LAW PUNDITS

Remuneration Committee

LP Learn Material

The remuneration committee

The UK Corporate Governance Code (**UKCG Code**) of the Financial Reporting Council (**FRC**) applies to UK and overseas companies with a premium listing of equity shares in the UK (**listed companies**). However, some companies (in particular, AIM-listed companies or companies with a standard rather than premium listing) choose to comply the with UKCG Code in the interests of best practice and good governance even though they are not required to do so.

References: UK Corporate Governance Code 2010

UK Corporate Governance Code 2012

The Listing Rules, LR 9.1.1 R, LR 9.6.8(5) R, LR 9.6.8(6) R and LR 9.8.7 R

The current version of the UKCG Code was issued in September 2012 and applies to companies with accounting periods beginning on or after 1 October 2012.

The previous version of the UKCG Code was issued in June 2010 and will continue to apply for a transitional period to companies that are still within accounting periods beginning prior to 1 October 2012.

The Combined Code was the predecessor to the UKCG Code. It is no longer applicable (it applied to companies with financial years beginning before 29 June 2010).

Requirement to establish a remuneration committee

One of the main principles of the UKCG Code is that there should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors, and that no director should be involved in deciding his own remuneration.
References: UKCG Code 2010, main principle D.2

UKCG Code 2012, main principle D.2

The UKCG Code provides that a listed company should establish a remuneration committee to ensure compliance with the main principle.
References: UKCG Code 2010, provision D.2.1

UKCG Code 2012, provision D.2.1

Membership of the remuneration committee

The UKCG Code provides that the remuneration committee should consist of three, or in the case of smaller companies outside the FTSE 350, two independent non-executive directors.

References: UKCG Code 2010, provision D.2.1

UKCG Code 2012, provision D.2.1

The company chairman may serve on the remuneration committee where he or she was considered independent on appointment as chairman, but that chairman should not also chair the committee.
References: UKCG Code 2010, provision D.2.1

UKCG Code 2012, provision D.2.1

Role of the remuneration committee

The UKCG Code requires the remuneration committee to be given delegated responsibility for setting the remuneration of all executive directors and the chairman, including pension rights and any compensation payments. The committee is also expected to recommend and monitor the level and structure of remuneration for senior management. The definition of 'senior management' for this purpose should be determined by the board but should normally include the first layer of management below board level.
References: UKCG Code 2010, provision D.2.2

UKCG Code 2012, provision D.2.2

The UKCG Code recommends as a general principle that no director should be involved in fixing his own remuneration. Accordingly, if the chairman is a member of the committee, he should not participate in discussions regarding his own remuneration.
References: UKCG Code 2010, main principle D.2

UKCG Code 2012, main principle D.2

Remuneration committees are expected to consult the chairman and/or chief executive officer about their proposals relating to the remuneration of other executive directors.
References: UKCG Code 2010, supporting principles to main principle D.2

UKCG Code 2012, supporting principles to main principle D.2

The UKCG Code also recommends as a principle that the committee should be responsible for appointing any consultants in respect of executive director remuneration.

Where the executive directors or senior management are involved in advising or supporting the remuneration committee, care should be taken to recognise and avoid conflicts of interest.

The chairman of the board should also ensure that the company maintains contacts as required with its principal shareholders about remuneration.

The Institute of Chartered Secretaries and Administrators (**ICSA**) publishes guidance and specimen terms of reference for remuneration committees.
References: ICSA Model Terms of Reference--Remuneration Committee

The remuneration committee must have terms of reference, which are made 'available' (eg by making them available on the company's website). Its terms of reference should explain the committee's role and the authority delegated to it by the board.
References: UKCG Code 2010, provision D.2.1

UKCG Code 2012, provision D.2.1

In addition, where remuneration consultants are appointed, a statement should be made available of whether they have any other connection with the company.
References: UKCG Code 2010, provision D.2.1

UKCG Code 2012, provision D.2.1

Operation of the remuneration committee

The UKCG Code does not contain any provisions regarding the operation of the remuneration committee. However, ICSA guidance on remuneration committees states that, as a matter of good practice:
References: ICSA Model Terms of Reference--Remuneration Committee

- the committee should also have access to the services of the company secretariat on all remuneration committee matters, including assisting the chairman in planning the remuneration committee's work, drawing up meeting agendas, maintenance of minutes, drafting of material about its activities for the annual report, collection and distribution of information and provision of any necessary practical support
- the company secretary should ensure that the remuneration committee receives information and papers in a timely manner to enable full and proper consideration to be given to the issues
- it is the company secretary's responsibility to ensure that the board and its committees are properly constituted and advised, and that there is clear co-ordination between the board and the various committees, and
- the frequency with which the committee needs to meet will vary considerably from company to company and may change from time to time, but it is good practice to plan a minimum number of meetings each year to cover the review of items that form part of the regular cycle such as directors subject to annual re-election or retiring by rotation, and senior management succession; and to review the statement of its activities in the annual report. In addition there will need to be ad hoc meetings for the committee to consider new appointments

Guidance on levels of remuneration

The main principle

Main principle D.1 states that levels of remuneration should be sufficient (but not more than is necessary) to attract, retain and motivate directors of the quality needed to run the company successfully. It also states that a significant proportion of executive directors' re-

muneration should be structured so as to link rewards to corporate and individual performance.
References: UKCG Code 2010, main principle D.1

UKCG Code 2012, main principle D.1

Remuneration in general

Some of the key UKCG Code provisions in relation to remuneration include the following:

- remuneration committees should judge where to position their company relative to others but should use such comparisons with caution in view of the risk of an upward ratchet of remuneration levels with no corresponding increase in performance
  References: UKCG Code 2010, supporting principle to main principle D.1

  UKCG Code 2012, supporting principle to main principle D.1
- committees should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases
  References: UKCG Code 2010, supporting principle to main principle D.1

  UKCG Code 2012, supporting principle to main principle D.1
- levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role, and
  References: UKCG Code 2010, provision D.1.3

  UKCG Code 2012, provision D.1.3
- the board itself or, where required by the company's articles of association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the articles. However, where permitted by the articles, the board may delegate this responsibility to a committee, which may include the chief executive
  References: UKCG Code 2010, provision D.2.3

  UKCG Code 2012, provision D.2.3

Performance-related remuneration

The performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to promote the long-term success of the company.
References: UKCG Code 2010, supporting principle to main principle D.1

UKCG Code 2012, supporting principle to main principle D.1

The UKCG Code sets out provisions for remuneration committees to follow when designing schemes of performance-related remuneration, which include:
References: UKCG Code 2010, provision D.1.1 and Schedule A

UKCG Code 2012, provision D.1.1 and Schedule A

- the committee should consider whether the directors should be eligible for annual bonuses and, if so:

  - performance conditions should be relevant, stretching and designed to promote the long-term success of the company
  - upper limits should be set and disclosed, and
  - there may be a case for part payment in shares to be held for a significant period

- the committee should consider whether the directors should be eligible for benefit under long-term incentive schemes and executive share options should not be offered at a discount (save as permitted by the relevant provisions of the Listing Rules of the Financial Conduct Authority (**FCA**))
- in normal circumstances, shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in less than three years, and
- in general, only basic salary should be pensionable

The remuneration for non-executive directors should not include share options or other performance related elements (although, if, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by the exercise of options should be held until at least one year after the non-executive leaves the board).
References: UKCG Code 2010, provision D.1.3

UKCG Code 2012, provision D.1.3

Shareholders should be invited specifically to approve all new long-term incentive schemes and significant changes to existing schemes, save in the circumstances permitted by the Listing Rules.
References: UKCG Code 2010, provision D.2.4

UKCG Code 2012, provision D.2.4

Listing Rules requirements

The Listing Rules require all share option and long-term incentive schemes established by a listed company or any of its subsidiaries to be approved by an ordinary resolution of a general meeting of the listed company unless:
References: LR 9.4.1 R, LR 9.4.2 R

- participation is offered to all or substantially all employees of the group, or
- the scheme is established specifically to facilitate, in unusual circumstances, the recruitment or retention of a director (in which case, detailed information on the special scheme must be given in the company's next annual report)

Service contracts

The UKCG Code provides that notice or contract periods should be set at one year or less and that, if it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.
References: UKCG Code 2010, provision D.1.5

UKCG Code 2012, provision D.1.5

The Companies Act 2006 (**CA 2006**) currently provides that directors' service agreements may not exceed two years' duration without shareholder approval.

References: Companies Act 2006, s 188

Compensation on termination

The UKCG Code recommends that the remuneration committee should carefully consider what compensation commitments (including pension contributions and all other entitlements) their directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance, and that the committee should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.
References: UKCG Code 2010, provision D.1.4

UKCG Code 2012, provision D.1.4

Other investor guidelines

Remuneration committees will also need to take into account the guidelines published by relevant institutional investor bodies, including:
References: ABI Guidelines--executive remuneration policies and practices

- guidance on executive remuneration policies and practices issued by the Association of British Insurers (**ABI**)
- the ABI's guidelines on executive remuneration uncapped incentive plans, and
  References: ABI Guidelines--executive remuneration--uncapped incentive plans
- a joint statement issued by the ABI and the National Association of Pension Funds on best practice in relation to executive contracts and severance
  References: ABI and NAPF statement--executive contracts and severance payments

Additional FCA guidance for firms

The FCA's Senior Management Arrangements, Systems and Controls sourcebook (**SYSC**) contains a code of practice for remuneration policies relevant to firms (as defined) (being authorised persons under Part IV of the Financial Services and Markets Act 2000).
References: Financial Conduct Authority Handbook, Glossary, definition of firm

The code sets out a number of principles, which are used by the FCA to assess the quality of a firm's remuneration policies and whether they encourage excessive risk-taking by the firm's employees. Non-compliant firms could face enforcement action or ultimately be forced to hold additional capital should they pursue risky processes.
References: SYSC, provision 19A

Remuneration reports by quoted companies

Quoted companies (as defined) are required to prepare a directors' remuneration report for each financial year of the company. The remuneration report must be approved by the shareholders by ordinary resolution at the company's accounts meeting (as defined), which will usually be the annual general meeting of the company.
References: CA 2006, s 385

CA 2006, s 420-422

CA 2006, s 437(3)

Disclosures in relation to the remuneration committee

The UKCG Code requires the annual report to identify the members of the remuneration committee and to set out the number of meetings held with the individual attendance by directors.
References: UKCG Code 2010, provision A.1.2

UKCG Code 2012, provision A.1.2

The UKCG Code also requires the annual report to include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are delegated.
References: UKCG Code 2010, provision A.1.1

UKCG Code 2012, provision A.1.1

The UKCG Code provides that, where remuneration consultants are appointed, a statement should be made available as to whether they have any other connection with the company.
References: UKCG Code 2010, provision D.2.1

UKCG Code 2012, provision D.2.1

There are numerous other legal and regulatory requirements for disclosing details regarding the remuneration committee within the remuneration report, which are outside the scope of this note.