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Business Briefing February 2012

A quarterly publication from Capita
Company Secretarial Services keeping
you updated on current industry issues



Inside this month's issue

Welcome to the February issue of Business Briefing. In this edition we look at the BIS consultation paper on narrative financial reporting and review the proposed changes to Annual Reports that are being made. We also discuss closed defined benefit pension schemes in light of a recent survey of FTSE 350 companies, the governance of these schemes and how a professional trustee can be of benefit to a pension trustee board.

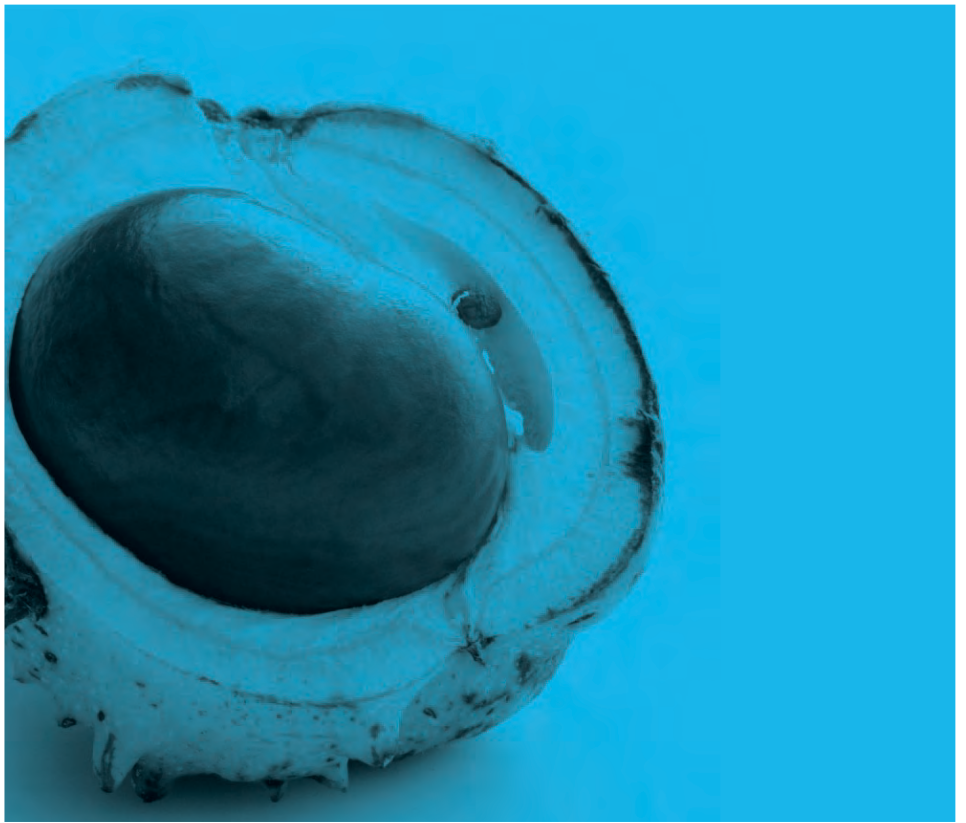
Another key topic covered in this edition is the BIS discussion paper on executive remuneration which sets out the government's proposals to tackle excessive levels of executive pay. We also consider the recommendations for ensuring board effectiveness set out in the ABI's recently published report.

And in our '**And finally**' section we encourage you to participate in our forthcoming events, which include a webinar on AGMs, a regional seminar for company secretaries and a governance roundtable discussion in conjunction with the Quoted Companies Alliance.



**Mark Cleland, Managing Director,
Capita Company Secretarial Services**

**We hope you find this edition
informative and welcome your
comments and queries - please
email: bus.brief@capitaregistrars.com**



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We are pleased to be able to confirm that this publication is CPD accredited so counts towards your annual professional learning objectives. Please email capitatraining@capita.co.uk if you would like to be sent a certificate.

The future of Narrative Financial Reporting

In September 2011 the Department of Business, Innovation and Skills (“BIS”) published its latest consultation paper setting out a proposed new framework for narrative reporting in UK Annual Reports. This follows on from the responses to a previous consultation in 2010 which indicated a clear consensus that changes to the current narrative reporting framework were both desirable and needed. The consultation also reflects the government’s commitment to improving corporate information, reducing the size of Annual Reports and the burden of disclosure for companies.

The new framework envisages replacing the current Business Review and Directors’ Report with a Strategic Report, which would be supported by detailed information in an Annual Directors’ Statement. The objective is to provide clear, transparent and relevant information to investors by removing (where possible) duplication and inconsistency and outdated disclosure requirements. No changes are being proposed to the financial statements or current audit requirements.

The Strategic Report will:

- Provide a concise description of the company’s strategy, business model and performance (including KPIs and key financial data);
- Include a forward-looking analysis by the directors of the challenges and opportunities that they face,

together with the principal risks, key information on corporate governance and remuneration, and information on social and environmental matters (where necessary);

- Provide a ‘clear line of sight’ from the strategy, business model and risks of the company to the financial results and resulting rewards for the directors;
- Be more concise than the existing narrative report and will cross-refer to the detailed information in the Annual Directors’ Statement. The level of prescription of detailed content and format will be kept to a minimum; and
- Be signed by each individual director as well as the company secretary.

For those companies that produce Summary Financial Statements, these would be replaced by the Strategic Report.

The Annual Directors’ Statement will:

- Include detailed information and statements of policy, including those reporting requirements which are disclosures required by law, irrespective of materiality or impact on the business as a whole. Additional information can be provided voluntarily within a consistent framework, including on social and environmental issues. It will include the Directors’ Remuneration Report, Corporate

Governance Statement and Audit Committee Report; and

- Be structured with online publication in mind, be easily searchable and not printed as a glossy report, although shareholders will be able to request a hard copy. It will have a set layout and standard headings to increase comparability between companies.

Executive remuneration

Some of the more controversial proposals relate to the reporting of executive remuneration and reflect the issues and recommendations set out in the BIS discussion paper on this subject issued in September, which is discussed in this Business Briefing.

Key information that would allow shareholders to understand and assess a company’s remuneration policy would be included in the Strategic Report, with the full, detailed remuneration report contained in the Annual Directors’ Statement.

The proposals on executive remuneration would only apply to quoted companies. However, as currently drafted, they are much more onerous than the current position.

Human rights issues

The consultation requests views on whether UK company law should make explicit the requirement for quoted companies to include information about human rights issues in the Strategic Report (to the extent necessary for an understanding of the



development, performance or position of the company's business).

Reporting gender diversity

In line with recommendations in Lord Davies' report "Women on Boards", quoted companies would have to report annually in the Strategic Report the proportion of women on their board. They would also be required to disclose the proportion of female employees for the parts of the organisation for which gender information is available, with an explanation of the approximate proportion of the global workforce that the gender figures relate to.

Audit Committee Report

An Audit Committee Report would form part of the Annual Directors' Statement, and BIS is looking for views on whether these reports should set out how long the current auditor has been in post, when a tender was last conducted and the length of time since the directors have held discussions with principal shareholders about the company's relationship with its auditors.

It should be noted that these proposals are part of a wider discussion that is currently underway, and they should therefore be considered in the context of the referral to the Competition Commission on the monopoly position of the 'Big Four' accountancy firms (PwC, EY, KPMG and Deloitte). In addition, on 30 November 2011 the European Commission published its final proposals on changes to audit

regulations which included reforms to audits of listed companies and audit firm practice.

What will be the impact of these proposals?

The proposals to abolish the Directors' Report and replace it with a new framework will affect all companies. However, the changes required for non-quoted companies will be minimal, and even less for small companies, who may be exempt from many disclosure requirements already, including the Business Review (this exemption will also apply to the Strategic Report). There may, however, be changes they would wish to make to align themselves with best practice, and they would be encouraged to report on environmental and social issues.

The changes will be much more significant for quoted companies, who will have to restructure and likely rewrite large parts of their annual report. Some of our clients are taking steps now to design their reports this year in a way which will make it much easier for them to convert to the new format.

The next steps

The BIS consultation closed on 25 November 2011. At the time of writing, responses to the consultation have not yet been published by BIS.

Capita Company Secretarial Services ("CCSS") have provided a response and fully supports the proposals

for a new, simpler framework for narrative reporting. We believe the proposed framework will enable increased comparability of the reports of different companies and will give investors the ability to assess the performance of the business across all aspects of activity, establish its value and exercise effective oversight.

The next step will be for the Government to publish draft regulatory and non-regulatory solutions, with a view to the regulatory solutions becoming effective for financial years beginning on or after 1 October 2012, with early adoption being fully supported.

It is hoped that BIS will provide sufficient, and relevant, guidance on the contents and structure of the new reports for company secretaries to interpret and implement the changes and guide their boards in the right direction. We will be monitoring developments closely and keeping our clients fully informed.

A copy of the consultation paper can be [found online](#)

ABOUT THE AUTHOR

Sally Porter, Manager, Capita Company Secretarial Services.

Closed defined benefit pension schemes

A Pandora's Box..... and the role of the professional trustee



Picture the scenario: your predecessor as FD closed the defined benefit pension scheme to new members a few years ago, and yet, despite that, the scheme trustees have now come back and asked for more money to fund an increased deficit. Not only would this cause a direct financial cost to the business, it negatively impacts by lowering the company's D&B score. To add insult to injury, it also increases the Pensions Protection Fund levy. How can this be? And, as importantly, how can this be managed?

The current economic climate has highlighted and increased the gulf between the heart and head as regards pension schemes. Heart, in that nobody denies that a lifetime of work should be followed by a well funded retirement. Head, as the cost of funding rests heavily on the company and current employees, no matter what the external economic environment looks like. Closing the defined benefit pension scheme to new members was supposed to curtail further cost, however, the existing scheme still needs to be funded.

So what can be done? As a start, effective management and control of what is already in place is imperative. Gone are the days when the pension scheme could be seen as an over-funded pool of assets that manages itself. Good oversight and decision

making is imperative, however, how many companies have the time to have effective oversight of their pension schemes? Indeed a recent survey carried out by Capita Fiduciary Group of FTSE 350 company's FD's * highlighted that only 10% of companies discuss their pension scheme at their regular quarterly board meetings.

The issue of pension scheme governance figured highly in the survey responses. Surprisingly, despite the growing financial impact, 82% of finance directors questioned said the company pension scheme features as an item on the agenda at less than half of company board meetings each year. For those finance directors operating closed defined benefit schemes, just 10% have it on the agenda at every board meeting.

There are a number of well publicised examples of blue chip companies that have had to change their strategy, retrench, or restructure and sell the company as a direct result of their legacy DB scheme. Given the potential negative impact a pension scheme in difficulty could have on the overall company balance sheet, best practice would be to include this as an agenda item for every meeting going forward. Indeed, the most effective method of managing a pension scheme would be for the sponsor to treat

it as a subsidiary of the business. As, whilst not making a profit, the pension scheme could certainly have the potential to severely impact the bottom line with the subsequent effect on business planning and budgets. As one survey respondent noted "It is the largest item on our balance sheet. The volatility makes financial planning and strategic development challenging and uncertain."

This then leads on to what the board actually expects from their pension scheme and its board of trustees? The trustee board is expected by all stakeholders, the Pensions Regulator, sponsor, advisers and members to be a professional and proactive team. Gone are the days when the trustee board could be exclusively made up of employee representatives, member nominated trustees and ex-employees. Nowadays they cannot be expected to have up-to-date, in-depth pension knowledge, especially with increased legislation being implemented on a regular basis and auto enrollment looming. Hence the pressure on trustee boards to meet the expectations of stakeholders has resulted in an increasing demand for a professional trustee presence.

There is a plethora of industry experts keen to assist, at a cost, with a generic one-size fits all approach to service. This works as long as the pension

“ It is the largest item on our balance sheet. The volatility makes financial planning and strategic development challenging and uncertain. ”

board has the tools and knowledge to challenge advice and ensure that service is aligned to the scheme's specific requirements. Professional advisors need to be challenged in their assumptions, advice and relevance of information to the specific pension scheme. Is it any surprise that it isn't always? In fact, one of the survey respondents suggested that one of the benefits of having a professional trustee in place was to "temper the actuary's assumptions".

So what can a professional trustee bring to a scheme board? Apart from the ability to challenge from a knowledgeable perspective, they can also bring expertise from other scenarios affecting other schemes. As well as industry knowledge that, by default, brings the knowledge of the other trustee board members forward without the need for excessive absence from undertaking the day job.

Another key consideration is that of conflicts of interests, real or perceived, which can have the unintended consequence of robbing trustee boards of the best available talent to serve and benefit other trustees. Over recent years finance and other senior directors have resigned from their trustee board positions to avoid the real issue of negotiating with themselves on funding scheme deficits, especially where the agreement of a

recovery plan is needed. Yet if their replacement is one of their team, the conflicts are even more heightened and pressure, perceived or actual, can be a major influence on decision making. A professional trustee who is not conflicted by concerns around job security or negotiating with superiors, and who has led sensitive negotiations before, is of real benefit in such situations.

Management time is not required until there is a clear plan with potential options set out. Professional negotiation of a recovery plan, with a full audit trail to share with the Pensions Regulator thereafter should any issues be raised after submission, can be undertaken. The experience for the company in entering into discussions with the trustee, led by someone who has done this before, is hugely more positive than the alternative.

A professional trustee is a key player in ensuring that the trustee board has the necessary degree of professionalism needed to fulfill its duties now and in the future. Similarities to the discussion and growth of non-executive board appointments and the professional trustee are real, and the benefits are similar. Equally, sponsors tapping into the pension knowledge which the professional trustee has, if only to act as a sounding board to any

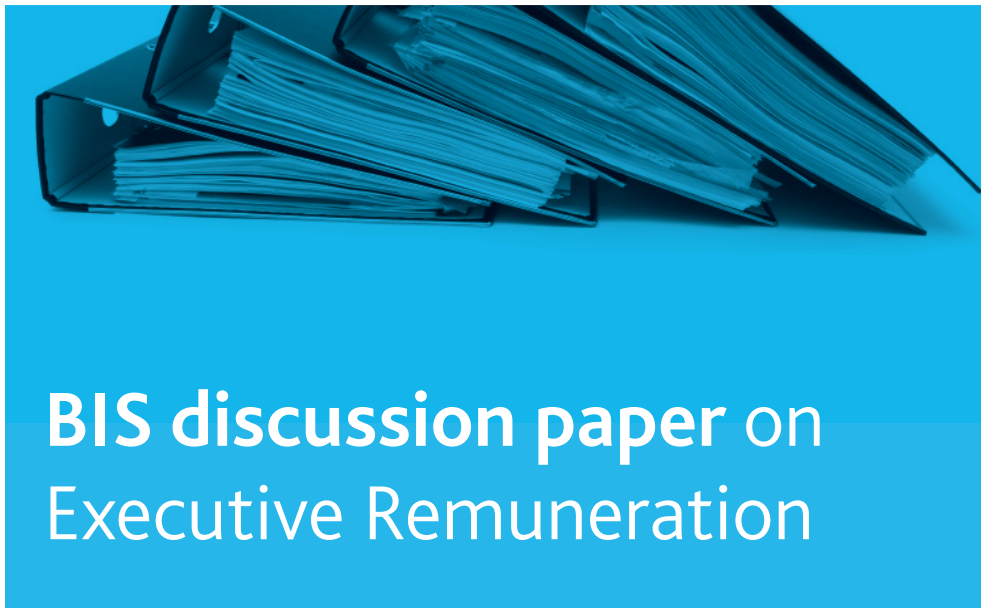
ideas and thoughts, is highly beneficial.

A professional trustee is able to bring a number of benefits to a trustee board and to the sponsor. There is a cost but our experience is that a proactive professional trustee can save both management time and money as well as serve to increase the professionalism of the trustee board. This was reflected by the majority of survey respondents. Pension schemes have been likened to a Pandora's Box, but with a proactive professional trustee in place, both the sponsor and the trustee board are better able to deal with the issues when they appear.

ABOUT THE AUTHOR

Michael Clark, Head of Pension Trusts, Capita Fiduciary Group

* Survey of FTSE350 Finance Directors undertaken by Financial Director Magazine in July 2011 on behalf of Capita Fiduciary Group. Further information and survey results can be obtained from Michael Clark, Head of Pension Trusts, Capita Fiduciary Group, London (email: mclark@capitafiduciary.co.uk)



BIS discussion paper on Executive Remuneration

The controversy surrounding executive remuneration has become increasingly high profile since the financial crisis with shareholders, the Government and the public believing that excessive levels of pay and incentives are unjustified and disproportionate.

To address these issues the Department for Business, Innovation and Skills published a Discussion Paper on Executive Remuneration in September 2011 which proposes a number of measures intended to promote a more transparent and stronger correlation between executive remuneration and company performance. Furthermore, it hopes to enable shareholders to hold companies to account.

The Paper identifies five causal issues relating to the current concerns with executive pay:

- The expansion of large firms has been linked with an increase in CEO pay.
- An analysis of the structure of remuneration provides support for the argument that the move towards trends of variable and deferred pay resulted in executives expecting higher pay for higher levels of risk.
- The additional transparency requirements introduced in 2002 have created competition between firms to pay an increasingly high competitive rate to attract and retain top executives.

“ The Government is ultimately intending to prevent a pay divide between the public and private sector and to show that their deficit cutting plan is as fair as possible ”

- Firms feel they need to pay above the average to attract the top CEOs and avoid such individuals moving away from the UK.
- The structure of remuneration does not incentivise a long-term approach to business and the level of pay often represents excessive reward for the actual performance carried out.

Combined, it has been argued that these issues have resulted in an increasing disparity in pay between senior executives and their employees, aiding the general feeling of dissatisfaction.

The Paper's recommendations for improvement include the following:

- A single cumulative remuneration figure for each director in the Annual Report. This would enable stakeholders to scrutinise and challenge such figures.
- Improved disclosure of the link between pay and performance, the link to pay across the organisation, the process of setting directors' remuneration and remuneration proposals for the year ahead. This would result in additional analysis in the annual report and the need for enhanced research across the relevant sector. This may also result in additional costs. The ICSA believes that payments to directors on termination could be more regularly paid out on a gradual basis rather than by way of a lump sum, with payments ceasing once alternative employment has been found and

that the remuneration committee could be actively involved at the point of departure.

- Enhancement of the quality of information available to shareholders, to make often lengthy and complex remuneration reports more accessible and relevant.
- A proposal for having shareholder representatives on nomination committees. The ICSA does not support this proposal as directors have been appointed by the shareholders to represent the shareholders and it is very unlikely that one shareholder would represent the views of all shareholders.
- The shareholder vote on pay should become binding; a requirement that could make companies more aware of shareholder views and encourage shareholder involvement. This would have significant implications for a company as there might have to be revision of the remuneration proposals in the event of a vote against, and these revisions may require verification from a second shareholder vote. However the ICSA does not believe it would be practical to have the report subject to a binding vote at the AGM or to recoup salaries or other payments already paid. Shareholder engagement in advance of an AGM is a more important factor.

With the average pay for a director of a FTSE 100 company reaching

just short of £2.7 million, the UK Government is also preparing to publish new proposals to curb "unjustified and irresponsible" pay rewards in the private sector. One of the most likely steps to be taken is widening the membership of remuneration committees to include employees. However this would appear to be contrary to the concept of a unitary board. The Government is ultimately intending to prevent a pay divide between the public and private sector and to show that their deficit cutting plan is as fair as possible; there is, however, general consensus that the Conservatives are unlikely to legislate a legal maximum for executive pay in the UK for fear of losing the most talented individuals.

The invitation for responses to this discussion paper closed on 25 November 2011 and we are awaiting publication of the results. The ICSA response calls for a more radical approach to be taken by remuneration advisers and more transparent processes generally, including in relation to the use of advisers, together with the use of KPIs, for example covering the wider set of directors' duties set out in the Companies Act in relation to promoting the success of the business. We will report further once the responses have been published.

ABOUT THE AUTHOR

Samantha Bennett, Assistant Consultant, Capita Company Secretarial Services

ABI releases report on Board Effectiveness



This recently published report is aimed at helping companies to understand the views of institutional investors on board effectiveness by drawing on examples of best practice. This follows the identification of a causal link between the global financial crisis and 'groupthink' in the boardroom. The report focuses on three key areas of corporate governance, covering the lifecycle of a board, namely: board diversity, succession planning and board evaluation.

The ABI's objective is to ensure that boards are effective in generating decisions of the highest quality. With over £1.7 trillion in assets to invest in the insurance industry it is imperative that boards give consideration to such investors' concerns. The ABI reviewed the annual reports of FTSE 100 – 350 companies during the year ends between 1 June 2010 and 30 April 2011 and made the findings outlined below.

Diversity

Following Lord Davies' report, 'Women on Boards', and in preparation for the results of the FRC's recent consultation, the ABI has devoted significant attention to gender balance. The report indicates that gender balance enhances the diversity of perspective, which, in turn, can tackle the scourge of 'groupthink'.

Despite the fact that 47.8% of FTSE 250 companies had no women on their boards, quotas are not the solution. The ABI figures are based on a review of all FTSE 350 company Annual Reports, excluding investment

trusts, between 1 June 2010 and 30 April 2011. The ABI urges that chairmen should ensure that talent is sourced from the widest pool available to ensure that the best candidates are proffered for appointment. The report recommended that companies widen their search remit to include the non-commercial sector and develop the potential of women throughout the corporate pipeline with a view to development to board level.

Furthermore, the ABI identified that 66.7% of FTSE 100 and 86.8% of FTSE 250 companies made no disclosures on diversity and stated that disclosure needs to improve to enable investors to assess whether boards are taking diversity seriously.

Succession planning

The ABI places importance on thorough succession planning, noting that during a disruptive period, a lack of succession planning can have a negative impact on the company's long-term performance and ultimately on shareholder value. Investors are particularly concerned that there is a lack of succession planning for CEOs in view of the fact that the global mean tenure for CEOs has dropped from 8.1 to 6.3 years.

The ABI recommends that companies include senior management as well as members of the board in their succession plans and improve their disclosures by reporting on their strategy, processes and how those plans are kept under review. Such disclosure should be made in

the annual report rather than in a standalone document.

Board evaluation

In line with the findings of the Walker review, the ABI report recognises that board evaluation is an effective way of ousting detrimental boardroom behaviours.

The ABI hopes that companies will report more openly about the outcomes of their evaluations, the methodology used and progress on remedial actions. The ABI stressed that disclosure on evaluation reassures shareholders that the board is continuously re-evaluating its ability to promote the success of the company by reviewing its ability to lead. The ABI is concerned that poor disclosure means that evaluation is of 'poor or average quality' and recommends that external evaluations are conducted by independent parties, prohibiting recruitment consultants previously used by the company.

The ABI intends to convene a round table discussion with companies to discuss the issues and will continue to monitor the quality of disclosure in company statements.

[The ABI report is available online](#)

[The ABI has also issued revised principles of executive remuneration](#)

ABOUT THE AUTHOR

**Sarah Davey, Assistant Consultant,
Capita Company Secretarial Services.**

And finally...

NAPF voting guidelines:

The NAPF revised Corporate Governance Policy and Voting Guidelines 2011 have been published with their intended application to the 2012 AGM season. The introduction to the Guidelines has been modernised to reflect NAPF's endorsement of the Stewardship Code. The revision has also seen the introduction of a new principle encouraging pension funds and asset managers to become signatories.

The topic of diversity has been addressed by NAPF which has requested that boards adopt a policy on diversity and keep its implementation under review. NAPF also stresses that in light of developments in board effectiveness, companies should detail the skills and experience that each director contributes to the role, including any other current appointments that they hold.'

[Guidelines available here.](#)

Join our events:

AGM webinars

A successful webinar took place on 6 December reviewing the results of the first Capita survey into the 2011 AGM season, 2012 AGM planning and voting engagement with 50 clients attending. The next AGM webinar will be held on 28 February 2012 and will include the results of our pre-AGM season investor sentiment survey. Book your place at marketing.registrars@capita.co.uk

If you missed the December webinar and would like a copy of the presentation and the 2011 survey report, contact marketing.registrars@capita.co.uk

Regional seminars for company secretaries – 27 March

As part of our regional programme which has seen Capita Company Secretarial Services host breakfast briefings in Leeds and Edinburgh, we are planning an event in Manchester on March 27 and an event in Bristol in September.

Please register your interest at marketing.registrars@capita.co.uk stating which event you are interested in attending.

Capita/Quoted Companies Alliance governance roundtable - July

The next roundtable discussion in this bi-annual programme for company secretaries and directors of smaller FTSE and AIM Companies will be held in July in the City of London and will discuss recent UK governance developments Book your place at marketing.registrars@capita.co.uk

Contact us

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