



Department  
for Business  
Innovation & Skills

**DIRECTORS' REMUNERATION  
REFORMS**

Frequently Asked Questions

MARCH 2013

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# Introduction

The purpose of this document is to help stakeholders understand how and when they will be affected by reforms to the legal framework for directors' remuneration in quoted companies.

These reforms are being implemented through a combination of primary legislation (currently subject to Parliamentary scrutiny as part of the Enterprise and Regulatory Reform Bill) and secondary legislation (which the Department has published in draft). The legislative reforms will take effect on 1 October 2013 and affect AGMs held in reporting years commencing on or after that date.

Until both the primary and secondary legislation has been approved by Parliament, the detail of these reforms is subject to change. This document should therefore be read with that in mind. However, the Department recognises the importance of providing stakeholders with as much time as possible to understand the proposed changes to the law and hopes that this document will be helpful. If necessary, this document will be updated in future to reflect the final text of the legislation.

This document is intended as a factual explanation of the legislative reforms. It is not intended to be comprehensive and companies should not rely on it for legal guidance on how the reforms will affect them. It is not intended to substitute any good practice guidance produced by companies, investors and other stakeholders to complement the legislation.

The Department welcomes feedback on this document. Please send any comments or queries to [executive.pay@bis.gsi.gov.uk](mailto:executive.pay@bis.gsi.gov.uk)

## A. Overview of Reforms

From 1 October 2013, the directors' remuneration report in quoted companies will need to contain:

- (i) A statement by the chair of the remuneration committee.
- (ii) The company's policy on directors' remuneration (hereafter the 'remuneration policy').
- (iii) Information on how the remuneration policy was implemented in the financial year being reported on (hereafter the 'implementation report').

Shareholders will have a **binding vote on a resolution to approve the directors' remuneration policy**. The remuneration policy will set out how the company proposes to pay directors, including every element of remuneration that a director will be entitled to and how it supports the company's long-term strategy and performance. The policy will also include details of the company's proposed approach to recruitment and loss of office payments.

Companies must put the remuneration policy to a shareholder resolution at least every three years. If a company wishes to make any changes to the remuneration policy it will have to put the new policy to shareholders for approval at a general meeting.

Once a remuneration policy has been approved, a company will only be able to make remuneration and loss of office payments which are permitted within the limits of the policy, unless the payment has been approved by a separate shareholder resolution.

Companies will also have to produce an annual implementation report on how the approved pay policy has been implemented, including a single figure for the total pay directors received that year. This will allow shareholders to make comparisons year-on-year and between companies.

Shareholders will also have an **annual advisory vote on a resolution to approve the implementation report**. If a company fails to pass this resolution in a year in which the remuneration policy was not put to a shareholder resolution, this will trigger the need for the company to put the remuneration policy to shareholders the following year.

To further improve transparency around loss of office payments, from 1 October 2013, whenever a director leaves office, companies will need to publish a statement setting out what payments the director has received or may receive in future. This statement must be published as soon as reasonably practicable.

## B. Scope

### 1. Which companies does this apply to?

Quoted companies, as defined by the Companies Act 2006. This means companies registered in the UK and with equity listed on the main market in the UK, in another state in the European Economic Area or on the New York Stock Exchange or NASDAQ. There are around 900 such companies.

### 2. Does this apply to AIM listed companies?

No.

### 3. What about companies that are foreign registered and UK listed?

The reforms apply to UK registered companies only and so do not capture foreign registered companies listed in the UK.

All companies listed in the UK have to comply with the remuneration elements of the Corporate Governance Code or explain reasons for non-compliance. UK companies with a premium listing must also comply with the Listing Rules requirements relating to remuneration.

The UK Listing Authority will consider how the Listing Rules need to be updated in light of the reforms being made to company law.

### 4. Do UK registered companies listed overseas have to comply with this legislation even if the country they are listed in does not require it?

Yes, all UK registered companies with equity listed on the main market in the UK, in a state in the European Economic Area or on the New York Stock Exchange or NASDAQ, have to comply with the legislation.

### 5. Do the rules apply equally across the UK?

Yes.

### 6. Do the new restrictions on remuneration and loss of office payments apply to non-executive directors who are not employees?

Yes. The legislation applies to all those who hold the office of director, regardless of whether or not they are an employee of the company.

## C. Timing

### 7. When will companies have to start complying with the new regime?

The new regime will come into force on 1 October 2013.

For the AGM held in the first financial year to begin on or after 1 October 2013 companies will need to produce a directors' remuneration report in the new format prescribed by regulations - with a separate policy part and implementation part. For the majority of companies this will mean AGMs held in the Spring/Summer of 2014. The first companies to comply with the new regime will be those with a financial year beginning on 1 October 2013.

At this AGM, both the remuneration policy and the implementation report must be put to shareholders for approval.

All companies must have successfully sought approval for a remuneration policy by no later than the start of the second financial year to begin after the reforms come into force. So for a typical December year-end company that means by the 1 January 2015.

After this date, the restrictions in new Chapter 4A of the Companies Act 2006 will take effect and all remuneration and loss of office payments to directors will need to be in line with the company's approved remuneration policy, or else separately approved by a shareholder resolution.

In the first year of the new regime, companies may choose to apply the restrictions in Chapter 4A from an earlier date if they wish (i.e. any date after a remuneration policy has been approved).

The Chapter 4A restrictions will not apply to any remuneration or loss of office payment required to be made as part of an agreement entered into, or other obligation arising, before 27 June 2012 and which has not been renewed or amended since.

Table 1: Date that restrictions on remuneration and loss of office payments will come into force

<b>Year-end</b>	<b>First AGM at which company must report in the new format and put the remuneration policy to a binding shareholder resolution</b>	<b>Date from which all remuneration and loss of office payments must be consistent with the approved policy or approved by a separate shareholder resolution</b>
30 September	Early 2014	1 October 2014
31 December	Spring 2014	1 January 2015
31 March	Summer 2014	1 April 2015
30 June	Autumn 2014	1 July 2015

**8. Does this mean that until the start of the second financial year (or whenever the company chooses to have the restrictions in Chapter 4A take effect) companies can pay whatever they want?**

The Chapter 4A restrictions on remuneration and loss of office payments will not take effect until the start of the second financial year to begin after the reforms come into force, or at an earlier date of the company's choosing (any date after a remuneration policy has been approved).

Before this date, remuneration and loss of office payments made which are not consistent with the approved remuneration policy will not be unlawful. Until the Chapter 4A restrictions come into effect the existing Companies Act 2006 provisions on payments for loss of office will continue to apply.

**9. When will the regulations prescribing the new format of the directors' remuneration report be finalised?**

The Government hopes to present these to Parliament in Spring 2013.

## D. Voting Procedure

### (i) Shareholder Resolution on the Implementation Report

#### 10. How often must companies put the implementation report to a shareholder resolution?

At every AGM.

#### 11. What are the consequences if a company fails the shareholder resolution on the implementation report?

No individual director's remuneration is dependent on the resolution on the implementation report being passed as it is an 'advisory' resolution.

However, if a company fails the annual advisory resolution in a year in which the remuneration policy was not also put to a shareholder resolution, this will trigger the need for the company to put its remuneration policy to a shareholder resolution the following year.

#### 12. What happens if a company fails the resolution on the implementation report but a resolution on the remuneration policy is approved at the same AGM?

As the shareholders have had the opportunity to vote on the remuneration policy and approved it, the company will not be required to put it back to shareholders at the next AGM.

### (ii) Shareholder Resolution on the Remuneration Policy

#### 13. How often must companies put the remuneration policy to a shareholder resolution?

All companies must put the remuneration policy to a shareholder resolution at the AGM held in the first financial year to commence on or after 1 October 2013.

After that, whenever companies want to introduce a new remuneration policy or make changes to an existing policy they will need to put the remuneration policy to shareholders for approval.

All companies will have to put their remuneration policy to shareholders for approval at least every three years.



## 14. How are the three years measured?

From the beginning of the first financial year to commence after the last AGM or other general meeting at which the remuneration policy was put to a shareholder resolution. The company must put the remuneration policy back to shareholders by the end of the third full financial year.

Table 2: Requirement to put the remuneration policy to a resolution every three years

Date of last AGM or other general meeting at which the remuneration policy was put to a shareholder resolution	Date of first financial year to commence after this AGM	Date by which the company must put the remuneration policy back to shareholders
Early 2014	1 October 2014	30 September 2017
Spring 2014	1 January 2015	31 December 2017
Summer 2014	1 April 2015	31 March 2018
Autumn 2014	1 July 2015	30 June 2018

## 15. From what date does a remuneration policy apply?

In the first year of the new regime the restrictions in Chapter 4A of the Companies Act 2006 will not take effect until the start of the following financial year (unless the company chooses for them to apply sooner). The company may adopt the policy immediately but the restrictions on payments will not apply until the end of that year.

Thereafter, the remuneration policy will take effect for the purposes of the restrictions in Chapter 4A from the date it is approved at the AGM or other general meeting.

If, as part of the proposed remuneration policy, a company wants to continue to operate according to the previously approved remuneration policy for a certain period of time (for example, up to the end of the financial year), the company must clearly indicate this intention within the remuneration policy being put to shareholders for approval.

## 16. Can companies make minor changes to their remuneration policy without putting it back to shareholders for approval?

No. Companies can only make remuneration or loss of office payments which are consistent with the last remuneration policy report to have been approved by shareholders, or which have been approved by a separate shareholder resolution. As such, any changes made to the policy need to be approved by shareholders.

## 17. Will companies be able to put a revised remuneration policy to shareholders for approval in between AGMs?

Yes. New section 422A of the Companies Act 2006 makes this possible by allowing companies to put a revised remuneration policy to a shareholder resolution at a general meeting which is not the accounts meeting.

## **18. Why would a company want to revise its remuneration policy in between AGMs?**

A company may want to revise its remuneration policy if it finds the current policy is no longer workable or is deficient in some way or if the company wishes to do something not previously contemplated (e.g. a particular loss of office payment). Following a merger or acquisition a company may want to change its policy without having to wait for the next AGM.

## **19. Can companies put a remuneration policy to a shareholder resolution earlier than the legislation requires?**

Yes. Companies have the option of calling a general meeting to ask shareholders to approve a revised remuneration policy before the AGM held in the first financial year to commence on or after 1 October 2013.

This will need to be a remuneration policy revised in accordance with section 422A. The new directors' remuneration reporting regulations will determine the content of a revised remuneration policy and will effectively require exactly the same content as any other remuneration policy to be prepared under the new regulations.

No remuneration policy approved prior to 1 October 2013 will be recognised as an approved remuneration policy for the purposes of the new legislation.

## **20. What are the consequences if a company fails the shareholder resolution on the remuneration policy?**

If the shareholder resolution on the remuneration policy is not passed, a company will have three options:

- i. Continue to operate according to the last remuneration policy to have been approved by a shareholder resolution.
- ii. Continue to operate according to the last remuneration policy to have been approved by a shareholder resolution and seek separate shareholder approval (via a resolution at a meeting) for any specific remuneration or loss of office payments which are not consistent with the policy.
- iii. Call a general meeting and put a remuneration policy to shareholders for approval. This could, but need not be, an amended version of the policy last put to shareholders for approval.

## **21. What are the consequences if a company fails the shareholder resolution on the remuneration policy report in the first year?**

In the first financial year after the reforms come into force a company which fails the resolution on the remuneration policy will not be able to rely on options (i) or (ii) as there is no previously approved policy to fall back on. The company would have to call a general meeting.

## **22. How does the new resolution on the pay policy fit with the existing resolution on long-term incentive plans (LTIPs) and employees' share schemes through the Listing Rules?**

The Listing Rules will continue to require shareholder approval for certain types of incentive schemes which involve the awarding of shares to directors and other employees.

In the remuneration policy companies will have to provide additional details of how any share awards made under such incentive schemes will work for the directors specifically. e.g. The maximum payout level and the performance conditions that will be applied. This may cross-refer to more detailed information in the rules of approved schemes.

## **23. If a company fails the resolution on the remuneration policy does that mean it can't pay out on its LTIPs?**

Not necessarily. Once the new regime is in steady state companies who fail the resolution on the remuneration policy will always have the option of falling back on the last policy to have been approved. If the last policy to have been approved makes provision for payments to directors under existing LTIP schemes then the company will be able to continue to make payments under them, subject to any conditions in the last approved policy.

The resolution on the remuneration policy will have no impact on how LTIP schemes can operate for staff who are not directors.

### **(iii) Voting Threshold**

## **24. What proportion of shareholders must support the resolution on the implementation report or the remuneration policy?**

A simple majority, like all ordinary resolutions.

## **25. Do abstentions/votes withheld count?**

Consistent with all ordinary resolutions abstentions/votes withheld will not count.

## **26. How does this fit with the proposed changes to the UK Corporate Governance Code, requiring companies to respond when a substantial minority of shareholders vote against a resolution on remuneration?**

Some stakeholders have suggested that when a substantial minority of shareholders oppose a resolution on directors' remuneration, companies should have to respond and say what they will do to address shareholder concerns.

The Financial Reporting Council (FRC) will consider this and consult on potential changes to the UK Corporate Governance Code once legislative reforms are finalised. At this stage, the FRC does not envisage making further changes to the UK Corporate Governance Code during 2013.

## E. Remuneration Reports

### **27. Can companies start reporting in the new format early?**

Companies can start to adopt the new reporting requirements before they come into force on 1 October 2013, provided that they continue to fulfil the legal requirements in the existing regulations.

### **28. Can companies go further than the requirements in the regulations and include extra information in their directors' remuneration reports?**

Yes. The new directors' remuneration reporting regulations will provide a reporting framework with minimum standards to ensure a consistent level of reporting, but they do not preclude companies from including additional information which they think is relevant and helpful for shareholders.

### **29. Do companies have to treat executive and non-executive directors in the same way when reporting on pay?**

The Act does not make a distinction between executive and non-executive directors and information about both must be included in the directors' remuneration report.

However, the Government recognises that remuneration of executive directors is more complicated than that of non-executive directors and is of most interest to shareholders. It is anticipated that the final directors' remuneration reporting regulations will take this into consideration and enable companies to provide less comprehensive disclosures on non-executive directors' remuneration.

## F. Restrictions on Remuneration Payments

### 30. When do the restrictions on remuneration payments come into force?

The restrictions in new Chapter 4A of the Companies Act 2006 will apply from the start of the second financial year to begin on or after 1 October 2013 (i.e. 1 January 2015 for a December year-end company), or at an earlier date of the company's choosing (any date after a remuneration policy has been approved by shareholders).

Before this date, remuneration payments made which are not consistent with the approved remuneration policy will not be unlawful.

Any remuneration payments made to directors after the restrictions come into force will need to be consistent with the approved remuneration policy or separately approved by a shareholder resolution. That is, unless the payments are required to be made as part of a legal obligation entered into before 27 June 2012 and not amended or renewed since.

### 31. What does it mean for a payment to be 'consistent with the remuneration policy'?

The approved remuneration policy must have made provision for the payment and the payment must be consistent with that provision.

### 32. The restrictions on remuneration and loss of office payments apply to people who are, are to be, or were directors – how does this impact on:

#### (i) Buying out existing remuneration arrangements of new recruits and other recruitment awards

The restrictions on remuneration payments will capture payments made to individuals who are going to become directors of the company. This includes payments a company may make to buy-out an individual's remuneration arrangements at another company which they would otherwise lose as a result of leaving. The recruiting company will need to ensure any such payments are consistent with the approved directors' remuneration policy and if not, have been separately approved by shareholders.

#### (ii) How much companies can pay new recruits

Any remuneration payments to directors, including individuals who become directors part way through the financial year, will need to be consistent with the approved directors' remuneration policy. This means that the policy will need to make reference to the company's approach to remuneration of new recruits.

#### (iii) Remuneration payments made to directors after they have left

Any remuneration payments made to former directors will need to be consistent with the approved directors' remuneration policy. As such, the company's remuneration policy will

need to make reference to their approach to making such payments to individuals after they have left office.

**33. Some remuneration schemes may be created under one policy and pay out under another – how does that work?**

All remuneration payments will need to be consistent with the approved remuneration policy at the point they are made.

Companies may want to consider including in their remuneration policy a brief reference to their intention to make payments under remuneration schemes created under a previous policy, including schemes created before the new legislation came into force.

Any payments which are required to be made as part of an agreement entered into or other obligations arising before 27 June 2012 and not renewed or amended since will not be subject to these restrictions and can be paid regardless of the remuneration policy.

**34. If a company includes information about how it pays people below board level in the remuneration policy will it be bound by this in the same way it is for directors?**

No. The Companies Act 2006 places no restrictions on the payments companies can make to individuals who are not directors.

## G. Restrictions on Loss of Office Payments

### 35. When do restrictions on loss of office payments come into force?

The restrictions in new Chapter 4A of the Companies Act 2006 will apply from the start of the second financial year to begin on or after 1 October 2013 (i.e. 1 January 2015 for a December year-end company), or at an earlier date of the company's choosing (any date after a remuneration policy has been approved by shareholders).

Before this date loss of office payments made which are not consistent with the approved remuneration policy will not be unlawful. Until the Chapter 4A restrictions come into effect the existing Companies Act 2006 provisions on payments for loss of office will continue to apply.

Any loss of office payments made to directors after the Chapter 4A restrictions come into force will need to be consistent with the approved remuneration policy or separately approved by a shareholder resolution. That is, unless the payments are required to be made as part of a legal obligation entered into before 27 June 2012 and not amended or renewed since.

### 36. How does the legislation affect the ability of companies to settle statutory or contractual claims arising in connection with loss of office?

The Companies Act 2006 definition of payments for loss of office includes settlement of claims associated with the loss of office. This means that companies will need to ensure their remuneration policy makes it clear how they will approach settling any such claims.

### 37. How does the legislation affect the ability of companies to make payments ordered by a court, e.g. as a result of a discrimination claim?

Where a court has ordered a payment – which could be construed as a loss of office payment - to be made, the legislation will not prevent the company from paying it.

### 38. How does the legislation affect the ability of companies to make statutory payments (e.g. for redundancy) or payments required to be made by law in another jurisdiction?

Where another Act of Parliament requires a payment – which could be construed as a loss of office payment - to be made, the legislation will not prevent the company from paying it.

### 39. What must be included in the statement that companies publish online when a director leaves?

Particulars of loss of office payments and remuneration payments which have been made or may be made in future, and how they were calculated. It will be up to investors and companies to work out what best practice looks like when it comes to this disclosure.

**40. Does the company need to publish a statement every time it makes a remuneration payment to a former director?**

No. The statement is only required at the point the director leaves office (or as soon as reasonably practicable afterwards).



## H. Contracts and other Legal Agreements

### **41. Impact on existing contracts and other legal agreements, not renewed or amended since 27 June 2012**

Payments required to be made under existing contracts and legal agreements entered into, and obligations arising, before the legislation introducing these reforms was published on 27 June 2012 and which have not been amended or renewed since, will not be subject to the restrictions in new Chapter 4A of the Companies Act 2006.

### **42. Impact on agreements entered into, and existing contracts and agreements amended or renewed on or after 27 June 2012**

All payments made under agreements entered into, amended or renewed on or after 27 June 2012 will be caught by the new rules.

This means that any payments made under these agreements must be consistent with the approved remuneration policy.

However, the restrictions in Chapter 4A will not come into force until the second financial year to begin on or after 1 October 2013 or an earlier date of the company's choosing, giving companies plenty of time to prepare.

### **43. You say companies can't pay outside of the remuneration policy but what if they have a legal agreement with a director?**

Obligations to make a payment which would be inconsistent with the approved remuneration policy and have not been separately approved by shareholders will have no effect.

# I. Unauthorised Payments

## **44. What happens if a company makes a payment which is inconsistent with the approved remuneration policy and has not been separately approved by shareholders?**

The unauthorised payment is to be held on trust by the individual recipient and an action can be brought to recover the payment.

## **45. Who can bring an action to recover an unauthorised payment?**

This action could be brought by the directors, on behalf of the company.

If the directors choose not to bring an action then the shareholders, acting on behalf of the company, may seek to do so, using their rights to shareholder derivative actions under section 260 of the Companies Act 2006. The shareholders would need to apply to a court to seek permission to pursue the action.

## **46. What happens if the company, or the shareholders acting on behalf of the company, cannot recover the payment?**

The directors who authorised the payment can be held liable for any losses incurred as a result.

## **47. What happens if the directors who authorised the payment made an honest mistake?**

If a director who authorised an unapproved payment can prove that he or she acted honestly and reasonably then the court – taking into account all of the circumstances of the case - may relieve the director either wholly or in part on such terms as the court sees fit.

## **48. Can the company or shareholders bring an action to recover a payment under section *without* also bringing an action to recover losses from the responsible directors or are the two processes always joined together?**

The action to recover a payment can be seen separately and so a company or its shareholders may take action to recover a payment without also seeking to recover any resulting losses from the directors who authorised the payment.

## **49. Do the directors who authorised the payment have to pay for losses if the payment is fully recovered from the individual who received it?**

Where the payment has been fully recovered it is possible there may have been no losses and so no grounds for an action against the directors.



## J. Miscellaneous

### 50. When do newly quoted companies have to start complying with the rules?

Newly quoted companies will need to put a remuneration policy to a shareholder resolution at the AGM in the first financial year to begin on or after the day which the company becomes a quoted company. The restrictions on remuneration and loss of office payments in Chapter 4A of the Companies Act 2006 will apply to newly quoted companies from the start of their second financial year as a quoted company.

### 51. How will this affect remuneration payments in a takeover situation?

Any remuneration payment made will need to be consistent with approved remuneration policy of whichever company is making the payment (if that company is a quoted company).

Where a company has taken over another company, the new parent company's remuneration policy becomes the relevant policy. Where a new quoted company is formed, that company would need to put a remuneration policy to a shareholder resolution at the AGM in the first financial year to begin on or after the day on which the company becomes a quoted company.

### 52. How will this affect loss of office payments in a takeover situation?

Any loss of office payment made will need to be consistent with the approved remuneration policy of whichever quoted company the director is departing from, regardless of who actually makes the payment. If, at the point the director departs, the company is no longer a quoted company then these restrictions do not apply.

### 53. What is the Financial Reporting Council consulting on?

The FRC will consider any changes that should be made to the UK Corporate Governance Code in light of legislative reforms. This includes:

- How companies should formally respond when a significant minority of shareholders oppose a resolution on the directors' remuneration report.
- Requiring all companies to adopt clawback mechanisms.
- The extent to which executives should serve on remuneration committees in other companies.

The FRC will consult on potential changes to the UK Corporate Governance Code once legislative reforms are finalised. At this stage, the FRC does not envisage making further changes to the UK Corporate Governance Code during 2013.

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**BIS/13/727**