

Directors' Remuneration Reforms in the United Kingdom: UK Enterprise and Regulatory Reform Act 2013 Published

1. Introduction

The UK Enterprise and Regulatory Reform Bill received Royal Assent on 25 April 2013 and became the Enterprise and Regulatory Reform Act 2013 (the "**Act**"). The Act was [published](#) on 2 May 2013 and introduces some key changes to the existing regime relating to the approval and reporting of the remuneration of executive and non-executive directors of UK incorporated "quoted" companies – that is, companies whose equity share capital is included in the Financial Conduct Authority's official list (i.e., not AIM listed companies) or is officially listed in another state in the European Economic Area or is admitted to dealing on either the New York Stock Exchange or NASDAQ. The Government estimates that there are approximately 900 such companies. The reforms do not apply to overseas companies who are listed in the UK.

The reforms are intended to give shareholders more power to hold companies to account over the structure and level of directors' remuneration through the introduction of a binding vote on a company's future remuneration policy, as well as increase transparency in remuneration reporting to make it clear what directors are earning and how this links to company strategy and performance. In addition to the new binding vote on the future remuneration policy for directors, shareholders will continue to have an annual advisory (i.e., non-binding) vote on the implementation of the directors' remuneration policy in the previous financial year, including the actual sums paid to the directors.

The reforms will come into force from 1 October 2013.

2. The new reporting requirements for directors' remuneration

From 1 October 2013, the directors' remuneration report prepared by UK quoted companies will need to contain three distinct elements:

- (i) a statement from the chair of the remuneration committee setting out the key messages on remuneration, the context in which decisions have been taken and the major changes during the reporting year;
- (ii) a section setting out the company's proposed remuneration policy for its directors, including its approach to payments for loss of office (the "**remuneration policy**"); and

- (iii) a detailed explanation of how the existing remuneration policy was implemented in the reporting year, including the actual sums paid to the directors in that year (the “**implementation report**”).

Detailed provisions on the form and content of the directors remuneration report will be provided in the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (the “**Regulations**”). The second consultation on a [draft version](#) of the Regulations closed on 25 March 2013 and it is anticipated that the Regulations will be laid before Parliament in the coming weeks.

Companies will be required to produce a directors’ remuneration report in the new format prescribed by the Regulations for the annual general meeting (“**AGM**”) held in the company’s first financial year to begin on or after 1 October 2013. Therefore, the first companies required to comply with the new reporting regime will be those with a financial year beginning on 1 October 2013.

3. The binding shareholder vote on the remuneration policy

The remuneration policy must be put to a shareholder vote at the AGM held in the company’s first financial year to begin on or after 1 October 2013. Thereafter, the remuneration policy must be proposed for shareholder approval at least every three years, or sooner if the company wishes to amend the policy (even to make minor changes), or if at an AGM the advisory vote on the implementation report is not approved, in which case the company will be required to put forward its remuneration policy for approval at the following year’s AGM.

The remuneration policy must be approved by an ordinary resolution of the company’s shareholders – that is, a simple majority (50% plus one vote) of votes cast. Once the remuneration policy has been approved, the company must not make remuneration payments or payments for loss of office that are inconsistent with it, unless such payments have been separately approved by the company’s shareholders.

4. Consequences of making a payment that is inconsistent with the approved remuneration policy

The restrictions on making remuneration payments or payments for loss of office that are inconsistent with the most recently approved remuneration policy take effect from the start of the company’s second financial year to begin on or after 1 October 2013 (i.e., 1 January 2015 for a December year-end company). Any such payment made after this date will be held by the recipient on trust for the company (or such other person making the payment) and an action can be brought to recover it. In addition, where the payment is made by the company, any director who authorised the payment is jointly and severally liable to indemnify the company for any loss resulting from it, unless the director is able to satisfy the court that he or she acted honestly and reasonably in the circumstances.

Any agreement which purports to entitle a director to a remuneration payment or payment for loss of office which is not consistent with the company’s approved

remuneration policy after the restrictions on such payments take effect will, unless the payment has been separately approved by shareholders, be unenforceable. There is a grandfathering provision which applies to payments that are required to be made by the company under an agreement entered into before 27 June 2012. However, an agreement entered into before 27 June 2012 that is modified or renewed on or after that date will be treated as having been entered into on the date on which it was modified or renewed and so will lose the protection of the grandfathering provision.

“Remuneration payment” is broadly defined in the Act to include any form of payment or other benefit made to or otherwise conferred on a person in return for them holding, agreeing to hold or having held office as a director of the company (or any other role in connection with the management of the affairs of the company or its subsidiaries whilst a director of the company). As such, the restrictions on remuneration payments apply to, for example, payments made to new directors to buy-out existing remuneration entitlements at their existing company. The restrictions on payments for loss of office extend to amounts paid to settle statutory or contractual claims arising in connection with a director’s loss of office. In each case, therefore, unless the remuneration policy contemplates such remuneration payments or payments for loss of office, they must be separately approved by the shareholders (although where other legislation or a court requires a payment to be made, the Act will not prevent the company from paying it).

5. The company’s options if the remuneration policy is not approved

If the remuneration policy is not approved by the company’s shareholders, the company has three options:

- (i) continue to operate according to the last approved remuneration policy;
- (ii) continue to operate according to the last approved remuneration policy and seek separate shareholder approval for any specific remuneration payments or payments for loss of office that are inconsistent with the remuneration policy; or
- (iii) convene a general meeting and put forward a remuneration policy for approval.

In the first financial year after the new regime comes into force, only option (iii) (convening a general meeting) will be available as the company will not have a previously approved remuneration policy to fall back on.

6. The advisory shareholder vote on the implementation report

Alongside the binding vote on the remuneration policy, shareholders will continue to have an annual advisory vote on how the remuneration policy has been implemented in the relevant financial year, including actual sums paid to directors. Like the binding shareholder vote, the advisory vote will also require the support of a simple majority of shareholders voting to pass, but as it is advisory only, no director’s remuneration is

dependent on the vote being passed. Instead, the vote is intended to allow shareholders to signal whether they are content with how the approved remuneration policy has been implemented.

If the company fails to pass the advisory vote it must put the remuneration policy back to shareholders the following year for re-approval in a binding vote (unless the remuneration policy was approved at the same AGM at which the advisory vote on the implementation report failed).

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If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under the 'Practices' section of our website at <http://www.clearygottlieb.com>.

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