Directors’ remuneration reporting: are you ready?

Introduction

On the 25 April 2013, the Enterprise and Regulatory Reform Bill containing the Large and Medium-sized Company and Groups (Accounts and Reports) (Amendment) Regulations received Royal Assent. This includes the requirement for a binding vote on remuneration policy. However, details on policy implementation and reporting will be covered in secondary legislation, which is not expected to be finalised until June 2013.

The 2013 reporting season has also brought about the first examples of voluntary reporting in (part) compliance with the draft Regulations. Once finalised, these regulations will take effect for financial years ending on or after 30 September 2013, although some companies have decided to become early adopters in the current reporting season.

The draft Regulations

The latest amendments to the draft regulations proposed by BIS include the following disclosure requirements:

- The maximum level of salary that may be awarded to a new director, expressed as a percentage of that paid to the current highest paid director.
- In-year performance targets, unless such disclosure is considered ‘seriously prejudicial’ to company interests.
- CEO pay in tabular not graphical form when comparing against TSR.
- Payments made in the financial year to former directors.
- The amount of tax paid by the company in the financial year, relative to profit and spend on pay.
- Comparison between the total (rather than base) remuneration of the CEO and employees.

Likely challenges

We believe many of the latest proposals, together with the overall level of detail now required, may present particular challenges for companies. Indeed, some of these challenges have already been discussed.

- Will it be possible to set a policy that is flexible enough to remain relevant for three years, or will an annual binding vote become a reality?
- In terms of the disclosure of targets, what will constitute ‘seriously prejudicial to company interests’?
- Will the disclosure of the maximum salary payable on recruitment unintentionally ratchet pay on recruitment upwards?
Which payments made to departed directors need to be disclosed? For example, will it include pension and/or healthcare?

Will CEO total remuneration versus employee remuneration encourage unwanted (and perhaps undeserved) headlines?

The practicalities

While we note the challenges faced, there are a number of steps the remuneration committee, with the support of its advisors, can start to take in preparation for when the secondary legislation is finalised. They can:

- **Avoid surprises:** do not underestimate the depth of change that may be required. A line-by-line review of the final Regulations (and best practice guidelines) is recommended to identify provisions requiring entirely new disclosures and those most likely to challenge existing remuneration policy.

- **Model disclosures now:** consider how potentially emotive disclosures will look. For example, total remuneration of the CEO against TSR, tax paid by the company, service contract provisions, the maximum amounts likely payable to a new director and payments (if any) being made to former directors.

- **Think long term:** is current remuneration policy fit for long-term purposes, will it provide sufficient flexibility once approved? A universal challenge will be balancing compliant disclosure with commercial sensitivities, so discuss expectations in detail with major shareholders at the earliest opportunity.

- **Monitor proxy advisors:** their reporting can influence shareholder perception in respect of remuneration policy. Be aware of the requirements they work to which often differ to the Regulations, and pre-empt questions they might ask following publication of the annual report by including sufficient disclosure and explanation.

- **Consider presentational style:** how easily can shareholders extract the information they require? Is critical information potentially lost amongst unnecessary detail? Consider the use of tabulation and graphical presentation wherever possible.

- **Articulate rationale:** consider whether sufficient justification has been made in respect of all material elements of pay policy, make clear the rationale behind, for example, performance measure selection, benchmarking methodologies and incentive design.

Emerging practice

While the Regulations will apply universally, their interpretation combined with the individuality of remuneration policy and commercial sensitivities are expected to result in a period of uncertainty regarding best practice. In any case, we would encourage a tailored review rather than adoption of a standard model.

We have, however, observed frequent examples of reporting in the spirit of the new Regulations during the latest reporting season. Elements that have most commonly been adopted early include:

- **Reporting an Implementation and Policy part (Part 3 and Part 4):** perhaps the most material change, a clear distinction between amounts paid and wider policy.

- **Statement by the Chair of the Remuneration Committee (Part 2):** many of the reports held up as best practice already included such an introduction.

- **Single total figure for remuneration (Part 3, Regulation 3(1)):** arguably a simple extension to the requirements of the existing emoluments table.

- **Future policy table (Part 4, Regulation 25(1)):** tabulation has always been an encouraged disclosure format.

- **Relative importance of spend on pay (Part 3, Regulation 21(1)):** comparison of tax paid, profit, shareholder return and pay spend (if a positive message).