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Terms of reference for the remuneration committee

Guidance note

The Chartered
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If you have any feedback on the content of these resources, or additional questions that you'd like to discuss, please contact The Chartered Governance Institute information centre: **020 7612 7035** | **informationcentre@icsa.org.uk**

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Terms of reference for the remuneration committee

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Introduction

This guidance note proposes model terms of reference for the remuneration committee of a company seeking to comply fully with the requirements of the UK Corporate Governance Code, published in July 2018 (the Code). It draws on the experience of company secretaries and is based on good practice as carried out in some of the UK's largest listed companies. The Code is available at www.frc.org.uk.

The model terms of reference are intended as a guide for companies to adapt to their needs. In particular

- Companies with additional primary listing(s) may need to amend the terms of reference in light of additional requirements in the relevant country, in particular the US Sarbanes-Oxley Act 2002.

- Some responsibilities that are relevant to certain companies or sectors only are shown in square brackets.

The guidance notes on terms of reference for all board committees should be read together when allocating responsibilities to the committees. It is important to recognise the links and overlap between the responsibilities of board committees and consequently the need for each board committee to have full knowledge of the deliberations of other committees through reports to the board and, if possible, by appointing at least one member of a committee to each of the other committees.

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The UK Corporate Governance Code

The Code states that

'A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management[1] remuneration should be established.'[2]

It also provides that

'The board should establish a remuneration committee[3] ... with appropriate terms of reference, which should be published on the company website.'[4]

As with most aspects of corporate governance, the company must be seen to be doing all these things in a fair and thorough manner. The Code requires companies to go through a formal process of considering executive remuneration. It is essential that the remuneration committee be properly constituted with a clear remit and identified authority.

1 Footnote 4 to the Code defines 'senior management' for these purposes as the executive committee or the first layer of management below board level, including the company secretary
2 Code Principle Q
3 Code Provision 32
4 FRC Guidance on Board Effectiveness 2018, paragraph 63

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Notes on the terms of reference

The list of duties of the remuneration committee is based on existing best practice from a number of sources. Some companies may wish to add to this list and some companies may need to modify it in other ways.

The Code states that the remuneration committee should comprise at least three independent non-executive directors (or in the case of smaller companies,[5] two). In addition to the independent non-executives, the chair of the board may also be a member of the remuneration committee if they were considered independent on appointment as chair of the board, but may not chair the committee.[6]

The company secretary is responsible for helping the board and its committees to function effectively.[7] The company secretary (or their nominee) should act as secretary to the committee. The committee should also have access to the services of the company secretariat on all remuneration committee matters, including assisting the chair in planning the committee's work, drawing up meeting agendas, maintenance of minutes, drafting of material about its activities for the annual report, collection and distribution of information and provision of any necessary practical support. The company secretary should ensure that the remuneration committee receives information and papers in a timely manner to enable full and proper consideration to be given to the issues.

The frequency with which the remuneration committee needs to meet will vary depending on the nature, scale and complexity of the business of a company and external regulatory requirements, which may change from time to time. It is clear, however, that it must meet close to the year end to review the executive directors' remuneration policy and the directors' remuneration report which quoted companies must submit to shareholders for approval at the AGM. It is recommended that the remuneration committee should meet at least twice a year in order to effectively discharge its responsibilities.

5 A smaller company is defined in footnote 8 to the Code as one which is below the FTSE 350 throughout the year immediately prior to the reporting year
6 Code Provision 32
7 FRC Guidance on Board Effectiveness 2018, paragraph 79

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Model terms of reference

Note: square brackets contain recommendations which are in line with best practice but which may need to be changed to suit the circumstances of the particular organisation.

1. Membership

1.1 The committee shall comprise at least [three] members, all of whom shall be independent non-executive directors. The chair of the board may also serve on the committee as an additional member if they were considered independent on appointment as chair.[8]

1.2 Appointments to the committee are made by the board on the recommendation of the nomination committee and in consultation with the chair of the remuneration committee and shall be for a period of up to three years which may be extended for up to two additional three-year periods, provided members (other than the chair of the board, if they are a member of the committee) continue to be independent.

1.3 Only members of the committee have the right to attend committee meetings. However, other individuals such as the chief executive, the head of human resources and external advisers may be invited to attend for all or part of any meeting, as and when appropriate.[9]

1.4 The board shall appoint the committee chair who shall be an independent non-executive director who should have served on a remuneration committee for at least 12 months.[10] In the absence of the committee chair and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting who would qualify under these terms of reference to be appointed to that position by the board. The chair of the board shall not be chair of the committee.

2. Secretary

The company secretary or their nominee shall act as the secretary of the committee and will ensure that the committee receives information and papers in a timely manner to enable full and proper consideration to be given to the issues.

8 Code Provision 32
9 FRC Guidance on Board Effectiveness 2018, paragraph 64
10 Code Provision 32

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3. Quorum

The quorum necessary for the transaction of business shall be [two].

4. Frequency of meetings

The committee shall meet at least [twice] a year and otherwise as required.[11]

5. Notice of meetings

5.1 Meetings of the committee shall be called by the secretary of the committee at the request of the committee chair or any of its members.

5.2 Unless otherwise agreed, notice of each meeting confirming the venue, time and date together with an agenda of items to be discussed, shall be forwarded to each member of the committee and any other person required to attend no later than [five] working days before the date of the meeting. Supporting papers shall be sent to committee members and to other attendees, as appropriate, at the same time.

6. Minutes of meetings

6.1 The secretary shall minute the proceedings and resolutions of all committee meetings, including the names of those present and in attendance.

6.2 Draft minutes of committee meetings shall be circulated to all members of the committee. Once approved, minutes should be circulated to all other members of the board and the company secretary unless, exceptionally, it would be inappropriate to do so.[12]

7. Engagement with shareholders

The committee chair should attend the annual general meeting to answer any shareholder questions on the committee's activities.[13] In addition, the committee chair should seek engagement with shareholders on significant matters related to the committee's areas of responsibility.[14]

11 The frequency and timing of meetings will differ according to the needs of the company and external regulatory requirements. Meetings should be organised so that attendance is maximised.
12 FRC Guidance on Board Effectiveness 2018, paragraph 65
13 FRC Guidance on Board Effectiveness 2018, paragraph 38
14 Code Provision 3 and FRC Guidance on Board Effectiveness 2018, paragraph 136

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8. Duties

The committee should carry out the duties detailed below for the parent company, major subsidiary undertakings and the group as a whole, as appropriate.

The committee shall

8.1 Have delegated responsibility for determining the policy for directors' remuneration and setting remuneration for the company's chair and executive directors and senior management, including the company secretary[15], in accordance with the Principles and Provisions of the Code.[16]

8.2 Establish remuneration schemes that promote long-term shareholding by executive directors that support alignment with long-term shareholder interests, with share awards subject to a total vesting and holding period of at least five years, and a formal policy for post-employment shareholding requirements encompassing both unvested and vested shares.[17]

8.3 Design remuneration policies and practices to support strategy and promote long-term sustainable success, with executive remuneration aligned to company purpose and values, clearly linked to the successful delivery of the company's long-term strategy, and that enable the use of discretion to override formulaic outcomes and to recover and/or withhold sums or share awards under appropriate specified circumstances.[18]

8.4 When determining executive director remuneration policy and practices, consider the Code requirements for clarity, simplicity, risk mitigation, predictability, proportionality and alignment to culture.[19]

8.5 No director or senior manager shall be involved in any decisions as to their own remuneration outcome.[20] The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association.[21]

15 Code Provision 33. Footnote 4 to the Code defines 'senior management' for these purposes as the executive committee or the first layer of management below board level, including the company secretary. See also FRC Guidance on Board Effectiveness, paragraph 80.
16 See Code Principle P and Code Provisions 33 and 38 to 40. See also FRC Guidance on Board Effectiveness 2018, paragraphs 130-135.
17 Code Provision 36
18 Code Principle P and Provision 37. See also FRC Guidance on Board Effectiveness 2018, paragraphs 133-135
19 Code Provision 40
20 Code Principle Q
21 Code Provision 34

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8.6 In determining remuneration policy, take into account all other factors which it deems necessary including relevant legal and regulatory requirements, the provisions and recommendations of the Code and associated guidance. The objective of such policy shall be to attract, retain and motivate executive management of the quality required to run the company successfully without paying more than is necessary, having regard to views of shareholders and other stakeholders.

8.7 Review the ongoing appropriateness and relevance of the remuneration policy.

8.8 Within the terms of the agreed policy and in consultation with the chair and/or chief executive, as appropriate, determine the total individual remuneration package of each executive director, the company chair and senior managers including bonuses, incentive payments and share options or other share awards. The choice of financial, non-financial and strategic measures is important[22], as is the exercise of independent judgement and discretion when determining remuneration awards, taking account of company and individual performance, and wider circumstances.[23]

8.9 Have full authority to appoint remuneration consultants[24] and to commission or purchase any reports, surveys or information which it deems necessary at the expense of the company. However the committee should avoid designing pay structures based solely on benchmarking to the market or on the advice of remuneration consultants.[25]

8.10 Review the design of all share incentive plans for approval by the board and, where required, shareholders. For any such plans, determine each year whether awards will be made, and if so, the overall amount of such awards, the individual awards for executive directors and senior managers, and the performance targets to be used.[26]

8.11 Review workforce remuneration and related policies.[27]

8.12 Work and liaise as necessary with other board committees, ensuring the interaction between committees and with the board is reviewed regularly.[28]

22 FRC Guidance on Board Effectiveness 2018, paragraph 137
23 Code Principle R and FRC Guidance on Board Effectiveness 2018, paragraph 138
24 Code Provision 35
25 FRC Guidance on Board Effectiveness 2018, paragraph 134
26 FRC Guidance on Board Effectiveness 2018, paragraphs 135 and 137
27 Code Provision 33 and FRC Guidance on Board Effectiveness 2018, paragraph 130
28 FRC Guidance on Board Effectiveness 2018, paragraph 65

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9. Reporting responsibilities

9.1 The committee chair shall report to the board after each meeting on the nature and content of its discussion, recommendations and action to be taken.[29]

9.2 The committee shall make whatever recommendations to the board it deems appropriate on any area within its remit where action or improvement is needed, and adequate time should be available for board discussion when necessary.[30]

9.3 The committee shall provide a description of its work in the annual report in line with the requirements of the UK Corporate Governance Code.[31]

9.4 The committee shall also ensure that provisions regarding disclosure of information as set out in The Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019[32] and the Code are fulfilled, and that a report on the directors' remuneration policy and practices is included in the company's annual report and put to shareholders for approval at the AGM as necessary.

9.5 If the committee has appointed remuneration consultants, the consultant should be identified in the annual report alongside a statement about any other connection it has with the company or individual directors.[33]

10. Other matters

The committee shall

10.1 Have access to sufficient resources in order to carry out its duties, including access to the company secretariat for advice and assistance as required.[34]

10.2 Be provided with appropriate an timely training, both in the form of an induction programme for new members and on an ongoing basis for all members.[35]

29 FRC Guidance on Board Effectiveness 2018, paragraph 62
30 FRC Guidance on Board Effectiveness 2018, paragraph 62
31 See Code Provision 41
32 For detailed guidance on the reporting requirements see GC100 and Investor Group: Directors' Remuneration Reporting Guidance 2019
33 Code Provision 35
34 Code Provision 16 and FRC Guidance on Board Effectiveness 2018, paragraphs 79-85
35 FRC Guidance on Board Effectiveness 2018, paragraph 81

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10.3 Give due consideration to all relevant laws and regulations, the provisions of the Code and published guidelines or recommendations regarding the remuneration of company directors and the formation and operation of share incentive plans, the requirements of the FCA's Listing Rules, Prospectus Rules, Disclosure Guidance and Transparency Rules sourcebook, and any other applicable rules, as appropriate.

10.4 Ensure that a periodic evaluation of the committee's own performance is carried out.

10.5 At least annually, review its constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the board for approval.[36]

11. Authority

The committee is authorised by the board to obtain, at the company's expense, outside legal or other professional advice on any matters within its terms of reference.[37]

36 See FRC Guidance on Board Effectiveness 2018, paragraph 63
37 FRC Guidance on Board Effectiveness 2018, paragraph 83

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