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Department of Business, Innovation and Skills
1 Victoria Street
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26 September 2012

By e-mail to executive.pay@bis.gsi.gov.uk
Cc: Richard Carter and Gemma Peck, BIS

Dear Mr Walker

Consultation on Revised Remuneration Reporting Regulations

The GC100 welcomes the opportunity to respond to the recent consultation paper issued by the Department of Business Innovation and Skills on revised reporting regulations in relation to directors' pay. The GC100 is the association for the general counsel and company secretaries of companies in the UK FTSE 100. There are currently over 120 members of the group, representing some 80 companies. Please note, as a matter of formality, that the views expressed in this letter do not necessarily reflect those of each and every individual member of the GC100 or their employing companies.

As you are aware, over the past few months, we have been in discussion with Richard Carter and colleagues reviewing the practicalities of implementing some of the proposals set out in the consultation paper. We do not propose to reiterate all the points we have discussed, as we believe that they have been well understood. We remain willing to continue work constructively with BIS in these matters.

General Points

Before reviewing the specific questions in the consultation paper, we have the following general comments to make:

- We believe that the revised remuneration reporting regulations as now proposed are, by and large, workable for companies. They are a practical alternative to some of the earlier recommendations and we welcome the aim to cut down on some of the detail, and focus on more concise and comprehensible reports on remuneration.

- The implementation of the proposals needs to be seen in the light of the fact that many of the UK-listed companies that will be subject to them are international or global in nature. Their executive directors will typically be employed on service contracts in other jurisdictions where employment practices differ. In some cases, particularly the provision of pension benefits by the employer, the regulations as proposed will lead to some anomalous disclosures and make meaningful comparisons difficult and therefore subject to misinterpretation. (See response to question 8).

- We have previously expressed a concern that shareholders should not be put in a position of micromanaging the companies in which they own shares. Equally, boards need to be able to rely on the trust placed in them by shareholders. That relationship of trust also imposes upon shareholders a duty to take their responsibilities towards the company in which they invest seriously and to engage constructively with boards in order to help sustain a focus on long term value creation. This is in part being addressed by the Stewardship Code; but we believe that the introduction of these regulations and the continued focus on the need for transparency in company's affairs places an even greater burden on shareholders. Accordingly and for this purpose, we would emphasise that the determination and assessment of performance by executives against commercial and financial targets is a matter that is best left to the members of the remuneration committee.

- We would recommend that greater clarity is provided on the information to be provided in the annual report and accounts. We understand that this is being addressed in the ongoing review of narrative reporting but would highlight that this draft legislation includes or excludes information which is currently required by the UK Corporate Governance Code, the FSA's Listing Rules and IFRS reporting requirements.

Question 1: The Government seeks comments on how well the draft regulations attached at Annex B give effect to the policy set out in this consultation document.

- Whilst we feel the draft regulations do give effect to the policy set out in the consultation document, we believe additional clarification is required to support the framework within which companies can agree and implement their own remuneration policy. We would therefore support BIS's call for guidance to be developed by companies and shareholders in this area and as you aware, the GC100 is working with a group of major investors to develop such guidance for consideration by BIS.

- Overall, the draft regulations appear to meet the Government's objective of creating a two-part remuneration report. There are some points to consider on the draft regulations as follows:

  - In the comparison of overall performance and pay provisions (paragraph 13), it is not clear if the ten year "relevant period" period starts when the new requirements come into force or whether this is a backward-looking disclosure over the last ten years. As set out in our response to question 14, we see little value in tracking these measures retrospectively.

  - Paragraph 14 on directors' shareholdings includes the total number of shares and share options of which the director is the legal (beneficial) owner. Whilst simpler and more concise reporting is to be welcomed, it may be appropriate to include some further information under these provisions to assist shareholders' understanding of these disclosures, for example, including option prices and vesting dates for share awards where appropriate.

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- In relation to the resolutions to approve the policy and implementation report, paragraph 16 requires disclosure, in respect of the votes cast, of the number of votes for, against and abstentions. We are concerned that the legislation is requiring disclosure of an 'abstention' which is not a vote in law and may further blur the distinction between an actual vote – whether for or against a particular resolution - and a shareholder's decision not to vote for various reasons. If the intention is that such disclosure is required, we would suggest that the legislation should follow the wording of the UK Corporate Governance Code and refer to 'votes withheld' and make it clear that such votes are not a vote in law.

- Part 4 (para 24), includes the 'Relative importance of spend on pay'. This relates to the percentage change in profit, dividends and overall expenditure on pay in the reporting period compared to previous years. This is currently included in the forward-looking Policy Report and shareholders may only see this information once every three years. Would this disclosure not sit better as part of the Implementation Report requirements?

Question 2: What costs will companies face in adjusting to these revised reporting regulations?

Adjusting to these new reporting regulations will place a significant burden on business. We anticipate that the costs associated with these proposed changes will be very high for corporates, particularly 2013 to 2015 as we get up to speed with the new requirements. The first votes on remuneration policy will be in 2014, with implementation reports against that policy in 2015 although some companies may seek to report against the new requirements earlier. This effectively means a three year transition period. Typically, there will be a number of people in our company secretarial, human resources and communications teams who will be involved in drafting the Policy Report for submission to shareholders and, thereafter, the Implementation Report regarding that policy.

We conservatively estimate that collectively each company will need at least 100 man hours to absorb and implement the changes. In addition, we believe that remuneration committees will need to take further advice from remuneration advisers, lawyers and auditors over and above existing requirements. Additional or lengthened remuneration committee meetings and briefings are likely to be required to ensure that boards and remuneration committee members fully understand the new requirements. We also anticipate that there will be a requirement for greater engagement with shareholders not only ahead of the Annual General Meeting but throughout the year in order to educate and help shareholders understand the new approach to determining and disclosing executive remuneration. This will inevitably take up more management time and incur travel and associated costs for remuneration committee members.

As a very rough estimate, we would estimate that transition to the new regulations could cost each FTSE100 between £100,000 and £250,000 in management time and additional advice, although some companies within the GC100 are already estimating significantly higher costs. As well as the costs of adjusting to the revised reporting regulations, there will be increased on-going costs, particularly for those companies where the vote on either the Policy Report or the Implementation Report has failed. Considerable management time and external advice will needed in analysing the vote and ascertaining which shareholders voted against and then engaging with those shareholders to understand which aspects of the report they did not support and then

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preparing and publishing an explanatory statement.

Question 3: The Government intends to introduce a table which sets out the key elements of remuneration and supporting information on the pay policy. The Government does not propose to prescribe the specific disclosures that are required for each element of pay. Is this a practical and informative approach?

We support the introduction of the remuneration table. It is a practice that is already being followed by many companies. We would strongly support the joint development of guidance and, as BIS is already aware, we are currently working with major investors to develop such guidance for consideration by BIS. We would however emphasise that such guidance should be seen as such, so long as it is apparent from the table how each element supports the achievement of the company's strategy, the potential value and the performance metrics associated with remuneration packages. We recommend that the guidance that is issued makes it apparent that it should be for companies to construct their tables in a way they think fit and explain why that is appropriate for their particular circumstances. The final form of the proposals should, in our view, embrace this principle.

Whilst we agree that the use of the table within the Policy Report is likely to succeed in providing an easy at-a-glance summary of the key elements of remuneration, our expectation is that the explanations of each element and the rationale for selecting particular performance measures will result in reports that are just as lengthy as at present.

Question 4: The Government intends to introduce reporting requirements on service contracts, what remuneration directors can receive in different scenarios and the percentage change in profit, dividends and overall expenditure on pay in the reporting period. Is this a practical and informative approach? If an alternative disclosure would be useful, please give details.

We recognise that the proposed reporting requirements using different scenarios to show how much remuneration directors would receive might be regarded as logical in providing useful information for investors. However, we are not convinced that this really is the case. Detailed scenarios will involve a lot more work for companies in disclosing potential outcomes for awards made under many plans and could be regarded as additional clutter, when the aim is for more concise reports. Showing three scenarios for a good, bad and average year is too simplistic as it is unlikely that all performance measures governing various different plans and arrangements will all move in the same direction at the same time. The proposals assume all companies identify a threshold level of performance which may not always be the case. We are currently working with major investors to develop guidelines for useful yet concise disclosures.

We also recognise that portraying this diagrammatically in a chart could be useful. We do however have some reservations about the chart given on page 18 of the consultation paper. In particular, we note that whatever the performance, the salary would remain the same and it would be the variable elements of pay that would go up or down depending on performance. In a successful year, the base salary would form a smaller proportion of the whole and bonuses and LTIPs would be higher. The different elements of variable pay are likely to be driven off different measures and therefore their relative percentages are also likely to change in different scenarios.

We appreciate the desire to view remuneration within the broader context. However, the

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proposed use of the same comparability measures (profits and dividends) will not be appropriate for all companies across all sectors. Shareholders invest in different companies and in different sectors for differing reasons. Some investors look for share price growth, whilst others will look for dividend yield. Requiring all companies to disclose the same measures appears to enable comparison across companies but will not in fact be comparing like with like. Importantly, setting out overall spend on pay in a reporting period relative to the percentage change in profit and dividends is of questionable benefit for investors and is more likely than not to feed misinformation amongst less informed investors, media and other commentators.

Further, an unintended consequence of requiring reporting of percentage change in profit and dividends alongside overall spend on pay would be to "reward" (from a disclosure perspective) companies that cut the workforce as a way of increasing profitability. An alternative would be for companies to be provided with the flexibility to determine their own reporting methodology for this purpose, e.g., the use of share price growth, dividends, profits, earnings per share etc and therefore permitting companies to uses two or three of the measures which are most appropriate to their particular circumstances. This allows sectoral differences over longer time periods to be more fairly reflected when comparing performance against total spend on pay. In addition, we do not believe that it is appropriate that such disclosure is made in the policy part of the remuneration report.

Question 5: The Government proposes that a company's statement on its approach to exit payments sets out the principles on which the determination of the payment will be made. If additional information would be useful, please give details.

The proposal in the proposed regulations that a description of the exit payments payable under different scenarios be included as part of the Policy Report, is far more practical and workable than some of the earlier proposals requiring a shareholder vote at the time of a termination. We do however see this as an area which could well lead to fairly extensive disclosure by companies. Caution is required if we are to cut the clutter. In line with the guidance that we proposed to develop with the investment community for this purpose, we would expect the policy on exit payments to be drafted broadly in order to retain the remuneration committee's ability to exercise their discretion. This is probably another example of where companies and investors should develop some joint guidance to determine the type of information that would be useful for investors but will not lead to excessively lengthy or complex disclosures.

Question 6: The Government would welcome views on the proposal for the policy part of the remuneration report to include a statement on whether and if so how a company sought employee views on the remuneration policy.

We note that the current proposals relating to employees' views on remuneration are more practical than some of the earlier proposals which would have been unworkable, particularly for very large companies with an international workforce. However, we still feel that ascertaining employee views on executive director remuneration will be a practical challenge and of questionable benefit, i.e. what is the advantage and for which set of stakeholders of a statement to the effect that employee views on the remuneration policy have been solicited? Many large companies conduct employee surveys on a regular basis, and could include an additional question on director remuneration. It is however hard to think how such a question could be framed so as to elicit meaningful responses, particularly in large, internationally diverse organisations, where

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the link between worker and director may be remote and global remuneration practices may vary considerably. We would also note that not all companies conduct employee surveys and this will be an additional regulatory burden for them.

We also have some concerns that asking employees about their views on executive remuneration raises expectations that employees might play a more significant role in influencing executive pay than would be the case.

We would expect that this provision would be on a "comply or explain" basis and that companies should be free to explain, where applicable, if it is impractical to ascertain employee views on remuneration.

In terms of the related disclosure on the percentage increase in pay of the workforce against the percentage increase in pay of the CEO, it is not clear from the draft regulations whether this relates to salary or total pay for the CEO. The structure of total pay for a CEO will typically have a much larger variable element that will only be earned dependent on performance, making comparison with the wider workforce more difficult. Further given the cultural and geographic spread of the employee base of many international companies, any comparison between the pay of the CEO with the earnings of the organisation's workforce would not be practical or relevant.

Question 7: The Government's intention is that the single total figure includes remuneration that becomes receivable as a result of the achievement of conditions relating to performance in the reporting year where the reporting year is the last year of the performance cycle. Do the specific disclosures set out in the table on page 24 correctly give effect to this intention?

We believe that the description in the table relating to the single figure accurately defines the governments' intention that becomes receivable as a result of the achievement of conditions relating to performance in the reporting year where the reporting year is the last year of the performance cycle.

Question 8: The Government proposes the application of the HMRC methodology to work out the value of defined benefit pension schemes. Is this a practical and informative approach?

The HMRC methodology is somewhat "crude" and may not cater for the many international companies that employ executive directors in different countries, often with local pension arrangements which can vary from country to country. The HMRC methodology may well not be appropriate in these circumstances and may give an anomalous figure. A more refined approach may be to adopt the transfer value of the increase in accrued benefit, given that there is a range of different retirement ages and benefit structures.

Question 9: The Government proposes that claw-back is recorded as part of the single figure. Is this a practical and informative approach?

We are not sure exactly how this is proposed to work and suspect that the inclusion of a figure for claw-back in the single figure could lead to double-counting in certain circumstances. It will depend on exactly how claw-back is applied by the reporting company and companies may well adopt different practices when applying claw back. Whilst recognising the importance of transparency regarding claw-back, we do not believe that it should form part of the single figure

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and would suggest that it be subject to a separate disclosure. Companies' remuneration committees are best placed to review the application of claw-back provisions on a case by case basis. This will necessarily require these committees to have the discretion to determine what is appropriate in particular circumstances and, if considered appropriate in material situations, to discuss this with key shareholders.

Question 10: The Government would welcome views on whether it would be commercially sensitive to require companies to publish full details of performance against metrics. If so, how can an appropriate degree of flexibility be achieved?

We are very concerned that full disclosure of performance against metrics brings with it a very real risk of disclosure of commercially-sensitive information and possible price sensitive information being mandated. It is our view that the detail in paragraph 77 of the consultation document goes far beyond what most companies would be comfortable to release into the public domain, particularly in relation to annual plans. Whilst companies are willing to disclose at a high level the performance conditions and their relative importance, disclosure of the precise target for each performance condition is understandably commercially sensitive, particularly if the target was set at the beginning of a year and may well be one stage within a longer term plan.

We would point out that the numbers within the remuneration report are audited and presume that this will continue to be the case under the new reporting requirements for the Policy Report and the Implementation Report. The audit is independent confirmation that the amounts paid out or the number of awards vested is in accordance with the performance targets.

Question 11: Will the Government's proposed disclosure requirements on pensions lead to reporting of sufficient information on the benefits received by directors?

Subject to the caveat that the disclosure requirement would be projection of pension entitlement, the proposals appear satisfactory.

Question 12: The Government proposes that scheme interests awarded to directors during the reporting year are disclosed at face value. Is this a practical and informative approach?

We would advocate an approach that includes disclosure both at face value and on an expected value basis. The face value alone may lead to misleading disclosure, namely remuneration levels that will only rarely materialise in practice.

Question 13: The Government proposes to simplify the reporting requirements regarding directors' interests. What are the costs and benefits of this approach? If an alternative disclosure would be more useful, please give details.

We welcome simplification of disclosure in this area. However, we question whether the disclosure of directors' total shareholdings is of value, given that these details have already been disclosed to the market through RNS announcements as shares are bought and sold or awards and options are granted and exercised. We would also point out that it is often the case that these details in the remuneration report are out of date by the time the report is printed, as awards are often made shortly after sign-off, and awards made in previous years vest at this time.

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We would suggest that there should be a requirement to maintain and update this information on corporate websites, so that shareholders are able to review the most up to date figures rather than using out of date figures form the annual report. We would not suggest replicating the full Register of Directors' Interests as this can be very complex, particularly where numerous current and former share plans are involved, with many vesting or lapsing points. We would therefore suggest that the total number of shares held and awards or options outstanding could be sufficient.

Question 14: The Government proposes that the remuneration report includes a graph that plots total shareholder return, as a proxy for company performance, against CEO pay. Do you agree that this graph would be useful? If so, do you agree that total shareholder return and CEO pay are the best proxies for company performance and pay? If not, what measures would be more appropriate?

It is difficult to find the perfect measure for comparison purposes between director pay and company performance and no single measure will please everyone. TSR is, in our members' views, as good as any other measure and, importantly, it provides a clear, simple and transparent reference point for relative as opposed to absolute performance.

We understand the rationale for tracking pay against performance going forward. However, we see little value in tracking these measures retrospectively. A graph showing performance in the past 10 years, when there were different CEOs, board, chairmen, members of the remuneration committee policies and strategies does not sit naturally either with a policy looking forward to remuneration in the years to come or with a policy describing how remuneration policy was implemented in the past 12 months. It does not seem right that a decision taken by a former remuneration committee relating to a former CEO say in year two should be subject to a shareholder vote eight years later.

Rather than solely focussing on TSR, allowing companies some degree of additional flexibility, for example comparing performance against CEO pay based on the company's strategic measures or the CEO's objectives for that period, may provide a more meaningful comparison.

We also note that this graph will throw up some anomalies in cases (the majority) where there have been a number of CEOs in the period, particularly where a new CEO may well have share awards in the early years that do not vest until later. There is also a concern that a very good CEO may come into their own when market conditions are difficult. A CEO comparator matrix may therefore give a misleading impression that the CEO is being "rewarded for failure".

Question 15: The Government proposes that the single figure, detail of performance against metrics, total pension entitlements, exit payments made and detail on variable pay are all subject to audit. Are there any other sections of the report that should be subject to audit?

We believe that these items detailed in paragraph 97 of the consultation paper and reflected in paragraph 32 of the draft regulations attached in Annex B are the appropriate items to be audited. The audit of these figures will give shareholders added assurance in cases where detailed disclosures cannot be given due to commercial sensitivities.

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We would welcome the opportunity to discuss these points with BIS in greater detail.

Yours sincerely,

Grant Dawson
Group General Counsel and Company Secretary, Centrica plc
Chairman of the GC100
For and on behalf of the GC100