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The Linklaters Employee Incentives team
Introduction

2020 marks the triennial point for many FTSE companies when they will be presenting new policies for shareholders’ binding vote. They will be doing this against the continuing focus on executive pay from shareholders, employees and other stakeholders, as well as politicians and the media. In preparing new policies and reviewing pay packages and potential vestings, remuneration committees need to ensure, more than ever, that they have full information on what’s expected and the appropriate powers and support to carry out their functions.

The plethora of rules around both design and disclosure of directors’ pay includes legislation, industry and government guidance, market practice and investors’ expectations has, if anything, grown over the last 12 months: the 2018 legislative and regulatory corporate governance reforms came into force and the EU ‘say on pay’ rules were implemented in the UK.

Our online tool, launched last year, is being continuously updated for the 2020 AGM season. This February update includes:

- Corporate Governance Code 2018 and what no longer applies from the 2016 Code;
- Corporate governance legislative changes effective for 1 January 2019;
- Changes implementing the EU rules on directors’ pay in the UK;
- The updated Investment Association’s Principles of Remuneration of 1 November 2019;
- The ISS 2020 Proxy Voting Guidelines for UK and Ireland;
- Glass Lewis 2020 Proxy UK Guidelines; and
- PLSA Stewardship Guide and Voting Guidelines 2020
The Code requires remuneration committee chairs to have at least 12 months’ previous experience on a remuneration committee. One institutional investor – Legal & General Investment Management – has taken a different view. They say that the remuneration committee chair should have at least one year’s experience on the company’s board before taking on the chair role. They consider that the remuneration committee chair should have knowledge of the business to align remuneration with the company’s strategy.

Most of the Code changes only apply to financial periods starting on or after 1 January 2019. Companies which have not, for example, fully implemented their employee engagement mechanisms during 2019, will need to report on what they have so far done, and their plans for the future. There may need to be a value judgement as to whether they are complying with the Code now.

**Workforce engagement**

In this context, it’s interesting to note that some companies have pre-complied with certain Code provisions. 171 companies (59 FTSE 100 and 112 FTSE 250) have included a statement in their annual reports that they have adopted or will adopt workforce engagement mechanisms:

> The most popular method (60% of companies) is a designated non-executive director;
> Next most popular is the workforce advisory panel (around 16% of companies);
> Only five companies have chosen a director appointed from the workforce; and
> Many companies have “alternative arrangements” (many are in addition to the other methods): employee forums, European works councils, board associate appointed from the workforce, ‘meet the board’ employee events.

The FRC have emphasised that the board must be fully informed of the issues the workforce raises, and what impact these have had on decisions taken. They therefore consider that the outcome is more important than the engagement method chosen. remuneration structures; and performance conditions. This follows on from last year’s message that levels of remuneration which are undeserved and excessive send a negative message to all stakeholders and are damaging in the long term.
Top tips for 2019 remuneration reports and the 2020 financial year

Companies preparing their 2019 implementation reports and, in many cases, new remuneration policies, should consider these developments and action points for 2020:

> **What applies when**: Both the 2018 Corporate Governance Code and the new reporting requirements on pay ratio and share price/discretion disclosures apply for financial years starting from 1 January 2019, so for most companies will need to be reported on for the first time during 2020.

> The new miscellaneous requirements of the EU ‘say on pay’ regime apply to remuneration policies adopted from 10 June 2019 onwards, and to implementation reports for financial years starting on or after that date. Therefore, any new policies will need to comply, but it’s more complicated for implementation reports:

   - Calendar year-end companies need to comply from implementation reports for their 2020 financial year i.e. in 2021 reports;
   - March year-end companies need to comply from implementation reports for their 2021/22 financial years; and
   - June and September year-end companies need to comply from implementation reports for their 2019/20 financial years.

There are also separate, enhanced website disclosures, which apply to any remuneration reports (i.e. both any new policy and the annual implementation reports) published after 10 June 2019.

> **Levels of pay and discretion**: The relentless pressure from investors to rein in executive pay is continuing. This is against a background of the new enhanced legislative reporting requirements on exercises of discretion, provisions in the Corporate Governance Code 2018 (Code) and in the FRC Guidance on Board Effectiveness (FRC Guidance) about overriding formulaic outcomes and being aware of possible monetary outcomes of grants. The Investment Association (IA) say (in their updated Principles of Executive Remuneration) that companies need to justify adequately the level of executive remuneration and increases to salary and variable pay.
> **Are your documents consistent?** It's clear that remuneration committees are expected to have full discretionary powers to vary bonus and LTIP outcomes and to report on how they have exercised such powers. It's important to take action to ensure they can comply with their obligations. Companies need to ensure that the matrix of documents relating to remuneration (policies, contracts, communications to employees) are all consistent so remuneration committees can, if necessary, reduce pay outcomes. The FRC expect remuneration committees to disclose if they have not been able to do so because of any mismatches between these documents. Having discretionary powers in remuneration policies does not of itself allow remuneration committees to reduce pay outs.

*Click here for details on the issues and help with difficult remuneration decisions.*

> **Pensions:** The theme of restraint in directors’ pay is again evident here. During 2019 investors have taken firm action to get companies to comply with the Code provision that pension contributions should be in line with the general approach of contributions for employees’ pensions. This led to increased media attention and some reduction in pension contributions for executive directors.

In September 2019 the IA issued its approach for the 2020 AGM season, applying to companies with year-ends on or after 31 December 2019.

*Click here for details.*

It is clear from the IA and other investor guidelines (such as PLSA, Glass Lewis, LGIM and ISS) that companies now should appoint new directors (including internal promotions) with pension contribution rates no higher than that paid to the majority of the workforce. If new policies or implementation reports do not reflect this, IVIS will red top (i.e. strongest concern) them. Existing directors’ rates must be reduced (by the end of 2022 according to the IA, within the “next few years”, according to the PLSA) to this level, with no compensation. Rates of 25% or more of salary risk an IVIS amber (significant issue to consider) or a red-top.

Last year LGIM said that they will vote against remuneration policies from 2020 if there are no changes to address this disparity. So companies need to address what can be a difficult issue, particularly for existing directors. LGIM have stated that although they would not force existing directors to reduce their pension provisions, they would encourage them to do so voluntarily.
Part A  
Overview of how the rules work

1. To whom do the rules apply?

1.1 By law

The legislation relating to remuneration reports applies to UK-incorporated companies which are listed on the London Stock Exchange, an EEA exchange, the New York Stock Exchange, or NASDAQ. From 10 June 2019, this includes UK-incorporated unquoted traded companies (see below).

In practice, many London listed companies which are incorporated outside the UK produce remuneration reports as if they were UK companies. The IA recommend that where companies are not subject to the regime, they should apply similar high standards. For such companies which are not listed in the EU, the vote on the remuneration policy is not technically binding: if the report is voted down, the company may agree to seek approval for a revised policy but there are no general constraints on its ability to pay directors in the meantime. Even if companies choose not to do this, they will have to comply with the CGC 2018 or explain any non-compliance. Media and investor pressure may also mean that non-UK companies do follow the Companies Act requirements.

From 10 June 2019, the new EU-wide directors’ pay regime applies to London-listed, EU incorporated companies. They will need to ensure they are complying with the rules for their country of incorporation, as well as manage the CGC 2018 and investors’ expectations for London-listed companies.

In addition, there are some UK-incorporated companies which are:

- not listed in London, but on another EEA exchange, the New York Stock Exchange, or NASDAQ; or
- listed on an EEA exchange (or the LSE) but outside an official list (mostly on the LSE’s Specialist Fund Segment), these are “unquoted traded companies”.

They are caught by the rules and need to comply.
5. Personal data

Remuneration reports for financial years starting on or after 10 June 2019 must not include any data:

> which refer to a director’s family situation;

> revealing an individual’s racial or ethnic origin, political opinions, religious or philosophical beliefs or trade union membership;

> concerning an individual’s health or sex life or sexual orientation; or

> relating to criminal convictions and offences or related security measures.

Some benefits disclosures (e.g. partner/spouse travel costs) may reveal such data, depending on the level of details given. So companies should ensure compliance when disclosing such items.

They must also not include genetic data and biometric data for the purpose of uniquely identifying an individual, though this is most unlikely to be relevant for remuneration reports.

6. Website disclosure

6.1 Remuneration reports

Each remuneration report must now be:

> kept on the company’s website for at least ten years; and

> removed after the ten years if it contains “information relating to an identified/identifiable living individual”.

In practice, this means most of the implementation report and some parts of the policy. Stripping this information out would be possible but would leave little useful information and no context. So companies should make sure they remove the remuneration report after ten years, to avoid breaching the legislation.
1.4 Previous approved policies

The policy must state which provisions of any previously approved policy are to continue to apply after the new policy receives shareholder approval, and for what period of time it is intended that those provisions should continue to apply.

Schedule 8, Paragraph 24(2)

1.5 Decision-making process

Policies adopted after 9 June 2019 must include an explanation of the decision-making process followed for determination, review and implementation of the policy. This should include:

> measures to avoid or manage conflicts of interest and
> where applicable, the role of the remuneration committee or other committees concerned (unless covered elsewhere in the report).

Schedule 8, Paragraph 24(1A)

1.6 Remuneration policy table

1.6.1 A table setting out:

A description of each component of the remuneration package for the company’s directors.

Schedule 8, Paragraph 25(1)
1.4 Previous approved policies

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1.6 Remuneration policy table

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A description of each component of the remuneration package for the company’s directors.

A payment must be within the policy at the time it is made. Incentive awards are usually granted under one approved policy but vest under another, which may not necessarily include that form of award because e.g. the company’s policy has changed due to market practice. To ensure that the payment is lawfully paid under an approved policy, companies need to include in the subsequent policy a reference to their intention to make payments under awards granted under previously approved policies. They will also need to identify which provisions in those policies will continue to apply and for how long those provisions will apply e.g. until vesting of those awards.

Most companies broaden this wording to cover other commitments made under one policy which fall to be honoured under another (e.g. promises to make grants or termination payments), and also commitments made before a person became a director or, where applicable, before listing.
1.4 Previous approved policies

The policy must state which provisions of any previously approved policy are to continue to apply after the new policy receives shareholder approval, and for what period of time it is intended that those provisions should continue to apply.

Schedule 8, Paragraph 24(2)

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- measures to avoid or manage conflicts of interest;
- where applicable, the role of the remuneration committee or other committees concerned (unless covered elsewhere in the report).

The GC100 (4.2, page 32) suggest that this might include procedures surrounding executive attendance at remuneration committee meetings and ensuring external advice received by the committee is independent.

1.6 Remuneration policy table

1.6.1 A table setting out:

A description of each component of the remuneration package for the company’s directors.

Schedule 8, Paragraph 25(1)
Part C
Implementation Report – detailed rules
3.12 Comparison of percentage change in CEO and employees pay

The percentage change between the year under review and the previous year, in:

> the salary, fees, taxable benefits and bonuses, as shown in the single figure disclosed for the chief executive; and

> the salary, fees, taxable benefits and bonuses for group employees generally (or another comparator group of employees if more appropriate, with an explanatory statement).

Schedule 8, Paragraph 19

3.13 Comparison of percentage change of directors and employees pay

The percentage change between the year under review and the previous year:

> the salary, fees, taxable benefits and bonuses, as shown in the single figure disclosed for each director;

and

> the salary, fees, taxable benefits and bonuses for employees of the listed company (other than directors) on a full-time equivalent basis.

This has to be shown for each financial year, beginning with the first one which starts after 9 June 2019, up to a maximum of five financial years.

Schedule 8, Paragraph 19

3.14 CEO:UK employee pay ratios

For financial years beginning on or after 1 January 2019 and for companies with 250 or more UK employees, a table setting out the ratios of pay between the CEO and the UK employees at the 25th percentile, median and 75th percentile. Part E includes full details on when this applies and how the ratios are calculated and set out.

Schedule 8, Paragraph 19A
3.12 Comparison of percentage change in CEO and employees pay

The percentage change between the year under review and the previous year, in:

> the salary, fees, taxable benefits and bonuses, as shown in the single figure disclosed for the chief executive; and

> the salary, fees, taxable benefits and bonuses for group employees generally (or another comparator group of employees if more appropriate, with an explanatory statement).

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This has to be shown for each financial year, beginning with the first one which starts after 9 June 2019, up to a maximum of five financial years.

3.14 CEO:UK employee pay ratios

For financial years beginning on or after 1 January, a table setting out the ratios of pay between the 25th percentile, median and 75th percentile. Part E includes full details on when this applies and how the ratios are calculated and set out.
The report must state how the company intends to implement the remuneration policy in the year after the year under review including:

> performance measures to be used and the relative weightings;
> performance targets and how awards will be calculated; 99
> any significant differences between the way the policy was implemented in the year under review and the next year (if the same policy applied in both years) 100 See Note 18 See Note 59; and
> for financial years beginning after 9 June 2019, details of any deviations from the implementation of the remuneration policy set out in the policy 101.

### 3.22 Remuneration waived

Details of any arrangements under which a director has waived or agreed to waive any emoluments or future emoluments 102.

LR9.8.4(5) and (6)

### 3.23 External directorships

The reasons why the board has permitted a director to take up additional significant external appointments should be explained in the annual report 104.

CGC 2018 Provision 15

Details of other current appointments, including any changes over the previous year.

CGC 2018 Provision 15

### 3.24 Key management personnel
The report must state how the company intends to implement the remuneration policy in the year after the year under review including:

> performance measures to be used and the relative weightings;
> performance targets and how awards will be calculated;
> any significant differences between the way the policy was implemented in the year under review and the next year (if the same policy applied in both years);

for financial years beginning after 9 June 2019, details of any deviations from the implementation of the remuneration policy set out in the policy.

3.22 Remuneration waived

Details of any arrangements under which a director has waived or agreed to waive any emoluments or future emoluments.

LR9.8.4(5) and (6)

3.23 External directorships

The reasons why the board has permitted a director to take up additional significant external appointments should be explained in the annual report.

CGC 2018 Provision 15

Details of other current appointments, including any changes over the previous year.

CGC 2018 Provision 15

3.24 Key management personnel
Part D
Single Figure
Table details
Part D
Single Figure Table details

This table lists the elements in a remuneration package, considers whether the board pay rules require their inclusion in the single figure table of the implementation report, and in which year. It includes statutory references and comments.

"Year" in this table means a reporting year.

<table>
<thead>
<tr>
<th>Element of remuneration</th>
<th>Granted in the year</th>
<th>Continuing in the year</th>
<th>Vested in the year</th>
<th>Paragraph in Schedule 8</th>
<th>Amount included in single figure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>Yes</td>
<td></td>
<td></td>
<td>7(1)(a), 10(1)(a)</td>
<td>Cash paid in or for the year. Only covers pay while a director.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Benefits e.g. car, medical insurance, accommodation</td>
<td>Yes</td>
<td></td>
<td></td>
<td>7(1)(b), 10(1)(b), 11, 12(1)</td>
<td>Cash equivalent (i.e. the taxable value).</td>
</tr>
<tr>
<td>Pay in lieu of pension</td>
<td>Yes</td>
<td></td>
<td></td>
<td>7(1)(e)(i), 10(1)(e)(i)</td>
<td>Amount of payment.</td>
</tr>
</tbody>
</table>

Continued on next page »
Part E
CEO: UK employee pay ratios
In later years, companies will also have to explain changes in the pay ratios (e.g. changes to employees’ pay, CEO pay, employment models or calculation methods). LGIM specifically require boards to consider whether the ‘year on year’ changes in the ratios are appropriate in the light of performance.

The GC100 (section 3.9, page 24), say that companies may also wish to consider reporting pay ratios as they relate to the global full-time equivalent employees. They say this will give context and further explanation.

4.3 Commentary on changes and trends

The legislation requires the report to include commentary on changes and trends in the ratio over the years. As noted below, pay ratio disclosures were not required for years which began before 1 January 2019. So companies reporting pay ratios for the first time will not have to include commentary on changes and trends (and should note this).

However, many companies, following institutional investors’ guidance, did include pay ratios on a voluntary basis in reports published in 2019. Arguably, the legislation requires commentary on changes and trends between the (mandatory) figures for the First Year and any voluntary figures published in previous years. It’s likely anyway that most such companies would want to provide some commentary along these lines. This is the required disclosure:

There should be an explanation of any change in the pay ratios from the previous year and a statement as to whether or not any such change is attributable to:

> a change in CEO pay;
> a change in the pay and benefits of UK employees taken as a whole;
> the company’s employment models (including any change in the size the non-UK workforce or in the use of non-employee contractors); or
> using a different Option to calculate the Reference Employees’ pay and benefits.
Using this document – What these symbols mean:

- An audited provision.
- A provision implementing the EU’s ‘say on pay’ regime (in the second Shareholder Rights Directive).
- Click to see linked document, section or note.

**Icons for footnote type:**

- Explanatory note.
- Investor and other guidance.
- Market practice.
- Pay design.