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Lab project report: Reporting of pay and performance

March 2013



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Background

At the request of the Department for Business, Innovation & Skills (BIS) the Financial Reporting Lab (Lab) carried out its first project on remuneration reporting in the Spring of 2012, resulting in the report *A single figure for remuneration* published on 21 June 2012. In that project, the Lab facilitated the testing of various approaches for measuring the single figure put forward by companies with investors. Through this process, a methodology for measuring and presenting the proposed new single figure for total remuneration was developed.

On 27 June 2012, the Secretary of State for Business issued a consultation on revised remuneration reporting regulations, ‘aimed at increasing transparency on directors’ pay’. The consultation, which includes draft regulations, proposes a new two part remuneration report, which ‘replaces rather than adds to current reporting requirements’. The consultation notes that the ‘Policy part of the report will be required when there is a binding vote on policy.’ The second part, the Implementation part, will contain the annual reporting of how the policy has been implemented, including ‘actual payments to executive directors’.

The draft regulations include a methodology for the single figure, which builds upon the methodology developed through the Lab. The consultation period

closed on 26 September 2012, and final regulations are expected in the Spring of 2013, coming into force on 1 October 2013.

- Given the positive response to the first project, BIS asked the Lab to undertake a second project on remuneration focusing on two new proposed reporting requirements set out in their consultation relating to the reporting of pay and performance, namely:
- The requirement to include scenario charts demonstrating how directors’ pay varies with performance (contained within the Policy part); and
 - The requirement to include a graph comparing CEO pay with company performance, measured using Total Shareholder Return (TSR) (contained within the Implementation part).

These two areas were selected for the Lab to focus on, as responses to the BIS consultation highlighted a number of challenges in relation to these particular new disclosure requirements.

The Lab also took the opportunity of the meetings with investors to follow up some detailed matters raised in relation to the first Lab report. These are discussed in *Appendix 1* ([see page 10](#)).

What is the Lab?

The Financial Reporting Lab has been set up by the Financial Reporting Council (FRC) to improve the effectiveness of corporate reporting in the UK.

The Lab provides a safe environment for listed companies and investors to explore innovative reporting solutions that better meet their needs.

Find out more about the Lab including information about other projects at: <http://www.frc.org.uk/Our-Work/Codes-Standards/Financial-Reporting-Lab.aspx>

Summary

Investors and companies are both concerned about the increasing length of remuneration reports and accordingly, investors favour measurement methodologies and presentation of remuneration information that is clear and simple, and prepared consistently from year to year.

The section entitled ‘Investor and company views’ considers each of the two areas of focus for this project in detail. There is a great deal of agreement between investors and companies on these areas, as well as those discussed in relation to the first project.

All agree that there is a need to educate the market and market commentators on the new regulations.

The views contained within this report represent those expressed by the 17 investment organisations and the 28 companies that have supported this project, and are not the views of the FRC. Unless otherwise stated, the views represent the majority view expressed by the investors and companies.

Scenario charts

Both groups favour a simplified version of the scenario charts proposed by BIS. Development of common practice, particularly around measurement methodology, would be very helpful, especially as such guidance could go some way towards ‘future proofing’ practice as remuneration plans develop and change.

Disclosure aid 1 on [pages 7](#) and [8](#) illustrates the simplified scenario charts and accompanying explanatory information favoured by investors and companies.

Assessing pay and performance

Investors and companies agree with BIS’ stated aim of the new requirement that there should be information to help investors assess the relationship between CEO remuneration and company performance. However, they both have a number of concerns about the specific proposals.

Instead of requiring the new graph, investors and companies suggest retaining the current five year TSR graph and supplementing this with a simple table setting out historic levels of CEO pay and information on the level of performance related elements of pay, against the maximum opportunity.

Disclosure aid 2 on [page 9](#) illustrates the table of historic data that investors believe would assist them in undertaking their own assessment of ‘the relationship between remuneration and performance over the longer term.’

Follow up of first Lab report

The main area of further discussion relating to the first Lab report on remuneration relates to companies using periods for TSR measurement other than the financial year end, in assessing long-term incentives. While this only seems to affect a minority of companies, the discussions have highlighted that there are a number of complexities. Accordingly, participants suggest that common practice guidance is developed to deal with the issue.

In addition, the Lab team followed up on some points of detail relating to:

- Clawbacks of remuneration
- Dividend equivalent payments
- Single figure table format
- The supplemental table disclosing amounts awarded

Appendix 1 ([pages 10-12](#)) discusses each of these.

Investor and company views

The high level of engagement by both investors and companies in this project demonstrates the commitment of both communities to try to ensure that the new regulations deliver useful information. The Lab’s work on both the single figure project and on this project, together with the significant work being undertaken by other groups such as the GC100 Investor Working Group*, illustrates that directors’ remuneration is also a complex area.

During the project, both investors and companies have expressed concerns about the length of the remuneration reports that may result from the new requirements. Longer reports will make it difficult for all users of remuneration reports to get to grips with the information that is important.

As well as being complex, directors’ remuneration is a sensitive issue and one that often makes headlines. Both investors and company participants reiterated their view, expressed in the previous Lab report that they would like to see the Government provide education to the media and other users of remuneration reports on the new regulations. Without such an initiative the fear is that remuneration reporting will continue to be misunderstood and lead to inappropriate conclusions being reached.

Investor views

In formulating their views, investors emphasised a number of principles that they believe should guide the development of requirements in relation to remuneration reporting, namely that both measurement and presentation of remuneration information should be:

- Clear and simple; and
- Consistently prepared year to year.

Clarity and simplicity are important both when establishing the measurement methodologies for remuneration information, as well as in how the resulting information is presented. Ensuring the information is prepared consistently year on year, will also improve the clarity, transparency and accessibility of remuneration reports. Investors would like to see remuneration information presented in a more transparent and simple way – this could ultimately lead to shorter remuneration reports.

Scenario charts

The draft regulations require that scenario disclosures are included within the Policy part of the remuneration report. The proposal is to provide three scenario bar charts, setting out remuneration payable when performance meets, exceeds and falls below threshold/target. The consultation noted that ‘The Government expects this disclosure to provide an indication of the expectations of the remuneration committee when setting pay rather than hard and fast

estimates of future pay packages.’ BIS propose that each scenario chart includes all elements of pay, and sets out the proportion of pay relating to each element (as a %), as well as total remuneration (in £). The most significant other disclosure within the Policy part, will be the ‘future policy table’, which sets out the company’s forward-looking policy on remuneration. The Policy part as a whole will be subject to the new binding vote on remuneration policy.

The investors’ view is that the aim of including scenario charts in the remuneration report should be to provide an indication of what an executive director could receive under the policy set out in the policy table, in different circumstances. The scenario charts are not expected to provide a prediction of the future remuneration of an executive director.

Investors debated which scenarios should be illustrated. Investors would like to see a set of charts for each executive director, setting out pay under the policy set out in the policy table, for each of three scenarios:

- Fixed – including all non-variable remuneration payable.
- On-budget/on-plan – indicating remuneration if performance is in line with budget or plan.
- Maximum – providing the maximum level of remuneration payable.

There was some debate on what the middle scenario should show, but investors concluded that their preference was that it should give

“Investors would like to see remuneration information presented in a more transparent and simple way – this could ultimately lead to shorter remuneration reports.”

** The GC100 Investor Working Group on remuneration comprises members of the GC100 (the association for general counsel and company secretaries of companies in the FTSE 100) and investors from the Corporate Governance Forum.*

a broad indication of what the remuneration policy (as set out in the policy table) could deliver for performance in line with budget or plan. The expectation is not that this would require a company to set out the specific budget or plan, but instead to set out what percentage of, say, the annual variable element would be awarded, e.g. 50%, 60% etc., if budget was met.

Rather than require that each scenario should illustrate each of the five elements of the single figure for total remuneration, as currently proposed by BIS, investors are supportive of simplified disclosure. Investors agree that three elements of remuneration should be illustrated in the scenario charts:

- A single element consisting of all the fixed elements of remuneration, which would usually encompass three elements of total remuneration (salary, benefits and pension);
- Annual variable remuneration (e.g. annual bonus); and
- Long-term incentives.

Investors also debated whether a separate set of scenario charts was necessary for each executive director. While a few investors believe that the scenario chart for the CEO, or alternatively the CEO and CFO, would be sufficient, the majority would like to see a separate chart for each of the executive directors. Investors believe that the cost of producing individual charts will not be excessive. In order to assist with the over-arching aim of improving transparency, investors believe it is essential that the scenario charts are

accompanied by a description of the assumptions underpinning the charts including:

- A disaggregation of the fixed elements; and
- The percentage of the maximum opportunity that would be awarded for on budget/on plan performance, for each variable element of remuneration.

Investors support BIS’ proposals that each scenario bar should set out the percentage of total remuneration attributable to each element (reduced to three elements), as well as the quantum of total remuneration (in £).

An example of the scenario chart disclosures reflecting the views of investors set out above, is illustrated in *Disclosure aid 1* (see [pages 7](#) and [8](#)).

There are various ways in which the elements of remuneration can be measured. However, in formulating their majority view, investors again stressed the principles that the measurement basis to be applied should be clear and simple. Investors believe this would enhance both the understandability and transparency of the disclosures. In later discussions with companies, they agreed that this would also reduce their burden in preparing the scenario charts. For example, it can be very difficult to determine benefits in advance, particularly when they are offered as a menu of potential benefits. Accordingly investors agree that the most efficient measurement basis to use is the benefit number in the current year single

figure for total remuneration. The methodology for the single figure has already been established and is supported by both investors and companies. Furthermore, in terms of total remuneration, benefits are usually not significant.

The same principles of clarity and simplicity underpin the measurement methodologies recommended by investors for the other elements of total remuneration, as set out below:

Element of total remuneration	Measurement basis
Salary	Latest confirmed salary, on the grounds of simplicity and that this information is the latest known future salary.
Benefits	Last year’s single figure value, excluding the benefits that are not expected to continue, e.g. one-off benefits such as recruitment payments or moving expenses. Investors expect such adjustments would be very unusual and should be fully disclosed.
Pension	For a defined benefit pension, last year’s single figure value. For other pension arrangements, such as cash in lieu or contributory pensions, a figure based on policy set out in the policy table, calculated with reference to the latest confirmed salary.
Annual variable element	Based on the policy set out in the policy table, calculated with reference to the latest confirmed salary.
Long-term incentives	Share based awards measured using face value, with no allowance for share price appreciation or dividends. For option awards, use a rule of thumb established by common practice. An initial suggestion was one third of the market value of the shares under option.

There is a concern amongst investors that the regulations should in some way be ‘future proofed’. Remuneration plans have evolved considerably over the last 10 years and are likely to continue to do so. Accordingly, investors believe the new regulations should contain sufficient flexibility to allow them to adapt to changing practice.

Comparison of CEO pay and company performance

BIS propose to require a graph comparing CEO pay (measured using the single figure of remuneration) with company performance (measured using TSR). This would replace the current requirement to publish a graph showing the company’s TSR over the previous five years alongside the TSR for a peer group of companies. The aim of the new graph, which would be included in the Implementation part of the remuneration report, is to provide shareholders with information ‘to enable them to assess the relationship between remuneration and performance over the long term’. The proposal requires CEO pay (in £) to be plotted against a one year TSR (as a percentage) over a ten year period.

Investors agree with the aim of the new requirement – that there should be information in the remuneration report to help them assess the relationship between pay and performance. However, investors have a number of concerns about the specific proposal including:

- Clarity of information – it will be difficult for readers to draw meaningful conclusions from the graph, particularly where two different quantities are to be shown on two vertical axis and could be subject to manipulation.

- Transparency of information – TSR is often only used as a performance measure for the long-term element of remuneration and it is usually not the only measure used, and may not even be used at all. If TSR performance is used to determine vesting of long-term incentives, the measurement period is likely to be a three or five year period, depending on the duration of the long-term incentive. The presentation of the one year TSR against the CEO pay will not give a complete, transparent picture of performance measures used to determine the remuneration of the CEO.

Whilst some investors do not find the current TSR graph useful, others believe that the current graph does serve a purpose – providing a ready reckoner of company performance over the last five years. Retail investors, in particular, find the existing graph helpful as they do not readily have access to the market data on which it is based, for example through data providers.

In considering the aim of the proposed disclosure, investors note that they each assess company performance in a number of ways, some of which are quantitative and some qualitative. Accordingly, the presentation of a simple table showing historic levels of CEO pay and information on the performance related elements of pay would be useful and assist investors in

undertaking their own assessment of ‘the relationship between remuneration and performance over a long term period’.

Historic information on the annual variable element and long-term incentive vesting rates would provide useful insight into the past decisions of the Remuneration Committee, and would be a useful complement to the forward-looking policy report. Although the information is largely available within remuneration reports currently, its collation is not easy and its provision by companies would increase transparency of past practice.

Accordingly, having considered the points noted previously, investors favour an alternative to the BIS proposal. Their view is that the presentation of the existing TSR graph should be retained, and should be supplemented by a table of historic data, providing CEO pay, as well as the annual variable element award rates and the long-term incentive vesting rates against maximum opportunity.

An example disclosure illustrating the table in a situation where there has been a change in CEO, is set out in *Disclosure aid 2* ([see page 9](#)).

There was no majority view as to how many years’ data should be provided in relation to the TSR graph and the table of historic data. A number of investors consider that for both, the presentation of five years’ data initially, building up to ten years’ data after implementing the regulations, would be useful. However, other investors believe that five years’ data would be sufficient.

Companies' views
Scenario charts

The company participants' views on the requirements for scenario charts were largely consistent with the investors' views.

In the Lab's initial discussions with the companies, they expressed the view that the biggest challenge was to determine what scenario chart information would prove most useful to investors and how this should be described. When assisting the Lab team in preparing for the meetings with investors, companies suggested using plain English descriptors for the ends of the range, i.e. minimum and maximum.

Companies realised that the greatest challenge would be in relation to the middle scenario. Difficulties arise as different companies employ both different practices and different language around threshold/target levels of performance in relation to variable elements of remuneration.

Therefore the challenge is to develop a definition for the middle scenario that is broad enough to be applicable across different companies, while at the same time producing information that investors want to see. Accordingly, companies are supportive of the investors' view that the regulations

should cover a high level description of the middle scenario with guidance describing, in broad terms, what is expected.

A few company participants expressed a view that the scenario charts should only be provided for the CEO, as the CEO is usually the highest paid.

Comparison of CEO pay and company performance

In initial discussions with companies, the majority expressed concerns about the new proposed graph showing CEO pay against a one year TSR.

The majority of the company participants agree with the investors that the existing requirement to show the company's TSR over the previous five years should be retained. Almost all company participants agree that a supplemental table of historic CEO remuneration, annual variable award rates and long-term incentive vesting rates would be useful.

As with the investor community, there were mixed views on whether the period covered by the supplemental table should start with five years and increase to ten years. A significant number of companies pushed back on this, as they believe that increasing

the disclosure to cover ten years is too long, given the extent of market and other changes that can occur over such an extended period.

“(overall) companies are supportive of the investors' view(s)…”

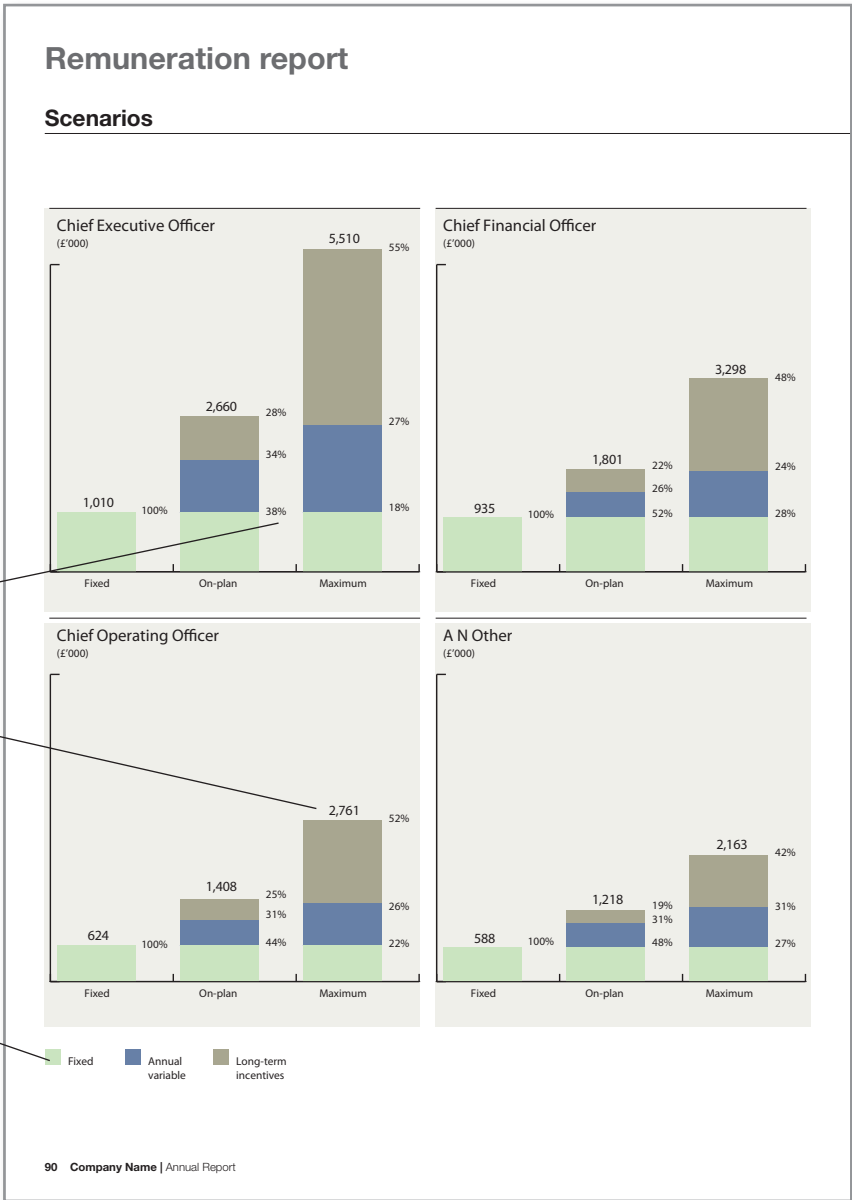
Disclosure aid 1: Scenarios

Provide scenario charts for each executive director for the period covered by the policy set out in the policy table. The charts should also be accompanied by a narrative explanation of the basis of preparation, as illustrated on [page 8](#).

Set out the percentage of total remuneration contributed by each of the three elements of total remuneration.

Provide the value of the total remuneration for each scenario.

Distinguish the three elements of total remuneration.



Disclosure aid 1: Scenarios (continued)

Provide a description of the basis of measurement for each scenario, as well as an explanation of any assumptions made.

In developing the scenarios, the following assumptions have been made:

Fixed	<ul style="list-style-type: none">• Consists of base salary, benefits and pension• Base salary is latest known salary• Benefits measured at benefits figure in single figure table on page x• Pension measured by applying cash in lieu rate against latest known salary for all executives, other than CFO who is a member of the defined benefit plan• CFO pension measured using single figure in pension figure as set out on page x				
		Base	Benefits	Pension	Total fixed
	CEO	750	35	225	1,010
	CFO	525	30	380	935
	COO	475	30	119	624
	A N Other	450	25	113	588
On-plan	Based on what a director would receive if performance was in line with plan: <ul style="list-style-type: none">• Annual variable element pays out at 60% for on-plan performance• Long-term incentive performance at median, therefore 25%.				
Maximum	<ul style="list-style-type: none">• Full payout of annual variable element, i.e. two times salary for CEO and 1.5 times for the other executive directors• 100% vesting of long-term incentive awards.				

Long-term incentives consists of share awards only, which are measured at face value, i.e. no assumption for increase in share price or dividends.

Provide a breakdown of the components of the fixed element.

Disclosure aid 2:
Assessing pay
and performance

Provide five years of information
in the table.

Provide the information for each
individual 'fulfilling the role of chief
executive officer' within a given year.

Remuneration report				
Assessing pay and performance				
Table of historic data:				
		CEO Single figure of total remuneration (£ '000)	Annual variable element award rates against maximum opportunity	Long term incentive vesting rates against maximum opportunity
2013	CEO2	X,XXX	XX%	XX%
2012	CEO2	X,XXX	XX%	XX%
2011 ¹	CEO2	X,XXX	XX%	XX%
	CEO1	X,XXX	XX%	XX%
2010	CEO1	X,XXX	XX%	XX%
2009	CEO1	X,XXX	XX%	XX%

¹CEO1 retired at the AGM on 21 May 2011, and CEO2 took over from that date, having been the COO.

Appendix 1: Follow up of first Lab report

During the course of this second project, a few points relating to areas addressed within the *Lab project report: A single figure for remuneration* were raised where some follow up could usefully be undertaken. The points were raised either by BIS and/or project participants. This Appendix summarises the issues and the conclusions of the discussions with investor and company participants.

TSR measurement periods *The issue*

In discussions, investors noted that the specifics of a company’s TSR measurement period for assessing vesting of long-term incentives can vary. Where TSR is used, companies use either a TSR measurement period ending around an anniversary of the grant date or the financial year end. The measurement of TSR has not been an issue in the past but variations in measurement periods will lead to timing differences in the recognition of long-term incentives within the new single figure. This is because long-term incentives are only included in the single figure when all performance criteria have been met.

Most long-term incentive plans use a number of performance measures, with performance measures other than TSR being measured over financial year ends.

- Accordingly, if a company uses a period ending around an anniversary of the grant date (uses ‘grant period’) to assess TSR performance:
- Not all the performance measurement periods used to assess vesting will be aligned with each other; and
 - Recognition of the long-term incentive will be pushed into the next year’s single figure, as the performance period will not end at the financial year but will extend to the end of the grant period.

Understanding current practice

Investors asked the Lab team to follow this up with the companies supporting the second Lab project, to get a better understanding of current practice. A questionnaire was sent to all company participants and 26 responses were received. While acknowledging the limitations of the sample size, the responses do shed some light on current practices indicating that:

- Not all companies use TSR as a performance measure for their long-term incentive plans (five do not use TSR).
- Of those using TSR, approximately 75% grant their long-term incentives within

- three months of the financial year end, and the significant majority use the financial year as the measurement period.
- Half of the remainder grant within six months of the financial year end, with the rest granting within eight months of the financial year end. The majority of these companies use the grant period to measure TSR.
 - There is no evidence that practice is dependent on the size of the company.

The *ABI Principles of Remuneration* call for the granting of long-term incentives ‘within a 42 day period following the publication of the company’s results’, with ‘company’s results’ meaning the date of the preliminary announcement. Based on the analysis above, most of the companies are following this guidance. There are of course situations where this is not possible, particularly where the grant date will have to be delayed until after the Annual General Meeting. In such cases, grant dates will likely be five or six months after the financial year end. For ease of discussion, the ABI guidance is described in shorthand as granting ‘within three months of the financial year end’, although the three month period should not be seen as a hard and fast rule.

Alignment of measurement periods
For grants made within three months of the financial year end, investors believe that companies should use the financial year to measure TSR performance. This ensures that all the long-term incentive performance measures are aligned. However, they also strongly believe that for grants made six months or more after the financial year end, the grant period should be used to measure TSR performance – as otherwise too much of the performance period is already known at the time of grant.

Investors believe that in the development of future policies and plans, Remuneration Committees should consider aligning all measurement periods for the performance measures used to assess long-term incentives vesting as much as practicable, and a number of participating companies have indicated that they are considering this.

Companies noted that even if they seek to align their performance measurement periods in the future, there will be awards outstanding under the current plans that will take a few years to unwind.

Seeking a pragmatic solution

As noted previously, most of the companies grant long-term incentives within three months of the financial year end and use the financial year end for measuring TSR performance. Accordingly, all their performance measures for long-term incentives are aligned. Further, they will include these awards in the single figure when reporting on the financial year where that year end is the last year of the performance cycle.

Agreeing a pragmatic solution to allow those few companies that currently use the grant period to measure TSR performance **and** grant long-term incentives within three months of the financial year end, to align all of their performance measurement periods around the financial year end, would be very helpful.

Any solution will need to consider both:

- When it is appropriate for companies to recognise a long-term incentive in the single figure when the TSR measurement period ends after the financial year being reported on; and
- Given the lack of data, how to assess TSR performance conditions and estimate vesting in such situations.

Benefits

Benefits of developing a pragmatic solution will include:

- A company will be able to recognise the long-term incentive within the single figure for the financial year used to assess the other performance measures.
- For companies that change their plans to align the TSR measurement period with the financial year, when grants under the new plans start to vest, the single figure will not include two long-term incentives (the first of the new plan and the last of the old plan) in the same year.

Use of estimation

Project participants discussed that a pragmatic solution could involve greater use of estimation. The draft regulations already allow for the use of estimation in relation to the market value of shares:

'for the purposes of the calculation in subsection (XYZ) where full vesting is not achieved by the date on which the remuneration report is signed off, an estimate of the value of the benefit will be calculated on the basis of an average market value over the last quarter of the financial year' (para 6 (e) (iii))

The first Lab report suggested other situations where estimation in measuring the long-term incentive element of the single figure could apply (see page 14 of *Lab project report: A single figure for remuneration*):

'...where the performance conditions to the end of the financial year being reported on cannot be fully assessed until after the sign-off date of the Annual Report, e.g. where the Remuneration Committee has not been able to meet prior to the sign off date, or where a performance condition needs to be assessed against peer companies and that information is not yet available, the company would complete an indicative assessment as at the year end, e.g. 31 December.'

The use of estimation could also be considered appropriate for those few companies that currently use the grant period to measure TSR performance **and** grant long-term incentives within three months of the financial year end. In such circumstances, the company would complete an indicative assessment of vesting as at the year-end. This approach seems to be acceptable to investors and companies.

There may also be other situations where estimation may be appropriate, e.g. where the grant date is later than three months from the financial year end, which will typically be the case where a plan needs approval at an AGM. One possible approach would be to extend the use of estimation further to include all vestings that take place within six months of year end.

Development of common practice

The suggestion of the majority of participants in this project is that common practice guidance should be developed to address these types of issues.

Transparent disclosure is essential

What is important to investors is that there is transparency in relation to:

- Dates of the grants.
- Periods used to assess TSR performance.
- The financial year the long-term incentives are included in the single figure.
- Any use of estimation to determine share price and/or the vesting percentage.
- Actual vesting rates once known.

Furthermore, investors would like to be informed of the estimated values used in the single figure, when the actual values become known and are reported to the stock exchange, as set out on page 5 of the *Lab project report: A single figure for remuneration*:

'As, in a number of circumstances measuring the long-term incentives will involve estimating vesting rates and/or a share price, investors have requested that when the stock exchange announcement is published relating to the actual vesting of the shares/options, the value at vesting (incorporating the actual vesting rates and market value of the shares at the date of vesting) is provided as well as the value included within the single figure in the announcement.'

Clawbacks

Clawbacks of remuneration can arise in a number of scenarios, for example when an executive director leaves and an award lapses on leaving; or in situations where the Remuneration Committee decides to clawback remuneration.

Clawbacks were addressed in the first Lab report; however, a number of respondents to BIS’ proposals raised them as an issue. Accordingly, it was felt that the meetings with investors during the second Lab project provided an opportunity to confirm or rebut the views expressed in the first Lab report.

The majority view of both investors and companies participating in this second Lab project is that clawbacks should be recognised in the single figure as negative figures in the year that they are determined. This confirms the view expressed in the first Lab report, see page 5 of *Lab project report: A single figure for remuneration*.

Dividend equivalent payments

Under some plans, dividend equivalent payments are made in relation to long-term share based incentives. They compensate the recipient for the dividends they would have received as a shareholder between the grant date and vesting date.

The first Lab project did not explicitly cover the treatment of such payments in the single figure, nor are they considered within the draft regulations. Participants in this project agree that these payments should be included as part of the long-term incentive element of the single figures once the award vests, and should be accompanied by a narrative explanation.

Single figure table format

The draft regulations in the BIS consultation are prescriptive in terms of the form of the single figure table, and concerns were raised about the degree of prescription.

Participants agree that the regulations should only prescribe the minimum contents of the table, thereby allowing additional columns for clawbacks, or unusual benefits (e.g. significant one-off moving expenses).

Supplemental table disclosing amounts awarded

The draft regulations refer to the disclosure of variable pay awards during the financial year. In developing the first Lab report, there was an expectation among participants that the figures shown would include those related to the latest awards as well (e.g. for 2012 year end Annual Report, awards granted in early 2013 in respect of 2012). Participants in this second project confirmed that the disclosure of the awards in respect of the financial year being reported on would be appropriate.

Other reports published by the Lab recently:

- February 2013:
[Presentation of market risk disclosures](#)
- November 2012:
[Debt terms and maturity tables](#)
- November 2012:
[Operating and investing cash flows](#)
- September 2012:
[Net debt reconciliations](#)
- June 2012:
[A single figure for remuneration](#)

Appendix 2: Project process

Involvement of companies

The support of companies is essential to all Lab projects and the interest in this second Lab project on remuneration has been considerable. In total, 28 companies volunteered to contribute to the project:

- Barclays
- BHP Billiton
- BP
- Cobham
- Diageo
- GlaxoSmithKline
- Halma
- HSBC
- International Personal Finance
- Kingfisher
- Invensys
- Legal & General
- London Finance & Investment Group
- Meggitt
- Old Mutual
- Petrofac
- RBS Group
- Reed Elsevier
- Royal Dutch Shell
- SABMiller
- Schroders
- Severn Trent
- SThree
- Tyman
- Vodafone

- Workspace
- WPP
- Xaar

All of these companies have thoughtfully considered the proposed new reporting requirements; several were in the process of developing disclosures in line with the BIS proposals to facilitate their own internal discussions. Working with these companies, the Lab team was able to gain a detailed understanding of some of the challenges they expect these new reporting requirements would pose. In some instances issues raised by companies relate to the need to clarify the requirements, while some of the other challenges are more fundamental.

These initial discussions with companies served to enhance the Lab team’s understanding of the two proposed disclosures, enabling the team to develop appropriate questions and illustrative disclosures for use in discussions with the investors (see *Appendix 3: Detailed investor materials*, [page 14](#)).

The involvement of companies was maintained throughout the project, as they continued to respond to questions arising from the Lab team’s meeting with investors, to participate in conference calls and to attend a meeting with investors.

Obtaining the views of investors

The high level of support for the project demonstrated by the companies was matched by the support from the investment community. In total, 17 face-to-face meetings took place during late December 2012 and January 2013. Investor participants were asked a number of questions and various illustrative disclosures were presented to focus discussion ([see Appendix 3](#)).

The Lab team met with 13 investors:

- Aviva Investors
- BlackRock Investment Management
- Fidelity Worldwide Investment
- Henderson Global Investors
- Hermes Equity Ownership Services
- Legal & General Investment Management
- London Finance & Investment Group
- Royal London Asset Management
- RPMI Railpen Investments
- Schroder Investment Management
- Standard Life Investments
- UBS Global Asset Management (UK)
- USS Investment Management

Four meetings were also held with investor organisations:

- Association of British Insurers
- The Investment Management Association
- National Association of Pension Funds
- ShareSoc (UK Individual Shareholders Society)

Building a consensus

Once individual meetings had taken place with investors, the Lab facilitated a face-to-face meeting of both investors and companies to discuss the main conclusions arising from those meetings and to build a consensus. Representatives of 11 of the investors and over 20 of the companies participated in the meeting, with a representative from BIS observing.

Appendix 3: Detailed investor materials

Investor participants were asked to consider the questions below.

Scenario charts

The Government proposes that the policy report contains a series of scenario charts.

1. What do you consider the underlying purpose of these scenario charts should be:
- a. To present the potential levels of payments to directors and manage expectations about what they may receive?

b. To present all the components of remuneration as described in the policy table under different performance scenarios?

c. To demonstrate how the variable elements of remuneration set out in the policy table change at different performance levels?

Comparison of pay and performance

Currently, there is a requirement to disclose a graph comparing total shareholder return (TSR) against the TSR of a peer group of companies. The Government noted in the narrative accompanying the June 2012 proposals ‘that stakeholders have commented that this graph (the existing performance graph showing company versus peer group) is of limited use to shareholders.’

2. Do you agree with this assessment?
Do you use the existing graph?

The Government is proposing to remove the existing requirement and instead require the presentation of a line graph that compares the pay of the CEO (measured using the single figure) with company performance (using a one year TSR).

3. Do you believe that this new graph will meet the stated objective, i.e. ‘enable investors to assess the relationship between remuneration and performance over a long term period’?
4. Do you believe that a one year TSR is an appropriate measure of company performance for this comparison?
5. Do you believe that ten years is an appropriate period for comparison?

Illustrative disclosures







In addition, the Lab team developed illustrative disclosures for use in discussions with investors. For the scenario charts, the five options discussed were:

Options	Number of scenario charts presented	Detail provided in relation to each chart
1	One for each executive director, four in our illustrative example.	<ul style="list-style-type: none">Each of the five components of total remuneration specified in the draft regulations, namely salary, benefits, pension, annual variable incentive and long-term incentive.Percentages for each component and the total remuneration under each scenario.Three scenarios simply described as minimum, middle and maximum.
2	One for the CEO and a second based on an average for the other executive directors (on the basis that the greatest variation in the package is for the CEO).	<ul style="list-style-type: none">Same as for Option 1.
3	Same as Option 1	<ul style="list-style-type: none">Three components of remuneration, salary, annual variable incentive and long-term incentive.Percentages for each component and the total remuneration under each scenario.Three scenarios simply described as minimum, middle and maximum.
4	Same as Option 2	<ul style="list-style-type: none">Same as for Option 3.
5	Rather than a graphical presentation, a simple table setting out base pay, and the percentage of base pay under each of the three scenarios, i.e. minimum, middle and maximum.	

For the consideration of pay versus performance, the Lab team developed a five year CEO pay v TSR graph (as a first option). During the initial investor meetings, an alternative table of information was suggested by one of the investors as being useful to enable investors to assess pay versus performance themselves. This table, which ultimately has developed into the ‘table of historic data’ set out in *Disclosure aid 2* ([see page 9](#)), was mocked up as a second option and used at the subsequent 15 investor meetings.

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