Lab project report: A single figure for remuneration

June 2012

Lab project report: A single figure for remuneration

Background

On 23 January 2012, the Secretary of State for Business announced a series of next steps relating to executive pay. These proposals address four areas of focus, one being "greater transparency so that what people are paid is clear and easily understood". The announcement followed an earlier consultation, published in September 2011, on improving company narrative reporting.

The current expectation is that the Department of Business Innovation and Skills (BIS) will set out more detail on the proposed disclosure requirements this summer, one of which will be for "one single figure for total remuneration of each director". Currently there is no agreed basis for calculating this 'single figure'.

Accordingly, at the request of BIS, the Financial Reporting Lab (Lab) agreed to undertake a short-term project to obtain the views from the investment community on how a 'single figure' might be measured and presented, with the objective that the output would be made available to help inform BIS' thinking in developing this disclosure requirement.

Contents

What is the Financial Reporting Lab?

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

The Lab provides a safe environment for companies, investors and analysts to discuss innovative reporting solutions that better meet the needs of both communities.

Find out more about the Lab, including information about other projects at: www.frc.org.uk/about/financialreportinglab.cfm

Process

Involvement of companies

As the Lab has been set up to facilitate testing of approaches to disclosure put forward by companies, a key requirement to ensuring a successful project is getting the support from the preparer community. Encouragingly, nine companies volunteered to contribute to this project:

- BHP Billiton
- Cobham
- GlaxoSmithKline
- HSBC Holdings
- InterContinental Hotels Group
- Legal & General
- Rio Tinto
- Royal Dutch Shell
- The Royal Bank of Scotland Group

All of these companies have put considerable thought into which components of remuneration should be included within a single figure of 'total remuneration', as well as how each component should be measured. Eight of the nine companies voluntarily published a 'total remuneration' figure in their last Annual Report. As participants in the project they then spent extensive time with the Lab team explaining their thinking in coming to their version of a single figure.

These discussions enabled the Lab to develop a matrix of options for what could be included within 'total remuneration' and how each component could be measured. This matrix was one of the key inputs to the discussions with investors (see page 12).

The support of the companies continued throughout the project and the majority were involved in a collaborative effort to develop proposals to address practical issues raised by investors. All of the practical issues have been resolved as part of the project, as discussed later within this report.

Obtaining the views of investors

The considerable support demonstrated by the companies to this project was matched by the support received from the investment community. Face-to-face meetings were undertaken by the Lab team with investors and investor organisations over a period of three weeks in April/May 2012. Each meeting lasted for approximately 30 minutes to one hour and participants were asked a number of high-level questions. In addition, the matrix of options setting out what could be included within a single figure of remuneration was discussed as well as how each component should be measured. (See *Appendix 1: Detailed investor materials, page 12*, for further details.) In most meetings, two individuals represented the investor organisation, with, in the majority of cases, at least one of the individuals having a focus on corporate governance matters.

In total 12 interviews took place, nine of which were with investors:

- BlackRock Investment Management
- Fidelity Investments
- Henderson Global Investors
- Hermes Fund Managers
- Legal & General Investment Management
- Royal London Asset Management
- RPMI Railpen Investments
- Schroder Investment Management
- Universities Superannuation Scheme

The other three meetings were with investor organisations:

- Association of British Insurers
- Investment Management Association
- ShareSoc (UK Individual Shareholders Society)

"The considerable support demonstrated by the companies to this project was matched by the support received from the investment community."

Views

The views contained within this report represent those expressed by the nine companies and 12 investment organisations that supported this project.

Investor views

Investors view the Government's proposed revision of the current remuneration reporting requirements as an opportunity to create a more transparent and simple way of presenting information on remuneration. They believe they would benefit from having a single place to find the information they want about remuneration and how it relates to current performance.

While investors understand the Government's reason for proposing the communication of a single figure of 'total remuneration' they have identified a number of practical problems in formulating the figure. They also believe that a single figure on its own cannot provide all the information they need. As a result, a single figure will need to be supplemented by disclosure that explains the various components of total remuneration, as well as additional disclosure related to amounts awarded that will vest in the future (see *Supplemental disclosure on amounts awarded, page 6*).

Consistency is essential both as to which components are included within total remuneration, as well as how each component is measured. An accepted benefit will be the ability to compare total remuneration year-on-year within a company. Ideally, peer comparisons will also be made easier by the provision of this information; however, without the experience of using total remuneration information, investors are currently uncertain if this will be achievable.

The views expressed by the majority of investors involved in the project, can be summarised in the following principles:

- The single figure of remuneration should be:
  – Comprehensive – that is it should include all types of reward
  – Consistently prepared – both with regard to what components are included and how each component is measured
- Salary should represent amount received; benefits and pension should represent an estimate of the benefit provided to the individual
- The variable element should reflect the remuneration relating to performance in the financial year being reported. Where the performance period for the variable pay is greater than a single year, it should reflect the remuneration where the financial year being reported is the last year of the performance cycle.

"Investors believe they would benefit from having a single place to find the information they want about remuneration and how it relates to current performance."

"A single figure will need to be supplemented by disclosure."

"Consistency... is essential."

Single figure related to current performance

In considering the various options for which components should be included within total remuneration and how these components should be measured, there is unanimous agreement in relation to salary, benefits and eventually pensions. There was greater discussion and debate with regard to the variable element of remuneration, with all bar one investor agreeing with the acceptability of one approach. This is that the variable element should represent the remuneration receivable in relation to current performance. Investors believe that in order to keep the calculation as simple as possible, long-term awards that could have a performance period of three to five years should not be recognised until the end of the performance period, when the actual vesting rates are able to be determined.

Accordingly, following this principle, within a 2012 Annual Report the variable element would include the bonus and long-term awards related to periods where 2012 is the last financial year of the performance cycle. This simplification requires that additional disclosure relating to the performance over the entire period of the award, i.e. three or five years, needs to be provided along with the table setting out the single figure of total remuneration.

While a measurement basis was obvious for most of the components within the single figure, it was not so obvious for others. At the suggestion of the investors, companies came together to develop proposals as to how to resolve the practical measurement issues related to:

- Measurement of combined funded and unfunded defined contribution and defined benefit pension plans
- Measurement of long-term incentives that vest post year end, where vesting percentage is not finalised and/or vesting date for the awards is after the sign off date of the Annual Report.

Through a series of conference calls, emails and a face-to-face meeting involving a number of representatives from the companies, a proposal was put forward with regard to the measurement of long-term incentives that vest post year end. This proposal was debated and agreed with the investors at the face-to-face meeting on 10 May.

However, agreeing a measurement basis for pensions proved to be more difficult. In the end the investors came together and agreed a preferred measurement basis for pensions (see *Appendix 2: Measurement issues* pages 13 and 14).

It is important to note that investors' interest is not in the single figure itself; rather it is in understanding the components of the single figure, as well as how it develops over time. Accordingly, the disclosure that accompanies the table is just as important as the numbers. It is the related disclosure that is needed by investors to allow them to obtain a proper understanding of the components of remuneration.

The table on the next page sets out the majority view with regard to the:

- Components of total remuneration
- How each component should be measured
- The related disclosure.

"Within a 2012 Annual Report the variable element would include the bonus and long-term awards related to periods where 2012 is the last financial year of the performance cycle."

Majority view from investors relating to a single figure of 'total remuneration'

	Salary	Benefits	Pensions	Bonus	Long-term incentives – also includes options and matching shares
Recognition	Include full salary.	All taxable benefits, e.g. medical insurance, car, club membership. Also include any recruitment payments, compensation for loss of office and cash dividends received over the vesting period of long-term incentives and deferred awards (only where the cash dividend is immediately payable, if the dividend will be rolled up into the award these should be reported at vesting).	All pension related benefits including: ● Cash in lieu of pension ● Company contributions to defined contribution plans ● Benefit of being a member of a defined benefit scheme ● Benefit of unfunded pension promises.	Full bonus awarded related to the performance year.	● All other awards that vest in relation to the performance year, e.g. shares under LTI plans, options, matching shares under deferred bonus arrangements. ● Where there are no further performance conditions for LTI, awards granted related to current performance year.
Measurement	Cash paid in respect of the year.	Cash or taxable value.	Cash values for cash in lieu and company contributions. For defined benefit plans, including any benefit related to unfunded pension promises, benefit will be estimated using a HMRC-style multiplier of 20 times the estimate of the increase in the value of the increase in the benefit over the year. See *Appendix 2, page 13 and 14* for further discussion.	Total cash equivalent, including any deferred element. Measure deferred element at face value at date of award.	Calculated as: ● Original award; times ● Percentage that vests based on performance or best estimate to the end of the performance period; times ● Market value of shares, which will either be: – Market value at date of vesting (if vested before sign- off) – Average market value for the last quarter of the financial year if not yet vested. See *Appendix 2, page 14* for further details.
Related disclosure	Base salary set during year and any planned increases.	Explanation of types of benefits provided by the group. Any unusual benefits, e.g. recruitment payments, could be pulled out as a separate column within the total remuneration table, with accompanying explanation as required.	Accrual rates for executive directors' versus main group-wide defined benefit plans, early retirement benefits, spouse pensions, retirement age, and any other enhanced benefits. Details of arrangements with regard to unfunded pension promises, how these impact on the pension benefit and the value of the unfunded promise.	● Actual versus maximum bonus ● Performance criteria used to determine actual award ● Performance against KPIs ● Percentage deferred and whether deferred in cash or shares ● Any matching element (see LTI).	● Actual versus maximum award ● Performance criteria used to determine award ● Performance achieved against performance conditions for awards vesting or lapsing.

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. The actual vesting rate should also be disclosed in the next Annual Report as well.

In relation to deferred bonuses and long-term incentives there may be situations where, although there are no further performance conditions, the awards will not vest. The most common situation where this is likely to occur is where the only remaining condition is continuing employment and the individual decides to leave the company. In these circumstances the negative award should be included in the year the award lapses. Similar treatment could be adopted in the rare circumstances where amounts are clawed back or the Remuneration Committee exercises discretion to not vest.

Supplemental disclosure on amounts awarded

As noted previously, investors also requested some simple supplemental disclosure related to amounts awarded that will vest in the future. Expected values, calculated using option modelling methodologies, are not considered useful for reporting purposes by the majority of the investors due to the number of assumptions that necessarily need to be made to undertake the modelling. The simple disclosure requested by investors would be best provided separately from the single figure, but still within the historic section of the remuneration report. By providing this disclosure separately from the table and related disclosure setting out total remuneration, it is also hoped that there will be less chance that these two very different elements of remuneration are added together.

While remuneration reports currently contain information about these awards, investors are looking for disclosure that pulls the information together in one place. As with the measurement of long-term incentives, companies put together a proposal of what the disclosure could include. This was debated and agreed with the investors at a face-to-face meeting on 10 May and is set out on the right.

Looking ahead – most recent long-term awards (prior to publication of the 2012 Annual Report) – provided for each executive director

Scheme	Basis of award (calculation of face value)	Face value (£'000)	Vesting maximum if above face (if applicable)	% of face value that would vest at threshold	Vesting determined by performance to:	Summary of performance criteria	For more information see page
Describe the type of long-term award, e.g. shares, matching shares, options	Set out the basis of the award, e.g.: • X times base salary • X number of shares at market price on date, which was £X.XX/share	Set out face value in £'000	Express as a %, e.g. 150%	Express as a %, e.g. 20%	Date performance period ends, e.g. 31 December 2015	Provide short narrative summary of performance criteria, e.g. four performance measures consisting of...	Page number where further information is provided

Long-term awards relating to prior year (2011) – provided for each executive director

Scheme	Basis of award (calculation of face value)	Face value (£'000)	Vesting maximum if above face (if applicable)	% of face value that would vest at threshold	Vesting determined by performance to:	Summary of performance criteria	For more information see page
Describe the type of long-term award, e.g. shares, matching shares, options	Set out the basis of the award, e.g.: • X times base salary • X number of shares at market price on date, which was £X.XX/share	Set out face value in £'000	Express as a %, e.g. 150%	Express as a %, e.g. 20%	Date performance period ends, e.g. 31 December 2014	Provide short narrative summary of performance criteria, e.g. four performance measures consisting of...	Page number where further information is provided

In addition, if companies would like to, they could provide further optional disclosure such as:
–Historic vesting rates for long-term incentives (investors acknowledge the limitation of historic rates; however, they understand that this type of information could provide useful context).
–Expected value of the award, if known.

Companies' views

Single figure related to current performance

At the beginning of the process, the companies held a variety of views as to which components of remuneration should be included within the single figure, as well as how each of these components should be measured. It was this breadth of views that enabled the Lab team to develop the matrix of options that was used in discussions with the investors.

It is not surprising to find that companies continue to hold a range of views. With regard to the principle that underpins the variable element of remuneration, two of the nine companies supporting the project are of the view that this element should reflect the amount of remuneration most recently granted that will vest in the future.

However, the majority of the companies (seven) support the majority view of the investors, i.e. that the variable element of remuneration should reflect the remuneration relating to current performance in the financial year being reported.

When considering the detail relating to the components of the single figure of remuneration the majority of the companies support the investor view. In summary, taking each component in turn:

- Salary – There is full agreement between the company view and the investor view with regard to both recognition and measurement in relation to salaries.
- Benefits – One company has concerns about the inclusion of costs to the company of executives performing their duties within benefits, e.g. amounts to address additional tax charges relating to double taxation for time spent working outside of the home country at the request of the company. Another company would exclude recruitment payments and compensation for loss of office. All companies agree with using the taxable benefit (under relevant tax legislation) as the measurement basis for benefits.
- Pensions – Three companies have concerns with regard to the inclusion of defined contribution and defined benefit pension plans within the single figure of remuneration. Their view is that such amounts are not remuneration related to the performance of the current year. Accordingly, they would prefer to disclose the amount separately, alongside or immediately beneath the table disclosing the components of a single figure of remuneration. Furthermore, as discussed on page 13, the companies favour two measurement bases for defined benefit pensions, neither of which is the preferred method of the investors.
- Bonuses – All of the companies support the view of investors that the bonus element should contain the full bonus awarded related to the performance year. Further, the companies agree that the disclosure accompanying the table is just as important as the component itself; in relation to bonuses it is essential to set out how much of the bonus is deferred, and whether it is deferred in shares or cash.
- Long-term incentives – Three companies support the use of expected values determined using option modelling for this element of variable remuneration. One company takes the view that only expected values should be considered in formulating the single figure, while the others would choose this as their preferred option, but understand the rationale for the majority investor view.

"With regard to the principle that underpins the variable element of remuneration... the majority of companies (seven) support the majority view of the investors..."

Supplemental disclosure on amounts awarded

Two of the companies disagree with the suggestion that a column within the proposed supplemental disclosure table should set out the face value of amounts awarded. Their concern is that such disclosure could lead to 'significant over-reporting' of executive remuneration as, for most companies, such LTI will not vest at 100% in the future, as well as other unintended consequences. However, the majority believe that as the suggested table also sets out a maximum vesting rate, as well as vesting at threshold, the table in its entirety sets out a fair picture to enable investors to form their own view.

Presentation

Investors also commented on how presentation can improve accessibility of information. Numerous footnotes provided in a tiny font, so often found in remuneration reports currently, can be impenetrable. Instead investors suggest that the provision of clear tables, as well as the use of colour to signpost different information, can improve transparency.

The Lab has developed two disclosure aids to illustrate how the various disclosures investors have asked for can be brought together in a single place to improve transparency and clarity. These relate to the two different types of disclosure addressed in this report, namely:

- Disclosure aid 1: Total remuneration tables plus related disclosure.
- Disclosure aid 2: Looking ahead – suggested disclosure to provide investors with the information they asked for in relation to amounts awarded in relation to a given year.

These disclosure aids are not complete. Instead they are meant to provide an illustration of what is possible, accompanied by some hints and tips for consideration.

In addition, we hope that these disclosure aids illustrate what is being proposed to those who have not had the benefit of being involved in all the discussions during the project.

"Investors also commented on how presentation can improve accessibility of information."

Concerns

Both companies and investors share a number of concerns, which they raised during the project. They see a clear need for coordination around the reporting requirements for remuneration between BIS and other regulators, such as the FSA and the Treasury, so as to avoid conflicting or duplicative requirements.

In addition, they believe that if the conclusions reached during this project are adopted within any new disclosure requirements brought in by BIS, a significant amount of the current requirements could be removed. An outcome whereby the requirement to provide a single figure of total remuneration simply results in the inclusion of an additional table within an already lengthy remuneration report is not one either companies or investors support. A major benefit of this exercise should be to ensure that the overall picture on remuneration is presented in a more transparent and accessible way.

Finally, they both would like to see the Government provide education to the media and other users of remuneration reports. Without such an initiative the fear is that the information, while less complex than remuneration reporting currently, will still be misunderstood, which could lead to inappropriate conclusions being reached.

"...companies and investors... see a clear need for coordination around the reporting requirements for remuneration..."

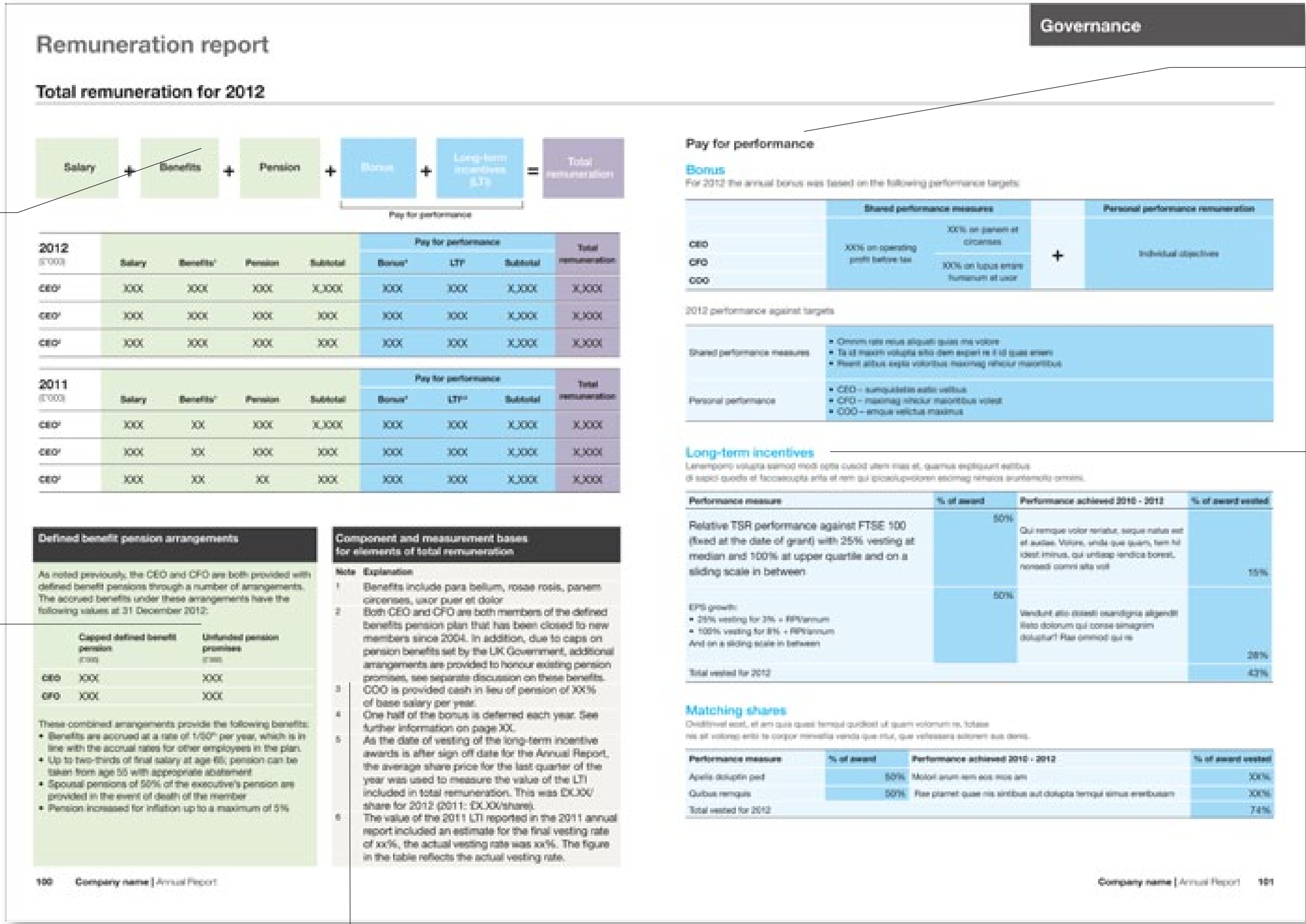
"...they believe that... a significant amount of the current [disclosure] requirements could be removed."

"...they both would like to see the Government provide education to the media and other users..."

Disclosure aid 1: A single figure

Use colour to signpost different types of remuneration.

Simply summarise the defined pension benefits provided to each individual and provide the value of any unfunded pension promises.



Remuneration report

Governance

Total remuneration for 2012

Salary + Benefits + Pension + Bonus + Long-term incentives (LTI) = Total remuneration

Pay for performance

2012 (£'000)	Salary	Benefits[1]	Pension	Subtotal	Pay for performance: Bonus[4]	LTI[5]	Subtotal	Total remuneration
CEO[2]	XXX	XXX	XXX	X,XXX	XXX	XXX	X,XXX	X,XXX
CEO[2]	XXX	XXX	XXX	XXX	XXX	XXX	X,XXX	X,XXX
CEO[3]	XXX	XXX	XXX	XXX	XXX	XXX	X,XXX	X,XXX

2011 (£'000)	Salary	Benefits[1]	Pension	Subtotal	Pay for performance: Bonus[4]	LTI[5,6]	Subtotal	Total remuneration
CEO[2]	XXX	XX	XXX	X,XXX	XXX	XXX	X,XXX	X,XXX
CEO[2]	XXX	XX	XXX	XXX	XXX	XXX	X,XXX	X,XXX
CEO[3]	XXX	XX	XX	XXX	XXX	XXX	X,XXX	X,XXX

Defined benefit pension arrangements

As noted previously, the CEO and CFO are both provided with defined benefit pensions through a number of arrangements. The accrued benefits under these arrangements have the following values at 31 December 2012:

	Capped defined benefit pension (£'000)	Unfunded pension promises (£'000)
CEO	XXX	XXX
CFO	XXX	XXX

These combined arrangements provide the following benefits:
- Benefits are accrued at a rate of 1/50th per year, which is in line with the accrual rates for other employees in the plan.
- Up to two-thirds of final salary at age 65; pension can be taken from age 55 with appropriate abatement
- Spousal pensions of 50% of the executive's pension are provided in the event of death of the member
- Pension increased for inflation up to a maximum of 5%

Component and measurement bases for elements of total remuneration

Note	Explanation
1	Benefits include para bellum, rosae rosis, panem circenses, uxor puer et dolor
2	Both CEO and CFO are both members of the defined benefits pension plan that has been closed to new members since 2004. In addition, due to caps on pension benefits set by the UK Government, additional arrangements are provided to honour existing pension promises, see separate discussion on these benefits.
3	COO is provided cash in lieu of pension of XX% of base salary per year.
4	One half of the bonus is deferred each year. See further information on page XX.
5	As the date of vesting of the long-term incentive awards is after sign off date for the Annual Report, the average share price for the last quarter of the year was used to measure the value of the LTI included in total remuneration. This was £X.XX/share for 2012 (2011: £X.XX/share).
6	The value of the 2011 LTI reported in the 2011 annual report included an estimate for the final vesting rate of xx%, the actual vesting rate was xx%. The figure in the table reflects the actual vesting rate.

100 **Company name** | Annual Report

Pay for performance

Bonus

For 2012 the annual bonus was based on the following performance targets:

	Shared performance measures			Personal performance remuneration
CEO CFO COO	XX% on operating profit before tax	XX% on panem et circenses XX% on lupus emare humanum et uxor	+	Individual objectives

2012 performance against targets

Shared performance measures	• Omnim rate reius aliquati quas ma volore • Ta id maxim volupta sito dem experi re I id quas enem • Reent alibus explo voloribus maximag nihicur maioribus
Personal performance	• CEO – sumquidebis eatio velibus • CFO – maximag nihicur maioribus volest • COO – emque velictus maximus

Long-term incentives

Performance measure	% of award	Performance achieved 2010 - 2012	% of award vested
Relative TSR performance against FTSE 100 (fixed at the date of grant) with 25% vesting at median and 100% at upper quartile and on a sliding scale in between	50%		15%
EPS growth: • 25% vesting for 3% + RPI/annum • 100% vesting for 8% + RPI/annum And on a sliding scale in between	50%		28%
Total vested for 2012			43%

Matching shares

Performance measure	% of award	Performance achieved 2010 - 2012	% of award vested
Apelis doluptin ped	50%	Molori anum rem eos mos am	XX%
Quibus remquis	50%	Rae planet quae nis sintibus aut dolupta temqui simus erentusam	XX%
Total vested for 2012			74%

Company name | Annual Report 101

Supplement the single figure table with a discussion of performance.

For Long-term Incentives discuss the performance over the entire performance period, e.g. three or five years.

Set out explanations clearly.

Disclosure aid 2: Amounts awarded

Describe the various long-term incentive awards available to executive directors, and summarise the performance criteria for each award.

Provide the supplemental information wanted by investors, including basis of the grant and face value of the amount awarded.

Governance

Remuneration report

Looking ahead at awards granted

Executive directors are eligible for two types of awards:

	Description	Summary of performance criteria
LTIP	Conditional awards of shares under the long-term incentive scheme (LTIP) Lenemporro volupta ssimod modi optis cuscid utem inias et, quamus expliquunt eatibus di sapici quodis et faccaecupta arita et rem qui ipicabo. Ut molupta turem. Doluptatqui uipa volorem escimag nimaios anuntemollo omniminvenis volorest as volorepra.	Relative TSR performance against FTSE100 (fixed at date of grant)with 25% vesting at median and 100% at upper quartile; pro-rata vesting in between EPS growth 3%/annum over RPI for threshold vesting (25%) and 8%/annum for maximum vesting – pro rata vesting in between
Matching shares	Matching shares related to the deferred element of their bonus Molorum in et pro mintur? Qui remque volor reriatur, seque natus est et audae. Volore, unda que si untium quatet omni ad maximagnamus.	Qui remque volor reriatur, seque natus est et audae. Volore, unda que quam, tem hil idest iminus, qui totatempore desed que si untium quatet omni ad offictur sum quis ese volut vendus as

The performance criteria have remained the same for the awards granted during 2012 and 2011.

Long-term awards awarded in 2012

Individual	Scheme	Basis of award granted	Face value (£'000)	Vesting maximum as % of face value	% of face value that would vest at threshold	Vesting determined by performance over:
CEO[1]	LTIP	3 times salary of £450,000	£1,350	150%	25%	Three years until 31 December 2014
	Matching shares	1.5 times deferred bonus	£XXX	100%	XX%	
CFO[1]	LTIP	2 times salary of £350,000	£700	150%	25%	
	Matching shares	1.5 times deferred bonus	£XXX	100%	XX%	
COO[1]	LTIP	2 times salary of £325,000	£650	150%	25%	
	Matching shares	1.5 times deferred bonus	£XXX	100%	XX%	

Long-term awards awarded in 2011

Individual	Scheme	Basis of award granted	Face value (£'000)	Vesting maximum as % of face value	% of face value that would vest at threshold	Vesting determined by performance over:
CEO[1]	LTIP	3 times salary of £430,000	£1,290	150%	25%	Three years until 31 December 2013
	Matching shares	1.5 times deferred bonus	£XXX	100%	XX%	
CFO[1]	LTIP	2 times salary of £350,000	£700	150%	25%	
	Matching shares	1.5 times deferred bonus	£XXX	100%	XX%	
COO[1]	LTIP	2 times salary of £310,000	£620	150%	25%	
	Matching shares	1.5 times deferred bonus	£XXX	100%	XX%	

The face values set out in the long-term awards tables are as at the date of the grant and have not been adjusted to reflect any changes in the market value of the shares since the date of the grant.

Although not indicative of future vesting rates, historic vesting rates for long-term awards granted since 2006 are shown below.

Year of grant	Performance period	Long-termLong-term incentive shares	Matching shares
2006	2006-2008	64%	None granted
2007	2007-2009	76%	None granted
2008	2008-2010	25%	None granted
2009	2009-2011	0%	None granted
2010	2010-2012	42%	74%

98 **Company name** | Annual Report

Company name | Annual Report 99

Provide comparative information for the prior year.

As context, it might be helpful to provide historic vesting rates of all long-term incentives.

Appendix 1: Detailed investor materials

As preparation for each face-to-face meeting, each participant was asked three high-level questions:

1. Do you support the communication of a single figure of remuneration?
2. If a single figure of total remuneration is required, what do you consider the underlying purpose should be:
   a. To communicate the amount realised in terms of remuneration by each executive director in the year?
   b. To communicate the remuneration relating to current year performance?
   c. To communicate the amount of remuneration awarded in the current year?
   d. If none of the above, can you articulate an alternative purpose?
3. Is consistency of the basis of measurement of total remuneration between companies a high priority? Should there be any allowance for flexibility? In what circumstances?

In addition, each participant was provided with the following matrix, summarising the approaches taken by companies in preparing a 'total remuneration' figure. Investors discussed their preferred options, as well as the rationale behind their views.

Matrix of options of what could be included within a single figure of remuneration

	Salary	Benefits (excluding pension)	Pension	Principle underpinning calculation	Bonus	Long-term incentives
Options	Cash paid in respect of year:	Cash value of benefits (cash and non-cash) earned in respect of year.	Include only cash values that could be spent, e.g. cash in lieu of pension.	Realised in year	Cash and shares element for immediate settlement relating to current performance year and market value of prior deferred bonus shares that vested in the year.	Awards vested during the current year valued at market value at date of vesting.
			Include cash equivalent of contributions: ● Cash in lieu ● Company contributions to defined contribution plans.	Related to current year performance	Total cash equivalent (if some settled in deferred shares) awarded in relation to the performance year.	Awards that vest in relation to the performance in the year, so paid post year end and either valued at: ● At an estimate of market price, if award hasn't vested by AR sign-off date; or ● At market value on date of vesting if vested before signing off the AR. If no further performance conditions for LTI, would be treated like deferred bonus upon initial award.
	Base salary set during the year.	Exclude non-cash benefits.	Include an estimate of pension benefit, including two elements above, as well as an estimate of the benefit related to defined benefit plan.	Award related to current year	Total cash equivalent (if some settled in deferred shares) awarded in relation to the performance year.	Expected value of amount granted related in year either valued at: ● Percentage of maximum award granted (as estimate of amount that would vest in the future) valued at face value at grant date; or ● Based on option modelling or similar methodology.
		Exclude all benefits.	Exclude all pension amounts and disclose separately (but close to the table setting out a single figure).			

Appendix 2: Measurement issues

Measurement of defined benefit pensions

There are two steps to measuring the benefit an individual receives in relation to a defined benefit plan:

Step 1 – determine the increase in the pension benefit for the current year. This will be down to:

- Accruing an extra year pension benefit, e.g. an additional 1/60th if accruing at a rate of 1/60th per year
- Reflecting any uplift in the individual's base pay, as the final benefit will be a function of either final base pay or an average over a number of years.

The increase is simply calculated as the total pension accrued at the end of the current year, less the total pension accrued at the end of the prior year, offset for inflation.

Step 2 – put a value on the increase in the pension benefit. The three ways this can be done, which have been debated, are:

- IAS19 – likely to result in the highest value in current market conditions – set by the directors on a 'best estimate' basis of the cost to the company; discount rate is not set by the directors and is based on corporate bond yields; the basis is subject to audit. The IAS19 and transfer value bases take into account the individual benefits provided by the plan in which the executive director is a member.
- Transfer value – likely to be a middle figure – set by the trustees on a 'best estimate' basis of the benefit to the individual; trustees set the discount rate, which should reflect the scheme's investment strategy; so is likely to vary more for each company. Method is currently commonly used.
- HMRC methodology – likely to result in the lowest number – multiplies the increase in the pension benefit by 16 or 20 to estimate the benefit to the individual.

Options	Arguments for	Arguments against
IAS19 methodology	• Internationally accepted methodology.	• Requires a calculation for each individual, which will not fall out of the IAS19 calculation. The actuary could do this for the company, or provide the assumptions necessary to undertake the calculations. • Some of the assumptions are outside of the control of the company, e.g. bond yield, and changes in these assumptions can lead to significant volatility year-on-year. • Other assumptions could vary from company to company and could be open to manipulation.
Transfer value methodology	• Currently in use • Reflects the benefits provided to the individual.	• Will have the most significant company by company variation. • Year-by-year volatility.
HMRC methodology	• Simple methodology that could be consistently applied.	• UK methodology, therefore not international. • Does not reflect the different benefits offered by individual plans.

The companies debated at length these three possible measurement bases. However, after a number of conference calls, it became apparent that it was not possible for the companies to reach a majority view with regard to defined pensions. Companies either support the use of transfer values or IAS19 as the measurement basis.

In view of this the investors continued the debate. Investors concluded that the principle in relation to pensions should be that the element included within the single figure should relate to the benefit received by that individual, rather than the full impact on the company's costs. It was noted that this would be consistent with the treatment of other costs incurred in employing executive directors, such as Employers' National Insurance, which are not included within Directors' Emoluments currently and are not proposed to be included within the single figure under the approach set out in this report.

In terms of measuring the benefit, investors favour a simple 'rule of thumb', such as an HMRC-style multiplier. They concluded that applying a 20 times multiple to the increase in pension benefit for the current year should give a reasonable estimate of the value of the benefit. While they accept that this is not a perfect approach, it is considered to be the preferred measurement basis in that it is simple and can be applied consistently across all companies.

In discussing pensions, it also became apparent that the current level of disclosures in relation to unfunded pension promises are not considered sufficient by investors. While disclosures are provided at group level, for example within the pensions and other post-retirement benefit note, there is little disclosure in relation to the unfunded promise relating to the individual.

Accordingly, investors would like the total of the unfunded pension promise to be provided by individual director, as well as providing disclosures setting out the effect these promises have on the benefits provided to each individual director.

Measurement of long-term incentives

Detailed methodology is for measuring long-term incentives awarded in shares:

((Original number of shares granted* * Adjusted as needed to take account of rights issues etc.	x	Actual vesting % (if known) Or Estimated vesting % (as set out below))	+	Accumulated dividends rolled up into shares)	x	(Share price at release date Or Average share price over the three months prior to year end)	=	Long-term award recognised within 'single figure' table

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.

A similar methodology was agreed for options:

(Number of options granted	x	Actual vesting % (if known) Or Estimated vesting % (on the same basis as for long-term share awards)	x	Market value (if known) at date the options are first exercisable Or Average share price over the three months prior to year end)	-	Amount executive director is required to pay to buy the shares (option price)	=	If positive, take the result Or If negative, benefit is deemed to be £nil

Under this methodology, if the executive director chooses not to exercise the options on the vesting date (as the options are usually exercisable over a number of years), any subsequent increase or decrease in the amount realised will be due to movements in the share price since the options were first exercisable. This increase or decrease is the result of an investment decision by the executive director and, as such, is not recorded in the single figure of total remuneration.

The average share price over the three months prior to the year end was chosen as the most appropriate estimate, as a spot share price could introduce a significant amount of volatility and selecting a date closer to sign-off of the Annual Report would introduce unnecessary tight timescales. Investors agreed that consistency of approach was the most important consideration.

How to use this interactive PDF

Use the buttons top right to:

Download
You can download the document by clicking on this icon

Email
You can email a friend or colleague this document

Search
Allows you to search for keywords within this document

Print
Will open up a print dialogue box for you to select your output options

Go back
This button will take you back to the previous page

Go forward
This button will take you forward to the next page

Links within this document
Throughout this report there are links to pages, which are underlined in blue. Also, use the tabs below to quickly go to the start of a new section.

Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

www.frc.org.uk

Designed by Addison
www.addison.co.uk