Securing the future of pensions

Department for Business Innovation and Skills: Revised Remuneration Reporting Regulations consultation

A response by the National Association of Pension Funds

September 2012

Contents

About the NAPF

The NAPF is the leading voice of workplace pensions in the UK. We speak for 1,300 pension schemes with some 16 million members and assets of around £900 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.

Introduction

The NAPF welcomes the opportunity to respond to the government's consultation on revised remuneration reporting regulations.

We are supportive of the Government's proposals to revise the remuneration reporting regulations in order to restructure remuneration reporting to increase transparency to shareholders. The NAPF and its members have long urged for restraint in setting directors' pay along with transparency and simplicity. If we are to make progress on executive remuneration, it is critical that companies explain clearly how their remuneration policy is structured, how it is linked to performance and how that impacts shareholder value.

Companies at present do not consistently disclose remuneration information in a format which is clear, transparent and comparable. The proposals for such information to be displayed in a standardised table will aid understanding on how the company's pay policy supports its strategy and performance.

Institutional shareholders such as pension funds will expect to see companies set out sufficient and specific detail within both this table and the accompanying narrative in order that they can judge the policy's appropriateness and vote on it accordingly. We have set out in response to some of the questions additional areas of disclosure that investors such as pension funds would welcome.

We are happy to work with other investor bodies, investors, company preparers and other interested and relevant stakeholders to agree on initial best practice guidance in this area ahead of its introduction next year.

David Paterson
Head of Corporate Governance
NAPF

Will Pomroy
Policy Lead: Corporate Governance
NAPF

Response to consultation questions

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.**

We do not feel in a position to comment on the effectiveness of the drafted regulations.

2. **What costs will companies face in adjusting to these revised reporting regulations?**

From an investor perspective, we perceive the likely costs incurred in adjusting to the revised reporting requirements to be small in relation to the benefits to be derived from greater transparency.

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?**

Companies at present do not consistently disclose remuneration information in a format which is clear, transparent and comparable. The proposals for such information to be displayed in a standardised table will aid understanding on how the company's pay policy supports its strategy and performance.

Companies do and should design their pay policy to suit their own unique business model and strategy; as such it is right that the Government is not proposing to prescribe required detail, beyond the suggested headings.

Institutional shareholders such as pension funds will expect to see companies set out sufficient and specific detail within both this table and the accompanying narrative in order that they can judge the policy's appropriateness and vote on it accordingly.

In addition to those items of remuneration which are already included, NAPF members would welcome the addition of:

- A row setting out the company's policy with regards to service contracts, including any provisions contained within such contracts.
- The company's policy with regards to recruitment, this should set out the expectations for recruitment under 'normal circumstances' and an indication that any recruitment which would require the company diverging from this due to 'exceptional circumstances' would involve shareholder consultation in advance.
- Any policy the company may have with regards to the management of individuals' tax exposure and hedging of variable pay and shareholdings.
- A catch all category for any other material elements.

Whilst we agree that companies should not be forced to disclose performance metrics where doing so would harm shareholder interests, we believe that companies should be required to at least disclose the performance criteria for annual bonuses in retrospect the following year if advance disclosure is not possible.

We are happy to work with other investors, company preparers and other interested and relevant stakeholders to agree on initial best practice guidance in this area. We'd expect this best practice to evolve and refine itself on a regular basis as investors and companies adapt to the new requirements.

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.**

Service contracts

Transparency around the content of directors' service contracts is very important and at present it is often difficult and impractical to get hold of them. We therefore welcome the proposed requirement that the policy report set out all existing contractual provisions that relate to directors remuneration. We also believe that Directors' contracts should be made available for shareholder scrutiny online.

Scenarios

As described in the consultation document some preparers already set out in graphical form expectations of what directors may receive at below, on and above target. We agree that this can be a beneficial disclosure.

However, the objective should be to foster a more trusting relationship between remuneration committees and shareholders. To this end, what investors want to be reassured about is that remuneration being awarded is reflective of performance, and thus aligned with their interests. We would therefore welcome disclosure which shows the single figure plotted over five years, compared to the TSR of the shares and a single measure of performance drawn from the remuneration KPIs.

Relative importance of the spend on pay

We would welcome preparers setting out in graphical form the relative share of the spend on pay, although we would question the appropriateness of the use of profit in all cases.

As investors we see considerable merit in this "share of the pie" approach; companies should be able to illustrate to shareholders the percentage of profit or cash flow being: a) retained for capital investment, b) paid out in dividends, c) being paid to staff in annual bonuses – split between directors and the rest of the employees, and d) being contributed to the company's pension scheme. While in of itself this disclosure will be of limited interest, the movement of the percentages over time should be most illuminating and allow investors to judge whether decisions are being taken in the long-term interest of the company and its shareholders.

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.

We welcome the move to include within the binding policy details of the company's approach to exit payments. Inclusion here will keep the structure simple, provide a link to recruitment (where the problems often start) and provide a policy framework for termination payments which is practical and allow companies to complete negotiations in a timeframe which is in the interests of all.

Disclosures in this area should include how the company defines a 'good leaver', the effort to mitigate against payment for failure and how the remuneration committee is able to use its discretion.

We see merit in the Australian model of setting out the likely circumstances of termination and the payments they would trigger; it might be further beneficial if the potential outcomes were illustrated for the CEO.

In the short term we would also welcome companies ensuring that such disclosures cover current contracts and indicates when they were last reviewed.

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.

On employee involvement, we believe it helps companies to focus on these issues if they have to communicate their general remuneration policy to staff and report to shareholders on that policy. Consultation on that policy will take place at different places in a company but we do not think it appropriate that all employees should be consulted on the policy for executive remuneration. It also adds to shareholder understanding of the culture of the company.

We do not see the need for this requirement to be any more detailed than is suggested.

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 welcome this proposal, however, the FRC's Financial Reporting Lab's proposal for this table also included a third column for the related disclosure, we see merit in this being included in addition to the definition and measurement to aid understanding of any unusual numbers as well as navigation of the report.

We would also welcome the inclusion of the comparative figures from the previous year.

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?

Yes, while there is no right answer to calculating this figure, the HMRC methodology is transparent, simple and understandable. It will provide sufficient practical information to be useful to shareholders. It is important that as far as is possible, disclosures should endeavour to aid understanding, the volatile values produced via IAS 19 would make comparability very difficult and thus reduce the usefulness of this disclosure to shareholders.

Given that the companies' policy in relation to pensions, including specific details, is to be set out within the new policy report, there is no need for this calculation to be any more complicated than is suggested.

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

We agree that where claw back occurs, the circumstances and factors that affected the decision should be disclosed and the values included within the disclosures for the single figure. We would also expect an explanation of the circumstances around such an occurrence to be set out within the Chairman's Statement.

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 believe companies should be required to disclose the performance metrics for annual bonuses, recognising that in some cases deferral of disclosure may be appropriate.

Investors would be concerned if the size of reward available under variable pay is high and are being asked to these support plans without being aware what the targets are. As stated in our Policy and Voting Guidelines, insufficiently demanding performance targets or insufficient disclosure on the scope of annual bonuses and performance conditions would likely cause concern to investors and trigger a voting sanction.

Where metrics are commercially sensitive, as investors, we would welcome companies explaining to shareholders, at a minimum, the nature of such metrics and attached targets and how they relate to the company's strategic objectives.

Where the actual metrics and targets in bonus plans are deemed too difficult to disclose there may be ways around this such as utilising a range of acceptable targets. It is important that if metrics are not disclosed for the year ahead that these are disclosed retrospectively soon after.

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

We would also welcome disclosure of any differences in the arrangements offered to directors and the rest of the staff. Generally we see little justification for the often significant disparity in these arrangements and investors may have important questions about fairness if the pensions of directors are disproportionately more generous than those of other staff

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?

Yes. Shareholders welcome the transparency offered by face value disclosures as opposed to expected values. We would also welcome increased narrative to explain why the performance measures are deemed to be stretching.

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 this simplified disclosure. We are encouraging companies to require directors to build up a significant shareholding within the company in order to align their interests with those of their shareholders. Given our desire for companies to move in this direction it will be important for investors to easily understand the total number of shares that each director owns or may potentially own.

We would also welcome a requirement to disclose any hedging undertaken by directors against risk within their variable pay.

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?

We agree it is important that the remuneration report enables investors to be able to easily assess the relationship between remuneration and performance over a long period.

We have sympathy with the suggestion of a graph which plots CEO pay against TSR given that this will be easily attainable from the single figure calculations and if operating correctly should be aligned with performance. We are conscious that the average tenure of a UK FTSE-100 CEO is approximately 5 years and as a result the suggested graph will likely cover a period of more than one CEO. We do not see this as a problem and will in itself be a useful graphical illustration of any jumps in pay, the value of which can thus be assessed.

We agree that the chosen metric used as a proxy for performance needs to be one that is easily understood and comparable. Given that long term sustainable shareholder return is what all Boards should be seeking to maximise, long-term absolute Total Shareholder Return (TSR) is an appropriate measure in this regard.

This information might usefully be combined with the disclosures described under Question 4.

We also believe that companies should include their estimated projections over at least the next three years, we do not believe that this should be too difficult to include given that remuneration policies are to be set on three year cycles.

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 agree that all historical elements such as the single figure, detail of performance against metrics, total pension entitlements, exit payments made and detail on variable pay should all be subject to audit.

We welcome the additional proposal to disclose the provision of advice from any consultant that provided advice to the company on remuneration. We also support the proposal to require disclosure of information about how the company engaged with their shareholders, including how shareholders voted on both the binding vote and advisory vote at the previous year's AGM and the action taken by the Committee to respond.

Finally, we believe that adherence to these new requirements should be included within the UK's listing rules in order to ensure that UK listed but not UK incorporated companies are also covered.