EXPLANATORY MEMORANDUM TO

THE LARGE AND MEDIUM-SIZED COMPANIES AND GROUPS (ACCOUNTS AND REPORTS) (AMENDMENT) REGULATIONS 2013

2013 No. XXXX

1. This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Enterprise and Regulatory Reform Act 2013 ("the 2013 Act") amended Part 10 of the Companies Act 2006 ("the 2006 Act") to provide that a quoted company be bound by the company's shareholder approved directors' remuneration policy in relation to payments to directors of remuneration or for loss of office, and further amended Part 15 of the 2006 Act to require that policy to be set out in a separate part of the company's directors' remuneration report ("DRR"). These regulations revise the existing provisions which set out the content of the annual report on remuneration paid in the financial year and also set out for the first time the minimum requirements for the directors' remuneration policy in order to ensure that shareholders will have clear information on how directors will be paid in the future. This will inform the binding vote on remuneration policy as prescribed in the amendments made by 2013 Act.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 These Regulations amend the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (S.I. 2008/410), in particular by the substitution of the Schedule to the Regulations for Schedule 8 of S.I. 2008/410. Schedule 8 prescribes the content of the directors' remuneration report which is required by section 420 of the 2006 Act to be prepared by all quoted companies (as defined in section 385 of the 2006 Act).

4.2 The Regulations are made under section 421 of the 2006 Act as amended by the 2013 Act. In respect of revised directors' remuneration policies, the regulations are made under section 422A of the 2006 Act as inserted into that Act by the 2013 Act.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

5.2 The UK Government is responsible for company law in England, Wales and in Scotland. The Northern Ireland administration has agreed that, while company law remains a transferred matter within the legislative competence of the Northern Ireland Assembly, the Companies Act 2006 should apply to the whole of the United Kingdom.

6. European Convention on Human Rights

The Minister for Employment Relations and Consumer Affairs has made the following statement regarding Human Rights:

In my view the provisions of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 are compatible with the Convention rights.

7. Policy background

7.1 These regulations form part of the Government's drive to improve the long-term performance of UK companies by building on our already world leading corporate governance standards.

7.2 Investors and businesses agree that the link between top pay and long term company performance needs to be re-established to mitigate against directors focusing on achieving short term goals, even when these are not in the long term interests of the company. In addition, as remuneration structures have become more complex it has become difficult and time consuming for investors to understand exactly what a director has been and could be paid. The Government has addressed these concerns through sections 79 to 83 of the 2013 Act and these regulations.

7.3 These regulations have two main purposes: (i) to prescribe the requirements of the annual remuneration report (set out in Part 3), and; (ii) to set out the requirements of the directors' remuneration policy (Part 4) as required by the 2013 Act.

Annual Remuneration Report (Part 3)

7.4 The DRR will continue to include information on an annual basis explaining how much directors have been paid in the reporting year, and how the pay policy will be implemented in the current financial year.

7.5 The most substantive introduction is the requirement for companies to disclose the amount each director has been paid and to express this as a single figure taking account of *all* elements of remuneration. The company must also explain the director's actual

performance, and the basis on which it has made decisions on the level of variable pay that is received.

7.6 The disclosures in the annual remuneration report will provide investors with a clear picture of what has been paid to directors in the reporting year and set it in the context of company performance, distributions to shareholders, and the change in pay of the wider workforce. Taken together, they will inform the annual advisory vote on the Directors' Remuneration Report (section 439 of the 2006 Act).

Directors' Remuneration Policy (Part 4)

7.7 The 2013 Act (section 79) introduces a new part to the DRR: the directors' remuneration policy. These regulations set out the minimum requirements for disclosure of this policy.

7.8 The pay policy must explain how each element of a directors' remuneration package supports the short and long-term strategy of the company, its potential value, and explain any performance measures relating to it. It must also set out a policy for paying newly recruited directors and a policy for loss of office payments.

7.9 Taken together, these disclosures will ensure that investors are clear about the potential size of directors' remuneration packages, how they align with performance and the extent to which the remuneration committee has considered the pay and conditions elsewhere in the company and the views of shareholders in setting the remuneration policy. They will inform investors in exercising the new voting powers introduced by the 2013 Act (section 439A of the 2006 Act).

8. Consultation outcome

8.1 In June 2012 the Secretary of State for Business, Innovation and Skills published a consultation on the draft revised remuneration reporting regulations[1] to seek evidence on the impact, costs and benefits of the proposals as well as detailed views on whether the draft regulations will achieve the government's policy objectives. The deadline for responses was 26 September 2012. 84 responses were received from companies, consultants, investors, lawyers, representative bodies and private individuals and can be read here[2].

8.2 Stakeholders supported the overall approach of including an annual remuneration report and a directors' remuneration policy within the DRR. They agreed with the intention to improve the link between company strategy and pay and performance, encourage engagement between companies and shareholders, and to make reports clearer.

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31358/12-888-directors-pay-consultation-remuneration-reporting.pdf
[2] https://www.gov.uk/government/consultations/directors-pay-revised-remuneration-reporting-regulations

8.3 Since the consultation Government officials have continued to engage closely with industry professionals, companies and investors to ensure the regulations are workable and enduring. Stakeholders are agreed that overall these regulations find the right balance between the objectives of greater transparency and accountability, and the commercial needs of UK companies.

9. Guidance

9.1 These regulations set out the minimum requirements for companies that are required to produce a DRR. The Department is not planning to issue any guidance on the Regulations.

9.2 However, we are expecting guidance to be prepared by organisations representing major quoted companies and major institutional investors that will describe investors' and companies' expectations over the level of information that they consider to be good practice.

10. Impact

10.1 These regulations replace an existing set of regulations. As a result the regulations will not create a significant extra reporting burden on companies, as the new reports primarily require existing information to be presented in a different way. However, companies will face moderate transitional costs as they adapt to the new regulations.

10.2 The IA concludes that these transitional costs are likely to be significantly outweighed by the potential improvements in company performance that can result from better aligned executive remuneration. These benefits are largely unquantified, as they will primarily be indirect and dependent on the behavioural change driven by these reforms.

10.4 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on the OPSI website.

10.5 The public sector is not impacted.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The amendments made by these regulations aim to improve engagement between shareholders and companies and to improve the link between pay and performance. As a result the impact of the policy will primarily be assessed by reference to behavioural change and the perceptions of companies and investors.

12.2 The Government has committed to review the policy in 2017.

13. Contact

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