

Introduction

This checklist sets out the main requirements of the Directors' Remuneration Report Regulations 2002 (the Regulations) which are contained in Schedule 7A to the Companies Act 1985. The Regulations require quoted companies to prepare a directors' remuneration report (the Report) which complies with the Regulations, and to put the Report to a shareholder vote.

The checklist is in four sections, with supplementary schedules:

- Section I establishes the framework of the Regulations by setting out directors' obligations in relation to their company's Report, and penalties for non-compliance;
- Section II summarises the 'non-audit' part of the Report – covering policy and 'softer' items that must be included in the Report, but are generally not capable of audit;
- Section III covers those matters which are subject to audit, forming the greater part of the Report;
- Section IV provides some definitions of key terms;
- Schedule 1 contains best practice recommendations on remuneration policy; and
- Schedule 2 sets out best practice recommendations on service contract policy.

The checklist sets out some practical comments on some of the requirements of the Regulations. In addition, it includes cross references in the text and separate schedules setting out related guidance on best practice, including the relevant provisions of the Combined Code on Corporate Governance (the Combined Code), the joint statement by the Association of British Insurers and the National Association of Pension Funds on best practice on executive contracts and severance (the ABI/NAPF Joint Statement), the Association of British Insurers principles and guidelines on remuneration (the ABI Guidelines) and the National Association of Pension Funds 2005 corporate governance policy (the NAPF Guidelines).

The checklist can also be used when preparing or reviewing Reports by ticking the penultimate column in the checklist to ensure each requirement is complied with.

Section I: framework

	✓	Section reference to the Companies Act 1985
<p>General</p> <p>The directors of a quoted company (the Company) must prepare a directors' remuneration report (the Report), containing the information set out below, for each financial year. See section IV below for definition of 'quoted company'.</p> <p><i>Comment</i></p> <p><input type="checkbox"/> It should be noted that these obligations are imposed on all directors, not just the remuneration committee.</p> <p><input type="checkbox"/> The DTI has confirmed that if a company has ceased to be quoted at the year-end (for example, as a result of a takeover) it does not need to prepare a Report.</p>		234B(1)
<p>In the case of a failure to comply with the Regulations, each director of the Company immediately before the end of the period for delivering accounts for the relevant financial year is guilty of an offence and liable to a fine. In the case of proceedings for such an offence, it is a defence that the person in question took all reasonable steps for securing compliance with the relevant requirement.</p>		234B(3); 234B(4)
<p>Any director of the Company, and any person who has been a director of the Company within the preceding five years, has a duty to give notice to the Company of matters relating to himself as required by the Regulations.</p>		234B(5)
<p>The Report must be approved by the board of directors and signed on behalf of the board by a director or the secretary of the Company. A signed copy of the Report must be delivered to the Registrar of Companies. Every copy of the Report, which is either circulated or laid before the Company in general meeting, must state the name of the person who signed it on behalf of the board.</p> <p><i>Comment</i></p> <p>Generally, the Remuneration Committee chairman signs the Report but companies may prefer to take a different approach. For example, as the Report covers non-executive directors' remuneration, having the Company Secretary sign avoids the Remuneration Committee chairman signing a Report which covers his own remuneration.</p>		234C
<p>Prior to the Company's general meeting, the Company must give to its shareholders notice of the intention to move an ordinary resolution approving the Report for the financial year, together with a copy of the Report (including the auditors' report thereon).</p>		241A(3) & (9) 238(1) & (5)

	✓	Section reference to the Companies Act 1985
<p>The directors must ensure the resolution is put to the vote at the meeting. However, the entitlement of any person to remuneration is not conditional on the passing of the resolution. If the resolution is not put to the vote at the meeting, each director is guilty of an offence and liable to a fine. Again, it is a defence to such proceedings for the relevant director to prove he took all reasonable steps for securing that the resolution was put to the vote.</p> <p><i>Comment</i></p> <p><i>a While the vote is advisory only, in that payments made or promised to directors would not have to be repaid in the event that the ordinary resolution (requiring a 50 per cent majority of those voting) is not passed, the failure to obtain approval effectively amounts to a vote of no confidence in the Remuneration Committee.</i></p> <p><i>b Companies facing a negative vote usually have good warning of impending problems – for example, via press and shareholder comment and/or proxy voting. In practice, thorough engagement by Remuneration Committee members with institutional shareholders once a problem has arisen, and a strong measure of humility, will often enable a negative vote to be avoided.</i></p> <p><i>c The Companies (Revision of Defective Accounts and Report) (Amendment) Regulations 2005 permit companies to revise their Report by way of replacement or supplementary note. The Directors must make various statements before they approve such amended reports. The Companies (Summary Financial Statement) Amendment Regulations 2002 (SFS Amendment Regulations) also include provisions permitting companies to review their summary reports where errors have been made.</i></p>		241A

Summary Financial Statements (SFS) – content requirements on remuneration matters	✓	SFS Amendment Regulations
<p>The SFS Amendment Regulations provide that an SFS must contain the following information.</p> <ul style="list-style-type: none"> □ The whole or a summary of that part of the notes to the accounts that sets out the aggregate amount of directors' emoluments etc (as required by paragraph 1(1) of Schedule 6 to the Companies Act 1985). □ Where a company is required to produce a Report, the whole or a summary of the statement of the Company's policy on directors' remuneration and the performance graph. <p><i>Comment on SFS Amendment Regulations</i></p> <p><i>a It is surprising that the only general requirement for quoted companies, beyond the inclusion of the aggregate amount of directors' emoluments, is to include the policy statement (or a summary thereof) and the performance graph – particularly as shareholders who receive the SFS will obviously be entitled to vote on the Report.</i></p> <p><i>b In light of this, many companies who produce an SFS provide substantially more information than the minimum described above. This is generally because companies consider that shareholders should receive reasonably full information on which to base their voting decision on the Report. Some companies reproduce the full Report in the notice of AGM.</i></p> <p><i>c Conversely, some companies have adopted the approach of including the bare minimum to comply with the SFS Amendment Regulations.</i></p>		

Section II: information not subject to audit

	✓	Paragraph reference to Schedule 7A
<p>Decisions on remuneration</p> <p>In relation to decisions on remuneration, if a committee of the Company's directors (the Committee) has considered matters relating to the directors' remuneration for the relevant financial year, the Report must include the following.</p>		
<p><input type="checkbox"/> The name of each director who was a member of the Committee.</p>		2(1)(a)
<p><input type="checkbox"/> The name of any person who materially assisted the Committee on remuneration decisions.</p> <p>In this context, 'person' is expressed to include any director of the Company who was not a member of the Committee during the relevant financial year.</p>		2(1)(b)
<p>If non-directors (eg external consultants or advisers) have provided advice, the nature of any other services they have provided to the Company within the financial year, and whether they were appointed by the Committee, must also be included.</p> <p><i>Comment on Regulations</i></p> <p><i>a Many companies take advice on remuneration from a variety of sources during a year, and it will often be a difficult issue to determine those which 'materially assisted' the Committee. Surprisingly, there is no obligation to identify areas of advice – for example, the advisers on a new option scheme may have no involvement with those advising on salary benchmarking. Companies normally liaise with external advisers regarding the reference to their name in the overall context of the Report.</i></p> <p><i>b Many companies are likely to indicate that the chief executive provided 'material assistance' in relation to those directors who report to him. Also, the Human Resources director – whether a plc director or not – would often be named.</i></p> <p><i>c To minimise potential conflicts of interest between board remuneration and that of the rest of the company, it is generally desirable to be able to indicate that the advisers were appointed by the Committee and did not advise on other remuneration issues.</i></p>		2(1)(c)

	✓	Paragraph reference to Schedule 7A
<p><i>Additional corporate governance recommendations</i></p> <p><i>a The Combined Code requires that listed companies establish a remuneration committee which should comprise at least three or, in the case of smaller companies two, members all of whom should be independent non-executive directors (B.2.1). The Combined Code contains a specific definition of ‘independence’ in B.2.1.</i></p> <p><i>b An amendment to the Combined Code, which applies to reporting years on or after 1 November 2006, specifies that, provided he or she was independent on appointment, the chairman may be a member of, but may not chair, the remuneration committee (B.2.1).</i></p>		
<p>Statement of Company’s policy on directors’ remuneration</p> <p>The Report must contain a statement of the Company’s policy on directors’ remuneration for the following and subsequent financial years which must include the items referred to against the bullet points below.</p> <p><i>Comment on Regulations</i></p> <p><i>a The policy statement is forward looking, and does not need to cover historic policy (although companies often wish to do this to illustrate how policy has developed).</i></p> <p><i>b This statement is intended to cover all aspects of remuneration policy – ie salary, bonus, pensions and other benefits. Generally bonus targets (and the extent to which they have been met) are described in this section.</i></p> <p><i>c The requirement to state remuneration policy for subsequent financial years should be approached with caution, as a policy inevitably evolves over time. Suitable wording might be included to address this.</i></p> <p><i>d An appropriate paragraph in the Report should address the position of non-executive directors – for example, stating that they do not have service contracts and that they are not eligible for share options or pension benefits. Companies often state all matters relating to non-executive directors in a single section of the Report.</i></p> <p><i>Additional corporate governance recommendations (See Schedule 1 at the end of this checklist)</i></p>		3(1)
<p><input type="checkbox"/> For each director, a detailed summary of any performance conditions attaching to share options or awards under a long-term incentive scheme (LTIS). See section IV below for definition of LTIS.</p>		3(2)(a)
<p><input type="checkbox"/> An explanation of why such performance conditions were chosen.</p>		3(2)(b)
<p><input type="checkbox"/> A summary of the methods to be used to assess performance and an explanation as to why such methods were chosen.</p>		3(2)(c)

	✓	Paragraph reference to Schedule 7A
<input type="checkbox"/> If any performance condition involves comparison with external factors, a summary of such factors including details of any index, or of companies comprised in any comparator group.		3(2)(d)
<input type="checkbox"/> A description and an explanation of any significant amendment proposed to be made to the terms of any entitlement of a director to share options or LTIS awards. <i>Comment on Regulations</i> <i>This requirement in relation to ‘proposed’ amendments should be read in conjunction with paragraphs 8(d) and 11(1)(d) (see below) which require disclosure of actual amendments to a share option or LTIS award. There is some flexibility as to what constitutes a proposed amendment (and whether it is significant), and committees should take care in formulating and minuting discussions if they do not intend to create a disclosable item. Obviously, an amendment to existing awards for which a company is seeking shareholder approval at the AGM, will be a ‘proposed amendment’.</i> <i>Additional corporate governance recommendations</i> <i>(See Schedule 1 at the end of this checklist)</i>		3(2)(e)
<input type="checkbox"/> If a director’s entitlement to share options or LTIS awards is not subject to performance conditions, an explanation as to why this is the case. <i>Comment on Regulations</i> <i>a It is now rare for a plan to permit new grants which are not subject to performance targets (a limited exception being deferred bonuses that are satisfied in shares).</i> <i>b Where a director’s historic option grants – eg unexercised options from the late 1990s – were not subject to performance targets, this does not need to be explained here as the policy statement is forward-looking; but see the comment on paragraph 8(e) below. Also see the comment in paragraph 10(5) in section IV below.</i>		3(2)(f)

	✓	Paragraph reference to Schedule 7A
<p><input type="checkbox"/> An explanation of the relative importance of elements of each director's terms and conditions relating to remuneration which are, and are not, related to performance.</p> <p><i>Comment on Regulations</i> <i>The concept of 'relative importance' is rather vague. Companies often express 'relative importance' as a comparison of the relative values of 'fixed' remuneration (eg salary) and variable remuneration (such as bonus, options and LTIS awards), taking the expected value of the latter (and bringing in options and awards at their Black Scholes valuation).</i></p> <p><i>Additional corporate governance recommendations</i> <i>The ABI/NAPF Joint Statement recommends that remuneration should be linked to performance by setting a relatively low base pay and a higher proportion of variable pay (paragraph 2.7).</i></p>		3(3)
<p><input type="checkbox"/> A summary of the Company's policy on (a) the duration of directors' contracts, and (b) notice periods and termination payments.</p> <p><i>Comment on Regulations</i> <i>This 'policy' requirement needs to be read in conjunction with the 'content' requirement in paragraph 5. Policy typically addresses (a) the fact that directors' contracts are terminable on 12 months' notice (longer periods are now unusual) and (b) mitigation of termination payments, should it prove necessary to terminate a director's contract.</i></p> <p><i>Additional corporate governance recommendations</i> <i>(See Schedule 2 at the end of this checklist)</i></p>		3(4)
<p>For sub-paragraphs 3(2) and 3(3), references to a 'director' are to any person who serves as a director of the Company at any time in the period beginning with the end of the relevant financial year and ending with the date on which the Report is laid before the Company in its general meeting.</p> <p><i>Comment on Regulations</i> <i>Consistent with the forward-looking nature of the policy statement, it should be noted that the matters referred to in paragraphs 3(2) and 3(3) above need only to relate to (a) directors in service at the year-end, and (b) directors appointed after the year-end.</i></p>		3(5)

	✓	Paragraph reference to Schedule 7A
<p>The performance graph</p> <p>The Report must contain a graph that shows a line joining points plotted to represent the total shareholder return (TSR) for (a) and (b) below for each of the five years preceding the end of the relevant financial year:</p> <ul style="list-style-type: none"> <input type="checkbox"/> A holding of the Company's shares. <input type="checkbox"/> A hypothetical holding of the same kinds and number as those by reference to which a broad equity market index is calculated. <p><i>Comment on Regulations</i></p> <p><i>a The FTSE 100, 250, 350 and All Share Indices are plainly 'broad' for this purpose. Some companies adopt a sector index (eg construction or oil), as published in the FT, despite doubts on whether this is 'broad'.</i></p> <p><i>b It is fairly common for companies to produce several graphs (eg over a longer or shorter period than five years) alongside the statutory graph.</i></p>		4(1)(a)
<p>If the Company has been operating for less than five years, then only those years need be covered.</p>		4(3)
<p>TSR must be calculated using a 'fair method' as set out in paragraph 4(4) of the Regulations. In summary, the calculation involves the following.</p> <ul style="list-style-type: none"> <input type="checkbox"/> Starting with the percentage increase in the market price of the holding over the period. <input type="checkbox"/> Following the assumptions stated in sub-paragraphs (5) and (7) regarding the reinvestment of income (eg dividends) and the funding of liabilities (eg the impact of a rights issue). <p><i>Comment on Regulations</i></p> <p><i>The purpose of the performance graph is to illustrate the Company's TSR performance against the selected 'broad equity market index' – even if the Company does not use TSR as a measure of performance for its share schemes. Comparative TSR is used as a benchmark of historic company performance, so that readers of the Report have this available when assessing incentive schemes and other remuneration matters. In other words, it seeks to give some objectivity to whether the remuneration arrangements have aligned executives' interests with those of shareholders.</i></p>		4(4)-(8)

	✓	Paragraph reference to Schedule 7A
<p>The Report must also show the name of the index selected and the reason for selecting it.</p> <p><i>Comment on Regulations</i> <i>In most cases, the reason for selecting the index will be obvious. More explanation may be needed where different indices are used for this purpose and for share scheme performance target purposes.</i></p>		4(1)(b)
<p>Information on directors' service contracts In relation to each director of the Company the Report must contain the following information.</p> <p><input type="checkbox"/> The date of the contract, the unexpired term and details of any notice periods.</p> <p><i>Comment on Regulations</i> <i>a This information (together with paragraph 5(1)(c) below) gives guidance on termination costs, and would usually be relevant whether or not a contract contains a payment in lieu of notice clause (see paragraph 5.1(b) below).</i> <i>b Non-executive directors usually serve under letters of appointment, which state they are not service contracts. If this approach is not clearly adopted, the disclosure requirement extends to non-executive directors – and non-executive director letters are often ambiguous on whether the director is entitled to compensation in the event of his appointment being terminated early.</i></p>		5(1)(a)
<p><input type="checkbox"/> Any provision for compensation payable upon early termination of the contract.</p> <p><i>Comment on Regulations</i> <i>This would include details of any 'payment in lieu of notice' clause – ie the ability of the employer to terminate by paying a predetermined sum (rather than by negotiating a settlement following termination in breach of the employee's entitlement to notice). Such provisions are usually only applicable at the employer's discretion (ie preserving the right to terminate in breach). Also, they can be complex – for example, if special terms apply following a change of control.</i></p>		5(1)(b)

	✓	Paragraph reference to Schedule 7A
<p><input type="checkbox"/> Details of any other provisions needed to estimate the liability of the Company in the event of early termination of the contract.</p> <p><i>Comment on Regulations:</i></p> <p><i>a Where the cost of terminating a contract depends on the salary, benefits, etc to which the director is entitled (that is, nearly all executive directors' contracts), this sub-paragraph requires disclosure of these contractual entitlements (as they are not expressly within paragraph 5(1)(a)).</i></p> <p><i>b This sub-paragraph is also a 'sweeper' which could pick up a variety of items – for example, potential qualification for a material non-statutory redundancy payment (which would be rare), special rights to compensation in particular circumstances (eg on change of control), early retirement benefits and any arrangements under which post-termination earnings are offset against the termination sum ('contractual mitigation'). Also, in relation to non-UK directors, thought should be given to including under this head details of statutory compensation on termination where the amount is material (eg by reference to UK amounts) and/or any consideration payable for post-termination restrictive covenants.</i></p>		5(1)(c)
<p><input type="checkbox"/> An explanation of any 'significant award' made in the relevant financial year to a former director under paragraph 14.</p> <p><i>Comment on Regulations</i></p> <p><input type="checkbox"/> <i>See commentary under section III in relation to paragraph 14 on the meaning of 'significant award'.</i></p>		5(2)

Section III: information subject to audit

	✓	Paragraph reference to the Regulations
<p>For the information set out below, the auditors of the Company are required to state whether the Report has been properly prepared in accordance with the requirements set out in the Regulations. To the extent that a company fails to comply with these requirements, the auditors are required to provide a statement giving details of the non-compliance.</p> <p><i>Comment on Regulations</i></p> <p><i>a This audit requirement is similar to the requirement in paragraphs 9.8.11 and 9.8.12 of the Listing Rules, the main difference being that the disclosure requirements, and consequently the audit requirements, of the Regulations are generally more onerous than the Listing Rules regime.</i></p> <p><i>b The Auditing Practices Board has issued guidance (Bulletin 2002/2) on various matters relating to the Regulations. The Bulletin is helpful in a number of areas, containing an illustrative auditors' report and a summary of the various requirements imposed on auditors as a result of the Regulations.</i></p>		Sections 235 and 237 Companies Act 1985
<p>Salary, bonus and benefits (and compensation for loss of office)</p> <p>For each director who has served in the relevant financial year, details of each of the following, insofar as they relate to 'qualifying services' (see definition in section IV below), must be disclosed in the Report.</p>		
<p><input type="checkbox"/> The total amount of salary and fees paid or receivable.</p>		6(1)(a)
<p><input type="checkbox"/> The total amount of bonuses paid or receivable.</p>		6(1)(b)
<p><i>Comment on Regulations</i></p> <p><i>Given the detail required on performance targets applicable to share options and LTIS awards (see below), it is surprising that there is no equivalent requirement in relation to annual bonuses. This is largely explained by the fact that the amount of bonuses is 'visible' (having been paid by the date of the Report) and so its reasonableness can be judged accordingly – whereas the reasonableness of long term incentives can, pending maturity, only be judged from surrounding information such as the maximum number of shares and performance targets.</i></p>		

	✓	Paragraph reference to the Regulations
<p><input type="checkbox"/> The total amount paid or receivable of expense allowances that are chargeable to UK income tax and are in respect of qualifying services.</p> <p><input type="checkbox"/> The total amount of compensation for loss of office, paid or receivable, and any other payments in connection with the termination.</p>		6(1)(c)
<p>The reference to ‘compensation for loss of office’ includes benefits otherwise than in cash, in which case references to its amount are to the estimated money value of the benefit.</p> <p>See section IV below for definition of ‘compensation in respect of loss of office’. Rather confusingly, this is a wholly separate definition.</p>		6(1)(d)
<p><input type="checkbox"/> The total estimated value of benefits received otherwise than in cash that are emoluments.</p> <p>See section IV below for definition of ‘emoluments’.</p>		6(1)(e)
<p><input type="checkbox"/> The total of the above five amounts for the relevant financial year, plus the corresponding total for the preceding financial year.</p>		6(1)(f); 6(2)
<p>The information in the above six bullet points must be presented in tabular form.</p> <p><i>Comment on Regulations</i></p> <p><i>a Information required to be disclosed under paragraph 9.8.8(2)(a) – (c) of the Listing Rules must be presented in tabular form ‘unless inappropriate’. In contrast, the Regulations do not include this qualification. Most companies take the view that information is still in tabular form where the table includes explanatory footnotes.</i></p> <p><i>b Most companies take the taxable value of a benefit as the value which must be disclosed in the Report. It follows that where a benefit is not subject to tax (eg an annual health check) it is not necessary to disclose that benefit under this head.</i></p> <p><i>Additional corporate governance recommendations</i></p> <p><i>a Both the ABI Guidelines and the NAPF Guidelines require disclosure of and an explanation for any ex-gratia or transaction payments (ABI – Guidelines for Structure of Remuneration, paragraph 7; NAPF – K.11).</i></p> <p><i>b The NAPF Guidelines require the disclosure of any non-compete payments made to directors (K.10).</i></p>		6(4)
<p><input type="checkbox"/> The nature of any element of the remuneration package that is not cash.</p>		6(3)

	✓	Paragraph reference to the Regulations
Share options For each director the following details must be provided in the Report.		
<input type="checkbox"/> The number of shares that are subject to a share option at the beginning and end of the financial year. See section IV below for definition of 'share option'.		8(a)
If a director was appointed during the financial year, then replace the beginning of the year with the date of appointment; if a director ceases to hold office before the end of the financial year, then replace the end of the year with the date of the termination.		8(a)
Share options having different terms and conditions must be differentiated between.		8
<input type="checkbox"/> Information identifying those share options which have been awarded, exercised, expired unexercised and varied during the financial year.		8(b)
<input type="checkbox"/> For each share option unexpired at any time in the financial year, details of any price paid for its award, the exercise price and the exercise and lapse dates.		8(c)
The information in the above three bullet points must be presented in tabular form.		7(3)
<input type="checkbox"/> A description of any variations made in the relevant financial year to terms and conditions of a share option.		8(d)
<input type="checkbox"/> A summary of any performance targets related to the award or exercise of share options, including any variation during the relevant financial year to such targets. <i>Comment on Regulations</i> <i>This requirement relates to all unexercised grants – a negative statement should be included where historic grants are not subject to a performance target; contrast paragraph 3(2)(f) above.</i>		8(e)
<input type="checkbox"/> For each share option exercised during the relevant financial year, the market price of the shares acquired at the time of exercise.		8(f)
<input type="checkbox"/> For each share option unexercised at the end of the relevant financial year, the market price of a share at the end of the year and the highest and lowest market prices during the year.		8(g)

	✓	Paragraph reference to the Regulations
<p><i>Additional corporate governance recommendations</i></p> <p><i>a The Combined Code provides:</i></p> <p style="padding-left: 20px;"><i>i shares under option schemes and benefits under long term incentive schemes should not usually become exercisable within less than three years from the date of grant (Schedule A, paragraph 2); and</i></p> <p style="padding-left: 20px;"><i>ii grants should be phased rather than awarded in one large block (Schedule A, paragraph 5).</i></p> <p><i>b The ABI Guidelines state that remuneration committees should have regard to outstanding dilution in accordance with the ABI's guidelines on dilution (Guidelines for Share Incentive Schemes, paragraph 2.3).</i></p> <p><i>c The NAPF Guidelines state that the board's assessment of the total value of rewards granted to directors should be made available (L.5) and directors should ideally participate in only one share based incentive scheme at once (L.6).</i></p>		
<p>If the directors of the Company consider that disclosure of information relating to share options would result in excessive length it is possible to avoid differentiation between option grants. However, full disclosure must be made in relation to options which have been granted, exercised or varied during the year. See paragraph 9(1) for relevant detail.</p>		9(1); 9(3)
<p>The weighted average price of options may be disclosed provided that underwater options are not aggregated with those in the money.</p>		9(2)
<p>Long term incentive schemes</p> <p><i>Comment on Regulations</i></p> <p><i>The definitions of 'long term incentive scheme' and 'scheme interest' are fundamental to this section, and contain some surprises. See the commentary on these definitions in section IV.</i></p> <p>For each director the following details must be included in the Report.</p>		
<p><input type="checkbox"/> Details of 'scheme interests' held at the beginning of the relevant financial year, those awarded during the year, and those held at the end of the year.</p>		11(1)(a); 11(1)(b); 11(1)(c)
<p><input type="checkbox"/> If a director was appointed during the financial year, then replace the beginning of the year with the date of appointment; if a director ceases to hold office before the end of the financial year, then replace the end of the year with the date of the termination.</p>		11(1)(a); 11(1)(c)

	✓	Paragraph reference to the Regulations
If shares may become receivable in respect of a scheme interest awarded during the year, then the number of shares, the market price at the time of award and details of qualifying conditions must also be included.		11(2)
<input type="checkbox"/> For each scheme interest, the end of the period (or periods) in which qualifying conditions must be fulfilled, and a description of any variation made in the terms and conditions of scheme interests during the relevant financial year.		11(1)(d)
<input type="checkbox"/> For each scheme interest vesting in the relevant financial year, relevant details of any shares (see below), the amount of any money and the value of any other assets that have become receivable.		11(1)(e)
A scheme interest 'vests' at the earliest time when it has been ascertained that the qualifying conditions have been fulfilled, and the nature and quantity of the assets receivable under the scheme in respect of the interest have been ascertained.		10(4)
'Relevant details' in relation to shares are the number of shares, the date of award, the market price at the time of award, the market price on vesting and performance conditions.		11(3)
The information in the above three bullet points must be presented in tabular form.		10(3)
The Regulations do not require disclosure of option details under this section if to disclose them would replicate information provided in the Report under the share options section.		10(2)
<p>Pensions</p> <p>For each director who has become entitled to rights under a 'defined benefit pension scheme' in respect of his 'qualifying services' the Report must contain the items referred to against the bullet points below.</p> <p>See section IV below for definitions of defined benefit scheme and qualifying services.</p>		
<input type="checkbox"/> Details of changes during the relevant financial year in the director's accrued benefits under the scheme.		12(2)(a)(i)
<input type="checkbox"/> Details of the director's accrued benefits under the scheme at the end of the relevant financial year.		12(2)(a)(ii)

	✓	Paragraph reference to the Regulations
<p><i>Comment on Regulations</i> There is no definition of ‘accrued benefits’ in the Regulations. It is probably best considered as the benefits payable to (or in respect of) the director as if he had left service. In this regard, it is worth noting that Listing Rule 9.8.8(12)(a) (which does not apply to the Regulations) states that accrued benefits are calculated on the basis that the director has left service.</p>		
<p><input type="checkbox"/> The transfer value of the director’s accrued benefits under the scheme at the end of the relevant financial year and the corresponding transfer value contained in the Report for the previous financial year.</p>		12(2)(b); 12(2)(c)
<p><input type="checkbox"/> The amount obtained by subtracting the transfer value of the director’s accrued benefits under the scheme at the beginning of the relevant financial year (ie contained in the report for the previous year) from the director’s accrued benefits under the scheme at the end of the relevant financial year, and then subtracting from the result of that calculation the amount of any contributions made to the scheme by the director in the relevant financial year.</p> <p>If there was no Report for the previous year, or no such value was contained in it, then the Report must include the corresponding value of the director’s accrued benefits under the scheme at the beginning of the relevant financial year.</p> <p><i>Comment on Regulations</i> a The transfer value is calculated in accordance with Guidance Note GN11 issued by the Faculty and Institute of Actuaries. b Paragraph 9.8.8(12)(b) of the Listing Rules allows disclosure of either the transfer value (less any contributions made by the director) of the relevant increase in accrued benefits for the period or specified information necessary to be able to make a reasonable assessment of this transfer value. In contrast, the Regulations require the actual transfer value to be disclosed.</p>		12(2)(d)
<p>For each director who has become entitled to rights under a ‘money purchase pension scheme’ in respect of his ‘qualifying services’, the Report must contain details of any contribution to the scheme that is paid or payable by the Company for the relevant financial year, or paid by the Company in that year for another financial year.</p> <p>See section IV below for definitions of money purchase scheme, pension schemes and qualifying services.</p>		12(3)

	✓	Paragraph reference to the Regulations
<p>Excess retirement benefits of directors and past directors</p> <p>For each person who has served as a director at any time during or before the relevant financial year, the Report must contain the following.</p>		
<p><input type="checkbox"/> The amount of retirement benefits paid or receivable in excess of the retirement benefits to which the person was entitled on the date on which the benefits first became payable or 31 March 1997, whichever is the later.</p> <p>See section IV below for definition of retirement benefits.</p>		13(1)
<p>Amounts paid or receivable need not be included if amounts were, or could have been, paid without recourse to additional contributions and were paid to or receivable by all pensioner members of the scheme on the same basis. In this context, ‘pensioner member’ means any person who is entitled to the present payment of pension under the scheme.</p> <p><i>Comment on Regulations</i> The ‘excess retirement benefits’ concept aims to identify improvements to pensions in payment received by former directors (or, if relevant, by current directors who are in receipt of a pension), where those improvements exceed those enjoyed by other pensioners.</p>		13(3)
<p><input type="checkbox"/> The nature of any retirement benefits received otherwise than in cash.</p> <p><input type="checkbox"/> In the case of benefits received otherwise than in cash, references to their amount must be to the estimated money value of the benefit.</p>		13(4)
<p>Significant awards to former directors</p> <p>The Report must include details of any significant award made in the relevant financial year to any former director of the Company including compensation in respect of loss of office.</p> <p>This information need not be included in this section of the Report if already included in the salary, bonus and benefits (and compensation for loss of office) section (see paragraph 6(1)(d)).</p>		14

	✓	Paragraph reference to the Regulations
<p><i>Comment on Regulations</i></p> <p><i>a The Regulations do not include a definition of ‘significant award’ but includes illustrations relating to remuneration and pension arrangements.</i></p> <p><i>b The Regulations differentiate between ‘compensation for loss of office’ and ‘compensation in respect of loss of office’. In the case of the former, the cash compensation sum needs to be identified in the emoluments table (paragraph 6(1)(d) above). A very wide definition of ‘compensation in respect of loss of office’ applies for paragraph 14 – paragraph 16(2) covers ‘compensation in consideration for, or in connection with, a person’s retirement from office’ (see commentary on paragraph 16(2) below).</i></p> <p><i>c In light of the above, examples of significant award items are as follows.</i></p> <p><i>i Preservation of share options and LTIS awards after leaving; it would in practice be relevant to disclose whether the award (ie the preservation) was the director’s contractual right under the relevant scheme or arose as a result of the exercise of a discretion by the Committee.</i></p> <p><i>ii Consultancy arrangements, or continued employment, following cessation of the directorship – and any termination payment following the end of such post-directorship arrangements (such a payment would not itself be linked to the directorship, and would therefore fall outside paragraph 6(1)(d)).</i></p> <p><i>d Paragraph 5(2) requires any significant award to be ‘explained’ in the Report.</i></p>		
<p>Sums paid to third parties in respect of a director’s services</p> <p>The Report must show in respect of each person who served as a director at any time during the relevant financial year, the aggregate amount of any consideration paid to or receivable by third parties for making available the services of that person.</p>		15(1)
<p><input type="checkbox"/> As a director of the Company or, while a director of the Company, as a director of any of its subsidiaries, any other undertaking of which he was a director by virtue of the Company’s nomination, or otherwise in connection with the management of the affairs of the Company or any other undertaking.</p>		15(1)
<p><input type="checkbox"/> The nature of any consideration otherwise than in cash.</p>		15(2)
<p>‘Consideration’ includes benefits otherwise than in cash and in which case references to their amount must be to the estimated money value of the benefit.</p>		15(2)

	✓	Paragraph reference to the Regulations
The reference to 'third parties' does not include the person himself, a person connected with him or a body corporate controlled by him; the Company; or any undertaking of the Company of which the person is a director by virtue of the Company's nomination.		15(3)
References to a person being 'connected' with a director, and to a director 'controlling' a body corporate shall be construed in accordance with section 346 Companies Act 1985. <i>Comment on Regulations</i> <i>The requirements of this section are almost identical to the requirements under paragraph 9, Schedule 6, Companies Act 1985 except in so far as the Regulations also require disclosure of a person's services as a director of any other undertaking of which he was a director by virtue of the Company's nomination.</i>		16(4)

Section IV: definitions

	✓	Paragraph reference to the Regulations
<p>'Amount' in relation to a gain made on the exercise of a share option, means the difference between the market price of the shares on the day on which the option was exercised and the price actually paid for the shares.</p>		16(1)
<p>'Company contributions' in relation to a pension scheme, means any payments (including insurance premiums) made, or treated as made, to the scheme in respect of a person (other than the person's own contributions).</p>		16(1)
<p>'Compensation in respect of loss of office' includes compensation received or receivable by a person:</p> <ul style="list-style-type: none"> i for loss of office as a director of the Company (or loss of any other office in connection with the management of the Company's affairs or any subsidiary undertaking's affairs); ii as compensation in consideration for, or in connection with, a person's retirement from office; or iii where retirement as a director is occasioned by a breach of the person's contract with the Company (or any subsidiary undertaking), as payments (aa) by way of damages for the breach, or (bb) made by way of settlement or compromise of any claim in respect of the breach and includes benefits otherwise than in cash. <p><i>Comment on Regulations</i></p> <p><i>a The layout in the Regulations is defective, but the format of (i),(ii) and (iii) above sets out what the draftsman must have intended.</i></p> <p><i>b This definition is broadly the same as the former definition in paragraph 8(1)-(4), Schedule 6, Companies Act 1985.</i></p> <p><i>c This definition relates to items falling within the 'significant award' category and does not include compensation for loss of office which is the only item included in the table in paragraph 6(1)(d).</i></p>		16(2); 16(3)
<p>'Defined benefit scheme' means a pension scheme which is not a money purchase scheme.</p>		16(1)
<p>'Emoluments' of a person includes salary, fees and bonuses, sums paid by way of expenses allowance (so far as they are chargeable to United Kingdom income tax or would be if the person were an individual) but does not include the following.</p> <ul style="list-style-type: none"> <input type="checkbox"/> The value of any share options granted to him or the amount of any gains made on the exercise of any such options. 		16(1)

	✓	Paragraph reference to the Regulations
<p><input type="checkbox"/> Any company contributions paid, or treated as paid, in respect of him under any pension scheme or any benefits to which he is entitled under any such scheme.</p> <p><input type="checkbox"/> Any money or other assets paid to or received or receivable by him under any long term incentive scheme.</p> <p><i>Comment on Regulations</i> <i>This definition is the same as that in paragraph 1(3), Schedule 6, Companies Act 1985.</i></p>		
<p><i>'Long term incentive scheme'</i> means any agreement or arrangement under which money or other assets may become receivable by a person and which includes one or more qualifying conditions with respect to service or performance that cannot be fulfilled within a single financial year. For the purpose of the Report, the following do not come with the definition of long term incentive scheme.</p> <p><input type="checkbox"/> Any bonus whose amount falls to be determined by reference to service or performance within a single financial year.</p> <p><input type="checkbox"/> Compensation in respect of loss of office, payments for breach of contract and other termination payments.</p> <p><input type="checkbox"/> Retirement benefits.</p> <p><i>Comment on Regulations</i> <i>This definition (which derives from the current Companies Act 1985 definition) is wider than the definition in Appendix 1 to the Listing Rules. This mainly impacts on the treatment of deferred bonus schemes under the Regulations. Under these schemes, an element of an executive's bonus is invested in shares, and the executive receives additional 'matching' shares free of charge if he remains in employment for (typically) three years. These schemes do not generally require shareholder approval under the Listing Rules because they normally fall within the definition of 'deferred bonus', and thereby fall outside the Listing Rules definition of LTIS. Only the latter requires shareholder approval, assuming that there is no performance (as opposed to service) condition attaching to the matching shares. By contrast, the Regulations do not carve out deferred bonus schemes from the LTIS definition. In consequence, the requirement to describe actual or potential changes to an LTIS applies to a deferred bonus scheme; in addition there is now a need to justify the absence of a performance condition.</i></p>		10(5)

	✓	Paragraph reference to the Regulations
'Money purchase benefits' means retirement benefits the rate or amount of which is calculated by reference to payments made, or treated as made, by the person or by any other person in respect of that person and which are not average salary benefits.		16(1)
'Money purchase scheme' means a pension scheme under which all of the benefits that may become payable to or in respect of a person are money purchase benefits in relation to the person.		16(1)
'Pension scheme' means a retirement benefits scheme within the meaning given by section 611 Income and Corporation Taxes Act 1988. <i>Comment on Regulations</i> <input type="checkbox"/> Section 611 was repealed by the Finance Act 2004 but no consequential amendment was made to the Companies Act 1985. 'Pension scheme' is now best defined in section 150(1) of the Finance Act 2004.		16(1)
'Qualifying services' means services of a person as a director of the Company and services at any time while a director of the Company. <input type="checkbox"/> As a director of a subsidiary undertaking of the Company at that time. <input type="checkbox"/> As a director of any other undertaking of which the person is a director by virtue of the Company's nomination (direct or indirect). <input type="checkbox"/> Otherwise in connection with the management of the affairs of the Company or any such subsidiary undertaking or any such other undertaking. <i>Comment on Regulations</i> <i>a This definition is very similar to that in paragraph 1(5), Schedule 6, Companies Act 1985 except in so far as the Regulations require disclosure in relation to the second bullet point above.</i> <i>b The definition is fairly narrow, and this may be helpful in practice. For example, services prior to becoming a director are not qualifying services, so earnings prior to becoming a director are not disclosable.</i>		16(1)

	✓	Paragraph reference to the Regulations
<p>'Quoted company' is defined in section 262(1) of the Companies Act 1985 and includes those companies that are incorporated in Great Britain whose share capital:</p> <ul style="list-style-type: none"> <input type="checkbox"/> has been included in the official list of the UK Listing Authority; <input type="checkbox"/> is officially listed in a country within the European Economic Area; or <input type="checkbox"/> is listed on either the New York Stock Exchange or NASDAQ. <p><i>Comment on Regulations</i> The Regulations do not apply to Alternative Investment Market companies. Nor do they apply to companies incorporated outside Great Britain which are listed in London (although many such companies produce a Report which seeks to comply with the Regulations) or to subsidiaries of listed companies.</p>		
<p>'Retirement benefits' means relevant benefits within the meaning of section 612(1) Income and Corporation Taxes Act 1988.</p> <p><i>Comment on Regulations</i> Section 612 was repealed by the Finance Act 2004 but no consequential amendment was made to the Companies Act 1985. 'Retirement benefits' should now be interpreted as those defined in section 150(1) of the Finance Act 2004.</p>		16(1)
<p>'Scheme interest' means an interest under a long term incentive scheme that is an interest in respect of which assets may become receivable under the scheme in respect of qualifying services.</p> <p><i>Comment on Regulations</i> The definition of 'scheme interest' is much wider than the 'interest in shares' definition arising from Part I of Schedule 13 to the Companies Act 1985. For example:</p> <p>a An LTIS which pays cash on maturity would be within the scheme interest definition.</p>		10(4)(a)
<p>b Where a release of shares under an LTIS is dependent on the exercise of a discretion by trustees or the Committee at the time of maturity (as well as satisfying relevant performance targets), a director's 'expectation' to receive a stated (or maximum) number of shares has often to date not been disclosed, as the director's right to the shares depended on the exercise of the discretion. Such interests are now plainly a 'scheme interest'. This is reinforced by the reference to assets which 'may become receivable' under the LTIS.</p>		16(1)

	✓	Paragraph reference to the Regulations
'Shares' means shares (whether allotted or not) in the Company, or any undertaking which is a group undertaking in relation to the Company, and includes a share warrant as defined by section 188(1) Companies Act 1985.		16(1)
'Share option' means a right to acquire shares.		16(1)
'Value', in relation to shares received or receivable on any day by a person who is or has been a director of the Company, means the market price of the shares on that day.		

Schedule 1: remuneration policy – additional corporate governance recommendations

This schedule sets out the recommendations of the Combined Code, the ABI/NAPF Joint Statement, the ABI Guidelines and the NAPF Guidelines which relate to remuneration policy. It should be read in conjunction with the section on the statement of company's policy on directors' remuneration above.

Derivation

The Report must contain a statement of the Company's policy on directors' remuneration for the following and subsequent financial years. Regulation 3.1

- a *The Combined Code requires that:*
- i *the remuneration committee should be responsible for setting remuneration for executive directors and the chairman and should recommend and monitor the level and structure of remuneration for senior management (B.2);*
 - ii *remuneration should be sufficient to attract, retain and motivate directors and should be linked to corporate and individual performance (B.1);*
 - iii *performance related elements of remuneration should form a significant proportion of executive directors' remuneration packages (B.1.1);*
 - iv *only basic salary should be pensionable and companies should consider the pension consequences and associated costs of basic salary increases, especially where directors are close to retirement (Schedule A, paragraphs 6 and 7); and*
 - vi *where directors are eligible to receive annual bonuses, the performance conditions applying to those bonuses should be relevant, stretching and designed to enhance shareholder value. Upper limits should be set and disclosed. The remuneration committee should consider whether it is appropriate to pay the bonus partly in shares which must be held for a specific period (Schedule A, paragraph 1).*
- b *It is a main principal of the ABI/NAPF Joint Statement that executives should not be rewarded for failure and companies should avoid agreeing to overly generous severance conditions.*
- c *The ABI Guidelines state:*
- i *there should be transparency on remuneration of present and past directors and, where appropriate, other senior executives. Companies should also draw shareholders' attention to special arrangements since the last Report (Principles, paragraph 9);*
 - ii *a company's remuneration policy should ensure a balance between fixed and variable remuneration and between long and short term*

- variable components of long term remuneration (Guidelines for Structure of Remuneration, paragraph 1);*
- iii companies should take into account the requirements of the market and competitive forces applicable to the sector in which the company operates when setting salary, bonuses and pension contributions (Guidelines for Structure of Remuneration, paragraph 2);*
 - iv the rationale behind share incentive schemes should be fully explained (Guidelines for Share Incentive Schemes, paragraph 5.2);*
 - v the Chairman and non-executive directors of a company should not participate in share incentive schemes. If, exceptionally, incentives are granted to the chairman, shareholder approval should be obtained in advance of any grant (Guidelines for Structure of Remuneration, paragraph 14);*
 - vi companies should consider setting salary levels at below the median point of the relevant comparator group as this gives greater scope to increase the amount of variable pay. The company will need to justify paying salary at above median (Guidelines for Structure of Remuneration, paragraph 3);*
 - vii commercial confidentiality considerations may apply to short-term targets performance targets applicable to bonuses but the basic parameters, both corporate and personal, adopted should be disclosed to shareholders. When bonuses are paid the Report should contain an analysis of the extent to which the targets have been met (Guidelines for Structure of Remuneration, paragraph 5); and*
 - viii remuneration committees are responsible for ensuring that bonus targets are fulfilled and, in cases of doubt, should consult with the audit committee to ensure that the basis for their decision is correct (Guidelines for Structure of Remuneration, paragraph 6).*
- d The NAPF Guidelines state that:*
- i companies should undertake an annual review of overall remuneration of executive directors to ensure their remuneration policy remains appropriate (K.13);*
 - ii internal and external comparators should be disclosed (K.2/K.3);*
 - iii the use of comparator groups should be disclosed (and is considered a useful tool). However, there is a danger of ‘spiral ratcheting’ (ie where increases in remuneration both follow and help drive market trends) (K.4);*
 - iv the Report should disclose the remuneration committee’s policy for setting base salaries (L.1);*
 - v it is good practice to disclose base salaries at the end of the financial year end as well as any material differences between salary at financial year end and the date of the Report (L.1); and*
 - vi bonus targets should not be changed after the start of a performance period and any changes in bonus targets and the business reason for those changes should be disclosed in the Report (L.2).*

Derivation

<input type="checkbox"/> For each director, a detailed summary of any performance conditions attaching to share options or awards under a long-term incentive scheme (LTIS).	Regulation 3(2)(a)
<input type="checkbox"/> An explanation of why such performance conditions were chosen.	Regulation 3(2)(b)
<input type="checkbox"/> A summary of the methods to be used to assess performance and an explanation as to why such methods were chosen.	Regulation 3(2)(c)
<input type="checkbox"/> If any performance condition involves comparison with external factors, a summary of such factors including details of any index, or of companies comprised in any comparator group.	Regulation 3(2)(d)
<input type="checkbox"/> A description and an explanation of any significant amendment proposed to be made to the terms of any entitlement of a director to share options or LTIS awards.	Regulation 3(2)(e)

- a The Combined Code requires that:*
- i long term incentives should be subject to challenging performance criteria and encourages the use of group comparators (Schedule A, paragraph 4);*
 - ii approval of shareholders should be obtained for all new long-term incentive schemes and for significant change to existing schemes, save in circumstances permitted by the Listing Rules (B.2.4);*
 - iii new long-term incentive schemes should preferably replace existing schemes or form part of a well considered overall plan, incorporating existing schemes. Total rewards potentially available should not be excessive (Schedule A, paragraph 3).*
- b The ABI Guidelines provide:*
- i the greater the level of a potential award, the more stretching and demanding the performance conditions should be. The Report should explain how this is achieved, especially when annual grants of options or long term share incentive awards are in excess of one times salary (Guidelines for Share Incentive Schemes, paragraph 6.4);*
 - ii matching share awards should be subject to additional performance targets (Guidelines for Share Incentive Schemes, paragraph 6.6);*
 - iii performance should not be retested if the performance criteria are not met when performance is first tested (Guidelines for Share Incentive Schemes, paragraph 8); and*
 - iv performance conditions should not be automatically waived on ceasing employment or on a change of control (Guidelines for Share Incentive Schemes, paragraph 11.1).*
- c The NAPF Guidelines provide:*
- i long term incentives should be subject to challenging performance criteria and the use of group comparators is encouraged (L.7);*

- ii performance should not be retested if the performance criteria are not met when performance is first tested (L.10);*
- iii the relationship between performance targets and rewards granted in the financial year under review and rewards potentially available in future financial years should be disclosed (L.5);*
- iv matching share awards should be subject to additional performance targets (L.4);*
- v any amendments to a long term incentive scheme should be approved by shareholders (L.9).*

Schedule 2: service contract policy – additional corporate governance recommendations

This schedule sets out the requirements of the Combined Code, the ABI/NAPF Joint Statement, the ABI Guidelines and the NAPF Guidelines which relate to service contract policy. It should be read in conjunction with the section on the statement of company's policy on service contracts.

	Derivation
The Report must contain a statement of the Company's policy on directors' remuneration for the following and subsequent financial years which must include the items referred to against the bullet points below.	Regulation 3(1)
<input type="checkbox"/> A summary of the Company's policy on (a) the duration of directors' contracts, and (b) notice periods and termination payments.	Regulation 3(4)

- a *The Combined Code provides that:*
- i *remuneration committees should consider what compensation commitments (including pensions) would occur on early termination of an executive director's service agreement and apply mitigation where appropriate (B.1.5);*
 - ii *notice periods should be set at one year or less (B.1.6); and*
 - iii *where an executive has a longer notice period (eg on recruitment), this should be reduced over time (B.1.6).*
- b *The ABI/NAPF Joint Statement provides that:*
- i *notice periods should be set at one year or less (paragraph 2.5);*
 - ii *companies should use phased payments (ie payments which cease when the executive finds new employment) and mitigation. The ABI and NAPF are not in favour of the use of liquidated damages clauses (thought it is questionable whether this provision has in mind liquidated damages clauses that impose 'contractual mitigation') and/or payments on change of control (paragraphs 3.2 to 3.6);*
 - iii *disclosure regarding pensions provided to executive directors should distinguish between the amount which is a contractual entitlement and the amount of discretionary enhancement which may form part of a severance package (paragraph 4.3).*
- c *Separately, the ABI has recently issued guidance on 'excessive' pension payments.*

The ABI takes that view that, whilst companies are bound to comply with directors' service contracts, they should not rely on this to avoid revising long-standing arrangements which are not in line with best practice (eg participation in pension schemes with substantial benefits, often on preferential terms). The ABI would like companies to enter into service

contracts, and even renegotiate existing ones, which do not have any special pension arrangements on termination to bring the arrangements up to date with current best practice. (Letter to remuneration committees of FTSE350 companies, August 2006)

- d The NAPF Guidelines require the disclosure of any employment terms or compensation rights which may be extended or enhanced on a change of control (K.8).*