more useful requirement. For example, spending on R&D, skills development and capital expenditure are better indicators of organic growth creation than total shareholder return.

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?
UK Shareholders' Association (UKSA)
Dear Barry Walker,

Further to our recent conversation I now have pleasure in enclosing a response on behalf of the UK Shareholders’ Association. You will note that we have taken the opportunity to put in some overall reactions before our main answers including some very specific comments on the appropriateness of the Government’s approach. In the absence of a question on the proposals on Remuneration Consultants, we have added our own as Q.14a.

There are two minor points on drafting which we would like to mention although not important enough to go in our main evidence:

In Reg 14.(b)(i) you use the expression “the legal owner”. This leaves open to doubt the position in respect of shares where the director has a beneficial interest but holds through a nominee company which, of course, is a very common position today. In such a situation the nominee company will be named on the register rather than the director and the nominee company will have voting and other rights and in many ways is the legal owner. We suggest that the expression needs to be changed to make sure that it includes all shares in which the director has a beneficial interest.

As discussed on the telephone, Reg 15 begins with the words “If a committee of the company’s directors has...” While it may be very unlikely, it seems to us that it would not be impossible for directors’ remuneration to be considered with the aid of consultants but without a committee being used. A change of wording to ensure that the requirement is all-inclusive seems desirable.

Yours sincerely,

Roy Colbran, Head of UKSA Government Policy group
Directors’ Pay: consultation on revised reporting regulations.
Response form.

The closing date for this consultation is 26 September 2012

Please return completed forms to:

Barry Walker
Executive Pay Consultation
Department of Business, Innovation and Skills
1 Victoria Street
SW1H 0ET
020 7215 3930
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection

In the interests of transparency, the Department may choose to publish the responses to this consultation. Please state clearly if you wish your response to remain confidential.

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<table>
<thead>
<tr>
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<th>ORGANISATION: UK SHAREHOLDERS' ASSOCIATION (“UKSA”)</th>
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</thead>
<tbody>
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</table>

I am responding on behalf of (please tick):

- [ ] Quoted company
- [ ] Other company
- [ ] Investor or investment manager
- [ ] Business representative organisation
- [ ] Investor representative organisation
- [ ] Non governmental organisation
- [ ] Trade Union
- [ ] Lawyer or accountant
- [ ] Other (e.g. consultant or private individual)
OUR OVERALL REACTIONS

It is greatly to be regretted that this consultation was issued only a month before publication of Professor Kay’s Review without taking any account of what he might recommend on this subject. The Review was, of course, also sponsored by BIS. The Review demonstrates in Chapter 11 how the general types of remuneration structure currently in use have adverse consequences. It goes on to recommend that incentives should be related to sustainable long-term business performance and then provided only in the form of company shares to be held at least until the executive has retired from the business. Professor Kay also questions, as UKSA has done in its own evidence to the Department, the need for bonuses at this level at all.

Now that we have the benefit of the Review, the draft regulations must surely be withdrawn and detailed thought given to what approach by Government will best help to achieve what he has recommended.

As written, the draft regulations would require a mass of new information to be included in annual reports and this at a time when the Government is committed to the reduction of red tape. The proposed information requirements directly relate to practice currently prevailing, and so, if these regulations are adopted in their present form, they will entrench current practices which is the very opposite of what the Government should be doing.

What we believe Government are really seeking, and certainly what we and Professor Kay are looking for, is a substantial change in present behaviour. Although not in the detail now proposed, sufficient information has been published under present requirements to show that pay levels have been very high and are increasing. Since this publicity has had little effect in curbing pay levels it is doubtful whether adding to the information already provided to shareholders will achieve any more.

We believe it would be wholly wrong to impose the immensely detailed requirements of these draft regulations on companies when Government is still considering its reaction to Kay, and his very strong comments in this area. To require companies to put in all the effort involved in changing their reports to meet these requirements, when further action in this area is clearly required from Government, would be completely wasteful.

General Principles on disclosure

We believe that all remuneration information should be analysed on the basis of

1. Commitments for the future
2. Current payments against past commitments
3. Current discretionary payments (including current payments against new longer term commitments)

Commitments for the future should then be analysed;

1. New commitments made since last report
2. Adjustments to previously reported commitments
3. Balances remaining on previously reported commitments

We are NOT suggesting that all information on all these things should be reported all the time. We are simply suggesting this conceptual framework as a basis for deciding
what is important and what is not; and therefore what levels of approval and reporting should apply in each category. The resulting regulations should require demonstrable adherence to principles, rather than the provision of specific information that may not have the desired consequences.

Remuneration commitments typically cover a multi-year period and are uncertain as to outcome (e.g. pensions and performance-related LTIPs). They are therefore much more important than actual current pay.

The consultation makes no reference to asymmetric performance awards and their consequent incentivisation of volatility and risk (Kay chapter 11). These require particular attention, because they incentivise the wrong things. Any attempt to summarise these into a single number conceals what should be revealed.

We continue with answers to such of the questions as we feel fall within our area of interest and based on the intentions of the consultation as it stands without prejudice to the foregoing general comments:

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.

We are concerned that the authors think it necessary to propose such extensive and detailed regulations to cover what should not be a major aspect of company reports. We suggest that they should be reviewed overall to see whether the Government’s objectives could not be met by regulations setting out principles rather than fine detail.

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

Relative to the total sum of their overall operations, the monetary cost may be small. However, the cost in time of senior management in producing answers to all the items in the regulations will be immense and a major diversion from their main jobs.
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?

We agree that the proposals already go far enough, possibly too far, in terms of detailed prescription.

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.

We would like to see examples of this in practice before agreeing that this approach is desirable. Like so many things in this paper it accepts the principle that directors’ performance can be meaningfully measured over short-term periods, which is contradicted by the conclusions in Professor Kay’s Review.

Draft Regulation 21 adds significantly to the amount of information to go in the Annual Report. We suggest it would be better to require service contracts to be available on the Company’s website, including full details of bonus plans and their relationship to performance.

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.

Surely all exit payments should be prescribed in service contracts and nothing additional allowed unless it receives prior approval by shareholders?

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.

While it might indeed be appropriate management practice in certain industries to engage in such consultation, it would be quite wrong (and a good example of burdensome regulation) to impose it as a legal obligation.

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?
The idea of reporting a single pay figure is an attractive one but the practical difficulties are enormous and the method proposed would not, in our opinion, achieve the desired outcome. Recognising the total of multi-year awards as a lump sum in the final year will simply lead to occasional high figures that will just be used to create headlines. The method is also ineffectual for year-on-year or company-on-company comparability. The fact is, a single figure for a complex aggregate will obstruct reasoned analysis and leave only knee-jerk reactions. The ‘single figure’ proposal should be abandoned in the interests of proper disclosure.

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?

It seems a practical solution to a difficult problem. The fact that in some circumstances it may be an inaccurate measure should not matter too much since one would not expect the value of DB pensions to be a large part of the whole package.

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

No. Any claw back must be shown separately, to satisfy shareholders’ need for specific assurance on this highly sensitive issue.

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?

Companies may conceal metrics on grounds of commercial confidentiality but in that case must be required to state a) the general nature of the target (e.g. sales growth, customer diversification) and b) the minimum and maximum awards under the Plan.

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

No comment.

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?

No comment.
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.

No comment

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?

No, we strongly disagree. Total shareholder return is subject to so many factors outside the control of the company, as well as others that can be directly influenced by the actions of the CEO, that this would be a very unsatisfactory measure. Companies should be required to choose from a short list of measures that can be taken straight from the published accounts.

Question 14a: The Government has included disclosure requirements about remuneration consultants in the draft regulations. What is your opinion of their approach?

The considerable amount of new information proposed will lend itself to boilerplate wording and is unlikely to change current practices which, again, Kay sees as undesirable. We believe that remuneration consultants should be appointed by and report to the shareholders thus eliminating the most important conflict of interest (see Kay Para 11.9).

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?

We are distinctly unenthusiastic to see yet more items made subject to audit. Surely this is an area where companies should be given the benefit of the doubt unless and until there is reason to think otherwise.
Mr Barry Walker  
Executive Pay Consultation  
Department for Business Innovation and Skills  
1 Victoria Street  
London  
SW1H 0ET

By email: executive.pay@bis.gsi.gov.uk  
25 September 2012

Dear Mr Walker,

United Utilities response to the consultation on directors’ pay: revised remuneration reporting regulations

I am writing in response to the consultation on the revised remuneration reporting regulations on behalf of United Utilities Group PLC.

In April we responded to the consultation on executive pay (shareholder voting rights).

We welcome the changes that have been made to the earlier proposals in response to consultation, particularly around the threshold voting level on future remuneration policy and the flexibility to pay appropriate exit payments (within the policy set out in the policy report).

With regard to the current consultation on revised remuneration reporting regulations, through our Company Secretary, we have been following the GC100’s proposals and support their approach on all the key areas. However, we would like to provide additional comments on three elements of the proposals outlined in the consultation:

* Disclosure of full details of performance targets  
* Level of prescription vs flexibility  
* Increased costs

Disclosure of full details of performance targets.

We are supportive of clear disclosure around performance metrics and how pay links to performance. However, we are concerned that full disclosure of targets for each performance measure could be highly commercially sensitive and may even constitute the unlawful disclosure of price-sensitive information. It could also lead to companies only choosing very anodyne measures that they are able to publish (e.g. TSR and EPS) and would reduce the use of measures more closely aligned to the company’s own objectives (e.g. efficiency targets, revenue targets etc).
Level of prescription vs flexibility

In some areas, we feel that the proposals are too prescriptive on how the company should disclose the link between pay and performance. Prescribing the use of one standard way of presenting information could lead to longer and more complex reports as companies would also feel the need to include additional information or measures of performance that they feel better reflects their business.

For example, the proposal for a 10 year chart showing how CEO pay has moved vs TSR would be unhelpful for companies for whom an additional or substitute measure of performance would be more appropriate. This chart would also be misleading for periods where there has been a change in CEO (e.g. the new CEO may be granted share awards which do not vest of a number of years).

Another example of an area where more flexibility is needed is the scenario analysis. This assumes that companies have identified an “on-target” level of performance, which may not be the case.

Increased costs

Although we already comply with some of the proposed reporting requirements (e.g. a single total figure for remuneration and summary table of pay policy) there will be additional costs associated with the other proposed changes, particularly in 2013 to 2015. These costs include time spent by our company secretarial and human resource teams on drafting the Policy and Implementation Reports as well as fees for advice from remuneration advisors, lawyers and auditors. This will be an additional burden both in the transition and once in use, particularly for smaller companies, as companies ensure that they adhere to these additional requirements.

In summary, we believe that the revised remuneration reporting regulations are, on the whole, workable for companies although we would prefer these to be mindful of commercially sensitive information and allow more flexibility in what information is presented.

Yours sincerely,

John McAdam
Chairman
Universities Superannuation Scheme
Executive Pay: Shareholder Voting Rights Consultation
Submission by USS, 27th April 2012

1. Introduction

Universities Superannuation Scheme (USS) is an open defined benefit pension scheme with assets of approximately £32 billion. As an asset owner with an in-house fund management capability, our perspective distinguishes us from many other institutional investors. We invest actively in UK equities and take seriously our role as an engaged and intrinsic investor and a long-term owner of assets.

We devote substantial resources to monitoring and analysing the companies in which we invest, and take an active approach to stewardship which includes engagement with companies on remuneration structures and pay plans. Shareholders have an important responsibility in scrutinising and approving board remuneration and currently have a variety of options available when voting on remuneration issues, including the advisory vote on the remuneration report, annual binding votes on director re-elections (including members of the remuneration committee) and binding votes when approving share-based incentive schemes.

We have, and we will, continue to press for restraint, responsibility and accountability by remuneration committees, and will continue to exercise our votes when we consider this has not been the case. We therefore welcome the ongoing debate on executive pay and the government’s aim of improving shareholder engagement on pay issues. We look forward to continued open dialogue with the government as proposals develop and near legislation.

We see a number of benefits of a binding vote on future remuneration policy in some form. However, we do not consider it necessary to offer shareholders a binding vote on future remuneration policy on an annual basis. Instead we favour a triennial binding vote on future remuneration policy and earlier if certain thresholds are breached. In Section 2 we detail our alternative solution, and in Section 3 we provide responses to the specific BIS questions.

Before going into our views on voting relating to remuneration matters, we believe it is vital to highlight the importance of the accounting system in driving inappropriate remuneration. We believe the accounting standards that currently apply to UK listed companies are not always providing a ‘true and fair view’ of underlying company health. This has important ramifications for measuring performance using these accounts. Since remuneration schemes are often tied to accounting numbers, where these numbers are misleading, remuneration payouts will be inappropriate. More specifically, because IFRS permits the recognition of ‘paper’ profits, including unrealised gains on assets for instance, through the Profit and Loss Account, we arrive at a situation where bonuses can be paid out based on profits that may never be realised. While the problems around IFRS accounting have not been dealt with in this consultation document, it is – in our view –

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1 McKinsey article “Communicating with the Right Investors”, Spring 2008 Intrinsic investors are long term investors who have an understanding of a company’s strategy, its current performance and potential to create long term value. Intrinsic investors may not be the top 10 investors on the company register, but their long term fundamental investment approach should offer a more informed, constructive and long term perspective to the board.

2 A related concern is that bonus payments may not always be consistent with the legal requirement that no distributions are made out of capital (2006 Companies Act, Part 23).
absolutely vital to tackling the problem of ‘payments for failure’. Likewise, a prudent accounting framework is an important input into incentive scheme that drive longer term and sustainable decision-making at companies. We are very happy to expand on this issue.

2. USS’ Alternative Solution:

We strongly consider that a binding vote on future remuneration policy should only be proposed in the following circumstances:

1. On a triennial basis; or
2. If the annual advisory vote on the remuneration report at the previous Annual General Meeting (AGM) received less than 80% support from shareholders; or
3. When substantial changes to the remuneration policy are proposed.

We believe there are a number of advantages to the proposed approach, including improving the effectiveness of engagement and accountability between companies and shareholders and ensuring a long-term, sustainable approach to remuneration structures is adopted.

2.1 Triennial Binding Vote on Future Remuneration Policy

Remuneration policy is a critically important strategic control mechanism at all levels of the corporation as a well-planned compensation system is essential in attracting, focusing, motivating and retaining the right people. Appropriate remuneration policies and structures are those that emphasise the need for performance to be evaluated over sufficiently long periods, discourage short-termism and excessive risk taking, measured against performance metrics that are closely tied to the company’s long-term strategy and durable shareholder value creation.

Therefore remuneration issues should be considered by the remuneration committee with a long-term strategic outlook. We have concerns that an annual binding vote will create pressure that will lead to an increase in the number of remuneration committees conducting short-term annual reviews and making small changes to policies. This could embed a short-term culture within the remuneration decision-making. We have experience of this already with companies who change their remuneration policy annually (e.g. in the banking sector, Barclays and Lloyds).

A triennial binding vote on future remuneration policy would:

- Encourage remuneration committee members to design a remuneration policy and structure for the longer-term.
- Ensure shareholders are able to provide sufficient oversight of future policy.
- Annually hold companies accountable on the implementation and interpretation of the remuneration policy through the annual advisory vote on the remuneration report and the annual elections of directors.

2.2 The advisory vote receives less than 80% support:

To facilitate more effective dialogue between remuneration committees and shareholders we propose the triennial binding vote would be brought forward to the next annual general meeting where a company fails to achieve 80% support level for its votes.
Where a remuneration report is supported by less than 80% of voting shareholders the company would be required to comply with the following:

i) Announcement to the stock market within a set number of days (e.g. 30 days) following the AGM detailing:
   i. Primary reasons for the high dissent by shareholders.
   ii. How the Board will be responding to the high level of dissent.
   iii. The Board’s timetable for response and engagement.

ii) The following year, the Annual Report shall include a statement outlining the engagement with shareholders on remuneration issues, how these concerns were considered by the Remuneration Committee and what has changed as a result.

iii) At the following AGM, a binding vote on future remuneration policy will be proposed to shareholders.

Such actions will increase the transparency and accountability between remuneration committees, shareholders and other interested stakeholders. The disclosures, combined with the binding vote at the next AGM, will encourage greater dialogue between remuneration committees and shareholders on the issues of concern and will meet the intent of the Stewardship Code. Please see the paragraph on Supporting Shareholder Engagement in question 1 below.

2.3 Substantial changes to the remuneration policy

Currently share-based incentive plans need to be re-approved by shareholders when there is a change in the scheme that is to the advantage of participants. The Dutch system of voting on remuneration is applied in a similar way. We believe both approaches provide a working precedent for the implementation of a binding vote on future remuneration policy in the UK.

Some shareholders have raised concerns that there are difficulties in defining a ‘substantial’ change. However, we believe the current working examples evidence an adequate level of response from companies and would encourage BIS to explore both approaches outlined in the box below.

Companies will still be accountable to shareholders through the advisory vote and annual director elections. These votes will ensure shareholders will still be able to hold the board accountable for any remuneration issue not captured by the definition of ‘substantial’ below.

We believe some general principles-based guidance on the definitions of ‘substantial’ changes would be welcomed by companies and investors. Please see the paragraph on Supporting Shareholder Engagement in question 1 below.

<table>
<thead>
<tr>
<th>Approaches to a binding vote on remuneration:</th>
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<tr>
<td><strong>UK Listing Rules:</strong></td>
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<td>The listing rules define the regulations governing the approval of long-term incentive share based awards. Schemes cannot be altered to the ‘advantage of participants’ without renewing shareholder approval.</td>
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<tr>
<td>LR 13.8.11: “cannot be altered to the advantage of participants without the prior approval of shareholders in general meeting (except for minor amendments to benefit the administration of the scheme, to take account of a change in legislation or to obtain or maintain favourable tax, exchange</td>
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control or regulatory treatment for participants in the scheme or for the company operating the
scheme or for members of its group);

LR 13.8.14: A circular to shareholders about proposed amendments to an employees’ share scheme
or a long-term incentive scheme must include:

(1) an explanation of the effect of the proposed amendments; and

(2) the full terms of the proposed amendments, or a statement that the full text of the scheme
as amended will be available for inspection.”

Dutch Remuneration Rules:

Eumedion has confirmed that:

- From ‘case law’ substantial changes should be submitted to a binding vote.
- ‘Substantial change’ has not been defined by either the legislator or the Dutch Corporate
  Governance Code.

Our experience in the Netherlands demonstrates that most issuers are comfortable with this
approach. Since the remuneration vote was introduced in the Netherlands we only have two
examples³ where shareholders have disagreed with the companies’ definition of a ‘substantial’
change.

3. Response to BIS’s specific questions:

Q1: The Government proposes to require an annual binding vote on remuneration policy. What
are the costs and benefits of this approach?

Effectiveness of engagement:

For most companies, annual engagement on remuneration issues should be unnecessary except
where ongoing dialogue has been demanded by shareholders. We have concerns that the current
government proposals may divert limited investor resources and board directors’ attention from
other important issues. Whilst we believe dialogue on remuneration may provide important insights
into how the board and non-executive directors operate and the expectations being placed on
management, it is essential that shareholders also monitor and engage on the areas of the
businesses that are critical to deliver long-term economic growth, such as corporate strategy,
financial viability, board succession and performance.

Our alternative solution outlined above will ensure that engagement on remuneration issues will
only be undertaken when there is a substantial change or when concerns are expressed by
shareholders. The dialogue encouraged by this approach, that only takes place when remuneration
matters are material, will improve the effectiveness of engagement and allow shareholders to
ensure sufficient resources are allocated to other corporate governance and strategic issues.

Supporting shareholder engagement:

We consider there may be a role for the Stewardship Code to provide guidance on engagement in
relation to the binding vote on remuneration policy. In order to facilitate collaborative engagement

³ KPN in 2009 and Ahold in 2012, source Eumedion 2012
amongst institutional investors on remuneration (and other matters), we would also welcome further guidance from the European Commission and FSA on acting in concert rules.

We would support the introduction of a UK monitoring mechanism where shareholders can report companies who have failed to respond to engagement on remuneration and other governance principles. For example, if USS’ alternative solution is adopted, companies could be reported for failing to hold a binding vote on future remuneration, even if shareholders consider there has been a substantial change in remuneration policy. The monitoring mechanism would have responsibility for investigating such breaches and have similar authority to the Financial Reporting Review Panel.

**Short-termism:**

Please refer to our alternative solution above.

We have concerns an annual binding vote on future remuneration policy could lead to a culture of short-termism within remuneration committees. We believe a triennial binding vote on future remuneration policy, as outlined above, creates an appropriate balance between ensuring remuneration structures are considered by the remuneration committees with a long-term strategic outlook and accountability to shareholders.

**Premium listed companies:**

We have concerns regarding:

- The scope of the legislation including the fact that non-UK incorporated companies would be exempt from the requirements; and
- How the proposed legislation would fit with the listing rules which require a binding vote on share-based incentive plans.

We would support a binding vote on future remuneration policy being applied to only Premium Listed companies through the UKLA Listing Rules.

An increasing number of companies are listed in the UK but incorporated elsewhere (e.g. Glencore International plc, WPP plc, International Consolidated Airlines Group plc). We believe that all companies listed on the premium market should adopt remuneration best practice and improve engagement. As a result, all companies should be subject to the same rules and requirements.

We believe that it will encourage greater consistency if the same authority oversees the binding voting on future remuneration policy and the current binding vote on share-based incentive plans.

**Dilution of voting and duplication of reporting:**

We have concerns that the shareholder vote on remuneration will be split across the different votes on remuneration, rather than focussed on one particular vote. The level of expertise required to understand the subtle differences of the remuneration related votes will be substantial. Our alternative solution described above provides a clear rationale for the binding vote on remuneration policy, and shareholders will more likely understand that this is a vote on the long-term future remuneration policy.

As discussed in USS’ submission to BIS on the Future on Narrative Reporting, we also have concerns regarding the separation of information across different reports. Any additional time taken searching for data to inform investment analysis, engagement, voting and stewardship activities
under the proposed regime could add a cost burden for users and would be an impediment to good stewardship.

Q2: In the event that a company fails the binding vote on remuneration policy, the Government proposes that it maintains its existing policy or returns to shareholders with amended proposals within 90 days. What are the costs and benefits of this approach?

The proposed ninety days period for the remuneration committee to return to shareholders with amended proposals is too short a timeframe for both remuneration committees and shareholders.

It is a serious problem for companies if a resolution fails. Ninety days is not sufficient to engage with shareholders and format a thoughtfully designed and appropriately amended remuneration policy. Currently large-cap companies tend to engage with shareholders on remuneration 3-6 months prior to the AGM. We also have concerns that during the peak voting season of April to July, shareholders may not have the resources to engage effectively in such a limited timeframe.

We would prefer companies to present an amended policy to shareholders at the next AGM and follow similar disclosure requirements on the board’s response to the failed vote as to those proposed in USS’ alternative solution above.

Q3: The Government proposes that directors’ service contracts and other arrangements should, if necessary, be amended to take account of the new requirement to seek shareholder approval of remuneration policy. What are the costs and benefits of this approach?

We have concerns that there are significant legal and practical issues in amending employment contracts. USS would not support boards and remuneration committees who choose to ‘buy-out’ current employment agreements and would vote against the appropriate resolutions at subsequent general meetings.

USS recently spoke to one large FTSE 100 Company, who commented that the proposed regulation on termination payments and binding resolutions on remuneration policy would not impact them because their executive directors were employed on a contract with an overseas subsidiary in a country with stronger employment law. We have serious concerns that other international companies could adopt a similar approach and re-employ executive directors with overseas subsidiaries thereby avoiding compliance with the proposals.

Q4: The Government proposes that remuneration packages offered to in-year recruits should be confined by the limits and structures set out in the agreed remuneration policy. What are the costs and benefits of this approach?

The future remuneration policy report should provide a clear framework of policies for new appointees, both for planned and unplanned succession. The company’s framework for the recruitment of executives should be sufficiently detailed to provide shareholders with the information to hold companies to account and appropriately challenge the remuneration of mid-
year recruited executives. We also believe that public disclosure of a policy for new recruits will help to reduce the level of ‘golden hello’ payments and strengthen the ability to negotiate a remuneration package that avoids paying more than is necessary for securing the appointment in line with the UK Corporate Governance Code.

Whilst we discourage the use of recruitment and retention awards, we recognise that there may be times when these are necessary or appropriate. Remuneration committees should ensure a link to performance and disclose in the annual report the leaver provisions that apply to such recruitment and retention awards.

Q5: The Government proposes that the report on future remuneration policy should provide more details on how approved LTIPs will operate for directors in that particular year. Do you agree with this approach?

Please refer to the paragraph on premium listing under question 1. We believe that it will create consistency if the same authority oversees the binding voting on future remuneration policy and the current binding vote on share-based incentive plans.

As the best remuneration reports already provide details of the performance metrics and targets applicable to future share-based incentive schemes, we do not want to see this diluted with the new reporting standards.

Q6: The Government proposes to increase the level of shareholder support that should be required to pass the vote on future remuneration policy. Do you agree with this approach and if so, what would be an appropriate threshold?

Please refer to our alternative solution detailed above. If an advisory vote receives less than an 80% vote in favour, the binding vote on future remuneration policy would be brought forward to the next AGM.

**Support majority limit:**
The supermajority voting requirements are currently reserved for resolutions relating to capital and the articles of association. We believe the higher level of support for such resolutions is appropriate given the importance of these issues to shareholder rights. However, companies ought to be responsive to shareholder concerns where there is a significant level of dissent.

We have concerns large minority shareholders could cause considerable disruption at the company if the remuneration related resolutions required a supermajority. We also have concerns a higher threshold may dissuade shareholders from voting against the future remuneration policy given the potential disruption to the company of a ‘failed vote’. This will dilute the impact of a separate binding vote on remuneration.

**Exclude beneficiaries from voting:**
New rules should be introduced to prevent Directors and related parties from voting their shares on resolutions approving the remuneration report and share-based incentive plans in which they, or related parties participate.
Adoption of poll voting:  
Any legislation or rule relating to a voting percentage outcome at the Annual General Meeting (beyond a pass or fail) would need to ensure votes were conducted on a poll. This is because where an AGM is voted on a show of hands the proxy results are not legally binding. Additionally shareholders who are voting on a show of hands at the meeting will not be reflected in the proxy results. Therefore to be fair to all shareholders and preserve the ‘one-share, one-vote’ philosophy poll voting will need to become universal. This is particularly important if the voting outcome of the annual advisory votes on the remuneration report becomes a threshold for a binding vote on future remuneration policy, in line with our alternative solution.

USS strongly advocates the use of poll voting for a number of reasons:

- Poll voting is legally mandated in many jurisdictions and has been widely adopted as best practice where not legally mandated.
- Nearly 90% of FTSE 100 companies voluntarily vote by poll.
- The minor costs associated by moving to poll voting are not significant obstacles.
- Section 341 of the 2006 Companies Act requires disclosure of the result of the poll to be disclosed on the Company’s website. Public disclosure would improve accountability and transparency between shareholders and companies which would ultimately lead to increased engagement.
- Section 342 of the 2006 Companies Act, allows shareholders to call for an independent report of the poll. We believe this right will improve the transparency of the voting system and ensure all participants in the voting chain are confident in the voting process.

Q7: The Government proposes to require companies to explain how the results of the advisory vote have been taken into account the following year and to issue a statement to the market sooner than this where there is a significant level of shareholder dissent. What are the costs and benefits of this approach?

Please refer to USS’ alternative solution detailed above.

USS strongly advocates this approach. We consider it is best practice for companies to acknowledge and explain how the vote results have been taken into account for any resolution that has received a significant dissenting vote.

Q8-11: Policies regarding a binding vote on exit payments.

Reservations on a separate vote on exit payments:  
We have a number of concerns regarding the practicalities of implementing a binding vote for every director who leaves a board with a potential payment of more than 12 months’ salary.

The current proposal could undermine mitigation policies currently being applied by companies. In many cases exit payments are paid in monthly instalments over 12 months, and stops when the director next finds paid employment. USS strongly supports such mitigation policies.
We also have reservations on including the ongoing LTIPs under these proposals. We consider the clawback provisions and remuneration committee discretion should ensure payments are not made for failure. In order to facilitate orderly succession and align the departing director with the long-term interests of the company beyond their employment, we often encourage extended holding periods and ongoing interests in share-based incentive plans.

**Alternative solution to a binding vote on exit payments:**

We would welcome greater transparency from companies on potential exit payments. Companies should disclose key elements of directors’ contracts on their website and provide a summary of the exit provisions in the annual Remuneration Report including:

- Full breakdown and disclosure of the constituent parts of any potential exit payment including salary, benefits, bonus, pension and share-based incentive plans, including those not necessarily included in the service contract.
- A total level of exit payment available to each director should the individual leave within the next reporting period.
- A breakdown of any exit payment made within the financial year.

Under USS’ alternative solution described above, shareholders would have a binding vote on future remuneration policy, which would include exit payments policies. Changes to the exit payment policies should be considered a ‘substantial’ change, and therefore subject to a binding vote. If shareholders consider a company breached or did not comply with the spirit of the exit payment policy, the remuneration committee could be held accountable through the annual advisory vote on remuneration and/or the re-elections of board directors.

For amending executive service contracts, please see question 3 above.

For new appointees, please see question 4 above.

Q12: The Government proposes to leave unchanged the existing requirement in company law (section 188 of the Companies Act) to get members’ approval for notice periods of more than two years. Do you agree with this approach?

We do not see any advantages to changing the 2006 Companies Act on this issue.

For further information please contact:

Dr Daniel Summerfield
Co-Head of Responsible Investment

Tel: 020 7972 0300
E-mail: responsibleinvestment@uss.co.uk
Yellow Hat Ltd
Directors’ Pay: consultation on revised reporting regulations.
Response form.

The closing date for this consultation is 26 September 2012
Please return completed forms to:

Barry Walker
Executive Pay Consultation
Department of Business, Innovation and Skills
1 Victoria Street
SW1H 0ET
020 7215 3930
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection
In the interests of transparency, the Department may choose to publish the responses to this consultation. Please state clearly if you wish your response to remain confidential.

Please note also that information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.
## About You

<table>
<thead>
<tr>
<th>Name: Andrew Menhennet</th>
<th>Organisation: Yellow Hat Limited</th>
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</thead>
<tbody>
<tr>
<td>Email: <a href="mailto:andrew.menhennet@yellow-hat-ltd.com">andrew.menhennet@yellow-hat-ltd.com</a></td>
<td>Address: Caterpillar Corner, Rectory Farm Barns, Little Chesterford, Essex CB10 1UD</td>
</tr>
</tbody>
</table>

### I am responding on behalf of (please tick):

| | 
|---|---|
| Quoted company | 
| Other company | 
| Investor or investment manager | 
| Business representative organisation | 
| Investor representative organisation | 
| Non governmental organisation | 
| Trade Union | 
| Lawyer or accountant | 
| Yes | Other (e.g. consultant or private individual) |
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.

The way the regulations is not easy for a lay reader to follow, however we did not observe any omissions from what was set out in the consultation document. However it is difficult to see how the government will achieve its goal of greater consistency in the way information is laid out without making some of the illustrative tables and charts that are included in the consultation document available alongside the regulations.

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

Some additional resource is likely to be required within the HR function to produce the information required for the reports.

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. Per response to question 1 above, it will be helpful if an example table such as is included at annex A of the consultation document is made available alongside the regulations.
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.

Yes this is helpful. It would be helpful to have a more precise explanation of overall expenditure on pay, otherwise organisations are likely to interpret this measure in different ways, rendering comparisons between companies misleading. Presumably what is intended is that companies report a single aggregated figure for all employees and directors and for all elements of the pay policy table contained in the 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.

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.
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?

Yes

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?

Yes, although it would be helpful if consistency between the private and public sectors could be achieved in this respect.
Question 9: The Government proposes that claw-back is recorded as part of the single figure. Is this a practical and informative approach?

Yes
**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?

In most cases it is unlikely that performance measures used for the purpose of executive variable pay will be commercially sensitive. Exceptionally however companies should have the flexibility not to reveal the full detail of a performance measure if the information is genuinely sensitive.

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

**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?

No. The differing characteristics of option versus share awards for example will make comparisons between and within organisations meaningless, and are likely to give a very misleading impression of the future value of executive reward packages where share options are used. It would be better to require a greater level of transparency and consistency between companies in the way that expected values are calculated for different types of award.
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.

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?

Yes (to both parts of the question).

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?