The Hundred Group
of Finance Directors

Investor Relations and Markets Committee

By email: executive.pay@bis.gsi.gov.uk

Mr Barry Walker
Department of Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET

26 September 2012

Dear Mr Walker

Directors' pay: Consultation on revised remuneration reporting regulations

We welcome the opportunity to contribute further on the proposed changes to executive remuneration reporting. We recognise the need for simplification and change to the remuneration report in order to assist users of Annual Reports and to increase transparency in reporting executive pay.

Who we are

The Hundred Group represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent almost 90% of the market capitalisation of the FTSE 100, collectively employing over 7% of the UK workforce and in 2011, paid, or generated, taxes equivalent to 13% of total UK Government receipts. Our overall aim is to promote the competitiveness of the UK for UK businesses, particularly in the areas of tax, reporting, pensions, regulation, capital markets and corporate governance.

Our views

The issue of executive compensation continues to be a hot topic for many media commentators and some members of the general public, particularly in the current tough economic environment, when it is believed that some executives have received unjustified levels of pay, when the results of their company in the current year have been poor. Whilst this is sometimes simplistic and overlooks achievement under long term incentive plan criteria which are now vesting, we agree that clearer remuneration reporting could help increase understanding of the relationships between pay and company performance, both long and short term.

We agree that executive remuneration reporting needs to be revised and we believe that the overarching principle should be the need to have reporting that is clear, concise and easily understandable, free from any unnecessary disclosures and that can be applied in a consistent manner to assist comparison between companies and individuals.

Our main concern with the proposed legislation is that the proposals should be clearer, especially with regard to what information should be included in the summary statement. We believe that confusion could lead to increased disclosures to ensure that prepares comply with the legislation 'by default'. We are opposed to any additional disclosure that does not have a clear purpose, and we fear that the legislation, as currently drafted, will not provide the necessary level of guidance to avoid unnecessary disclosure, clutter and duplication in the Annual Report. Our view is that remuneration reports have become too long due to the extensive disclosure requirements which already exist. We hope that these proposals will replace rather than add to existing disclosure requirements. We also recommend that guidance should be offered to remuneration committees to encourage them to consider what is material disclosure so that reports remained succinct and clearer.

We are supportive of the proposed disclosures for long term incentive plans "LTIPs", but highlight that the proposed disclosures for the cost of LTIPs and pensions are not aligned with international accounting standards and will therefore lead to different amounts being reported in the remuneration report and the accounts. We believe that one of the key parts of the Annual Report is consistency and this could be reduced by these proposals, although on balance we understand why a "value settled" approach has been selected.

We disagree with the proposal to automatically use the "HMRC methodology", involving a multiplier of 20 to calculate a director's pension liability in a defined benefit pension scheme, as we believe this methodology is flawed, can give non-intuitive results and outcomes which do not reflect specific scheme rules, thus reducing the real comparability of pension related values, even between co-directors who are often in different schemes from one another. We do not believe that this methodology produces reporting that is clear, comparable and understandable. We would prefer to use either IAS19 or the cash equivalent transfer value method instead, as we believe these approaches give a more accurate liability at the reporting date. We feel the "HMRC methodology" would be better positioned as a fall- back method, in the event that more accurate methods were not viable.

We support the proposal to align the UKLA Listing Rules with the revised legislation and see this as a good step towards removing current duplication and subtle variances in reporting.

We have taken this opportunity to answer some of the consultation questions raised (see the appendix to this letter), but believe that the Financial Reporting Lab's report 'A single figure for remuneration' provides a good basis for remuneration reporting. We also highlight our previous response to you on 27 April 2012 on your consultation on enhanced shareholder voting rights.

Yours sincerely

Robin Freestone
Chairman
Hundred Group: Investor Relations and Markets Committee

Annex: Our view on specific questions raised in the BIS consultation paper

We have chosen not to respond to all questions raised in the consultation paper, instead focussing on the ones we consider most significant to our members.

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 any disclosure that presents complicated information in a clear and concise manner. We believe that the illustrative disclosure included in Annex A of the consultation paper achieves this aim.

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 agree that the proposed approach is a practical and informative approach, however we also note a couple of specific issues.

In keeping with our desire for reduced, focussed disclosure, we believe that a summary rather than the detail of all existing contractual provisions relating to directors' remuneration should be sufficient in the policy report.

We also note that the illustrative graph on page 18 of the consultation document is, as currently presented, likely to confuse preparers. Our main concern is that there appears to be a significant variance in the quantum of the example base salary, which, in our experience, remains broadly constant regardless of the other variable elements of pay.

Whilst presenting a large amount of information in graphical format is often a helpful way to convey key points, we believe that this and the other proposals in the draft legislation could lead to a plethora of graphs, especially if companies have a large number of directors. We recommend clarification that this graph should not need to be applied to non-executive directors, the vast majority of which are not subject to any variability in remuneration.

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 support the Government's proposals and recommend that an explanation of contractual rights should also be given if valuable to the users understanding.

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 disagree with the proposal to report on how a company has sought employee views as we don't currently see enough guidance on how this can be done effectively to represent the views of a meaningful population of employees within our member's companies. As we represent a large number of companies with a significant international presence, we also believe that the disclosure of the ratio between CEO pay and the median earnings of the workforce is misleading. The inclusion of this ratio would not, in our view, add anything to users understanding of directors' remuneration, nor would it be directly comparable to any other company falling within the amended disclosure requirements due to the large variances in geographic reach and workforce distribution of each FTSE 350 company.

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 acknowledge that there is no simple way to communicate remuneration in a single figure, but we are not convinced that the approach set out in the table on page 24 meets the objectives of this legislation. We appreciate the Government's desire to reflect actual pay rather than potential pay for a particular reporting period, however we note that this is contrary to accounting principles. Under the proposals, the treatment of both LTIP and pension reporting does not accord with applicable accounting standards and will result in different amounts being shown in the remuneration report and the accounts.

The disclosure of amounts paid for LTIP awards with performance conditions that end in the year is likely to lead to certain years where the remuneration disclosed is significantly higher than the preceding or subsequent years. This could cause more public disquiet about the levels of executive compensation than a model which reflects the potential amounts accrued each year over the life of an LTIP scheme. We recognise that the Financial Reporting Lab proposed this "paid" approach as the solution that satisfies most interest groups and therefore we would accept this disclosure model, but would suggest that the Government ensures that the implications of such disclosures have been considered fully.

If the Government remains committed to showing remuneration on a "paid", rather than an accrued basis, we reiterate our view that this needs to be explained with a "one number: two drivers" approach, with clarity on how the elements of remuneration related to long term performance are aligned with Company performance.

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?

We believe that valuing the benefit of a defined benefit pension scheme should be done using IAS19 (or the existing cash equivalent transfer value method), as this calculation is based on current market conditions and provides the most accurate calculation of any benefit at the reporting date. Whilst the calculation methodology may be complex, it will have already been calculated for each director as part of the IAS19 disclosures in the notes to the Annual Report and we believe using two differing calculation methodologies to calculate the same benefit would lead to confusion.

The HMRC method seems flawed, as the annual allowance methodology is extremely complex and may give non-intuitive results, dependent on the specific wording of scheme rules. This means that the results will not be comparable between directors who are members of different schemes, which is often the case. This would seem at odds with the Government's desire for clarity of reporting.

Should the Government reject using the IAS19 calculation methodology, we would recommend further definition of the 'HMRC method' and we believe that using a multiplier of 20 to this calculation is a very arbitrary and approximate way of calculating the pension benefit for a director that takes no account of whether there is a spouse's pension, pension increases, early retirement benefit, or even how old the member is. The single figure disclosure is designed to be as accurate as possible (with auditors significantly reducing their level of materiality to audit these numbers down to the nearest thousand or less), therefore introducing this approximation for pension benefits seems counter to the overall aim of this legislation.

We would prefer to see the HMRC methodology as a fall back, only to be used if other more precise methods weren't viable. We'd support the need to disclose the methodology adopted which should be consistently applied.

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

Yes. We agree with this approach, as clawbacks can significantly alter the total remuneration a director receives in any one year.

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 in certain circumstances it could be commercially sensitive to disclose details of performance against very precise company metrics which may not have been disclosed elsewhere, depending on what metrics have been used to set director's remuneration. However, providing a blanket exemption could lead to abuse unless clear guidelines are also issued. We recommend that criteria are set for when the exemption can be taken as well as requiring an explanation for why metrics have not been disclosed.

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

We agree with the principle that additional information may be needed to supplement the single figure where a director has defined benefit pension benefits. However, we do not think that the current proposals provide sufficient clarity as to what is proposed. Is the accrued benefit to be calculated as if the member remained in service until their normal pension age, or as if they had left at the end of the year? How is the additional early retirement benefit to be calculated, given that the actual annual figure is unlikely to change, but rather the date from which it is paid? Further clarification of the disclosures required is needed.

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 any simplification in reporting requirements and would be supportive of any alignment between the Companies Act and the Listing Rules to ensure clear disclosure requirements for directors' interests.

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 do not believe that this disclosure is useful for a two reasons. Firstly, using total shareholder return as a proxy for company performance is a very crude assumption and, whilst it may be appropriate for many companies, it is likely that some CEOs are remunerated on other measures such as increased market share. Therefore, if this disclosure is retained in the final legislation, we would recommend that companies should be allowed to choose an appropriate alternative benchmark, as long as the reason for choosing the benchmark (if not TSR) is disclosed and it is consistently reported. Secondly, we believe the use of CEO pay alone is also a crude assumption and would recommend using total director or key management personnel pay, which would be more appropriate.

We accept that over a ten year period there will be years in which pay will 'spike' when one CEO leaves and another joins, and we note that it is often companies which are struggling to increase shareholder return that may change CEOs more regularly than more stable companies, meaning that the comparison would be even more misaligned.

Finally, we are unsure what guidance will be given when dealing with companies that have substantial change, such as demerger during the ten year period. We presume the 'newco' will only have a short period to report, however should the legacy company show the TSR and CEO pay for the original combined group prior to demerger or carve out the return to shareholders and what the executive in charge of the demerged operations was paid for the period prior to demerger? Further guidance on this would be welcome.

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 do not believe that it is necessary to expand the scope of the audit to other areas of the remuneration report and agree that the specific numbers highlighted are the most appropriate ones that should be audited. As much of the remuneration report relates to statements of policy, we do not see any criteria which would be able to be appropriately verified by the auditor. We note that, whilst no explicit audit opinion is given on the other parts of the remuneration report, auditors are required to read all sections of the Annual Report and to highlight any misstatements or inconsistencies when compared to the audited financial statements.