

Executive Remuneration: shareholders' say on pay

Yesterday the Government formally launched its consultation on improving the governance arrangements surrounding executive pay. It outlined the proposed model that aims to enhance shareholders' influence over executive pay.

The Government's objective is to enable shareholders to promote a stronger, clearer link between pay and performance in order to prevent executives being rewarded for perceived mediocrity or failure but at the same time enabling deserving individuals to be rewarded for outstanding performance.

The main components of the proposed model for providing greater shareholder influence are:

- An annual binding (as opposed to advisory) vote on future remuneration policy;
- Increasing the level of support required on votes on future remuneration policy to a threshold of between 50-75%;
- An annual advisory vote on how the previous year's remuneration policy has been implemented;
- A binding vote on exit payments of more than one year's base salary.

Key issues

- Timetable
- Future remuneration: annual binding vote
- Increasing shareholder power
- Annual advisory vote
- Exit payments: binding vote

Have your say

Some of the proposals are quite controversial and could significantly restrict the flexibility that UK plc's currently have in structuring the remuneration of executives. You have until 27 April 2012 to respond to the consultation and give your views. Whilst you are free to make your own submission, if you would like us to submit comments on your behalf (whether on a named basis or not), please let us know and we will include them in the submission that we will be making.

Timetable

- The consultation closes on 27 April 2012.
- Draft regulations on remuneration reporting requirements to be published in the Autumn.
- Legislation on remuneration reporting requirements and shareholder voting rights to come into force April 2013.
- The new regime will apply in respect of reporting years ending after 1 October 2013.

Future remuneration: annual binding vote

The Government has recognised that a binding shareholder vote on historic pay would be impractical and a proposal for a binding vote on the whole remuneration report has been dropped. Instead, the proposal is that shareholders are to be given a binding vote on a company's proposed remuneration policy at the beginning of the year. The proposed regime for UK plc's would operate as follows:

- The company's proposed future pay policy will be set out in its remuneration report which will include details of:
 - potential pay outs
 - performance measures
 - composition and potential level of pay for each director
- The policy will be put to an annual shareholder vote;
- Proposed changes to the previous year's policy will be contingent on the resolution being carried;
- If the resolution is not passed the company will either have to continue with the preceding year's policy or put revised proposals to another shareholders' meeting within 90 days;
- Shareholders will not however be able to reverse basic salary or pension agreements already entered into or awards of deferred variable pay granted in previous years;
- Directors recruited mid-year will have to be remunerated in accordance with the approved policy;
- Directors who authorise an executive service agreement that is inconsistent with the approved policy will be liable to account to the company for any loss and the director who receives the payment will hold it on trust for the company.

From a practical perspective, this would mean companies having to:

- Revise current service agreement provisions relating to variable remuneration so that the company has the flexibility to amend the remuneration package in line with future remuneration policies as approved by shareholders;
- Avoid entering into new remuneration arrangements with directors that guarantee an entitlement that may conflict with remuneration policies approved in the future;
- Seek shareholder approval of the performance measures that they intend to use for LTIPs and other incentive arrangements on an annual basis.

The Government will publish in the Autumn new regulations setting out the required content of remuneration reports which also includes a new section on the future remuneration policy. The required remuneration report content is intended to provide a framework for remuneration. However, it is acknowledged that the remuneration committee's future discretion on remuneration will ultimately be dictated by shareholder preference on the level of detail they expect to see in the remuneration policy which may well exceed the regulatory framework.

"Binding votes ... risks turning shareholders into micro-managers..."

John Cridland
Director General of the CBI
13 March 2012

Increasing shareholder power

Recognising shareholder frustrations that companies are currently able to proceed with remuneration proposals even where a large minority of shareholders are opposed, the Government is proposing that more than a majority vote will be required before shareholders can approve future pay policy. It is considering a threshold of between 50% and 75%.

Annual advisory vote

Shareholders are to be given an annual advisory vote on whether they are satisfied with the implementation of the previously approved remuneration policy. If less than 75% shareholder support is secured the company will be required to issue a statement to the market within 30 days, setting out the main issues raised by shareholders and how it proposes to address them.

To inform this vote, the new remuneration report regulations will require companies to include a backwards looking section setting out how the remuneration policy has been implemented in the preceding year detailing:

- Total pay figure per director;
- How pay awards relate to company performance and the policy agreed with shareholders at the start of the year;
- How spend on executive pay relates to other dispersals such as dividends, tax, business re-investment and general staffing costs.

Exit payments: binding vote

The Government proposes that shareholders of UK plc's should be given a binding vote on any exit payment to a director that exceeds the equivalent of one year's base salary as follows:

- The vote will be required after termination when the director's contract has been terminated early and without due notice by the company or the executive;
- The vote would have to approve the entire exit package over and above the value of one year's base salary;
- Payments made under the exit package comprised of performance related awards such as in-year bonus, deferred bonuses, unvested LTIP awards and share options would all be subject to shareholder approval;
- Approval is to be secured by way of ordinary resolution at a general meeting;
- In advance of the vote the company must supply the shareholders with the following details:
 - the amount to be paid;
 - how they have been calculated;
 - why they are deserved.
- Where approval is not obtained the company can only pay the basic limit of a year's base salary.

If an exit payment includes a sum referable to statutory compensation for unfair dismissal, redundancy or discrimination claims that have been awarded by an employment tribunal or agreed bonafide on termination then these sums will not be subject to the shareholder vote.

From a practical perspective, companies would need to take the following steps:

- Refrain from concluding new contracts that provide a contractual entitlement to exit payments in excess of one year's base salary;
- Ensure that exit payments in new contracts in excess of one year's base salary are conditional upon shareholder approval;
- Revise existing contracts that provide for payments in excess of one year's base salary to make them conditional upon shareholder approval. This may require buying the director out of his existing entitlement;
- Be prepared for the exercise of remuneration committee discretion in relation to "good" and "bad" leaver provisions in LTIPs and other incentive plans to be challenged by shareholders as part of this vote.

The consultation paper can be found [here](#). Our Briefing on the Government's January announcement on executive remuneration can be found [here](#).

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