

COMPANY
LAW

Directors' Remuneration

A CONSULTATIVE DOCUMENT

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Department of Trade and Industry

Directors' Remuneration

**A Consultative Document
December 2001**

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Company Law: a Consultative Document

DIRECTORS' REMUNERATION

December 2001

The Department of Trade and Industry invites comments by **15 March 2002** on the issues set out in this paper.

You are invited to send comments on any issue covered by this consultation to:

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FOREWORD BY THE SECRETARY OF STATE FOR TRADE AND INDUSTRY

The subject of directors' remuneration continues to attract lively interest and not a little controversy. There are a number of reasons why it is an important area, both for Government and the business community.

- The ability of our major companies to attract, retain and, not least, motivate their executive directors is important to UK productivity and competitiveness. Remuneration is not, of course, the only factor, but it is clearly a significant one.
- It lies at the heart of the debate on effective corporate governance. This is the issue, above all others, on which directors face a conflict of interest; it is also one on which there is a clear need for non-executive directors to exercise independent judgement. Indeed, some commentators have suggested that non-executive directors who are unable to ensure proper performance linkage in respect of executive directors' remuneration are unlikely to be well placed to respond effectively to strategic proposals generated by the chief executive and management.
- It affects the way in which business is perceived in this country, both by employees and in the community at large. The Greenbury Report noted in 1995 that paying directors over the odds, particularly where the company has performed badly, can cause resentment among staff and damage the company's reputation. That remains true today.

More than six years ago, the Greenbury Report set out three fundamental principles in this area: accountability, transparency, and performance linkage. The Government agrees that these are the right principles, but it does not believe that the best practice framework has been successful in achieving adequate levels of compliance. Although many quoted companies have complied fully, this is not an area where so patchy a performance is acceptable.

It is not for the Government to take a view on the appropriate level of remuneration for executive directors. That is a matter for companies and their shareholders. But it does intend to legislate to ensure that the corporate governance framework delivers proper transparency and accountability. I would welcome your views on our proposals to achieve these objectives.

PATRICIA HEWITT

INTRODUCTION

1.1 The Department issued a consultative document in July 1999 which made a number of recommendations with a view to strengthening transparency and accountability in the area of directors' remuneration. The Government has subsequently announced that it intends to legislate in the current Parliamentary session to require companies to:

- publish a report on directors' remuneration as part of the company's annual reporting cycle;
- disclose within the report details of individual directors' remuneration packages, the company's remuneration policy, and the role of the board and remuneration committee in this area; and
- put an annual resolution to shareholders on the remuneration report.

This consultative document seeks views on the detailed implementation of these new requirements.

Purpose of the new legislative requirements

1.2 The Government's concern is with the corporate governance framework – that is, with the system by which companies are directed and controlled. In particular, the Government wishes to ensure that the regulatory framework promotes transparency and accountability to shareholders. The remuneration policies of individual companies, and the details of the remuneration packages of executive directors, are a matter for the boards and remuneration committees of quoted companies, and for their shareholders; and this consultative document does not seek to offer a view on recent developments in these areas.

1.3 The proposed regulations will impose new requirements only on quoted companies incorporated in Great Britain. (The definition of a "quoted company" under the regulations is considered further in paragraphs 3.4 – 3.8 below.) Unquoted companies incorporated in Great Britain will continue to be required to comply with the disclosure requirements in Part I of Schedule 6 to the Companies Act 1985. Companies which are listed in London but which are not incorporated in Great Britain will not be subject to the new requirements.

The draft regulations

1.4 This consultative document covers two draft statutory instruments. These are attached at Annex A and Annex B respectively, and a commentary on them is provided in chapter 3 below. In brief, the draft regulations would impose the following requirements on quoted companies incorporated in Great Britain:

- the Directors' Remuneration Report Regulations would require companies to provide shareholders with more detailed information than that currently required by either Part I of Schedule 6 to the Companies Act 1985 or by the Listing Rules, particularly in respect of the forward looking

remuneration policy of quoted companies; and would require an annual shareholders' vote on the directors' remuneration report;

- the Companies (Summary Financial Statement) Amendment Regulations would require those companies which choose to publish a Summary Financial Statement to make some of the new disclosures within the Summary Financial Statement.

Commencement

1.5 The Government proposes that the regulations should have effect as respects companies' financial years ending on or after 31 December 2002. This is discussed further in paragraphs 3.1 – 3.2 below.

Company Law Review

1.6 In July 2001, the Government published the final report of the independent Company Law Review. The report did not specifically address directors' remuneration since the Government had consulted on this separately; but it did consider a number of related issues, such as voting at general meetings and the provisions under Part X of the Companies Act 1985 concerning the enforcement of fair dealing by directors. The Government is giving detailed consideration to the Review's recommendations, with a view to consulting on draft legislation. This consultative document refers to some of the Review's recommendations, but does not represent the Government's response to them.

Costs and benefits to business

1.7 A draft Regulatory Impact Assessment is at Annex C, setting out the possible costs and benefits to business. The Government would welcome comments on the assumptions on which they are based.

Q1: Do you wish to make any comments on the costs and benefits of the draft regulations as set out in the Regulatory Impact Assessment?

The Consultation Process

1.8 The Government's code of practice for written consultations applies the criteria set out in Annex E to all UK national public consultations on the basis of a document in electronic or printed form. The complete code is available on the Cabinet Office's web site, address www.cabinet-office.gov.uk/servicefirst/index/consultation.htm.

1.9 This consultation complies with the code of practice. If you have any complaint or comment about the consultation process, you should contact:

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POLICY SUMMARY

The corporate governance framework for directors' remuneration

2.1 The corporate governance framework in Great Britain operates at a number of levels.

- There are some areas – particularly those relating to conflicts of interest – where either Parliament, or, in some cases, the Listing Authority, has taken the view that it is appropriate to impose requirements on companies.
- There is also, however, widespread agreement that there is an important role for a generally accepted code of best practice: in the United Kingdom, the Combined Code has fulfilled this role since 1998. Responses to the Company Law Review suggest that it is generally considered that it would be unhelpful or inappropriate to put the provisions of the Code into legislation or regulation. The main reasons given were that: the case for maintaining flexibility on company governance structures is very strong; the definitional problems in the field are very severe; and that shareholder control is the appropriate mechanism for regulating such matters.
- There are, in addition, some areas where institutional investors have chosen to supplement the Combined Code with their own best practice guidance. Examples include the policy document, *Responsible Voting*, which was issued jointly by the Association of British Insurers and the National Association of Pension Funds in summer 1999.

2.2 The Government believes that all of these levels will continue to be important. In particular, it takes the view that, whilst legislative and regulatory requirements will have an essential role, there will also be a continuing need for a code of best practice and other guidance. There is also a vital need for regular, systematic contact between directors and shareholders.

2.3 The Financial Services Authority, which as the designated Listing Authority for the United Kingdom has responsibility for the Listing Rules, has agreed to delete the current requirements in the Listing Rules relating to the disclosure of directors' remuneration at the time when the new legislative requirements come into force.

2.4 The Government will discuss the desirability of any consequential amendments to the Combined Code with bodies such as the Financial Reporting Council, which has general oversight of the Code, following Parliamentary approval of the draft regulations.

The role of the remuneration committee

2.5 Under the Combined Code, boards of directors should set up remuneration committees of independent non-executive directors to make recommendations to the board, within agreed terms of reference, on the company's framework of executive remuneration and its cost; and to determine on their behalf specific remuneration packages for each of the executive directors, including pension rights and any compensation payments.

2.6 The draft regulations do not require quoted companies to establish a remuneration committee; but it is the Government's expectation, as it is of all leading shareholders, that companies will wish to do so to minimise conflicts of interest.

2.7 It is also important that executive directors do not seek to exert any improper influence over any of the members of the remuneration committee. For that reason, the name of any director who is not a member of the committee but who has provided advice or services to the committee which was of material assistance to their consideration of directors' remuneration must be named under the draft regulations.

2.8 The Government believes that it is very important that the members of the remuneration committee are independent, and are perceived to be independent, of the executive directors. It does not believe that it would be helpful or appropriate to attempt a legislative definition of an independent non-executive director, but it welcomes the work of organisations such as the Association of British Insurers and the National Association of Pension Funds in this area.

2.9 External remuneration consultants often play an important role in advising remuneration committees. In view of this, and because of the potential for conflict of interest in circumstances where the consultancy is part of a group which provides, or might provide, other services to the company, the regulations would also require the disclosure of the name of any remuneration consultancy which had provided advice or services to the committee which was of material assistance to their consideration of directors' remuneration.

Disclosure of directors' remuneration

2.10 The Greenbury Group recommended in 1995 that the remuneration committee should make a report each year to the shareholders on behalf of the board. The report should set out both the company's general policy on executive remuneration and the actual remuneration packages of the individual directors by name.

2.11 The Greenbury Group stressed in its report that it attached the highest importance to full disclosure of directors' remuneration as a means of ensuring accountability to shareholders and reassuring the public. The chapter in the report on disclosure made the following points:

“Full disclosure does not mean swamping shareholders with a mass of detail in which the essential points risk being lost. The important point is rather that companies and their remuneration committees should adopt a new philosophy

of full transparency such that shareholders have access to all the information they may reasonably require to enable them to assess the company's general policy on executive remuneration and the entire remuneration packages of individual directors."

2.12 The Government believes that, as a result of the disclosure requirements in the Listing Rules, there is an acceptable level of transparency in respect of the disclosure of individual directors' remuneration packages. It does not believe, however, that there has been adequate compliance with the Greenbury recommendations on the disclosure of remuneration policy. It proposes therefore to require quoted companies to make specific disclosures in respect of key aspects of remuneration policy such as the main parameters and rationale for any share option or other long term incentive scheme.

2.13 The requirement under the draft regulations is that the board of directors, rather than the remuneration committee, should report to shareholders. This is so for two main reasons. Firstly, as the Hampel Committee stated in its report in 1998, the remuneration committee is constitutionally a committee of the board and responsible to the board. Secondly, the report covers the remuneration of non-executive as well as of executive directors.

2.14 The new disclosure requirements build on the existing Listing Rules' requirements in this area, especially with respect to the disclosure of individual directors' remuneration packages. The Government believes, however, that the new directors' remuneration report will significantly strengthen transparency in this area:

- the new report will have a clearer focus on the forward looking disclosures on remuneration policy;
- there will also be a requirement for additional information on performance linkage, including a new requirement for a performance graph, or graphs, which will show how the company has performed in respect of comparator companies or groups of companies;
- for the first time, there will be disclosure requirements relating to the role of the board and remuneration committee in respect of their consideration of directors' remuneration.

2.15 The Government believes that the new disclosure requirements will provide a firm foundation for effective transparency in this area; but it will discuss with institutional investors and with business organisations how existing best practice might be developed to enhance the new requirements.

2.16 It has been suggested that some senior managers do not wish to join the main board of a quoted company because of the requirements relating to directors' remuneration. The Government accepts that this would be an undesirable consequence of greater transparency in this area; but, at the same time, it believes that such transparency is essential in respect of executive directors. The Government does not believe that there is a strong case for requiring the disclosure of the remuneration of company employees below board level, as such persons do not face the same conflict of interest as directors; but it invites comments on whether the

disclosure requirements should be extended to cover the remuneration of highly remunerated persons other than directors.

Contracts and compensation

2.17 “Rewards for failure” raise the issue of effective performance linkage in a particularly stark way. There continues to be widespread criticism at the scale of some of the payments made and at their apparent lack of justification in terms of performance. At the same time, the Government accepts that this is not an area where there are easy solutions, and that a director is usually entitled to compensation if his contract of employment is terminated.

2.18 The Government believes that it is especially important that there is adequate transparency in this area. The directors’ remuneration report will require companies to explain their policy on service contracts, and on notice periods and termination payments under such contracts, and to provide a *post hoc* justification to shareholders of any compensation arrangements agreed by the board following the departure of a director who was under contract to the company.

2.19 The Government welcomes the movement towards setting notice or contract periods at, or reducing them to, one year or less. It is giving careful consideration to the Company Law Review recommendations relating to directors’ service contracts, including the recommendation that, except on a director’s first appointment, service contracts in excess of one year should require prior shareholder authorisation.

Directors’ accountability to shareholders: a new requirement for an annual vote by shareholders on the directors’ remuneration report

2.20 Directors face a conflict of interest over their remuneration. The Government therefore believes that it is essential that there is effective accountability to shareholders in this area.

2.21 The Greenbury Group suggested that boards of directors should feel free to put down a resolution approving the policy in the remuneration committee’s report if they believed that there were special circumstances which made this appropriate. The Group suggested that such circumstances might arise if a company wished to change radically its remuneration policies, or if its policies in this area had attracted controversy.

2.22 The Greenbury Group also recommended that shareholders should be invited to approve all long term incentive schemes available to directors and senior executives, on the grounds that they potentially commit shareholders’ funds for more than one year ahead, or dilute the equity. A Listing Rule to this effect was introduced in 1996.

2.23 The consultative document published by the Department in 1999 set out the Government’s view that accountability to shareholders needed to be strengthened; and the Government remains of this view. Although there has been a modest increase in the number of companies choosing to put the remuneration report or remuneration

policy to a shareholder vote, there is little evidence that companies which have radically changed their remuneration policy or attracted controversy have necessarily elected to do so. Accountability to shareholders therefore remains weak.

2.24 The Government announced on 19 October that it would bring forward legislation to require quoted companies to put an annual resolution to shareholders on the directors' remuneration report. Some commentators have suggested that a requirement for a vote on remuneration policy would be preferable, on the grounds that it would be more clearly forward looking and would distance shareholders from the details of individual remuneration packages. These arguments have some force, but the Government still believes that there are advantages in a vote on the remuneration report. In particular, it believes that circumstances may arise in which shareholders want to express a view on payments such as annual bonuses or compensation payments which were made in the preceding financial year; that it is important that shareholders vote on the company's procedure for developing policy on remuneration and for fixing the remuneration packages of individual directors; and that shareholders should vote in such a way that they can express a view on the quality of the disclosures made by directors in the remuneration report. More generally, there is also merit in shareholders being asked to consider remuneration issues – including the company's forward looking policy – in the round.

2.25 The Government has proposed that the vote on the remuneration report should be advisory; and there is widespread agreement that it would not be feasible for shareholders to approve specific levels of remuneration. This would be the first time that companies legislation had been used to require such a vote, but the Government believes that it would be appropriate in this case, on the grounds that the board should continue to have responsibility for remuneration matters (subject to the company's articles of association). A non-advisory vote could also cause significant legal difficulties in respect of individual directors' contractual entitlements.

2.26 The Government does not believe that the annual vote on the directors' remuneration report should necessarily be the only vote at the annual general meeting relating to directors' remuneration. It will continue to be important that shareholders are invited to approve all long term incentive schemes available to directors and senior executives; and there may be specific issues relating to directors' remuneration on which either the board or shareholders wish to put forward a separate resolution. The Company Law Review has put forward recommendations to facilitate shareholder resolutions, and the Government is considering them carefully.

2.27 It will continue to be very important that there is effective dialogue between companies and shareholders in this area. The Government believes that dialogue between the board and investors on remuneration issues is more likely to be effective if it is underpinned by a requirement for an annual shareholder vote on the remuneration report.

2.28 The Government considers that it is essential that quoted companies publish the result of the shareholder vote on the remuneration report each year. It expects quoted companies to comply with the provision in the Combined Code relating to the counting of, and disclosure of, proxy votes; and it will consider whether there is a case for requiring companies to call a poll in respect of the resolution on the directors'

remuneration report, and to disclose the result of the poll vote on their websites and in their annual reports.

Summary

2.29 The Government's aim is that these new requirements will, over time, help to change the climate for discussion of directors' remuneration. It has no wish to see high profile or disproportionate controversy as a regular feature of companies' general meetings – nor does it believe that this will be the effect. Rather, it believes that the new requirements will underpin a framework in which there is more effective dialogue between companies and investors, and in which there is greater transparency on policy issues such as performance criteria and measurement.

COMMENTARY ON THE DRAFT REGULATIONS**Commencement**

3.1 The Government proposes that the new requirements should have effect as respects companies' financial years ending on or after 31 December 2002. Such a commencement date would require companies with a financial year ending on 31 December to lay a copy of the directors' remuneration report before the company in general meeting, and to put a resolution approving the report to shareholders, in 2003.

3.2 The Government accepts that this timetable envisages that some companies will be required to report on a period that predates Parliamentary approval of the legislation. It believes that this would be appropriate in this instance because the Government is, for the most part, simply requiring companies to comply with the code of best practice published by the Greenbury Group in 1995.

Q2: Do you agree that, subject to Parliamentary approval, the draft regulations should have effect as respects companies' financial years ending on or after 31 December 2002?

Disclosure required in notes to accounts

3.3 The draft regulations will continue to apply paragraph 1 of Part I of Schedule 6 to the Companies Act 1985 [*disclosure of aggregate amount of directors' emoluments etc*] to quoted companies incorporated in Great Britain. This is necessary to ensure compliance with Article 43 of the Fourth EEC Company Law Directive, which has a provision concerning the emoluments of directors and past directors in paragraph 12. Article 43 requires that the notes on the accounts set out information in respect of the following matters:

“the amount of the emoluments granted in respect of the financial year to the members of the administrative, managerial and supervisory bodies by reason of their responsibilities, and any commitments arising or entered into in respect of retirement pensions for former members of those bodies, with an indication of the total for each category.”

Application: definition of a “quoted company”

3.4 The Government intends to apply the draft regulations to companies which are incorporated in Great Britain and quoted on a major exchange, whether in the United Kingdom or overseas; at the same time, it does not wish to extend the requirements to companies quoted only on exchanges such as the Alternative Investment Market. It therefore proposes that the new requirements should apply to companies whose equity share capital:

- (a) has been included in the official list in accordance with the provisions of Part VI of the Financial Services and Markets Act 2000; or
- (b) is officially listed in an EEA State; or
- (c) is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq.

3.5 The Government wishes to extend the requirements to companies quoted on major foreign markets for two main reasons. In the first place, it believes that the regulations will form an important part of the corporate governance framework for major quoted companies incorporated in Great Britain. Secondly, it does not believe that it would be desirable for quoted companies incorporated in Great Britain to seek to avoid such requirements by listing their shares only on a major overseas market, such as the New York Stock Exchange or Nasdaq.

3.6 The Government has not sought to cover all international exchanges in the draft regulations. (It would, if necessary, be possible for Parliament to add additional exchanges in the future by making further regulations under section 257(2) of the Companies Act 1985.) It believes that, for the time being, it would be appropriate to extend the requirements only to companies which are either officially listed in another state in the European Economic Area (that is, EU member states plus Iceland, Norway and Liechtenstein) or which have been admitted to dealing on either of the two main US markets, the New York Stock Exchange and Nasdaq.

3.7 "Company" is given the meaning set out in section 735 of the Companies Act 1985; as a result, the draft regulations will not apply to those companies which are incorporated overseas but are on the Official List of the United Kingdom Listing Authority. (Paragraph 12.43A of the Listing Rules has a similar application in that it only applies to companies incorporated in the United Kingdom.)

3.8 "Equity share capital" is defined in section 744 of the Companies Act 1985 as a company's "issued share capital excluding any part of that capital which, neither as respects dividends nor as respects capital, carries any right to participate beyond a specified amount in a distribution". The definition of a "quoted company" would not therefore apply to companies of which only the debt or non-equity share capital is quoted. This would continue the effect of the current Listing Rules' requirements relating to the disclosure of directors' remuneration (Rule 12.43A), which do not apply to companies whose only listed securities are debt securities or fixed income shares.

Q3: Do you agree with the definition of "quoted company" in the draft regulations?

Application of Schedule 6 to the Companies Act 1985 and the draft regulations

3.9 Part I of Schedule 6 to the Companies Act 1985 currently imposes disclosure requirements in respect of directors' emoluments on both listed and unlisted companies. (The legislative requirements are currently supplemented in respect of

listed companies by the disclosure requirements in paragraph 12.43A of the Listing Rules.)

3.10 Under the draft regulations, the whole of Part I of Schedule 6 will continue to apply to unquoted companies. Quoted companies would not have to comply with Part I (with the exception of paragraph 1 of Part I of Schedule 6 [disclosure of aggregate amount of directors' emoluments etc]). Part II (Loans and quasi loans), and Part III (Other transactions) will continue to apply to both quoted and unquoted companies.

3.11 Subparagraph 1(2) of Schedule 6 currently has the effect that a company which is not listed has only to make a very limited disclosure in respect of gains on the exercise of share options. Under the draft regulations, a company which is quoted on the Alternative Investment Market (AIM) would also be required to provide the information required by subparagraphs 1(1) (b) and (c) of Schedule 6. On the other hand, a company which has only debt securities or non-equity shares quoted or otherwise "on offer to the public" would, under the draft regulations, not have to provide such information.

Duty to prepare directors' remuneration report

3.12 The directors' remuneration report will not form part of a quoted company's report and accounts. The draft regulations therefore establish a duty on the directors to prepare the report; this is based on the current duty on the directors to prepare the directors' report in section 234 of the Companies Act 1985.

Role of auditors

3.13 The draft regulations also establish a duty on the auditors to audit the disclosures made under Part 3 of Schedule 7A (that is, the information relating to payments made to directors and past directors in the preceding financial year).

3.14 It is not proposed that the auditors should be required to audit the information provided under Part 2 of Schedule 7A, which relates to matters such as the board's forward looking remuneration policy and to the board's procedures for considering directors' remuneration. The Government has considered whether legislation should require the auditors to consider whether the information given in Part 2 is consistent with that provided in the annual accounts or in Part 3 of Schedule 7A; and has decided that such a requirement is unnecessary. (There is a requirement to this effect in relation to the directors' report under section 235(3) of the Companies Act 1985; but that implements a specific EC directive requirement.) The Government is aware that, as a matter of auditing standards, auditors will look at the disclosures made under Part 2 of Schedule 7A, and will seek to resolve any inconsistencies between Part 2 and the audited accounts and the audited Part 3 disclosures.

Q4: Do you agree that the auditors should not be required under the regulations to consider whether the disclosures made under Part 2 of Schedule 7A are

consistent with those provided in the annual accounts or under Part 3 of Schedule 7A?

Members' vote on remuneration report

3.15 Regulation 7 would require a "quoted company" to circulate a resolution approving the directors' remuneration report for the preceding financial year to its shareholders prior to its annual general meeting; and would require the "existing directors" to ensure that the resolution was put to the vote of the meeting. The Government's underlying policy in respect to the requirement for such a vote is set out in paragraphs 2.20 – 2.28 above.

3.16 The vote would be advisory. It would not require directors to amend contractual entitlements, nor to amend their remuneration policy. The Government nevertheless believes that the result of the vote will send a very strong signal to directors, and that, in practice, directors will wish to take notice of the views of the company's members, and to respond appropriately.

3.17 The Government believes that the requirement to ensure that the resolution is put to the vote of the meeting should apply to all "existing directors" (that is, to every person who, immediately before the general meeting, is a director of the company). As such, the requirement would not apply to past directors (even if they had served on the board or as members of the remuneration committee in the current financial year), but it would apply to "existing directors" who were, for whatever reason, not present at the general meeting.

Q5: Do you agree that all "existing directors" should be required to ensure that the resolution is put to the vote of the general meeting?

Summary Financial Statement

3.18 Section 251 of the Companies Act 1985 allows listed companies (that is, companies which have been admitted to the Official List in either the United Kingdom or the Republic of Ireland) to produce a summary financial statement (SFS). In respect of directors' remuneration, an SFS must currently show the figure required by paragraph 1(1) of Part I of Schedule 6 to the Companies Act 1985 (paragraph 3(4) of Schedule 1 to the Companies (Summary Financial Statement) Regulations 1995).

3.19 The Government proposes that the power contained in section 251(3) of the Companies Act 1985 should be expanded to include a reference to the directors' remuneration report; and that, using that power, the Department should amend the Companies (Summary Financial Statement) Regulations 1995 to require parts of the directors' remuneration report to be contained in any SFS which is produced by a listed company which is also a "quoted company", as defined in regulation 10 of the draft Directors' Remuneration Report Regulations. If a company falls within the definition of a quoted company but is not a listed company for the purposes of section 251, the company will have to supply its members with a full copy of the directors' remuneration report.

3.20 The Government is mindful of the importance of minimising disclosure requirements in respect of the SFS; but, at the same time, it wishes to ensure that shareholders who have opted to receive the SFS have sufficient information to make an informed decision in respect of the advisory resolution on the directors' remuneration report. In particular, it wishes to ensure that the disclosure requirements in this area reflect the importance which the Government attaches to the demonstration of effective linkage between directors' remuneration and corporate performance. In view of this, the Government proposes that the following disclosures on directors' remuneration should be required to be made in the SFS:

- (a) the whole of, or a summary of, that portion of the notes to the accounts for the year in question which set out the information required by paragraph 1(1) of Part I of Schedule 6 of the Companies Act 1985 (*Aggregate amount of directors' emoluments etc*); and
- (b) to the extent that the company is required to produce a directors' remuneration report, the whole of, or a summary of, those portions of the report which set out the matters required by paragraphs 3 (*Statement of company's policy on directors' remuneration*) and 4 (*Performance Graph*) of the Schedule to the Directors' Remuneration Report Regulations.

Q6: Do you agree that the information set out in paragraph 3.20 above should be required to be disclosed in the summary financial statement?

Schedule 7A Directors' Remuneration Report

Summary

3.21 Schedule 7A is split into four parts.

- Part 1 introduces the report, and explains that information required to be shown in the report for, or in respect of, a particular person should link the information shown in the report to that person by name.
- Part 2 covers information not subject to audit. It includes the disclosure requirements relating to the consideration of remuneration matters by the directors; the requirement for a forward looking report on remuneration policy; and the requirement for a performance graph. Much of Part 2 is new in that it goes beyond what is currently required either by Schedule 6 to the Companies Act 1985 or by the Listing Rules.
- Part 3 will cover the detailed disclosure of remuneration and other forms of benefit paid to directors and former directors in the preceding financial year; and is subject to audit.
- Part 4 contains the interpretation of terms used in Parts 2 and 3, and supplementary provisions.

Consideration of remuneration matters by the directors

3.22 Paragraph 2 relates to the consideration of directors' remuneration by the board's remuneration committee. It does not require quoted companies to establish a remuneration committee, but, if a committee of the board of directors has considered matters relating to the directors' remuneration in the preceding financial year, it requires the disclosure of the following information:

- (a) the names of the committee's members;
- (b) a statement as to whether the board accepted the committee's amendments without substantial amendment, and, if not, particulars of any recommendations that were not accepted; and
- (c) the name of any "person" who provided to the committee advice, or services, that materially assisted the committee in their consideration of the directors' remuneration in the preceding financial year.

3.23 The Government believes that, in view of the conflict of interest which directors face in deciding their remuneration, it is important that there is as much transparency as possible about the board's consideration of such matters. It has noted in this context the two following recommendations by the Hampel Committee:

- the establishment of the broad framework of executive remuneration and its cost should be a matter for the full board, on the advice of the remuneration committee;
- the determination of the remuneration packages of executive directors should be delegated to the remuneration committee.

The Government supports both recommendations, but believes that it is essential that shareholders have reasonable confidence that companies are complying with them.

3.24 The Government accepts that it may be appropriate for one or more of the executive directors, most obviously the Chief Executive, to provide advice or information to the remuneration committee. It nevertheless believes that, as the Hampel Committee suggested, it is clearly wrong for the executive directors of quoted companies to participate in decisions on their own remuneration packages. It therefore believes that it is important that the report names any executive director who has provided advice or services to the committee that have materially assisted the committee in their consideration of the directors' remuneration in the preceding financial year term; and that the report should contain a statement as to whether the board accepted the committee's amendments without substantial amendment, and, if not, particulars of any recommendations that were not accepted.

3.25 The Government is aware that such disclosure requirements could have undesirable consequences. In particular, it accepts that they might encourage some directors to have substantive discussions in private, so that, for example, it could be argued that they had not provided advice to the full committee. The Government believes, however, that most directors will be mindful of the need to ensure that they do not participate in decisions on their own remuneration packages; and also of the

damage that might be caused to their own reputations, and to that of the company, if they fail to make the necessary disclosures.

3.26 Remuneration consultants often play an important role in providing advice to the remuneration committee; and the Government believes that companies should disclose the names of any consultants who have provided to the committee advice, or services, that have materially assisted the committee in their consideration of the directors' remuneration in the preceding financial year. (The term "person", as used in paragraph 2(1)(c), would apply to any remuneration consultant or consultancy, whether a company, a partnership or an individual.) This is especially important in view of the potential for conflict of interest in circumstances where the consultancy is part of a group which provides, or might provide, other services to the company; and the Government wishes to seek views as to whether companies should be required to disclose other services provided to the company by such groups.

3.27 The Combined Code recommends that the remuneration committee should have access to professional advice inside and outside the company. The Government agrees; but it also believes that it is, in practice, important that the remuneration committee is able to choose its source of external advice. There is potential for conflict of interest if the consultancy which has been appointed to advise the remuneration committee on the remuneration packages of executive directors is also providing advice to the executive directors on the remuneration of the company's senior managers; this is especially so if the external consultancy which is advising the remuneration committee has been appointed by the company's executive management, rather than by the committee itself.

Q7: Should companies be required to disclose (a) other services provided to the company by the firm(s) which provide remuneration advice to members of the board; and (b) who appointed the remuneration consultants?

Statement of company's policy on directors' remuneration

3.28 Paragraph 3 requires a forward looking statement of the company's policy in certain areas of directors' remuneration. This would be the central, forward-looking part of the report. The most important change from the current Listing Rules' requirement would be that the board of directors would be required to make some specific disclosures as part of the policy statement. These would include:

- details of, performance criteria for long-term incentive and executive share option schemes, or of any amendments, or proposed amendments, to the terms and conditions of such schemes;
- details of comparator group(s) of companies;
- details of, and an explanation of, the company's policy on contract and notice periods for executive directors, and on compensation to former directors.

The new requirements reflect the recommendations on the disclosure of general remuneration policy by the Greenbury Group, which reported in 1995.

3.29 The Government believes that it is important that there is full transparency in relation to long-term incentive schemes and executive share option schemes. It notes in this regard that the Greenbury Group recommended that companies should set out the company's policy on major issues such as:

- the main parameters and rationale for any share option or other long-term incentive schemes;
- the comparator groups of companies considered;
- how performance is measured, how rewards are related to it, how the performance measures relate to longer-term company objectives and how the company has performed over time relative to comparator companies.

The Government agrees; indeed, it takes the view that it is essential that such information is disclosed to shareholders. It does not, therefore, intend to permit companies to withhold details of the performance criteria used in long term incentive schemes and executive share option schemes, or details of comparator companies or indexes in relation to such schemes, on the basis that such information is commercially confidential.

3.30 The draft report would require companies to provide "a detailed summary of any performance requirements". The Government is aware in this regard that vesting scales which determine awards according to varying levels of performance play an increasingly important role in both executive share option schemes and long-term incentive plans. It believes that it is important that companies whose schemes use a vesting scale explain in detail how such scales will operate. This is an area where existing best practice guidance might usefully be developed further in the light of the new disclosure requirements.

3.31 The Greenbury Group also recommended that companies should disclose the main parameters and rationale for any annual bonus schemes. The Government agrees with this as a best practice principle, but, equally, it believes that it may be appropriate for companies to use parameters in such schemes that are commercially sensitive. It does not, therefore, intend to require companies to disclose such information.

3.32 The Government also shares the Greenbury Group's view that companies should provide an explanation of the division between basic and performance-related components. It therefore intends to require companies to explain the relative importance of those elements of each director's terms and conditions which are, or are not, related to performance

3.33 Many investors believe that it is important that companies disclose information in relation to: the potential value of awards to individual directors under long term schemes; the expected value at the onset of such awards; and the overall dilution limit. The Government agrees that these are important issues; and it is aware that some companies in 2001 either breached the Association of British Insurers' guideline that commitments under all share schemes should not exceed 10% of the issued share capital over any rolling ten year period, or failed to state the overall dilution limit. It

therefore seeks views as to whether it would be appropriate to require such information to be disclosed in the directors' remuneration report.

Q8: Do you agree that companies should not be permitted to withhold details of the performance criteria used in long term incentive schemes and executive share option schemes on the basis that such information is commercially confidential?

Q9: Do you agree that companies should not be permitted to withhold details of comparator group(s) of companies on the basis that such information is commercially confidential?

Q10: Do you agree that it would not be appropriate to require companies to disclose performance conditions in relation to annual bonuses?

Q11: Should there be disclosure requirements in relation to: (a) the potential value of awards to individual directors under long term schemes; (b) the expected value at the onset of such awards; and (c) the overall dilution limit? If so, should companies be permitted to select (and required to disclose) their own basis for calculating the value of future awards?

Performance graphs

3.34 Paragraph 4 of the directors' remuneration report would require a quoted company to produce one or more performance graphs comparing the company's performance over the last five years with that of a comparator company, a group of comparator companies or an index.

3.35 The requirement is broadly based on the requirement for a performance graph by the US Securities and Exchange Commission (SEC), but there would be significant differences to reflect the areas where British remuneration practice differs from US practice. The most important difference between British and US practice is the use in Great Britain of performance criteria specific to the company. The Government therefore proposes that British companies which operate a long term incentive scheme or share option scheme under which the directors' entitlement is subject to one or more performance conditions which involve comparison with external performance factors should be required to provide a line graph in respect of each relevant performance condition. Furthermore, it proposes that they should be required to state the name of the company, or companies, or index which has been used for purposes of comparison in respect of each performance condition, and to indicate on the line graph how the comparator company, companies or index have performed in respect of the relevant performance condition.

3.36 The Government believes that this approach would give the British disclosure requirement a sharper edge than the SEC requirement. Schedule A to the Combined Code recommends that companies should give consideration to performance criteria which reflect the company's performance relative to a group of comparator companies in some key variable such as total shareholder return.

The Government supports this recommendation; and it also accepts that the directors are best placed to select the criteria and comparator group which are most appropriate to their company. At the same time, it believes that the board should disclose to shareholders both the nature of those criteria, and the company's subsequent performance in relation to them. The proposed requirement for a performance graph would help to achieve this.

3.37 The Government proposes that, as is the case under the SEC requirement, each line graph should cover the previous five financial years. If the company is unable to provide a graph for this period, it will be required to set out the reasons for this, and provide a line graph which covers at least the previous three financial years. (The Government believes that this is appropriate, in view of the best practice recommendation in Schedule A to the Combined Code that, in normal circumstances, shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in under three years.)

3.38 The Government proposes that companies should be required to produce a graph in respect of each relevant performance condition that is a "comparison condition" for the purposes of paragraph 4. It accepts that this could result in some companies producing two or more performance graphs, but believes that this is justifiable in view of the importance of full transparency in this area. The graph(s) would be required:

- in respect of a share option scheme, if share options under the scheme were capable of exercise by a director in the relevant financial year;
- in respect of a long-term incentive scheme, if a director has a "scheme interest" that vested in that year. ("Scheme interest" is defined in paragraph 10(4) of the draft directors' remuneration report.)

3.39 Some British quoted companies do not operate schemes with such performance conditions. There would therefore need to be default requirement that such companies provide a graph relating to a stated criterion. The Government believes that, as under the SEC rules, the most appropriate default criterion would be total shareholder return. Sub-paragraphs 4(9)-(13) explain how total shareholder return would have to be calculated by such companies with respect to the performance graph. Companies would be required to produce a line graph which showed the total shareholder return on:

- (i) a holding of shares of that class of the company's equity share capital whose listing, or admission to dealing, had resulted in the company falling within the definition of "quoted company"; and
- (ii) a holding of hypothetical shares whose aggregate market price at any time is the amount at that time of a broad equity market index.

Companies would be permitted to select an index for the purposes of the graph; but would be required to set out the reasons for selecting that index. The graph would, in respect of such companies, be required to cover a five year period, except in circumstances where the company had been incorporated for a period of less than five years.

Q12: Do you agree that total shareholder return is the most appropriate default criterion for the performance graph?

Service contracts and compensation

3.40 Part 2 of the directors' remuneration report contains two separate disclosure requirements in respect of directors' service contracts:

- in the forward looking policy statement (paragraph 2), there is a requirement for the company to summarise, and explain, the company's policy on (a) the duration of contracts with directors; and (b) notice periods, and termination payments, under such contracts;
- in paragraph 5, there are provisions which would require quoted companies to:
 - (i) disclose certain details in respect of the contract of service, or the contract of services, of each person who had served as director of the company in the preceding financial year; and
 - (ii) provide an explanation for any significant award made in the preceding financial year to any person who was not a director of the company at the time the award was made but had previously been a director of the company.

Disclosure of each director's remuneration in the preceding financial year

3.41 The requirements in Part 3 of Schedule 7A concern the detailed disclosure of remuneration and other forms of benefit paid to directors and former directors in the preceding financial year. They draw heavily on the existing requirements in Part I of Schedule 6 to the Companies Act 1985 (particularly with regard to their interpretation) and in paragraph 12.43A of the Listing Rules (particularly with regard to the scope of the requirements). Much of the information is required to be presented in tabular form.

3.42 The disclosure requirements are summarised below.

(a) *Emoluments and compensation* (paragraph 6)

Companies would be required to report in respect of each director:

- the total amount of salary and fees paid to or receivable by the director in respect of qualifying services;
- the total amount of bonuses so paid or receivable;
- the total amount paid by way of expenses;

- the total amount of any compensation for loss of office and any other payments paid to or receivable by the director in connection with the termination of qualifying services;
- the total estimated value of any other benefits received by the director otherwise than in cash.

(b) *Share options* (paragraphs 7,8 and 9)

The information which would be required to be disclosed in respect of share options granted in respect of a director's qualifying services is set out in paragraph 8. The disclosure requirements in this area are largely intended to reproduce the effect of the Accounting Standards Board's Urgent Issues Task Force Abstract 10, but the Government is concerned that this should be achieved in such a way as to allow shareholders to understand the linkage between the award or exercise of a share option and the company's performance in respect of relevant performance criteria. Paragraph 9 would permit companies to aggregate certain information if, in the opinion of the directors, disclosure in accordance with paragraphs 7 and 8 would result in a disclosure of excessive length; however, aggregation would not be permitted in respect of share options that, during the relevant financial year, had been awarded or exercised or had had their terms and conditions varied.

(c) *Long term incentive schemes* (paragraphs 10 and 11)

The information which would be required to be disclosed in respect of long term incentive schemes is set out in paragraph 11. Once again, the Government is concerned that the disclosures should allow shareholders to understand the linkage between awards under the scheme (in particular, on the vesting of a "scheme interest", as defined in paragraph 10) and the company's performance in respect of relevant performance criteria.

(d) *Pensions* (paragraph 12)

Paragraph 12 sets out the proposed disclosure requirements in respect of pension rights under a defined benefit scheme and under a money purchase scheme.

(e) *Excess retirement benefits of directors and past directors* (paragraph 13)

Paragraph 13 would require the disclosure, in respect of each director, of the amount of so much of the retirement benefits paid to or receivable by the director as was in excess of the retirement benefit to which the director was entitled on the date on which benefits first became payable (or on 31 March 1997, if that date were later).

(f) *Compensation for past directors* (paragraph 14)

Paragraph 14 would require the disclosure of details of any significant award made to a past director, including (in particular) compensation in respect of loss of office. The disclosure would exclude any sums which had already been shown in the report under paragraph 6.

(g) Sums paid to third parties in respect of a director's services (paragraph 15)

Paragraph 15 would require the disclosure, in respect of each director, of the aggregate amount of any consideration (including benefits otherwise than in cash) paid to or receivable by third parties for making available the services of that person-

- as a director of the company, or
- while director of the company-
 - (i) as director of any of its subsidiary undertakings;
 - (ii) as director of any other undertaking of which he was (while director of the company) a director by virtue of the company's nomination (direct or indirect); or
 - (iii) otherwise than in connection with the management of the affairs of the company or any such other undertaking.

DRAFT

Draft regulations laid before each House of Parliament, under section 257(2) of the Companies Act 1985, for approval by resolution of each House of Parliament.

S T A T U T O R Y I N S T R U M E N T S

2002 No.**COMPANIES****The Directors' Remuneration Report Regulations 2002**

Made - - - - - 2002

Coming into force -- 2002

The Secretary of State, in exercise of the powers conferred upon him by section 257 of the Companies Act 1985 ⁽¹⁾ and of all other powers enabling him in that behalf hereby makes the following Regulations of which a draft has been laid before Parliament in accordance with section 257(2) of that Act and approved by a resolution of each House of Parliament:

Citation, commencement and interpretation

1. - (1) These Regulations may be cited as the Directors' Remuneration Report Regulations 2002.

(2) These Regulations shall come into force on [] 2002 and shall have effect as respects companies' financial years ending on or after 31st December 2002.

(3) In these Regulations, "the Act" means the Companies Act 1985.

Disclosure required in notes to accounts

2. - For section 232 (1) of the Act substitute-

"(1) The information specified in Schedule 6 shall be given in notes to a company's annual accounts, save that the information specified in paragraphs 2-14 in Part I of

⁽¹⁾ 1985 c.6; section 257 was substituted by sections 1 and 20 of the Companies Act 1989 (c.40).

Schedule 6 shall be given only in the case of a company which is not a quoted company. "

Directors' remuneration report

3. After section 234A of the Act, insert -

" Quoted companies: directors' remuneration report

234B Duty to prepare directors' remuneration report

(1) The directors of a quoted company shall for each financial year prepare a directors' remuneration report which shall contain the information specified in Schedule 7A and comply with any requirement of that Schedule as to how information is to be set out in the report.

(2) In Schedule 7A -

Part 1 is introductory,

Part 2 relates to information about remuneration committees, performance related remuneration and liabilities in respect of directors' contracts,

Part 3 relates to detailed information about directors' remuneration (information included under Part 3 is required to be reported on by the auditors, see section 235), and

Part 4 contains interpretative and supplementary provisions.

(3) In the case of any failure to comply with the provisions of this Part as to the preparation of a directors' remuneration report and the contents of the report, every person who was a director of the quoted company immediately before the end of the period for laying and delivering accounts and reports for the financial year in question is guilty of an offence and liable to a fine.

(4) In proceedings against a person for an offence under subsection (3) it is a defence for him to prove that he took all reasonable steps for securing compliance with the requirements in question.

(5) It is the duty of any director of a company, and any person who has at any time in the preceding five years been a director of the company, to give notice to the company of such matters relating to himself as may be necessary for the purposes of Parts 2 and 3 of Schedule 7A.

(6) A person who makes default in complying with subsection (5) commits an offence and is liable to a fine.

234C Approval and signing of directors' remuneration report

(1) The directors' remuneration report shall be approved by the board of directors and signed on behalf of the board by a director or the secretary of the company.

(2) Every copy of the directors' remuneration report which is laid before the company in general meeting, or which is otherwise circulated, published or issued, shall state the name of the person who signed it on behalf of the board.

(3) The copy of the directors' remuneration report which is delivered to the registrar shall be signed on behalf of the board by a director or the secretary of the company.

(4) If a copy of the directors' remuneration report-

(a) is laid before the company, or otherwise circulated, published or issued, without the report having been signed as required by this section or without the required statement of the signatory's name being included, or

(b) is delivered to the registrar without being signed as required by this section, the company and every officer of it who is in default is guilty of an offence and liable to a fine."

Auditors' report

4. In section 235 of the Act, after subsection (3) insert -

"(4) If a directors' remuneration report is prepared for the financial year for which the annual accounts are prepared -

(a) the auditors shall in their report also report to the company's members on the auditable part of the directors' remuneration report, and

(b) the auditors' report shall state whether in the auditors' opinion that part of the directors' remuneration report has been properly prepared in accordance with this Act.

(5) For the purposes of this Part, "the auditable part" of a directors' remuneration report is the part containing the information required by Part 3 of Schedule 7A."

Duties of auditors

5. In section 237(1) of the Act, after paragraph (b), insert "and

(c) (in the case of a quoted company) whether the auditable part of the company's directors' remuneration report is in agreement with the accounting records and returns."

6. For section 237(4) of the Act, substitute -

"(4) If -

(a) the requirements of Schedule 6 (disclosure of information: emoluments and other benefits of directors and others) are not complied with in the annual accounts, or

- (b) where a directors' remuneration report is required to be prepared, the requirements of Part 3 of Schedule 7A (directors' remuneration report) are not complied with in that report,

the auditors shall include in their report, so far as they are reasonably able to do so, a statement giving the required particulars."

Members' vote on directors' remuneration report

7.- After section 241 of the Act, insert -

"241A Members' approval of directors' remuneration report

- (1) This section applies to every company that is a quoted company immediately before the end of a financial year.
- (2) In this section "the meeting" means the general meeting of the company before which the company's annual accounts for the financial year are to be laid.
- (3) The company must, prior to the meeting, give to the members of the company entitled to be sent notice of the meeting notice of the intention to move at the meeting, as an ordinary resolution, a resolution approving the directors' remuneration report for the financial year.
- (4) Notice under subsection (3) shall be given to each such member in any manner permitted for the service on him of notice of the meeting.
- (5) The business that may be dealt with at the meeting includes the resolution.
- (6) The existing directors must ensure that the resolution is put to the vote of the meeting.
- (7) Subsection (5) has effect notwithstanding -
- (a) any default in complying with subsections (3) and (4);
 - (b) anything in the company's articles.
- (8) In the event of default in complying with the requirements of subsections (3) and (4), every officer of the company who is in default is liable to a fine.
- (9) If the resolution is not put to the vote of the meeting, each existing director is guilty of an offence and liable to a fine.
- (10) If an existing director is charged with an offence under subsection (9), it is a defence for him to prove that he took all reasonable steps for securing that the resolution was put to the vote of the meeting.
- (11) In this section "existing director" means a person who, immediately before the meeting, is a director of the company."

Provision of summary financial statement to shareholders

8. (1) Section 251 of the Act shall be amended as follows.

(2) For subsection (3) substitute -

"(3) The summary financial statement-

- (a) shall be derived from the company's annual accounts, the directors' report and (in the case of a quoted company) the directors' remuneration report, and
- (b) shall be in such form and contain such information as may be specified by regulations made by the Secretary of State."

(3) For subsection (4) substitute -

"(4) Every summary financial statement shall-

- (a) state that it is only a summary of information in the company's annual accounts, the directors' report and (in the case of a quoted company) the directors' remuneration report;
- (b) contain a statement by the company's auditors of their opinion as to whether the summary financial statement is consistent with those accounts and those reports and complies with the requirements of this section and regulations made under it;
- (c) state whether the auditors' report on the annual accounts, or on the annual accounts and the auditable part of the directors' remuneration report, was unqualified or qualified, and if it was qualified set out the report in full together with any further material needed to understand the qualification;
- (d) state whether that auditors' report contained a statement under -
 - (i) section 237(2) (accounting records or returns inadequate or accounts or directors' remuneration report not agreeing with records and returns); or
 - (ii) section 237(3) (failure to obtain necessary information and explanations),and if so, set out the statement in full."

Content of directors' remuneration report

9.- After Schedule 7 to the Act insert the Schedule 7A which is set out in the Schedule to these Regulations.

Minor and consequential amendments

10.- (1) The following minor and consequential amendments to the Act shall have effect.

(2) In section 237(2), after "the company's individual accounts are not in agreement with the accounting records and returns," insert " or if in the case of a quoted

company the auditable part of its directors' remuneration report is not in agreement with the accounting records and returns,".

(3) In section 238 (1), for " A copy of the company's annual accounts, together with a copy of the directors' report for that financial year and of the auditors' report on those accounts," substitute " A copy of each of the documents mentioned in subsection (1A)."

(4) In section 238, after subsection (1), insert -

"(1A) Those documents are -

- (a) the company's annual accounts for the financial year,
- (b) the directors' report for that financial year,
- (c) (in the case of a quoted company) the directors' remuneration report for that financial year, and
- (d) the auditors' report on those accounts or (in the case of a quoted company) on those accounts and the auditable part of the directors' remuneration report."

(5) In section 238(4A), for " a company's annual accounts, of the directors' report and of the auditors' report" substitute "copies of the documents mentioned in subsection (1A)."

(6) In section 239 (1), for the words after "without charge," substitute " with a copy of -

- (a) the company's last annual accounts,
- (b) the last directors' report,
- (c) (in the case of a quoted company) the last directors' remuneration report, and
- (d) the auditors' report on those accounts or (in the case of a quoted company) on those accounts and the auditable part of the directors' remuneration report for the financial year for which those accounts are prepared."

(7) In section 241 (1), for the words after "lay before the company in general meeting" substitute "copies of –

- (a) the company's annual accounts,
- (b) the directors' report,
- (c) (in the case of a quoted company) the directors' remuneration report, and
- (d) the auditors' report on those accounts or (in the case of a quoted company) on those accounts and the auditable part of the directors' remuneration report."

(8) In section 242(1), for the words after "deliver to the registrar" substitute " a copy of -

- (a) the company's annual accounts,
- (b) the directors' report,

- (c) (in the case of a quoted company) the directors' remuneration report, and
- (d) the auditors' report on those accounts or (in the case of a quoted company) on those accounts and the auditable part of the directors' remuneration report."

(9) In section 245-

- (a) in subsection (1), after "directors' report" insert " or directors' remuneration report"; and
- (b) in subsection (3), insert "or a revised directors' remuneration report" after "a revised directors' report".

(10) In section 245B(3)(b) after the words " directors' report" insert ", directors' remuneration report".

(11) In section 262(1), after the definition of "qualified" insert-

"quoted company" means a company whose equity share capital -

- (a) has been included in the official list in accordance with the provisions of Part VI of the Financial Services and Markets Act 2000; or
- (b) is officially listed in an EEA State; or
- (c) is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq;

and in paragraph (a) "the official list" shall have the meaning given it by section 103(1) of the Financial Services and Markets Act 2000;".

(12) In section 262A, after the entry for "associated undertaking" insert -

"auditable part (of a section 235(5) directors' remuneration report)

and, after the entry for "qualified" insert-

"quoted company section 262(1)".

(13) In Schedule 6 -

(a) after the heading for Part 1 (and before the italic heading for paragraph 1) insert

"CHAPTER 1
PROVISIONS APPLYING TO QUOTED AND UNQUOTED COMPANIES";

(b) in paragraph 1(2), for "In the case of a company which is not a listed company" substitute "In the case of a company which is not a quoted company and whose equity share capital is not listed on the market known as AIM";

(c) in paragraph 1(5), omit the definition of "listed company"; and

(d) after paragraph 1 (and before the italic heading for paragraph 2) insert-

"CHAPTER 2
PROVISIONS APPLYING ONLY TO UNQUOTED COMPANIES".

(14) Schedule 24 [the summary of offence provisions will be amended to reflect the relevant substantive provisions.]

[] 2002

Parliamentary Under-Secretary of State
for Corporate and Consumer Affairs,
Department of Trade and Industry

SCHEDULE

"Section 234B

SCHEDULE 7A

DIRECTORS' REMUNERATION REPORT

PART 1 INTRODUCTORY

1.- (1) In the directors' remuneration report for a financial year ("the relevant financial year") there shall be shown the information specified in Parts 2 and 3 below.

(2) Information required to be shown in the report for or in respect of a particular person shall be shown in the report in a manner that links the information to that person identified by name.

PART 2 INFORMATION NOT SUBJECT TO AUDIT

Consideration by the directors of matters relating to directors' remuneration

2.- (1) If a committee of the company's directors has considered matters relating to the directors' remuneration for the relevant financial year, the directors' remuneration report shall -

- (a) name each director who was a member of the committee at any time when the committee was considering any such matter;
- (b) state whether the directors of the company accepted without substantial amendment the recommendations (if any) of the committee and, if not, provide particulars of any recommendations that were not accepted; and
- (c) name any person who provided to the committee advice, or services, that materially assisted the committee in their consideration of any such matter.

(2) In sub-paragraph (1)(c) "person" includes (in particular) any director of the company who does not fall within sub-paragraph (1)(a).

Statement of company's policy on directors' remuneration

3.- (1) The directors' remuneration report shall contain a statement of the company's policy on directors' remuneration for the following financial year and for financial years subsequent to that.

(2) The policy statement shall include the particulars set out in sub-paragraphs (3), (4) and (5).

(3) The policy statement shall include -

- (a) for each director, a detailed summary of any performance conditions to which any entitlement of the director -
 - (i) to share options, or

- (ii) under a long-term incentive scheme, is subject;
- (b) an explanation as to why any such performance conditions were chosen;
- (c) a summary of the methods to be used in assessing whether any such performance conditions are met and an explanation as to why those methods were chosen;
- (d) if any such performance condition involves any comparison with factors external to the company -
 - (i) a summary of the factors to be used in making each such comparison, and
 - (ii) if any of the factors relates to the performance of another company, of two or more other companies or of an index on which the securities of a company or companies are listed, the identity of that company, of each of those companies or of the index;
- (e) a description of, and an explanation for, any significant amendment proposed to be made to the terms and conditions of any entitlement of a director to share options or under a long term incentive scheme; and
- (f) if any entitlement of a director to share options, or under a long-term incentive scheme, is not subject to performance conditions, an explanation as to why that is the case.

(4) The policy statement shall, in respect of each director's terms and conditions relating to remuneration, explain the relative importance of those elements which are, and those which are not, related to performance.

(5) The policy statement shall summarise, and explain, the company's policy on -

- (a) the duration of contracts with directors, and
- (b) notice periods, and termination payments, under such contracts.

(6) In sub-paragraphs (3) and (4), references to a director are to any person who serves as a director of the company at any time in the period beginning with the end of the relevant financial year and ending with date on which the directors' remuneration report is laid before the company in general meeting.

Performance Graph

4.- (1) For the purposes of this paragraph-

(a) "relevant performance condition" means a performance condition to which a director's entitlement -

- (i) to share options under a relevant share option scheme, or
- (ii) under a relevant long-term incentive scheme,

is subject, and here "director" means a person who has served as a director of the company at any time during the relevant financial year;

(b) "relevant share option scheme" means a share option scheme in respect of which the following conditions are met-

(i) the scheme provides for the award of share options to directors of the company, and

(ii) share options under the scheme are capable of exercise in the relevant financial year by a person who has served as a director of the company at any time during that year;

(c) "relevant long-term incentive scheme" means a long-term incentive scheme under which a person who has served as a director of the company at any time in the relevant financial year has a scheme interest that vests in that year, and here "scheme interest" and "vests" have the meaning given by paragraph 10(4); and

(d) "comparison condition" means a performance condition that involves comparison with factors relating to the performance of one or more other companies or relating to the performance of an index.

(2) For each relevant performance condition that is a comparison condition, the directors' remuneration report shall contain a line graph that shows for each of -

(a) the company itself, and

(b) the comparator company or companies or index,

a line drawn by joining up points plotted to represent, for each of the previous five financial years, the performance of that company or index.

(3) The line graph, or notes to it, shall state the name of the comparator company or of each of the comparator companies or index.

(4) If the company is unable to provide a graph that (apart from this sub-paragraph) is required by sub-paragraph (2), the directors' remuneration report shall-

(a) set out the reasons for this; and

(b) instead contain a corresponding line graph covering as much as possible of the previous five financial years but at least covering the previous three financial years.

(5) Sub-paragraph (6) applies if -

(a) the directors' remuneration report contains a graph under sub-paragraph (4) in place of one that would otherwise have been required under sub-paragraph (2), or

(b) any relevant performance condition is not a comparison condition, or

(c) the company does not have any relevant performance conditions.

(6) The directors' remuneration report shall -

(a) contain a line graph that shows for each of -

(i) a holding of shares of that class of the company's equity share capital whose listing, or admission to dealing, has resulted in the company falling within the definition of "quoted company", and

(ii) a holding of hypothetical shares whose aggregate market price at any time is the amount at that time of a broad equity market index,

a line drawn by joining up points plotted to represent, for each of the five relevant periods, the total shareholder return on that holding;

(b) state, and explain, why the report is required to contain the graph; and

(c) state the name of the index selected for the purposes of the graph and set out the reasons for selecting that index.

(7) For the purposes of sub-paragraphs (6) and (9), "relevant period" means -

(a) the five financial years of which the last is the relevant financial year,

(b) the first four of those five years;

(c) the first three of those five years;

(d) the first two of those five years; or

(e) the first of those five years.

(8) Where the relevant financial year is the company's second, third or fourth financial year, sub-paragraph (7) has effect with -

(a) the substitution of "two", "three" or "four" (as the case may be) for "five", and

(b) with the omission (as the case may be) of paragraphs (b) to (d), paragraphs (b) and (c) or paragraph (b);

and where the relevant financial year is the company's first financial year "relevant period", for the purposes of sub-paragraphs (6) and (9), means the relevant financial year;

(9) For the purposes of sub-paragraph (6), the "total shareholder return" for a relevant period on a holding of shares or a holding of hypothetical shares must be calculated using a fair method that -

(a) takes as its starting point the percentage change over the period in the market price of the holding;

(b) involves making -

(i) the assumptions specified in sub-paragraph (10) as to reinvestment of income, and

(ii) the assumption specified in sub-paragraph (12) as to the funding of liabilities; and

(c) makes provision for any replacement of shares in the holding by shares of a different description;

and the same method must be used for each of the holdings mentioned in sub-paragraph (6).

(10) The assumptions as to reinvestment of income are -

(a) that any benefit in the form of shares of the same kind as those in the holding is added to the holding at the time the benefit becomes receivable; and

(b) that any benefit in cash, and an amount equal to the value of any benefit not in cash and not falling within paragraph (a), is applied at the time the benefit becomes receivable in the purchase at their market price of shares of the same kind as those in the holding and that the shares purchased are added to the holding at that time.

(11) In sub-paragraph (10) "benefit" means any benefit (including, in particular, any dividend) receivable in respect of any shares in the holding by the holder from the company of whose share capital the shares form part.

(12) The assumption as to the funding of liabilities is that, where the holder has a liability to the company of whose capital the shares in the holding form part, shares are sold from the holding -

(a) immediately before the time by which the liability is due to be satisfied, and

(b) in such numbers that, at the time of the sale, the market price of the shares sold equals the amount of the liability in respect of the shares in the holding that are not being sold.

(13) In sub-paragraph (12) "liability" means a liability arising in respect of any shares in the holding or from the exercise of a right attached to any of those shares.

Service contracts

5(1) The directors' remuneration report shall contain, in respect of the contract of service or contract for services of each person who has served as a director of the company at any time during the relevant financial year, the following information:

(a) the date of the contract, the unexpired term and the details of any notice periods;

(b) any provision for compensation payable upon early termination of the contract; and

(c) such details of other provisions in the contract as are necessary to enable members of the company to estimate the liability of the company in the event of early termination of the contract.

(2) The directors' remuneration report shall contain an explanation for any significant award made to a person in the circumstances described in paragraph 14.

PART 3
INFORMATION SUBJECT TO AUDIT

Amount of each director's emoluments and compensation in the preceding financial year

6.- (1) The directors' remuneration report shall for the relevant financial year show, for each person who has served as a director of the company at any time during that year, each of the following-

(a) the total amount of salary and fees paid to or receivable by the person in respect of qualifying services;

(b) the total amount of bonuses so paid or receivable;

(c) the total amount of sums paid by way of expenses allowance that are -

(i) chargeable to United Kingdom income tax (or would be if the person were an individual); and

(ii) paid to or receivable by the person in respect of qualifying services;

(d) the total amount of -

(i) any compensation for loss of office paid to or receivable by the person, and

(ii) any other payments paid to or receivable by the person in connection with the termination of qualifying services;

(e) the total estimated value of any benefits received by the person otherwise than in cash that -

(i) do not fall within any of sub-paragraphs (a) - (d) or paragraphs 7-11 below,

(ii) are emoluments of the person, and

(iii) are received by the person in respect of qualifying services; and

(f) the amount that is the total of the sums mentioned in paragraphs (a) to (e).

(2) The directors' remuneration report shall show, for each person who has served as a director of the company at any time during the relevant financial year, the amount that for the financial year preceding the relevant financial year is the total of the sums mentioned in paragraphs (a) to (e) of sub-paragraph (1).

(3) The directors' remuneration report shall also state the nature of any element of a remuneration package which is not cash.

(4) The information required by sub-paragraphs (1) and (2) shall be presented in tabular form.

Share options

7. (1) The directors' remuneration report shall contain, in respect of each person who has served as a director of the company at any time in the relevant financial year, the information specified in paragraph 8.

(2) Sub-paragraph (1) is subject to paragraph 9 (aggregation of information to avoid excessively lengthy reports).

(3) The information specified in paragraphs (a) to (c) of paragraph 8 shall be presented in tabular form in the report.

(4) In paragraph 8 "share option", in relation to a person, means a share option granted in respect of qualifying services of the person.

8. The information required by sub-paragraph (1) of paragraph 7 in respect of such a person as is mentioned in that sub-paragraph is -

(a) the number of shares that are subject to a share option -

(i) at the beginning of the relevant financial year or, if later, on the date of the appointment of the person as a director of the company, and

(ii) at the end of the relevant financial year or, if earlier, on the cessation of the person's appointment as a director of the company,

in each case differentiating between share options having different terms and conditions;

(b) information identifying those share options that have been awarded in the relevant financial year, those that have been exercised in that year, those that in that year have expired unexercised and those whose terms and conditions have been varied in that year;

(c) for each share option that is unexpired at any time in the relevant financial year-

(i) the price paid, if any, for its award,

(ii) the exercise price,

(iii) the date from which the option may be exercised, and

(iv) the date on which the option expires;

(d) a description of any variation made in the relevant financial year in the terms and conditions of a share option;

(e) a summary of any performance criteria upon which the award or exercise of a share option is conditional, including a description of any variation made in such performance criteria during the relevant financial year;

(f) for each share option that has been exercised during the relevant financial year, the market price of the shares, in relation to which it is exercised, at the time of exercise; and

(g) for each share option that is unexpired at the end of the relevant financial year -

- (i) the market price at the end of that year, and
- (ii) the highest and lowest market prices during that year,

of each share that is subject to the option.

9. (1) If, in the opinion of the directors of the company, disclosure in accordance with paragraphs 7 and 8 would result in a disclosure of excessive length then, (subject to sub-paragraphs (2) and (3)) -

- (a) information disclosed for a person under paragraph 8(a) need not differentiate between share options having different terms and conditions;
- (b) for the purposes of disclosure in respect of a person under paragraph 8 (c)(i) and (ii) and (g), share options may be aggregated and (instead of disclosing prices for each share option) disclosure may be made of weighted average prices of aggregations of share options;
- (c) for the purposes of disclosure in respect of a person under paragraph 8 (c) (iii) and (iv), share options may be aggregated and (instead of disclosing dates for each share option) disclosure may be made of ranges of dates for aggregation of share options.

(2) Sub-paragraph (1)(b) and (c) does not permit the aggregation of -

- (a) share options in respect of shares whose market price at the end of the relevant financial year is below the option exercise price, with
- (b) share options in respect of shares whose market price at the end of the relevant financial year is equal to, or exceeds, the option exercise price.

(3) Subparagraph (1) does not apply (and accordingly, full disclosure must be made in accordance with paragraphs 7 and 8) in respect of share options that during the relevant financial year have been awarded or exercised or had their terms and conditions varied.

Long term incentive schemes

10. (1) The directors' remuneration report shall contain, in respect of each person who has served as a director of the company at any time in the relevant financial year, the information specified in paragraph 11.

(2) Sub-paragraph (1) does not require the report to contain share option details that are contained in the report in compliance with paragraphs 7 to 9.

(3) The information specified in paragraph 11 shall be presented in tabular form in the report.

(4) For the purposes of paragraph 11-

- (a) "scheme interest", in relation to a person, means an interest under a long term incentive scheme that is an interest in respect of which assets may become receivable under the scheme in respect of qualifying services of the person; and
- (b) such an interest "vests" at the earliest time when-

- (i) it has been ascertained that the qualifying conditions have been fulfilled, and
- (ii) the nature and quantity of the assets receivable under the scheme in respect of the interest have been ascertained.

(5) In this Schedule "long term incentive scheme" means any agreement or arrangement under which money or other assets may become receivable by a person and which includes one or more qualifying conditions with respect to service or performance that cannot be fulfilled within a single financial year, and for this purpose the following shall be disregarded, namely -

- (a) any bonus the amount of which falls to be determined by reference to service or performance within a single financial year;
- (b) compensation in respect of loss of office, payments for breach of contract and other termination payments; and
- (c) retirement benefits.

11. (1) The information required by sub-paragraph (1) of paragraph 10 in respect of such a person as is mentioned in that sub-paragraph is-

- (a) details of the scheme interests that the person has at the beginning of the relevant financial year or if later on the date of the appointment of the person as a director of the company;
- (b) details of the scheme interests awarded to the person during the relevant financial year;
- (c) details of the scheme interests that the person has at the end of the relevant financial year or if earlier on the cessation of the person's appointment as a director of the company;
- (d) for each scheme interest within paragraphs (a) to (c), the end of the period over which the qualifying conditions for that interest have to be fulfilled (or if there are different periods for different conditions, the end of whichever of those periods ends last); and
- (e) for each scheme interest that has vested in the relevant financial year -
 - (i) the relevant details (see sub-paragraph (3)) of any shares,
 - (ii) the amount of any money, and
 - (iii) the value of any other assets,that have become receivable in respect of the interest.

(2) The details that sub-paragraph (1)(b) requires of a scheme interest awarded during the relevant financial year include, if shares may become receivable in respect of the interest, the following -

- (a) the number of those shares;
- (b) the market price of each of those shares when the scheme interest was awarded; and
- (c) details of qualifying conditions that are conditions with respect to performance.

(3) In sub-paragraph (1)(e)(i) "the relevant details", in relation to any shares that have become receivable in respect of a scheme interest, means-

- (a) the number of those shares;
- (b) the date on which the scheme interest was awarded;
- (c) the market price of each of those shares when the scheme interest was awarded;
- (d) the market price of each of those shares when the scheme interest vested; and
- (e) details of qualifying conditions that were conditions with respect to performance.

Pensions

12. (1) The directors' remuneration report shall, for each person who has served as a director of the company at any time during the relevant financial year, contain the information in respect of pensions that is specified in sub-paragraphs (2) and (3).

(2) Where the person has rights under a pension scheme that is a defined benefit scheme in relation to the person and any of those rights are rights to which he has become entitled in respect of qualifying services of his-

(a) details -

(i) of any changes during the relevant financial year in the person's accrued benefits under the scheme, and

(ii) of the person's accrued benefits under the scheme as at the end of that year;

(b) the transfer value, calculated in a manner consistent with "Retirement Benefit Schemes - Transfer Values (GN 11)" published by the Institute of Actuaries and the Faculty of Actuaries and dated [date of version current when regulations made], of the person's accrued benefits under the scheme at the end of the relevant financial year;

(c) the transfer value of the person's accrued benefits under the scheme that in compliance with paragraph (b) was contained in the director's remuneration report for the previous financial year or, if there was no such report or no such value was contained in that report, the transfer value, calculated in such a manner as is mentioned in paragraph (b), of the person's accrued benefits under the scheme at the beginning of the relevant financial year;

(d) the amount obtained by subtracting -

(i) the transfer value of the person's accrued benefits under the scheme that is required to be contained in the report by paragraph (b), from

(ii) the transfer value of those benefits that is required to be contained in the report by paragraph (c),

and then subtracting from the result of that calculation the amount of any contributions made to the scheme by the person in the relevant financial year.

(3) Where -

(a) the person has rights under a pension scheme that is a money purchase scheme in relation to the person, and

(b) any of those rights are rights to which he has become entitled in respect of qualifying services of his,

details of any contribution to the scheme in respect of the person that is paid or payable by the company for the relevant financial year or paid by the company in that year for another financial year.

Excess retirement benefits of directors and past directors

13. (1) Subject to sub-paragraph (3), the directors' remuneration report shall show in respect of each person who has served as a director of the company -

- (a) at any time during the relevant financial year, or
- (b) at any time before the beginning of that year,

the amount of so much of retirement benefits paid to or receivable by the person under pension schemes as is in excess of the retirement benefits to which he was entitled on the date on which the benefits first became payable or 31st March 1997, whichever is the later.

(2) In subsection (1) "retirement benefits" means retirement benefits to which the person became entitled in respect of qualifying services of his.

(3) Amounts paid or receivable under a pension scheme need not be included in an amount required to be shown under sub-paragraph (1) if—

- (a) the funding of the scheme was such that the amounts were or, as the case may be, could have been paid without recourse to additional contributions; and
- (b) amounts were paid to or receivable by all pensioner members of the scheme on the same basis;

and in this sub-paragraph "pensioner member", in relation to a pension scheme, means any person who is entitled to the present payment of retirement benefits under the scheme.

(4) In this paragraph—

- (a) references to retirement benefits include benefits otherwise than in cash; and
- (b) in relation to so much of retirement benefits as consists of a benefit otherwise than in cash, references to their amount are to the estimated money value of the benefit; and the nature of any such benefit shall also be shown in the report.

Compensation for past directors

14. The directors' remuneration report shall contain details of any significant award made in the relevant financial year to any person who was not a director of the company at the time the award was made but had previously been a director of the company, including (in particular) compensation in respect of loss of office and pensions but excluding any sums which have already been shown in the report under paragraph 6(1)(d).

Sums paid to third parties in respect of a director's services

15. (1) The directors' remuneration report shall show, in respect of each person who served as a director of the company at any time during the relevant financial year, the aggregate amount of any consideration paid to or receivable by third parties for making available the services of the person —

- (a) as a director of the company, or
- (b) while director of the company—
 - (i) as director of any of its subsidiary undertakings, or
 - (ii) as director of any other undertaking of which he was (while director of the company) a director by virtue of the company's nomination (direct or indirect), or
 - (iii) otherwise in connection with the management of the affairs of the company or any such other undertaking.

(2) The reference to consideration includes benefits otherwise than in cash; and in relation to such consideration the reference to its amount is to the estimated money value of the benefit.

The nature of any such consideration shall be shown in the report.

(3) The reference to third parties is to persons other than—

(a) the person himself or a person connected with him or body corporate controlled by him, and

(b) the company or any such other undertaking as is mentioned in sub-paragraph

(1)(b)(ii).

PART 4 INTERPRETATION AND SUPPLEMENTARY

16. (1) In this Schedule -

"amount", in relation to a gain made on the exercise of a share option, means the difference between—

(a) the market price of the shares on the day on which the option was exercised; and

(b) the price actually paid for the shares;

"company contributions", in relation to a pension scheme and a person, means any payments (including insurance premiums) made, or treated as made, to the scheme in respect of the person by anyone other than the person;

"defined benefit scheme", in relation to a person, means a pension scheme which is not a money purchase scheme in relation to the person;

"emoluments" of a person -

(a) includes salary, fees and bonuses, sums paid by way of expenses allowance (so far as they are chargeable to United Kingdom income tax or would be if the person were an individual) but,

(b) does not include any of the following, namely—

(i) the value of any share options granted to him or the amount of any gains made on the exercise of any such options;

(ii) any company contributions paid, or treated as paid, in respect of him under any pension scheme or any benefits to which he is entitled under any such scheme; or

(iii) any money or other assets paid to or received or receivable by him under any long term incentive scheme;

"long term incentive scheme" has the meaning given by paragraph 10(5);

"money purchase benefits", in relation to a person, means retirement benefits the rate or amount of which is calculated by reference to payments made, or treated as made, by the person or by any other person in respect of that person and which are not average salary benefits;

"money purchase scheme", in relation to a person, means a pension scheme under which all of the benefits that may become payable to or in respect of the person are money purchase benefits in relation to the person;

"pension scheme" means a retirement benefits scheme within the meaning given by section 611 of the Income and Corporation Taxes Act 1988;

"qualifying services", in relation to any person, means his services as a director of the company, and his services at any time while he is a director of the company—

(a) as a director of an undertaking that is a subsidiary undertaking of the company at that time;

(b) as a director of any other undertaking of which he is a director by virtue of the company's nomination (direct or indirect); or

(c) otherwise in connection with the management of the affairs of the company or any such subsidiary undertaking or any such other undertaking;

"retirement benefits" means relevant benefits within the meaning given by section 612(1) of the Income and Corporation Taxes Act 1988;

"shares" means shares (whether allotted or not) in the company, or any undertaking which is a group undertaking in relation to the company, and includes a share warrant as defined by section 188(1);

"share option" means a right to acquire shares;

"value", in relation to shares received or receivable on any day by a person who is or has been a director of the company, means the market price of the shares on that day.

(2) In this Schedule "compensation in respect of loss of office" includes compensation received or receivable by a person for—

(a) loss of office as director of the company, or

(b) loss, while director of the company or on or in connection with his ceasing to be a director of it, of—

(i) any other office in connection with the management of the company's affairs, or

(ii) any office as director or otherwise in connection with the management of the affairs of any undertaking that, immediately before the loss, is a subsidiary undertaking of the company or an undertaking of which he is a director by virtue of the company's nomination (direct or indirect);

(c) compensation in consideration for, or in connection with, a person's retirement from office; and

(d) where such a retirement is occasioned by a breach of the person's contract with the company or with an undertaking that, immediately before the breach, is a subsidiary undertaking of the company or an undertaking of which he is a director by virtue of the company's nomination (direct or indirect) —

(i) payments made by way of damages for the breach; or

(ii) payments made by way of settlement or compromise of any claim in respect of the breach.

(3) References in this Schedule to compensation include benefits otherwise than in cash; and in relation to such compensation references in this Schedule to its amount are to the estimated money value of the benefit.

(4) References in this Schedule to a person being "connected" with a director, and to a director "controlling" a body corporate, shall be construed in accordance with section 346.

17. (1) For the purposes of this Schedule emoluments paid or receivable or share options granted in respect of a person's accepting office as a director shall be treated as emoluments paid or receivable or share options granted in respect of his services as a director.

(2) Where a pension scheme provides for any benefits that may become payable to or in respect of a person to be to be whichever are the greater of —

(a) such benefits determined by or under the scheme as are money purchase benefits in relation to the person; and

(b) such retirement benefits determined by or under the scheme to be payable to or in respect of the person as are not money purchase benefits in relation to the person, the company may assume for the purposes of this Schedule that those benefits will be money purchase benefits in relation to the person, or not, according to whichever appears more likely at the end of the relevant financial year.

(3) In determining for the purposes of this Schedule whether a pension scheme is a money purchase scheme in relation to a person or a defined benefit scheme in relation to a person, any death in service benefits provided for by the scheme shall be disregarded.

18. (1) The following applies with respect to the amounts to be shown under this Schedule.

(2) The amount in each case includes all relevant sums paid by or receivable from—

(a) the company; and

(b) the company's subsidiary undertakings; and

(c) any other person,

except sums to be accounted for to the company or any of its subsidiary undertakings or any other undertaking of which any person has been a director while director of the company, by virtue of sections 314 and 315 of this Act (duty of directors to make disclosure on company takeover; consequence of non-compliance), to past or present members of the company or any of its subsidiaries or any class of those members.

(3) References to amounts paid to or receivable by a person include amounts paid to or receivable by a person connected with him or a body corporate controlled by him (but not so as to require an amount to be counted twice).

19. (1) The amounts to be shown for any financial year under Part 3 of this Schedule are the sums receivable in respect of that year (whenever paid) or, in the case of sums not receivable in respect of a period, the sums paid during that year.

(2) But where—

(a) any sums are not shown in the directors' remuneration report for the relevant financial year on the ground that the person receiving them is liable to account for them as mentioned in paragraph 18(2), but the liability is thereafter wholly or partly released or is not enforced within a period of 2 years; or

(b) any sums paid by way of expenses allowance are charged to United Kingdom income tax after the end of the relevant financial year or, in the case of any such sums paid otherwise than to an individual, it does not become clear until the end of the

relevant financial year that those sums would be charged to such tax were the person an individual,

those sums shall, to the extent to which the liability is released or not enforced or they are charged as mentioned above (as the case may be), be shown in the first directors' remuneration report in which it is practicable to show them and shall be distinguished from the amounts to be shown apart from this provision.

20. Where it is necessary to do so for the purpose of making any distinction required by the preceding paragraphs in an amount to be shown in compliance with this Part of this Schedule, the directors may apportion any payments between the matters in respect of which these have been paid or are receivable in such manner as they think appropriate.

21. This Schedule requires information to be given only so far as it is contained in the company's books and papers, available to members of the public or the company has the right to obtain it. "

EXPLANATORY NOTE

(This note is not part of the Regulations)

Schedule 6 of the Companies Act 1985 requires a company to produce certain information concerning directors' remuneration by way of notes to the company's accounts. These regulations exempt a quoted company from most of the requirements contained in Part I of Schedule 6 and instead require such a company to set out a large part of the information concerning directors' remuneration in the directors' remuneration report. Part I of Schedule 6 will continue to apply to companies which are not quoted and Parts II and III of that Schedule will apply to both quoted and unquoted companies.

A quoted company is defined in regulation 10 as a company whose equity share capital has been included in the official list in accordance with the provisions of Part VI of the Financial Services and Markets Act 2000, is officially listed in an EEA State or is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq.

The directors of a quoted company are required to produce for each financial year a directors' remuneration report which shall be approved by the board of directors and signed on behalf of the directors by a director or the secretary of the company.

The company's auditors are to report to the company as to whether that part of the directors' remuneration report which contains the information required by Part 3 of Schedule 7A has been properly prepared in accordance with the Companies Act 1985. To the extent that the requirements of Schedule 6 or Part 3 of Schedule 7A are not complied with the auditors shall include in their report, so far as they are reasonably able to do so, a statement giving the required particulars.

A copy of the directors' remuneration report is to be sent to each member of the company, every holder of the company's debentures and every person who is entitled to receive notice of general meetings. If the quoted company is also a listed company, to which section 251 Companies Act 1985 applies, then it may send to those persons a summary financial statement instead of the accounts, directors' report and directors' remuneration report. The content of the summary financial statement is set out in the Companies (Summary Financial Statement) Regulations 1995 (SI 1995/2092) and it is proposed to amend those regulations to set out those elements of the directors' remuneration report which are to be summarised in the summary financial statement.

Regulation 7 inserts a new section 241A into the Companies Act 1985 which requires that a resolution approving the directors' remuneration report for the financial year is moved as an ordinary resolution at the general meeting of the company before which the company's annual accounts for the financial year are laid.

A quoted company is, in addition, required to deliver a copy of the directors' remuneration report to the Registrar of Companies.

Part 2 of Schedule 7A requires information concerning four areas. First, circumstances surrounding the consideration by the directors of matters pertaining to directors' remuneration. Second, a statement of the company's policy on directors' remuneration for the following financial year. Third, a performance graph which either compares the company's performance, during the relevant period, with the performance of a group of companies, selected by the company for the purpose of structuring the share options or long term incentive plans of directors, or which sets out the total shareholder return of the company on the class of equity share capital, if any, which caused the company to fall within the definition of "quoted company". Finally, Part 2 requires certain information to be set out concerning each director's contract of service or contract for services.

Part 3 of Schedule 7A requires detailed information to be set out concerning the emoluments, share options, long term incentive plans, pensions, compensation and excess retirement benefits of each director and, in some cases, of past directors as well.

2002 No.

COMPANIES

The Directors' Remuneration Report Regulations 2002

DRAFT

 STATUTORY INSTRUMENTS

2002 No.

COMPANIES

Companies (Summary Financial Statement) Amendment Regulations 2002

<i>Made - - - - -</i>	2002
<i>Laid before Parliament ---</i>	2002
<i>Coming into force --</i>	2002

The Secretary of State, in exercise of the powers conferred upon him by section 251(3) of the Companies Act 1985 ⁽²⁾ and of all other powers enabling him in that behalf hereby makes the following Regulations:-

Citation, commencement and interpretation

1. - (1) These Regulations may be cited as the Companies (Summary Financial Statement) Amendment Regulations 2002.

(2) These Regulations shall come into force on [] 2002 and shall have effect as respects companies' financial years ending on or after 31st December 2002.

(3) In these Regulations -

"the Act" means the Companies Act 1985;

"directors' remuneration report" shall have the meaning given to it in the Directors' Remuneration Report Regulations 2002 ^(b);

"the Regulations" means the Companies (Summary Financial Statement) Regulations 1995^(c); and

"Schedule 6" means Schedule 6 to the Act (disclosure of information: emoluments and other benefits of directors and others)^(d).

⁽²⁾ 1985 c.6; section 251 was inserted by section 15 of the Companies Act 1989 (c.40) and amended by the Directors Remuneration Report Regulations 2002 S.I. 2002/ .

^(b) The Directors' Remuneration Report Regulations 2002 S.I. 2002/ ..

^(c) S.I. 1995/2092.

^(d) Schedule 6 was substituted by section 6(4) of , and Schedule 4 to, the Companies Act 1989 (c.40) and amended by S.I. 1997/570.

Interpretation

2. In regulation 2 of the Regulations -

(1) Between the definitions of "banking company" and "EEA State", insert

"Directors' Remuneration Report Regulations" means the Directors' Remuneration Report Regulations 2002 S.I. 2002/ ;".

(2) In the definition of "full accounts and reports", insert ",the directors' remuneration report (if any)" after the words "the directors' report" in the first place where it occurs and for the words "group accounts or directors' report" substitute "group accounts, directors' report or directors' remuneration report".

Provisions applying to all companies and groups

3. In regulation 7-

(1) in paragraph (3) after "state of affairs of the company" insert ",and of its policies and arrangements concerning directors' remuneration,"; and

(2) in paragraph (4) after "state of affairs of the company or of the group" insert ", and of their policies and arrangements concerning directors' remuneration,".

Form of summary financial statement

4. In Schedule 1 to the Regulations, in subparagraph 1(2) for "the company's annual accounts and the directors' report" substitute " the company's annual accounts, the directors' remuneration report (if any) and the directors' report".

Form and content of summary financial statement of companies and groups other than banking or insurance companies and groups

5. - In Schedule 1 to the Regulations-

(1)Insert after paragraph 2 -

" Summary of paragraph 1(1) of Schedule 6 and of the directors' remuneration report

2A. The summary financial statement shall contain the whole of, or a summary of -

(a) that portion of the notes to the accounts for the year in question which set out the information required by paragraph 1(1) of Part I of Schedule 6 (*Aggregate amount of directors' emoluments etc*); and

(b) to the extent that the company is required to produce a directors' remuneration report, those portions of the directors' remuneration report for the year in question which set out the matters required by paragraphs 3 (*Statement of company's policy on*

directors' remuneration) and 4 (*Performance Graph*) of the Schedule to the Directors' Remuneration Report Regulations.";

(2) Omit paragraph 3 (4); and

(3) In paragraph 7 before "the corresponding amount" insert "or summary of paragraph 1(1) of Schedule 6 and of the directors' remuneration report".

Form and content of summary financial statement of banking companies and groups

6. In Schedule 2 to the Regulations-

(1) Insert after paragraph 2 -

"Summary of paragraph 1(1) of Schedule 6 and of the directors' remuneration report"

2A. The summary financial statement shall contain the whole of , or a summary of -
(a) that portion of the notes to the accounts for the year in question which set out the information required by paragraph 1(1) of Part I of Schedule 6 (*Aggregate amount of directors' emoluments etc*); and

(b) to the extent that the company is required to produce a directors' remuneration report, those portions of the directors' remuneration report for the year in question which set out the matters required by paragraphs 3 (*Statement of company's policy on directors' remuneration*) and 4 (*Performance graph*) of the Schedule to the Directors' Remuneration Report Regulations.";

(2) Omit paragraph 3 (4);

(3) In paragraph 7 before "the corresponding amount" insert "or summary of paragraph 1(1) of Schedule 6 and of the directors' remuneration report"

Form and content of summary financial statement of insurance companies and groups

7. In Schedule 3 to the Regulations-

(1) Insert after paragraph 3 -

"Summary of paragraph 1(1) of Schedule 6 and of the directors' remuneration report"

3A. The summary financial statement shall contain the whole of , or a summary of -
(a) that portion of the notes to the accounts for the year in question which set out the information required by paragraph 1(1) of Part I of Schedule 6 (*Aggregate amount of directors' emoluments etc*); and

(b) to the extent that the company is required to produce a directors' remuneration report, those portions of the directors' remuneration report for the year in question

which set out the matters required by paragraphs 3 (*Statement of company's policy on directors' remuneration*) and 4 (*Performance Graph*) of the Schedule to the Directors' Remuneration Report Regulations.";

(2) Omit paragraph 4 (4); and

(3) In paragraph 8 before "the corresponding amount" insert "or summary of paragraph 1(1) of Schedule 6 and of the directors' remuneration report".

[] 2002

Parliamentary Under-Secretary of State
for Corporate and Consumer Affairs,
Department of Trade and Industry

EXPLANATORY NOTE

(This note does not form part of the regulations)

These Regulations amend the Companies (Summary Financial Statement) Regulations 1995 (S.I. 1995/2092) following the introduction by the Directors' Remuneration Report Regulations 2002 (S.I. 2002/) of a requirement that certain companies should produce a directors' remuneration report. Certain of those companies which are permitted under section 251 Companies Act 1985 to produce a Summary Financial Statement will fall within the category of companies required to produce a directors' remuneration report.

These Regulations expand the disclosure required in a Summary Financial Statement to include either the whole or a summary of certain information concerning directors' remuneration contained in the notes to the accounts and in the directors' remuneration report.

The relevant information is the aggregate amount of directors' emoluments, a statement of the company's policy on directors' remuneration, for the next following financial year; and performance graphs.

The aggregate amount of directors' emoluments will be contained in the notes to the company's accounts whereas the other two items will be contained in the directors' remuneration report.

The requirements will apply to companies and groups, whether or not they are banking or insurance companies and groups.

2002 No.

COMPANIES

Companies (Summary Financial Statement) Amendment Regulations 2002

REGULATORY IMPACT ASSESSMENT

Purpose and Intended Effect of the Measure

Issue and Objective

1. Issue: The introduction of new disclosure requirements for quoted companies on directors' remuneration; and of a requirement for an annual shareholders' vote on the directors' remuneration report.
2. Objective: To enhance the competitiveness of UK companies through improving the linkage between directors' pay and performance and by strengthening the position of shareholders.

Risk assessment

3. In the context of the introduction of these Regulations, there is no perceived hazard or threat to companies or to their shareholders. The information required will not affect a company's ability to offer remuneration packages that will attract and retain the best executives or compromise its competitiveness through releasing commercially sensitive information.
4. Within the existing regulatory framework, boards of directors are faced with a conflict of interest when determining their own remuneration. Rewarding poor performance is bad for companies' competitiveness and for shareholders' interests.

Identify Options

5. Three options have been identified:

Option 1 – To continue to rely on compliance with accepted best practice

Option 2 - To introduce amending regulations to give legislative backing to existing voluntary codes of practice through statutory disclosure requirements, and to legislate to enable shareholders to vote each year on the directors' remuneration report.

Option 3 - To strengthen shareholder controls through legislation to implement the recommendations of the Company Law Review.

Option 1

6. Best practice guidance on directors' remuneration has been available to companies since 1992 with the publication of the Cadbury Committee Report which was followed in 1995 by more specific detailed recommendations in Greenbury Report. However the Government is concerned that many quoted companies are failing to respond adequately to best practice recommendations on transparency, accountability

and linkage to performance. A monitoring exercise carried out for the Department by PricewaterhouseCoopers showed a disappointing level of voluntary compliance.

Option 2

7. The proposed regulations would require quoted companies to:

- publish a report on directors' remuneration as part of the company's annual reporting cycle;
- disclose within the report details of individual directors' remuneration packages, the company's remuneration policy, and the role of the board and remuneration committee in this area; and
- put an annual resolution to shareholders on the remuneration report.

8. This would equip shareholders with the information necessary to help them properly to assess a company's approach to boardroom remuneration and to enable them to vote on it each year.

Option 3

9. The Government published the final report of the independent Company Law Review (which can be accessed at http://www2.dti.gov.uk/cld/final_report/index.htm or obtained from Mary McKevevtt by telephoning (020) 7215 0768) in July 2001. The Government intends to consider its recommendations carefully and consult fully on draft legislation in due course. This process may present the opportunity to strengthen existing shareholder controls.

Identify the benefits

10. Option 1: This option offers no perceived benefits in terms of increased transparency, accountability and linkage to performance and therefore none in relation to increased competitiveness. The level of voluntary compliance with accepted codes of best practice has been disappointing and shows no signs of increasing significantly.

11. Option 2: The introduction of new disclosure requirements and a statutory shareholder vote on the directors' remuneration report would ensure that shareholders have the necessary information to enable them to assess a company's approach to directors' remuneration and make companies more accountable to their shareholders. Legislation to underpin existing best practice guidance will achieve what reliance on voluntary compliance has not: increased transparency, strengthened accountability and more effective linkage between pay and performance and the competitiveness benefits this brings.

12. Option 3: Legislation to implement the recommendations of the Company Law Review will, very properly, take time to draft, consult on and introduce. While the prospect of strengthening shareholder controls in a major package of companies' legislation has attractions on the basis of legislative tidiness and coherence, the benefits that would be offered in the shorter term by Option 2 would be some way off.

Issues of equity and fairness

13. For the majority of the 1.5 million companies on the register at Companies House, and indeed the large majority of the 15,000 public companies on the register there would be no change to reporting requirements if the regulations were to be introduced. The Government believes that the proposed measures would impact equally across quoted companies as the information required should be already at hand. While, as always, larger companies tend to have greater administrative resources available, the cost and impact of presenting this readily available information as required is believed to be minimal.

14. Directors should undoubtedly be adequately rewarded for good performance but rewarding poor performance, or indeed failure, hinders competitiveness and is often at odds with the treatment of others such as employees and shareholders.

Compliance Costs For Business

Business Sectors Affected

15. The regulations as currently drafted would apply to companies incorporated in Great Britain whose equity share capital:

- (a) has been included in the official list in accordance with the provisions of Part VI of the Financial Services and Markets Act 2000; or
- (b) is officially listed in an EEA State; or
- (c) is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq.

It is estimated that there are just over 2,700 such companies.

Compliance costs

16. The Government believes that its proposals would not add significantly to the costs of companies whose securities have been admitted to the UK's Official List. Such companies are already encouraged to apply the best practice provisions in the Combined Code on directors' remuneration. The Government believes that any additional costs on quoted companies should be considered alongside the benefits which might be achieved by a more effective link between directors' remuneration and company and individual performance.

17. Those who responded to the public consultation on directors remuneration (see below) were asked to comment on compliance costs and few saw this as an issue. The Government would again welcome comments on potential compliance costs associated with the new disclosure requirements, in particular specific estimates of any additional costs together with information on whom these would fall.

Results Of Consultation

18. A public consultation took place in 1999 on a range of measures proposed to effect a closer linkage between directors remuneration and performance. These included new disclosure requirements. A total of 140 substantive responses were received from a wide spectrum of interests ranging from quoted companies, institutional investors, remuneration consultants, representative bodies and interested individuals. A summary of those responses is available on the DTI's website at www.dti.gov.uk/cld/condocs.htm. The majority (74%) of those who responded to the consultation were generally supportive of the concept of strengthening the linkage to performance by requiring companies to make more informative disclosures.

Recommendation

19. Having weighed up the advantages and disadvantages of the three options outlined, with their respective time-scales, and taking into account the results of consultations on this issue, Option 2 which introduces regulations to give legislative backing to existing voluntary codes of practice through statutory disclosure requirements [and legislating to enable shareholders to vote directly on the directors remuneration report.] is believed to be the most appropriate solution.

SUMMARY OF QUESTIONS

- Q1: Do you wish to make any comments on the costs and benefits of the draft regulations as set out in the Regulatory Impact Assessment?
- Q2: Do you agree that, subject to Parliamentary approval, the draft regulations should have effect as respects companies' financial years ending on or after 31 December 2002?
- Q3: Do you agree with the definition of "quoted company" in the draft regulations?
- Q4: Do you agree that the auditors should not be required under the regulations to consider whether the disclosures made under Part 2 of Schedule 7A are consistent with those provided in the annual accounts or under Part 3 of Schedule 7A?
- Q5: Do you agree that all "existing directors" should be required to ensure that the resolution is put to the vote of the general meeting?
- Q6: Do you agree that the information set out in paragraph 3.20 of this consultative document should be required to be disclosed in the summary financial statement?
- Q7: Should companies be required to disclose (a) other services provided to the company by the firm(s) which provide remuneration advice to members of the board; and (b) who appointed the remuneration consultants?
- Q8: Do you agree that companies should not be permitted to withhold details of the performance criteria used in long term incentive schemes and executive share option schemes on the basis that such information is commercially confidential?
- Q9: Do you agree that companies should not be permitted to withhold details of comparator group(s) of companies on the basis that such information is commercially confidential?
- Q10: Do you agree that it would not be appropriate to require companies to disclose performance conditions in relation to annual bonuses?
- Q11: Should there be disclosure requirements in relation to: (a) the potential value of awards to individual directors under long term schemes; (b) the expected value at the onset of such awards; and (c) the overall dilution limit? If so, should companies be permitted to select (and required to disclose) their own basis for calculating the value of future awards?
- Q12: Do you agree that total shareholder return is the most appropriate default criterion for the performance graph?

The Consultation Criteria

- 1 Timing of consultation should be built into the planning process for a policy (including legislation) or service from the start, so that it has the best prospect of improving the proposals concerned, and so that sufficient time is left for it at each stage.
- 2 It should be clear who is being consulted, about what questions, in what timescale and for what purpose.
- 3 A consultation document should be as simple and concise as possible. It should include a summary, in two pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact or complain.
- 4 Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others) and effectively drawn to the attention of all interested groups and individuals.
- 5 Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for a consultation
- 6 Responses should be carefully and open-mindedly analysed, and the results made widely available, with an account of the views expressed, and the reasons for decisions finally taken.
- 7 Departments should monitor and evaluate consultations, designating a consultation co-ordinator who will ensure the lessons are disseminated.

The complete code is available on the Cabinet Office's web site, address www.cabinet-office.gov.uk/servicefirst/index/consultation.htm.