

## **DIRECTORS' REMUNERATION: SUMMARY OF RESPONSES TO THE CONSULTATIVE DOCUMENT URN 01/1400**

### **General**

The Department received a total of 110 substantive responses to its 2001 consultative document on Directors' Remuneration. The responses came from a wide spectrum of interested parties. The largest of these were categorised and numbered as follows: 30 public limited companies, 18 institutional investors/fund managers and their representative bodies, 16 accountancy/actuary firms or organisations, 13 remuneration consultancies and 8 legal firms/bodies. Amongst the other respondents there were trade unions, business organisations, mutual societies, a private investors' organisation, an academic institution, a political organisation and 12 individuals. Some of the responses were sent in confidence.

Respondents generally indicated broad support for an improvement in transparency of links between boardroom pay and company performance. It was also acknowledged that it is important that UK companies can offer competitive remuneration to their directors. Some respondents also mentioned that a positive impact of the annual vote on remuneration is that it would focus shareholders' attention on remuneration as a whole and that basic pay, bonuses, short and long term incentives, contracts, pensions and other incentives will be scrutinised by investors.

Some thought that at present too many remuneration reports are vague and do little to aid shareholder understanding of the board's remuneration policy and how it links to company performance. However, some who welcomed the initiatives thought that they did not go far enough and gave little power to stakeholders.

Many others had serious reservations about the proposals and some went so far as to say that directors' salary inflation is mainly caused by Government action. One respondent mentioned that one fear expressed at the time of the Greenbury recommendations was that the proposals could well lead to a 'ratcheting up' of directors' remuneration and that there is a strong argument to support the view that this is what has happened. They thought that the proposals might exacerbate the situation.

Others stated their support of measures promoting greater transparency and consistency in the reporting of directors' remuneration but also went on to say that company law is not necessarily the best vehicle for achieving this. Others suggested that the proposals appear contrary to the views received in responses to the Company Law Review and that the approach would not achieve the stated objective which will only be achieved through the recommendations of the Company Law Review. Some respondents considered that provisions governing disclosure and accounting regulation should be taken out of company law and, instead, be covered by codes overseen by a competent authority such as the Accounting Standards Board or the Company Law and Reporting Commission.

Others reiterated that the imposition of the proposed disclosure and accountability regime through a legislative route, rather than through amendment to corporate governance best practice, was not the best route forward. It was also suggested that companies comply with the letter of the law whilst ignoring the spirit and that a statutory approach will result in box-ticking mentality. Amendment to the Combined Code was suggested as such codes, it was put forward, encouraged by active investor bodies, have been successful in raising UK corporate governance standards and compliance.

A shareholder vote on the remuneration report was considered by some to be of questionable value. Some respondents were concerned at what they thought was a somewhat unbalanced focus on backward-looking disclosure and accountability and considered that it is remuneration policy, and its implementation, going forward which are of primary concern to shareholders. New legislation, if it is to be introduced, should be directed at voting on the remuneration policy rather than the whole of the remuneration report. Also the use of criminal sanction was thought to be a disproportionate response to any likely mischief. Others voiced concern in relation to the status of the advisory resolution approving the directors' remuneration report and what the effect of a negative vote would be.

**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?**

Although some respondents did not think that the proposals would add significantly to the costs of a large company which is already subject to substantial disclosure, by far the majority, about three-quarters, of the responses received to this question were negative in nature.

Many suggested that the inclusion of the directors' remuneration report in the Summary Financial Statement (SFS) would for some companies increase the costs very considerably. One plc said that it was one of the first companies to opt for the short form report, and that this had been very well received by its shareholders. To include the directors' remuneration report would double the size of the document and double the cost in terms of paper and printing.

As well as this, others pointed out other areas for a potential increase in costs. One of these was the requirement to produce performance graphs, for which many companies would need to employ the services of a consultant; also, more generally, companies were likely to seek external advice in relation to the level of disclosure that they propose to make to ensure compliance. As well as this, some respondents mentioned that the additional resolution and vote would increase costs.

Others believed that the increased disclosure would be a further deterrent to more outstanding senior managers becoming board directors of UK companies and it would cause them to take up board appointments outside the UK. Some respondents suggested that the regulations will add to the burden on non-executive directors, making them potentially harder to recruit

and more expensive. Also, the emphasis on compliance and remuneration will detract from their other role as an independent voice on the board.

**Q2: Do you agree that, subject to Parliamentary approval, the draft regulations should come into force in respect of company financial years ending on or after 31 December 2002?**

Comments on this question were fairly evenly balanced, although there were slightly more who were in agreement.

Some respondents considered that many companies are already in a position to meet the reporting requirements and that there should not be undue problems. Others agreed that the Government was simply requiring companies to comply with the code of best practice published by Greenbury in 1995. There were others who agreed, on condition that Parliamentary approval is given on or before the end of September 2002 so that the implications of compliance are clear in advance. If, however, the regulations were delayed until later in the year, it was thought more appropriate for them to come into effect for financial years ending on or after 31 December 2003.

Others opposed the proposal that the new requirements should take effect in respect of companies' financial years ending on or after 31 December 2002. This, they said, would require quoted companies to report on a period predating Parliamentary approval of the legislation. Companies will be reporting under the new regime on decisions they are making before the regulations have been finalised and come into force. Although it was accepted that much of the material which companies need to prepare to comply with the new law reflects current legal and regulatory requirements, it was suggested that a substantial amount of work would be required to review and reorder the material. Some considered that the Government had underestimated the significance of the new information which companies must provide as well as the time required to ensure that adequate procedures are put in place for proper collation and presentation of this material. A significant number of respondents suggested that the requirement should take effect in relation to companies' financial years ending on or after 31 December 2003, or that alternative transitional provisions should be introduced.

Some respondents recommended that the draft regulations should have effect for financial years ending on or after 23 December 2003 to ensure the inclusion of those companies with a floating year-end as permitted by s.223 of the Companies Act 1985. Companies who use the 7-day flexibility in financial years would otherwise, it was stated, be able to delay implementation by 12 months.

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

Responses to this question were split more or less equally between those who agreed and those who disagreed.

Of those who agreed, some saw no reason for restricting the geographical scope to the EEA & USA and thought that the definition should be extended to cover all overseas exchanges. Others thought that there was a case for bringing companies which are listed on AIM within the scope of the regulations. One suggested that the exclusion of AIM listed companies might encourage more small capital companies to transfer their listing from an official listing to AIM in order to avoid increased disclosure.

Some respondents questioned whether the proposals should be directed at UK companies which are quoted on a major exchange, or whether they should be aimed at all companies listed in the UK. Some considered the definition provided was too narrow and allowed scope for avoidance by companies which did not wish to comply. It was also suggested that the definition should be broadened to include any recognised international stock exchange otherwise UK quoted companies will be put at a significant competitive disadvantage to companies listed on exchanges not included in the definition. Also another effect, some stated, would be to encourage any UK incorporated company contemplating an overseas quote on any of the relevant exchanges to reincorporate outside the UK prior to that listing. Such a scenario was considered unfavourable to the UK's international competitiveness.

It was acknowledged that UK company law could not legislate for companies registered outside the UK, and inclusion of the requirements in company legislation would result in different requirements applying across the population of UK-listed companies. This was considered by some to reflect poorly on UK governance arrangements and regarded as similar to a 'flag of convenience' arrangement for governance and other obligations. Also, competitor companies incorporated overseas may not have similar disclosure requirements and UK companies may suffer competitive disadvantage from having to disclose information that might be regarded as commercially sensitive. Some respondents thought, therefore, that there was a case for extending the definition to also cover companies which are quoted on a major exchange in the UK but which are incorporated elsewhere. For this reason, it was suggested that, to ensure that the regulations are enforceable for all overseas jurisdictions, compliance should become a requirement of the UK Listing Authority.

**Q4: Do you agree that the auditors should not be required under the regulations to consider whether the information given in Part 2 of the directors' remuneration report is consistent with that provided in either the annual accounts or in Part 3 of the report?**

About three-quarters of respondents who answered this question agreed with the proposal. Many respondents thought that the forward-looking remuneration policy statement would not be capable of audit and auditors would have great difficulty in reviewing it to normal audit standards. Some pointed out that SAS (Statement of Auditing Standards) 160 'Other information in documents containing audited financial statements' requires auditors to read 'other information' and if they become aware of any apparent

misstatements or identify material inconsistencies with the financial statements, to seek to resolve them. However SAS 160, one respondent stated, only requires auditors to read 'other information' that is included in documents containing audited financial statements. If the remuneration report were to be included in a document that did not contain the annual accounts, Auditing Standards would not require the auditors to consider the implications of any inconsistencies between Part 2 and the audited accounts. As presently drafted, the proposals do not require the directors' remuneration report to be included in the same document (eg company annual report) as the annual accounts.

Others thought that if the auditors were not under a duty to report, then there would be no independent objective assessment and suggested that there should be a statutory requirement for auditors to check disclosure consistency in the directors' remuneration report. One respondent suggested that investors would expect the auditors to ensure that sums distributed as remuneration are consistent with the policy. In particular, shareholders would wish to know whether payments made in the year in question are in accordance with the policy disclosures made in relevant preceding years. Another said that, although consideration needed to be made of the cost implications of additional auditing work, if shareholders are to be specifically asked to approve the adoption of a report, it is necessary that they should have confidence in its accuracy. If it is thought, this respondent continued, that remuneration matters pose particular conflicts of interest then it followed that statements made by directors and by the board need enhanced scrutiny.

**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?**

About three-quarters of those who responded to this question agreed with the approach and that Regulation 7 should not be applied to past directors. Of those who did not agree, some stated that the expression "existing directors" is not mirrored elsewhere in company law and considered that responsibility should be on the board as a whole, not individual directors. One did, however, mention that they had no objection to the use of the term subject to its meaning being clearly defined and there being an exclusion from liability in respect of directors who took all reasonable steps to ensure that the resolution is put to the vote of the general meeting. Another also expressed concern that individual directors should be charged with such specific statutory responsibilities.

One respondent asked whether, because it was a re-statement of current practice, sub-paragraphs 9-11 of the proposed revised s241A needed to be so explicit as to the responsibility of 'existing directors'. Another saw no reason to depart from the normal requirement for "the directors of a company" to be responsible for the terms of the resolutions dealing with such business.

Some saw practical difficulties in applying the proposed Regulation to "existing directors" as defined, ie those who are directors immediately before the general meeting. It was suggested that, as drafted, a responsibility is

being placed on a person who becomes a director of the company a few days before the AGM and new directors could be put in a difficult position if forced to defend decisions in which they did not play a part. Some respondents suggested that the draft regulations should refer to the persons who are directors on the date the notice of the AGM is issued. One respondent thought that it would be fairer to ask all directors who were involved in the decision-making process to defend their decisions.

**Q6: Do you agree that the information set out in paragraph 3.21 of this consultative document should be required to be disclosed in the summary financial statement?**

Responses to this question were evenly balanced with very similar numbers both for and against the proposal. Many thought that if the remuneration report is subject to shareholders' vote then it should be disclosed in the summary financial statement (SFS). This, it was suggested, would allow all shareholders an opportunity to assess the performance linkage and cost of directors' remuneration. Others mentioned that it would be important, however, that the degree of disclosure in summary statements is proportionate to the whole statement.

Some respondents suggested that a proper understanding of remuneration required much more detail than is appropriate for the SFS. In particular, the requirement to include performance graphs may do little to assist shareholders' understanding of the issues without an accompanying explanation of how the elements of remuneration are related to various performance targets. This could, it was suggested, result in a very lengthy summary. Others thought that there was a danger that inclusion of the envisaged amount of detail on remuneration matters, relative to more central aspects of financial performance and prospects for the company, would send a distorted message regarding the key matters of significance to shareholders.

There was also concern that the length of the remuneration disclosures will increase production and distribution costs of the SFS. One respondent thought that the inclusion of the required disclosures on remuneration policy, together with the performance graphs, could increase the length of the average SFS for a FTSE 100 company from, on average, eight pages to around twelve pages. If the SFS were to be significantly lengthened, it was suggested, some companies might consider whether it is cost effective to produce an SFS in addition to the full report and accounts.

One respondent suggested that a prominent note to the effect that the directors' remuneration report is available at no charge would deal with the situation. Others mentioned that shareholders who want this information can get it via the company website or by asking for a copy of the full accounts.

**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?**

**(a) other services provided to the company by the firm(s) which provide remuneration advice to members of the board**

Nearly half of those who responded to this question were clearly in favour; many agreed in principle but had misgivings, and about a third were clearly opposed to the idea.

Those who were in favour considered that there were potential conflicts of interest that needed to be managed as well as a need for transparency. Disclosure would help shareholders assess whether the remuneration consultants were free of conflicts of interest which might compromise their objectivity. Some of those in favour in principle considered that there would be a need for guidance as to the materiality and extent of those services before any requirement for disclosure was triggered.

Others thought that transparency would be best achieved by not only disclosing the name of the consultancy, but also the fees received for work carried out on behalf of the remuneration committee as well as fees in respect of advice to the rest of the group. This point, some suggested, is perhaps best left to the UK Listing Authority to provide guidance.

Some respondents mentioned that most large companies would use a number of different advisers. Some boards may take advice from a number of different sources so the list could be extensive but still not convey accurately the type or extent of advice provided by any individual provider and the extent to which the advice was followed. One respondent suggested that the naming of advisers should be an optional disclosure by companies and another that it may be appropriate to require anyone who is to be named in the remuneration report to consent to the form and context in which their name is to appear.

Other respondents questioned what actually constituted advice to the board and considered that the proposal raised questions and potential difficulties that were out of all proportion to the benefit of the disclosure.

It was also mentioned that Identifying advisers might be overstating the importance of advisers in general and the area of remuneration in particular.

**(b) who appointed the remuneration consultants**

As with the first part, nearly half of those who responded to this question were clearly in favour; again, many agreed in principle but had misgivings, and about a third were clearly opposed to the idea.

Those who supported the proposal thought that it would help clarify whether remuneration consultants are independent from the executives. One

mentioned that, although under Hampel this might be expected to be the remuneration committee who appointed the remuneration consultants, it would be useful to confirm this. Another mentioned that it can be useful to know whether the remuneration consultants have been appointed by and are accountable solely to the non-executive directors of the remuneration committee, or if they are appointed by the executive team. This respondent went on to say that the relevance of this sort of information may change over time and was therefore better suited to best practice guidance than to legislation. Another considered that the process of appointment, both by whom and on what criteria, should be disclosed.

Some respondents mentioned that it might be difficult in practice to establish who actually appointed the consultants as the appointment can arise through discussions between various parties, both executive and non-executive. In such circumstances, it was suggested, little would be achieved by the probable statement that the remuneration committee had made the appointment. Management, others stated, may initially commission the advice provided; for many companies this will most often be the company secretary or human resources function following discussions with remuneration committee members. Another mentioned that it is impossible to detect whether someone else is leading the choice from behind the scenes.

Others thought that the appointment of advisers was a company decision and doubted whether the information would be useful to shareholders.

**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?**

Well over half of those who responded to this question agreed with the proposal. It was acknowledged by many that, in disclosing details of performance criteria used in long-term incentive schemes and executive share option schemes, there was a conflict between commercial confidentiality and openness. Many, however, agreed that the principle of transparency was desirable and disclosure of performance criteria for use in long-term incentive schemes and executive share option schemes was essential for shareholders to be able to make informed decisions as to the appropriateness of such schemes both at the time of their approval and in subsequent monitoring. Many thought that companies should aim for full transparency in their disclosures and that long-term financial prospects and expectations for a company should not be a commercially sensitive matter.

One respondent mentioned that the provision of an exemption on the grounds of commercial confidentiality would allow companies to provide little or no information other than a simple “boiler plate” explanation that they had taken advantage of such an exemption. Some suggested a limited exemption, while others categorically stated that there should be an exemption for criteria that are considered commercially sensitive. One respondent mentioned that those who might take advantage of it should state that they had done so and on

what basis. The proposals as drafted could lead to companies moving away from these forms of incentive schemes and relying more on annual bonuses. Such short-termism, it was mentioned, would not be in the best interests of the shareholders.

Others respondents suggested that there could be considerable risk to corporate performance if commercial confidentiality were not to be permitted. Compulsory disclosure of the performance criteria for these schemes in advance could disadvantage a company in certain circumstances. Concern was expressed about the effect of putting what was considered highly commercial and price sensitive information in the public domain; material which might be interpreted by analysts or the market in a certain way and lead to speculation about a company's performance and strategic direction. One respondent suggested that legislation would have the opposite effect to that intended by causing companies to operate a plan that is less linked to corporate performance.

**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?**

About three-quarters of those who responded to this question agreed with the proposal. Many agreed in principle but mentioned that many companies may have difficulty in identifying relevant comparators but would be able to identify a suitable market or sector index against which investors might compare the company's performance.

Some suggested that a description of the comparator group or its constituents should be sufficient without necessarily naming each individual company and if the comparator group were a defined group such as FTSE 100, then it would not be necessary to list them. However, it was pointed out, that if companies were to use publicly available comparator groups such as FTSE 100, then this may well mean that remuneration plans were less effective than they might be if the comparator group were more closely aligned with the company's own business/environment.

Others suggested that the proposal was not workable and that it makes the assumption that there will be homogeneous comparator groups across all businesses or by industry and that they would remain constant over a long enough period to make valid comparisons. For some companies, the creation of an appropriate comparator group might not be possible. Potential comparator groups may not be UK based and publish financial data using different rules and conventions, they may be conglomerate businesses – like for like comparisons would not be possible; also the number of potential comparators may be small. Therefore the use of a general index (eg FTSE 250) would be the only alternative.

Some respondents suggested that to make any meaningful comparison, either with individual comparator group companies or the full group, is likely to require considerable explanation. There was a danger that the report would

be submerged in data, some or much of which would require further explanation to make comparison understood. Such data, it was thought, would not be relevant to all shareholders.

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

About three-quarters of those who responded to this question agreed that it would not be appropriate to require companies to disclose performance conditions in relation to annual bonuses. Some respondents considered that performance measures for annual bonuses are often strongly operational and typically include divisional or individual performance measures as well as measures in respect of the whole company. It was also mentioned that the payment of an annual bonus may relate closely to corporate strategy and, therefore, this information is often commercially confidential and detailed disclosure is best dealt with in terms of best practice.

Another respondent mentioned that it was reasonable for companies to have a measure of flexibility both in the setting of performance conditions in relation to annual bonuses, and in disclosure of these to shareholders. Others considered that shareholders would not need to know detailed targets but they would want to know the kinds of targets that will be set. A meaningful narrative commentary to explain the basis for paying, or not paying, annual bonuses should be provided in order to enable effective accountability to shareholders

It was also suggested that, if targets are exempt, then it is important that the previous year's criteria and targets are disclosed. This, it was considered, would both serve to justify any annual bonus that had been paid, and would enable shareholders to assess whether the targets then set had been sufficiently robust.

**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; (c) the overall dilution limit? If so, should companies be permitted to select (and disclose) their own basis for calculating the value of future awards?**

**(a) Should there be disclosure requirements in relation to the potential value of awards to individual directors under long term schemes**

Just over half of those who responded to this question did not think that there should there be disclosure requirements in relation to the potential value of awards to individual directors under long-term schemes.

Some respondents considered that the disclosure of both potential and expected values are crucial elements of the disclosure required to enable shareholders to judge the merits of incentive arrangements, as well as the

impact on shareholder value. It was mentioned that the increasing sophistication of incentives being introduced in UK companies is driving a need for shareholders to be given sufficient information through which to compare new incentive plans with existing plans and those offered by peer companies. The disclosure of potential and expected values would enable shareholders to make more informed judgements as to whether a new incentive plan, or a change to an existing plan, is in their interests and provides an appropriate relationship between pay and performance.

Others, however, thought that assessing the potential or expected value of awards is very problematic and that share-based incentives are very difficult to value. Some respondents considered that neither “potential value” nor “expected value” are terms that are used consistently or have a commonly understood definition and there was no universally accepted methodology for valuing these different incentives. They suggested that there is likely to be as much difficulty in shareholders assessing the implications of variations in models and assumptions as there would be in them arriving at their own valuation of the awards and there would be significant risks of the information being misrepresented. Others went further to say that it would be impossible to put a meaningful figure to the future value of share options and that it would be more helpful if this were expressed as a range from minimum to target to maximum.

Others pointed out that a requirement for potential value and expected value could impose significant costs on smaller quoted companies. Many of these companies, which did not at present employ remuneration consultants, would have to do so.

Two respondents also mentioned that the International Accounting Standards Board (IASB) is currently examining ways in which these types of awards should be valued and believed that any disclosure requirements in relation to the value of awards should be delayed until the IASB has formally pronounced on a suitable and accepted method of valuation.

**(b) Should there be disclosure requirements in relation to the expected value at the onset of such awards**

About sixty percent of those who responded to this question did not think that there should be disclosure requirements in relation to the expected value at the onset of such awards. Much of the argument put forward both for and against this proposal has been covered in part (a) above. As well as this, one respondent also pointed out that, where expected value calculations represent the perceived likelihood of achieving a certain level of performance, they would be equivalent to a profit forecast by the company and that this would be similar to making a forecast of company performance. It was considered that the calculation of such values would require a number of assumptions to be made about future performance and market conditions and this would be both commercially sensitive and contrary to open market trading.

**(c) Should there be disclosure requirements in relation to the overall dilution limit**

About sixty percent of those who responded to this question agreed with the proposal that there should be disclosure requirements in relation to the overall dilution limit.

Respondents who supported disclosure of the overall dilution limit thought that it could be easily achieved and was relevant to shareholders. It was suggested by one respondent that disclosure should be made of the dilution limits applying to a company's schemes and the current level of dilution that exists. In addition, this respondent continued, the proportion of awards that have been met or provided through means other than the issue of new shares should be disclosed. Such disclosures would be particularly useful in assessing the operation of share schemes.

Another respondent also thought that the intention would be to supplement the Association of British Insurers (ABI) Guidelines with a legal requirement to disclose each year in the annual report and accounts the overall dilution limit relating to all employee share schemes. This, it was suggested, would only be of real value to the shareholder if it were coupled with an analysis of the shares already committed to employee share schemes and whether these were to be satisfied by newly issued shares or shares purchased in the market.

One respondent mentioned that dilution limits are normally set out within share plan rules which are subject to prior shareholder approval. If shareholders approve the plan rules, it seemed unnecessary to show that plans subsequently operate within those rules. Another said that it was unclear whether this proposal refers to the dilution limits included in the plan rules as approved by shareholders, or the level of actual dilution represented by current commitments under all share schemes. Another considered that, although not unduly onerous such disclosure would add to the size of the remuneration report.

**If so, should companies be permitted to select (and disclose) their own basis for calculating the value of future awards?**

Few respondents answered this question directly so no meaningful assessment of numbers for or against the proposal was feasible. A range of views was, however, put forward.

One respondent mentioned that the ability to accurately judge proposed incentive plans would be dependent upon the consistency of the methodology used to develop potential and expected values. Others agreed that there should be a standard basis for calculating these values and one respondent suggested that it might be appropriate for an independent body such as the ABI or DTI to provide guidelines for such a calculation.

Others also agreed that that uniformity of disclosure would aid comparison both of the value of the long-term incentives and the total value of the remuneration package. However, some suggested that if there was not to be a standardised approach, then companies should be required to state what method of valuation has been used and any assumptions made in arriving at that valuation.

Others thought that companies should be allowed to select what they see as the most appropriate method(s) of valuation, but also to make full disclosure of these method(s). One respondent thought that to allow companies to choose their own methods of calculating the benefit, even when accompanied by disclosure of the methodology, would create confusion and frustrate the ability to make direct comparison between companies. This respondent, as well as another, suggested, however, that it would be premature to impose a prescribed methodology at the moment, because the whole area of accounting for employee benefits, particularly share-based payments, is under active discussion by the IASB. In their view, it would be preferable to await the outcome of this debate before imposing a methodology that could prove to be significantly different and have to be revisited within a relatively short period (see also Q11(a) above).

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

A little over half of those who responded to this question agreed that total shareholder return (TSR) is the most appropriate default criterion for the performance graph. Others, however, took the opportunity to object to the introduction of performance graphs per se (see below).

Many who agreed saw TSR as an objective measure of value created for shareholders, independent of accounting policies. Some agreed for the vast majority of cases but suggested that for some companies, eg those in the property sector, it is not particularly meaningful. In these cases scope should be allowed for the use of an alternative default criterion such as Net Asset Value but companies should be required to justify their use of an alternative. Some considered that a company should be able to choose what to show and that it should not be compulsory to use TSR.

One respondent considered that the most appropriate criterion for any performance graph is that approved by shareholders in relation to the incentive scheme concerned, and that, while many companies have chosen TSR, other companies use different criteria such as earnings per share. Therefore, this respondent continued, if there are no performance criteria, or the previous performance criteria cannot for some reason be used, then TSR would seem to be the most appropriate default. Some respondents thought that more consideration needed to be given to providing for alternatives such as earnings per share or retail price index (RPI) + x%. Another respondent said that TSR had certain merits but was backward looking and may reflect the achievements of a previous management team.

It was also suggested that, although TSR is a widely used measure of comparative performance, it has serious shortcomings and is not universally regarded as a good measure of performance. Particularly, in the context of executive remuneration, because it does not clearly reflect management performance, its use as a default measure left scope for misinterpretation.

### Performance Graphs

As mentioned above, in answering this question, many respondents took the opportunity to object to the production of performance graphs. Some thought that their introduction added further complexity to an already extensive set of additional requirements and that any performance graphs would need extensive qualification on assumptions and circumstances which would reduce their value. Many suggested that the graphical data could become very complex with an excessive number of graphs and may offer scope for manipulation. Some suggested that there is a good argument for a system where only one graph is needed.

Another objection was the requirement for five-year graphs for performance criteria which may, however, be judged by reference to a shorter period of, for example, three years.