

## DIRECTORS' REMUNERATION: SUMMARY OF RESPONSES TO THE CONSULTATIVE DOCUMENT URN 99/923

### 1. General

1.1 The Department received a total of 140 substantive responses to its consultative document on Directors' Remuneration. The responses came from a spectrum of interested parties which numbered and were categorised as follows: 57 quoted companies (other similar large enterprises, organisations representative of the business community and the chairmen of public limited companies who wrote in to express their own personal views were also included in this category for the purposes of analysis), 2 mutual/building societies, 15 institutional investors and their representative bodies, 10 remuneration consultancies, 7 other consultancies/accountants, 9 legal firms/bodies (one in conjunction with a remuneration consultancy), 13 other institutes/federations, 10 other organisations not falling into the above categories, 3 private investors' organisations, 2 academic institutions and 12 individuals. There was one anonymous response. Two of the remuneration consultancies also included with their responses their own client surveys; eleven of the responses were sent in confidence.

1.2 The Government requested comments on the approach set out in the consultative document. In particular, on the following proposals.

### 2. The Remuneration Committee

#### **2.1 All quoted companies should be required to set up a remuneration committee of independent non-executive directors.**

The responses to this proposal were overwhelmingly positive with over 80% of all respondents viewing it in a favourable light - both quoted companies and institutional investors registered high levels of support (see Table (i) ). Several respondents saw the incorporation of the requirement into the Listing Rules as the way forward.

Of those who did not view the proposal favourably, some pointed out that, although they were behind the principle of an independent remuneration committee for determination of directors' pay, they had reservations about this becoming a formal requirement for all quoted companies. It was pointed out that the majority of quoted companies have already established remuneration committees in accordance with the requirements of the Combined Code and that the position would not change significantly if it were to become a formal

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\* See end for key to the tables.

requirement. One respondent foresaw difficulties in determining whether such a requirement had been complied with, given the difficulty of defining what constitutes an “independent non-executive director”.

**Table (i): The Remuneration Committee**

Respondent Group	All quoted companies should be required to set up a remuneration committee of independent non-executive directors			
	✓	(✓)	(✗)	✗
Quoted companies	20	8	3	2
%	61%	24%	9%	6%
Institutional investors	12	0	0	0
%	100%	0%	0%	0%
Remuneration consultants	3	2	0	1
%	50%	33%	0%	17%
All other respondents	17	4	3	5
%	59%	14%	10%	17%
Total	52	14	6	8
%	65%	17.5%	7.5%	10%

Particular concerns included the fact that a number of companies, such as investment trusts, have no executives and therefore no need of a remuneration committee. It was also mentioned that for smaller quoted companies the proposal may, in practice, be impossible to comply with or, alternatively, it could result in them having to appoint otherwise inappropriate directors to their boards, and adding to their costs, in order to comply.

## **2.2 The best practice framework should be strengthened by its stating that:**

### **(a) the chairman of the board should not be a member of the committee;**

This proposal was viewed unfavourably by over 60% of all respondents who commented on it (the figure was over 70% for quoted companies; see Table (ii)(a)). It was pointed out by many that they had, in principle, no objection to the proposal, provided that the chairman was non-executive and independent, although he should not chair the committee and he should not be present when his own remuneration was being discussed. A number of respondents suggested that the chairman was, in fact, the ideal candidate to be a member of the committee and that he had an important contribution to make to the assessment of the performance of director colleagues. He was seen, often, as best placed to assess the chief executive’s performance.

**Table (ii)(a): The Remuneration Committee**

Respondent Group	The best practice framework should be strengthened by its stating that the chairman of the board should not be a member of the committee			
	✓	(✓)	(✗)	✗
Quoted companies	6	4	3	34
%	13%	9%	6%	72%
Institutional investors	4	0	2	8
%	29%	0%	14%	57%
Remuneration consultants	1	1	0	8
%	10%	10%	0%	80%
All other respondents	10	2	6	15
%	30%	6%	18%	46%
Total	21	7	11	65
%	<b>20%</b>	<b>7%</b>	<b>10.5%</b>	<b>62.5%</b>

Some thought that this proposal may, in practice, be impossible to comply with for smaller quoted companies and even some who viewed the proposal favourably suggested that smaller companies should be exempted.

**(b) the chairman of the board should ensure that the remuneration committee has access to professional advice from outside the company;**

See (c) below.

**(c) if the committee wishes to seek advice from outside consultants, the committee should itself choose and appoint the consultants;**

Although not many respondents commented directly on (b), virtually all who commented on (c) considered that the remuneration committee should be able to take independent advice and did not disagree with the proposal.

**(d) the committee should not employ remuneration consultants who are also employed by the company's executive management.**

This proposal was viewed unfavourably by 70% of all, and by 93% of quoted companies, who commented on it (see Table (ii)(b)). Many pointed out that the

choice should be at the discretion of the remuneration committee or its chairman and that this was an adequate safeguard against abuse.

**Table (ii)(b): The Remuneration Committee**

Respondent Group	The best practice framework should be strengthened by its stating that the committee should not employ remuneration consultants who are also employed by the company's executive management			
	✓	(✓)	(✗)	✗
Quoted companies	0	1	2	40
%	0%	2%	5%	93%
Institutional investors	4	1	3	6
%	29%	7%	21%	43%
Remuneration consultants	0	0	3	5
%	0%	0%	37.5%	62.5%
All other respondents	13	1	0	14
%	46%	4%	0%	50%
Total	17	3	8	65
%	<b>18%</b>	<b>3%</b>	<b>9%</b>	<b>70%</b>

It was also considered by many that there may only be a limited number of consultancy firms with the appropriate expertise and that the requirement would lead, particularly, to increased costs and unnecessary duplication; it was also mentioned that consultants already engaged by a company may be the best qualified, or have particular knowledge or skills, which may be advantageous.

### **3. Linkage to performance**

**3.1 The general framework on linkage to performance should be strengthened by amending the disclosure requirements so that companies are required to make more informative disclosures on linkage to performance.**

The majority of respondents were generally supportive of this proposal with 42% of all who commented appearing to be firmly in favour (the figure was 75% in the case of institutional investors but only 15% for quoted companies - see Table (iii)); only 13% of all who commented appeared to be firmly against the proposal. It was, however, thought by some respondents that, in order to provide "more informative disclosures", companies might simply provide more information and that some clarification of the proposal was required. Others considered that the level of disclosure required on pay was already excessive

and that in companies' annual reports a disproportionate amount of space was already devoted to this and related issues. Some also saw the possibility that the requirement may force companies into disclosing commercially sensitive information and that this could be potentially damaging.

**Table (iii): Linkage to Performance**

Respondent Group	The general framework on linkage to performance should be strengthened by amending the disclosure requirements so that companies are required to make more informative disclosures on linkage to performance			
	✓	(✓)	(✗)	✗
Quoted companies	5	11	9	8
%	15%	33%	27%	25%
Institutional investors	9	2	1	0
%	75%	17%	8%	0%
Remuneration consultants	3	5	0	0
%	37.5%	62.5%	0%	0%
All other respondents	17	8	1	3
%	59%	28%	3%	10%
Total	34	26	11	11
%	42%	32%	13%	13%

Some who considered the proposal to be beneficial thought that there was a lack of consistency and clarity in current disclosures but that strengthening reporting requirements would not necessarily lead to longer reports on remuneration. It was mentioned that it would, however, benefit shareholders by increasing their ability to review and evaluate remuneration reports. US Securities and Exchange Commission regulations were suggested, by three respondents, as a model to follow.

#### **4. Disclosure of directors' remuneration**

**4.1 There should be scope for simplifying the disclosure requirements on individual directors' remuneration. Companies could, for example, be required to state the amount of gains made by directors on the exercise of share options rather than to provide the information on share options required under the Listing Rules; or to state the transfer value of the increase in accrued pension benefit rather than, as at present, having the option of providing information from which the transfer value can be calculated.**

There was somewhat cautious support for this proposal with 64% of all respondents who commented doing so positively to some degree (66% and 46%, respectively, in the case of quoted companies and institutional investors; see Table (iv)).

**Table (iv): Disclosure of Directors' Remuneration**

Respondent Group	There should be scope for simplifying the disclosure requirements on individual directors' remuneration			
	✓	(✓)	(✗)	✗
Quoted companies	14	13	9	5
%	34%	32%	22%	12%
Institutional investors	1	4	3	3
%	10%	36%	27%	27%
Remuneration consultants	3	0	2	1
%	50%	0%	33%	17%
All other respondents	10	10	3	5
%	36%	36%	10%	18%
Total	28	27	17	14
%	<b>33%</b>	<b>31%</b>	<b>20%</b>	<b>16%</b>

Those who were not supportive saw the problem not as one of complexity of information but of format and consistency and that standardisation and clearer presentation should be the aim; disclosure should be made more meaningful rather than simplified. One respondent stated that directors' remuneration packages, appropriately designed to achieve business targets, would inevitably be complex - over-simplification could lead to a loss of useful information. In relation to the examples given, some expressed the view that the present arrangements for disclosures on both share options and pensions were arrived at after much debate, have not been in place for very long and should be left alone for the time being.

However, many of those who were supportive, thought that the current disclosure requirements, as well as being onerous, were excessive and took up a disproportionate amount of space in the accounts compared to other matters. It was considered that the level of detail now required went far beyond what was necessary in order to assess policy and overall remuneration levels and obscured the essential features of remuneration arrangements.

**4.2 New disclosure requirements should be introduced to improve disclosure of linkage to performance. Companies might, for example, be required to state or otherwise show:**

**(a) the longer-term objectives that the company is seeking to achieve in relation to the performance of the board;**

The responses to this proposal were fairly evenly balanced with 52% of all who commented doing so unfavourably; for quoted companies the figure was 63% but, in the case of institutional investors, specific comments were nearly all favourable (see Table (v)). The main concerns were the need to secure commercially sensitive information and the fact that UK companies, competing worldwide, already disclose more information than competitors in many other countries. It was thought that this could lead to generalised statements of limited value which could in turn generate uncertainty and confusion.

**(b) the criteria which the company will use to measure the performance of the directors against those objectives;**

Of all those who commented on this proposal 57% did so favourably (the figure was 42% for quoted companies but, in the case of institutional investors, nearly all comments were favourable - see Table (v)). The main concerns expressed were that commercial confidentiality and competitive advantage should not be compromised.

**(c) whether the company will be measuring its performance against a comparator group of companies (and, if so, the names of the comparator companies or, where applicable, the relevant index);**

See (d) below.

**(d) how the company has performed in relation to the comparator group of companies in respect of its objectives during the preceding financial years; (companies could, for example, be required to provide a performance graph which allows investors to evaluate how both the company and its main competitors have performed against the relevant performance criteria over a three or five year period);**

The comments on proposals (c) and (d) were very evenly balanced with the figures being 49% favourable and 51% unfavourable in both cases (the figure was 26% and 30%, respectively, for quoted companies but, in the case of institutional investors, nearly all comments were favourable - see Table (v)); many of those who commented dealt with the proposals together as one issue.

Concerns mentioned included the difficulty in identifying genuine comparator companies, which have the same objectives, especially in the case of fast developing or smaller quoted companies; the composition and maintenance of comparator groups in sectors with regular mergers and acquisitions could also be a problem. It was thought that these difficulties could result in misleading or meaningless comparisons, which might then require lengthy explanation.

**(e) the proposed balance between elements in the package which are and are not related to performance;**

Of all those who commented on this proposal 59% did so favourably (the figure was 41% for quoted companies but, in the case of institutional investors, nearly all comments were favourable - see Table (v)). It was pointed out that this disclosure was already done for many companies and that it should be evident in most cases.

**(f) the relationship between awards made under incentive schemes and the company's performance in the year in which the awards were earned.**

The responses to this proposal were fairly evenly balanced with 54% of all who commented doing so favourably (the figure was 32% for quoted companies but, in the case of institutional investors, nearly all comments were favourable - see Table (v)). Some respondents thought that this disclosure might be irrelevant and misleading as the comparison would not be like for like because performance periods applicable to incentive schemes lasted usually from three to five years. It could also be misleading if the motive for making an award were not to reward past performance but to incentivise the executive to achieve future performance targets.

**Table (v) Disclosure of Directors' Remuneration**

New disclosure requirements should be introduced to improve disclosure of linkage to performance. Companies might, for example, be required to state or otherwise show:												
Group	a) the longer-term objectives that the company is seeking to achieve in relation to the performance of the board		b) the criteria which the company will use to measure the performance of the directors against those objectives		c) whether the company will be measuring its performance against a comparator group of companies		d) how the company has performed in relation to the comparator group in respect of its objectives during the preceding financial years		e) proposed balance between elements in the package which are/are not performance related		f) the relationship between awards made under incentive schemes and the company's performance in the year in which the awards were earned	
	✓	x	✓	x	✓	x	✓	x	✓	x	✓	x
Quoted cos	11	19	11	15	8	23	10	23	11	16	9	19
%	37%	63%	42%	58%	26%	74%	30%	70%	41%	59%	32%	68%
Inst invs	8	0	8	0	10	0	10	0	8	0	8	0
%	100%	0%	100%	0%	100%	0%	100%	0%	100%	0%	100%	0%
Rem cons	2	4	2	4	4	2	4	2	4	2	4	2
%	33%	67%	33%	67%	67%	33%	67%	33%	67%	33%	67%	33%
All others	10	10	12	6	12	10	11	11	10	5	12	7
%	50%	50%	67%	33%	55%	45%	50%	50%	67%	33%	63%	37%
Total	31	33	33	25	34	35	35	36	33	23	33	28
%	48%	52%	57%	43%	49%	51%	49%	51%	59%	41%	54%	46%

## 5. Contracts and compensation

**5.1 The disclosure provisions on service contracts and compensation arrangements should be strengthened:**

**(a) by requiring information which is currently available only on inspection of directors' service contracts to be disclosed as part of the board's remuneration report to shareholders;**

This proposal was viewed unfavourably by 60% of all who commented (the figure was 73% for quoted companies but, in the case of institutional investors, it was only 29% - see Table (vi)(a)). Concern was expressed that the proposal would add substantially to the length and complexity of the remuneration report. The proposal was considered unnecessary by many because shareholders already have the right to inspect directors' service contracts and existing requirements were considered adequate; it was suggested by some that, if anything were to be done, it should be that accessibility to the information should be improved. It was also mentioned that there was very little demand for some of this information.

**Table (vi)(a): Contracts and Compensation**

Respondent Group	The disclosure provisions on service contracts and compensation arrangements should be strengthened by requiring information which is currently available only on inspection of directors' service contracts to be disclosed as part of the board's remuneration report to shareholders			
	✓	(✓)	(✗)	✗
Quoted companies	4	4	2	28
%	10%	10%	7%	73%
Institutional investors	4	1	0	2
%	57%	14%	0%	29%
Remuneration consultants	2	1	1	3
%	29%	14%	14%	43%
All other respondents	7	3	2	14
%	27%	11%	8%	54%
Total	17	9	5	47
%	<b>22%</b>	<b>12%</b>	<b>6%</b>	<b>60%</b>

**(b) by requiring companies to provide a clear explanation to shareholders of any compensation arrangements agreed by the board following the departure of a director who was under contract to the company.**

This proposal was viewed favourably by 58% of all who commented (the figure was 47% for quoted companies but, in the case of institutional investors, it was 91% - see Table (vi)(b)). Some respondents considered that confidentiality agreements often prevented full disclosure and that there was considerable sensitivity about the reasons for termination of a contract. It was also mentioned that current disclosure requirements were sufficient and that shareholders were able to raise issues on compensation at the annual general meeting. Those in favour thought that it would be a useful way of assessing the degree to which mitigation had been applied and that it would counter the criticism that companies reward failure; it would also aid comprehension by shareholders.

**Table (vi)(b): Contracts and Compensation**

Respondent Group	The disclosure provisions on service contracts and compensation arrangements should be strengthened by requiring companies to provide a clear explanation to shareholders of any compensation arrangements agreed by the board following the departure of a director who was under contract to the company			
	✓	(✓)	(x)	x
Quoted companies	14	2	5	9
%	47%	6%	17%	30%
Institutional investors	10	1	0	0
%	91%	9%	0%	0%
Remuneration consultants	5	0	0	1
%	83%	0%	0%	17%
All other respondents	10	4	1	5
%	50%	20%	5%	25%
Total	39	7	6	15
%	<b>58%</b>	<b>11%</b>	<b>9%</b>	<b>22%</b>

## 6. Directors' accountability to shareholders

**6.1 The Government sought views on the options set out below or any other proposals to improve accountability to shareholders:**

**(a) requiring quoted companies to ask shareholders to vote on the board's remuneration report every year;**

The proposal was viewed unfavourably by 64% of all who commented (the figure was 82% for quoted companies but, in the case of institutional investors, it was 14% - see Table (vii)). Some respondents thought that the proposal would be expensive and would attach disproportionate importance to the report as opposed to the general business of the company. It was also considered unclear as to what the next steps would be if the remuneration report were to be voted down. Respondents who commented favourably mentioned that, as well as the costs being minimal, it would encourage dialogue with shareholders before the AGM as well as allowing shareholders to express dissatisfaction with aspects of remuneration without having recourse to vote against the overall Report and Accounts.

**Table (vii): Accountability to Shareholders**

Group	Proposals to improve accountability to shareholders:									
	(a) requiring quoted companies to ask shareholders to vote on the board's remuneration report every year		(b) requiring quoted companies to have a remuneration policy and to seek shareholder agreement to that policy every year		(c) requiring directors of quoted companies to stand for (re-) election every year		(d) requiring quoted companies to ask shareholders to (re-) elect the chairman of the remuneration committee every year		(e) creating special procedures under which shareholders could move a resolution on remuneration at the annual general meeting	
	✓	✗	✓	✗	✓	✗	✓	✗	✓	✗
Quoted cos	9	40	5	34	4	31	2	38	3	42
%	18%	82%	13%	87%	11%	89%	5%	95%	7%	93%
Inst invs	12	2	4	6	4	9	1	11	4	9
%	86%	14%	40%	60%	31%	69%	8%	92%	31%	69%
Rem cons	2	6	0	6	0	7	1	6	3	6
%	25%	75%	0%	100%	0%	100%	14%	86%	33%	67%
All others	13	16	7	14	7	18	5	17	10	14
%	45%	55%	33%	67%	28%	72%	23%	77%	42%	58%
Total	36	64	16	60	15	65	9	72	20	71
%	<b>36%</b>	<b>64%</b>	<b>21%</b>	<b>79%</b>	<b>19%</b>	<b>81%</b>	<b>11%</b>	<b>89%</b>	<b>22%</b>	<b>78%</b>

**(b) requiring quoted companies to have a remuneration policy and to seek shareholder agreement to that policy every year;**

The proposal was viewed unfavourably by 79% of all who commented (the figure was 87% for quoted companies and 60% for institutional investors - see Table (vii)). Some respondents thought the proposal inappropriate but suggested that shareholders might vote on a company's general remuneration policy every three years or, alternatively, only when there was a change in policy.

**(c) requiring directors of quoted companies to stand for (re-)election every year;**

The proposal was viewed unfavourably by 81% of all who commented (the figure was 89% for quoted companies and 69% for institutional investors - see Table (vii)). It was considered by some respondents that this would compromise board stability and introduce insecurity into the running of the company as well as leading to the loss of good directors.

**(d) requiring quoted companies to ask shareholders to (re-)elect the chairman of the remuneration committee every year;**

The proposal was viewed unfavourably by 89% of all who commented (the figure was 95% for quoted companies and 92% for institutional investors - see Table (vii)). Some respondents considered that it was for the board, and not the shareholders, to appoint the chairman of the remuneration committee and that it would be likely to undermine the role and responsibilities of the board; others saw no basis for seeking greater accountability from the chairman of the remuneration committee than any other board committee. It was also thought that the proposal would deter directors from accepting invitations to become members of the remuneration committee.

**(e) creating special procedures under which shareholders could move a resolution on remuneration at the annual general meeting.**

The proposal was viewed unfavourably by 78% of all who commented (the figure was 93% for quoted companies and 69% for institutional investors - see Table (vii)). Many respondents saw this proposal as impractical and cumbersome. It was considered that this would put undue focus on what is only part of the business at the AGM and that the procedures under which a shareholder might table a resolution should not be any different for remuneration matters than for anything else. It was also suggested that it might serve to create opportunities for dissident groups to cause unnecessary disruption. The issue was seen to go wider than remuneration and it was

suggested by some that it should be considered by the current company law review.

## **6.2 The Government invited views on the timing of the announcement of proxy votes for and against resolutions on directors' remuneration.**

The proposal was viewed unfavourably by 85% of all who commented (the figure was 97% for quoted companies and 86% for institutional investors - see Table (viii)). It was thought that this would tend to undermine the purpose and value of the AGM, particularly in the eyes of private shareholders, who would be discouraged from attending; also the standard of debate at meetings was weakened when this was done. It was suggested by some that the current Hampel arrangements (the announcement of all proxy votes following a vote on a show of hands) were effective and that there was no reason for treating the proxy votes on a remuneration resolution any differently from other proxy votes. Some mentioned that they saw the proposal as a trailer for fundamental change to the nature and purpose of AGMs or even for the idea that the AGM in its current form should be abolished.

**Table (viii): Directors' Accountability to Shareholders**

Respondent Group	The announcement of proxy votes for and against resolutions on directors' remuneration to be made the day before the AGM	
	✓	✗
Quoted companies	1	30
%	3%	97%
Institutional Investors	1	6
%	14%	86%
Remuneration consultants	1	4
%	20%	80%
All others respondents	6	10
%	37.5%	62.5%
Total	9	50
%	15%	85%

## Key to the Tables

- ✓ Proposal viewed favourably
- (✓) Proposal viewed either mildly favourably or favourably but with proviso(s) attached
- (✗) Proposal not viewed particularly favourably but some positive aspect(s) recognised
- ✗ Proposal not viewed favourably

Please note that for ease of comprehension Tables (v), (vii) and (viii) have been simplified by considering responses as either favourable ✓ or unfavourable ✗