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Your guide
Directors' remuneration in FTSE 250 companies

The Deloitte Academy: promoting excellence in the boardroom
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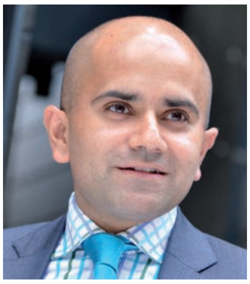
Overview from Mitul Shah



2015 is the second year in which UK companies have been required to disclose remuneration arrangements in line with the new disclosure regulations that took effect in 2013. The new reporting requirements have brought about a perceptible improvement in the overall quality of disclosure. Only 20% of companies have chosen to put an amended policy up for approval for a second year therefore for most companies there has been no change to the approved policy.

Executive pay in FTSE 350 companies continues to attract the attention of the media with articles appearing on a daily basis during the peak of the AGM season. The focus has typically been on high profile companies and individuals, headline-grabbing awards (including to newly appointed executive directors) and anticipated shareholder unrest. There has also been an increase in commentary focusing on the increasing gap between the general workforce and those at the top of organisations. In the US the Securities and Exchange Commission has now adopted rules which require companies to disclose the median pay of the workforce with that of the CEO and there is an ongoing debate within the European Parliament as to whether the provisions on the disclosure of executive pay in the Shareholder Rights Directive should require companies to disclose this ratio.

Whilst media commentary focuses on the key issues that concern shareholders, coverage does not accurately conveyed the trends arising from the 2015 AGM season. FTSE 250 companies have generally received higher support for the annual remuneration report than in recent years. Many companies have sought to respond to shareholder concerns through the introduction of measures that provide a stronger alignment of directors' interests with the long-term performance of the company and this, in conjunction with improved engagement and dialogue between companies and shareholders, has resulted in 85% of companies receiving support in excess of 90% of the votes in favour of the annual remuneration reports.

Shareholders and their advisory bodies continue to be more likely to act against large salary increases or where companies do not provide adequate explanation of the rationale behind bonus awards. But a key issue for 2015 has been that of recruitment arrangements. There have been a number of high profile cases where the arrangements for a newly appointed executive director, in all cases appointed from outside, have come under fire from shareholders. This is generally due to buy-out arrangements but general concerns over the size of the overall package have also been raised.

This suggests that having an approved policy in place is no safeguard against shareholder dissatisfaction with the way in which the policy has been implemented. Companies understandably chose to retain some flexibility in relation to the recruitment policy when it was first introduced. How this flexibility ought to be used in practice should now be on the remuneration committee's radar and it may make sense to draw up parameters in advance of any future board appointment. This ensures clarity throughout the recruitment process and will help to avoid some of the issues arising this year. An increased focus on succession planning may also help to alleviate some of these pressures. Research suggests that internally appointed CEO's are likely to stay in position for longer and perform better. They almost certainly cost less. Investors are turning their attention to this area and with the Financial Reporting Council (FRC) about to publish a discussion paper on the subject we expect this to be a key priority over the coming year.

We continue to see a number of encouraging trends which started to emerge last year and which have further taken hold during 2015.

There has been a positive shift over the past year in expectations around directors' shareholdings. 90% of companies now have formal shareholding requirements and almost a quarter of companies increased shareholding requirements during the year. The median shareholding requirement for the top full time executive has increased from 150% to 175% of salary. It is also worthy of note that the median levels of directors' actual shareholdings have risen this year to 520% for top full time executives and 250% for other executive directors.

We are also seeing an increased emphasis on longer time horizons. The number of performance share plans now incorporating a further holding period following the end of the performance period has doubled over the year to around a third of plans. Pressure from certain shareholders to introduce plans where shares vesting are not released for a minimum of five years from grant is now translating into action in FTSE 250 companies, with the proportion of companies meeting this requirement rising from 8% to 21% this year.

Another key issue for shareholders is the simplification of remuneration arrangements. The Investment Association has announced the formation of an Executive Remuneration Working Group, which has been tasked with reporting on 'radical proposals' to simplify remuneration arrangements. Our findings suggest that FTSE 250 companies are already moving towards simpler remuneration arrangements.

Deferred bonus matching plans are now almost non-existent and around 85% of companies now operate only one annual bonus plan and one long term plan. The Working Group is expected to publish proposals in the Spring of 2016 and we encourage companies to contribute to this project.

Shareholder concerns can primarily be linked to the need for a clear and justifiable link between pay and performance. Any awards outside of normal policy, or decisions to apply discretion to increase levels of incentive payouts must therefore be accompanied by additional explanation and consultation. We particularly expect further scrutiny from shareholders in relation to bonus payouts in the 2016 AGM season. The median bonus payout in respect of the most recent financial period remains at just under 70% of maximum and has rarely dropped below two thirds of maximum in the last ten years. Remuneration committees should continue to focus on the target setting process to ensure that targets are appropriate, stretching and should ensure that the payouts are justified in the disclosures.

We believe there is still a long way to go to rebuild shareholder confidence and change public perception of the way in which executive remuneration is structured and implemented. However, improved reporting, greater dialogue and stronger relationships between companies and their shareholders are all helping to achieve that goal.

Mitul Shah
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October 2015

2. Main findings

Base salary

38% of all top full time directors and 29% of all other directors received no increase for 2015.

The median increase is 2.3% in 2015.

Salary increases are lowest in retail & services companies with a median of 2.0% compared with 3.0% in finance & property companies.

Shareholdings

90% of companies have formal shareholding requirements – increased from 85% last year.

Almost a quarter of companies increased the shareholding requirements, which is significantly more than in the previous year. The median requirement for top full time executives has increased from 150% to 175%.

Over half of top full time executive directors and almost a third of other executives hold shares worth more than 500% of salary.

Pension

Only 8% of executive directors currently participate in a defined benefit plan which is similar to last year. Only 3% of FTSE 250 companies would offer a defined benefit plan to new appointments.

Typical contributions to defined contribution or personal pension plans, or pension allowances are between 13% and 20% of salary, with a median of 18%.The top full time director typically receives slightly higher contributions.

Annual bonus

Median level of bonus opportunity remains at 120% of salary in FTSE 250 companies. However, in all but the largest of these companies, it is lower at 105%.

There is now little difference between industry sectors in terms of the maximum bonus opportunity.

Bonus payouts are slightly higher than last year with a median payout of 69% of maximum.

Nearly two thirds of plans are at least partially based on non-financial measures, a significant increase on last year.

An element of bonus must be deferred in over 60% of companies.

Longer time horizons

32% of plans now include a further holding period for at least part of the performance share plan award, which has doubled since last year. In 21% of plans participants will not receive any shares for five years from award, which represents a significant increase on last year.

Shareholders

Support for the remuneration report has generally increased slightly with 85% of companies receiving more than 90% of votes in favour compared with 82% last year. No companies have failed to receive less than 50% of votes in favour so far this year. However, 10% of companies received less than 80% of votes in favour compared with 9% last year.

Long term incentives

The trend towards simpler structures continues. Very few companies operate deferred bonus matching plans and in 84% of companies the remuneration structure now consists of an annual bonus plan and one long term plan, compared with 74% last year.

The median potential performance share plan award is unchanged at 150% of salary but has increased from 175% to 200% of salary in the top 50 companies.

Almost half of plans now incorporate measures other than TSR and EPS.

The median vesting of 2011 awards in 2014 is at a significantly lower level than awards in the previous year, falling from 70% to 50% of the maximum potential.

Clawback and malus provisions

Provisions are in place in relation to both annual and long term plans in around 85% of companies.

Non-executive fees

The median increase in base fees is 0% in 2015, down from 2.4% last year.

Typical fee levels for non-executive directors in FTSE 250 companies are between £45,000 and £55,500, with a median of £50,000.

Typical fee levels for the chairman in FTSE 250 companies are between £157,600 and £250,000, with a median of £187,500.

The median fee for chairing either the remuneration or the audit committee remains at £10,000.

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