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Consultation response form: The Future of Narrative Reporting

A copy of the consultation available at: http://www.bis.gov.uk/consultations.

Responses to the Consultation by be received by 19 October 2010

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Please tick the box from the following list of options that best describes you:

	Quoted company
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✓	**Investor or investment manager**
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The co-operative
asset management

This submission is made on behalf of The Co-operative Asset Management (TCAM), which carries out the fund management activities of The Co-operative Financial Services (CFS).

The Co-operative Financial Services (CFS) is part of The Co-operative Group, the UK's largest mutual retail business with around five million members, more than £14 billion turnover and core business interests in food, financial services, travel, pharmacy and funeral care. The Co-operative Group has more than 5,000 trading outlets across the UK.

CFS' merger with Britannia, in August 2009, created a strong diversified financial services business with £70 billion of assets, 13000 colleagues and nearly nine million customers.

The Co-operative Group's Governance department was recently shortlisted in the Institute of Chartered Secretaries and Administrators Company Secretary Awards 2010 in the category of Company Secretarial Team of the Year. The team was previously shortlisted in this category in 2008 and won the award for effective shareholder communication in 2007.

About The Co-operative Asset Management (TCAM)

TCAM offers a distinctive responsible investment approach which fully integrates consideration of financial and ESG (environmental, social and governance) issues throughout the investment process.

We consider that sound corporate governance in the companies in which we invest is of central importance to create and sustain long-term shareholder value. We also consider that it is the responsibility of institutional investors to act as owners of the companies in which they invest and we will seek to maximise value from our investments by using our influence as a shareholder, through engagement and the use of our voting rights, to further good corporate governance in investee companies.

We welcome the opportunity to respond to the Future of Narrative Reporting consultation and would be pleased to discuss further the issues raised in our response.

Before turning to our answers to the consultation's specific questions, we would like to make some observations regarding the strategic context in which companies are operating in light of the evolving challenges of sustainability development. Our recent Good Companies Guide analysed the FTSE350 to determine which companies would be positively or negatively affected by

sustainability considerations defined as climate change, resource depletion, pollution, demographics and resource distribution. Our findings included, that the first three ecological factors would have a significant and detrimental impact on over half of the index by weight while only around 10% of current companies were well positioned to benefit from providing solutions.

As an indication of the significance of these issues, in the UK alone, the Green Investment Bank Commission estimated that the financing requirement would be of the order of £550bn to 2020 to meet the UK's commitments under the Climate Change Act 2008. This will imply a radical restructuring of industries including energy, construction and transport and the financial services industry will have a significant role to play, given that government balance sheets have been weakened following the banking system collapse.

Most boards should be considering such issues in their strategic planning now. In our experience the majority of boards are not alive to the challenges and while there are limitations to the Annual Report as a tool for presenting boards' strategic views, the general lack of discussion of short, medium and long-term consideration of sustainability issues presents a mounting concern for the stable functioning of the UK economy and society as well as any potential impact on the ecological system.

Our key recommendations include that there should be far greater emphasis on explanation of the boards strategy and far greater transparency on board training to enable planning around such issues to be undertaken with confidence.

Our response to the specific questions raised in the consultation is outlined below.

Value of narrative reporting

<u>Question 1</u>: Are company directors providing useful and relevant information on the company's:

i) forward-looking strategy and
ii) principal risks and opportunities?

Comments
In our experience, most narrative reporting focuses on the strategy in the year under review or even a re-telling of events rather than a focus on future risks and opportunities. In many cases, the company's forward looking strategy is not clear. On balance, the principal or material risks to the business are more likely to be identified than a forward looking strategy. There are some good examples of companies who are in the vanguard of providing forward looking strategy and identifying the principal risks and opportunities under the guise of their voluntary OFR-type narrative reporting. In our view, corporate social responsibility (CSR) reporting, for example, can tend to focus disproportionately on non-material community investment or boilerplate environmental

initiatives (whether material or not) as opposed to risks and opportunities presented by the sustainability of the company's operations. There is usually insufficient provision of performance data on material non-financial issues. For example, in the case of sectors where carbon emissions are a material issue, such as the oil and gas industry, relatively few companies are disclosing their future strategy on how they will manage the impact of carbon pricing or highlighting the potential risks related to these emissions.

Question 2: What are the constraints on companies providing information on these issues?

Comments

We have identified a number of areas where we believe that the provision of information can be improved:

a) Length of Report

We are conscious of the need for quality over quantity in environmental and social reporting and there may be unintended consequences of the demand for more disclosure and the incentives around sustainability reporting. The recent 'Trends in FTSE 100 sustainability reports' white paper by Spada Research, suggested that companies that write longer sustainability reports are more likely to win environmental awards. In our view, disclosure should focus on the principal and material risks and opportunities to the company. If the OFR is to go ahead, it should focus on a requirement to achieve the right outcomes for the reader of the OFR giving latitude to the companies to lengthen or shorten, rather than prescribe disclosure in detail.

b) Guidance

The market's corporate governance expectations are underpinned by the UK Corporate Governance Code which is explicit in its requirements and applicable to and accepted by all main market listed UK companies (there is an expectation that those who do not comply are expected to explain why not). However, OFR style reporting is by necessity more open ended. The Business Review has not been helped by the lack of sector specific guidance.

Also, the profusion of competing reporting standards in key areas such as greenhouse gas (GHG) emissions can make it harder to report consistently and appropriately. Mandatory regulations for reporting of GHG emissions would provide the certainty in this area that businesses and investors need and we would welcome moves to mandatory reporting by 2012 as outlined in the Climate Change Act 2008. This could form the basis of guidance on the disclosure of risks related to future emissions.

c) Opening themselves up to criticism

We believe that companies may feel that, by including a forward looking statement, they are making themselves a hostage to fortune if their predictions do not materialise, with a consequential impact on the volatility of their share price. However, it is important to make the distinction between a forward-looking projection of issues likely to be important and a profits forecast.

d) Governance Systems

In some companies, a lack of appropriate governance systems can result in an inability to develop appropriate strategy. This includes such factors as senior level oversight and responsibility, appropriate policy, measurement and mitigation approaches.

e) Momentum

For some companies, sustainability issues present genuine challenges to business as usual. Drax is a notable counter-example, where the company is seeking approval to switch from coal to biomass, in recognition of the unsustainable nature of unabated coal use.

<u>Question 3:</u> Does the information provided reflect the issues discussed by the directors in board meetings?

Comments
In our experience, listed companies to not typically report on the agenda, content and minutes of board meetings (save for attendance rates of directors). The limited reporting of board proceedings in annual reports and accounts is unlikely to give an authentic impression of the board meetings. For this reason we are not in a position to say whether the information provided reflects the issues discussed in board meetings. Although there is no ideal solution to this, we believe that independent board evaluations being reported to investors would help close the gap between reporting and reality.

<u>Question 4</u>: Does the information help shareholders to press directors on key issues relating to strategy and risk, or inform their business decisions?

Comments
If the right, material, information is properly presented it can help shareholders such as TCAM to press directors on key issues relating to strategy and risk. However it does greatly depend on the appetite of investors to read the information and use it to question and evaluate companies. We also appreciate that different companies may select different approaches to present their strategies. For example, some companies may chose to present their strategy at a set-piece event (often as a webcast and then archived). At TCAM, we assess disclosure when considering whether to vote in favour of the resolution adopting the Annual Report and Accounts of the companies under review. Our engagement with companies on this subject has so far focused on disclosure, as poor disclosure frequently indicates lack of sensitivity to an issue. We use all available channels of communication – Annual report, CSR/Sustainability report, website, Carbon Disclosure Project etc – when assessing disclosure. We engage where disclosure is poor, which generally indicates an issue is not being managed, and increasingly on performance. Although we remain firm in our commitment to an OFR we caution that those who are asking or responsible for its implementation – principally the Environmental, Social and Governance (ESG) personnel as a subset of the asset management community, the third sector and companies who tend to lead on reporting anyway – place excessive and possibly naïve emphasis on the utility of the Report and Accounts (especially the Report) in everyday investment decision-making. Our own experience and anecdotal evidence suggests the Report is not the prime tool used by investment analysts and fund managers. This is because of two main factors: Firstly, in our opinion, many reports are of poor quality and contain large amounts of non-material and irrelevant information, but secondly and more importantly, because the Report as currently written is not timely. An investment analyst is more interested in following company news flow in real time, through statements to the stock exchange, sell-side research and on-going engagement including meetings with the companies. In our view, the Report and Accounts should provide quality information and strategy, in a forward-looking fashion focused on longer term strategy as well as historic information in order to redeem its status.

<u>Question 5</u>: If a company does not provide sufficient or material information to you, do you challenge it? Is there anything which could help you to do so?

Comments
TCAM is a signatory to the Principles of Responsible Investment (PRI), which is an investor initiative of the UNEP Finance Initiative and the UN Global Compact. The third principle of the Principles states, '*We will seek appropriate disclosure on ESG issues by the entities in which we invest'* and, as a signatory, this is a driver for our engagement and challenge with investee companies. Requests for improved disclosure on ESG issues feature heavily in our voting activities; typically in relation to executive pay (performance conditions, contractual obligations etc) and how a company is managing its material social, ethical and environmental (SEE) issues. We have paid particular attention, when voting on the Annual Report and Accounts of UK companies (where the bulk of our equity holdings are focused), to climate change and diversity disclosure since 2009, abstaining or voting against where disclosure was inadequate and explaining our concerns via letters, emails, phone calls and meetings, along with making

suggestions for improvement.

TCAM's Corporate Governance team is in regular consultation with our larger shareholdings about sufficient disclosure (and the acceptability of that disclosed) so as to reach a solution beforehand and reduce the number of occasions where we feel compelled to withhold support from management.

We also collaborate with other like-minded investors. We will very occasionally resort to tabling a shareholder resolution where we believe a matter of serious concern is not being adequately addressed by the company and where earlier private engagement has failed, as we did at Royal Dutch Shell and BP this year on oil sands.

The provision of an advisory vote on the OFR, which has been mooted to help challenge companies, is discussed further in our response to Q12.

<u>Question 6:</u> What other sources of company information do you use and how valuable are they (e.g. information provided on the website, analysts' briefings, dialogue with the company, corporate social responsibility report)?

Comments

Our analysis of our shareholdings encompasses the entire spectrum of sources of information. However, as noted earlier investment analysts do not rely heavily on the Report and Accounts or sustainability reports for on-going sources of information on the company. Nevertheless, we believe that the act of committing ESG strategy to the public domain is useful to encourage a company to 'nail their colours to the mast' on certain material reporting areas.

As previously mentioned, our experience of CSR reporting, is that it tends to focus disproportionately on non-material community investment as opposed to material risks and opportunities presented by the sustainability of the company's operations.

We consider ongoing dialogue with our investee companies to be of paramount importance and the non-financial information gleaned from them feeds into our stock analysis. We produce quarterly and annual reviews of our engagement with investee companies, which are available here:

http://www.cooperativeassetmanagement.co.uk/advisers/responsible-investment.php

Question 7: Is there scope to reduce or simplify the requirements on which companies report?

Comments
We do believe there is scope to reduce and simplify the requirements on which companies report. When engaging with investee companies, investors look for evidence of high-quality decision making and risk management. In our view, all narrative reporting should be focused on material disclosure of information and particularly material risks and opportunities. In our experience, companies often feel compelled to include information requested from different Codes or stakeholders without being convinced that it brings a clear benefit. A consultation which involves a range of different sized companies from a range of sectors and investors could help identify what requirements could be reduced or simplified. In our view, It would be useful for a company to consider at all stages what they want to achieve by publishing its annual report and what matters to their company and their sector whilst taking into account the wider context. The guidance available should be more robust, with accompanying good practice examples, than that made available for the Business Review. But it should be just that: guidance, meant to help rather than constrain.

Question 8: Is there scope to arrange the information in a more useful way?

Comments
From an investor point of view, we believe that there needs to be more consistency in the style and structure of reporting which will aid comparison between businesses within sectors. 'The Future of Corporate Reporting - State of Play' report which was published by the Tomorrows Company in February 2007, provides some useful pointers as to how reporting can be arranged in a useful way. For instance, it explores financial and non-financial key performance indicators and the holding back of certain elements of Director's performance pay until after the end of the business cycle when the true impact of their leadership became clear. We believe that there is a tendency for CSR reports to focus on the easily reportable and miss the difficult matters which are very obvious but are not discussed or addressed. Any narrative reporting should encourage critical thinking on bigger issues facing the company, the sector and the wider environment. The pitfall of box-ticking is a distraction from providing meaningful information to stakeholders. Finally, the Board should disclose what time horizons they are using when discussing strategy and the disclosure of goals/KPIs.

Business Review

<u>Question 9</u>: Looking at an Operating & Financial Review and the existing business review (see Annex D), do you see value in reinstating elements of an OFR and if so what would they be? In particular, would a statutory reporting standard help to improve the quality of reporting?

Comments
We believe that there is a consensus amongst the investment community that a considerable amount of useful information has been generated on the back of the Business Review. However, it is apparent that we are not yet in a position where the Business Review provides, sufficiently, the kind of data, reassurance or forward looking strategic sustainability information that investors want and need. We regard the OFR as a more thorough-going, strategically oriented standard than its 'lite' version: The Business Review. In our view, it is highly significant that the original OFR, while not perfect, had some support from the companies whom it would have affected as well as from progressive investors, and its abrupt shelving caused dismay. Given the broad consensus that the OFR was sensible, we believe that it should be reinstated on a statutory basis, which would help improve the quality of reporting, particularly amongst reporting laggards rather than placing an unwanted burden on those companies who have led the way in reporting. The International Integrated Reporting Framework is relevant to this debate and is another way in which ESG reporting can be integrated throughout both the narrative reporting and the day to day workings of companies. Essentially, we would like to see ESG considerations woven into the report in a pragmatic way be it the Chairman's statement, Directors Remuneration Report, Internal controls etc. In addition, there is a growing expectation for companies by investors and broader stakeholders in the 3rd sector, to produce credible and verifiable reporting. We place a great deal of value of independent, third party assurance of sustainability and carbon reporting as well as the publishing of assurance statements alongside the report in question. The Carbon Smart report '*Just off the starting blocks – benchmarking of sustainability and carbon assurance in the FTSE350*' found that only 75 of the FTSE 350 companies published an assurance statement in 2009 with the most popular standard of assurance using either AA100AS or ISAE3000. We strongly believe that independent verification, not just on the process involved in compiling the content within the OFR, but whether the contents are a true and fair reflection of reality at the company, should be an outcome of this consultation process. Finally, we believe that the Financial Reporting Council (FRC) has either not been resourced or not emboldened to take action against the many companies who do not even live up to the Business Review (to our knowledge no action has been taken against any company for failing to meet it requirements).

<u>Question 10</u>: The business review provisions require quoted companies to report, to the extent necessary, on:

- **main trends and factors likely to affect the future development, performance and position of the company's business**
- **information on environmental matters**
- **information on employees**

- **information on social and community matters**
- **persons with whom the company has essential contractual and other relationships**

i) is this information useful to you? How do you use it?
ii) Could disclosure be improved? If so, how?
iii) Are there key issues which are missing? If so, please explain?

Comments	
i.	We do believe that the information provided in the business review is useful but that this utility does vary from company to company. The operative words here are "to the extent necessary." If information is material it will be germane and consequently, materiality should always influence the level of disclosure. We have outlined how we use the information in our response to Q2.
ii.	We do believe that disclosure could be improved. For example we strongly support financial and non-financial KPIs. However, companies should focus on the most strategic and material KPIs. The abundance of non-effective KPIs demonstrates that it is neither necessary nor possible to measure everything. There is evidence that, following the introduction of the Business Review the number of companies reporting KPIs has increased with the media sector being particularly strong. The Association of British Insurers offers guidance to its members in relation to voting at General Meetings. One of its assessment areas is what training has been received by directors on environmental and social issues and what the governance arrangements are for managing ESG issues. In our experience, the extent to which ESG issues material to a company's future are understood by board directors varies hugely; even at companies where ESG reporting, such as through Sustainability Reports, is extensive. It follows that directors, particularly executives and Chairpersons who have a thorough understanding of ESG issues are more likely to drive management of the attendant risks and capitalise on the opportunities throughout the company.
iii.	There are some key issues which are not currently reported in the business review. We have outlined three areas where we believe disclosure could be improved: ▪ Directors training on ESG matters – it would be both instructive and an incentive for improvement, if companies were required to disclose whether directors received training on ESG matters (for example whether the CEO sits on the HSE or Risk Committee) and crucially whether any element of executive of sub-executive pay is subject to performance on environmental, social, health and safety issues and how this operates. ▪ Biodiversity – we believe that many companies are failing to report on their impacts and dependencies on ecosystems. ▪ Conflicts of interest – it would be insightful to understand how companies deal with certain conflicts of interests: for example where directors' duties to shareholders may be at variance with the requirement on companies under The Companies Act 2006 to consider their impacts on other stakeholders. Again, this touches on having good governance and whistle blowing arrangements.

Question 11: Would more guidance be helpful? If so, what form should this take? For example, best practice example, sample Key Performance Indicators, etc?

Comments
As previously outlined we would welcome more guidance which centres on best practice in action. We consider the following links to reports to be very helpful in respect of sector specific KPIs: http://www.sd-m.de/files/SD-KPI_Standard_2010-2014_V12e.pdf http://hausercenter.org/iri/wp-content/uploads/2010/05/IRI_Transparency-to-Performance.pdf http://www.dvfa.de/files/die_dvfa/kommissionen/non_financials/application/pdf/KPIs_for_ESG_Exposure_Draft.pdf

Question 12: Should there be a shareholder's advisory vote on the Business Review?

Comments
We do believe that the directors' remuneration report has undoubtedly increased the quality and depth of dialogue as well as transparency of remuneration disclosure. However it falls down in respect of having specific redress. We believe, therefore, that the key question to ask when considering an additional resolution covering the Business Review is what consequences arise from it being voted down? Furthermore, unless shareholders write to the company to say they have abstained or voted against the discussion cannot be opened and the company cannot know the cause of the shareholder concerns. This would be compounded in the case of a vote on the OFR, as it would be an imprecise signal - the OFR covering so many issues. Any voting activity should be complemented with engagement as voting as a stand alone activity is too blunt an instrument. Being realistic, shareholders will not always communicate the rationale behind their voting decisions. Consideration could however be given to a shareholder's advisory vote on the company's reporting of ESG matters which would be applicable to some degree to all companies and be a reasonably precise signal in the absence of being able to require all investors to vote and communicate their reasons why (which incidentally, would bring its own unintended consequences). In conclusion, we are not in favour of an advisory vote on the Business Review or the OFR, not because we are against shareholder democracy and transparency but because this particular measure is likely to fall short of its goal as currently constructed. An advisory vote on the reporting of environmental, social and governance matters would be a superior alternative. For those investors who are unhappy with narrative reporting other than ESG matters, they may still withhold support from or vote against the Annual Report and Accounts.

Question 13: Are there non-regulatory solutions to increasing quality through better guidance or publicising excellence in business reports? If so, what?

Comments

We do not believe that there is a non-regulatory solution to increasing quality in business reports. Our experience is that a voluntary approach results in 'best in class' reporting by the companies who are already in the vanguard but the majority will not rise to the challenge. A mandatory and regulated OFR will likely help drive up standards of the 'average' while there will always, by definition, be laggards.

For example, considering carbon reporting for example, while the majority of FTSE 350 companies report Greenhouse Gas emissions (GHG), there are still a number do not, even though there is ample evidence that investments in monitoring are generally repaid multiple-fold in cost savings through enhanced efficiency. In such circumstances mandatory approaches that force director attention and understanding are in the companies' best interest.

Directors' Remuneration Report

<u>Question 14:</u> Do the current disclosure requirements provide clear and usable information about:

- **the total remuneration paid to directors, and how this is made up;**
- **the performance criteria for payments to directors, and how these relate to the company's strategic objectives;**
- **company performance against these criteria, so that there is a demonstrable link between pay and performance.;**
- **the process by which directors' remuneration is decided?**

Comments

- **Total remuneration paid and how this is made up**

On the whole the level of disclosure relating to total remuneration paid is sufficient with the exception of various event driven payments and pensions.

Event driven examples can relate to such things as change in control and termination provisions for directors. Each is deemed of importance due to the implication of perverse incentives in both. Large payments on a change of control can effectively indemnify directors for poor M&A strategy or at worse, incentivise decision making that is entirely incongruous to the long-term interests of shareholders. Disclosure here is typically lost between events, as the provisions are only invoked when a Company is acquired and therefore no longer required to report such information.

A similar theme relates to termination payments. The levels of discretion non-executive directors have in determining whether an executive is a good-leaver or otherwise is problematic. Given the uncertainty regarding the nature of the circumstances prevailing when a director leaves a company there is tremendous potential for significant reward for failure as things stand. This again gives rise to perverse incentives as having such significant indemnity may alter the psychology / decision making of management. For example, there is arguably an insurance policy (in some cases) for directors to take on disproportionate levels of risks to meet highly charged bonus targets, all the while knowing that if things go wrong their personal wealth is insured. Further disclosure relating to the nature of departure and how this equates to the payments made on departure would certainly help. Additionally, further information on how discretion has been applied in relation to mid performance-cycle share awards when pro-rating is applied for time and performance would aid transparency.

Disclosure relating to pension arrangements is typically the most opaque element of executive pay and is currently not effectively captured under the Directors Remuneration Reporting Regulations (DRRR). This lack of clarity is problematic given the huge potential for reward for failure with *enhanced* or *preferential* treatment for directors. We believe there is need for greater clarity in the following areas:

- Disclosure of accrual rates to be standardised and to explain any divergence from the employee-wide scheme
- Explanations in respect of preferential treatment in respect of contributions to defined contribution schemes. Again explanations to be required where this is a significant divergence from the employee-wide scheme
- The normal retirement age for directors under all pension schemes
- To what extent the remuneration committee can exercise discretion to provide early unreduced pension benefits

- **The performance criteria for payments to directors, and how these relate to the company's strategic objectives**

Disclosure relating to performance conditions for payment to directors is of fundamental importance to the veracity of pay-for-performance policies espoused by Companies. While it is clearly important to have confidence in the information provided on performance conditions, those chosen can be significantly undermined if they bear no resemblance or alignment with the strategic imperatives identified in the Business Review. It is a common phenomenon to find 'off the shelf' performance share plans with conditions entirely dislocated from a strong range of Key Performance Indicators (KPIs) in a Company's Business Review.

We believe that there should be a much greater link between a Company's strategic considerations that lead to the identification of KPIs and those considerations that lead to identifying targets under management incentives. Proponents of the abolished OFR like ourselves had seen it as a framework to link objectives, strategy and KPIs with executive remuneration. Much in the same way as the Business Review ought to describe effectively both the operational developments during the year as well as the financial, we believe that performance targets should be relevant to a company's financial and non-financial performance. It is logical therefore for consideration to be given to the inclusion of companies' sustainability objectives among the performance targets for the vesting of shares under long-term share schemes. Director leadership on such issues is crucial so that the importance of the various objectives filters through an organisation; alignment with management incentives underlines the importance of their leadership on long-term sustainability goals.

A recent development that is increasingly problematic is the use of *adjusted* calculations for the purpose of reflecting 'underlying' performance. This is most frequently applied to Earning per Share (EPS) targets. In any one annual report one can be confronted with a multitude of different EPS figures, whether the basic accounting standard 'base' EPS figure, an EPS figure to be presented in the Business Review or an entirely different EPS figure for the purposes of determining variable rewards. The use of adjusted EPS for remuneration is problematic unless the disclosure is able to sufficiently describe and justify the specific accounting items over which discretion has been applied. This is just as problematic under capital efficiency measures such Return on Capital Employed (ROCE) which arguably has a greater and more opaque margin for discretion to be applied. At a FTSE100 retailer we recently identified a significant differential between Business Review ROCE and remuneration report ROCE. The problem is no explanation or specific accounting calculation information was provided. For shareholders to have confidence in the veracity of information provided for performance targets we advocate stronger disclosure requirements concerning the calculations applied for the purpose of determining awards and where there is material divergence from other calculations across the annual report, for explanations to be provided.

- **Company performance against these criteria, so that there is a demonstrable link between pay and performance**

A positive step witnessed across the FTSE has been for slightly more Companies to describe how strategy objectives chime with and justify the structure of variable pay components. Despite this the majority of Companies still make no genuine reference to how different strategy objectives will be incentivised by different remuneration components. In this spirit we would advocate the formalisation of a section under the DRRR detailing these important considerations.

It is logical that such strategic grounding could form the foundation for disclosure that details how the performance provided during the year justifies the variable award that vested during the year. There is need for significant improvement in the level of retrospective disclosure of performance under annual bonus schemes that led to awards being granted for the year under review. It is still the case that some Companies provide no information to justify large annual bonus awards.

In our view, past targets are no longer commercially sensitive; therefore, given the magnitude of award and importance to overall incentives, shareholders should be provided with quantitative information of performance that triggered any award next to the target set.

- **The process by which directors' remuneration is decided?**

The process toward developing and implementing remuneration policy has to start by populating the remuneration committee with a majority of independent non-executive directors. As things stand investors are able to determine the level of independence on the Committee. So where would further clarity augment shareholders ability to determine the suitability of award decisions?

We believe this relates to a) applications of discretion in the decision making process and b) much more detailed explanations of consultation processes undertaken during the year when launching new shares schemes or material amendments to performance targets.

a) Applications of discretion: it is a common occurrence that remuneration committees' apply discretion in determining vesting levels under share schemes or bonus awards to more effectively reflect 'underlying' performance. It is common that this is used in instances where the specific targets had not quite been met but that there were exceptional circumstances or reasons why certain amounts should vest. However, in these cases, it is common for very little supporting information to be provided to shareholders to justify the decision. We would therefore advocate that in cases where targets are not hit and discretion is applied that an explanation of the specific circumstances should be mandated.

b) Explanations of consultation processes: often the fundamental changes and decision making occurs during consultation processes. However, it is often that shareholders are involved at the final stage once plans having been significantly written up. To simplify, the process largely goes:

   1) what do we want to achieve and how will we incentivise with pay;

   2) speak to employees, what would help keep you incentivised, feedback into process;

   3) draw up proposal and;

   4) present to major shareholders via consultation with only minor margins available for change.

We believe that the ex-post nature of this process ought to be replaced with initial input from shareholders on an ex-ante basis within stage one. This will help align shareholders with the underlying premise of changes and help them to feedback on proposals more effectively. In terms of disclosure of consultation processes Companies currently provide little information other than that top shareholders had been consulted and they are 'broadly supportive'. This is problematic as there is no means of collating responses for shareholders to know if there is a genuine accord on the proposals. We advocate moving away from a divide and collate system and suggest Companies disclose more detail about the different stages involved, the amount of shareholders consulted, how many responses they received, how many were positive or negative, changes that were implemented as a result of the process etc. We would support naming the institutions involved and their level of satisfaction with the proposals as this would increase accountability on investors to be effective stewards and feed into proposals for the disclosure of voting decisions.

Finally, we strongly support annual re-election for all directors of listed companies to improve accountability.

Costs

Question 15:

If you can provide any information on costs associated either with the existing narrative reporting requirements e.g. preparing your business review or your views on potential costs and benefits in relation to any of the ideas in this consultation, please give details

Comments
We appreciate that there is a cost of compliance. However if the OFR is based primarily around ensuring the right reporting outcomes are achieved and less with prescribing in detail how this must be achieved i.e. erring towards a principles-based approach then the cost of reporting should in most cases be proportionate to either the size of the company, or the risks and opportunities it faces or both; all of which are acceptable outcomes. The Company Secretary is well placed to coordinate and invaluable in the preparation of narrative reporting.