

The new remuneration report
Disclosure regulations



The new remuneration disclosure regulations have now been laid in Parliament for approval. Assuming they are approved, they will come into force on 1 October 2013.

The binding vote on policy

As originally envisaged, the remuneration report will be split into a policy report and an annual remuneration report which provides details on how the policy has been implemented in the financial period under review, along with some details on how the policy will be implemented in the next financial period.

The annual remuneration report will, as currently, be subject to an annual advisory vote but the biggest change from the current remuneration disclosure and shareholder voting regime is the introduction of a binding vote on the policy report.

Companies with financial years beginning on or after 1 October 2013 will have to put the remuneration policy to the vote at the AGM taking place in that year. The policy does not need to apply until the following financial year (i.e. the financial year starting in 2014/2015) unless a company chooses otherwise in which case remuneration and loss of office payments which are not consistent with policy, and which are made before this date, will not be unlawful. However, if a company chooses to apply the policy earlier, the restrictions on payments will also apply from that date. It is important to note that a company must disclose the date from which the policy applies in the remuneration report.

Once the binding policy is in force, all future remuneration and loss of office payments must be consistent with it and all directors will be liable if the company breaches this policy. There is a helpful, but not risk-free, safe harbour provided in the Enterprise and Regulatory Reform Act which, if proceedings were to be taken against a director, allows the court to relieve the director, either wholly or in part, from liability if the director can show that he or she acted honestly and reasonably. However, as this relief from liability can only be obtained at the stage of court proceedings, with no certainty that the court's decision would be in the director's favour, the safe harbour should only be used as a last resort and it is important that existing indemnity insurance is checked to ensure that it covers this potential liability.

Who the regulations apply to

The new legal framework and disclosure requirements apply to UK incorporated companies with a listing on the main market in the UK or other EEA country, on the New York Stock Exchange or NASDAQ.

It is worth noting that the regulations have no impact on employees who are not directors but the disclosures and the restrictions on payments apply to all directors, including non-executive directors. However, the regulations state that the disclosures can distinguish between directors who perform executive functions and those who do not and that any requirement to disclose information that is not applicable to non-executive directors may be omitted as long as this is explained.

Timing

The first companies to report under the new regulations and to put the policy report to a binding shareholder vote will be those with financial years ending on 30 September 2013.

Year end	First AGM at which company must report in the new format and put the remuneration policy to a binding shareholder resolution	Date from which all remuneration and loss of office payments must be consistent with the approved policy or approved by a separate shareholder resolution
30 September	Late 2013/early 2014	1 October 2014
31 December	Spring 2014	1 January 2015
31 March	Summer 2014	1 April 2015
30 June	Autumn 2014	1 July 2015

Voting

A resolution to approve the policy report must be put to shareholders at least every three years or sooner if a company wants to make any changes to the policy. There will continue to be an advisory vote on the annual remuneration report every year. Both votes will be passed with a simple majority.

Failing the vote

If a company fails to get the remuneration policy approved in the first year after the reforms come into force, there will be no previously approved policy to fall back on and it will therefore be necessary to call another general meeting to obtain approval.

In subsequent years, if the policy is not approved, there are three options:

- Continue to operate under the last approved policy.
- Continue to operate under the last approved policy but seek separate shareholder approval for any specific remuneration or loss of office payments which are not consistent with policy.
- Call a general meeting and put a new/revised policy to shareholders for approval.

If a company fails the shareholder resolution on the annual remuneration report, it will not impact on the remuneration of any individual director but it will trigger the requirement to put the remuneration policy to the vote at the next AGM.

Content of the report

The required disclosures in the remuneration report have changed quite substantially since the first draft of the regulations was released in 2012. However, the main structure remains the same:

- An annual statement from the chairman of the remuneration committee.
- An annual report on remuneration (previously called the implementation report) which includes details of what directors have been paid in the reporting period and some details of how policy will be implemented in the next financial period.
- A policy report which includes details of the remuneration policy.

In a number of areas the regulations do not prescribe the detail to be included and we expect further guidance and clarification to be provided by the Association of General Counsel and Company Secretaries in the FTSE 100 (known as the GC100) and investors and investor bodies in due course. Best practice will no doubt continue to evolve over the coming years.

The policy report

This section of the report, which will be binding, could potentially be in force for up to three years. Unless a company wants to seek shareholder approval every year, the policy must therefore provide sufficient flexibility to remain appropriate for a number of years. Companies are likely to want to be able to change some elements of the remuneration package, such as annual increases to salaries or specific targets applicable to annual bonus arrangements, within the approved policy.

A well drafted policy statement is likely to be the best protection against the possibility of breaching it.

Flexibility	<p>Flexibility – the policy report must strike a reasonable balance between providing sufficient detail for shareholders to be comfortable, while allowing for some degree of flexibility to react to changing circumstances.</p> <p>This may mean making a judgement about how often measures and weightings will need to be adjusted and ensuring that the policy allows for this. It may also mean giving some assurance that salary increases will usually be in line with those for the wider workforce while allowing for the need to deal fairly with changes in responsibility, or the need to appoint someone in unforeseen circumstances.</p> <p>Note that where the policy provides for an element of discretion to vary, change or amend any aspect of the policy, the extent of this discretion must be disclosed.</p>
The policy table	<p>The structure of this table, which requires information on each component of the package, has not changed since the first draft of the regulations. However, the detail of what must be included in relation to each column has been amended slightly.</p> <p>The regulations state that the maximum that may be paid for each component may be expressed in monetary terms or otherwise. This helpfully provides some flexibility in what may be disclosed, particularly in relation to salary. Companies will need to consider the level of detail to include here which might range from a statement on how salary increases are determined to providing an indication of the limit on the salary increase which would apply in normal circumstances, which might be expressed in terms of the wider employee population, or in relation to inflation. Most companies will, however, want to provide for the possibility of making increases in excess of any limits as mentioned above.</p> <p>The final regulations do not require details of the actual performance targets to be included in the table which is welcomed. However a description of the measures and an indication of the weighting of the measures, or the group of measures, is required. Companies will also have to include some degree of information on the payout/vesting schedule.</p>
Information supplementing the policy table	<p>The key point to note here is that the regulations require companies to explain any differences in the policy in place for directors and that in place for employees generally. This is not information that has been previously required and it will be important to gauge how much detail to include.</p>
Policy on recruitment	<p>The policy report must now specifically include the policy applying to remuneration arrangements on recruitment.</p> <p>Companies will be required to provide details of the principles which will normally apply in a recruitment situation, the components that may be included in the package and the approach to each of these, including the approach to the buy out of existing arrangements.</p> <p>It will also be necessary to include a maximum level of variable pay which may be awarded. This can be expressed as a monetary amount or as a multiple of salary. Buyouts of forfeited awards are not included in this, which is helpful, but any other awards will have to be within the overall maximum limits given in the policy statement. Note that companies cannot simply rely on Section 9.4.2 of the Listing Rules to make recruitment and retention awards outside of the usual plans (e.g. one-off plans) and may want to explicitly state the potential use of this provision to allow this flexibility. Companies may also want to review the headroom in current plans to ensure that normal plans have sufficient flexibility to deal with specific circumstances.</p>

Scenario charts	<p>This section is now called 'Illustration of the application of the remuneration policy'. The three scenarios are now defined as:</p> <ul style="list-style-type: none"> • Minimum (fixed remuneration). • Remuneration receivable if, in respect of the performance conditions, the company is performing in line with expectations. • Maximum receivable. <p>The details of the measurement basis for each component are no longer included in the regulations, allowing more flexibility in the format of the charts, although a description of the basis of calculation and any assumptions must be included.</p>
Service contracts and policy on loss of office	<p>The policy report must include details of any obligation contained in all directors' service contracts, in the service contracts of any one or more existing directors if not contained in all and any proposed obligations to be contained in future contracts. Companies will need to ensure that all obligations are disclosed to ensure that these can be met once the policy is binding. The policy report must also include details of the principles on which the determination of payments for loss of office will be made. This includes how each component of the payment is calculated and whether, and how, the circumstances of the loss of office and performance are relevant to the exercise of any discretion.</p>
Consideration of employment conditions elsewhere in the company	<p>The policy report must state how the pay and employment conditions of employees have been taken into account when setting the policy for directors' remuneration. This requirement is not new but there is now also a requirement to include any details of whether and how the company consulted with employees and whether any comparison metrics were used. We expect that, in combination with the disclosure requirement on any differences in policy between directors and employees, this may be an area where companies might consider adding further information.</p>
Ensuring all potential payments can be made	<p>Because of the restrictions on making payments which are not consistent with the policy it is critical that the policy report makes reference to any payments that will need to be made while the policy is in force. This may include payments that will be made under arrangements which are no longer in operation and payments to former directors. If it transpires that the policy does not cover any potential payments it will be necessary to call a general meeting to approve these separately.</p> <p>These restrictions do not apply in relation to remuneration payments or payments for loss of office that are required to be made under an agreement entered into before 27 June 2012, as long as the agreement has not been renewed or amended since this date.</p>

Once the policy has been approved it will not be possible to make payments which are not consistent with that policy. It is therefore critical that the policy report makes reference to any payments that will need to be made while the policy is in force.

The annual remuneration report

There are number of new disclosures in this section which companies will need to plan for:

The single figure	<p>Many companies have already started to disclose a single total figure of remuneration for each director. However, in many cases, the single figure is not compliant with the methodology laid out in the regulations and it is worth noting the following points:</p> <ul style="list-style-type: none"> • Additional columns can be added to the minimum requirements of the regulations in order to aid understanding of the single figure and companies may want to consider whether this will be useful. • The value of the annual bonus should include any amount deferred where any further conditions relate to service and not performance of either the company or the individual and therefore the value of deferred shares should not be included at the time of vesting. • The value of long term awards should be based on awards vesting in respect of the financial period under review. Although this will not be the case in all companies, this will typically relate to awards vesting after the year end, but where the performance period ends at the financial year end, or shortly afterwards. This may mean estimating the proportion that will vest if not yet known. • The value of long term awards should also include the value of any additional cash or shares receivable in respect of dividends accrued. • The pension number should include the aggregate pension contribution across all pension plans in which the director accrues benefits.
The link between pay and performance	<p>It is important to note that information to supplement the single figure is required which will explain the link between pay and performance. The supplemental information required includes, for variable components, the disclosure of the performance measures, weightings, targets set at the beginning of the performance period, the value achievable if targets are met, the actual performance achieved and the resulting level of award.</p> <p>A provision has been added in the introduction of the regulations, covering all parts of the report, stating that no requirement of the regulations requires the disclosure of information in respect of performance conditions which the directors consider is commercially sensitive. This means that companies do not have to publish targets that even retrospectively would be considered sensitive, but where information is not included in reliance on this provision, the reasons for omitting it will need to be given as well as an indication of when, or if, it will be provided to shareholders. Companies will need to think carefully about the need to provide some indication that the measures and targets set were relevant and stretching and that payouts clearly relate to the level of performance achieved.</p>
Payments to past directors	<p>The report must include details of any payments made to past directors. However there are a number of exclusions which include payments for loss of office, payments included in the single figure table, payments disclosed in previous remuneration reports, payments by way of regular pension benefits and payments in respect of employment of contractual services other than as a director. Also excluded are any payments below a 'de minimis threshold'. This threshold is set by the company but it is important to note that this threshold must be disclosed.</p>
Payments for loss of office	<p>Companies will need to disclose the total amount of any payment for loss of office, broken down into each component, and an explanation of how each component was calculated and any other payments, including how outstanding incentive awards are to be treated. Where any discretion has been exercised, this must be explained. Payments below a de minimis threshold are also excluded from this section but again the threshold must be stated in the report.</p> <p>It is also important to note that the Enterprise and Regulatory Reform Act requires that when a director leaves, the company must publish a statement on its website including the particulars of the loss of office payments and remuneration payments which have been made and may be made in the future. The legislation requires that this statement must be published as "soon as reasonably practicable" and is separate to the requirement in the Listing Rules to disclose board changes to a Regulated Information Service.</p>
Statement of directors' shareholding and share interests	<p>The regulations do not prescribe the level of detail to be disclosed in relation to outstanding share awards. However, it is worth noting that the requirements in the Listing Rules in relation to long term awards remain, although these are currently under review.</p>

Performance graph and table	There have been a number of changes to this section but the final regulations require a TSR chart as currently. Alongside this a table should be included which provides, for the CEO, the single total figure of remuneration, the amount of bonus earned as a percentage of the maximum opportunity and the vesting of long term awards as a percentage of the maximum number of shares that could have vested. Both the chart and the table should, in the first year of reporting under the new regulations, cover five years. Over the next five years the chart and table should build up to cover ten years.
Percentage change in remuneration of the CEO	Companies will have to show the increase in the remuneration of the CEO compared with the increase in the remuneration of other employees. However, this should not be based on total remuneration including share awards but should include salary, fees, taxable benefits and annual bonus which will make a comparison with other employees slightly easier for companies to calculate. If a comparison with all employees is not considered appropriate, companies can choose a more relevant comparator group of employees, and should explain the rationale. It will be necessary to ensure that these numbers are comparable and the choice of employee group will therefore be particularly important.
Relative importance of spend on pay	Companies can now choose to disclose this information in a chart or table and must include the actual expenditure for the current and previous year, and the percentage change, in relation to remuneration paid to all employees, dividends and any other significant distribution deemed helpful in assisting shareholders with an understanding of the relative importance of spend on pay. Careful consideration needs to be given as to which financial measures will be most appropriate.
Statement of implementation of remuneration policy in the following year	<p>This section was not in previous drafts of the regulations. In practice, many companies already include some degree of information about practice in the next financial period, typically including the salaries, the potential bonus payable, level of awards to be made under long term plans and some information on performance conditions.</p> <p>The degree of detail to be included is not prescriptive other than it should include the performance measures and weighting, the targets determined for the performance measures and how awards will be calculated. In some cases the disclosure of specific targets may be considered commercially sensitive, particularly for annual bonus plans and companies will need to think about how this should be balanced with providing shareholders with assurances that the targets are relevant and appropriately stretching.</p>
Consideration of directors' remuneration	Companies will now have to disclose whether and how they satisfied themselves of the independence of their adviser(s) and disclose the fees for this advice.

The report should include a statement on how the policy will be implemented in the following year.

Action plan

The remuneration committee should start preparing for the 2014 remuneration report and the binding vote as soon as is practical over the next few months. With all listed companies requiring a binding vote on policy at the 2014 AGM, shareholders are going to be particularly busy and it may be helpful to consider the approach that will be taken to shareholder communication over the next twelve months.

Policy report

Policy

- Consider changes to remuneration policy taking into account shareholder expectations following prior year disclosure.
- Review benefits policy.
- Review and/or develop recruitment and exit policy.

Policy table

- Consider level of detail vs flexibility to be included.

Service contracts and exit payments

- Review service contracts to ensure all aspects are covered by the policy.
- Review whether additional information needs to be disclosed.
- Review incentive, share plan and pension rules – how are leavers treated?

Remuneration policies for employees

- Consider the remuneration structure and policies in place across the organisation.
- Are any differences fair and reasonable?

Scenario charts

- Determine what will be included in the 'in line with expectations' scenario.

Restrictions on payments

- Ensure all potential payments that may need to be made while the policy is in force are identified in the report.

Annual remuneration report

Single number

- Calculate the single number of the last financial period and identify any areas where detailed explanation is required (e.g. vesting of buy-outs, recent appointments etc).
- Consider the presentation of any contextual information.

Performance targets

- Review the level of detail to be disclosed on retrospective bonus targets and the level of performance achieved.

CEO pay vs performance

- Calculate the single figure for the CEO for five years, as well as short and long term payout/vesting levels.

CEO pay increase in relation to employees

- Choose the most relevant employee group and the best approach to measuring change in salary, benefits and bonus.

Relative spend on pay

- Determine the most appropriate financials to include.

Exit payments

- Consider the disclosure of any payouts to exiting directors.

General

Dialogue with shareholders

- If, as a result of a review of existing policies, changes are considered appropriate, companies should consider whether or not the changes require shareholder consultation.
- Decide on the level of shareholder communication necessary and plan timetable.
- If there have been no major changes and recent reports have been uncontroversial, there may be less need for significant consultation.
- If there have been regular concerns and/or the policy requires explanation, it may be necessary to consult earlier and in more detail.

Directors' liability

- Ensure the remuneration policy is drafted to cover all expected and agreed payments and provides some discretion to allow the Committee to deal with unexpected and unforeseen circumstances.
- The restrictions on remuneration and loss of office payments to directors do not apply to any payments required to be made as part of an agreement entered into, or other obligation arising, before 27 June 2012 and which has not been renewed or amended since. The committee will need to identify whether any arrangements fall into this category and ensure that the agreement has not been renewed or amended since this date.
- Check that all payments are appropriately covered with general counsel – "honest and reasonable" test.
- Review level of indemnity insurance.

Remuneration committee

- In light of the new disclosure requirements committees may want to review existing policies (for example this might include aspects such as recruitment policies, exit payments, clawback and malus arrangements, the use of discretion, shareholding requirements etc) to ensure they are line with investor expectations and best practice guidelines. Sufficient time should be built into the committee agenda and scheduling over the next few months to accommodate this review.

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