



EMPLOYMENT  
LAWYERS  
ASSOCIATION

P.O. BOX 353  
UXBRIDGE UB10 0UN  
TELEPHONE/FAX 01895 256972  
E-MAIL [ela@elaweb.org.uk](mailto:ela@elaweb.org.uk)  
WEBSITE [www.elaweb.org.uk](http://www.elaweb.org.uk)

## **Directors' Pay: Revised Remuneration Reporting Regulations Consultation**

### **Response from the Employment Lawyers Association**

**24 September 2012**

# **Directors' Pay: Revised Remuneration Reporting Regulations Consultation**

## **Response from the Employment Lawyers Association**

### **Introduction**

The Employment Lawyers Association ("**ELA**") is a non-political group of specialists in the field of employment law and includes those who represent employees and employers in the Courts and Employment Tribunals. It is therefore not ELA's role to comment on the political merits or otherwise of proposed legislation, rather to make observations from a legal standpoint. ELA's Legislative and Policy Committee is made up of both Barristers and Solicitors who meet regularly for a number of purposes including to consider and respond to proposed new legislation.

An ELA sub-committee responded to the Shareholder Voting Rights Consultation in April 2012. A new sub-committee was set up by the Legislative and Policy Committee of the ELA under the joint chairmanship of Clare Fletcher of Slaughter and May and Julian Roskill of Slater & Gordon (formerly Russell Jones & Walker) to consider and comment on the Directors' Pay: Revised Remuneration Reporting Regulations Consultation. Its report is set out below. A full list of the members of the sub-committee is annexed to the report.

ELA intends only to address certain of the questions posed by the consultation paper, as set out in Part A below, focussing on the practical experience and expertise of its members, who represent both plcs and directors. ELA's comments are also limited to issues of employment law, and do not encompass those aspects of the consultation paper which deal with pensions and share schemes. This response is primarily directed towards the drafting of the proposed draft Regulations, which are set out in Annex B of the consultation paper. ELA's comments on these Regulations are set out in Part B of this document.

**Part A: Response to the consultation questions**

- 1. The Government seeks comments on how well the draft regulations attached at Annex B give effect to the policy set out in this consultation document.**

See Part B

- 3. The Government intends to introduce a table which sets out the key elements of remuneration and supporting information on the pay policy. The Government does not propose to prescribe the specific disclosures that are required for each element of pay. Is this a practical and informative approach?**

See section 1.1(A) of Part B

- 4. The Government intends to introduce reporting requirements on service contracts, what remuneration directors can receive in different scenarios and the percentage change in profit, dividends and overall expenditure on pay in the reporting period. Is this a practical and informative approach? If an alternative disclosure would be useful, please give details.**

See sections 1.2 and 1.3 of Part B

- 5. The Government proposes that a company's statement on its approach to exit payments sets out the principles on which the determination of the payment will be made. If additional information would be useful, please give details.**

See section 1.5 of Part B

- 7. The Government's intention is that the single total figure includes remuneration that becomes receivable as a result of the achievement of conditions relating to performance in the reporting year where the reporting year is the last year of the performance cycle. Do the specific disclosures set out in the table on page 24 correctly give effect to this intention?**

See section 2.1(B) of Part B

- 10. The Government would welcome views on whether it would be commercially sensitive to require companies to publish full details of performance against metrics. If so, how can an appropriate degree of flexibility be achieved?**

See sections 1.1(B) and 2.1(C) of Part B

- 14. The Government proposes that the remuneration report includes a graph that plots total shareholder return, as a proxy for company performance, against CEO pay. Do you agree that this graph would be useful? If so, do you agree that total shareholder return and CEO pay are the best proxies for company performance and pay? If not, what measures would be more appropriate?**

See section 2.3 of Part B

## Part B: Comments on the proposed draft Regulations

Note: “Section X” refers to the numbered sections within the body of the consultation document. “Paragraph X” refers to paragraphs of the draft new Regulations.

### General comments

- ◆ There are a number of instances (set out in detail below) where the drafting of the Regulations is inconsistent and/or unclear.
- ◆ The drafting of the Regulations will also need to be amended (as set out below) to tie in with the provisions of the Enterprise and Regulatory Reform Bill which propose a new Chapter 4A of the Companies Act 2006 (CA 2006) governing executive remuneration.
- ◆ Sections 8, 30 and 31 make it clear that there will be guidance to accompany the Regulations, but this has not yet been published. The following paragraphs set out some suggestions for areas which could be usefully covered in the guidance. ELA is also conscious that guidance on related issues is currently being produced or updated by other regulatory bodies, including the Financial Reporting Council (in relation to the UK Corporate Governance Code) and the UK Listing Authority (in relation to the Listing Rules). It would be helpful if the guidance to accompany the Regulations takes into account (and is consistent with) this related guidance.

### 1. Policy part of the report

#### 1.1 Future pay policy table

- (A) **Comment:** Paragraphs 18-20 do not prescribe in any detail the form or content of the future pay policy table. Section 43 makes it clear that it is intended that the content of the table will largely be dictated by guidance. This appears to allow companies to set a wide framework for pay policy within this table, and give them the flexibility to make a range of remuneration arrangements whilst remaining within the approved policy. This is a welcome approach from the companies’ perspective, as it allows them to formulate a pay policy which is appropriate for their sector as well as their individual circumstances.

That said, ELA’s view is that in many cases companies will need to seek annual approval of their remuneration policy (as opposed to triennial approval), under the proposed new section 439A CA 2006. This is due to requirements such as that in paragraph 19(c) to set out the maximum potential value of each element of the remuneration package.

**Suggestion:** ELA agrees with the Government’s approach of leaving the detailed content of the future pay policy table to guidance rather than setting it out in the Regulations.

However, ELA suggests that there should be some link between the elements included in this table and the definition of “remuneration payment” in the proposed new section 226A(1) CA 2006.

(B) **Comment:** Paragraphs 20(b) and (c) require an explanation of why performance conditions on variable pay were (or were not) chosen. ELA agrees with the statement (at Section 44) that the Government does not expect companies to be forced to disclose performance metrics, where to do so would harm shareholder interests. However, this statement is not included in the Regulations. ELA's concern is that reference to specific performance conditions could give rise to problems for many companies as regards sensitive information.

**Suggestion:** It would be helpful if the statement at Section 44 was reflected in the Regulations, so that the Regulations explicitly provide that companies need not disclose specific performance conditions where to do so would involve disclosure of commercially sensitive information, or otherwise harm shareholder interests.

## 1.2 Service contracts

**Comment:** Paragraph 21 requires a statement setting out all contractual provisions that relates to directors' remuneration. This has the potential to make the report very lengthy, since it would require describing the provisions relating to salary, benefits, pension, and other benefits, as well as the terms on which benefits are payable on termination in different circumstances, for each director. ELA's view is that this could jeopardise the Government's objective of making remuneration reports more concise and transparent and enabling shareholders to more easily locate the information which they find most helpful. The new disclosures would also be of limited additional benefit, given the existing requirement on companies to have directors' service contracts available for inspection by shareholders (under sections 228 and 229 CA 2006).

**Suggestion:** ELA considers that the Government's objectives could be better met if Paragraph 21 were removed, or amended so that it is confined to the terms governing the fundamental components of remuneration which are likely to be of most interest to shareholders. Alternatively, the existing provisions of sections 228 and 229 CA 2006 could be strengthened to ensure that shareholders have ready access to directors' service contracts.

## 1.3 Graph of performance scenarios

**Comment:** Paragraph 22 assumes that there will be a single threshold set for performance conditions. In practice, there may be multiple thresholds within one element of variable remuneration. There may also be different thresholds for different elements of variable remuneration. Therefore, ELA's view is that Paragraph 22 will require companies to produce numerous different graphs, to illustrate the various different thresholds which apply to each element of variable remuneration.

Further, it is not clear how the operation of malus/clawback provisions would be accommodated within the graph. ELA assumes that this information would in fact be provided as a note to the graphs.

**Suggestion:** It would be helpful if the guidance on Paragraph 22 confirms the approach which companies are obliged to take in respect of the above issues.

#### 1.4 Relative importance of spend on pay

**Comment:** Paragraph 24 requires disclosure of the percentage change “compared to previous years”. It is not clear for which (and how many) years this comparison must be made.

In addition, it is not clear whether the “overall expenditure on pay” in Paragraph 24(c) is limited to directors’ pay, as opposed to pay for the entire workforce.

Finally, it is not clear how the “pay” in Paragraph 24(c) should be calculated (for example, whether it is limited to base salaries, or should also include other elements of remuneration such as bonus, benefits and pension)

**Suggestion:** It would be helpful if Paragraph 4 is amended to clarify the above issues. ELA suggests that Paragraph 4 should be amended as follows (a) the comparison that should be required is with the previous year only; (b) the “overall expenditure on pay” in Paragraph 24(c) should be limited to directors’ pay; and (c) “pay” should be calculated as the single total figure for remuneration as set out in Paragraph 3.

#### 1.5 Exit payment policy

(A) **Comment:** Paragraph 25 applies to, amongst other things, “termination payments”. This concept is not defined in the Regulations, but seems to be limited to contractual payments, by the wording of Paragraph 25(b). It is not clear why the concept of “termination payment” has been used in Paragraph 25, and a separate definition of “compensation in respect of loss of office” is used in Paragraph 33(2) (in relation to the implementation part of the report). Further, both these concepts/definitions are different to the definition of “payment for loss of office” in the proposed new section 226A(1) CA 2006. ELA’s concern is that this creates significant uncertainty and inconsistency in relation to what companies’ obligations are to disclose exit/termination/compensation for loss of office payments to shareholders.

**Suggestion:** ELA suggests that paragraph 25 should use the same definition of “payment for loss of office” as the definition which is used in the new provisions of the CA 2006.

However, it is also ELA’s view that there is a fundamental problem with the proposed new section 226A(1) CA 2006, insofar as it is not consistent with the current provisions in Chapter 4 CA 2006 (sections 215-222 CA 2006). Although the section 226A(1) definition incorporates the section 215 definition, it does not incorporate the exceptions in the remaining provisions of Chapter 4 (notably, in section 220 CA 2006, where a payment is made in good faith in discharge of an existing legal obligation, by way of damages for breach of such an obligation, by way of settlement or compromise of any claim arising in connection with the termination of office or employment, or by way of pension in respect of past

services). ELA suggests that the section 226A(1) definition should be amended to incorporate these exceptions and make it consistent with the current Chapter 4 provisions.

ELA is aware that other concerns with the proposed new Chapter 4A CA 2006 are being raised by other respondents to this consultation. This response on behalf of ELA does not seek to repeat those concerns. However, members of the working party would be happy to discuss and give their views on those concerns, if representatives of the Government would find this useful.

- (B) **Comment:** Paragraph 26 requires an explanation of how “termination payments” will be determined. It is not clear what this will require companies to disclose as regards the exercise of discretion. ELA agrees with the principle that companies should be required to disclose where discretion exists. However, ELA’s view is that it would be impractical for companies to be required to explain how discretion will be exercised in certain circumstances, and that this would be contrary to the very nature of discretion. ELA notes that this form of obligation is explicitly included in Paragraph 11(d), but has not been included in Paragraph 26.

**Suggestion:** It would be useful if the guidance on Paragraph 26 confirms the approach which companies are required to take as regards discretion, and that this is as outlined above.

- (C) **Comment:** Paragraph 26(d) applies to contractual provisions on exit payments agreed prior to the commencement of the Regulations. This contrasts with the transitional provisions for the new Chapter 4A CA 2006, which exempt any contractual provisions which arise before 27 June 2012 (unless that provision has since been modified or renewed) (see clause 64 of the Enterprise and Regulatory Reform Bill). ELA’s concern is that this creates significant uncertainty and inconsistency in the approach to pre-existing contractual agreements.

**Suggestion:** ELA suggests that Paragraph 26(d) should adopt the same date in respect of pre-existing contractual agreements as the transitional provisions for the new Chapter 4A CA 2006.

## 1.6 Statement of consideration of conditions elsewhere in company and group:

**Comment:** ELA’s view is that the requirement in Paragraph 30(1) to disclose the percentage increase in pay of the workforce, as against the percentage increase in pay of the CEO, may involve the same problems which prevented the Government pursuing its plan to require disclosure of the ratio between the pay of the CEO and median earnings of the organisation’s workforce (as set out in Sections 53 and 54, i.e. firm-specific factors such as workforce composition and main country of operation obscuring meaningful comparison between companies). The option for directors to choose a comparator group rather than using the whole workforce may help to alleviate these issues, although it may also allow a choice of comparator group which puts the directors’ remuneration in the most favourable light (for example, by choosing the

management level immediately below the board, where remuneration levels are likely to be comparable to (or in some cases, even higher than) than those at board level).

**Suggestion:** ELA agrees that the option for directors to choose a comparator group for the purposes of Paragraph 30(1) provides useful flexibility. However ELA also suggests that it would be helpful if Paragraph 30(1) permits the disclosure of the increases as being within a range, as opposed to a specific percentage.

## 2. Implementation part of the report

### 2.1 **Single total figure of remuneration:**

- (A) **Comment:** ELA's view is that, in Paragraph 5, there are some amounts which could fall within more than one of columns (a) to (e). There is therefore a risk of duplication or uncertainty about how the table should be completed.

**Suggestion:** ELA suggests that paragraph 5 should be amended to provide for amounts to only appear in one of columns (a) to (e).

- (B) **Comment:** The drafting of Paragraph 5(d) requires disclosure of remuneration "awarded in the reporting period" as a result of the achievement of performance conditions that relate to that period. In the experience of ELA's members, this does not accord with usual practice, which would be to award remuneration shortly after the end of the period in which the performance conditions have been satisfied.

**Suggestion:** ELA suggests that Paragraph 5(d) is amended to require disclosure of remuneration which is "awarded for" the reporting period, rather than that which is "awarded in" the reporting period.

- (C) **Comment:** Paragraph 8 requires additional disclosures about performance conditions attaching to variable remuneration within the single total figure of remuneration. Paragraph 8(2)(c) requires the company to disclose, for each performance condition, how the company performed against the targets set for that condition. ELA notes that it does not, however, specify that the same will apply for individual performance against individual performance conditions.

In addition, Paragraph 8(2)(a) requires "details" of performance conditions and of the target set when the performance condition was agreed. Although Section 78 makes it clear that the Government does not expect Paragraph 8 to require companies to disclosure performance metrics where doing so would harm shareholder interests, this is not codified in the Regulations. This is the same issue that is outlined in 1.1(B) above.

**Suggestion:** ELA suggests that either the wording of Paragraph 8(2)(c), or the guidance on that Paragraph, should clarify whether disclosure of performance against individual performance conditions is required. The suggestion made at 1.1(B) above is also repeated here.



## 2.2 Loss of office payments:

**Comment:** Paragraph 11 requires the company to disclose any “compensation for loss of office”, as defined in Paragraph 33(2). This definition is different from the definition of “payment for loss of office” in the proposed new section 226A(1) CA 2006. As noted in 1.5(A) above, it is also different from the concept of “termination payments” used in Paragraph 25 (in relation to the policy part of the report). It is not clear why these different definitions have been used. ELA’s concern is that this creates significant uncertainty and inconsistency in relation to what companies’ obligations are to disclose exit/termination/compensation for loss of office payments to shareholders.

**Suggestion:** ELA suggests that paragraph 11 should use the same definition of “payment for loss of office” as the definition which is used in the new provisions of the CA 2006 (and in Paragraph 25).

## 2.3 Comparison of overall performance and pay:

**Comment:** Paragraph 13 currently provides for a comparison of company performance against the pay of the CEO. However, ELA agrees with the suggestion in Section 91 that the figure for total directors’ pay should be used, instead of the pay of the CEO. In ELA’s view, this would give a better overall picture of executive pay versus company performance.

Further, Paragraph 13 requires that the comparison be conducted over the previous 10 years. This could create a significant administrative burden for companies, in performing the calculation under Paragraph 3 for such a long period. ELA is also not convinced that a 10 year period is necessary to produce a meaningful comparison.

**Suggestion:** ELA suggests that the approach set out in Section 91 should be adopted, and the figure for total directors’ pay should be used in Paragraph 13 instead of the pay of the CEO. However, ELA recognises that there may need to be a distinction made for this purpose between executive and non-executive directors (whose remuneration packages usually vary significantly). ELA therefore suggests that Paragraph 13 should require the graph to show total pay for executive directors only. Alternatively, Paragraph 13 should require the graph to show one line for total executive directors’ pay, and a separate line for total non-executive directors’ pay.

ELA also suggests that the comparison under Paragraph 13 should be conducted over the previous 5 years, instead of the previous 10 years. In ELA’s view, a 5 year comparison would still produce a meaningful comparison, while imposing a reduced administrative burden on companies. A 5 year period would also accord with the period required for the performance graph under Regulation 5(1) of the current version of the Regulations.

**Members of ELA Working Party**

**Co-Chairs:**

Clare Fletcher, Slaughter and May

Julian Roskill, Slater & Gordon (formerly Russell Jones & Walker)

**Working party:**

Paul Harrison, Baker & McKenzie LLP

Sinead Hall, BG Group Plc

Jean Lovett, Linklaters LLP

Clare Peake, Linklaters LLP

Caroline Stroud, Freshfields Bruckhaus Deringer LLP

Andrew Taggart, Herbert Smith LLP

Alistair Woodland, Clifford Chance LLP