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How companies and shareholders have responded to new requirements on the reporting and governance of directors' remuneration

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Executive Summary

Introduction

This paper considers how companies and shareholders have responded to new requirements on the reporting and governance of director's remuneration introduced in the Large and Medium-Sized Companies and Groups (Accounts and reports) (Amendment) Regulations 2013 ("the Regulations").

It examines the level of compliance with the Regulations amongst a selection of UK incorporated companies listed on the London Stock Exchange.

The paper examines and assesses a number of questions on a "Pass/Fail" basis, assessing as to whether the required information was provided as set out in the Regulations.

In addition it makes a qualitative assessment of compliance with three further questions relating to requirements in the regulations, namely:

- whether acceptable explanation is provided of how workforce pay is taken into consideration when setting executive pay;
- the appropriateness of the group of employees used to calculate the relationship between average employee pay and executive pay; and
- the suitability of the statement of consideration of shareholder views.

In assessing compliance with the regulations, we have also considered relevant aspects of the GC100 and Investor Group Directors' Remuneration Reporting Guidance[1] ("the Guidance").

We also examine shareholders voting results of the remuneration policy and remuneration report votes from the 2014 AGM season, in the context of the four previous years' votes, with a particular focus on turnout and dissent levels.

Finally, it presents some analysis of recent developments in the structure and levels of directors' remuneration more generally.

Judgements and opinions presented in this paper are those of Manifest, and do not necessarily reflect the Government's position.

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[1] GC100 and Investor Group "Directors' Remuneration Reporting Guidance" (as amended on 14th October 2013), available at: http://uk.practicallaw.com/6-540-9731

Research Methodology

A list of all UK incorporated companies main listed in London (ex-investment trusts) for whom the most recent AGM vote results had been disclosed in respect of meetings held since the 1st October 2013 was drawn up. A subset of this group of companies was then selected at random. These companies were then divided into three groups defined by measure of company size:

- Group 1 consists of 38 companies and are those with more than 20,000 employees.
- Group 2 consists of 38 companies and are those with fewer than 20,000 employees, except for those designated Group 3 companies.
- Group 3 consists of 17 companies and are those which fit the EU definition of small or medium sized enterprises (SME's) defined as those with fewer than 250 employees and which turnover less than €50,000,000 per annum or which have less than €43,000,000 in assets.

Conclusions

Companies compliance with the regulations

The Pass/Fail assessment found that most companies in the sample complied with the majority of the requirements in the regulations. There was 100% compliance with 8 of the 19 questions assessed, and a very high level of compliance (95% - 99%) with a further 7 of the questions. This represented just 11 instances of non-compliance, of which 5 were by one Group 3 company. Indeed, the majority of compliance issues with the Regulations in the Pass/Fail section were amongst the Group 3 companies, indicating that by and large compliance among Group 1 and Group 2 companies is very good indeed.

The 4 remaining questions (covering requirements to provide details of pension entitlements, information on payments to past directors, information on payments for loss of office, and future salary policy) evidenced more notable levels of non-compliance.

The first 3 of these disclosures are subject to audit. Accordingly we conclude that it is likely that the lack of explicit disclosure means that the company has no relevant information to disclosure. We conclude that it would be helpful for companies to provide a positive confirmation that no information can be disclosed. For example, in relation to pension accrual and age of retirement in cases where the individual does not participate in a company scheme, or in cases where the company has made no payments to past directors or for loss of office during the year, a positive confirmation that such information is not available would enhance transparency and promote trust.

We suggest that it might be useful for the Guidance on disclosure of pension entitlements, payments to past directors and payments for loss of office, to be adjusted to promote positive confirmation of an absence of such payments, or confirmation that there is no need to provide a break down of pension entitlements.

Finally, we find a significant level of non-compliance with the requirement to specify clearly, in monetary terms or otherwise, the maximum future salary that may be paid under the remuneration policy.

We conclude that there may have been some confusion as between the Guidance that invites companies “to describe the considerations the remuneration committee will take into account for increasing salaries during the remuneration policy period” and the overriding guidance (and requirement) that “the maximum must be explained”, with many companies appearing to use the former to excuse themselves from the latter. It may be helpful to consider adjusting the guidance to ensure that it is clear that the maximum amount must be explained, irrespective of additional disclosure of any considerations the remuneration committee takes into account in determining proposed increases during the policy period.

Our qualitative assessment as to whether companies are complying with the disclosure requirements in three further areas found that there is some scope for companies to give greater clarity to facilitate appropriate shareholder understanding.

Specifically, in relation to the consideration of workforce pay when setting director’s remuneration policies, a significant minority of companies provided insufficient detail for shareholders to judge how such consideration actually works in practice. That said, there was evidence of emerging good practice in this respect, with around 50% of the companies in the sample making detailed disclosures about how they took consideration of employee pay and conditions into account. A similar picture emerged in relation to consideration of shareholder views when setting remuneration policy.

This problem is far less prevalent in companies’ disclosures of the comparisons of changes in CEO pay with those of employees generally. The majority of companies either compared the change in CEO pay with all employees in the company, all employees in the UK, or all employees in the UK and other main markets of operation.

Shareholder Voting Results

We examined the behaviours of shareholders in use of their voting rights on remuneration issues over the past 5 years, with a particular focus upon the introduction of the binding policy vote.

Shareholders at smaller companies have more recently voted in increasing numbers, mirroring the comparatively high levels of turnout at larger companies, towards 70%.

We have shown that dissent has steadily increased, though with a discernible "peak" in 2012.

Average dissent on Remuneration Reports is much greater than for resolutions in general. Throughout the period 2008 to2013, average dissent across all resolutions has approached but never breached 3%. By comparison, Remuneration Report resolutions are on average three times more contentious than other types of resolutions. The paper shows that dissent has steadily increased, though with a discernible peak in 2012.

Looking specifically at the use of "Against" votes, a similar pattern can be observed – once more, 2012 is the standout year, marking the peak of dissent and an even bigger peak in terms of "Against" voting by shareholders, when it constituted 80% of dissent. However, even though the proportion and number of "Against" votes has fallen in 2013 and 2014, shareholders are still more likely to use "Against" votes than five or six years ago.

Early evidence from the first round of binding, forward-looking policy votes shows marginally higher levels of dissent for binding votes on remuneration policies than for advisory votes on remuneration reports. It also suggests that shareholders are more likely to vote against remuneration policies than to abstain compared with votes on remuneration reports. This suggests that the introduction of the binding vote has not discouraged dissent, as some commentators feared.

Recent developments in structures and levels of directors' remuneration

Analysis of recent developments in the structure and levels of directors' remuneration more generally finds that the increase in total pay has radically slowed, especially in the last two years. For example total remuneration awarded to FTSE 100 CEOs has fallen significantly in 2012 and 2013.

Salary increases are slowing more aggressively at larger companies than smaller ones, though of course the absolute amounts concerned are far greater at larger companies. In terms of maximum bonus and long term incentive opportunity available, generally a greater percentage of salary is available to those at larger companies. Similarly, in terms of actual bonus realised or expected value of long term incentive options, the higher percentages are also to be found at larger companies, though these too are reducing in the more recent past.

Research Methodology

Data Sample Selection

A list was drawn up of all UK-incorporated companies listed on the main market of the London Stock Exchange (excluding investment trust companies) for whom the most recent AGM vote results had been disclosed in respect of meetings held since the 1st October 2013 .A subset of this group of companies was then selected at random. These companies were then divided into three groups defined by measure of company size:

- Group 1 consists of 38 companies and are those with more than 20,000 employees.

- Group 2 consists of 38 companies and are those with fewer than 20,000 employees, except for those designated Group 3 companies.

- Group 3 consists of 17 companies and are those which fit the EU definition of small or medium sized enterprises (SME's) defined as those with fewer than 250 employees and which turnover less than €50,000,000 per annum or which have less than €43,000,000 in assets.

As far as possible we maintained an equal number of companies in each group. The smaller number of companies fitting the criteria for Group 3 led to the smaller sample size here. Care is therefore needed in interpreting comparisons between this group and Groups 1 and 2.

Research Objectivity & Conflicts of Interest

Some companies within the sample set may have a licence agreement with Manifest under which they have access to view our research reports about the shareholder meetings, once published. The analyst involved in the primary analysis was not aware of the licensee status of the companies. No companies have been contacted during the process of producing this research, nor have they played a role in it. The list of licensees is available to customers upon request.

For further information on Manifest's Conflicts of Interest policy, please see our web site at www.manifest.co.uk.

Data Analysis

The remuneration reports and remuneration policy sections of companies' Directors' Remuneration Reports, published ahead of their Annual General Meetings (AGM) were examined to establish the extent to which the disclosures of each were in compliance with the requirements of The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment)

Regulations 2013 (“the Regulations”). The Schedule to these regulations amended Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. References to specific requirements below are therefore made to the new Schedule 8, for instance “Sch.8:19”.

Companies’ compliance with the regulations

A number of questions have been examined and assessed on a “Pass/Fail” basis, assessing as to whether the required information was provided as set out in the Regulations. We explain general overall levels (in terms of general proportions) of compliance as well as any patterns which appear related to company size. The questions examined are:

- Does the Remuneration Report include the “single total figure table”?
- Does the table provide the breakdown of each director's remuneration?
- Does the table show the figures for the relevant year next to those corresponding to the preceding year?
- Has the single figure been audited?
- Are total pension entitlements broken down, or an explanation provided as to why not?
- Are scheme interests awarded during the financial year disclosed?
- Are payments to past directors disclosed, or their positive absence confirmed?
- Are payments for loss of office disclosed, or their positive absence confirmed?
- Has the company provided a statement of directors’ shareholding and share interests?
- Has the company provided a performance graph and table as required by Sch. 8:18?
- Has the company provided the required illustration of the percentage change in remuneration of director undertaking the role of CEO?
- Has the company disclosed the relative importance of spend on pay compared to all employee remuneration, shareholder returns and any other appropriate measures?
- Has the company provided a statement of implementation of remuneration policy in respect of the following financial year?

- Is consideration by the directors of matters relating to directors' remuneration explained?

- Does the company provide a future policy table, and does it provide the information required by the Regulations?

- Has the company provided illustrations of application of remuneration policy

- Are the principles of the company's approach to recruitment remuneration explained?

- Are the remuneration implications of director's service contracts explained?

- Has the company explained its policy on payments for loss of office?

We have also made some observations related to the quality of the disclosures and, in some cases, anonymous examples of the way in which the requirements of the Regulations themselves were not met in a sufficiently transparent manner. Where compliance issues were identified these have been subject to re-checking and further examination.

In addition to the Pass/Fail assessment of compliance, we have also conducted analysis of aspects of the regulations which require companies to set out:

- how pay and employment conditions of employees were taken into account when setting the policy for directors' remuneration and whether, and if so, how employees were consulted; and

- whether, and if so, how the views of shareholders were taken into account when setting the policy for directors' remuneration.

We have also examined companies' approach to setting out information on the respective changes in the remuneration of the CEO and of average employees, where the regulations permit flexibility to choose the comparator group of employees, if the company believes a comparison with all employees is not appropriate.

Qualitative analysis has again been carried out by reference to the remuneration reports of the companies in the sample cohort. As with the "Pass/Fail" assessments, we provide analysis of general proportions of compliance using the requirements of the Regulations as a starting point, as well as providing some explanation of any patterns which emerge relating to company size. We also explain the subjective judgements we have used in assessing compliance. In particular we have examined whether companies are making meaningful disclosures in these areas.

We again make some observations related to the quality of the disclosures and, in some cases, anonymised examples of the way in which the requirements of the Regulations themselves could be met in a more transparent manner.

Shareholder Voting

Analysis of shareholder voting behaviour in respect of the remuneration disclosures examined has been carried out, as well as in respect of the preceding 4 years of remuneration report votes (where available). This historical perspective should throw some light on the question of whether the Regulations may have had an impact on investor behaviour.

Throughout all of our analysis Manifest analysts use the FRC's memorandum "What constitutes an explanation under 'comply or explain'?" for reference, which we have applied for evaluation of explanations provided by companies in the context of the Regulations[2], in order to determine what we deem to be a suitable explanation for the purposes of this project where it requires evaluation of qualitative explanations.

Recent Developments in Structures and Levels of Directors' Remuneration

Our research in this area draws from data and analysis in the Manifest/MM&K Total Remuneration Survey, July 2014, and its predecessors. This analysis uses FTSE Index constituencies, market cap brackets or turnover brackets as the reference points for company size cohorts, which are different to those used in the rest of this study.

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[2] FRC's memorandum "What constitutes an explanation under 'comply or explain'?" available at: https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/What-constitutes-an-explanation-under-comply-or-ex.pdf

Companies’ compliance with the regulations

Questions with which all companies fully complied

By and large, most companies in the sample complied with the majority of the specific questions this study examines. The questions in respect of which all companies reached complete compliance with the Regulations were:

- “Single Figure” table provided as required by Sch.8:4;

- The table provides a breakdown of each director’s remuneration as set out in Sch.8:5 (1);

- The single figure has been audited as required by Sch 8:41 (Note: not all companies specifically confirmed section by section which of the elements have been audited, rather providing assurances that the correct sections had been audited in line with the Regulations);

- Scheme interests awarded during the year were disclosed or their absence positively confirmed as required by Sch 8:14;

- Statement of directors’ shareholding and shareholder interests provided as required by Sch 8:17;

- Statement of consideration by the directors of matters relating to directors’ remuneration as required by Schedule 8:22;

- Policy report illustrations of application of remuneration policy stipulated in the Regulations provided as required by Sch 8:33-35; and

- Policy report includes service contracts detail as required by Sch 8:30-32.

The remaining commentary pertains specifically to the questions identified below where noticeable levels of non-compliance were identified.

Questions with minor levels of non-compliance

The following were questions where minor levels of non-compliance were identified – in other words where fewer than 10% of companies were non-compliant. In respect of these questions, due to the high levels of compliance, patterns of non-compliance may not be inferred due to the small number of instances concerned therefore commentary is minimal. It should be considered that levels of compliance with these questions may not be perfect but are reasonable.

The majority of instances of failure to comply with the Regulations in this section were amongst the Group 3 companies, indicating that by and large compliance among Group 1 and Group 2 companies is very good indeed. In total there were 11 instances of non-compliance with individual requirements under the Regulations, 5 of which were by the same Group 3 company.

The Single Figure Table shows the figure for the preceding year next to those for the current year as required by Schedule 8:9 (1)(95%);
Four Group 3 companies did not meet this requirement.
Performance graphs and tables as required by Schedule 8:18 provided (99%);
One Group 3 company did not meet this requirement.
Percentage change in remuneration of the person undertaking the role of CEO provided as required by Schedule 8:19(97%);
One Group 3 company and one Group 1 company did not meet this requirement.
Statement of the relative importance of spend on pay provided as required by Schedule 8:20 (1) (99%);
One Group 3 company did not meet this requirement.
Policy report statement of implementation of remuneration policy in the following financial year provided as required by Schedule 8:21 (1-2) (96%)
Two Group 3 companies did not meet this requirement.
Policy report statement of approach to recruitment remuneration provided as required by Schedule 8:29 (99%)
One Group 3 company did not meet this requirement.

Policy on loss of office payments provided as required by Schedule 8:36 (99%)
One Group 2 company did not meet this requirement.

Questions with notable or significant compliance issues

The following section identifies questions from the Pass/Fail analysis where notable levels of non-compliance were identified. We deemed general compliance levels of below 90% as notable. Because of this, we provide details of the actual regulatory requirements, alongside a breakdown of compliance by company Group, as well as commentary on the nature of non-compliance identified.

Details of total pension entitlements

Regulatory Requirement

Sch.8:13. (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, and who has a prospective entitlement to defined benefits or cash balance benefits (or to benefits under a hybrid arrangement which includes such benefits) in respect of qualifying services, contain the following information in respect of pensions—

a) details of those rights as at the end of that year, including the person's normal retirement date;

b) a description of any additional benefit that will become receivable by a director in the event that that director retires early; and

c) where a person has rights under more than one type of pension benefit identified in column headed "e" of the single total figure table, separate details relating to each type of pension benefit.

General patterns of compliance

Amongst the Pass/Fail analysis, this was the question with which companies complied the least. 53% of companies satisfied the criterion. Breaking down the analysis by company size, non-compliance is particularly prevalent amongst the Group 3 companies in the sample (with only 29% of companies compliant), though Group 1 companies did not display as high a level of compliance as those in Group 2 (53% compliance amongst Group 1 yet 63% amongst Group 2).

General nature of compliance issues

The most common problem amongst most companies where compliance was not met was a complete absence of breakdown of the pension entitlement despite in a significant minority of cases the pension figure being disclosed in the single figure table. A small handful of companies evenly spread across all groups gave some detail but typically neglected to show the total pension entitlement as at year end.

This question is subject to audit. Shareholders may therefore reasonably infer, in the absence of a breakdown, that the pension entitlement is a single figure. However, a model disclosure would break down all pension entitlements as at year end, or positively confirm that no such breakdown is required because the pension entitlement is a single figure.

Guidance

With regard to disclosure of both breakdown and total pension entitlement, there is some scope for the Guidance to be clearer so as to avoid the potential for lack of clarity in disclosures. The Guidance states that "[i]f the pension value reported in the single remuneration figure includes more than one type of pension benefit, the breakdown or relative weighting of each type must be provided" (p11). However, the Guidance is silent on whether companies might consider providing positive confirmation that no such breakdown is required. Although the information concerned is subject to audit (ergo, an absence of information should reasonably be trusted to confirm that no such payments have been made), such a confirmation may contribute positively towards the realisation of the goal set out in the introductory guidance to this issue: "Investors would find it helpful for them to be disclosed by companies in a comprehensive form *and in a way that aids understanding of the figures*" (emphasis added).

Information on payments made to past directors during the year

Regulatory Requirement

Sch.8:15. The directors' remuneration report must, for the relevant financial year, contain details of any payments of money or other assets to any person who was not a director of the company at the time the payment was made, but who had been a director of the company before that time, excluding—

a) any payments falling within paragraph 16;

b) any payments which are shown in the single total figure table;

c) any payments which have been disclosed in a previous directors' remuneration report of the company;

d) any payments which are below a de minimis threshold set by the company and stated in the report;

e) payments by way of regular pension benefits commenced in a previous year or dividend payments in respect of scheme interests retained after leaving office; and

f) payments in respect of employment with or any other contractual service performed for the company other than as a director.

General patterns of compliance

Overall, 71% of companies across the whole sample complied with this requirement.

However, there was a very clear pattern of poorer compliance for smaller companies. Group 1 companies showed 90% compliance, Group 2 companies 66% compliance and Group 3 companies just 41% compliance.

General nature of compliance issues

All companies on which we identified a shortfall on this question simply did not include a statement that payments to past directors had not been made.

This question is subject to audit. Shareholders may therefore reasonably infer, in the absence of a statement, that no payments have been made to past directors. However, a model disclosure would include a positive confirmation that no payments have been made, if that is the case.

Examples of compliance issues

All occurrences of non-compliance were cases where no positive confirmation that no payments had been made was given.

Guidance

Similarly to the observation about the Guidance on information relating to total pension entitlements, there is no mention of positive confirmation that no payments have been made. Although the information concerned is subject to audit (ergo, an absence of information should reasonably be trusted to confirm that no such payments have been made), a positive confirmation that no such payments have been made would be a more robust way of ensuring shareholders (and analysts) have clarity of information.

Information on payments for loss of office during the year

Regulatory Requirement

Sch.8:16. The directors' remuneration report must for the relevant financial year set out, for each person who has served as a director of the company at any time during that year, or any previous year, excluding payments which are below a de minimis threshold set by the company and stated in the report—

a) the total amount of any payment for loss of office paid to or receivable by the person in respect of that financial year, broken down into each component comprised in that payment and the value of each component;

b) an explanation of how each component was calculated;

c) any other payments paid to or receivable by the person in connection with the termination of qualifying services, whether by way of compensation for loss of office or otherwise, including the treatment of outstanding incentive awards that vest on or following termination; and

d) where any discretion was exercised in respect of the payment, an explanation of how it was exercised.

General patterns of compliance

Overall, 78% of companies satisfactorily disclosed information relating to payments for loss of office made during the year.

However, Group 1 companies were noticeably better, with 90% compliance amongst their number, compared to around 71% for Group 2 and Group 3 companies.

General nature of compliance issues

As with the issue of payments made to previous directors, the sole problem our analysis identified amongst companies who did not comply with the Regulations were where there was an absence of confirmation that no payments were made. Again, as with the issue of payments made to previous directors, the fact that this question is subject to audit leaves shareholders to assume that an absence of any statement on this question means no such payments were made, rather than that payments had been made but have gone unreported.

A model disclosure would therefore include the possibility of a positive confirmation that no payments have been made.

Examples of compliance issues

All occurrences of non-compliance were cases where no positive confirmation that no payments had been made was given.

Guidance

Again, we make the simple observation that Guidance should stipulate the importance of including a positive confirmation that no payments have been made, where this is the case, for the same reasons as we outlined in respect of the disclosure of payments made to past directors during the year.

Future Policy Table

Regulatory Requirement

Sch.8:25. (1) The directors' remuneration report must contain in tabular form a description of each of the components of the remuneration package for the directors of the company which are comprised in the directors' remuneration policy of the company.

(2) Where the report complies with sub-paragraph (1) by reference to provisions which apply generally to all directors, the table must also include any particular arrangements which are specific to any director individually.

(3) References in this Part to "component parts of the remuneration package" include, but are not limited to, all those items which are relevant for the purposes of the single total figure table.

Sch.8:26. In respect of each of the components described in the table there must be set out the following information:

(a)how that component supports the short and long-term strategic objectives of the company (or, where the company is a parent company, the group);

(b)an explanation of how that component of the remuneration package operates;

(c)the maximum that may be paid in respect of that component (which may be expressed in monetary terms, or otherwise);

(d)where applicable, a description of the framework used to assess performance including—

(i)a description of any performance measures which apply and, where more than one performance measure applies, an indication of the weighting of the performance measure or group of performance measures;

(ii)details of any performance period; and

(iii)the amount (which may be expressed in monetary terms or otherwise) that may be paid in respect of —

(aa)the minimum level of performance that results in any payment under the policy, and

(bb)any further levels of performance set in accordance with the policy;

(e)an explanation as to whether there are any provisions for the recovery of sums paid or the withholding of the payment of any sum.

The future policy table was the area where we found the most significant compliance issue.

General extent and nature of the compliance issue

The specific (and only) problem in question related to the requirement to set out the maximum that may be paid out in respect of salary. In the case of salary especially, the fact that the policy is, by definition, in place for three years, we failed companies that disclosed the current salary level (i.e. the initial salary level in the first year of the policy) but went on to confirm that salary increase would be possible under the current policy without specifying an identifiable absolute upper limit to the possible salary increases.

Promises such as the “rate of increase (in percentage terms) is typically linked to those of the wider workforce” were not considered a “Pass”, due to the obvious caveat that an ‘atypical’ salary rise could be possible. Many companies referred to “normally” when describing the conditions under which the principles of their salary increase policy are to apply, similarly thereby providing for the possibility of “abnormal” changes within the wording of the policy itself.

Examples of compliance

Those companies that did comply with these requirements displayed little uniformity of application of limit. One referred to an absolute sum of money per annum above which salary levels would not pass for the duration of the policy; another stipulated the specific salary levels for the three years of the policy, and another simply set the salary amount for the duration of the policy.

General patterns of non-compliance

85 companies (93% of the full sample) did not state an absolute limit on potential salary increases for the lifetime of the policy. 36 were Group 1 Companies, 34 Group 2 Companies, and 15 Group 3.

There were many whom we judged had attempted to respect the spirit of the Regulations without meeting the letter. There were others who evidenced they understood the letter of the regulations but chose not to follow them. Broadly speaking, we identified the following characteristics among this group (in descending order of proximity to the spirit of the Regulations:

- Specific statements of non-compliance qualified by detail as to reference points for limits.

- Disclosure of the principles according to which limits are proposed to be applied

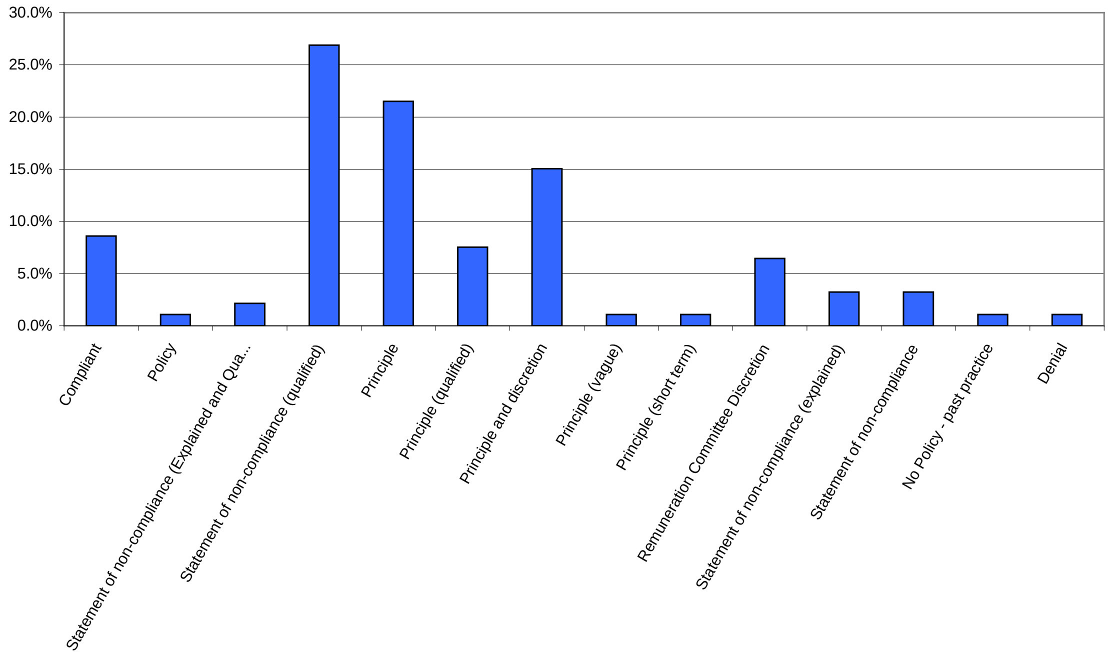
- Disclosure of the process by which salary increases are elaborated

- Specific statements of non-compliance without detail as to reference points for limits

- Absence of reference to an upper limit or principles for limiting salary increases

A breakdown of our analysis is shown in Figure 1 below.

Figure 1: Percentage of companies in noncompliance with aspects of the GC100 Guidance



Those who had met the spirit of the Regulations but not the letter mainly qualified their lack of an upper limit by detailing the factors taken into account in setting salary rises (27% of the sample). Of these, the vast majority referred principally to employee pay standards. Two companies not only provided a qualification to their lack of upper limit, but also explained for shareholders that they did not have one in place “to avoid setting expectations of executive directors and other employees”.

One company neglected to positively confirm what the upper limit to their salary increases might be, but committed to a specific principle for establishing the salary increase to be applied (“standard increases awarded to other employees”) to the extent that we also judged them to have respected the spirit if not the letter of the Regulations.

The largest proportion of companies (46%) were those which referred in some way to the principles by which they intend to limit salary increases, without committing to absolute limits or mentioning whether they applied any (thereby missing the letter and some element of the spirit of the Regulations). We judged the difference between a principle and a policy to be whether there was some element of qualification applied (such as "increases will generally/normally/typically not exceed…"). Within these we identified a considerable variety of response detail.

Approximately one in five (21%) of all companies set out a principle (or principles) according to which limits would normally be set. Of these, two thirds cited average employee pay rises in the company as the prime reference, with a small minority referring instead to inflation or market comparators. It is notable that many of the companies that cited employee pay rise rates as the reference point in fact intend to refer only to those employees in the country of residence of the executive.

Additionally, seven per cent of companies cited a firm principle, but specified potential qualifications to the principle, such as instances where the executive had changed role, increased responsibilities or occasionally where the executive had initially been hired on a below market rate until their experience at the company merits a market-level rate (thereby necessitating an accelerated salary increase year-on-year which remains at or below market rate).

A notable minority (15%) cited general principles but qualified them by referring to the possibility of Remuneration Committee discretion to override them. The circumstances under which that might happen were frequently described, and were consistent with the qualifications described in the paragraph above.

Two companies referred to the application of principles but were either too vague (a lack of overall reference point for the principle, but citing two specific instances illustrating where a principle might be over-ridden) or too short term in their policy (reference only made to the following year's salary rate policy, rather than for the full three years required of the policy).

Also, fifteen per cent of companies in the sample set fell short of detailing principles. The largest proportion of these (6.5% of the sample set) neglected to refer to the absence of an absolute limit or elaborate on general principles to be applied, but did detail the factors under which it is intended for the Remuneration Committee to determine the discretion they are to apply. Once more, employee rate rises are the most common reference point, but less frequently the prime reference point, evenly distributed alongside individual performance levels (ergo salary levels are themselves subject to sensitivity to performance?) or market comparators.

A similar proportion (6.5%) made an explicit, unqualified statement of non-compliance (i.e. without referring to any factors taken into account in limiting salary rises). Half of them did at least explain why they refrained from implementing a salary increase limit (all three of them referring to avoidance of setting expectations).

Guidance

The Guidance goes into some detail on the issue of dealing with the salary element of the future policy table. It is clear in setting the expectation that the maximum amount of salary increase to be applied "must be explained in monetary terms or any other way appropriate to the company (for example, a percentage of salary)" (p26). Therefore, whilst investors may not expect to see an absolute monetary amount disclosed, it would be reasonable for investors to expect enough information to be able to calculate such a figure.

The spirit of the Guidance is clear that investors should expect to find information which enables understanding of a maximum amount, given that, in the context of explaining the impact of potential complexities of currency fluctuations in cases where salary may be expressed in multiple currencies, the Guidance is that "if different currencies are used, it may also be important to set out maxima in all relevant currencies and not only one currency".

There would appear to have been some possible confusion as between the Guidance that invites companies "to describe the considerations the remuneration committee will take into account for increasing salaries during the remuneration policy period" and the overriding guidance (and requirement) that "the maximum must be explained", with many companies using the former to excuse not disclosing the latter. It may be helpful to consider adjusting the guidance to ensure that it is clear that the maximum amount must be explained, irrespective of additional disclosure of any considerations the remuneration committee takes into account in determining proposed increases during the policy period.

Qualitative assessments

The additional questions of this section all imply some degree of discretion in judging whether they fulfil the spirit of the requirements. Again, in addition to responding to the questions to be investigated, we explain how and where we have applied our judgment.

In addition to general observations made during our pass/fail assessments of information disclosure, we have also examined some specific questions, including:

- whether acceptable explanation is provided of how workforce pay is taken into consideration when setting executive pay;

- the appropriateness of the group of employees used to calculate the relationship between average employee pay and executive pay; and

- the suitability of the statement of consideration of shareholder views.

Explaining How Workforce Pay Is Considered In Setting Director’s Pay

Regulatory Requirement

Sch.8:38. The directors’ remuneration policy must contain a statement of how pay and employment conditions of employees (other than directors) of the company and, where the company is a parent company, of the group of other undertakings within the same group as the company, were taken into account when setting the policy for directors’ remuneration.

Sch.8:39. The statement must also set out—

a) whether, and if so, how, the company consulted with employees when drawing up the directors’ remuneration policy set out in this part of the report;

b) whether any remuneration comparison measurements were used and if so, what they were, and how that information was taken into account.

Guidance

The Guidance is clear that some statement must be provided regarding whether employees are consulted, and that disclosures should provide some explanation as to how wider conditions are taken into account.

Judgement framework

When considering compliance with explaining how workforce pay is considered in setting director’s pay, we applied the following judgments.

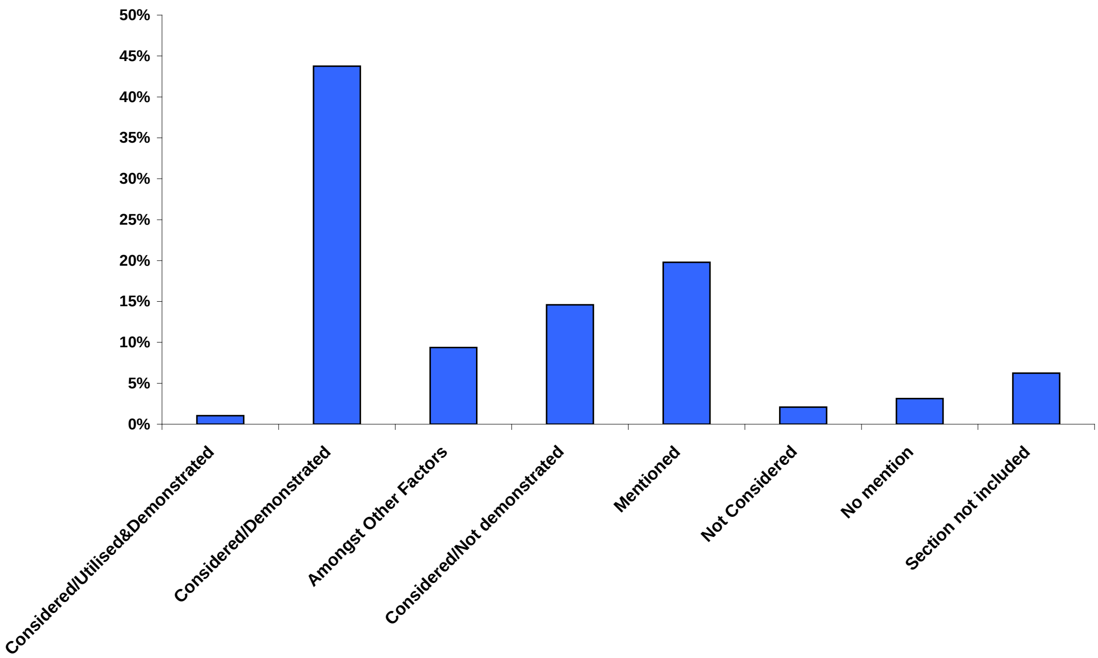
Conclusion	Judgement
Considered/ Demonstrated	Companies considered workforce pay when setting compensation for directors and demonstrated that they've utilised it as a measure.
Considered/ Not demonstrated	Companies stated that they considered workforce pay when setting compensation for directors; however this could not be proven.
Amongst Other Factors	Companies stated that they considered workforce pay but also mentioned/specified other factors used when considering increases for directors
Mentioned	Companies mentioned the consideration of workforce pay but didn't explain how or if it was relevant. (as if with relatively low importance)

Not Considered	Companies stated that pay workforce is not considered when setting compensation for directors.
No mention	No mention whatsoever whether workforce pay is considered when setting compensation for directors.
Section not included	Section has not been included in the annual report

Overall Findings

A summary of our overall findings is represented in Figure 2: Consideration of Workforce Pay.

Figure 2: Consideration of Workforce Pay



It shows that the vast majority of companies complied with the Regulations in terms of having a statement addressing the issue – only 9 companies either had no statement or made no mention of the consideration of workforce pay in setting directors pay.

However, of the companies who did include a statement, there is some variety in the quality of that consideration reported, ranging from the provision of information to demonstrate how such consideration worked in practice, down to simply making mention of having made consideration.

The largest proportion (nearly 50% of companies) demonstrated how they take such consideration into account. In respect of these companies, shareholders were therefore in a position to be able to make their own judgement as to whether they deemed adequate the nature of consideration of workforce pay in setting directors pay.

However, nearly a third mentioned consideration without any corroborating information to demonstrate how such consideration operated in practice. Shareholders in these companies were left to take it on faith that the consideration applied was indeed adequate in their view.

Example disclosures
A ‘model’ answer: One answer included details of the specific RPI measure used to determine base salary increases across the group, explained that the executive directors were employed in the UK and that therefore that was the frame of reference for the salary increase for the directors. We considered this a model answer because it was explicit in the actual measures to be used and gave a worked example of how those principles operate in practice, as well as giving some information about how employees were also consulted as a part of the process.

Some typical example answers of the large number of companies which considered workforce pay and described how that consideration is to be applied in practice (but without a worked example of the policy in practice such as measures to be used for comparison) include:

- Regular information gathering by the Remuneration Committee of information about pay practices within the company;

- Remuneration Committee invites the Group Head of HR for consultation;

- The Remuneration Committee considers budgeted salary increases across the group;

- Remuneration Committee monitors overall spend on bonus and participation levels in incentive plans across the group; and

- Director remuneration forms a part of general employee survey mechanisms, though employees are not directly engaged specifically about executive remuneration questions.

Companies which made mention of the consideration of workforce pay but no more than that tended to offer varying levels of detail of the other factors in determining director pay. These include the importance of attracting and retaining high quality leadership, alignment of director incentives with shareholder interests and a lack of comparability with general staff due to the diverse conditions within specific business units.

Findings by Group

The majority of Group 1 companies complied with this part of the Regulations. Of those that left gaps in the information provided to shareholders, comparatively very few left notable gaps. Shareholders in Group 2 companies were, by comparison, left much more to take companies at their word about the consideration given to workforce pay. Group 3 companies are those which are most likely to have offered no information at all to shareholders on this topic. However, those which have included mention of the issue are by and large no less likely to leave their shareholders in the dark than other companies.

Group 1 companies

Figure 3: Group 1 Companies Consideration of Workforce Pay

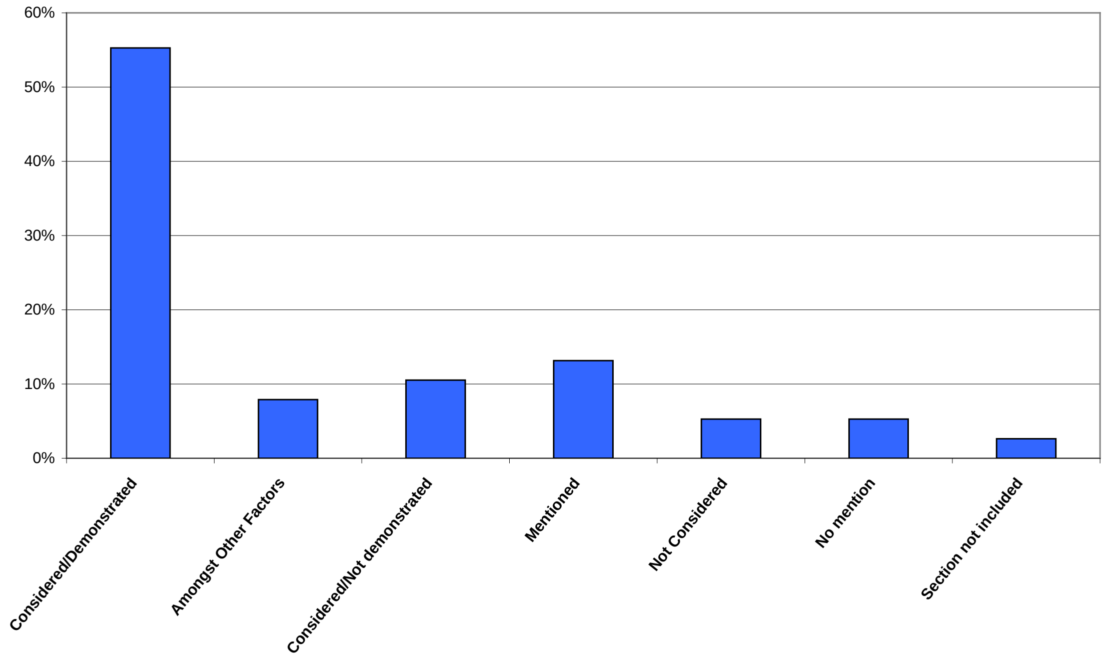


Figure 3: Group 1 Companies Consideration of Workforce Pay shows that the majority of Group 1 companies complied with this part of the Regulations. Of those that left gaps in the information provided to shareholders, comparatively very few left notable gaps. Roughly 20% of this group considered workforce pay without giving shareholders information to be able to judge how such consideration worked in practice.

Group 2 companies

Figure 4: Group 2 Companies Consideration of Workforce Pay

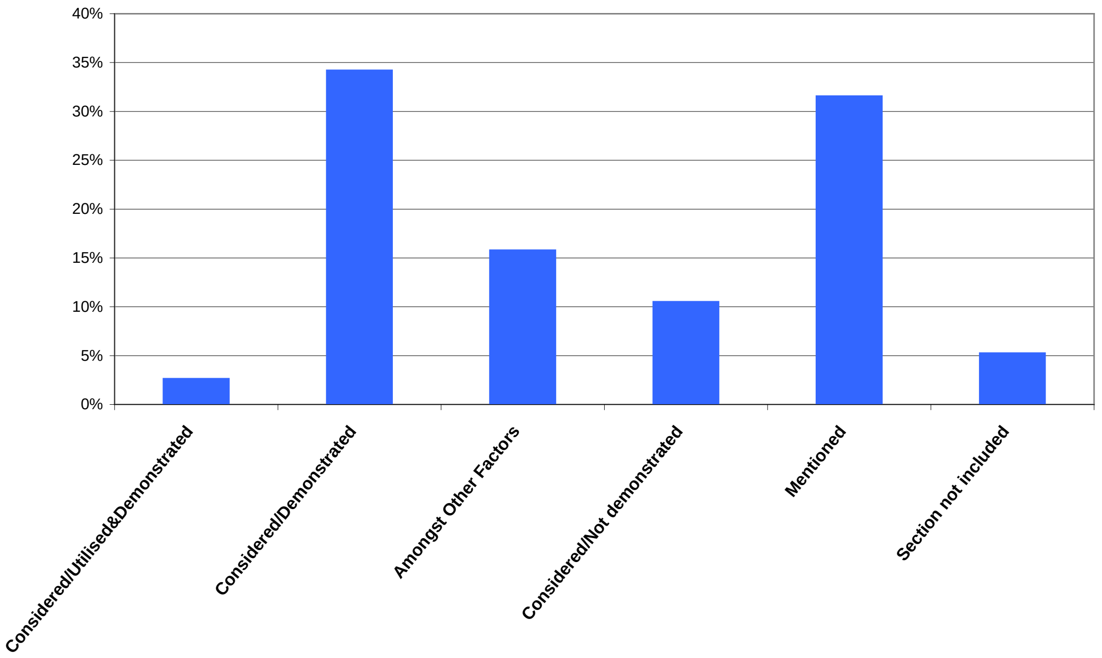


Figure 4: Group 2 Companies' Consideration of Workforce Pay shows that Group 2 companies disclosures are generally less ideal by comparison with Group 1 companies. Continuing the comparison with Group 1 companies, whilst a much smaller proportion did not mention the topic altogether, a much higher proportion made mention without giving detail that shareholders could use to assess the quality of the consideration process referred to.

Therefore, shareholders in Group 2 companies were, by comparison, left much more to take companies at their word that consideration to workforce pay was given.

Group 3 companies

Figure 5: Group 3 Companies Consideration of Workforce Pay

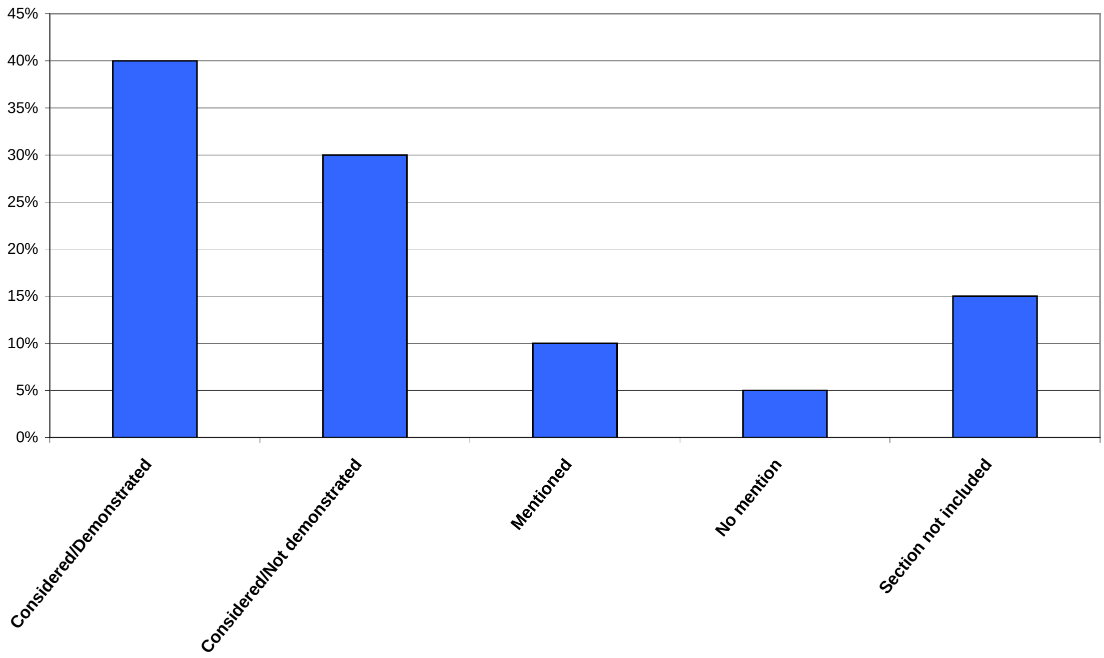


Figure 5: Group 3 Companies Consideration of Workforce Pay illustrates that, of the three Groups, Group 3 companies are those which are most likely to have offered no information at all to shareholders on this topic. Nevertheless, 80% of these companies still made some mention of the question.

Furthermore, of those that did make mention of the issue, half of them showed evidence to demonstrate the quality of consideration of workforce pay in setting directors remuneration. On balance, therefore, Group 3 companies which have included mention of the issue are by and large no less likely to leave their shareholders in the dark than other companies.

Employee Groups Used For Comparison with CEO Pay Changes

Regulatory Requirement

Sch.8:19. (1) The directors' remuneration report must set out (in a manner which permits comparison) in relation to each of the kinds of remuneration required to be set out in each of the columns headed "a", "b" and "c" of the single total figure table the following information—

a) the percentage change from the financial year preceding the relevant financial year in respect of the director undertaking the role of the chief executive officer; and

b) the average percentage change from the financial year preceding the relevant financial year in respect of the employees of the company taken as a whole.

(2) Where for the purposes of sub-paragraph (1)(b), a comparator group comprising the employees taken as a whole is considered by the company as an inappropriate comparator group of employees, the company may use such other comparator group of employees as the company identifies, provided the report contains a statement setting out why that group was chosen.

(3) Where the company is a parent company, the statement must relate to the group and not the company, and the director reported on is the director undertaking the role of chief executive officer of the parent company, and the employees are the employees of the group.

Guidance

The Guidance makes allowance for companies to "set out what they believe is the appropriate comparator group" and that "companies may wish to consider using a group of employees defined by geography, business unit or level". This makes provision for some flexibility, despite the fact that the Regulations are clear in presenting a comparison with all employees as the preferred measure.

Judgements applied

In assessing this question, we categorised the various disclosures we found into the following categories, listed in descending order of preferred answer quality.

Category	Explanation
All Employees	All employees of the company
UK employees	Solely UK employees
Main markets	Main markets in which the Company operates
Country of Residence	Country of residence of the Chief Executive Officer

	(Excluding UK)
Specific Range of Employees	Reviewed against a specified range of employees (differentiating between white collar and blue collar employees)
Excluded range of employees	Review excluded a specific set or group of employees (e.g. excluding employees in a certain region or full-time only)
Not specified	Company did not provide an explanation for the origin of employees utilised when reviewed against the CEO.

Comparative judgements based on preference between the different groupings chosen by companies present some challenges and merit some explanation.

Given the fact that the regulations apply to UK incorporated companies, we considered comparison with all UK based employees as the next preferred option, followed by limiting to the main markets of operation of the company, because this was likely to include a comparatively larger proportion of overall employees in the company on a basis which is to some degree indiscriminate. The next preferred option was the country of residence of the CEO where it is not the UK, which at least implies a measure of fair comparison in terms of cost of living, which is a relevant consideration when examining the relative pay levels of CEO and employees, though with the possibility that the group of employees for comparison could be so small as to be unrepresentative.

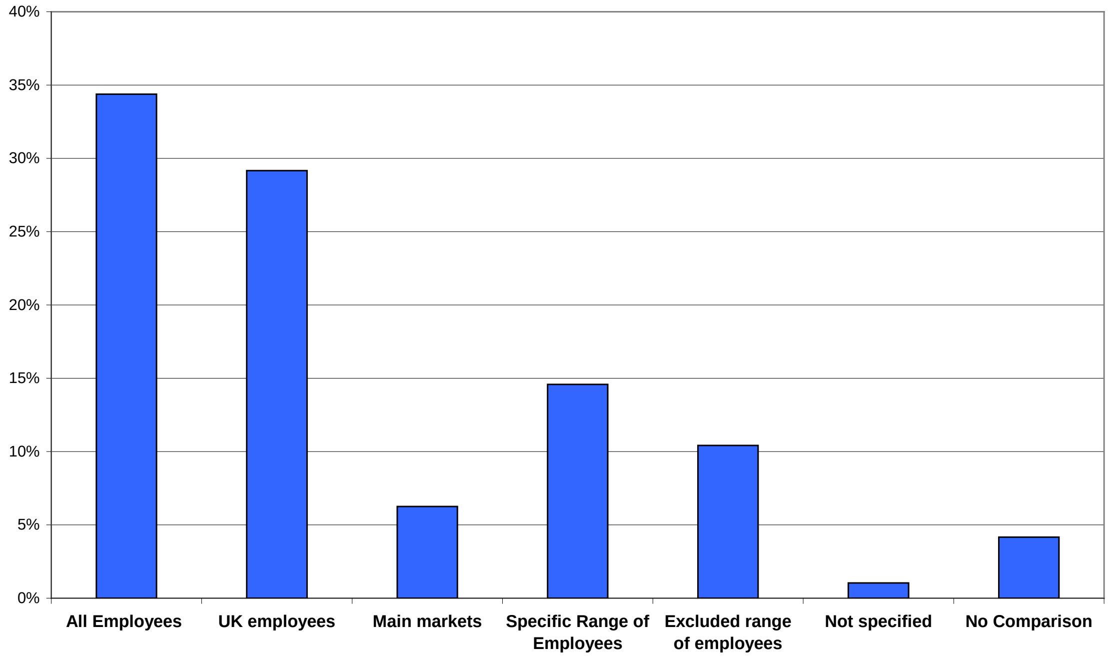
Companies which restricted their comparison to certain types of employees we viewed less favourably, as this suggests some level of discrimination by reference to the position (and by inference, the income) of the employees used for comparison. Whilst judgements between inclusions or exclusions overlap to a large degree, the explicit exclusion of specific ranges of employees we viewed as more explicitly cynical in its potential.

Readers should note that as a general rule, the greater the restriction placed upon the selection of employees to be used for this comparison, the greater the possibility that the group selected compare more favourably than would have been the case with a wider group.

Overall Findings

Our overall findings across the entire group of companies are shown in Figure 6: Employee Groups Used For Comparison with CEO Pay Increase.

Figure 6: Employee Groups Used For Comparison with CEO Pay Increase



The chart shows that a third of companies have chosen to compare CEO pay increases with all employees in the company. A second similarly significant minority have compared with all UK employees or all employees within the main market(s) of operation of the company.

Of those which applied some measure of discrimination or who did not comply with the requirement, the majority were those which referred to a chosen group and disclosed the inclusions/exclusions applied to the comparator group which at least gives shareholders the opportunity to evaluate whether they agree with the adopted methodology.

One company presented no specification as to the basis of the comparison. This might be interpreted to mean that the comparison was with all employees, in line with the requirement, even though this was not stated explicitly. 4% presented no comparison for their shareholders, which therefore shows a very high level of issuer adherence to presenting some information on this issue to shareholders.

Example Disclosures

Because of the nature of the question, examples of disclosures by companies whose explanations made it clear they compared with all employees would be redundant. We therefore offer some examples of how companies approached explanation of some element of limitation of the group of employees used for reference, given that the Regulations are clear on the “comply or explain” nature of the requirement to compare with all employees.

Far from all companies that used UK-based employees as the basis for comparison gave any explanation for doing so. Where they did, the most common explanation offered was that that was the same market as the CEO, and therefore made for the most accurate like for like comparison. Other reasons cited for choosing UK employees as the basis for comparison included concerns over wage inflation in foreign markets. Some companies also used different areas of comparison for different aspects of the pay package (e.g. UK based employees for variable pay but global employees for salary).

Those that limited their comparator groups to main markets of operation all included the UK within the chosen markets, but their reasoning was to maximise the number of employees included in the comparison through including other significant markets of comparison, such as the US or Ireland.

Companies which chose specific groups of employees (as opposed to employees in specific locations) approached the construction of the comparator group rather differently, approaching the issue from a hierarchical perspective. Typical explanations referred to comparisons with only full-time employees, or to some definition which had the effect of restricting comparison to just senior management (inferring that that is a better like-for-like comparison), or just to employees who participate in similar bonus or long term incentive arrangements as the CEO.

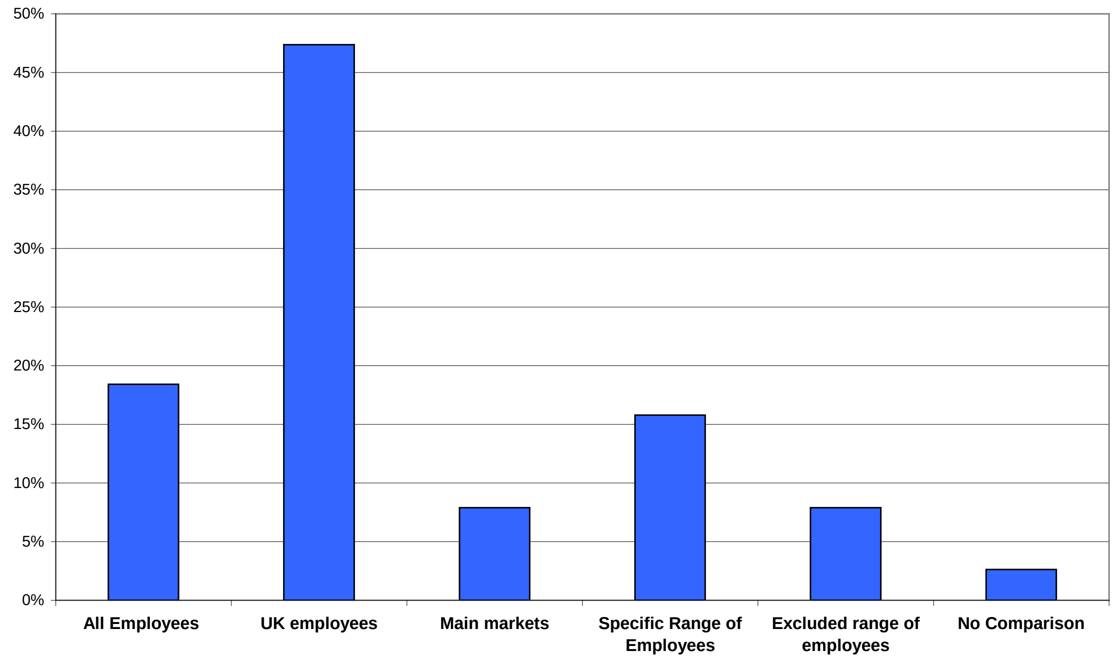
Findings by Group

Group 1 Companies

Figure 7: Group 1 Companies Group Selections for Comparison between Employee and CEO Pay Increase shows that some two thirds of the largest companies in the sample compared with at least all UK employees if not all employees. However, they were far more likely to restrict the employee group to UK employees than to compare with all employees.

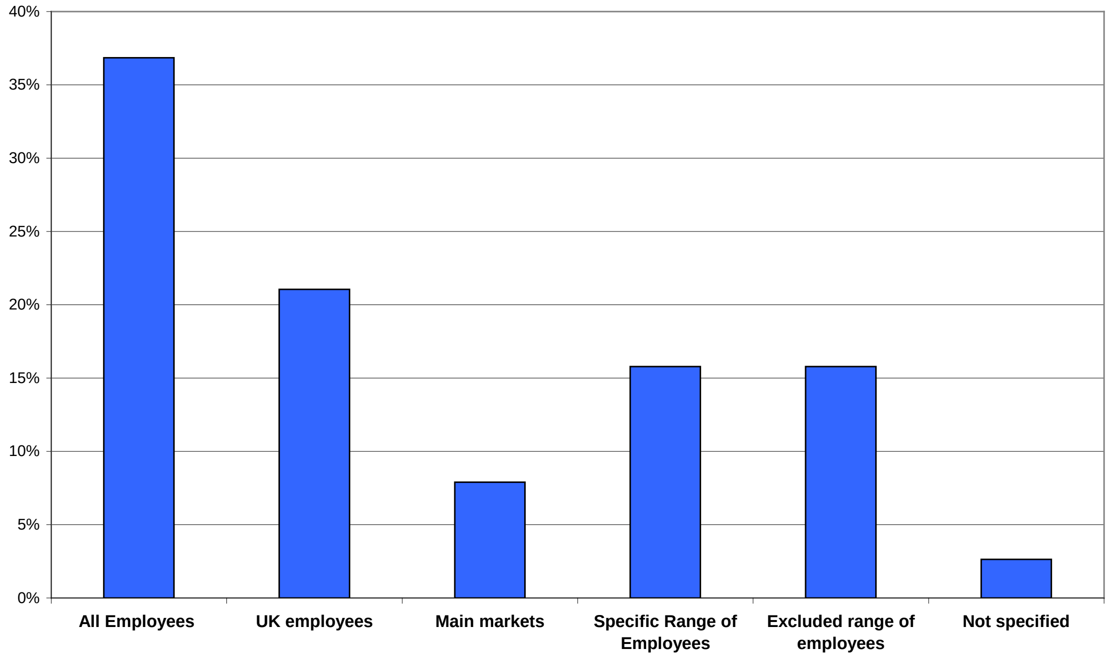
Of those that restricted the employee comparator group differently, the most common restriction used was by reference to a specific range of employees, which more than 15% of the companies in Group 1 chose to do.

Figure 7: Group 1 Companies Group Selections for Comparison between Employee and CEO Pay Increase



Group 2 Companies

Figure 8: Group 2 Companies Group Selections for Comparison between Employee and CEO Pay Increase

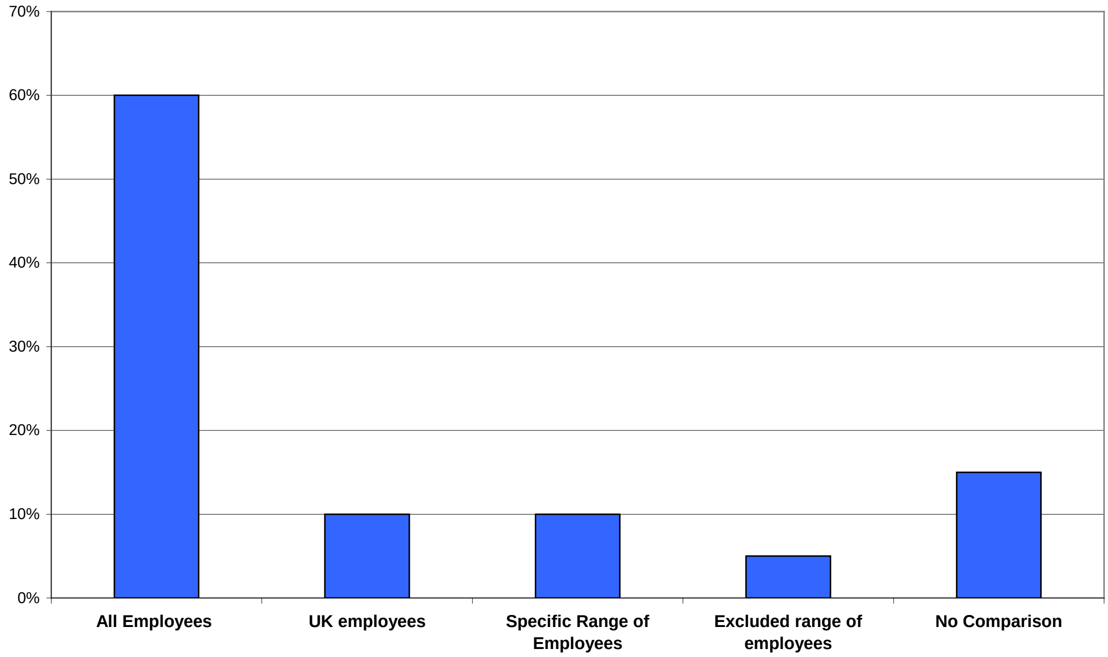


By and large the difference between Group 1 and Group 2 companies are limited, though by comparison with Group 1 companies, Group 2 companies are not as likely to use at least all UK employees if not all employees for the comparison group. However, the majority still do, and furthermore of those they are far more likely to use an all-employee comparator group as opposed to all UK employees than are the Group 1 companies.

A similar proportion of the Group 2 companies are likely to discriminate by inclusion of a specific range of employees as are the Group 1 companies (around 15%), however a similar proportion (thereby much high by comparison with group 1 companies) also excluded specific employee groups from the comparison as well.

Group 3 Companies

Figure 9: Group 3 Companies Group Selections for Comparison between Employee and CEO Pay Increase



Group 3 companies are far more likely to not limit the employee comparator group at all, with 60% comparing CEO pay rises with those of all employees. A slightly larger proportion than those of other groups did not provide any comparison at all. However, the overriding pattern with Group 3 companies is that they do not limit their comparisons at all. This is most likely to be because, as smaller sized companies meeting the EU definition of SME, there is far less scope to do so.

Statement of Consideration of Shareholder Views

Regulatory Requirement

Sch.8:40. The directors' remuneration policy must contain a statement of whether, and if so how, any views in respect of directors' remuneration expressed to the company by shareholders (whether at a general meeting or otherwise) have been taken into account in the formulation of the directors' remuneration policy.

Guidance

The Guidance, like the Regulations, suggests no obligation to take shareholder views into account when setting remuneration policy. Rather, the obligation is to report whether investor views have been taken into account, and furthermore, by making mention of the fact that disclosure will vary according to the extent of engagement, the Guidance places emphasis upon the idea that taking investor views into account is optional.

Judgements applied

We identified a range of shareholder consultation activities reported by issuers in the context of the Schedule 40 requirement, which have formed the basis of the categories we list below, again in descending order of most desirable first. A significant challenge lies where issuers report multiple activity types as a part of their narrative (such as consulting main shareholders and responding to shareholder enquiries). Where this occurs, companies have been categorised according to the highest activity on the list.

Category	
Contacted	All shareholders have been contacted and / or surveyed
Engaged	Investor events used for engagement on remuneration (road-shows/analyst calls etc)
Responded	Shareholders responded to when engaging with the company (e.g. AGM feedback)
Main Shareholders	Main shareholders have been contacted/interviewed/consulted
Specific Shareholders	Specified limited number of (major only) shareholders consulted
Groups & representatives	Shareholder groups/representatives consulted
Mentioned	Policy of shareholder engagement referred as taken into account; however does not provide sufficient information on how it impacted the final result
Vague	Vague explanation which doesn't enhance understanding of the process
No	No engagement or indication of activity

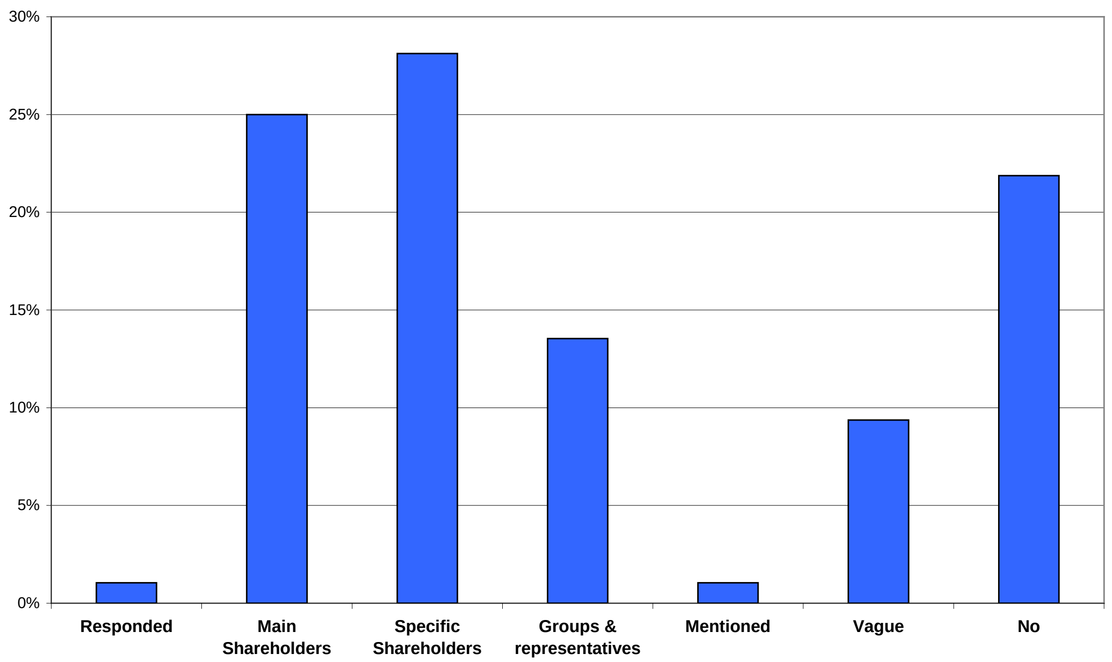
Some clarification of the categories is merited. As a principle, we determined that actions which involved the company either initiating contact with large numbers of shareholders, or committing to reply to all shareholders who made contact, should be identified as most desirable. Categories which matched with this type of action are “Contacted”, “Engaged” and “Responded”. This group includes companies which made mention that shareholder voting at previous AGMs is a factor in their procurement of shareholder opinion on remuneration.

Following from this, we then determined that where some more limited engagement was referred to as being initiated by the company, either directly towards shareholders or, less ideally towards (self-appointed) shareholder representatives rather than shareholders themselves, these should be accorded “next best” status. Categories which matched with this type of action are “Main Shareholders” and “Groups & Representatives”.

Lastly, disclosures which referred to some element of engagement policy or approach without reporting actual activity, or made no disclosures at all, came towards the bottom of the list.

Overall Findings

Figure 10: Overall Consideration of Shareholder Views



Most notable is that no companies ensured they contacted all shareholders, nor did any make mention of the use of general investor roadshows and events to communicate with investors on remuneration specifically. Such a disclosure could serve to demonstrate issuers promoting the integration of “extra-financial” considerations in their own presentation of investment relevant information about their company. A very small proportion of companies confirmed they responded to all shareholder enquiries they received on remuneration.

A little over 50% of all companies in the sample reported some element of contacting a limited set of shareholders – either by specifying their “main” shareholders, or by referring to having contacted “specific” shareholders (without necessarily identifying who these are or how they were identified). A further 13% referred to consulting with groups and representatives of shareholders.

A significant minority - nearly a third - of companies made either vague or no mention of shareholder engagement on remuneration at all.

Example Disclosures

Many of the examples of companies which disclosed they consulted their main shareholders or specific shareholders were almost interchangeable in terms of the nature of their consultation. We differentiated between them on the basis that “main shareholders” infers some element of indiscrimination, in the sense that provided a shareholder was one of the largest shareholders they would be consulted, irrespective of who they were. By contrast, those who explained that they consulted specific shareholders lacked some explanation as to how those shareholders were selected for consultation. It should be considered that many of the latter chose the former methodology in reality.

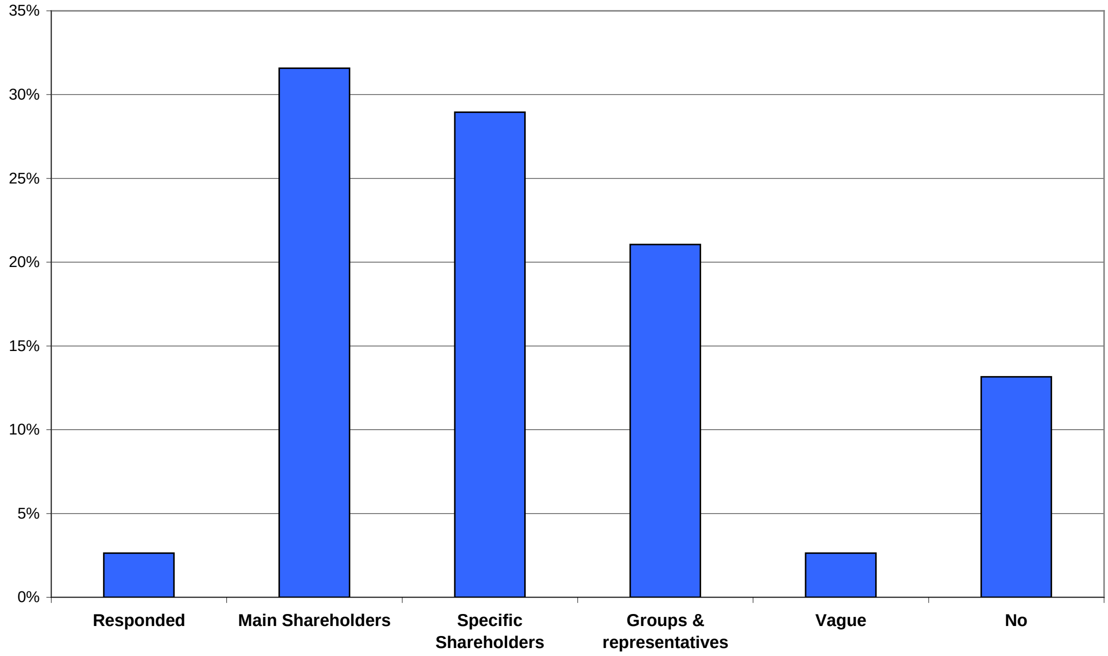
Among those who reported consulting Shareholder Groups and Representatives, the largest number reported consulting with “Shareholder bodies” or take into account “institutional guidelines” of investor bodies. Some gave a more specific indication, such as shareholder voting advisors or named organisations such as trade associations or even specific voting analysis service providers.

Many of the explanations which we deemed vague made no reference to any kind of process for consulting shareholders or of how shareholder views are taken into account even where shareholders have made contact with the company specifically about remuneration. Typical examples are where companies assure readers of their annual report that shareholder views are “taken seriously”, or consultation happening “from time to time”.

Findings by Group

Group 1 Companies

Figure 11: Group 1 Companies Consideration of Shareholder Views

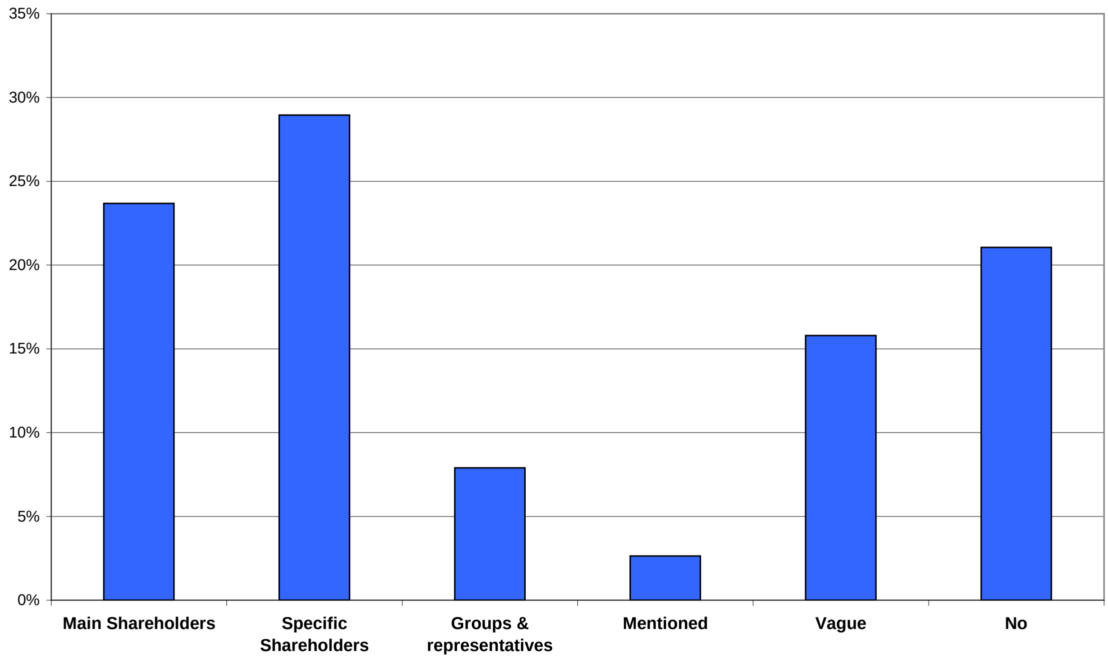


Among the Group 1 companies, a very large majority refer to some element of consulting either shareholders or their representatives. 60% of them also refer to consulting with shareholders themselves (albeit main or specific shareholders in the main), as opposed to shareholder representatives.

Nevertheless, the proportion of companies making no reference to consideration of shareholder views is small but certainly not negligible, at nearly 15%.

Group 2 Companies

Figure 12: Group 2 Companies Consideration of Shareholder Views

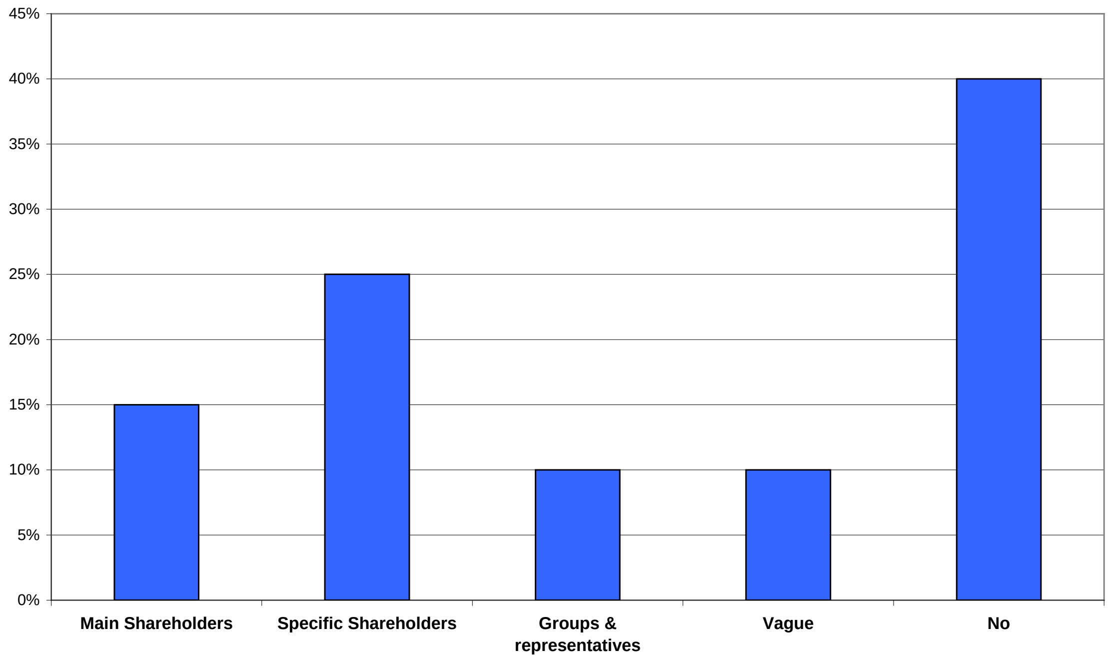


Among the Group 2 companies, none mentioned responding to all shareholder enquiries, and of those that solicited views from shareholders themselves, they were more likely to do so from specific shareholders as opposed to simply their main shareholder. They were less likely to use engagement with shareholder groups and representatives than the larger companies.

Over a third of the Group 2 companies either made a vague statement about consideration of shareholder views, or made no reference to consideration of shareholder views at all. This is the single biggest contrast with the Group 1 companies.

Group 3 Companies

Figure 13: Group 3 Companies Consideration of Shareholder Views



Among the Group 3 companies, again none made mention of engaging with all shareholders or even responding to all shareholder enquiries. Those that did make mention of consulting either main or specific shareholders were a much lower proportion than for the other two groups, and again (as was the case with Group 2 companies) these were more likely to be with specific shareholders as opposed the main shareholders generally.

Shareholder Voting Results

Basis of Voting

We have examined a number of aspects of the shareholder voting results available for the AGMs of the companies in the sample set over the last 5 years, in order to observe any patterns there may be in terms of shareholder voting.

Resolutions which are voted on a poll or by correspondence ensure that all votes cast are actually counted (votes cast ahead of the meeting appointing the Chair as their proxy as well as those in the meeting on the day). The technology to facilitate this is both widespread and affordable.

Companies that report resolutions having been carried on a show of hands frequently report just the votes cast ahead of the day, without counting the votes in the meeting. Whilst the Chair has a legal duty to ensure the vote on the day is consistent with the votes cast in advance (and to call a poll where this is not the case), this could also affect the reported data on turnout levels and voting results.

Analysis suggests that the larger the company size, the more likely it is that votes will be held on a poll or by correspondence as opposed to by a show of hands, with the larger size companies cohort having 95% of votes held on a poll since 2010 (100% since 2012), medium at 48.9% and smaller companies at 25%.

This suggests that, if turnout reported for resolutions voted on a show of hands is indeed lower than the actual turnout including those present in the room, the average turnout figures for the smaller companies may in fact have been higher than reported.

Turnout

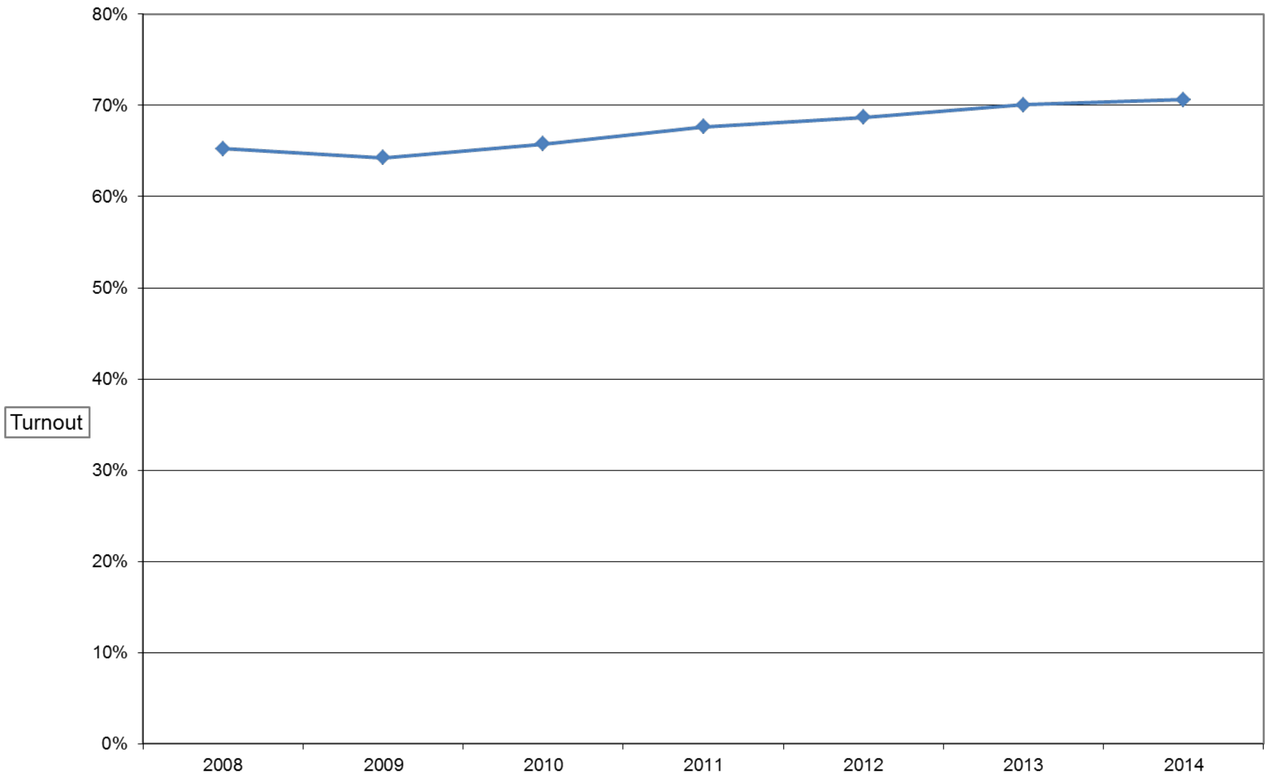
Where turnout figures are not explicitly disclosed by the company in question, Manifest calculates a turnout figures by adding up the total number of shares voted on the resolution with the largest aggregate number of votes reported. Therefore the turnout figures may not have been calculated directly from the remuneration resolutions themselves.

We would expect to see an increase in turnout over time, as institutional shareholders in particular are under increasing regulatory and best practice pressure to ensure they vote their shares. Additionally and increasingly, foreign shareholders are under obligations to vote their shares. To the increasing extent that UK plc's have foreign shareholders on their register, these developments too would affect turnout levels positively, provided the complexities of the cross-border voting system do not hinder the arrival of votes from foreign shareholders. We would caution any inference that the quantity of voting is related to any objective measure of quality of decision making behind the vote.

Average Turnout per Year

Figure 14: Average Turnout per Year shows a clear upwards progression in average turnout across the sample set during the last 5 years of about 5 percentage points. The data shows a consistent level of increase since 2009 in the order of 1% point each year, though a slightly lower level of increase is observable in 2014. By comparison with other European markets in particular, these turnout levels are generally notably higher.

Figure 14: Average Turnout per Year



Turnout by Group per Year

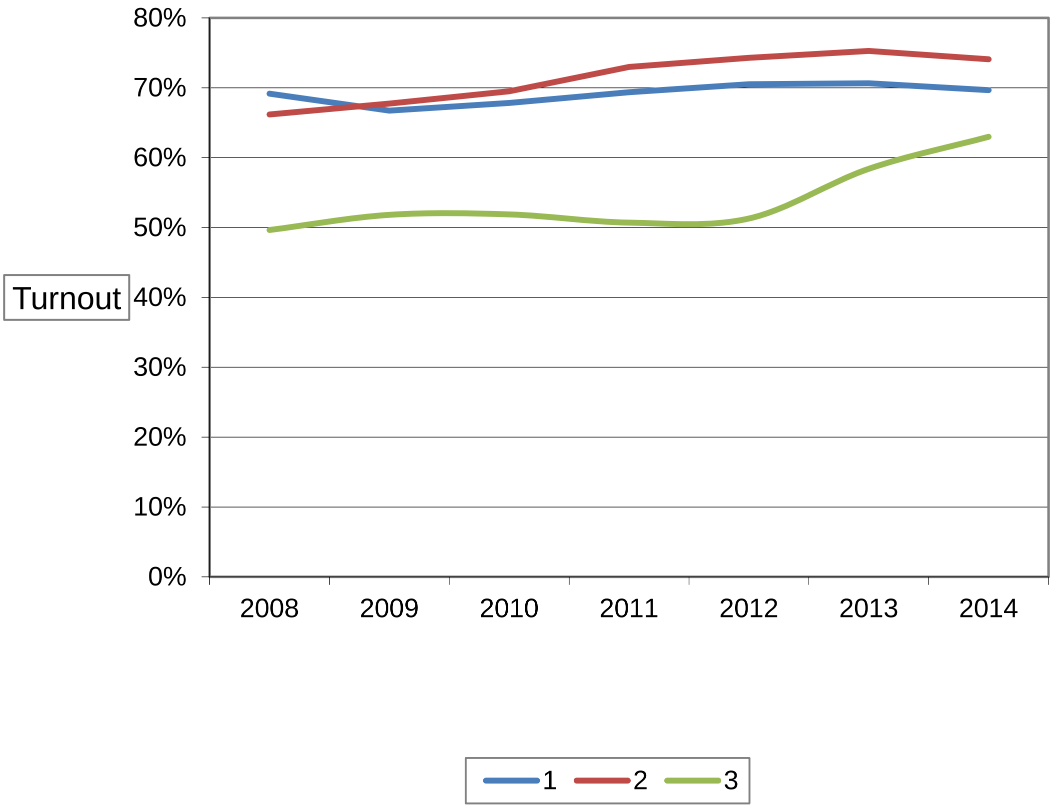
Figure 15: Turnout by Group per Year shows some interesting underlying detail compared to the aggregate view.

Firstly, it is clear that the Group 3 companies have lower turnout levels than those in Groups 1 and 2. Explanations may focus upon our anecdotal observation that smaller companies are more likely to be “off the radar” when it comes to voting by institutional shareholders. Smaller companies will likely be a much smaller element of the institutional investor’s risk profile, and historically the perceived cost benefit of voting those positions may therefore be viewed as not in favour of voting meetings at those companies.

Secondly, the Group 3 companies have shown a notable increase in average turnout since 2012. It is likely that this is the impact of the Shareholder Spring and the resulting public and policy reaction to it, in particular with investors making a more concerted effort to ensure they vote a wider proportion of their portfolios, and in particular again with the impact of regulatory developments in continental Europe making share voting a quasi-compulsory activity for some types of investors. It should be noted that this group is considerably smaller than the others sampled and care should be taken when interpreting these findings.

Thirdly, the pattern of growth in turnout for the Group 1 companies is very similar to that for the aggregate results in Figure 14, but at a slightly higher overall level.

Figure 15: Turnout by Group per Year



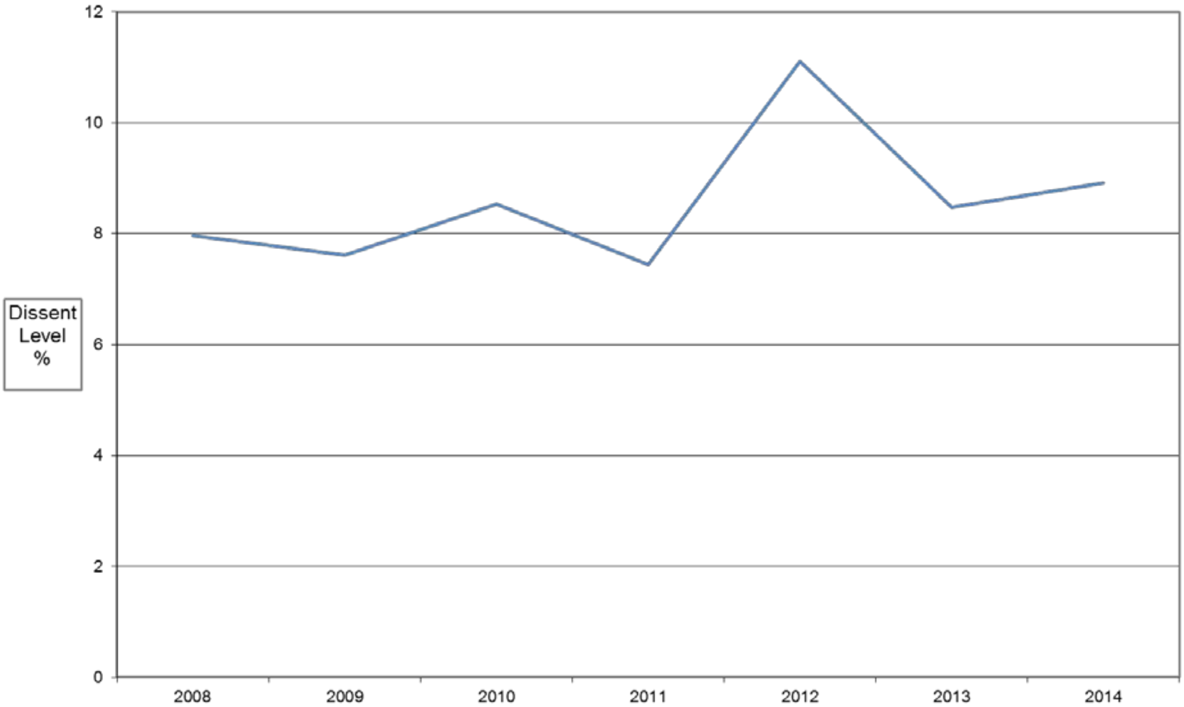
Dissent

Where Manifest uses the term “dissent”, this refers to the total amount of votes cast against management added together with those votes positively abstained or withheld. Many companies opt not to take this approach in their reporting of meeting results, meaning that where they report the proportion of votes cast “For” management, this percentage doesn’t take into account the “Abstain” votes, leading to a higher “For “ percentage than we use in our research.

Manifest takes this approach because the main significance of this question is whether shareholders actively choose to support a management with their votes. In this context, any positive vote which is not “For” management is significant and should merit management attention.

For the “Dissent” analysis, we look specifically and only at remuneration report resolutions 2010 to 2013, and we take into account both the remuneration implementation vote and the remuneration policy votes in 2014. This means that the data set for average dissent levels in 2014 is twice as large as that for each of the prior years, because each company in the set held two separate resolutions in 2014, whereas previously each held just one.

Figure 16: Average Dissent per Year



Average dissent on Remuneration Reports is much greater than for resolutions in general. Throughout the period 2008 to present day, average dissent across all resolutions has approached but never breached 3%. By comparison with this figure, we can see that Remuneration Report resolutions are on average three times more contentious than other types of resolutions.

This wider data set includes more consistent examples of general shareholder dissent, and clearly tells the story of the increase in general dissent in 2012 in particular, when dissent peaked at over 11% for Remuneration Report resolutions.

Dissent by Group by Year

We have broken down the average dissent by group to examine whether there are any discernible patterns that may be attributed to company size.

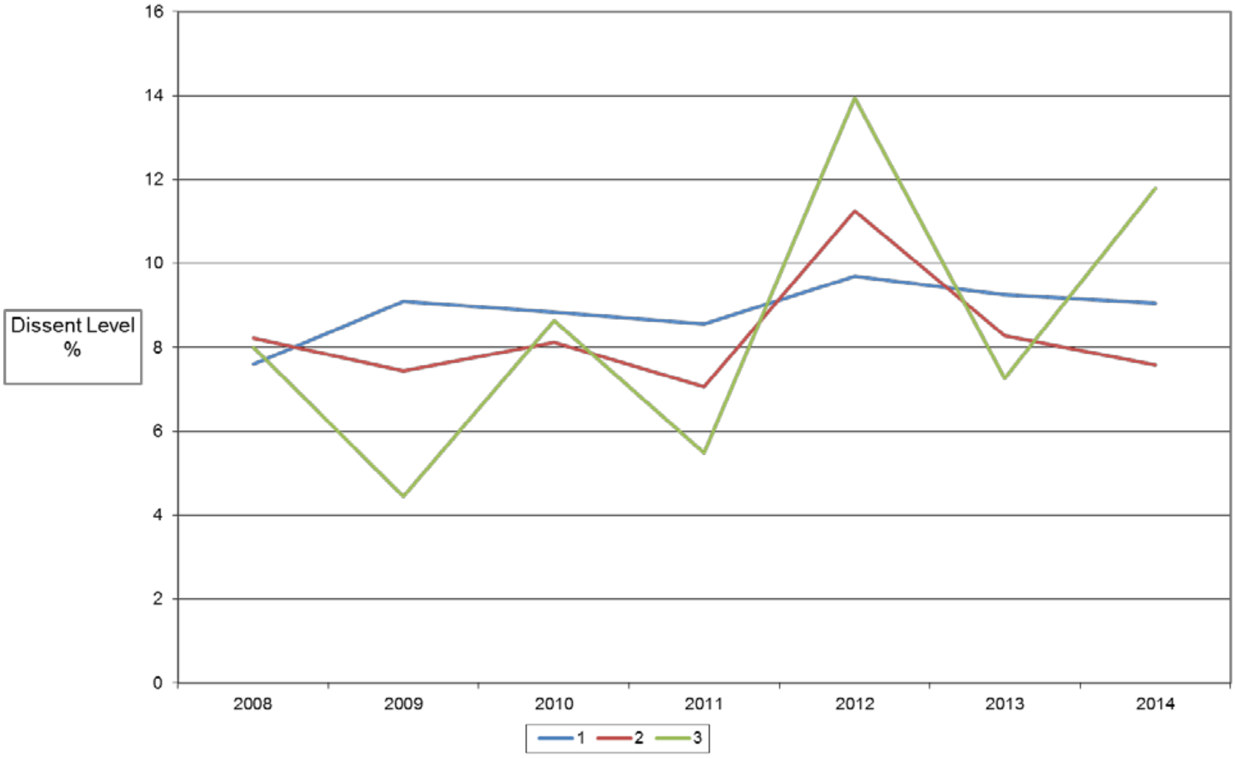
The data would suggest that the Group 3 companies' average dissent levels are more volatile, but this is in fact more likely to be due to the comparatively smaller number of companies in that data set. Nevertheless, it is interesting to observe that the Group 3 and Group 2 companies have a similar pattern of dissent levels, with 2014 being the only year in which the direction of dissent from one year to the next diverged.

The 2014 dissent levels among the Group 3 companies merits some explanation. Three companies in particular attracted a significant level of dissent from shareholders. One company's Remuneration Policy and Remuneration Report votes were only passed due to abstention votes not being counted, with 53% of shares voted to "Abstain". Two other companies attracted large levels of "Against" votes – in the order of 30% - which also contributed to the uptick in dissent levels for Group 3 companies.

The Group 1 companies have the smoothest curve, and this points to the explanation that larger companies tend to have a more diverse shareholder base, and therefore are less susceptible to the impact that a single significant shareholder may have on the overall voting results for a meeting.

Again, the peak of 2012 is clearly observable, as is the generally calmer time since then.

Figure 17: Dissent By Group By Year



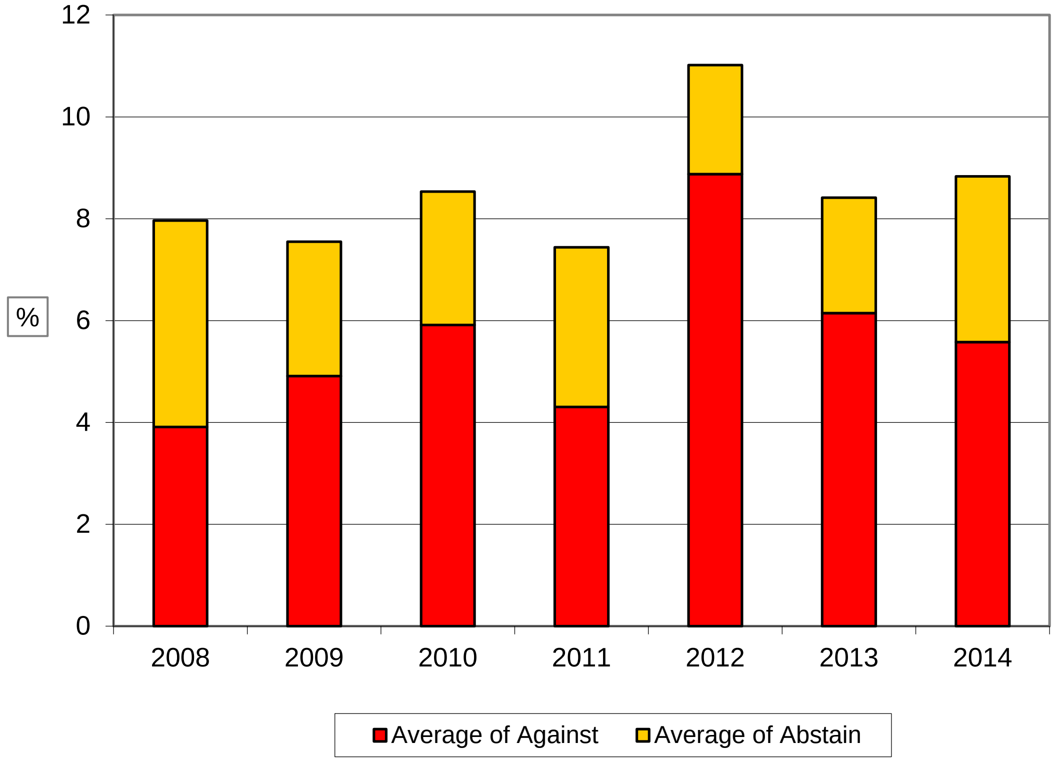
Composition of Dissent by Year

We have already referred to the potential of the difference between “Abstain” and “Against” votes in the analysis of meeting results, especially insofar as many companies only acknowledge the latter as true dissent.

Figure 18 below examines the patterns of “Abstain” versus “Against” votes in the composition of overall dissent. The general pattern is the growth of “Against” votes as a proportion of the dissenting votes over time.

Once more, 2012 is the standout year, marking the peak of dissent and an even bigger peak in terms of “Against” voting by shareholders, when it constituted 80% of dissent. However, even though the proportion and number of “Against” votes has fallen in 2013 and 2014, shareholders are still more likely to use “Against” votes than five or six years ago.

Figure 18: Composition of Dissent By Year



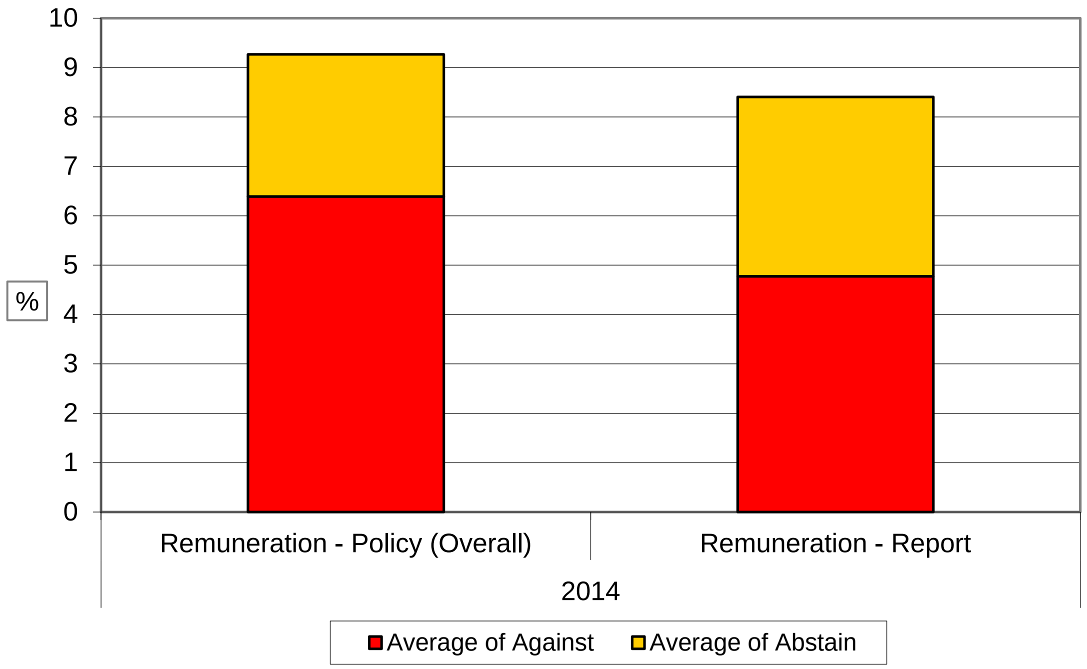
Composition of Dissent – Report v Policy 2014

Some commentators posited that, by making the Remuneration Policy vote binding, there may be a risk that it would discourage investors from opposing management on these resolutions, with a binding vote making such actions more forceful in their message.

Figure 19 investigates this theory by comparing the composition of dissent votes on the binding Remuneration Policy votes (on the left) with those of the advisory Remuneration Report votes (on the right).

The results suggest that the opposite is true – that investors have been slightly more likely to oppose management on the binding Remuneration Policy resolutions and also to use their “Against” votes with which to do it.

Figure 19: Comparison of Dissent on Report v Policy Votes



Further investigation of the motives behind investor voting decisions would be required to provide better clarity on why this is the case, in order to balance the comparative impacts of the binding versus non-binding elements and the different substance of the resolutions themselves (i.e. investors may simply be inclined to vote more forcefully on something forward-looking – on which their votes may have an impact on the future governance of the company – than a backward-looking Remuneration Report vote).

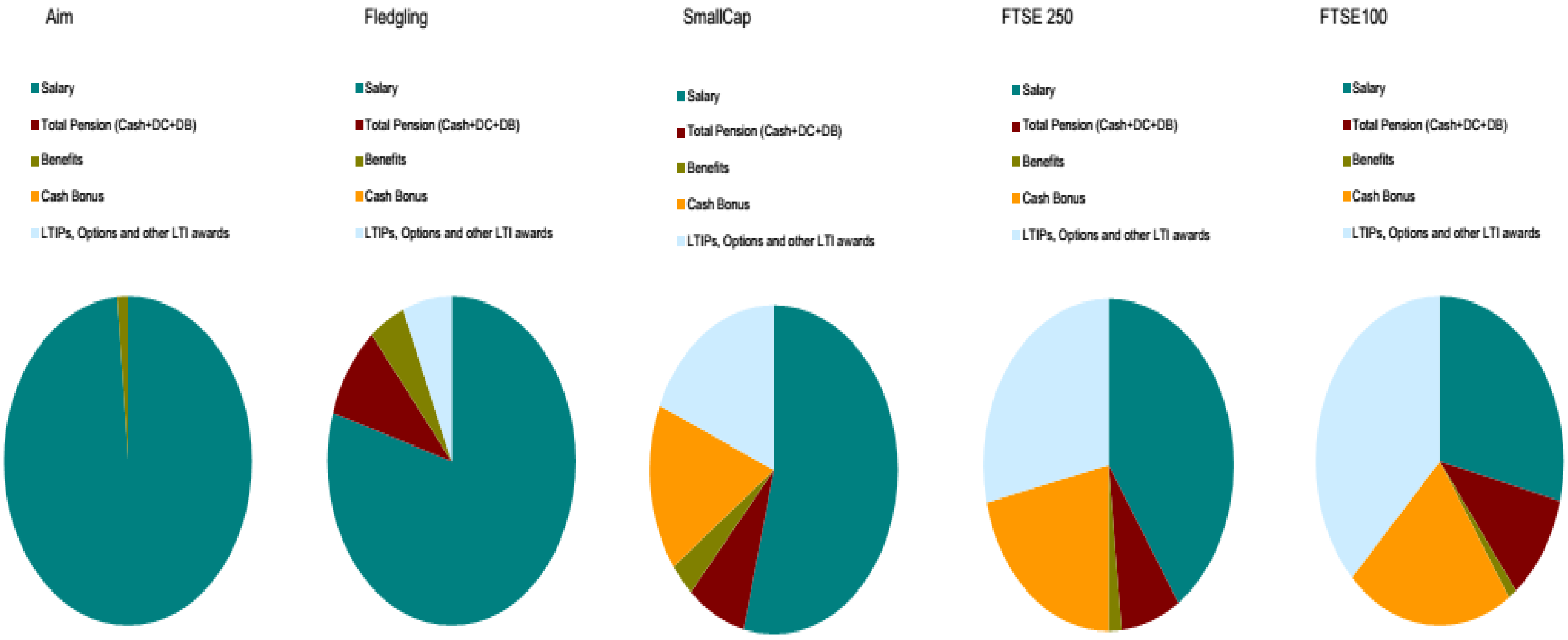
Recent Developments in Structures and Levels of Directors' Remuneration

We draw from data and analysis from the Manifest/MM&K Total Remuneration Survey, July 2014, and its predecessors. Readers should note that this analysis uses FTSE Index constituencies, market cap brackets or turnover brackets as the reference points for company size cohorts, which are different to those used in the rest of this study.

Pay Structure

Figure 20 and Figure 21 together illustrate the development of the mix of remuneration of CEOs over the last 5 years (using Total Remuneration Awarded as the base figures).

Figure 20: Pay Structures in 2010 by Index[3]

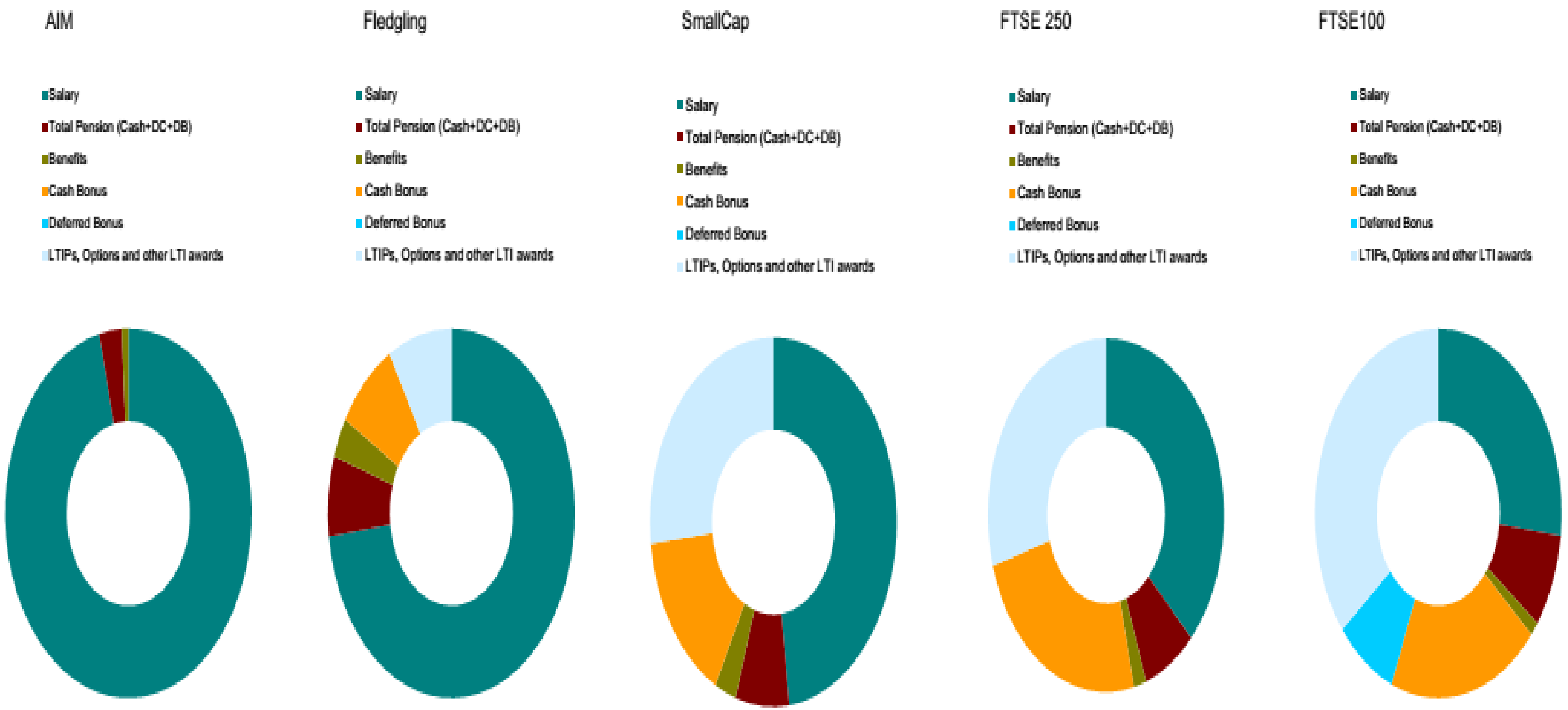


[3] The Manifest/MM&K Executive Director Total Remuneration Survey 2010, September Update, p32

Some observations should be noted. Firstly, in the case of every index category, the proportion of the Total Remuneration Awarded attributable to salary has declined. However, there is significant disparity in the salary proportion when comparing smaller companies with larger companies. The larger the company, the smaller the proportion of Total Remuneration Awarded is attributable to salary, ranging from over 90% at AIM companies (some of which may be in fact large enough to enter the FTSE250 if they were main listed) and a little over 25% for FTSE100 companies.

Secondly, in general the proportion of pay attributable to incentive-related elements has grown. The proportion attributable to cash bonus has grown amongst mid-cap and Fledgling companies, and in both cases more or less directly explain the concomitant drop in salary proportion, conversely among Small-Cap companies, it is long term incentives which do so.

Figure 21: Pay Structures in 2014 By Index[4]



[4] The Manifest/MM&K Total Remuneration Survey 2014, July 2014, p27

Particularly notable amongst FTSE100 companies, alongside the slight increase in proportion attributable to long term incentives, is the phenomenon of deferred bonus. It is notable for two reasons, Firstly, it is a new notable addition to the remuneration mix over this period, and secondly it is yet to meaningfully appear among Mid-Cap companies and smaller. Whilst many companies now operate a deferral mechanism on their annual bonuses, outside the FTSE100 many of these arrangements are relatively new, therefore meaning that we are yet to see the payment of deferred bonus awards appear significantly in the data set. In addition, the proportion of TRA attributable to deferred bonus is likely to be greatest at the largest companies, where bonus opportunity as a percentage of salary is at its highest, as well as being where the highest levels of bonus achievement are to be found.

Total Remuneration

The Manifest/MM&K Total Remuneration Survey found that average total remuneration awarded[5] to chief executives of FTSE100 companies fell by 5% in 2012 and a further 7% in 2013.

The survey also presented data on the total remuneration realised[6]. It concluded that general improvements in share prices coupled with higher levels of performance vesting has led to increases in the value of long-term elements of the pay packages in the last two years. Thus average total remuneration realised by FTSE100 CEOs, having fallen by 21% in 2010 and 10% in 2011, increased by 6% in 2012 and 15% in 2013. The survey makes clear that these increases reflect pay-outs from long-term incentive plans set up in the past which have benefitted from recent share price improvements. It notes, with reference to the data on total remuneration awarded, that companies are now reducing the value of new awards.

This is reflected in data disaggregated by different categories of company. Over the last 5 years, the median increase in total remuneration awarded peaked in 2010 in respect of all categories – AIM, SmallCap, MidCap and top 100 companies – at between 8% and 15%. In 2013, the top 100 showed no increase at all, with AIM, SmallCap and MidCap registering just 3-4% each. The increase in total pay has therefore radically slowed, especially in the last two years. This is also borne out when examining the figures for median total remuneration realised.

[5] The sum of salary, pension, benefits, cash bonus and the expected value of deferred bonus, share options and other long-term incentives awarded during the year.

[6] The sum of salary, pension, benefits, cash bonuses and the amount of long-term incentives "paid out".

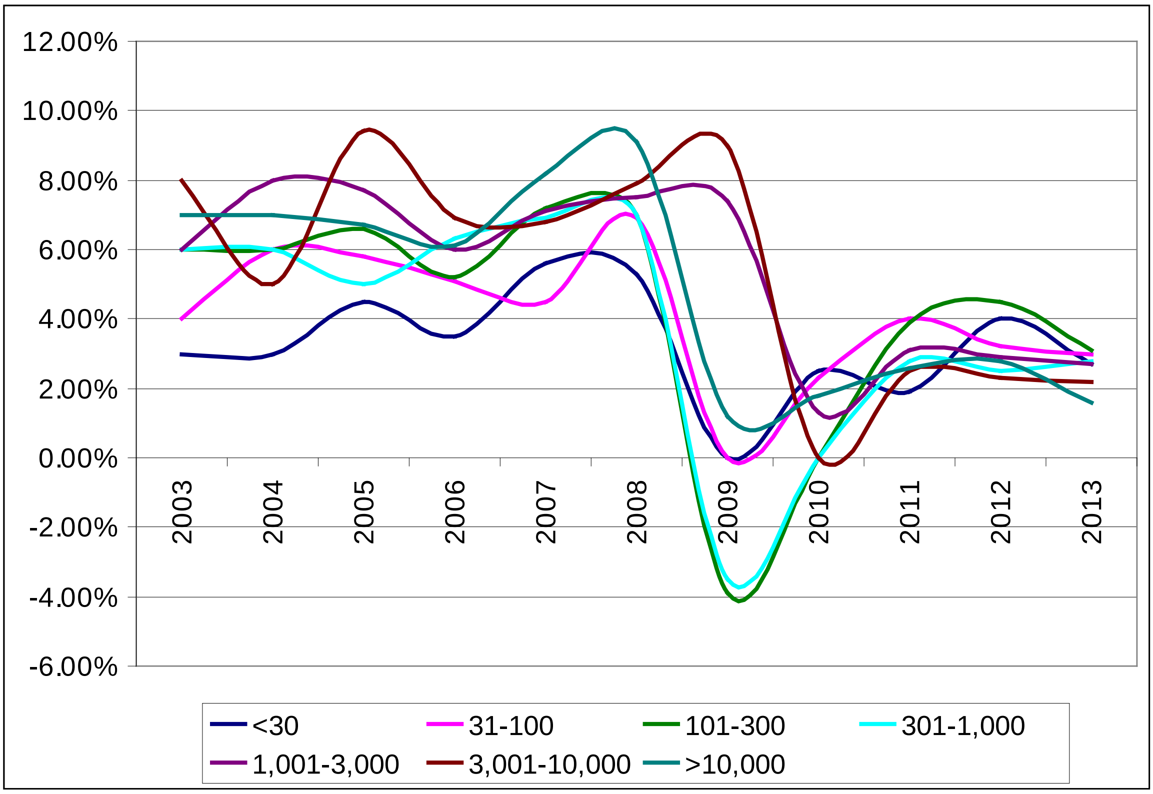
Salary

In terms of salary increase, the median remains comparatively lower in the top 100 companies at between 2 and 2.7% (2% in 2014) , with Small and MidCaps increasing from 0 or 1% in 2010 to nearer 3% and AIM companies showing an increase from 2% to nearly 4% in 2013.

Looking at turnover brackets, most recent trends show that companies at the larger end of the spectrum are slowing salary increases faster than smaller companies, with those in the greater than £10bn bracket slowing to 1.6% in 2013 (average 4.9% since 2003), with those in the £0m to £300m bracket at around 3% in 2014 (compared to a ten year average of 4.1%).

It is also notable that the general shape of the salary increase trend remains broadly similar over time, and that the actual level of salary increase rate has shown a tendency towards convergence between all company sizes in the last 3 years, combined with an overall downward trajectory in the percentage increase year on year.

Figure 22: CEO Median Salary Increases by Turnover - Trends

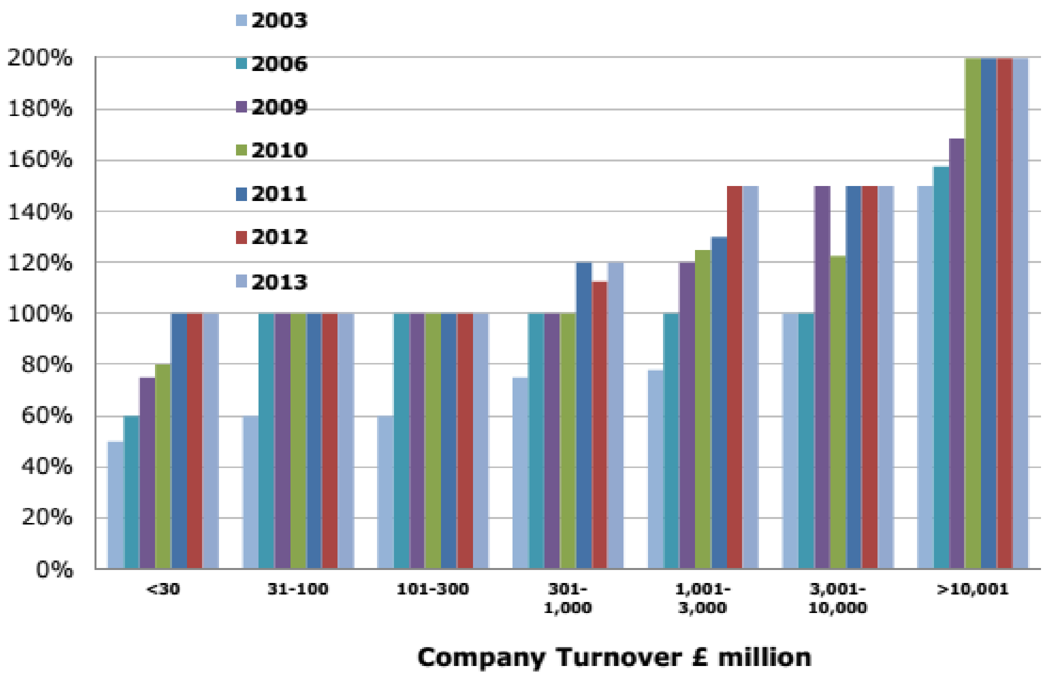


Bonus

Observations about cash bonus paid are complicated by the increased practice of deferring some element of the bonus, as well as the maximum bonus opportunity, the achievability of the targets and the performance against those targets. Analysis of median increases in cash bonuses paid show none whatsoever at AIM companies since 2008, and 2010 being the only year where any increase registered for SmallCap (3%) and MidCap (16%) companies. Top 100 companies registered just two years of increase – 7% in 2009 and 17% in 2010, but tempered by a decrease of 5% in 2012.

Bonus opportunity analysis (Figure 23) shows a clear pattern that the smaller the company, the smaller the maximum opportunity available (expressed as a percentage of salary). The median bonus as a percentage of salary was at 100% or less for all companies with turnover of £1bn or less until 2011, with only the larger companies in that smaller end bracket breaking the 100% barrier to 120% at that point. By contrast, companies in the largest bracket (>£10bn turnover) show a median of 200% since 2010, starting at 150% in 2003. Bonus opportunity levels therefore currently show little signs of abating; rather the contrary in fact, although it would be unfair to omit that the most recent 2-3 years have been marked by a halt in the previous rate of increase,

Figure 23: CEO Bonus Maximum Opportunity as % of Salary

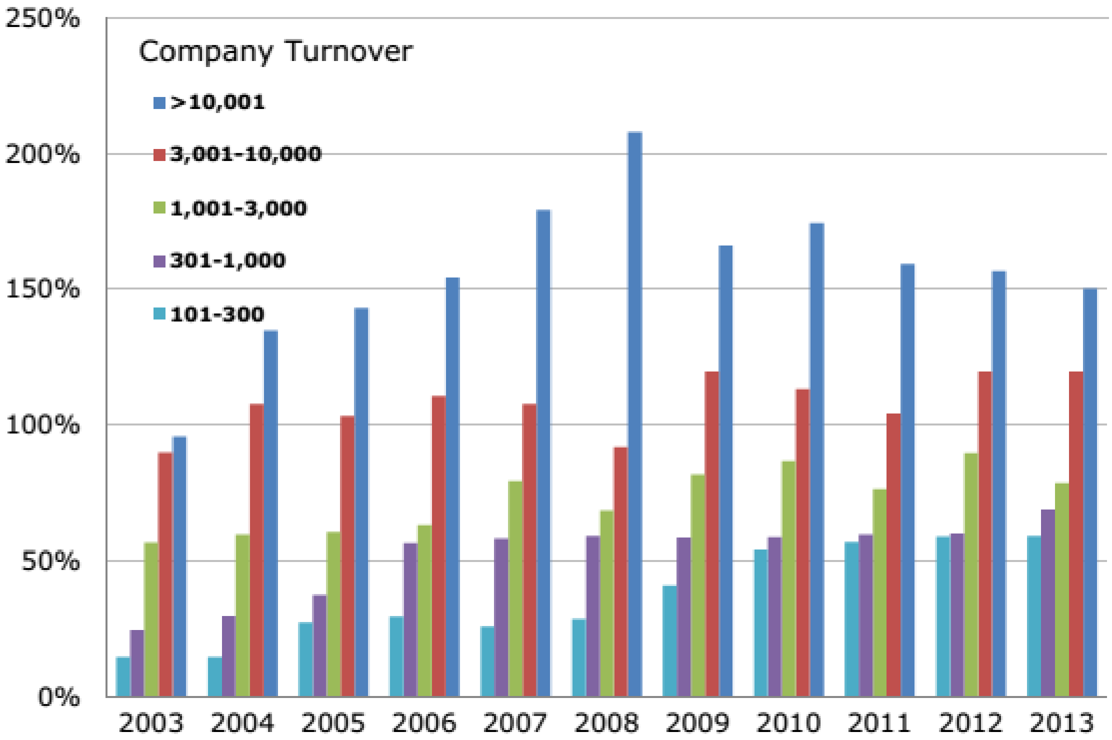


Bonus realised as a percentage of maximum opportunity has remained relatively stable over the last 10 years, with companies turning over £300m or more returning an average of around 50%, and smaller companies tailing downwards towards 30% over time. Whilst companies in the £30m to £300m bracket currently remain at or around historical average levels, larger companies are currently 10-20% below their historic averages, suggesting that either companies are setting harder targets or performance is slowing.

Long Term Incentives

Observations on LTI Awards are similarly complex, with the added challenge of expected value. Only MidCap and Top 100 companies registered any median increase in the expected value of LTI awards made during each year, with MidCaps currently around 3% from a 2011 peak at 11%, and top 100 companies at 2% following a 7% level in 2011 and 11% in 2008.

Figure 24: Median Expected Value of Options & LTIPS (%Salary) - Trends



As regards the median expected value of options and LTIPs,(as a percentage of salary) the general pattern is that there is a clear distinction between the largest companies (turnover more than £10bn) and the others. CEO's at the largest companies enjoyed a median level at just above 200% of salary in 2008, but has since declined steadily to 150% in 2013. By contrast, the same measure in respect of CEOs at smaller companies in the survey continue to rise steadily, from a very low base (15% in 2003) to a still modest level of 60% in 2013. The CEOs of mid size companies enjoy a relatively stable level of expected value of options and LTIPs, at between 75% and 125% of salary, depending largely on company size.

It should be borne in mind amongst all of this that, where we discuss bonus expressed as a percentage of salary, the absolute levels are vastly different from smaller companies to larger companies. So where we identify that the expected value of options and LTIPs for CEOs at smaller companies is growing but remains at barely more than one third the level of their counterparts at larger companies, we should also remember that that one third level is one third of a much smaller total by comparison. That therefore creates a magnifying effect upon the quantum, which is why the debate about the structure of pay is as important as the quantum.

Overall observations

Based on the above analysis, we can make some general overall observations:

- Companies have reduced the total value of new remuneration awards on average over the last 2 years.

- Incentive pay accounts for a far greater proportion of total pay awarded at larger companies, and continues to account for a greater proportion of total pay awarded.

- Salary increase rates have converged and reduced, especially in the most recent 2-3 years

- Bonus opportunity remains divergent, but previous rates of increases appear to have halted in the past 2-3 years

- The expected value of Long Term Incentive awards continues to be divergent with larger companies attracting the largest sums (even when expressed as a percentage of salary), but the difference between the largest and smaller companies is narrowing from its peak in 2008

- There is a significant difference between All-Share companies and others in the proportion of pay accounted for by incentive-related pay. Outside the All-Share, incentive pay forms a very small proportion of total pay awarded.

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Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5000

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