

Need to know

New directors' remuneration report regulations laid before Parliament

In a nutshell

New requirements for directors' remuneration reports for quoted companies have now been finalised and laid before Parliament for approval. Assuming they are approved, the regulations will affect companies for periods ending on or after 30 September 2013.

Under the regulations and related changes to the Companies Act 2006:

- the remuneration report will be split into a policy report (not subject to audit) and an annual report on remuneration (some elements of which are subject to audit);
- the policy report will be subject to a binding shareholder vote which must take place in the first financial year beginning on or after 1 October 2013;
- the annual report on remuneration must provide details on remuneration in the period and some information for the following year and will be subject to an annual advisory shareholder vote; and
- the contents of the annual report on remuneration are substantially different from existing requirements and include the 'single figure' for each director and a number of new requirements.

The new style of report applies to periods ending on or after 30 September 2013 and will contain the details of the policy to be put forward for approval at the first AGM held after that date.

All change for remuneration reporting

The changes being implemented now are based on proposals published in June 2012 by the Department for Business, Innovation and Skills. The objectives included:

- giving shareholders more power through binding votes, so they can hold companies and directors to account; and
- boosting transparency so that what people are paid is clear and easily understood.

While some significant changes have been made to the original proposals, the key elements remain in place. Shareholders will get a binding vote on pay policy.

The requirements for the content of the directors' remuneration report have been completely rewritten and include some significant new disclosures. In particular, they include the requirement for a 'single figure' for the remuneration of each director (executive and non-executive). This figure includes all elements of remuneration including salaries, fees, benefits, bonuses, share schemes and pension benefits. The new style report applies to periods ending on or after 30 September 2013.

New requirements for directors' remuneration reports have been laid before Parliament and are expected to come into force for periods ending on or after 30 September 2013 – giving companies little time to prepare.



The changes apply to 'quoted companies' i.e. those that are currently required to prepare a directors' remuneration report. This includes those that are listed in the UK or another EEA state or are traded on NASDAQ or the New York Stock Exchange. It does not include AIM or the ISDX Growth Market.

The binding vote on policy

Companies with financial years beginning on or after 1 October 2013 will have to put their remuneration policy to a vote at the AGM taking place in that year. However, that policy does not need to apply until the following financial year unless the company chooses to do so. For example, a company with a calendar year will hold its first vote on remuneration policy at the AGM during 2014 based on a policy report set out in the 31 December 2013 annual report and can choose to apply the policy from the AGM or for the year beginning on 1 January 2015. The company will have to make that clear in its report.

Once the binding policy is in force, all future remuneration and loss of office payments must be consistent with it and all directors will be liable if the company breaches the policy (there is a helpful, but not risk free, safe harbour). After the first vote, shareholders must vote on pay policy every three years or sooner if the company wants to make changes to the policy.

Observation

Unless a company wants to seek shareholder approval every year, the policy must provide sufficient flexibility to remain appropriate for a number of years. It must strike a reasonable balance between providing sufficient detail for shareholders to be comfortable, while allowing for some degree of flexibility to react to changing circumstances. Companies will often wish to seek professional advice on setting the pay policy.

The contents of the directors' remuneration report

The new style directors' remuneration report, which must be adopted for financial years ending on or after 30 September 2013, contains the following elements:

- an annual statement from the chairman of the remuneration committee;
- a policy report which includes details of the remuneration policy; and
- an annual report on remuneration which includes details of what directors have been paid in the reporting period and some details of how the policy will be implemented in the next financial year.

The annual statement by the chairman of the remuneration committee should summarise the major decisions on directors' remuneration and substantial changes made to directors' remuneration in the year. It should set out the context in which those decisions were taken and changes occurred.

In a number of areas, the regulations do not prescribe the detail to be included and we expect further guidance and clarification to be provided by the Association of General Counsel and Company Secretaries in the FTSE 100 (known as the GC100) and investors and investor bodies.

The policy report

The policy report will need to include a table showing each element of remuneration, how it supports the strategy, how the element is operated, the maximum that may be paid and a description of the framework used to assess performance. In addition to this there are a number of new disclosures required including the policy on recruitment, the policy on loss of office payments, scenario charts which show the level of remuneration each director may receive under different performance scenarios, a statement of how the employment conditions elsewhere in the company have been taken into account and a statement of whether, and if so how, the views of shareholders have been taken into account.

Observation

In the first year ending on or after 30 September 2013, the policy report will set out the policy which has not yet been approved but which is being put forward for approval at the AGM. It will be important to plan adequately to ensure the proposed policy will be agreed before the annual report is finalised. If the company loses the vote on its policy, it will have no choice but to hold an EGM because it will need to have an approved policy by the beginning of the next financial year. Companies should consider the extent to which they need to consult with shareholders on the policy prior to the vote.

The single figure

Many companies have already started to disclose a single figure of total remuneration for each director. However, in many cases those figures are not compliant with the methodology laid out in the regulations.

The requirement is in fact not just for a single total figure for each director but for a table in the following format. Each column must set out current year amounts together with corresponding amounts for the prior year.

Single Total Figure Table						
	a	b	c	d	e	Total
Director 1	xxx	xxx	xxx	xxx	xxx	xxx
Director 2	xxx	xxx	xxx	xxx	xxx	xxx

The amounts to be included in each of the columns (a) to (e) are specified in detail in the regulations including details of the basis of calculation. The five columns are broadly:

- salaries and fees;
- benefits in kind;
- short-term performance related remuneration such as annual bonuses;
- long-term performance related remuneration; and
- pension benefits.

Additional columns must be added to cover any other items in the nature of remuneration and may be added to provide sub-totals.

The value of annual bonuses should include any amount deferred where further conditions relate to service but not performance. The value of such deferred awards will therefore not be included at the time of vesting.

The value of long term awards should be based on awards vesting in respect of the period under review. This will typically relate to awards vesting after the year end but where the performance period ends at the financial year end, or shortly thereafter. This may involve estimating the proportion that will vest if not yet known, with a true up being applied in the next period.

Other disclosures in the annual report on remuneration

Significant new disclosures include the following.

The link between pay and performance – Information to supplement the single figure is required explaining the link between pay and performance. The required information includes, for variable components, disclosure of the performance measures, weightings, targets set at the beginning of the performance period, the value achieved if targets are met, the actual performance achieved and the resulting level of award. However, there is an exemption from disclosure of information about performance conditions that the directors consider to be commercially sensitive.

Payments for loss of office – Companies now need to disclose the total amount of any payment for loss of office, broken down into each component, an explanation of how each component was calculated, any other payments including the treatment of outstanding incentive awards and whether any discretion was exercised in respect of the payments.

Performance graph and table – The existing requirement to include a graph showing total shareholder return continues to apply. Alongside this graph, for the same period covered, should be provided for the CEO, the single total figure of remuneration, the amount of bonus earned as a percentage of maximum opportunity and the vesting of long-term awards as a percentage of the maximum number of shares that could have vested. These details are required for five years in the first year of reporting under the new requirements but build up over the next five years to cover ten years.

Percentage change in the remuneration of the CEO – The increase in the remuneration of the CEO compared with the increase in remuneration of other employees of the company as a whole (or a sub-group of employees at the company's choice) must be disclosed. This is not based on the single total figure but should include salary, fees, taxable benefits and annual bonus, making a comparison with other employees slightly easier.

Relative importance of spend on pay – Companies can choose to disclose this information in their chosen format and must include actual expenditure for the current and previous year, and percentage change, in relation to remuneration of all employees, dividends and other significant distributions at the company's choice. This is for comparison purposes and to set the remuneration disclosures in context.

Statement of remuneration policy in the following year – This must explain how the company intends to implement the policy in the next financial year. The degree of detail to be included is not prescriptive other than it should include the performance measures and weightings, the targets determined for the performance measures and how awards will be calculated.

Consideration of matters relating to directors' remuneration – Companies will have to disclose whether and how they satisfied themselves of the independence of advisers to the remuneration committee and disclose the fees for this advice.

Observation

This is just a summary of the significant new requirements. There is a lot more detail in the regulations and also some areas where the regulations may require interpretation. Companies should begin early planning for implementation of these new requirements. The directors' remuneration report will look very different in future.

Further information

The regulations laid before Parliament can be obtained [here](#).

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