

The ICSA **Remuneration Committee Guide**

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Remuneration Committee Guide

Sean O'Hare

Remuneration Committee Institute

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Preface

Corporate governance excellence continues to be an important element of UK business. The expectations of stakeholders in the corporate governance process, including the process of setting executive remuneration, have never been higher, and scrutiny by investors never more stringent. As a consequence, remuneration issues continue to dominate the corporate governance landscape in the UK, as indeed they have for the past decade. Whereas public shareholder anger was once a rarity, nowadays significant votes against the Director's Remuneration Report are increasingly common. As a result, the role of the Remuneration Committee has increased in terms of its responsibility to its stakeholders, and its processes have become somewhat more onerous as a result.

Recognising that effective corporate governance is a cornerstone of shareholder protection, initiatives by regulators and stakeholders to help shape and guide corporate governance practices have confirmed the Remuneration Committee's key role in corporate governance and oversight. The Financial Reporting Council's revised Combined Code and the related guidance for Remuneration Committees (Higgs guidance and Greenbury) contain recommendations designed to strengthen the effectiveness of Remuneration Committees, clarify and enhance their oversight roles, and enhance their accountability for the setting of an executive remuneration process.

Charged with setting executive remuneration, Remuneration Committees find themselves trying to balance the expectations of executives with the needs of the company and its shareholders. Unfortunately this challenge is not always met with success. If you are seen to pay too much, then you will have failed the 'appropriateness' test laid down by shareholders and can expect them to protest through the use of their votes at the next general meeting. Alternatively, if you fail to offer enough incentive, you run the risk of losing the most critical employees upon whom the success of the company is based.

As with most things in life, there is no right answer as such, but the Remuneration Committee Institute (RCI) believes that a properly constituted Remuneration Committee with sufficient authority and independence of mind will be well placed to meet the challenge of attracting and retaining the right talent and, ultimately, of motivating them to deliver real shareholder value.

This book identifies current and emerging issues that Remuneration Committees should be aware of, and react to, and describes Remuneration Committee practices that can provide the support and structure necessary in fulfilling their terms of reference. We at the RCI believe all Remuneration Committees can benefit from comparing their practices against those described in this publication in their effort to critique, tailor and improve the ways in which they operate.

In today's complex and evolving business environment a Remuneration Committee that operates effectively is a key feature in a strong corporate governance culture and can bring significant benefits to a company. We hope this publication will help ensure that Remuneration Committees achieve their objectives and thereby add value to the board of directors, their organisation and its stakeholders.

We owe our thanks to those who have supported the Remuneration Committee Institute since its formation in 2004. We believe this book will help Remuneration Committee members meet the challenges demanded of them by providing genuinely practical guidance. Our thanks in particular to David Snell and Nicola Collins, without whose efforts this book could not have been produced.

Sean O'Hare

*Chairman, Remuneration Committee Institute,
sponsored by KPMG LLP (UK)*

About the Remuneration Committee Institute

While the work of the Remuneration Committee is scrutinised ever more closely by investors and the media, developments in corporate governance, accounting, tax and disclosure regulations over recent years have made its work increasingly complicated. Recognising these developments, the Remuneration Committee Institute (RCI) has been created to assist Remuneration Committee members in keeping pace with their changing role. Sponsored by KPMG LLP (UK), the Remuneration Committee Institute is a sister organisation of the Audit Committee Institute and provides a forum to foster the exchange of ideas and experience, as well as a resource to which members can turn for information or to share knowledge, experience and ideas. The RCI can be reached via email at remunerationcommittee@kpmg.co.uk.

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Introduction

Shaping the remuneration committee agenda

The role of those responsible for corporate governance, and the setting of executive remuneration, continue to face intense scrutiny by regulators, legislators, institutional investors and the general public. Attention is focused not only on the board of directors but also on those committees that have been delegated responsibility and accountability by the board. Remuneration Committees are clearly viewed as a critical component of the overall corporate governance process. Accordingly, many Remuneration Committees are examining the nature and extent of their roles, members' qualifications and independence, and their interaction and involvement with the performance evaluation process.

Effective Remuneration Committees are supported by fundamental 'building blocks' – an appropriate structure and foundation, reasonable and well-defined responsibilities, and an understanding of current and emerging issues. Only through carefully designed practices can a Remuneration Committee maximise its contribution to an organisation. Remuneration Committees need to understand these building blocks and the specific practices that can be used in implementing governance activities. By comparing practices currently being performed to leading practices, Remuneration Committees can identify and select a set of practices as the most effective and efficient in its particular circumstances. This book describes such practices.

Remuneration Committees have evolved from ad hoc committees with few defined responsibilities to what they are today: critical committees with growing responsibilities that are accountable to the board of directors, and ultimately to shareholders.

Brought to prominence in 1995 through Sir Richard Greenbury's report on *Directors' Remuneration*, the duties of Remuneration Committees have

grown with successive corporate governance reports. These culminated in the Financial Reporting Council's revised *Combined Code on Corporate Governance* (see Appendix 1) and the related guidance for non-executive directors by Sir Derek Higgs, issued in 2003.

Greenbury, Higgs and the Combined Code are all designed to assist boards in making suitable corporate governance arrangements. Although specific practices are not mandated, the Financial Services Authority's Listing Rules require companies incorporated within the UK to report on how they apply the 14 corporate governance principles and 21 supporting principles included in the Combined Code, and to confirm the extent of their compliance with the 48 detailed Combined Code provisions, explaining the rationale behind any non-compliance.

Using this book

This book starts by looking at the role of the Remuneration Committee as set out by the revised Combined Code. The chapters that follow look at how to create an effective Remuneration Committee, and then how to run that committee. The last chapter discusses the responsibilities of the Remuneration Committee.

For the convenience of readers, many of the documents contained in the appendices are reproduced on the accompanying CD so that they may easily be adapted to suit individual requirements.