

Greenbury Recommendations

2 CODE OF BEST PRACTICE

Introduction

- 2.1 The purpose of the accompanying Code is to set out best practice in determining and accounting for Directors' remuneration. The references at the end of each provision of the Code are to the fuller discussion in sections 4 to 7.
- 1.2 The detailed provisions have been prepared with large companies mainly in mind, but the principles apply equally to smaller companies.
- 2.3 We recommend that all listed companies registered in the UK should comply with the Code to the fullest extent practicable and include a statement about their compliance in the annual reports to shareholders by their remuneration committees or elsewhere in their annual reports and accounts. Any areas of non-compliance should be explained and justified.
- 2.4 We further recommend that the London Stock Exchange should introduce the following continuing obligations for listed companies:
 - . an obligation to include in their annual remuneration committee reports to shareholders or their annual reports a general statement about their compliance with section A of the Code which should also explain and justify any areas of non-compliance;
 - . a specific obligation to comply with the provisions in section B of the Code which are not already covered by existing obligations, and with provision C10 of the Code, subject to any changes of working which may be desirable for legal or technical reasons.
- 2.5 Within section B, provision B3 requires remuneration committees to confirm that full consideration has been given to sections C and D of the Code.

THE CODE

A The remuneration committee

- A1 To avoid potential conflicts of interest, Boards of Directors should set up remuneration committees of Non-Executive Directors to determine on their behalf, and on behalf of the shareholders, within agreed terms of reference the company's policy on executive remuneration and specific remuneration

packages for each of the Executive Directors, including pension rights and any compensation payments (paragraphs 4.3 - 4.7).

- A2 Remuneration committee Chairmen should account directly to the shareholders through the means specified in this Code for the decisions their committees reach (paragraph 4.4).
 - A3 Where necessary, companies' Articles of Association should be amended to enable remuneration committees to discharge these functions on behalf of the Board (paragraph 4.3)
 - A4 Remuneration committees should consist exclusively of Non-Executive Directors with no personal financial interest other than as shareholders in the matters to be decided, no potential conflicts of interest arising from cross-directorships and no day-to-day involvement in running the business (paragraphs 4.8 and 4.11).
 - A5 The members of the remuneration committee should be listed each year in the committee's report to shareholders (BI below). When they stand for re-election, the proxy cards should indicate their membership of the committee (paragraphs 4.12 and 5.25).
 - A6 The Board itself should determine the remuneration of the Non-Executive Directors, including members of the remuneration committee, within the limits set in the Articles of Association (paragraph 4.13).
 - A7 Remuneration committees should consult the company Chairman and/or Chief Executive about their proposals and have access to professional advice inside and outside the company (paragraph 4.14 - 4.17).
 - A8 The remuneration committee Chairman **should attend** the company's Annual General Meeting (AGM) to answer shareholders' questions about Directors' remuneration and should ensure that the company maintains contact as required with its principal shareholders about remuneration in the same way as for other matters (paragraph 5.27).
 - A9 The committee's annual report to shareholders (BI below) should not be a standard item of agenda for AGMs. But the committee should consider each year whether the circumstances are such that the AGM should be invited to approve the policy set out in their report and should minute their conclusions (paragraphs 5.28 - 5.32).
- B Disclosure and approval provisions
- BI The remuneration committee should make a report each year to the shareholders on behalf of the Board. The report should form part of, or be annexed to, the company's Annual Report and Accounts. It should be the main vehicle through which the company accounts to shareholders for Directors' remuneration (paragraph 5.4).
 - O2 The report should set out the Company's policy on executive remuneration, including levels, comparator groups of companies, individual components,

performance criteria and measurement, pension provision, contracts of service and compensation commitments on early termination (paragraphs 5.5 - 5.7).

- B3 The report should state that, in framing its remuneration policy, the committee has given full consideration to the best practice provisions set out in sections C and D below (paragraph 5.25).
- B4 The report should also include full details of all elements in the remuneration package of each individual Director by name, such as basic salary, benefits in kind, annual bonuses and long-term incentive schemes including share options (paragraphs 5.8 - 5.12).
- B5 Information on share options, including SAYE options, should be given for each Director in accordance with the recommendations of the Accounting Standards Board's Urgent Issues Task Force Abstract 10 and its successors (paragraphs 5.13 - 5.16).
- B6 If grants under executive share option or other long-term incentive schemes are awarded in one large block rather than phased, the report should explain and justify (paragraph 6.29).
- B7 Also included in the report should be pension entitlements earned by each individual Director during the year, calculated on a basis to be recommended by the Faculty of Actuaries and the Institute of Actuaries (paragraphs 5.17 - 5.23).
- B8 If annual bonuses or benefits in kind are pensionable the report should explain and justify (paragraph 6.44).
- B9 The amounts received by, and commitments made to, each Director under B4, B5 and B7 should be subject to audit (paragraph 5.4).
- B10 Any service contracts which provide for, or imply, notice periods in excess of one year (or any provisions for predetermined compensation on termination which exceed one year's salary and benefits) should be disclosed and the reasons for the longer notice periods explained (paragraph 7.13).
- B11 Shareholdings and other relevant business interests and activities of the Directors should continue to be disclosed as required in the Companies Acts and London Stock Exchange Listing Rules (paragraph 5.24).
- B12 Shareholders should be invited specifically to approve all new long-term incentive schemes (including share option schemes) whether payable in cash or shares in which Directors or senior executives will participate which potentially commit shareholders' funds over more than one year or dilute the equity (paragraph 5.33).
- C** Remuneration policy
- C1 Remuneration committees must provide the packages needed to attract, retain and motivate Directors of the quality required but should avoid paying more than is necessary for this purpose (paragraphs 6.5 - 6.7).

- C2 Remuneration committees should judge where to position their company relative to other companies. They should be aware what other comparable companies are paying and should take account of relative performance (paragraphs 6.11 - 6.12).
- C3 Remuneration committees should be sensitive to the wider scene, including pay and employment conditions elsewhere in the company, especially when determining annual salary increases (paragraph 6.13).
- C4 The performance-related elements of remuneration should be designed to align the interests of Directors and shareholders and to give Directors keen incentives to perform at the highest levels (paragraph 6.16).
- C5 Remuneration committees should consider whether their Directors should be eligible for annual bonuses. If so, performance conditions should be relevant, stretching and designed to enhance the business. Upper limits should always be considered. There may be a case for part-payment in shares to be held for a significant period (paragraphs 6.19 - 6.22).
- C6 Remuneration committees should consider whether their Directors should be eligible for benefits under long-term incentive schemes. Traditional share option schemes should be weighed against other kinds of long-term incentive scheme. In normal circumstances, shares granted should not vest, and options should not be exercisable, in under three years. Directors should be encouraged to hold their shares for a further period after vesting or exercise subject to the need to finance any costs of acquisition and associated tax liability (paragraphs 6.23 - 6.34).
- C7 Any new long-term incentive schemes which are proposed should preferably replace existing schemes or at least form part of a well-considered overall plan, incorporating existing schemes, which should be approved as a whole by shareholders. The total rewards potentially available should not be excessive (paragraph 6.35). (See also B12.)
- C8 Grants under incentive schemes, including new grants under existing share option schemes, should be subject to challenging performance criteria reflecting the company's objectives. Consideration should be given to criteria which reflect the company's performance relative to a group of comparator companies in some key variables such as total shareholder return (paragraphs 6.38 - 6.40).
- C9 Grants under executive share option and other long-term incentive schemes should normally be phased rather than awarded in one large block (paragraph 6.29). (See 06.)
- C10 Executive share options should never be issued at a discount (paragraph 6.29).
- C11 Remuneration committees should consider the pension consequences and associated costs to the company of basic salary increases, especially for Directors close to retirement (paragraphs 6.42 - 6.45).
- C12 In general, neither annual bonuses nor benefits in kind should be pensionable (paragraph 6.44). (See B8.)

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- D Service contracts and compensation
 - D1 Remuneration committees should consider what compensation commitments their Directors' contracts of service, if any, would entail in the event of early termination, particularly for unsatisfactory performance (paragraph 7.10).
 - D2 There is a strong case for setting notice or contract periods at, or reducing them to, one year or less (see BIO). Remuneration committees should, however, be sensitive and flexible, especially over timing. In some cases notice or contract periods of up to two years may be acceptable. Longer periods should be avoided wherever possible (paragraphs 7.11 - 7.15).
 - D3 If it is necessary to offer longer notice or contract periods, such as three years, to new Directors recruited from outside, such periods should reduce after the initial period (paragraph 7.16).
 - D4 Within the legal constraints, remuneration committees should tailor their approach in individual early termination cases to the wide variety of circumstances. The broad aim should be to avoid rewarding poor performance while dealing fairly with cases where departure is not due to poor performance (paragraphs 7.17 - 7.18).
 - D5 Remuneration committees should take a robust line on payment of compensation where performance has been unsatisfactory and on reducing compensation to reflect departing Directors' obligations to mitigate damages by earning money elsewhere (paragraphs 7.19 - 7.20).
 - D6 Where appropriate, and in particular where notice or contract periods exceed one year, companies should consider paying all or part of compensation in instalments rather than one lump sum and reducing or stopping payment when the former Director takes on new employment (paragraph 7.20).