EXPLANATORY MEMORANDUM TO

THE COMPANIES (DIRECTORS' REMUNERATION POLICY AND DIRECTORS' REMUNERATION REPORT) REGULATIONS 2019

2019 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

This instrument implements in part Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement[1] ("the Directive"). The Directive amends Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies ("the Original Directive"). This instrument contains the implementation of article 9a (right to vote on a company's remuneration policy) and article 9b (information to be provided in and right to vote on the remuneration report), which are inserted into the Original Directive. These Directives are commonly known as the Shareholders' Rights Directive. The measures in articles 9a and 9b of the Directive are required to be implemented in UK law by 10th June 2019.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 The territorial application of this instrument includes Scotland and Northern Ireland.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 Kelly Tolhurst MP, Parliamentary Under Secretary of State and Minister for Small Business, Consumers and Corporate Responsibility, has made the following statement regarding Human Rights:

"In my view the provisions of the Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019 are compatible with the Convention rights."

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017L0828

6. Legislative Context

6.1 This instrument is being made to implement articles 9a and 9b of the Directive, and to ensure that the implementation works with the framework already in place in UK legislation with regards to directors' remuneration.

6.2 The legislation on directors' remuneration are contained in the Companies Act 2006 (c.46) ("the Act") and in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (S.I. 2008/410) ("the 2008 Regulations"). The Act, specifies the requirement on quoted companies to have a directors' remuneration policy and directors' remuneration report, provides for members' approval of the remuneration report and the remuneration policy, contains the conditions on making remuneration payments to directors and provides for other matters in relation to the publication, reporting and accounting, and auditing of the remuneration report. The 2008 Regulations, which were made under the Act, relate to the content of the directors' remuneration policy and remuneration report.

6.3 In order to implement the Directive to the extent that it is not already implemented in UK legislation, this instrument amends the following provisions in the Act and the 2008 Regulations:

- Part 10 (chapter 4 and 4A relating to members' approval and remuneration of directors),
- Part 15 on accounts and reports in chapters 6 (directors' remuneration report), 7 (publication of accounts and reports), 9 (members' approval of directors' remuneration report), 10 (filing of accounts and reports) and 12 (supplementary provisions),
- Part 16 on audit (chapter 3 (functions of the auditor)), and
- Regulation 11 of and, Schedule 8 to, the 2008 Regulations.

7. Policy background

7.1 The Original Directive applies to a company whose shares carry voting rights and are admitted to trading on a regulated market within the EEA. In the UK, the definition of "traded company" is in section 360C of the Act and it covers this type of company. The Original Directive was transposed through the Companies (Shareholder Rights) Regulations 2009 (S.I. 2009/1632) and related to the right to vote on resolutions at company meetings and the right to receive information from the company about its performance and management. It did not contain provisions on the reporting of directors' remuneration.

7.2 The Directive amends the Original Directive by introducing a number of provisions, including articles 9a and 9b on the reporting of directors' remuneration, which are intended to strengthen the governance and performance of traded companies.

7.3 The Act and the 2008 Regulations already provide a legal framework in the UK for approval of and voting on directors' remuneration, and this legislation currently applies to quoted companies (as defined in section 385 of the Act) which includes traded companies unless they are unquoted companies. Given the considerable overlap in company scope between traded companies and quoted companies, this instrument makes the necessary amendments in the Act and the 2008 Regulations to acknowledge the overlap between the two types of companies by bringing unquoted

traded companies within the existing legal framework and the implementing the Directive in respect of both types of companies.

7.4 Most of the requirements on directors' remuneration reporting contained in the Directive are already implemented in UK law, including the requirement on companies to produce a directors' remuneration report and a directors' remuneration policy, each subject to a shareholder vote (advisory for the report and binding for the policy).

7.5 In order to implement articles 9a and 9b of the Directive to the extent that it is not already implemented in domestic UK legislation, this instrument transposes new requirements as follows:

Directors' remuneration policy

- Where a company loses a shareholder vote on a proposed remuneration policy, it must bring a new remuneration policy to a shareholder vote at the next accounts meeting or other general meeting;
- In respect of share-based remuneration to directors, the remuneration policy must provide details on vesting periods, and any deferral and holding periods;
- The remuneration policy must give an indication of the duration of directors' service contacts;
- The remuneration policy must set out the decision-making process for its determination, review and implementation, and must explain all significant changes compared to the previous policy;
- The date and results of the shareholder vote on the remuneration policy must be put on the company's website as soon as reasonably practicable and remain there for the life of the policy.

Directors' remuneration report

- The remuneration report must be available free of charge on the company's website for ten years;
- The remuneration report must show the split of fixed and variable remuneration awarded to each director each year;
- The remuneration report must specify any changes to the exercise price and date for the exercise of shares or share options by directors
- The remuneration report must compare the annual change in directors' remuneration to the annual change in pay of the company's employees and of the company's performance (measured in terms of total shareholder return) over a five year rolling period.

Directors' remuneration payments

- An existing provision in section 226B(1)(b) of the Act for shareholders to approve any proposed payments to directors which are inconsistent with the approved remuneration policy is amended to comply with a requirement in the Directive that all payments to directors must be made in accordance with an approved remuneration policy. The amended section 226B(1)(b) requires a shareholder approval to allow a payment by way of an amendment to the approved remuneration policy.

Scope

- This instrument extends the scope of the UK's existing executive pay framework to cover unquoted traded companies, in order to comply with the Directive's application to traded companies while maintaining the UK's long-standing application of directors' remuneration reporting to quoted companies. In practice, only a very small number of UK-registered companies are traded and unquoted, and such companies appear to already comply with the existing directors' remuneration reporting requirements.
- This instrument also implements a requirement of the Directive that the remuneration of persons in the role of the chief executive officer and any deputy chief executive officer must be reported even if they are not a director on the board of the company. Under existing UK law, only the remuneration of the directors on the board and shadow directors must be reported.

Enforcement

- The penalties and offences for failing to comply with the existing requirements are in the Act and the 2008 Regulations are provided in the Act. The amendments made by this instrument ensure that they apply to the implementation of the new requirements in the Directive as appropriate and that they apply to unquoted traded companies.

Application and transitional arrangements

- This instrument will come into force on 10th June 2019. There are particular amendments made by this instrument that will apply as follows:
    - - remuneration payments or payments for loss of office will need to comply with the new requirements in respect of an approved remuneration policy which takes effect on or after 10th June 2019,
    - - the new publication requirements will apply to directors' remuneration policy and remuneration report from 10th June 2019, and for unquoted traded companies this will now include their annual accounts and reports
    - - the new requirements on the contents of the remuneration report will apply where the report covers a financial year on or after 10th June 2019
    - - the new requirements on the content of the remuneration policy will apply to a remuneration policy approved after 10th June 2019.
- An unquoted traded company will now be subject to new requirements as a result of the transposition of the Directive and because this instrument brings them in line with those requirements on quoted companies. Transitional provisions have been provided in relation to an unquoted traded company which already exists before this instrument comes into force. They will be required to bring forward a remuneration policy for a shareholder vote in the financial year 2020 and to comply with the requirements in the law as it applies after 10th June 2019. If an unquoted traded company, despite not being subject to the legal requirements before 10th June, has been complying with the provisions relating to a quoted company under the existing legislation, it can continue with the remuneration policy that was approved before 10th June in the same way that a quoted company can (i.e. the next remuneration policy put forward for a vote, after 10th June, would need to comply with the new requirements).

7.6 The transposition table published alongside this explanatory memorandum sets out all the new requirements on directors' remuneration contained in the Directive, and highlights which are already enacted in UK law, and which are enacted through this instrument.

7.7 The impact of the instrument will be to give shareholders new information with which to assess the performance of directors and to form a view on the effectiveness or otherwise of the company's approach to directors' remuneration and performance incentives. This will in turn help inform shareholders' approach to voting on the annual remuneration report and the remuneration policy.

7.8 In addition to articles 9a and 9b on directors' remuneration, the Directive introduces certain other new provisions not enacted by this instrument, which are to be implemented separately by the Financial Conduct Authority, Her Majesty's Treasury, the Department of Work and Pensions and the Department for Business, Energy and Industrial Strategy. Those other requirements are summarised below:

- disclosure by asset managers and institutional investors of their stewardship activities (i.e. how they engage with the companies in which they invest to protect and enhance their clients' invested capital) – this will be implemented by the Financial Conduct Authority with regard to asset managers and insurance funds, and by the Department for Work and Pensions with regard to pension funds;
- new transparency requirements covering the work of proxy advisers (that is, companies who provide research services to investors) – this will be implemented by the Financial Conduct Authority;
- enhanced requirements for the transparency and approval of related party transactions by traded companies – this will be implemented by the Financial Conduct Authority;
- requirements to further facilitate the exercise of shareholder rights – this will be implemented by the Department for Business, Energy and Industrial Strategy.

7.9 These separate requirements are also due to be transposed by 10th June 2019, with the exception of the provisions covering the further facilitation of shareholder rights, which have a transposition deadline of 3rd September 2020.

7.10 The UK Government is responsible for the operation and regulation of business entities in England and Wales, and in Scotland. Previously the Northern Ireland administration has agreed that, while the operation and regulation of business entities remains a transferred matter within the legislative competence of the Northern Ireland Assembly, amendments to the Companies Act 2006 and legislation regulating business entities should be made in the same terms for the whole of the United Kingdom.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 This is not a consolidation.

10. Consultation outcome

10.1 The new requirements enacted in this instrument form part of a revised Directive published in draft by the European Commission on 9th April 2014[2] and agreed by the European Parliament and the European Council on 17th May 2017[3].

10.2 Technical comments were sought by the Department for Business, Energy and Industrial Strategy from business groups, investors, professional advisers and other interested parties in the preparation of the instrument.

11. Guidance

11.1 The Department for Business, Energy and Industrial Strategy will be publishing Frequently Asked Questions on Gov.UK to help companies with their understanding of the instrument. The European Commission is also preparing non-binding guidelines covering the format of the remuneration report.

12. Impact

12.1 There is no significant impact on business, and no impact on charities or voluntary bodies.

12.2 There is no impact on the public sector.

12.3 An Impact Assessment has not been prepared for this instrument because the additional requirements on the reporting of directors' remuneration apply only to UK-registered quoted and traded companies, of which there are currently around 600, and since the additional measures are not extensive. The UK's existing executive pay framework already implements most of the remuneration reporting requirements contained in the Directive.

13. Regulating small business

13.1 The legislation applies only to quoted and traded companies.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is in the first instance a requirement to notify the European Commission by 10th June 2019 of the implementation of the Directive requirements which would include those enacted through this instrument. A transposition table has been produced to note the implementation in UK legislation. Any alleged non-compliance with the legislation by a company and its directors would be addressed in the first instance by Companies House, since the legislation primarily concerns new requirements contained in company reports submitted to Companies House.

14.2 A statutory review clause is not included in the instrument since the additional reporting requirements are not extensive and are considered to meet the Government's 'de minimis' regulatory impact criteria, meaning no impact assessment is required (in particular, because the impacts are below £5m, do not impact on small business and

[2] http://eur-lex.europa.eu/resource.html?uri=cellar:59fccf6c-c094-11e3-86f9-01aa75ed71a1.0003.01/DOC_1&format=PDF

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017L0828

create no open-ended new powers in legislation); and also since the instrument implements EU requirements with limited scope for domestic flexibility.

15. Contact

15.1 Robin Mueller at the Department for Business, Energy and Industrial Strategy. Telephone: 0207 215 1389 or email: robin.mueller@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Sanu de Lima, Deputy Director for Corporate Governance, Responsible Business and Leadership Diversity at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 Kelly Tolhurst MP, Parliamentary Under Secretary of State at the Department for Business, Energy and Industrial Strategy, can confirm that this Explanatory Memorandum meets the required standard.