

Guidance note

Terms of reference for the remuneration committee

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A Introduction

This guidance note reflects the updated UK Corporate Governance Code, published September 2012 (the Code) which is effective for accounting periods beginning on or after 1 October 2012. It draws on the experience of company secretaries and is based on best practice as carried out in some of the UK's largest listed companies. The Code is available at www.frc.org.uk.

B The UK Corporate Governance Code

The Code states that:

'There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors.'¹

It also provides that:

'The board should establish a remuneration committee ... [which] should make available its terms of reference, explaining its role and the authority delegated to it by the board.'²

1 Code Principle, D.2

2 Code Provision D.2.1 (e.g. by including the information on a website maintained by or on behalf of the company, see footnote 7 to the Code)

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As with most aspects of corporate governance, the company must be seen to be doing all these things in a fair and thorough manner. The Code requires companies to go through a formal process of considering executive remuneration. The chairman of the remuneration committee should attend the AGM to answer any questions which may be raised by shareholders on matters within the committee's area of responsibility.³ It is essential that the remuneration committee be properly constituted with a clearly articulated remit and authority.

C Notes on the terms of reference

The list of duties we have proposed are based on existing best practice from a number of sources.⁴

The Code states that the remuneration committee should comprise at least three independent non-executive directors (although two is permissible for smaller companies).⁵ In addition to the independent non-executives, the chairman of the board may also be a member of the remuneration committee if he or she was considered independent on appointment as chairman, but may not chair it.⁶

Although not a provision in the Code it is good practice for the company secretary (or his/her nominee) to act as secretary to the committee. The committee should also have access to the services of the company secretariat on all remuneration committee matters. The company secretary should ensure that the remuneration committee receives information and papers in a timely manner to enable full and proper consideration to be given to the issues. The frequency with which the remuneration committee needs to meet will vary depending on the nature, scale and complexity of the business of a company which may change from time to time. It is clear, however, that it must meet close to the year end to review the directors' remuneration report which quoted companies must submit to shareholders for approval at the AGM. It is recommended that the remuneration committee should meet at least twice a year in order to effectively discharge its responsibilities.

3 Code Provision E.2.3

4 Including the Code and associated guidance

5 A smaller company is defined in footnote 6 to the Code as one which is below the FTSE 350 throughout the year immediately prior to the reporting year

6 Code Principle D.2.1

D Model terms of reference

Note: square brackets contain recommendations which are in line with best practice but which may need to be changed to suit the circumstances of the particular organisation.

1 Membership

- 1.1 The committee shall comprise at least [three] members, all of whom shall be independent non-executive directors. The chairman of the board may also serve on the committee as an additional member if he or she was considered independent on appointment as chairman.⁷ Members of the committee shall be appointed by the board, on the recommendation of the nomination committee and in consultation with the chairman of the remuneration committee.
- 1.2 Only members of the committee have the right to attend committee meetings. However, other individuals such as the chief executive, the head of human resources and external advisers may be invited to attend for all or part of any meeting, as and when appropriate and necessary.⁸
- 1.3 Appointments to the committee are made by the board and shall be for a period of up to three years extendable by no more than two additional three-year periods, so long as members (other than the chairman of the board, if he or she is a member of the committee) continue to be independent.
- 1.4 The board shall appoint the committee chairman who shall be an independent non-executive director. In the absence of the committee chairman and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting who would qualify under these terms of reference to be appointed to that position by the board. The chairman of the board shall not be chairman of the committee.

⁷ Code Provision D.2.1

⁸ Code Supporting Principle B.1

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2 Secretary

The company secretary or his or her nominee shall act as the secretary of the committee and will ensure that the committee receives information and papers in a timely manner to enable full and proper consideration to be given to the issues.

3 Quorum

The quorum necessary for the transaction of business shall be [two].

4 Meetings

The committee shall meet at least [twice] a year and otherwise as required.⁹

5 Notice of meetings

- 5.1 Meetings of the committee shall be called by the secretary of the committee at the request of the committee chairman.
- 5.2 Unless otherwise agreed, notice of each meeting confirming the venue, time and date together with an agenda of items to be discussed, shall be forwarded to each member of the committee, any other person required to attend and all other non-executive directors, no later than [five] working days before the date of the meeting. Supporting papers shall be sent to committee members and to other attendees, as appropriate, at the same time.

6 Minutes of meetings

- 6.1 The secretary shall minute the proceedings and resolutions of all committee meetings, including the names of those present and in attendance.
- 6.2 Draft minutes of committee meetings shall be circulated promptly to all members of the committee. Once approved, minutes should be circulated to all other members of the board unless in the opinion of the committee chairman it would be inappropriate to do so.¹⁰

⁹ The frequency and timing of meetings will differ according to the needs of the company; meetings should be organised so that attendance is maximised (for example by timetabling them to coincide with board meetings)

¹⁰ FRC Guidance on Board Effectiveness, para 6.2

7 Annual general meeting

The committee chairman should attend the annual general meeting to answer any shareholder questions on the committee's activities.¹¹

8 Duties

The committee should carry out the duties detailed below for the parent company, major subsidiary undertakings and the group as a whole, as appropriate.

The committee shall:

- 8.1 Have responsibility for setting the remuneration policy for all executive directors and the company's chairman, including pension rights and any compensation payments.¹² The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association.¹³ No director or senior manager shall be involved in any decisions as to their own remuneration.¹⁴
- 8.2 Recommend and monitor the level and structure of remuneration for senior management.¹⁵
- 8.3 In determining such policy, take into account all factors which it deems necessary including relevant legal and regulatory requirements, the provisions and recommendations of the Code and associated guidance. The objective of such policy shall be to attract, retain and motivate executive management of the quality required to run the company successfully without paying more than is necessary, having regard to views of shareholders and other stakeholders. The remuneration policy should have regard to the risk appetite of the company and alignment to the company's long strategic term goals. A significant proportion of remuneration should be structured so as to link rewards to corporate and individual performance and designed to promote the long-term success of the company.¹⁶

11 Code Principle E.2.3

12 Code Provision D.2.2 and Schedule A. Recommendations 29 – 34 of the final report of the Walker review of corporate governance in UK banks and other financial industry entities, published November 2009 states the remit of remuneration committees of Banks or other Financial Institutions should cover "high end" employees. The Walker report is available separately from HM Treasury website at www.hm-treasury.gov.uk/walker_review_information.htm

13 Code Provision D.2.3

14 Code Provision D.2

15 Code Provision D.2.2; the definition of "senior management" for this purpose should be determined by the board but should normally include the first layer of management below board level

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- 8.4 When setting remuneration policy for directors, review and have regard to pay and employment conditions across the company or group, especially when determining annual salary increases.¹⁷
- 8.5 Review the on-going appropriateness and relevance of the remuneration policy.
- 8.6 Within the terms of the agreed policy and in consultation with the chairman and/or chief executive, as appropriate, determine the total individual remuneration package of each executive director, the company chairman and other designated senior executives including bonuses, incentive payments and share options or other share awards.¹⁸
- 8.7 Obtain reliable, up-to-date information about remuneration in other companies of comparable scale and complexity.¹⁹ To help it fulfil its obligations the committee shall have full authority to appoint remuneration consultants²⁰ and to commission or purchase any reports, surveys or information which it deems necessary at the expense of the company but within any budgetary restraints imposed by the board.
- 8.8 Be exclusively responsible for establishing the selection criteria, selecting, appointing and setting the terms of reference for any remuneration consultants who advise the committee.
- 8.9 Approve the design of, and determine targets for, any performance-related pay schemes operated by the company and approve the total annual payments made under such schemes (in accordance with the provisions in Schedule A of the Code).²¹
- 8.10 Review the design of all share incentive plans for approval by the board and shareholders. For any such plans, determine each year whether awards will be made, and if so, the overall amount of such awards, the individual awards to executive directors, company secretary and other designated senior executives and the performance targets to be used.²²

16 Code Principle D.1; recommendation 35 of the Walker review, November 2009: remuneration committees of Banks or other Financial Institutions should seek advice from the board risk committee on specific risk adjustments to be applied to performance objectives

17 Code Supporting Principle D.1

18 Code Principle D.2

19 Code Principle D.1

20 Code Provision D.2.1

21 Code Provision D.1.1

22 Recommendation 34 of the Walker review, November 2009: remuneration committees of Banks or other Financial Institutions should note the requirements for "high end" employees to maintain a shareholding

- 8.11 Determine the policy for, and scope of, pension arrangements for each executive director and other designated senior executives.²³
- 8.12 Ensure that contractual terms on termination, and any payments made, are fair to the individual, and the company, that failure is not rewarded and that the duty to mitigate loss is fully recognised.²⁴
- 8.13 Oversee any major changes in employee benefits structures throughout the company or group.
- 8.14 Agree the policy for authorising claims for expenses from the directors.
- 8.15 Work and liaise as necessary with all other board committees.

9 Reporting responsibilities

- 9.1 The committee chairman shall report to the board on its proceedings after each meeting on all matters within its duties and responsibilities.²⁵
- 9.2 The committee shall make whatever recommendations to the board it deems appropriate on any area within its remit where action or improvement is needed.
- 9.3 The committee shall ensure that provisions regarding disclosure of information, including pensions, as set out in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the Code, are fulfilled and produce a report of the company's remuneration policy and practices to be included in the company's annual report and ensure each year that it is put to shareholders for approval at the AGM. If the committee has appointed remuneration consultants, the annual report of the company's remuneration policy should identify such consultants and state whether they have any other connection with the company.²⁶
- 9.4 Through the chairman of the board, ensure that the company maintains contact as required with its principal shareholders about remuneration.²⁷

²³ Code Provision D.2.2

²⁴ Code Provision D.1.4 and D.1.5; recommendation 37 of the Walker review, November 2009 sets out disclosure requirements for remuneration committees of Banks and other Financial Institutions in relation to any additional enhanced benefits for executive directors or other "high end" employees

²⁵ FRC Guidance on Board Effectiveness, para 6.2

²⁶ Code, D.2.1

²⁷ Code Principle D.2

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10 Other matters

The committee shall:

- 10.1 Have access to sufficient resources in order to carry out its duties, including access to the company secretariat for assistance as required.²⁸
- 10.2 Be provided with appropriate and timely training, both in the form of an induction programme for new members and on an on-going basis for all members.²⁹
- 10.3 Give due consideration to laws, regulations and any published guidelines or recommendations regarding the remuneration of directors of listed/non listed companies and formation and operation of share schemes including but not limited to the provisions of the Code, the requirements of the UK Listing Authority's Listing, Prospectus and Disclosure and Transparency Rules as well as guidelines published by the Association of British Insurers and the National Association of Pension Funds and any other applicable rules, as appropriate.
- 10.4 Arrange for periodic reviews of its own performance and, at least annually, review its constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the board for approval.³⁰

11 Authority

The committee is authorised by the board to obtain, at the company's expense, outside legal or other professional advice on any matters within its terms of reference.³¹

Acknowledgement

This guidance note has been prepared with the assistance of a working group comprising ICSA members and Slaughter and May.

28 Code Principle B.5.1

29 Code Principle B.4, B.4.1-2

30 Code Principle B.6

31 Code Provision B.5.1

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