New Remuneration Reporting Regime for Directors

One Year On

Far-reaching government reforms in executive pay – affecting the way that companies must report their directors' remuneration and how shareholders vote on it – came into effect in October 2013 with new legislation on remuneration reports for UK-listed companies.

One year on, almost all companies have now made their first reports under the new regime. This new research project by e-reward.co.uk has examined the first batch of remuneration disclosures.

20 pages

Median length of remuneration report.

About the e-reward.co.uk research

- Focuses mainly on **UK's largest companies**, the FTSE 100.
- Draws on information from **smaller companies**, and even **overseas**, where disclosure or policy exhibited unique practice.
- **Almost 200 company reports** examined, including 90% of FTSE 100 available up to mid-November 2014.
- Draws extensively on **named-company examples**, highlighting numerous notable instances of good, poor and innovative practice.
- **100 different tables and charts** relating to each section of the regulations with most containing numerous named-company examples.

Average fee level paid to remuneration consultants. **£131,396**

£3m £3m £3m £3m

Total remuneration

Median total remuneration for FTSE 100 CEOs has remained over £3m for last 4 years; in preceding year (just following economic crisis) it was £2.4m.

£1m Bonuses

Bonuses

More than 50 directors received bonuses over £1m in latest year.

LTIPs

As many as 90 directors made long-term incentive gains in excess of £1m; 7 gained more than £5m.

›£1m 90 directors

›£5m 7 directors

Salary levels next year*

£866k Chief executive

£513k Finance directors

£477k Other directors

* Where actual salary levels stated, median FTSE 100.

2.5% Median salary rises for main FTSE 100 board positions – chief executive, finance director and other director – over last 12 months.

6 How many times a typical committee meets each year.

£0.5 billion Total face value of awards from deferred, matching and LTIP schemes in FTSE 100.

Pros and cons of new regulations

Pros

- ✔ New votes provide shareholders with real power.
- ✔ More information and better disclosure – e.g. recruitment policy.
- ✔ "Rewards for failure" should be addressed.
- ✔ Slowdown in remuneration growth likely to continue.
- ✔ More engagement with shareholders.
- ✔ Voting outcomes on remuneration policy and future implementation were largely positive.
- ✔ Disclosure of discretion and judgement permitted in policies improved.
- ✔ Clawback and malus details enhanced.

Cons

- ✘ Some regulations watered down or interpreted in a way to make information emerging of little use.
- ✘ Don't tackle "rewards for mediocrity".
- ✘ Some companies didn't comply fully with spirit of reforms, disclosing the minimum required – results in less information.
- ✘ Don't tackle problem that shareholdings aren't dominant part of most remuneration packages.
- ✘ Some regulations interpreted in different ways by different organisations – makes some comparisons problematic.

Actual salary rates 2014/15

	Chief executive	Finance director	Other director
Maximum	£1.25m	£841k	£1.5m
Median	£866k	£513k	£477k
Minimum	£150k	£320k	£217k

Annual bonus levels 2013/14, median

£958k Chief executives

£490k Finance directors

£479k Other directors

75% Per cent of directors with bonuses over £0.5m

57 Number of directors with bonuses over £1m

7% Per cent of directors with bonuses of £200k or less

Types of bonus scheme for board members, per cent of companies

2.2% No scheme

12% Cash-only

17.4% Cash with deferred and matching share schemes

68.5% Cash with deferred share schemes

Top Five LTIP awards 2013/14

1st Reckitt Benckiser – Chief executive £11,205,600

2nd WPP – Chief executive £11,200,994

3rd Reed Elsevier – Chief executive £10,030,061

4th BG – Finance director £8,368,999

5th Vodafone – Chief executive £7,908,759

Deferred scheme periods

Range is two years to five years

75% operate for three years

Proportion of directors receiving awards

90% LTIP awards

52% Deferred bonus shares

26% matching bonus shares

11% Share option grants

£0.6 billion

Face value of awards from deferred, matching, share option and LTIP schemes in FTSE 100

Approach to bonus deferral

76% compulsory

4% voluntary

19% mixed approach

e-reward.co.uk

- How companies responded to new reporting regime for directors' remuneration
- Examples of good and bad practice
- In-depth analysis of different approaches taken to disclosure
- Named-company examples
- Verdict on new regime
- Suggested improvements
- Essential reading for Remco members and reward

A New Remuneration Reporting Environment One Year On:

Policy, Practice, and Implications

THREE-PART RESEARCH PROGRAMME

The e-reward.co.uk research is published in three parts:

Part 1: Introduction and analysis (available December 2014)

Introduction to the new regime.

- Overview of the latest remuneration trends in terms of outcomes and policy
- Discussion of the different approaches companies have taken to disclosure with examples of good practice as well as highlighting those parts of the regulations that appear to have fallen short of expectations and suggested improvements
- Overall verdict on the success of the new regime, while outlining some of the implications for future policy.

A **checklist** summarises the range of approaches that companies used when disclosing all the main elements of remuneration policy that appear in the future policy table, as well as the corresponding institutional investor requirements.

Part 2: Annual statements and annual remuneration report (January 2015)

Examines all aspects of the regulations covering annual statements and annual remuneration reports.

- Annual statements
- Single total figure of remuneration
- Total pensions entitlements
- Scheme interests awarded during the financial year
- Statement of directors' shareholding and share interests
- Payments to past directors
- Payments for loss of office
- Performance graph and table
- Percentage change in remuneration of director undertaking the role of chief executive officer compared to staff
- Relative importance of spend on pay
- Consideration of matters relating to directors' remuneration
- Statement of voting at general meeting.

Part 3: Future policy, outcomes and implementation (February 2015)

Outlines companies' future policies, how the policies will be implemented in the coming year and the outcomes resulting from their implementation in the previous period.

- Salaries
- Benefits
- Relocation
- Pensions
- Short-term incentives
- Long-term incentive plans
- Share options
- Clawback and malus
- Discretion and judgement
- Choice of performance targets
- Non-executive directors
- Recruitment
- Service contracts and loss of office policy
- Illustrations of application of remuneration policy
- References to other staff
- Consideration of shareholders' views.

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What improvements can be made to the reporting regime

1 Single figure remuneration

Some measure of realised pay would be preferable to the single figure used in remuneration reports.

2 Future policy table

To improve the future policy table, it should be expanded to include:

- ✔ how policy should be implemented in the coming year
- ✔ changes from previous years
- ✔ discretions permitted for each element of remuneration
- ✔ clawback and malus permitted for each element of remuneration.

3 Lost incentive award information

Return to past method of disclosing incentive awards, including information on:

- ✔ all new awards
- ✔ all unvested awards from the past, as well as those that lapsed
- ✔ all other relevant grant, vesting and any other prices.

4 Annual bonus targets

More guidance on what's "considered commercially" sensitive to prevent companies from using this as a blanket reason for not providing performance outcomes, even in retrospect. In addition, a greater insight into the rationale used in setting the target levels – that way shareholders can judge for themselves whether they are rigorous enough.

5 Percentage change in chief executive's remuneration

Disclosure in these sections is so diverse it's difficult to see how it can be of much use. Although there is some opposition to introducing a "chief executive-staff ratio", it's hard to see how anything but a ratio can be of much use, although even this is not without flaws.

6 Illustrations of the application of the remuneration policy

Provide more clarification on the proportions of incentive scheme maxima that should be used to calculate target levels so that figures are truly comparable. Also, by including a range of example share price increases into the scenarios, it would be possible to understand the effect of share price rises, although this might over-complicate disclosure.

7 Relative importance of pay

Provide data on the total cost of executive directors, executive committees and non-executives – information that's already provided elsewhere in most annual reports. It would also be useful to compare with key performance metrics – such as EPS, TSR and profits – to examine how pay on key management varies with these measures.

8 Chief executive single figure over five years and TSR graph

In addition to the raw figures, provide both the TSR and remuneration figures on one indexed graph – that way changes in TSR can be easily compared with remuneration in a consistent manner.

9 Share price information

Compel companies to provide year-end share price as well as the range in the year in a uniform fashion in a standard location in the annual

Problems with chief executive's remuneration comparisons with staff

- ✘ No consistency in employee groups chosen, so cross-company comparisons meaningless.
- ✘ Matched samples of employees or even matched chief executives often not used.
- ✘ Huge percentage changes in bonuses and benefits sometimes make comparisons problematic.
- ✔ A ratio would be more informative.

VERDICT ON THE NEW REGULATIONS

The positives

#1 Shareholders now have a binding vote on aspects of executive pay, so they have real power.

#2 There's more information and better disclosure available.

#3 Extreme cases of "rewards for failure" are likely to be addressed.

#4 Regulations do build on and reinforce some positive trends that were already occurring.

The negatives

#1 Vast majority of performance-related bonuses and long-term incentives made payments to CEOs in every year – even the post-Lehman-shock years (2009-11).

Schemes have been paying out in good times and bad.

Has the bar for some incentive scheme targets has been set too low?

Are some directors receiving **"rewards for mediocrity"**?

#2 Most companies set guideline levels of shares that directors must build up over a certain period of time. The logic is fairly straightforward – if board members are large shareholders, then they will think like shareholders and are more likely to focus on the long-term wellbeing of the business.

But the monetary values of most shareholding guideline levels are lower than what board members receive each year in earnings, undermining this link.

Surely, for a director to think like a shareholder, their shareholdings need to be the dominant part of their wealth? For all too many, they are not.

REWARDS FOR MEDIOCRITY?

Incentive profits in latest year

94% of FTSE 100 directors received a bonus.

82% of FTSE 100 directors made LTIP gains.

Financial performance in latest year

62% of FTSE 100 cos. saw increases in profits. Median increase was 5%.

75% of FTSE 100 cos. saw year-end share prices increase compared to 12 months ago. Median increase was 20%.

Paying for performance?

Exhibit #1 **Average CEO total earnings, £m**

2009/10	2010/11	2011/12	2012/13	2013/14
£3.44	£4.09	£4.99	£4.75	£4.44

Exhibit #2 **Median director bonus as per cent of maximum possible**

2009/10	2010/11	2011/12	2012/13	2013/14
80%	85%	74%	69%	71%

Exhibit #3 **Median director LTIP profits as per cent of maximum possible**

2009/10	2010/11	2011/12	2012/13	2013/14
50%	57%	68%	76%	64%