

SHAREHOLDERS GET TO VOTE ON DIRECTORS' PAY

DTI regulations on directors' pay introduced in August of this year will apply to quoted companies with financial years ending on or after 31 December 2002. Most companies already comply with most provisions, but now shareholders get the vote.

The aim of the new Directors' Remuneration Report Regulations 2002 is to "bring greater transparency, improve accountability to shareholders and require proper linkage between directors' pay and performance," says Guy Abbiss, employee benefits specialist with law firm Lewis Silkin.

They apply to UK-incorporated businesses regardless of whether their share listing is in the UK, elsewhere in the European Economic Area or even the New York Stock Exchange or Nasdaq. "The government's thinking here is that all British companies should be covered by the same corporate governance framework for boardroom pay, regardless of where they have chosen to be listed," Abbiss says. There are criminal sanctions for non-compliance.

As Aim companies are technically not "listed", they are exempt. But law firm Olswang says in a newsletter that any Aim company considering a full listing "should have regard to these more onerous provisions that they will need to comply with".

Many features of the new rules incorporate existing UK Listing Authority requirements to produce

a remuneration report. The regulations create a new Schedule 7A in the Companies Act 1985, detailing the contents of the remuneration report. The schedule breaks the list of disclosures into two sections: those subject to audit and those not.

Not subject to audit

There must be a detailed summary of any performance conditions attaching to *each* directors' remuneration and an explanation as to why such conditions were chosen. There must also be a summary of the methods to be used in assessing whether performance conditions have been met (which would appear to cover more subjective tests rather than strict financial criteria, for example), and the reasons for choosing such methods. There must also be detailed information about any external factors that will be relevant, for example, financial performance of a peer group of companies or an index: the companies or index concerned must be identified.

Changes in the terms and conditions relating to entitlement to share options or long-term incentive plans must be disclosed, and an explanation if a long-term plan has no performance criteria attached to it. Companies will also have to explain the relative importance of remuneration which are and are not subject to performance criteria.

There must be a summary and explanation of the company's

policy on directors' contract notice periods and termination payments. The need to explain termination payment terms could be particularly interesting reading, given the requirement to detail any good leaver/bad leaver provisions, enabling investors to be aware of the cost of early termination of a contract.

If there's a remuneration committee each member must be named, as well as any remuneration consultant or other person who "materially" assisted in setting pay policy. This is intended to ensure that executive directors do not get involved in setting their own pay package, but if, for example, a chief executive provides advice to the remuneration committee, then that fact will be disclosed, says Olswang.

A new requirement is for a performance graph comparing the company's total shareholder return over the past five years, compared with that of a "broad equity market index".

Subject to audit

The auditors are required to comment on whether certain types of information has been properly prepared. In particular, details of each directors' remuneration, share options and long-term incentive schemes, such as:

- Remuneration: salaries, fees, bonuses, expenses allowances, compensation for loss of office, value of non-cash benefits, pensions and payments made to third parties, such as a director's own management company.
- Options: full details of terms applying to options, number of options awarded, exercised, lapsed, the share price at the time of exercise, the end-of-year share price and 12-month high-low.
- LTips: details of directors' scheme interests at the beginning of the year (or date of appoint-

ment), awarded during the year, and as of the end of the year (or date of departure), plus interests that have vested during the year.

Signature and vote

The remuneration report must be approved by the board and signed by either a director or the company secretary. At the annual general meeting, shareholders must pass an ordinary resolution approving the remuneration report. This is an unusual provision in that there are no legal consequences if the shareholders vote against the report. The rules state that no directors' remuneration is conditional on the resolution being passed. Clearly, however, as Abbiss points out, this offers shareholders an opportunity "to register discontent" with the board's remuneration policy (especially in a difficult year for the company).

Andrew Sawers.

www.financialdirector.co.uk/briefing

Useful links

- www.lewissilkin.com/level1/newsnotes/corporate/corporate1.html
- www.olswang.com/shares
- The rules themselves can be accessed at www.legislation.hmso.gov.uk/stat.htm, then look for SI1986 in the section for calendar year 2002