

26 September 2012

Executive Pay Consultation
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

By email to: executive.pay@bis.gsi.gov.uk
FAO: Mr Barry Walker

Dear Sirs,

Directors' Pay: consultation on revised reporting regulations

MM & K Limited ("MM & K") is an independent firm of remuneration consultants.

We think you have done a very good job. The creative approach of combining additional voting and better disclosures will force companies to re-think their approach to remuneration. We just hope the 10 year graph does not get buried in the depths of the remuneration report. It should be the headline story that underpins the whole logic of why the company is paying the way it is.

We support the thrust of your suggested changes in respect of remuneration. We attach your response form as Appendix 2 to this letter.

Our main observations are as follows:

1. The removal of the requirement to state all previous long term incentive awards would be a huge backwards step. It would add to complexity and reduce transparency as investors would have to plough through many years of old reports to see what awards had been made, which had vested and when and which were still live.

Remuneration is not just the awards made or received in the year. It is the cumulative effect of all awards made over the lifetime of the executive that are currently unexercised, plus the impact of share ownership and share sales rules that are a condition of the director's employment. Your proposals fail to recognise the importance of this point.

The current requirements of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 Schedule 8 Paragraphs 9 to 12 should be retained.

2. **We think that para 14 should be audited. It would be extraordinary if shareholdings and changes in shareholdings were no longer audited.**
3. The problem of excessive pay as perceived by most politicians, the media and the general public is limited almost entirely to banks and the FTSE 100. Therefore these proposals are disproportionate to smaller and medium sized quoted companies. We would prefer proposals that reflect this and are proportionate. It would be best to trial

these proposals for 5 years with larger companies (eg FTSE 350) before forcing smaller companies to adopt them.

4. It is already apparent that many companies are adopting many of the new proposals as best practice before the new proposed legislation is enacted. We are confident that most smaller companies would adopt proportionate responses that meet their shareholders' needs, without this legislation.
5. It seems to us that main criticisms of pay are:
 - a. Pay is too high (although we have noted that this does not appear to be a policy objective. We assume that as the document is silent on this key issue that the Government/BIS has no view other than it is for shareholders to approve pay levels.)
 - b. Payments for failure are too high
 - c. Payments for mediocre performance are too high
6. The proposals are unlikely to reduce pay, to any significant extent. Pay is driven by:
 - a. The supply and demand of talented people and the attractiveness and challenges of different roles. Accordingly, pay levels and structures in UK listed PLCs will need to compare and compete with the levels of pay available including:
 - i. other companies both in the UK and abroad
 - ii. private equity backed businesses and private equity investment partnerships
 - iii. privately owned professional services firms
 - iv. investment banking.
 - b. The power of the CEO and the executive team to influence the Board and the Remuneration Committee.
 - c. The preference of NEDs to keep the CEO and the executive team happy and the lack of incentive in the system for them to do anything else. Annual votes on re-election of directors have helped in this regard, but few NEDs have left as a result of being too generous in the pay they awarded executive directors.
 - d. For FTSE 100 and most FTSE 250 companies the costs of remuneration for CEOs and executive directors are only a small proportion of shareholder value. As a result there is little or no economic constraint on their remuneration. For smaller companies, pay is very much constrained by affordability.
7. We agree there is a problem of perception in respect of large payments to executives who leave when past performance has been mediocre or poor. We believe that a maximum termination payment of six months' salary should be enough for most good senior executives, who should be able to find another job within that period if they want one. Anything more is likely to generate negative PR when the executive leaves and this is an increasing problem with the age discrimination legislation.

A key way to meet your policy objectives of improved linkage of pay and performance would be to change the Companies Act to limit the maximum contractual termination payment to six months' salary, except for new hires and those cases where shareholders have formally approved a length in excess of six months.

8. We think that the requirement to produce a ten year graph of TSR performance and CEO pay will highlight those cases where high pay is being made for mediocre performance. We expect that companies will choose to disclose their KPIs as well as TSR over the ten year period so they can explain the linkage of pay and performance. The votes on policy and implementation will allow shareholders to exercise their power to control pay in cases where it is necessary to do so. This will encourage the adoption of many of the good ideas in the Kay Review and of the Narrative Reporting proposals.

9. We congratulate you on forcing a consensus on the definition of a single figure of total remuneration. Nevertheless you should note that using a single figure is a gross oversimplification and it is important that disclosures enable shareholders and their representatives to be able to see and/or calculate:
 - a. the expected value of remuneration awarded (as has to be disclosed in the USA)
 - b. the amounts that the executive receives when he/she exercises their options
 - c. the amounts that the executive receives when he/she sells their shares.
10. The public debates have tended to be on individual companies where pay is perceived as egregious. In practice, the engagement between shareholders and companies tend to produce a compromise, so that shareholders can say that their intervention has been successful in reducing the remuneration proposals. However another interpretation of this process is that the resulting compromise has increased the norm and subsequent benchmarking (which will include the egregious case, albeit slightly reduced in value from its original proposition) will further fuel the inflationary pay spiral.¹
11. Historically there has been too much short termism in pay. We believe this is beginning to change. These proposals will assist this, which is one reason we support them.

Detailed answers to your consultation questions are attached. We have only responded in relation to remuneration matters, upon which we regards ourselves as experts.

Yours faithfully,
For and on behalf of MM&K

Cliff Weight
Director

Attachments:
Appendix 1 About MM&K
Appendix 2 Consultation response form

¹ The issue of benchmarking and its inflationary impact is described well in a recent paper "Executive Superstars, Peer Groups and Over--
-Compensation –Cause, Effect and Solution" by Charles M. Elson and Craig K. Ferrere see <http://irrinstitute.org/pdf/Executive-Superstars-Peer-Benchmarking-Study.pdf>



Appendix 2 - About MM&K

MM&K is a leading independent consultancy specialising in the planning, design and implementation of executive pay and reward strategies.

Founded in 1973, MM&K focuses on directors' and senior executive remuneration, but we have added other services to support our clients' needs through the acquisitions of Independent Remuneration Solutions and The Share Option Centre and the launch of **higher talent**, our specialist recruiter of HR professionals. MM&K is owned by its employees and directors.

Our consultants' expertise areas include HR, share schemes, law, accountancy, tax, corporate governance, business management and statistics. Our multi-disciplinary approach to remuneration is always tailored to individual client requirements.

MM & K Limited is owned by its employees and directors.

MM & K Limited is authorised and regulated by the Financial Services Authority.

Who We Are

Paul Norris, Chief Executive

Masters graduate in Law and Barrister. Paul started his career with MWP Incentives Limited, and then spent a period in merchant banking before joining the buy-in team that created MM & K in 1985. He advises a number of remuneration committees on business-linked remuneration strategies and is experienced in the design and implementation of cash and share based incentive plans.

Nigel Mills, Director

PPE graduate and chartered accountant. Nigel joined MM & K in 1985 having spent 6 years at Price Waterhouse after graduating from Oxford. He is an authority on executive and all employee cash and equity based incentive schemes for public and private companies. He also leads the Private Equity business of MM & K and is an expert on carried interest and co-investment plans for Private Equity houses.

Cliff Weight, Director

Graduate in Mathematics and Statistics from Cambridge. Cliff has over 20 years' experience as a remuneration consultant. He was a Director of Independent Remuneration Solutions, who merged with MM & K in November 2006. He specialises in advising companies on executive directors' remuneration, annual and long term incentives and non-executive directors' fees. He is a regular speaker at conferences and is co-author of Tottel's Corporate Governance Handbook, for which he wrote the chapters on directors' remuneration.

Damien Knight, Executive Compensation Director



Graduate in Physics from Oxford. After a period in construction management, Damien has followed a career in human resources and remuneration consulting, spanning 30 years. Damien was a director of the Hay group where he worked for over 20 years and most recently Damien was a Senior Consultant with Watson Wyatt. For the past 20 years he has specialised in executive remuneration and has advised the remuneration committees and management of a wide range of companies in the UK and elsewhere in Europe, including several FTSE 100 and other major corporations.

Mike Landon, Executive Compensation Director

BA in Economics & Politics and MBA from London Business School. Mike has 25 years of experience as a remuneration consultant and over this period has been at the forefront in developing innovative share and cash-based incentive arrangements for executives and employees generally. This has included assisting with the design and implementation of all types of tax-favoured “approved” share plans, executive and “phantom” plans, as well as extending share plans around the world. Mike plays an active role in ifsProShare, the ESOP Centre and the Quoted Company Alliance and is a member of the Consultative Committee for the Office of Tax Simplification's Employee Share Schemes Review. He previously worked for Mercer, PricewaterhouseCoopers and Watson Wyatt.

Ian Murphie, Share Plans Director

Graduate in Economic History, Law and a qualified Barrister. Ian heads the share plan design and administration teams within MM&K and has over twelve years' experience in advising quoted and unquoted companies in the area of share plan design, affiliated employee trust structures, share valuation, employee communication and share plan administration. Ian has worked both in private practice and in-house, as head of legal services at a specialist remuneration consultancy and most recently as reward director at a top-10 audit and accountancy firm. Ian is currently Chairman of the ifsProshare SME Sub Focus Group, member of the ESOP Centre's International Steering Committee and attending member of HMRC's Fiscal Valuation Forum Group.

Directors' Pay: consultation on revised reporting regulations. Response form.

The closing date for this consultation is 26 September 2012

Please return completed forms to:

Barry Walker
Executive Pay Consultation
Department of Business, Innovation and Skills
1 Victoria Street
SW1H 0ET
020 7215 3930
executive.pay@bis.gsi.gov.uk

Confidentiality & Data Protection

In the interests of transparency, the Department may choose to publish the responses to this consultation. **Please state clearly if you wish your response to remain confidential.**

Please note also that information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

About You	
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I am responding on behalf of (please tick):	
	Quoted company
	Other company
	Investor or investment manager
	Business representative organisation
	Investor representative organisation
	Non governmental organisation
	Trade Union
	Lawyer or accountant
X	Other (e.g. consultant or private individual)

Questions

Question 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.

The policy objectives are not clear.

On page 10, Policy objective para 15 seems to list 5 goals:

1. *The Government believes that these measures will give shareholders more leverage on executive pay and encourage improved pay discipline.*
2. *Shareholder empowerment lies at the heart of the UK's corporate governance framework and these reforms are consistent with that approach.*
3. *They will enable shareholders to promote a stronger, clearer link between pay and performance in order to prevent rewards for mediocrity or failure, while still allowing for exceptional performance to be rewarded.*
4. *Companies will be encouraged to be proactive in designing long term pay policy that is clearly linked to the company's strategy and which is acceptable to shareholders.*
5. *Companies will respond appropriately to shareholder challenge on remuneration issues.*

However in two other parts of the document other objectives are listed:

1. Better, lasting engagement (see Executive summary para 3)
2. Stronger link between pay and long term performance(see Executive summary para 3)
3. As part of an effective framework (see Foreword on page 5).

Exec summary para 3 says:

Through these reforms the Government is seeking to increase the power of shareholders and promote better, lasting, engagement between shareholders and companies to encourage a stronger link between pay and long term performance.

In the Foreword on page 5 it says:

These revised regulations must be assessed in relation to the framework announced by the Secretary of State for Business, Innovation and Skills announced a far reaching package of measures to address failings in the corporate governance framework for executive remuneration. This included:

1. *Giving shareholders more power through binding votes, so they can hold companies to account.*
2. *Boosting transparency so that what people are paid is clear and easily understood.*
3. *Working with responsible business and investors to promote good practice and ensure reforms have a lasting impact.*

We note that the document is "silent" on the levels of pay. The Secretary of State mentions the ratcheting up of pay in his Foreword, but this is not a policy objective.

We believe that these regulations will not directly affect pay levels and the problem with rising executive pay which is not linked to performance.

The impact when combined with the voting proposals will be longer term and cultural in its effect. We are strongly supportive of the intentions behind these proposals which should create much more clarity about directors' pay. In particular we congratulate you on:

1. The proposals for a single figure which has forced an agreement of how the individual elements can be defined in a consistent basis.
2. The proposal for 10 year comparison of CEO pay and performance which will illustrate the long term approach and logic in each company's approach and expose any flawed approaches where pay is not linked to performance and where increases have been arbitrary.

The problem of excessive pay as perceived by most politicians, the media and the general public is limited almost entirely to banks and the FTSE 100. These proposals are disproportionate to smaller and medium sized quoted companies. It would be best to trial these proposals for 5 years with larger companies before forcing smaller companies to adopt them.

It is already apparent that many companies are adopting many of the new proposals as best practice before the new proposed legislation is enacted. We are confident that most smaller companies will adopt proportionate responses that meet their shareholders' needs, without this legislation.

A key way to meet your policy objectives of improved linkage of pay and performance would be to change the Companies Act to limit the maximum contractual termination payment to 6 months' salary, except for new hires and those where shareholders have formally approved a length in excess of 6 months) – see answer to question 5.

As a general comment, we would point out that the quality of drafting of these regulations does not meet normal Parliamentary standards and so we feel the final version needs to be much improved.

Tables are easier to understand than draft legislation and it would be useful if more of these were included in an explanation of the legislation. Using tables also enables you to indicate what might be best practice, where it is felt inappropriate to legislate at this moment in time.

Question 2: What costs will companies face in adjusting to these revised reporting regulations?

Many larger companies will have a secretariat HR function which will be able to deal with the matters covered by these regulations. Many companies will have to arrange for outside consultants to help draft these on their behalf given the legal consequences of an erroneously drafted or sufficiently inflexible policy. On an ongoing basis, the extra audit costs will also be considerable (see our answer to Q15).

As noted in our answer to question 1, the problem of excessive pay as perceived by most politicians, the media and the general public is limited almost entirely to banks and the FTSE 100. These proposals are disproportionate to smaller and medium sized quoted companies. It would be best to trial these proposals for 5 years with larger companies before forcing smaller companies to adopt them.

It is already apparent that many companies are adopting many of the new proposals as best practice before the new proposed legislation is enacted. We are confident that most smaller companies would adopt proportionate responses that meet their shareholders' needs, without this legislation.

The use of XBRL formats and technology will reduce costs of companies, remuneration

consultants, fund managers and proxy advisers. Time saved could be better spent on more value added activities. Government should move towards XBRL formats as a long term approach.

Question 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?

Yes. This seems sensible. The table is not sufficient. Supporting narrative will be required, particularly in narrative reporting of KPIs and why they have been chosen and why weightings have changed.

The pay policy table ought to be in the remuneration report every year (not only when the pay policy changes). If shareholders have to cross refer to previous remuneration reports this adds complexity and reduces transparency.

It may be better to have an explicit policy for new hires. There are pros and cons for more requirements in this regard.

Question 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.

Our comments on the proposals, as set out in the draft regulations, are as follows:

Paragraph 21 (service contracts) will require companies to provide detailed information about directors' remuneration covering all benefits. This is likely to be a lengthy disclosure and will contain a significant amount of information which is not of interest to most shareholders. This will be a costly exercise for companies. Companies are already required to have directors' service contracts available for inspection by shareholders. Can there be a degree of materiality? We also think a requirement to have a table showing the potential payments in £s as well as descriptive words will be clearer and more easily understood by shareholders and others reading the report. See example - Table 5 below.

Paragraph 22 (scenarios) requires a graphical representation of what directors are expected to receive if the performance criteria threshold is met, exceeded or not met. In practice, there may be different performance criteria applying to different awards. It will, therefore, be difficult to produce one clear graph showing this information. If a number of different graphs are included this may significantly add to the length of the report and the cost to companies of preparing the report and at the same time result in a lack of clarity for shareholders. The regulations should only proscribe this for the CEO. We suggest you leave it to companies to decide whether and if so how to do it for others.

Paragraph 24 (relative importance of spend on pay) requires the report to set out the percentage change in profit, dividends and pay over the period.

Surely this ought to be in the implementation report?

It ought to be shown for several years (see Table 12 in answer to question 14).

Table 5: Example table of exit payment policy

Name	Contract duration	Notice Period	Termination Payments										
				Salary	Benefits	Pension	Bonus	Deferred bonus awards	LTIP awards – unvested	LTIP awards vested	Options unvested	Options vested	
CEO	6 months rolling	6 months	how each element of the payment will be calculated	6 months			Pro-rate to service in year	Vests on normal date, but award must be exercised within 6 months	Vests on normal date, but award must be exercised within 6 months				
			whether the company will distinguish between— (i) types of leaver or (ii) the circumstances under which a director left;	No differentiation			Only good leavers receive bonus.	Only good leavers receive bonus	Only good leavers can exercise awards; others lapse awards on leaving.				
			how performance will be taken into account	Not applicable			Yes according to the scheme rules	Not applicable	Pro rate for performance in the performance period and pro-rate for proportion of performance period served.	Not applicable	Pro rate for performance in the performance period and pro-rate for proportion of performance period served.	Not applicable	
			any contractual provision agreed prior to the commencement of these regulations that could impact on the quantum of the payment.										
Dir 2 etc.													

Example note - employees who are terminated for gross misconduct are not entitled to any payment. Claw-back provisions apply to all bonus and LTIP awards made after [xxx].

Question 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.

Companies should be required to state the average termination payments paid to employees in the group and to explain why the executive director is being given more than the average employee.

Any termination payment of more than 6 months' salary should require shareholder approval. **We suggest you to change the Companies Act to limit the maximum contractual termination payment to 6 months' salary, except for new hires and those where shareholders have formally approved a length in excess of 6 months).**

Most of the dissent about the fairness of directors' pay (apart from the 5 quoted banks) arises in cases when a director leaves with a large payoff. The above proposals would reduce the frequency of such problems and switch the responsibility to shareholders who approve such a policy.

Question 6: The Government would welcome views on the proposal for the policy part of the remuneration report to include a statement on whether and if so how a company sought employee views on the remuneration policy.

We see no harm in this and it might even be beneficial.

It would also serve as warning that failure to take account of this issue might lead to even more extreme measures from the Government such as employee representatives on remuneration committees or on the Board.

Question 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 below correctly give effect to this intention?

We believe that the Government is right that a headline single table will allow meaningful comparisons between companies even when the long list of disclosures will in effect show how complicated the position behind single figures is.

1. The proposal for a single figure will use a definition of Total Remuneration which includes:

- the estimated value of deferred bonuses awarded in the year (i.e. it ignores the change in value of share price between date of award, vesting and sale of shares)
- the realisable value of share options, which is the notional gain at the date of vesting (i.e. it ignores the gains or losses from the vesting date until the date the option is exercised and the date the shares are sold)
- defined benefit pension, which is valued at 20 times the increase in accrued pension in the year (i.e. it ignores the impact of changes in the cost of funding the pension obligation, makes no allowance for the age of the director or their prospective widow,

nor the expected salary progression in the period up to retirement).

2. You ought to encourage the use of two figures. Both MM&K and Manifest in separate submissions to government consultations have argued that a single figure of total remuneration is over-simplistic and likely to lead to misleading analyses. Publication of both “total remuneration awarded” and “total remuneration realised/realisable” would be a better approach:
 - Awarded measures remuneration committee decisions made in the financial year and
 - Realised/Realisable measures the outcomes of performance based on decisions which may have been made several years earlier.

3. The following example shows what happens when somebody is recruited and shows the amount of disclosed total remuneration in each year:

New CEO appointed

Salary £1 million p.a.

Bonus £1 million p.a. (target)

Share Award of £10 million of shares which vest in 5 years' time, with “easy” 5 year performance condition

Disclosed Total Remuneration

- Year 1 = £2 million (assumes bonus is at target level)
- Year 2 = £2 million
- Year 3 = £2 million
- Year 4 = £2 million
- Year 5 = £12 million

Using only the proposed single figure is a nonsense. The average remuneration in the above example is £4 million p.a. The total remuneration awarded, would be £12 million in year one and then £2 million for each of years 2 to 5.

The example shows why both figures are needed, as a minimum.

4. From the shareholders point of view, what they're interested in is the total cost of employing a person not the value of the package to the individual and therefore a comment on page 7 about benefits is irrelevant.
5. On page 8 the consultation document does not mention pictures or tables. A picture paints 1000 words.
6. We think there should be a **Disclosure Aid 3** which is the total remuneration awarded. This is required in the US, and will therefore be required for all large companies with a dual listing. This needs to be shown a full three-year period, as in the US, and we think that arguably this should be five years for chief executives. (see below – Table 6)
7. We consider that the specific disclosures in the table, in principle, cover the elements necessary for a single total remuneration figure. However, we are concerned that there is a lack of clarity on certain aspects – for example it is not clear that each element of remuneration should only appear once and where, when there is overlap, it should appear. In addition, it will be important for there to be consistency in how the single total figure is calculated to avoid unhelpful comparisons between companies.
8. In relation to the specific drafting of the draft regulations covering the table and single remuneration figure, we have the following comments:
 - *Paragraph 5a Salary*– it would be helpful to state the salary for someone appointed in the year and the number of months that the reported salary reflects.

- *Bonus* – the table wording should read “Full bonus awarded for performance in the relevant performance year.”
- Deferred bonus is often paid in shares and the value of these shares will reduce or increase in the period until vesting. Executives are not allowed to hedge positions in shares in their company so are exposed to changes in the share price. Therefore this is remuneration and it should be measured. A footnote of explanation might be appropriate.
- Options. We think you should define the value of options as market price at date of vesting minus the exercise price times number of shares vesting.
- *Paragraph 5 (single total remuneration figure)* – it would be helpful to clarify that each element of remuneration should only appear in one column, as, in practice, certain items could fall into more than one column.
- *Paragraph 5(d)* – it is unclear what is intended to be caught here. The regulation refers to money or assets “awarded in the reporting period as a result of the achievement of performance conditions which relate to that period...”. However, in practice, awards will normally be made following the end of the reporting period – for example an award made in respect of performance in the year ending 31 December 2014 will be made during the 2015 reporting year.
- For example an LTI with 50% of the award made on 20 February 2012 based on EPS in respect of performance in the year ending 31 December 2014 and 50% based on TSR in the 3 year period to 20 February 2015, would be in different years (unless the draft legislation is changed and an estimate of the TSR outcome is made).
- *Paragraph 7 (benefits)* – to avoid uncertainty and duplication, it would be helpful to clarify that amounts included in paragraph 5 are not also included in paragraph 7 and explain which paragraph takes precedent.
- *Paragraph 7 (benefits)* – it is possible that a departing director will receive payments and benefits following the reporting year in which he ceases to be a director. It is not clear whether those payments and benefits should be included in respect of the year of departure (and, if so, how they are measured at that time) or the year of receipt.
- *Paragraph 8 (variable pay – additional disclosures)* – While we support the aim of improving narrative around LTIPS, we are concerned that there are practical issues with these proposals. In particular, we are concerned by the requirement in paragraph 8(2) to provide details of performance conditions and the relative weighting of each and the targets set when the performance condition was agreed. In most circumstances, performance conditions relate to confidential internal performance measures. We are concerned that too much information will be required concerning the company’s strategy which could be advantageous to competitors who may not be subject to the same reporting requirements or in the alternative to sub-optimal remuneration design to avoid such disclosure. (See answer to question 8).

We have identified a number of potential consequences that may arise from this drafting. These include the swap of deferred bonus into long term incentive (which reduces the amount of disclosed single figure of total remuneration as deferred bonus is counted in the year it is awarded and long term incentive in the year it vests) and increases in the performance period of long term incentives (as this delays the inclusion of the amount in the single figure of total remuneration until the final year of the performance period). Another consequence is that new hires will appear to have lower total remuneration than those who have been in comparable roles for several years.

Table 6: Suggested best practice format to show 5 years of CEO and 3 years of other Directors.

List the executive directors above the Chairman and NEDs; and show sub totals at the bottom.

Table 6: Single Total Pay Figure (£'000)										LTI Awarded EV	Total Remuneration Awarded
notes	Pay for performance				Pay for performance			Total Received	f		
	Salary	Benefits	Pension	sub-total	Bonus	LTI Received	sub-total				
	a	b	c	sub-total	d	% deferred	e	sub-total	f		
CEO 2012 (current year)	xxx	xxx	xxx	xxx	xxx	50%(S)	xxx	xxx	xxx	xxx	xxx
CEO 2011 (previous year)											
CEO 2010											
CEO 2009											
CEO 2008											
Director 2											
2012											
2011											
2010											
Director 3											
2012											
2011											
2010											
etc.											
sub totals executive directors											
2012											
2011											
2010											
sub totals Non-Executive Directors (state if including or excluding Chairman)											
2012											
2011											
2010											
Total of all directors											
2012											
2011											
2010											

not applicable as no LTIs for NEDs

NOTE re Bonus % deferred: this is a requirement of paragraph 9 and it seems sensible to put it in here. Enter C or S to show whether deferred in cash (C) or shares (S).

Question 8: The Government proposes the application of the HMRC methodology to work out the value of defined benefit pension schemes. Is this a practical and informative approach?

It is more important that all companies use the same method than we continue to haggle over the different approaches. However all parties should be aware of the deficiencies of the proposed approach.

The 20x increase in accrued benefit is a rule of thumb which understates the value of DB pension for older executives and overstates it for younger ones, particularly with short service (although few of the latter now accrue DB benefits).

The disclosure is inadequate and does not reflect the NAPF/LAPFF recommendations.

Although not a legal requirement, it should be noted that the NAPF and LAPFF¹ in 2010, called for greater transparency in disclosures on:

“Accrual rates in defined benefit pensions, which include ‘final salary’ schemes. Some directors benefit from a rapid accrual rate, such as 1/30th, when other employees may typically be on a rate of 1/60th or 1/80th.

Company contributions to defined contribution pension schemes. Recent studies have shown that contributions for directors are often far higher than those made for other staff.

Payments in lieu of pensions. An increasing number of firms offer cash payments instead of a pension contribution. These can be sizeable – in some cases over 50% of salary.

The retirement ages of directors. The reasons for any differences between the boardroom and other employees should be explained.

Special early retirement provisions. Firms should make it clear that an unreduced pension on early retirement is usually inappropriate.”

The following should be proposed as best practice. How much should required by legislation needs further thought.

¹ Local Authority Pension Fund Forum
UK - 73625180.3

Recommended Best Practice: see Table 9a and 9b below**Table 9a: Pension components**

Name	Total Pension Benefit £00 as shown in Table 6/6a	Cash in lieu of pension		Money purchase scheme benefit achieved in year		Defined benefit scheme benefit achieved in year		Defined benefit scheme additional value if retires early
		£000	% of total pension	£000	% of total pension	£000	% of total pension	
CEO								
Director 2								
Director 3								

Table 9b: Additional defined benefit disclosures

Name	Retirement age	Age	Length of service	Accrual rate	Individual's contribution to DB plan	Accrued Pension as % of final pensionable salary	Accrued pension at end of year	Increase in accrued pension in the year	Increase in accrued pension net of inflation	Transfer value of accrued pension at start of year	Transfer value of accrued pension at end of year	Increase in transfer value of accrued pension net of individual's contributions	Benefit achieved in year from participating in a defined benefit scheme (HMRC value of 20x increase in accrued benefit)
CEO													
Director 2													
Director 3													

Notes:

1. If retirement age is different for any director and other employees the reasons for any differences should be explained.
2. Personal pension contributions to company pension plans should be disclosed the reasons for any differences to other employees should be explained.

Tables 9a and 9b also include the items required by the NAPF/LAPFF policy on pension disclosure.

Question 9: The Government proposes that claw-back is recorded as part of the single figure. Is this a practical and informative approach?

Yes.

We do not believe a disproportionate amount of time is being spent on discussions regarding clawback, which is likely to play only an exceptional role outside the financial services industry. There are numerous examples in other industries with large tail risk, Consider oil exploration, Pharmaceuticals, eg Thalidomide, Manufacturing/Chemicals eg Bhopal, PIP breast implants, Perrier (benzene), Newspapers and Media (phone tapping), Electricity (Fukushima) , Retail (Ronson's Crap comments about jewellery), Automobiles (Ford Pinto), Tobacco (cancer effects), Food & Beverages (Coca-Cola also had water problems). There may be a backlash on high fat, high sugar products which cause obesity and can be linked to diabetes.

That said, we agree with the approach in respect of awards vesting i.e that it should not be a financial adjustment, but a footnote. If clawback occurs in relation to a vested award, we agree it should be referred to, though it may require a separate column as it may be difficult to relate the amount clawed back to any particular head(s) of remuneration. However, if shares are forfeited as the means by which clawback occurs, how would they be valued?

The approach proposed seems ok and will rarely occur, so it is not worth debating too much. Footnotes will cover it and there will be bigger issues to be addressed if it occurs.

As noted above, there is currently no true-ing up or down for deferred bonus awarded in shares and if you plan to true up for clawback then we think deferred bonus should be treated similarly.

Question 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?

We consider that it will be commercially sensitive to require companies to publish full details of performance conditions as well as full details of actual performance against metrics. Companies will be very reluctant to disclose such sensitive information. In particular, this may be advantageous to competitors who might not be subject to the same reporting requirements.

We suggest that companies are instead required to include a description of the nature of the performance targets required and include an indication of what actual performance against them has been.

It is also important that the measures link in with the KPIs, the narrative reporting and the description of the business model.

Analysts' reports on companies typically contain much information on the company and what is important. **We think the question of commercial sensitivity of publishing data is overblown by some commentators.**

Question 11: Will the Government's proposed disclosure requirements on pensions lead to reporting of sufficient information on the benefits received by directors?

See our answer to Question 8.

Question 12: The Government proposes that scheme interests awarded to directors during the reporting year are disclosed at face value. Is this a practical and informative approach?

Yes, but it would be even better if the expected value is also required (as it is in the US).

The removal of the requirement to state all previous long term incentive awards would be a huge backwards step. It would add to complexity and reduce transparency as investors would have to plough through many years of old reports to see what awards had been made, which had vested and when and which were still live.

Remuneration is not just the awards made or received in the year. It is the cumulative effect of all awards made over the lifetime of the executive that are currently unexercised, PLUS the impact of share ownership and share sales rules that are a condition of the director's employment. Your proposals fail to recognise the importance of this point.

The current requirements of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 Schedule 8 Paragraphs 9 to 12 should be retained.

Question 13: The Government proposes to simplify the reporting requirements regarding directors' interests. What are the costs and benefits of this approach? If an alternative disclosure would be more useful, please give details.

Any effort to simplify any aspect of the report is to be welcomed from both a cost and a presentation perspective. However, the existing regime for directors' interests' disclosure has always appeared one of the more sensibly framed disclosures.

As noted above, a move to XBRL would be helpful.

The current drafting is:

Statement of directors' shareholding

- 14.** *The directors' remuneration report must, in respect of each person who was a director in the financial year, set out—*
- (a) any requirements on a director to own shares in the company and state whether or not those requirements have been met;*
 - (b) total numbers of shares and share options in respect of that director—*
 - (i) of which the director is the legal owner,*
 - (ii) which have been awarded subject to deferral on satisfaction of conditions other than performance conditions,*
 - (iii) the award of which are subject to performance conditions.*

We think this would be much easier if it were specified in tabular format, e.g.

Minimum Disclosure, see Table 13

Best Practice, see Table 13a

Table 13: Directors' shareholdings

Name	requirement to own shares	whether requirement met	shares owned	deferred shares without performance conditions	deferred shares subject to performance conditions	options without performance conditions	options subject to performance conditions
CEO							

Best practice disclosure**Table 13a: Directors' shareholdings**

Name	Salary	Share ownership guideline (as multiple of salary or as number of shares)	Shares owned at year end, including vested awards	Value as multiple of salary	whether requirement met	shares owned	deferred shares without performance conditions		deferred shares subject to performance conditions		options without performance conditions		options subject to performance conditions	
							Vested	Un-vested	Vested	Un-vested	Vested	Un-vested	Vested	Un-vested
CEO	£750,000	5 x salary	800,000	2.0	No	400,000	100,000	50,000	100,000	50,000	100,000	50,000	100,000	50,000
Number			£2,400,000			£1,200,000	£300,000	£150,000	£300,000	£150,000	£300,000	£150,000	£300,000	£150,000
£ value ¹			£500,000			£250,000	£62,500	£31,250	£62,500	£31,250	£62,500	£31,250	£62,500	£31,250
Increase in value in the year ²														
Dir 2														
etc.														

¹ value is at end of the last financial year. For options it is the notional gain if the option were exercised at the end of the last financial year.

² if any shares have been sold during the year then this should be explained in notes to the above table.

There should be a cross reference to performance conditions or a description of them, including the latest estimate of their outcome, unless judged commercially sensitive.

Question 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?

We think this is a wonderful idea. We attach below an example of what may become best practice.

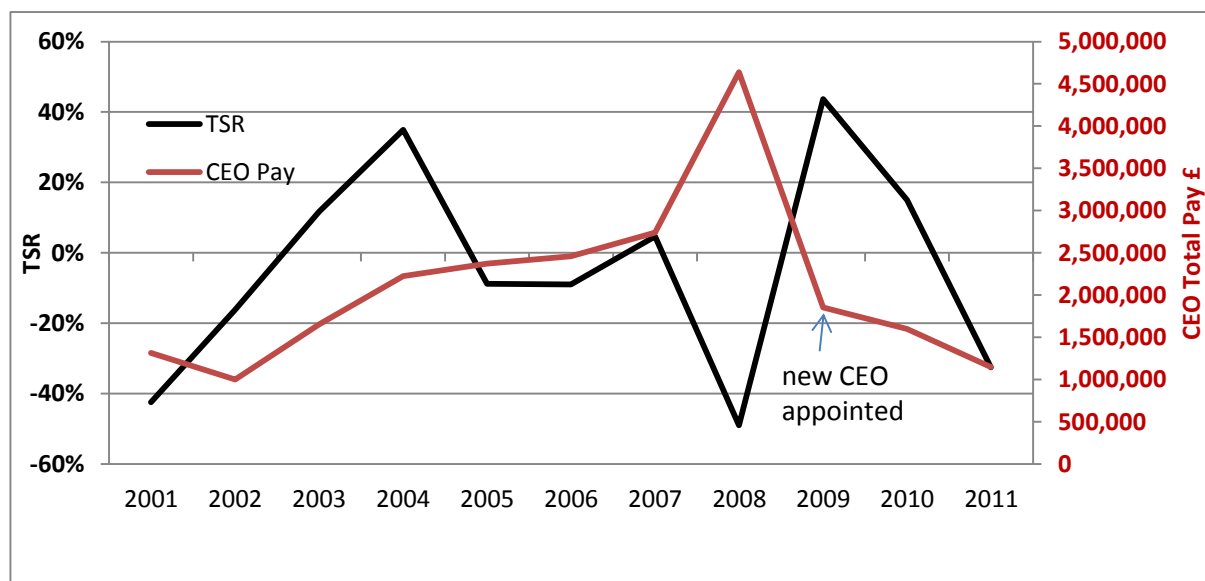
If a comparison is required, this seems as useful as any and a TSR graph is one with which shareholders are familiar.

Companies will be free to add other measures as well as TSR. This proposal will encourage companies to do so and merge their remuneration reporting with that on narrative reporting on KPIs.

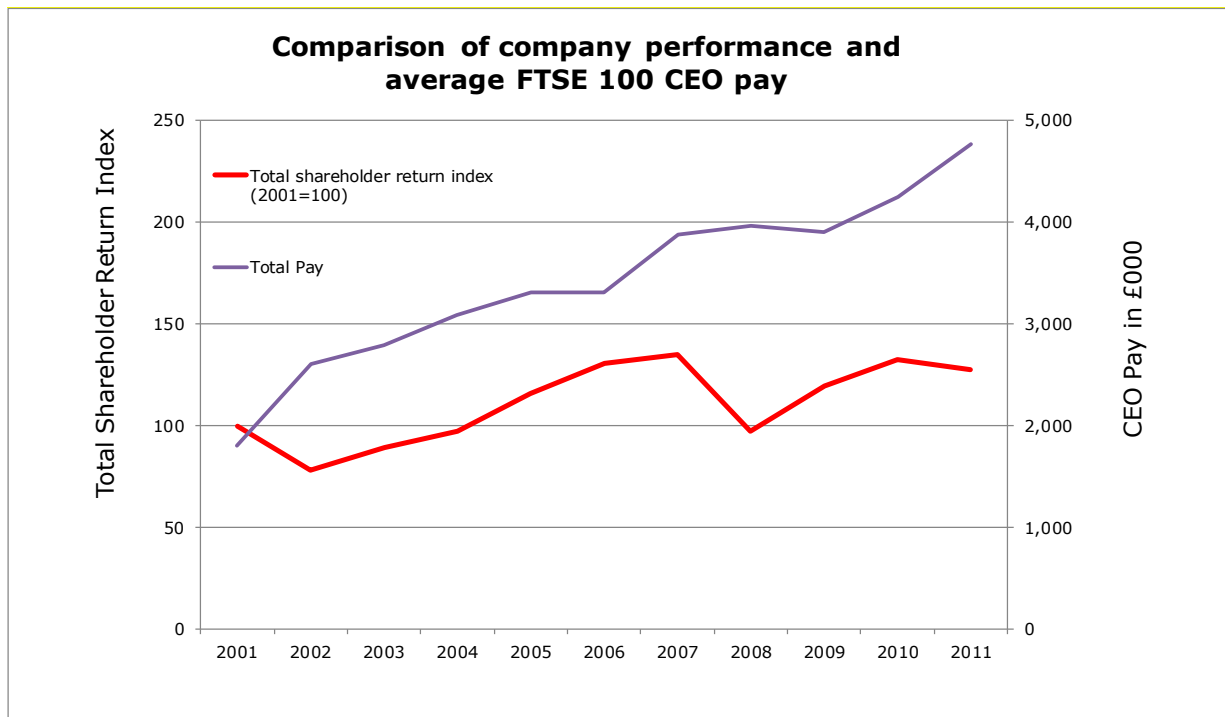
The line graph comparison, of overall performance and pay of Single Total Figure and Performance over 10 years as required by paragraph 13, will seem to some readers the most logical place to start when explaining the linkage of pay and performance.

The **minimum disclosure** is shown in the chart below:

Comparison of TSR and CEO pay for last 10 years



We question whether this is the right format. Statisticians will question whether it is right to join up the points and whether bars are more appropriate for pay figures. More important is whether the TSR figure should also be an index. For example:



The use of TSR rather than the cumulative returns over the 10 years will lead to sensationalist headlines and fails to reflect the policy goal of linking pay to performance over the long term. Inevitably there will be reasons for pay being high in particular years, but it is the long term picture which validates whether the pay policy has been effective.

However, best practice would be to include the index of the components of pay and the actual amounts in a table. (See Table 12) In addition, the requirements of paragraph 24 could usefully be included in this table.

The commentary would explain why the Remuneration Committee had adopted the policy and why it had paid out the amounts it had, noting the performance of the company and the linkage of pay and performance and other material factors.

Table 12: Detailed comparison of company performance and CEO pay and profit, dividends and overall compensation costs

Year	-10	-9	-8	-7	-6	-5	-4	-3	-2	-1	0
TSR	100	77	86	93	109	121	123	87	105	115	109
Total Pay	100	144	154	171	183	183	215	219	216	235	264
Salary	100	118	125	128	136	135	144	154	156	157	162
Other Benefits	100	91	102	105	110	110	120	90	111	95	116
Pension	100	123	142	145	155	154	163	135	185	144	168
sub-total not performance related	100	118	130	132	141	140	149	142	163	147	160
Bonus	100	154	191	231	248	266	317	303	316	362	429
LTI	100	189	175	202	217	205	266	309	243	312	344
sub-total performance related pay	100	174	182	214	230	232	288	306	275	334	381
KPIs											
TSR	100	77	86	93	109	121	123	87	105	115	109
Turnover	100	100	107	109	117	138	108	151	157	163	221
Profit	100	100	107	109	117	138	108	151	157	163	221
ROCE	100	135	131	118	122	116	97	122	140	141	175
ARPU	100	101	75	104	82	95	86	87	90	95	100
Dividends	100	100	113	115	129	164	164	234	245	256	351
Overall expenditure on pay	100	100	107	109	117	138	108	151	157	163	221
Average employee pay	100	100	102	107	113	128	106	128	135	141	142
CEO remuneration in £000											
Salary	525	620	659	672	716	711	755	810	818	825	850
Other Benefits	83	75	84	87	91	91	99	74	92	78	96
Pension	347	427	494	504	537	534	566	467	642	499	581
sub-total not performance related	954	1,122	1,237	1,262	1,344	1,336	1,421	1,351	1,552	1,402	1,527
Bonus	372	573	708	859	922	990	1,178	1,127	1,177	1,345	1,597
LTI	479	904	841	966	1,038	983	1,278	1,480	1,167	1,497	1,647
sub-total performance related pay	851	1,477	1,549	1,825	1,960	1,973	2,456	2,607	2,344	2,842	3,244
Total Pay	1,806	2,600	2,786	3,087	3,305	3,309	3,877	3,958	3,896	4,244	4,771
annual % change (profit, dividends and overall expenditure on pay are required by Para 24)								Note minimum disclosure is only latest year			
Profit	11%	0%	8%	1%	8%	18%	-22%	39%	4%	4%	35%
Dividends	5%	0%	8%	1%	8%	18%	-22%	39%	4%	4%	35%
TSR	-15%	-23%	12%	7%	17%	11%	2%	-29%	21%	9%	-5%
Overall expenditure on pay	3%	35%	-3%	-10%	3%	-5%	-16%	25%	15%	1%	24%
Average employee pay	0%	0%	2%	5%	5%	13%	-17%	21%	5%	5%	1%
Total Pay	29%	44%	7%	11%	7%	0%	17%	2%	-2%	9%	12%

Other possible KPIs and remuneration figures

(Note these are examples. Each company should choose its own KPIs.)

CEO Pay - Total expected value of awards
CEO Pay - Total received
Total Shareholder Return – absolute value
Total Shareholder Return – relative to an index e.g. FTSE 100, 250, All Share etc. and/or comparator index or group of companies
Share price growth (as the make-up of TSR is useful to see)
Dividends – yield as % share price
Market Capitalisation (Note: it is suggested this is included as well as TSR and share price. It is not quite the same as share price as, by issuing new shares, a company might increase market cap but reduce the price per share. Pay is correlated to size of company so this is an important piece of background)
Net Debt
Enterprise Value
Turnover
Profit (EBITDA)
Profit margin
Profit growth / Turnover relative to peers
Cash flow
ROCE
WACC
Debt/ EBITDA
EPS
P/E ratio (share price/ EPS)
Other KPIs
E.g. ARPU (average revenue per user), key strategic goals, Customer satisfaction, staff effectiveness, Health and Safety, CSR measures
CEO Salary
CEO Bonus
CEO shares and options – expected value of awards made in the year
CEO share awards and options realised – total of gains from options exercised in the year and restricted shares that vested in the year
Pension – transfer value of increase in accrued benefits
Benefits – taxable value of benefits received
Average Remuneration of employees
Ratio of CEO (expected/realised) pay to average employee

Question 15: The Government proposes that the single figure, detail of performance against metrics, total pension entitlements, exit payments made and detail on variable pay are all subject to audit. Are there any other sections of the report that should be subject to audit?

We think that para 14 should be audited. It would be extraordinary if shareholdings and changes in shareholdings were no longer audited.

The audit costs of checking the report will be considerable and disproportionate for smaller companies. We suggest that, as one way of reducing the cost for companies, the Government should remove the need for companies to have sections of this report (other than shareholdings) audited.

The directors already have a legal obligation to ensure the report is accurate.