



THE
HIGH PAY
COMMISSION

What are we paying for? Exploring executive pay and performance

About The High Pay Commission

This report has been prepared by **Incomes Data Services (IDS)** for the **High Pay Commission**.

This report has been researched and written by:

Steve Tatton
Adam Elston
Jessica Matthews.

Incomes Data Services
Finsbury Tower
103-105 Bunhill Row
London
EC1Y 8LZ

Telephone: 0845 077 2911
Facsimile: 0845 310 5517
E-mail: ids@incomesdata.co.uk
Website: www.incomesdata.co.uk

The High Pay Commission is an independent inquiry into high pay and boardroom pay across the public and private sectors in the UK. The Commission was established by Compass with the support of the Joseph Rowntree Charitable Trust.

The Commission is independent from any political party or organisation. It is non-partisan in its approach and will draw conclusions based solely on the findings of the Commission.

Over the last 30 years pay at the top has increased, and pay differentials have grown. The Commission provides an opportunity to explore and understand the drivers behind this trend and to look at its effects. It will also seek to look at reforms that could to mitigate or reduce this trend.

The Commission will run for one year from November 2010.

For more information visit:
www.highpaycommission.co.uk

@highpaycom

Foreword

The total earnings for the top-paid director at BAE Systems have increased by more than 8,000 per cent since 1978 when the company was called British Aerospace. That compares to a rise of 556 per cent in median male income over the period.

Many factors have driven up pay at the top, but one of the most important when it comes to directors' pay has been the mantra that rewards must be linked to company performance.

"It's a factor," said John Cridland, director general of the CBI employers' group in April. "Business has to show high levels of remuneration are payment for results. It's not payment separate from the achievement of senior executives." Since the 1980s, corporate governance reforms have all tried to align directors and shareholders' interests by linking pay to performance.

However, as we show in this latest report prepared for the High Pay Commission by Incomes Data Services, there is rarely a link between directors' incentives and the way a company performs. In the past 10 years, the average annual bonus for FTSE 350 directors went up by 187 per cent and the average year-end share price declined by 71 per cent.

Many companies that have not survived over the period paid above the odds to their directors. This is no more evident than in pay at the bailed-out banks where rewards were much higher than the norm.

Pay for performance has added to the staggering complexity of executive packages and yet there is no clear evidence that it works.

Boards need to think again about how to structure their pay awards.

**Deborah Hargreaves,
Chair of the Commission**

Contents

6	Executive summary
9	1 Introduction
10	2 How did we get here?
18	3 Paying for boardroom performance: the evidence
22	4 What has happened to annual bonus payments?
25	5 Long-term share-based incentive performance trends
27	6 Changes in numbers receiving incentives
28	7 Do incentives help long-term survival?
32	8 Pay for performance in finance
38	Appendix i: survey details
39	Appendix ii: definitions

Executive summary

Since the mid-1990s there has been a strong drive towards 'pay for performance' that has dominated corporate governance culture.

Boardroom remuneration policy has been to:

- Align the interests of directors and shareholders by emphasising share incentive schemes and share ownership.
- Incentivise senior executives by increasing the proportion of total earnings coming from incentive schemes.

This trend has led to huge increases in performance-related remuneration and means that what passed as a maximum bonus in 2002 is lower than what a director would receive today for meeting basic targets.

- For on-target performance FTSE 100 lead executives received a bonus worth **48 per cent of salary at the median in 2002.**
- For the same level of performance, a FTSE 100 lead executive bonus was worth **90 per cent of salary at the median in 2010.**
- In 2002, the median maximum grant of shares that a FTSE 100 lead executive could be awarded was **100 per cent of salary.**
- By 2010, the median maximum grant for a FTSE 100 lead executive had **risen to 200 per cent of salary at the median.**

This increase in variable pay has not come at the expense of absolute rises in salary: **salary levels have increased 63.9 per cent over the decade.**

PAY AND COMPANY PERFORMANCE INDICATORS

Variable elements directors' pay typically includes an annual bonus, a share option scheme and a Long Term Incentive Plan (LTIP).

All the components of boardroom pay, with the exception of share option gains, increased at a faster rate over the last 10 years than corresponding measures of corporate performance.

- Salary growth bears no relation to either market capitalisation, earnings per share (EPS) or pre-tax profit.
- There is no or little relation between the total earnings trend and market capitalisation.
- A slightly closer relation seems evident between total earnings, pre-tax profit and EPS, but they do not mirror each other exactly and the trend diverges significantly during certain periods, most particularly during the last few years of recession.
- 25.3 per cent of FTSE 100 companies use EPS as an indicator to determine bonuses but this report shows that whatever is driving bonus levels, it is not EPS.

While during the crisis there was a dip in total pay it has not taken long for directors' earnings to resume 'business as usual'.

- Even at the deepest point of the latest recession, when pre-tax profit was at its lowest point, the lowest bonus level was still 134 per cent higher than in 2000.
- The post-crisis recovery in earnings has matched or outpaced most indicators of corporate recovery.

There has been spectacular growth in the average value of **LTIP awards, which have gone up by over 700 per cent since 2000.**

- This growth seems out of proportion to any change in stock market measures.
- Year-end share prices have fallen dramatically; market capitalisation has barely improved while there is a **640 index point difference between the growth in LTIP awards and EPS.**

In both good and bad times, the majority of directors continue to receive a performance-related bonus.

- Annual bonus payments are the most common type of award received, with proportions over **the 10 years varying from 76.3 per cent receiving bonuses in the early noughties to as high as 95 per cent in 2010.**
- The proportion of directors receiving LTIP awards has increased dramatically, **from just 16.7 per cent of all FTSE 350 directors in 2000 to over half in 2010.**

SURVIVORS AND NON-SURVIVORS

While the data casts serious doubt on any claim that there is a relation between incentives and corporate performance, it does not tell the whole story. Another dimension of pay for performance has to be the long-term health and survival of the company.

Although only an indicative measure 'non-survival' does signify that incentives have not secured independent long-term survival of a company.

- Of 757 companies that have featured in the FTSE 350 over the decade, just 124 or **16.4 per cent of the total have remained on the index since 2000.**
- Since 2000, the **average value of LTIPs in survivors has gone up by 488 per cent**, but the average value of LTIPs received in non-survivors has gone up by **1,476 per cent.**

FAILURE IN FINANCE

Nowhere is there a clearer example of corporate failure than in finance. Looking at the banks as a case study in assessing whether pay has been effectively linked to performance we know:

- Average total earnings in the state supported banks were just under £4 million in 2010, compared to £1.7 million in 2000, **a difference of nearly 130 per cent, over the period.**
- Earnings in state-supported and bailed-out at banks far outstrip those on offer in the rest of the FTSE 350 and in non-state supported banks.
- Average basic salaries in these banks are more than double the salaries in the rest of the FTSE 350 and 2010 total earnings, at an average of **£3.7 million, were more than £1.7 million ahead of earnings on offer in non-state supported FTSE 350 banks.**
- Finally, looking at those three banks which, in 2008, were recipients of a £37 billion new capital bail-out (HBOS, Lloyds Banking Group and Royal Bank of Scotland) **chief executives, have, except for 2008, been paid at rates far higher than both FTSE 350 lead executives and non-supported FSA-defined banks.**

Based on this evidence it is clear that the drive to link executive pay to performance in publicly listed companies cannot be said to have been successful. We have witnessed massive growth in performance related pay and yet no such corresponding leap forward in company performance.

1 | Introduction

“Ridiculous levels of remuneration are going unchallenged as the norm, when there is no clear evidence of a correlation with performance.”

Vince Cable, Secretary of State, Department for Business, Innovation and Skills (BIS)

Pay for performance has long been the watchword of executive compensation design and over the years the sums received by board directors from incentive schemes have increased significantly. Like the rest of the corporate world, banks such as Northern Rock, HBOS and RBS enthusiastically embraced the pay for performance culture, but in the wake of their dramatic failures the question is raised all the more urgently whether the generous incentive schemes that top directors participate in really do improve company performance.

Incomes Data Services (IDS) has been asked by the High Pay Commission (HPC) to investigate the relationship between the compensation of FTSE 350 executive directors and key measures of corporate performance. The IDS Executive Compensation Review team have been monitoring annual accounts since 1990 and producing a comprehensive annual report of FTSE 350 directors pay since 1998.

From our records, we have compiled a detailed dataset of executive director compensation for companies with year-end dates between 2000 and 2010. To feature in the dataset, the executive directors must have served a full-year and altogether we have captured some

11,907 annual remuneration records, although the sample includes individuals who have served on the same board over several years. Our dataset includes all the main elements of compensation: salary, benefits, annual bonus, long-term incentive plan (LTIP) payouts and nominal gains following the exercise of share options. In our calculations, salary plus benefits and annual bonuses are combined into a total cash figure, while total cash plus the value of 'crystallised' LTIPs and options are combined into total earnings.

Corporate performance measures have been supplied separately from our sister company Thomson Reuters DataStream. The performance measures have been matched against the year-end dates of the annual accounts that feature in our executive compensation database. The measures supplied include: market capitalisation; earnings per share (EPS), pre-tax profit; earnings before interest and taxation (EBIT); earnings before interest, taxes, depreciation and amortization (EBITDA) and underlying pre-tax profit. Company turnover figures have been taken from our own database.

2 | How did we get here?

In 1978, the reported earnings of the top paid director at British Aerospace was just £29,000. By 2010, the salary, benefits plus bonus of the highest paid director at BAE Systems, the company British Aerospace has evolved into, was £2,363,000. Over the period, that represents a pay increase, excluding share-based incentives, of 8,048 per cent, which compares to a corresponding rise since 1978 of 556 per cent in the median earnings of all UK full-time male employees. While BAE Systems is just one company, the scale of the changes captures the process by which boardroom compensation has got from there to here – why there has been growing public disquiet about what has happened to directors' remuneration. But the story is not just about higher pay increases; it is also about growing complexity in the structure of compensation packages. It is also the story of how shareholders are now the only players in the corporate governance game and how a 'pay for performance culture' has come to dominate thinking about executive reward.

In many ways 1979 was year zero as far as directors' remuneration in the UK is concerned. It is widely recognised that the 1970s represented a significant squeeze on pay differentials, but 1979 brought in a new Government and a new attitude to top pay. The new Conservative administration set the tone for executive remuneration policy for the next decade by immediately dropping the top marginal tax rate from 83 per cent to 60 per cent.

The 1988 Budget went even further by abolishing the 45, 50, 55 and 60 per cent rates and leaving a single top rate of 40 per cent. Earlier in 1984 it had backed up its desire to foster an 'enterprise culture' by introducing tax privileges for executive share option schemes. It was from this moment on that share-based incentives took-off and by the end of the decade share options were a standard part of executive compensation.

GROWTH IN CORPORATE GOVERNANCE

It was from the Conservative's very first Budget that the steady rise in executive compensation began, gathering pace as the decades wore on. But by the end of the 1980s and the onset of recession in 1990 the tide began to turn, when both the public and members of the Government started to express concerns about executive excess at a time when many employees were either losing their jobs or being told they must accept pay restraint.

Recession also had another impact – it kick-started the development of formal corporate governance codes in the UK. The early 1990s was when the UK experienced its own Enron moment, when stock market stars BICC and Polly Peck crashed and burned. It turned out that their accounts did not tell the whole truth and nothing but the truth and left shareholders who lost money believing

they were misled. The diagnosis at the time was that the directors of these companies were able to engage in such sharp practices because the UK had a poor corporate governance environment. In response, Sir Adrian Cadbury was asked in 1991 to come up with the first formal corporate governance framework for the UK. The final report appeared in December 1992 and the principals articulated at that time have guided corporate governance ever since. These are:

- accountability to shareholders;
- a greater role for non-executive directors;
- transparency;
- comply or explain;
- voluntarism.

While much of the emphasis of Cadbury was on audit, directors' remuneration was also a central concern. One of the key recommendations has had lasting effects, that: 'Boards should appoint remuneration committees, consisting wholly or mainly of non-executive directors and chaired by a non-executive director, to recommend to the board the remuneration of the executive directors in all its forms, drawing on outside advice as necessary.'

At the time, it was hoped that publishing the data on how much directors are paid coupled with an explanation of why it was paid would take the heat of the debate

on 'executive excess', especially if it was thought to be decided by 'independent' non-executives. But the prognosis turned out to be premature as concerns about 'fat cat' directors resurfaced in the mid-1990s fuelled by some big pay rises for the executives of the recently privatised utilities such as British Gas.

Once again the answer was a committee to come up with a code of best practice headed by a top business leader, this time Sir Richard Greenbury of Marks and Spencer. Reporting in 1995, Greenbury accepted and built on the principles laid down by Cadbury, but emphasised two further key themes that shaped future executive compensation practice. These were:

- pay for performance;
- alignment of shareholder and directors interests.

Like Cadbury, however, Greenbury's code of best practice failed to stem the tide of criticism and further committees were set up to make more recommendations and finally the new Labour administration amended company law in 2002 putting some remuneration disclosure requirements on a statutory footing.

But whatever the committee or code of practice, Cadbury has set the pattern for UK corporate governance. When a concern arises, whether the range of non-executives on boards is drawn from too

narrow a constituency (Higgs) or whether there are insufficient women serving as directors (Davies), policy makers turn to corporate governance guidelines and accountability to shareholders when seeking an answer.

TRENDS IN DIRECTORS' COMPENSATION PACKAGES

Today's boardroom compensation practice has been largely shaped by the corporate governance environment, with pay for performance and the alignment of directors' and shareholder interests in particular driving the changes of the last two decades. In summary, key trends have included:

- a shift in the balance between fixed and variable pay in response to a desire to increasingly 'incentivise' directors... but not at expense of salary
- a growing complexity of incentive arrangements with several schemes that often have overlapping aims and targets
- ever increasing potential maximum payouts from incentive schemes with more directors receiving incentives of higher value
- double digit earnings growth

But while corporate governance is a major influence on the structure of directors' remuneration, it is not the only factor. Globalisation and the development of an international market

for executive directors has also been said to have pushed up UK boardroom pay levels. Because of the pressure to create shareholder value there has also been an increase in the demands on executive directors to deliver. The result, as our own research has shown, is a shortening in the tenure of directors on UK boards, with the average time in post now lasting just five years. In this environment, where tenure is result driven, the tendency is to bid up the pay of those individuals who are seen to deliver. Compensation benchmarking is also seen as a factor driving up remuneration with investors warning against the ratcheting up affect of companies wanting to be upper quartile payers.

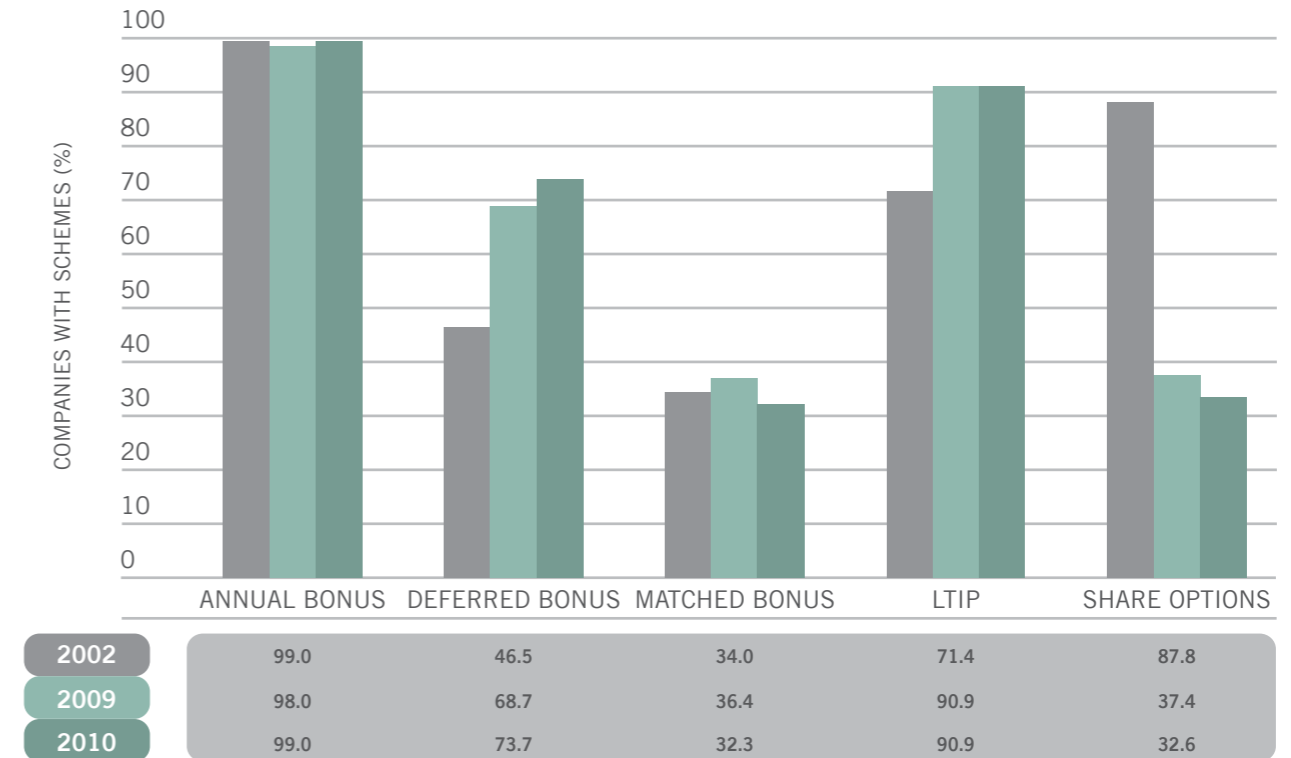
COMPONENTS OF DIRECTORS' PAY

Over the last two decades, incentive schemes have become more elaborate in design and the range of plans delivering awards has grown in number. The days when directors simply received a salary, benefits plus annual cash bonus are long gone. In both the FTSE 100 and mid-250, remuneration committees have developed a mix of fixed and variable reward vehicles, each designed to achieve different objectives and follow different payment cycles¹.

The total remuneration arrangements for current directors could include:

- base salary;
- benefits;

GRAPH 2.1 PROPORTION OF INCENTIVE SCHEMES IN FTSE 100 COMPANIES 2002 TO 2010



- short-term incentive, such as annual bonus;
- medium-term incentive, such as deferred and matching shares;
- long-term incentives consisting of performance shares, share options or both running concurrently;
- self/co-investment plan
- pension

Additionally, over the last few years pension cash supplements have started to increasingly feature in remuneration packages, sometimes as part of a salary sacrifice arrangement.

KEY INCENTIVE TRENDS

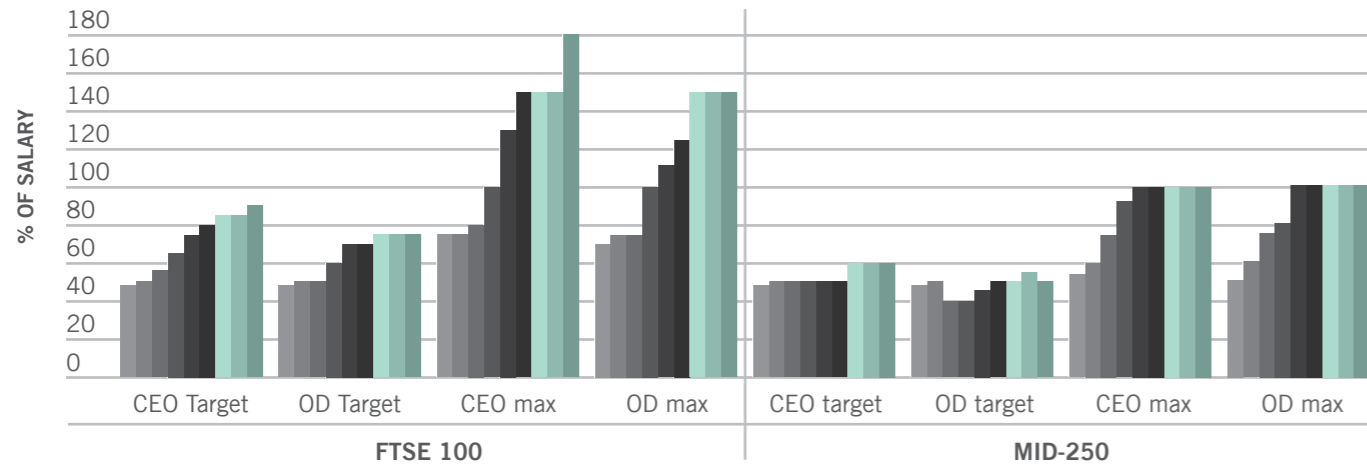
Since the mid-90s, several key incentive trends have been evident.

- a decline in share options as the long-term incentive of choice and the corresponding rise in the popularity of performance share plans (PSP), alternatively known as long-term incentive plans (LTIPs);
- a steady increase in incentive scheme maxima;
- an evolution of annual bonus schemes into medium-term incentive plans involving deferred and matching shares;
- a steady decline in the proportion of total remuneration coming from fixed pay ie basic salary and benefits;
- a consequent increase in the value of total earnings as a result of higher incentive payments.

The shift in the balance of incentive scheme practice can be seen in the graph above.

¹ Please note, this report uses the terms 'lead executive' and 'CEO' interchangeably, while 'OD' refers to all other executive directors. See Appendix II for further details.

GRAPH 2.2 BONUS ON-TARGET AND MAXIMUM THRESHOLDS FOR FTSE 350 DIRECTORS 2002 TO 2010



	FTSE 100	MID-250
2002	48, 48.3, 75, 70	40, 40, 54, 50
2003	50, 50, 75, 75	50, 50, 60, 60
2004	56, 50, 80, 75	40, 40, 75, 75
2005	65, 60, 100, 100	40, 40, 93, 80
2006	75, 70, 130, 111	50, 46, 100, 100
2007	85, 70, 150, 125	50, 50, 100, 100
2008	85, 75, 150, 150	60, 50, 100, 100
2009	85, 75, 150, 150	60, 55, 100, 100
2010	90, 75, 180, 150	60, 50, 100, 100

RISE IN BONUS SCHEME PAY THRESHOLDS

An indication of scale in the increase in annual bonus on-target and maximum thresholds can be seen in the graph below. As **Graph 2.2** demonstrates, both the on-target and maximum levels have increased so that what passed as the maximum bonus in 2002 is lower than what a director would receive today for on-target performance. Key points include:

- for on-target performance FTSE 100 lead executives received a bonus worth 48 per cent of salary at the median in 2002;

- for the same level of performance in 2010, a FTSE 100 lead executive bonus was worth 90 per cent of salary at the median;
- in 2002, the median bonus for maximum performance for a FTSE 100 lead executive equalled 75 per cent of salary;
- by 2010, maximum performance for a FTSE 100 lead executive commanded a bonus worth 150 per cent of salary at the median;
- although less spectacular, similar increases in bonus thresholds took place for other FTSE 350 directors.

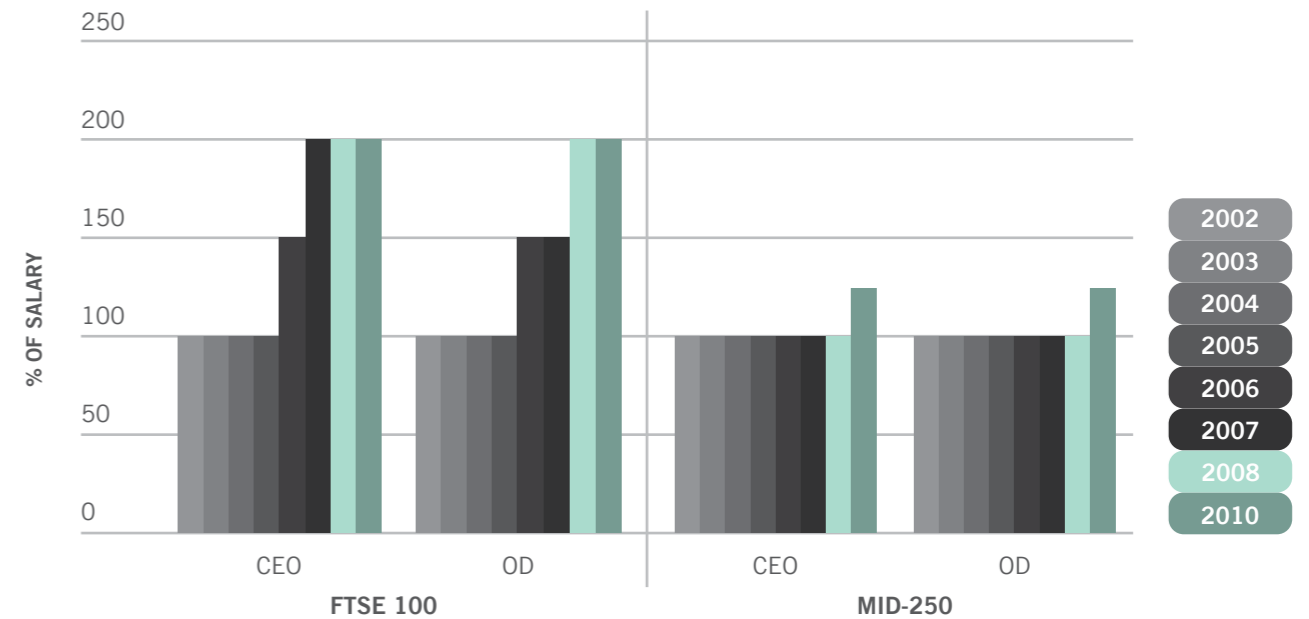
RISE IN LTIP GRANT THRESHOLDS

It is not just annual bonus thresholds that have increased since 2002. As **Graph 2.3** shows, the median maximum value of LTIP share grants that can be awarded to FTSE 350 directors, expressed as a percentage of salary, has risen over the last eight years. Key points include:

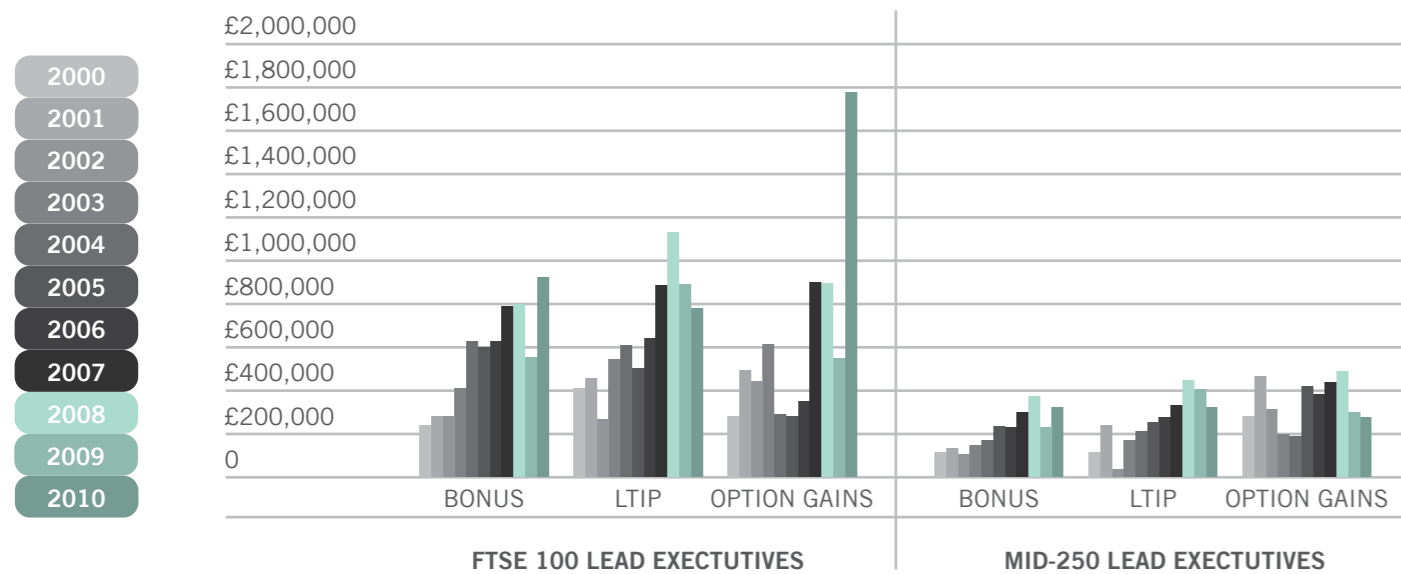
- in 2002, the median maximum grant of shares that a FTSE 100 lead executive could be awarded was 100 per cent of salary;

- by 2010, the median maximum LTIP grant for a FTSE 100 lead executive had risen to 200 per cent of salary;
- there was a corresponding rise in the LTIP ceilings for other FTSE 100 directors;
- a similar, but less spectacular increase was evident in the FTSE 250.

GRAPH 2.3 MEDIAN MAXIMUM LTIP GRANT LEVELS FOR FTSE 350 DIRECTORS 2002 TO 2010



GRAPH 2.4 MEDIAN INCENTIVE PAYMENTS OF FTSE 350 LEAD EXECUTIVES 2000 TO 2010



RISE IN MEDIAN VALUE OF AWARDS FROM ALL INCENTIVES

As a consequence of these trends the median value of the incentive payouts received has increased, as illustrated by the graph above. Not only have the value of awards increased, but also the numbers of directors receiving them. The result is the sharp upturn in total earnings shown in the data tables and graphs in chapter 3.

SHIFT IN PROPORTION OF TOTAL EARNINGS COMING FROM SALARY

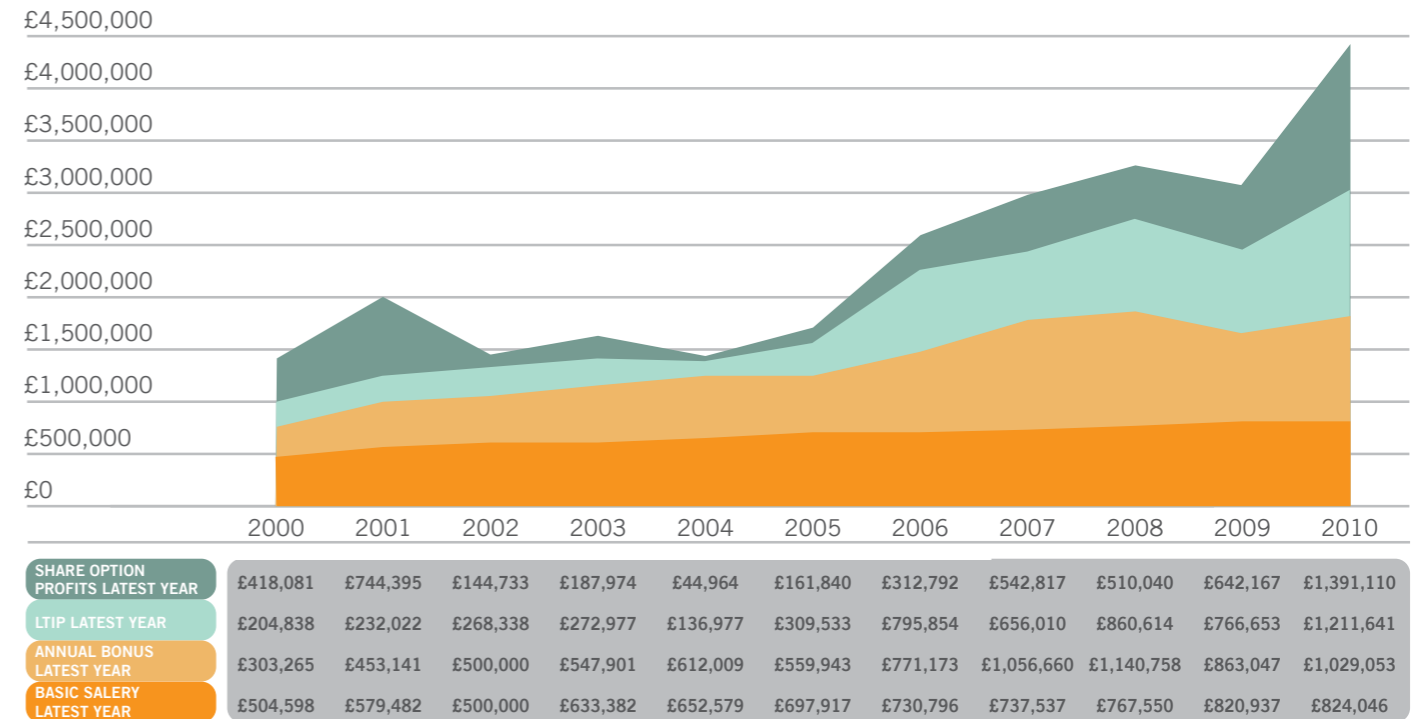
All the documented trends have been driven by a strong emphasis on ‘pay for performance’ that has dominated corporate governance culture since the mid-1990s. The direction of boardroom remuneration policy has been to:

- incentivise senior executives, which has increased the proportion of total earnings coming from incentive schemes and reduce the proportion coming from fixed pay (ie salary and benefits);
- align the interests of directors and shareholders by emphasising share incentive schemes and share ownership.

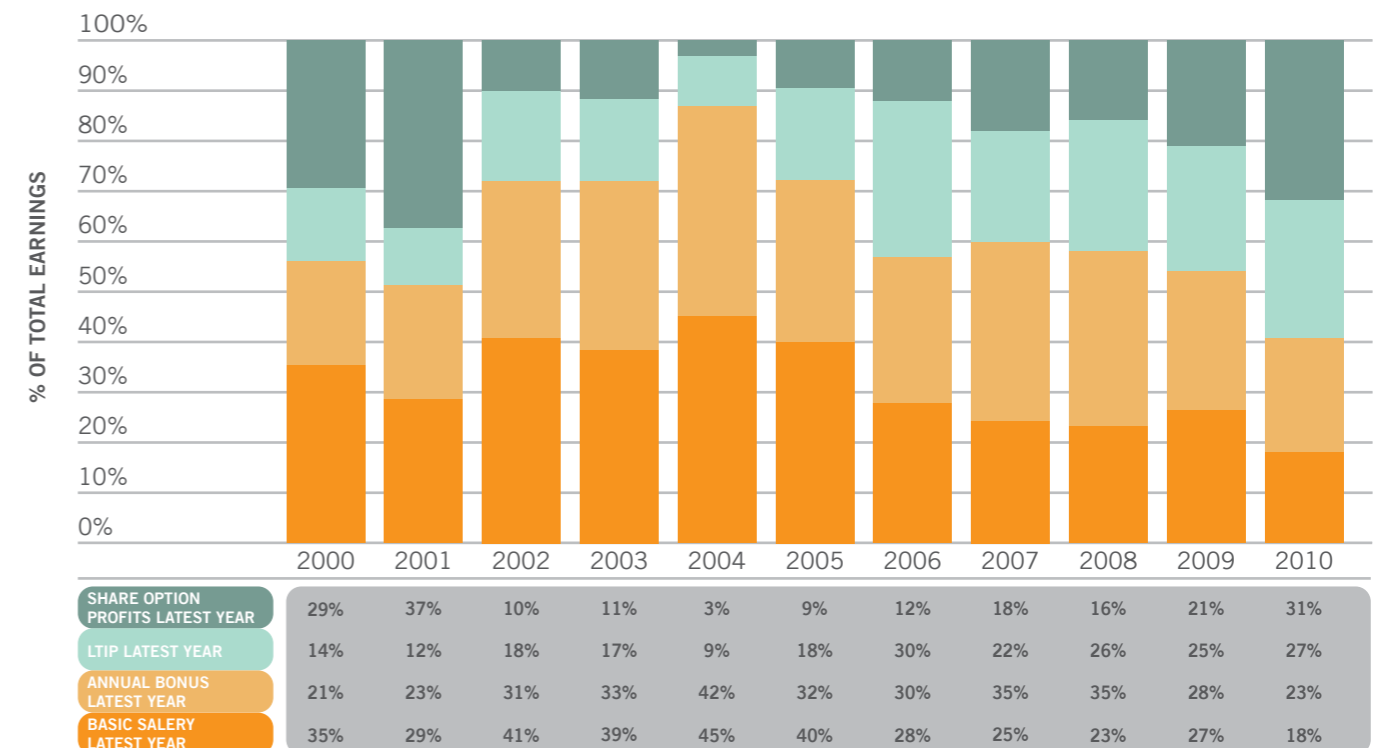
It should be noted that the desire to change the balance between fixed and variable pay has not come at the expense of absolute rises in salary. Rather, what has taken place is an addition of higher incentive awards on top of salary levels which have increased 63.9 percent over the decade.

The impact of these policies can be seen in the graphs opposite

GRAPH 2.5 WEIGHTED AVERAGE SALARY AND ACTUAL INCENTIVE PAYMENTS RECEIVED BY FTSE 100 LEAD EXECUTIVES 2000 TO 2010



GRAPH 2.6 WEIGHTED AVERAGE PROPORTIONAL BALANCE BETWEEN SALARIES AND ACTUAL INCENTIVES RECEIVED BY FTSE 100 LEAD EXECUTIVES 2000 TO 2010



3 | Paying for boardroom performance: the evidence

BOX 3.1 What has happened to pay of all FTSE 350 directors and corporate performance measures between 2000 and 2010 (Source: IDS/HPC)

Remuneration element	Change over 10 years	Corporate performance measure	Change over 10 years
Salary	63.9%	Pre-tax profit	50.5%
Bonus	187.0%	EPS	73.0%
Total Cash	133.4%	Year-end share price	-71.3%
LTIP	253.5%	EBITDA	62.0%
Share options	-40.0%	Turnover	80.4%
Total Earnings	108.0%	Market cap	8.0%

Drawing on our data, a summary of the key trends can be found in Box 3.1. The box shows the headline changes in the key components of the compensation received by all FTSE 350 directors between 2000 and 2010, along with corresponding changes in the main corporate performance measures. Key findings from the box are that over the 10-year period:

- average total earnings of all FTSE 350 directors increased by 108 per cent;
- average salary of all FTSE 350 directors increased by 64 per cent;
- average annual bonus for all FTSE 350 directors went up by 187 per cent;
- average year-end share price declined by 71 per cent;
- average pre-tax profit went up 51 per cent;
- average EPS increased by 73 per cent;
- average market capitalisation increased by 8 per cent.

Overall, our results show that nearly all the components of boardroom pay, with the exception of share option gains, increased at a faster rate over the last 10 years than corresponding measures of corporate performance.

On the face of it, these findings suggest that there is little relationship between how much FTSE 350 directors earn and corporate performance, but the picture is more subtle if the trend as tracked over the period as in **Graph 3.1**. The graph shows indexes of the average compensation components of all FTSE 350 directors since 2000 along with equivalent indexes for the main market indicators. In the graph, the base year, 100, starts in 2000. To help with understanding, the index numbers are tabulated at the bottom of the graph, while the pay components are shown as solid and the market indicators as dotted lines.

When the shape of the lines in **Graph 3.1** is looked at, the following trends are evident:

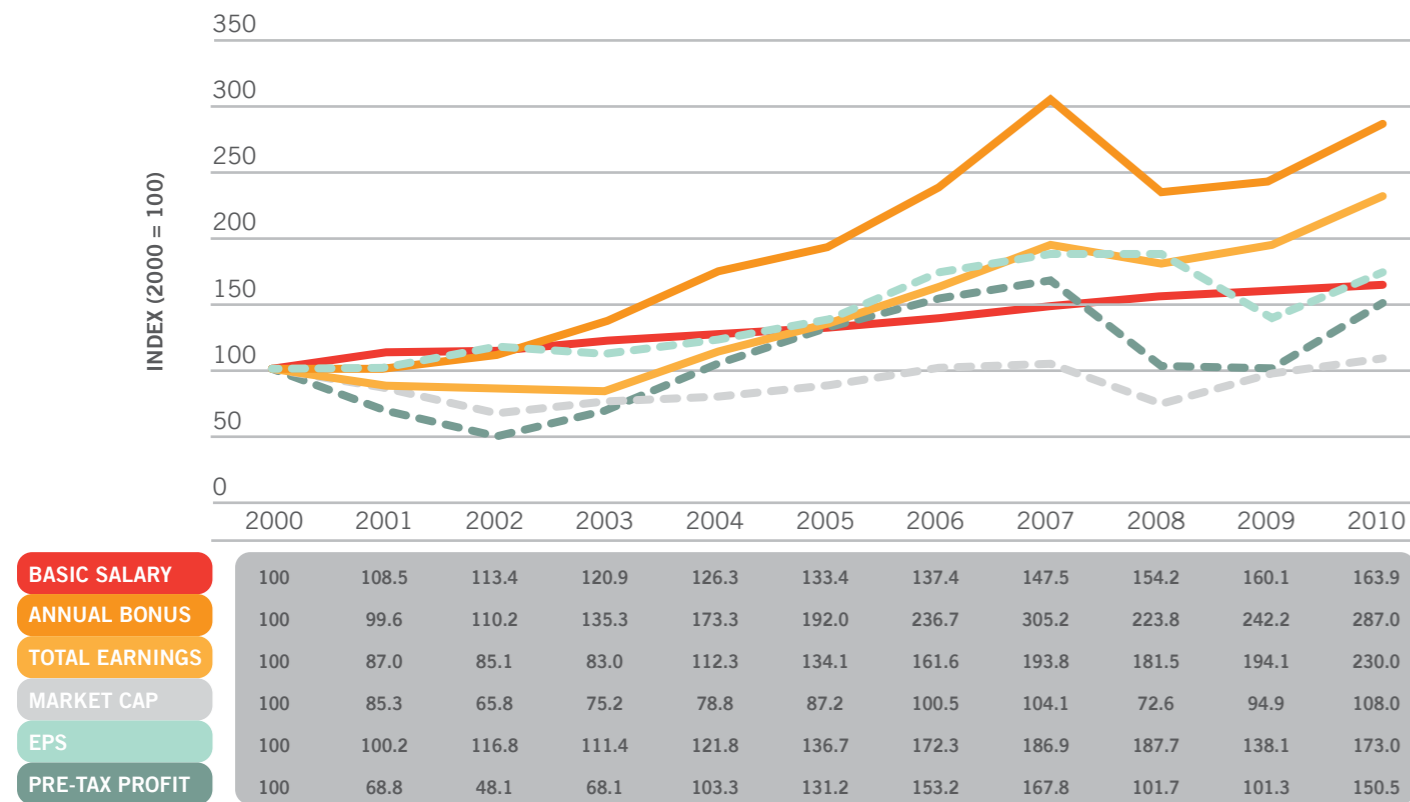
- at this level of aggregation salary growth bears no relation to either market capitalisation, EPS or pre-tax profit;
- there is no or little relation between the total earnings trend and market capitalisation;
- slightly closer relation seems evident between total earnings, pre-tax profit and EPS, but they do not mirror each other exactly and the trend diverges significantly during certain periods, most particularly during the last few years of recession.
- most spectacular is the growth in bonus payments over the period which

have pulled significantly ahead of market capitalisation, EPS and pre-tax profit.

What the graph illustrates most clearly is the point at which the recession took hold and its impact on boardroom remuneration. There was a fall in bonuses in 2008 which all but reversed a steep rise in boardroom payouts enjoyed in previous years, particularly since 2006. The effects, however, of the 2008 bonus drought were dampened by less drastic declines in the remaining variable elements of directors' remuneration and by the continuing rise in basic salary levels. As a result, total earnings (solid yellow line) suffered only marginally during the crisis. To put this into perspective, even at the deepest point of the latest recession, when pre-tax profit was at its lowest point, the lowest bonus level was still 134 per cent higher than in 2000.

With the recovery still in its infancy, it is too early to gauge whether the post-crisis remuneration landscape will look any different once the dust has settled. But if the trend in the most recent period is any guide, it has not taken long for directors earnings to resume 'business as usual'. In particular, the post-crisis recovery in earnings shown in the graph has matched or outpaced most indicators of corporate recovery. This means that save for a brief interlude in 2008, incentive levels are on track to resume the trends that had been unfolding prior to the recession.

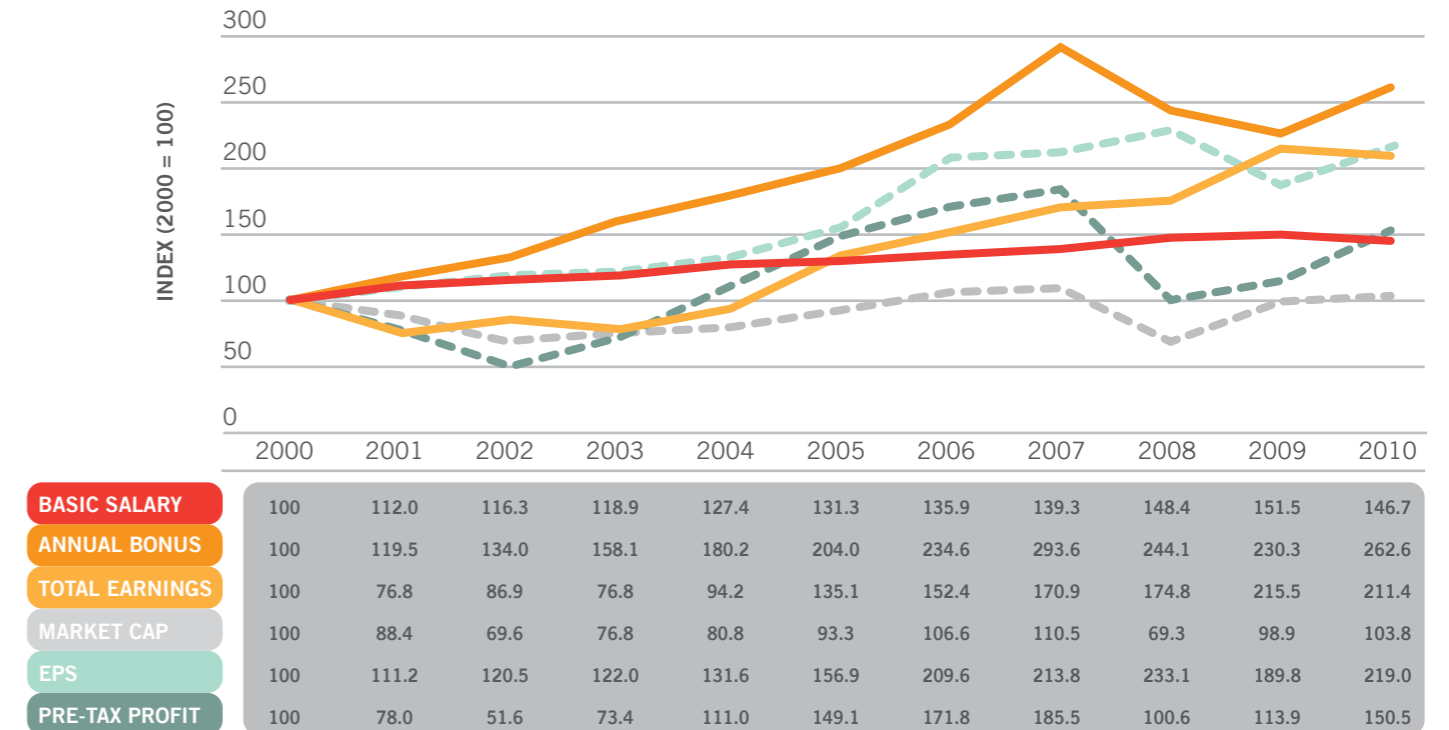
GRAPH 3.1 SUMMARY OF TRENDS IN FTSE 350 BOARD REMUNERATION AND MARKET INDICATORS 2000 TO 2010 (SOURCE: INCOMES DATA SERVICES/HIGH PAY COMMISSION)



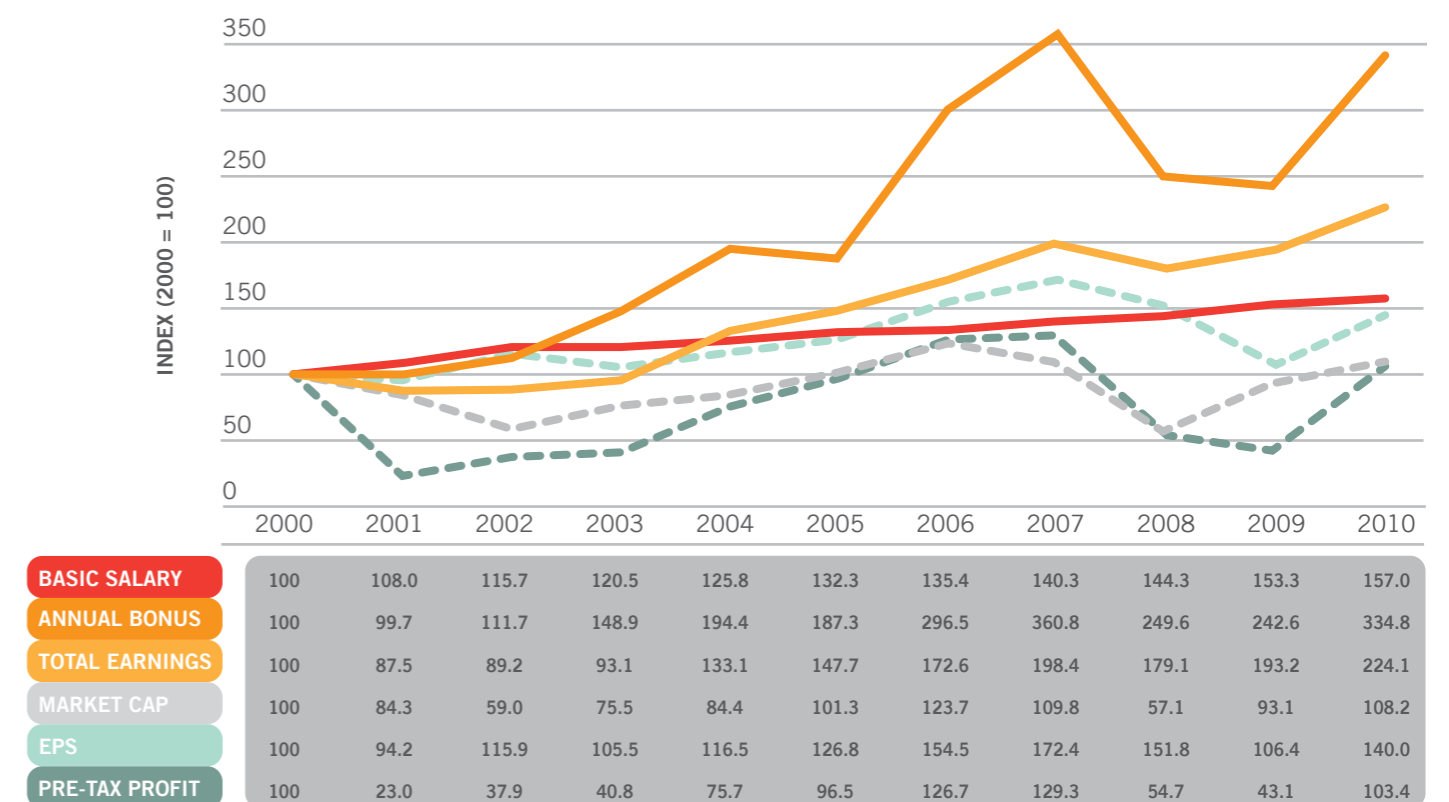
Although the numbers are different, similar patterns are demonstrated when the figures are broken down by board position and FTSE segment. This is particularly evident in the FTSE 100. This can be seen in **Graph 3.2**, which charts the trend for FTSE 100 lead executives. While the main points are

the same as for all FTSE 350 directors, the growing gap between how much is received and performance over the 10-year period seems more exaggerated for FTSE 100 directors. By contrast, **Graph 3.3** demonstrates the trend for FTSE mid-250 lead executives.

GRAPH 3.2 SUMMARY OF TRENDS IN FTSE 100 LEAD EXECUTIVE REMUNERATION AND MARKET INDICATORS 2000 TO 2010 (SOURCE: INCOMES DATA SERVICES/HIGH PAY COMMISSION)



GRAPH 3.3 SUMMARY OF TRENDS IN FTSE MID-250 LEAD EXECUTIVE REMUNERATION AND MARKET INDICATORS 2000 TO 2010 (SOURCE: INCOMES DATA SERVICES/HIGH PAY COMMISSION)



4 | What has happened to annual bonus payments?

As the previous graphs indicate, one of the key trends of the last decade has been a marked increase in the value of annual bonus payments. The graphs also suggest that the relation between how much is paid in bonus is not clearly linked to corporate performance. This can be explored more fully by tracking movements in annual bonus and two key measures that are often used as bonus performance targets – pre-tax profit and EPS. Our latest Directors’ Pay Report 2010/11 found that 66.7 per cent and 60.1 per cent of FTSE 100 and mid-250 bonus scheme targets are linked to some measure of profit, while 25.3 per cent and 18 per cent use EPS.

To test how closely bonuses received reflect changes in pre-tax profit we have drawn on our whole 10-year dataset. **Graph 4.1** provides a broad overview of bonus trends, focusing more closely on the payments received by all FTSE 350 directors since 2000, tracked alongside three key measures of corporate performance – pre-tax profit, EPS and year-end share price. As in earlier graphs, all the figures have been indexed for ease of comparison. Additionally, to make the trends even clearer the graph includes linear regression lines for annual bonus, pre-tax profit and EPS.

But examining our dataset further it is possible to probe the relationship between annual bonuses and pre-tax profit and EPS in more detail. In particular, we can see whether the

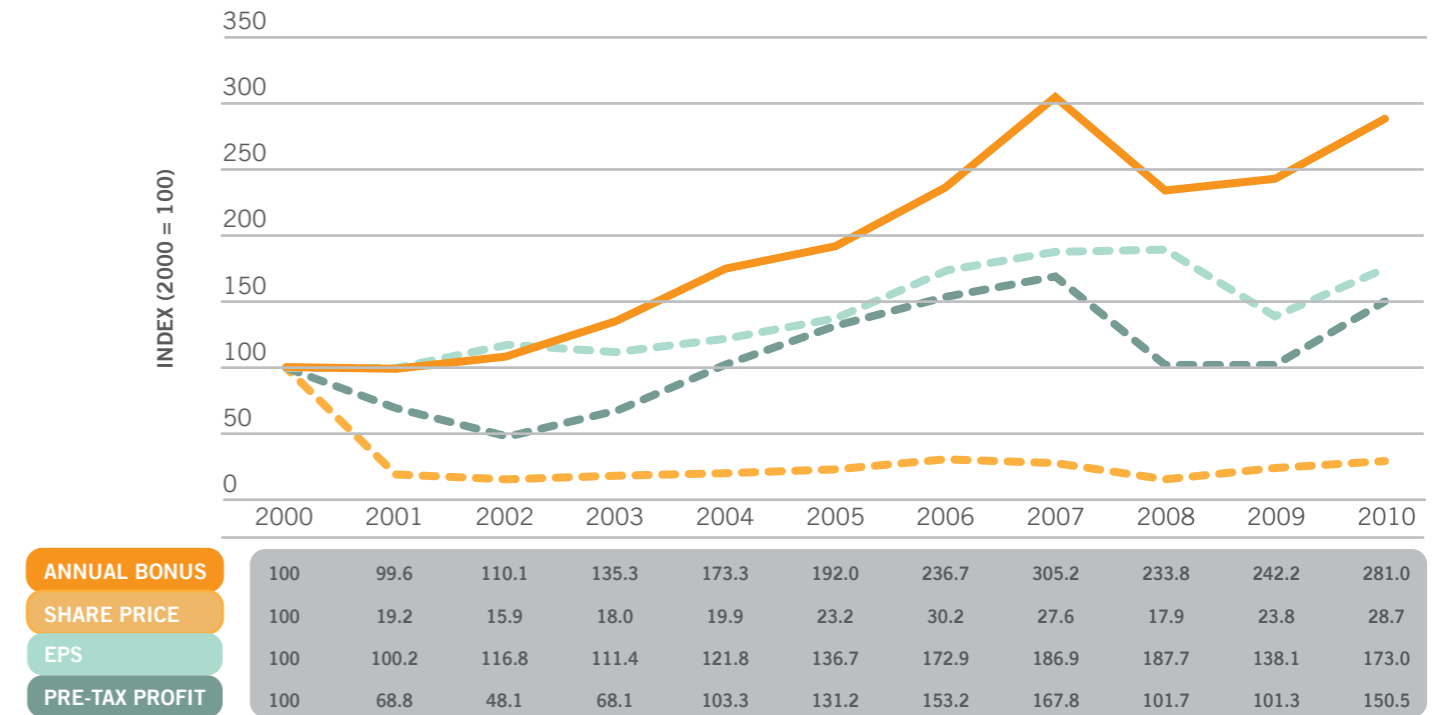
What is clear from the angle of the regression lines in **Graph 4.1** is that whatever the ups and downs in the various indexes over the 10-year period, annual bonus payments have significantly outstripped corporate performance.

change in the corporate performance correlates with changes in the bonus received. That is, does an increase or decrease in pre-tax profit and EPS result in an increase or decrease in the annual bonus received. The correlation between the change in pre-tax profit and annual bonus for all FTSE 350 directors over the whole 10 years is shown in **Graph 4.2**. Due to the mathematical issues inherent in tracking changes involving zeros² all changes in the graph are in pounds Sterling. Statistically, the closeness of the correlation is expressed by R², with 1 indicating a perfect relationship and anything less than 0.5 indicating little or no relationship.

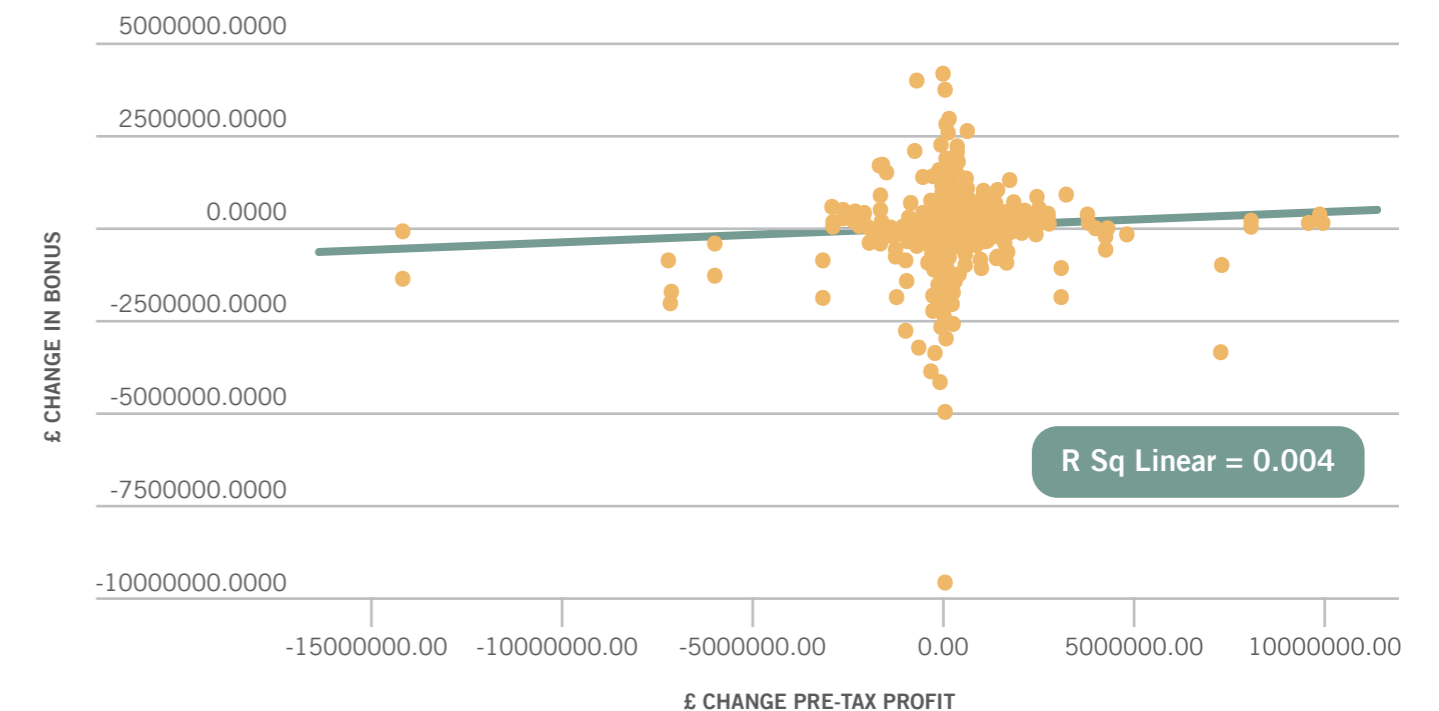
With the R² in **Graph 4.2** registering at 0.004, our findings strongly suggest there is no relationship between how much more or less directors receive in annual bonus and any changes in pre-tax profit.

² For example, bonus schemes do not pay every year, especially if certain threshold performance conditions have not been met. We have recorded these occurrences as a zero in our dataset to provide the most accurate reflection of current remuneration practice. Likewise, companies often report nil profit and turnover figures. Relative change cannot be calculated, mathematically, using these zeros. We have therefore used actual year-on-year cash change figures to capture trends in incentive payments and corporate performance.

GRAPH 4.1 ANNUAL BONUS PAYMENTS RECEIVED BY ALL FTSE 350 DIRECTORS COMPARED TO CORPORATE PERFORMANCE 2000 TO 2010



GRAPH 4.2 CORRELATION BETWEEN REAL (£) CHANGES IN ANNUAL BONUS AND REAL (£) CHANGES IN PRE-TAX PROFIT FOR ALL FTSE 350 DIRECTORS 2000 TO 2010 (SOURCE: IDS/HPC)

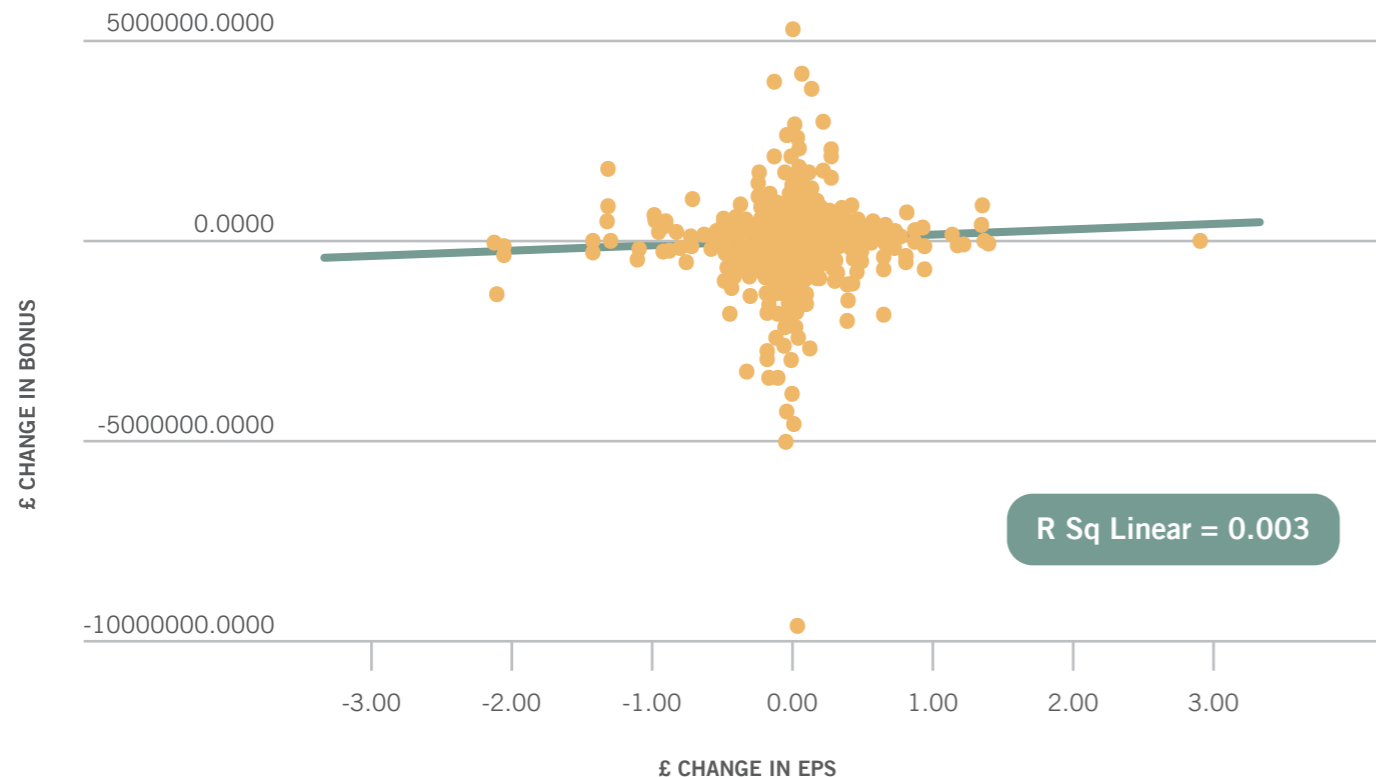


Graph 4.3 shows the R^2 for the correlation between changes in the annual bonuses of all FTSE 350 directors and changes in EPS is 0.003. In conclusion, we can say that whatever is driving bonus levels it is not EPS.

While no evident correlation exists between changes in annual bonus and pre-tax profit, what about the other key performance target, EPS? A picture of the results can be found in **Graph 4.3**, which shows a similar scatter graph of the relevant data points of the changes in EPS and annual bonus along with a regression line.

Because bonuses are dependent on a multitude of variables, we would not expect to see a perfect linear correlation between changes in bonus payouts and any one individual factor. However, given the overwhelming prevalence of EPS and pre-tax profits as performance indicators in incentive scheme design, we would expect to see a stronger correlation between changes in these measures and bonus payouts.

GRAPH 4.3 CORRELATION BETWEEN REAL (£) CHANGES IN ANNUAL BONUS AND REAL (£) CHANGES IN EPS FOR ALL FTSE 350 DIRECTORS 2000 TO 2010 (SOURCE: IDS/HPC)



5 | Long-term share-based incentive performance trends

In FTSE 350 boardrooms, however, incentive pay arrangements are not confined to annual bonus schemes which are principally designed to drive improvement in short-term performance such as in pre-tax profit and EPS. In contrast, longer term performance is incentivised through share-based schemes and is often tied to measures of shareholder value.

There are two types of share-based incentive, share options and LTIPs. Share options are the better known and involve companies granting directors the right to buy shares at a future date at today's price. A director may be given the option, for example to buy a block of 100 shares at £1 each after three years. If, over the three years the share price goes up to £2 each, then the director can buy the 100 shares at £100, immediately sell them and make a £100 profit. Under current arrangements, directors usually have the right to exercise their options at any time between three and 10 years after the initial grant.

In contrast, LTIPs do not require directors to purchase shares at any time, rather future receipt of shares is tied to corporate performance. In an LTIP, at the beginning of a performance cycle (usually three years) a director is awarded an initial grant of shares, perhaps worth between 100 per cent and 200 per cent of salary. Depending on how well the pre-specified performance targets are

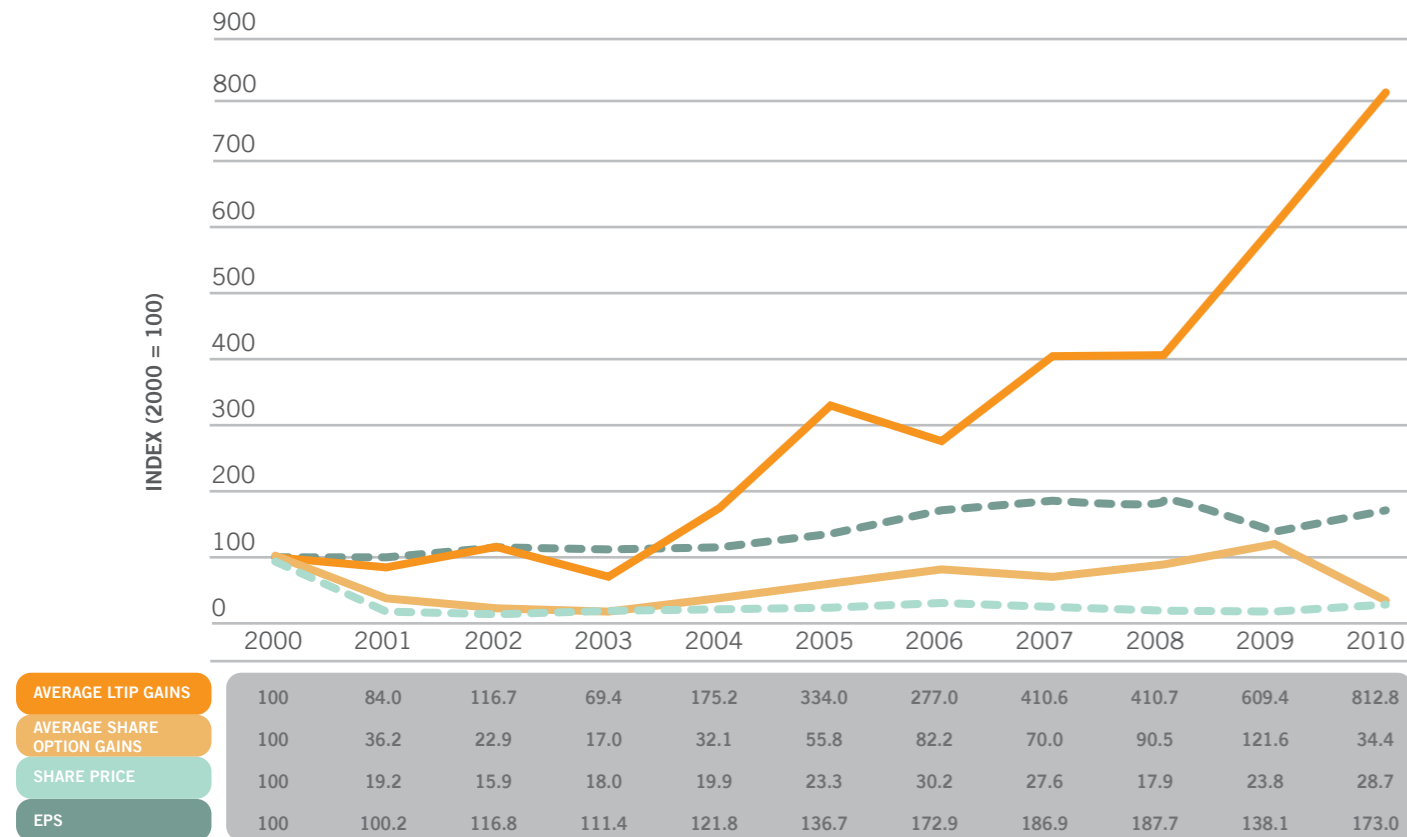
satisfied, a proportion or all of the initial grant may vest and the director will receive a block of shares with a certain face-value. At no point in the transaction do directors lay out their own money.

An illustration of the how much FTSE 350 directors have received from each of these types of share-based incentive scheme over the 10-year period 2000 to 2010 can be seen in **Graph 5.1**. To put the trend in context, the indexed movement in LTIP and share option gains is tracked against similar indexes for three measures of stock market performance – year-end share price, market capitalisation and EPS. For LTIPs, these measures have to stand in proxy for a performance target used in many schemes, total shareholder return (TSR). But as this is usually compared relative to a group of peers or an index over a specified period and because most companies do not feature across the whole of the 10-year period it is not possible to calculate aggregate TSR figures.

What is most striking about **Graph 5.1** is the spectacular growth in the average value of LTIP awards, which has gone up by over 700 per cent since 2000. What is equally evident is that this growth seems out of proportion to any change in stock market measures. Year-end share prices have fallen dramatically; market cap has barely improved while there is a 640 index point difference between the growth in LTIP awards and EPS.

Improvements in share option gains, by comparison, are more modest and have varied more widely over the decade. But what is still striking is that despite flat year-end share price movements, option gains increased between 2003 and 2009, when they were 22 per cent higher than in 2000. On the other hand, stock market conditions have had an impact at the beginning and the end of the decade. Pulled down by falling share prices, average share options gains dropped in the early noughties, recovering in mid-decade and slumped again in 2010.

GRAPH 5.1 AVERAGE SHARE INCENTIVE GAINS OF FTSE 350 LEAD EXECUTIVES COMPARED TO STOCK MARKET INDICATORS 2000 TO 2010 (SOURCE: INCOMES DATA SERVICES/HIGH PAY COMMISSION)



6 | Changes in numbers receiving incentives

GRAPH 6.1 PROPORTION OF FTSE 350 LEAD EXECUTIVES RECEIVING INCENTIVE PAYMENTS 2000 TO 2010



What is important about incentives, however, is not just how much is received, but how many directors receive a payment. Over the years, more directors have generally been receiving incentives of greater value and this in turn has greatly fuelled total cash and total earnings growth. An indication of the proportions of FTSE 350 directors receiving each type of incentive – annual bonus, LTIP and share option gains – can be seen in **Graph 6.1**. This shows that:

- annual bonus payments are the most common type of award received, with proportions over the 10 years varying from as low as 76.3 per cent in the early noughties in the wake of the

bursting of the dot.com bubble to as high as 95 per cent in 2010. What is evident is that, in both good times and bad times, the majority of directors continue to receive a performance-related bonus;

- the proportion of directors receiving LTIP awards has increased dramatically, from just 16.7 per cent of all FTSE 350 directors in 2000 to over half in 2010;
- fewer directors exercise share options than receive LTIPs, at between a fifth and a quarter of all FTSE 350 board members up to 2007. But with the onset of recession even fewer have had the opportunity to cash in their options.

7 | Do incentives help long-term survival?

While the data casts serious doubt on any claim that there is a relation between incentives and corporate performance, it does not tell the whole story. Another dimension of pay for performance has to be the long-term health and survival of the company. If the purpose of an incentive is to promote the good performance of a company, then we may expect this to translate into the long-term continuation of the company in the FTSE 350 – the public badge of corporate success. Dropping out of the FTSE 100 or mid-250 is often interpreted as a sign of corporate failure as it is often the result of poor share returns based on poor corporate indicators.

To capture this aspect of pay for performance, we have divided our sample into ‘survivors’ and ‘non-survivors’. Survivors consist of those companies that were in the FTSE 350 in 2000 and continue in the FTSE 350 today. In contrast, non survivors are companies that were in the FTSE 350 in 2000 but have since dropped out at some point over the 10 years. Companies, of course, may fall out of the FTSE 350 for a number of reasons, not all of which are signs of failure. But although only an indicative measure, ‘non-survival’ does signify that the whole array of high-paying incentives has not secured independent long-term survival of a company.

If survival in the FTSE 350 is interpreted as sign of that incentive schemes deliver long-term performance then our results

indicate they have not delivered. Of 757 companies that have featured in the FTSE 350 over the decade, just 124 or 16.4 per cent of the total have remained on the index since 2000. The question is, what role have incentives played in this. An indication of this can be seen in **Graph 7.1**, which shows the average LTIP gains received by the lead executives of surviving and non surviving companies. This shows that:

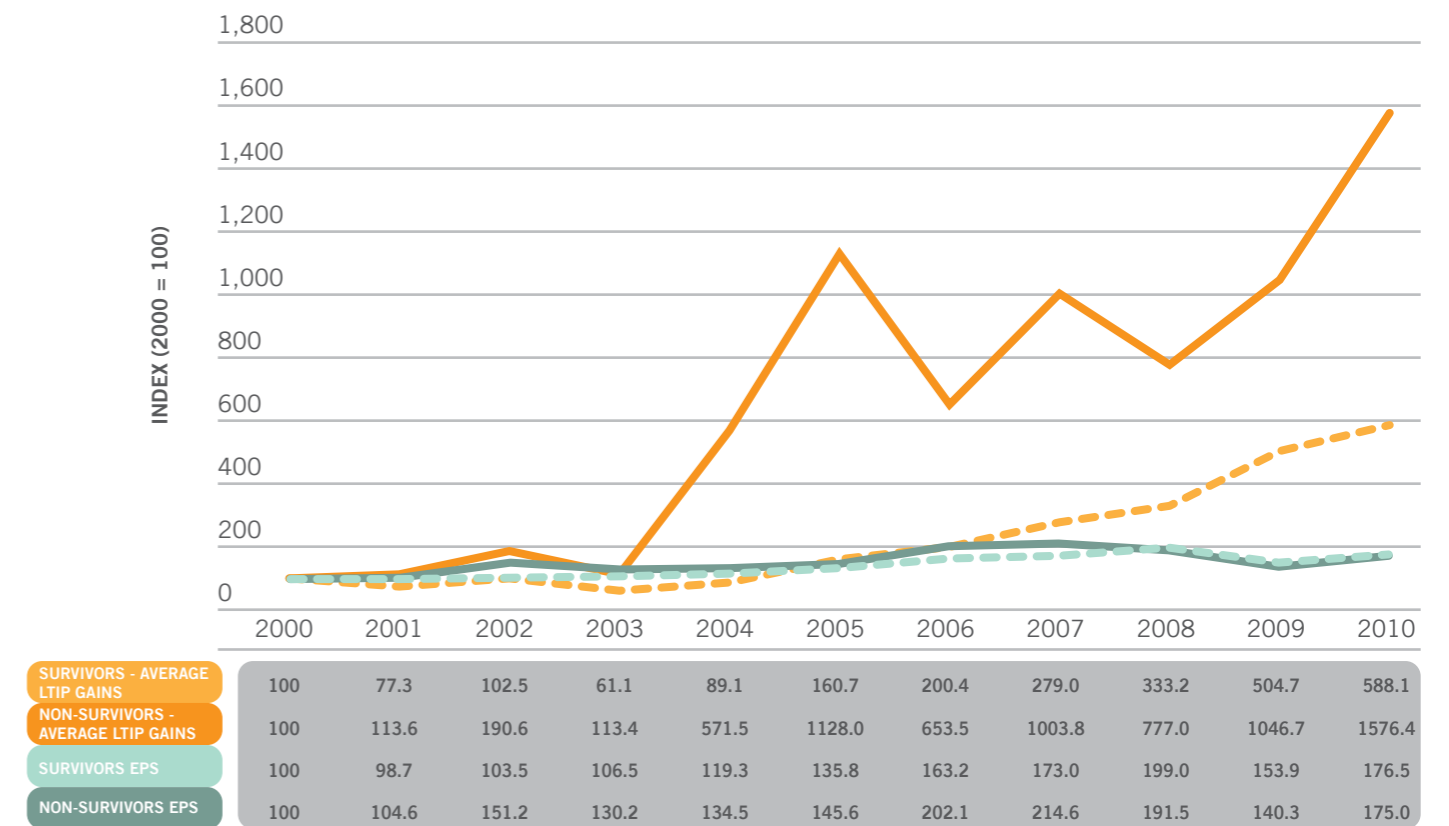
- growth in the average value of the LTIPs received by the lead executives of ‘survivors’ was much less than their counterparts running non-surviving companies;
- since 2000, the average value of LTIPs in survivors has gone up by 488 per cent, but the average value of LTIPs received in non-survivors has gone up by 1,476 per cent;
- over the same period EPS growth in the two groups of company has been similar.

Graph 7.2 plots similar changes in the average value of the share option gains realised by lead executives of surviving and non-surviving FTSE 350 companies. This paints a slightly different picture. In both survivors and non-survivors the average value of options has declined, but for most of the period there seems to be only slight variations in the sums received. The most noticeable difference is in the last two years, when the average realised option gain shot up spectacularly

in the survivor group but then dropped just as significantly in 2010. In contrast, the average value of the gains received by non-surviving lead executives reached

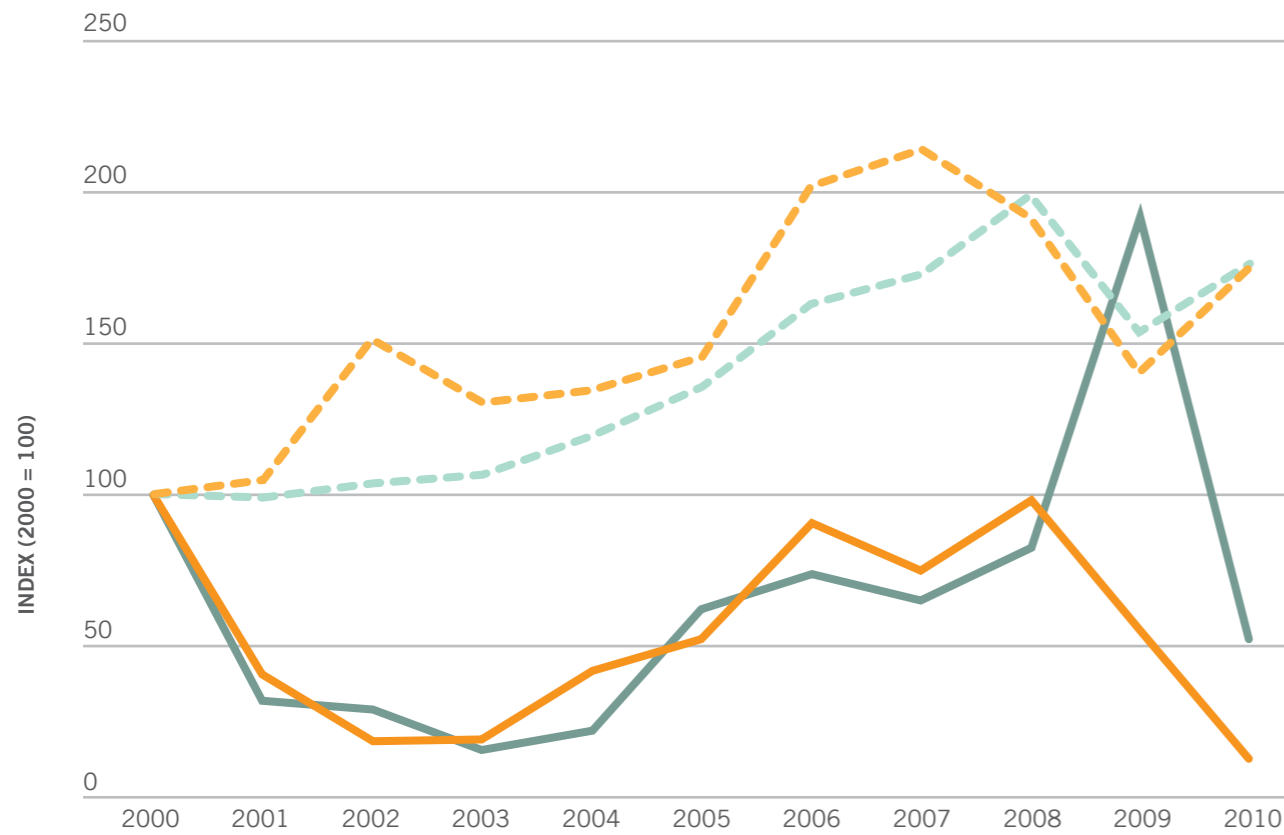
a height in 2009, though far short of the levels reached by the survivors, but dropped even more spectacularly in 2010.

GRAPH 7.1 AVERAGE LTIP GAINS AMONG LEAD EXECUTIVES IN SURVIVING AND NON-SURVIVING COMPANIES IN THE FTSE 350 2000 TO 2010 (SOURCE: INCOMES DATA SERVICES/HIGH PAY COMMISSION)



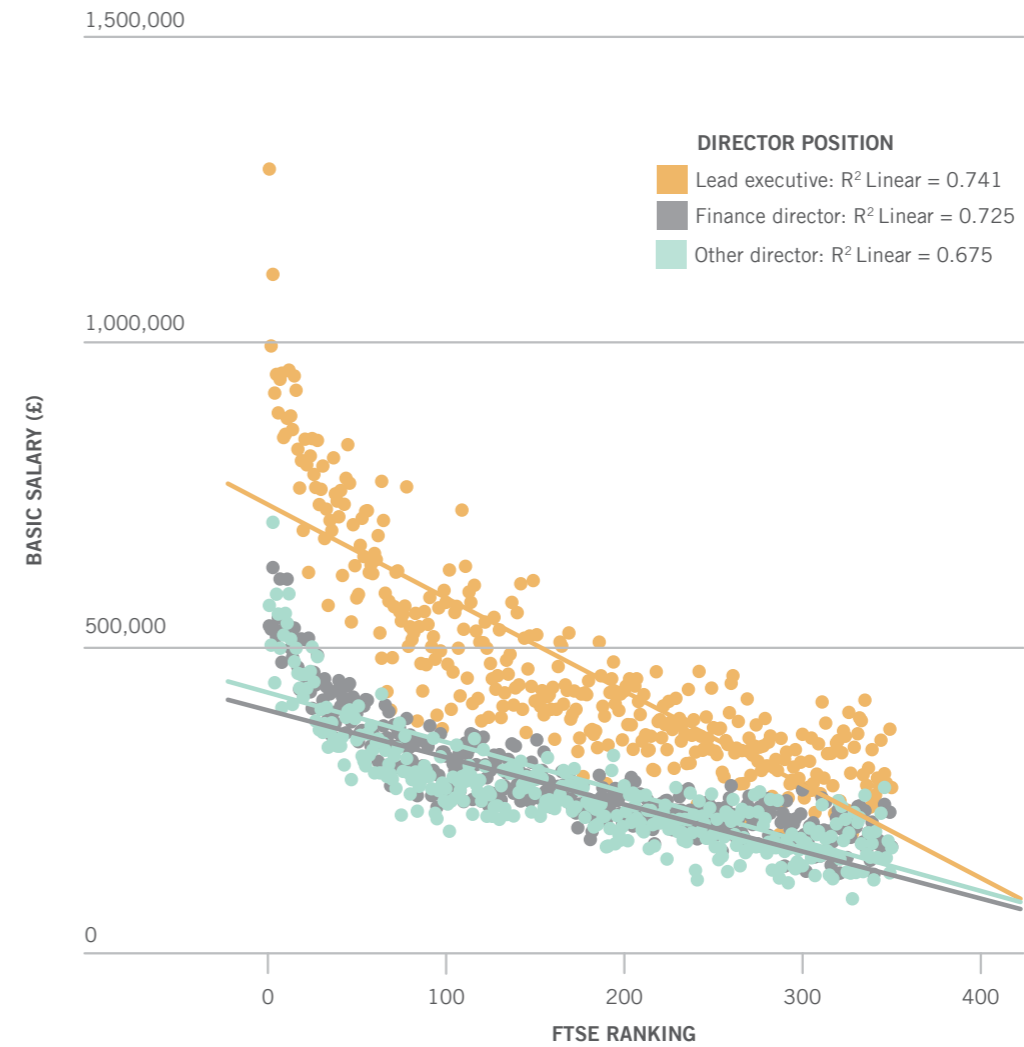
Taking all the evidence together, our analysis of survivors and non-survivors suggests that having a highly rewarding long-term incentive is no guarantee of a company's long-term membership at the table of top listed companies.

GRAPH 7.2 AVERAGE SHARE OPTION GAINS AMONG LEAD EXECUTIVES IN SURVIVING AND NON-SURVIVING COMPANIES IN THE FTSE 350 2000 TO 2010 (SOURCE: INCOMES DATA SERVICES/HIGH PAY COMMISSION)



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
SURVIVORS - AVERAGE SHARE OPTION GAINS	100	31.7	28.8	15.2	21.6	61.7	73.4	73.4	82.5	191.8	51.8
NON-SURVIVORS - AVERAGE SHARE OPTION GAINS	100	40.2	18.0	18.6	41.6	52.0	90.3	90.3	97.8	54.9	12.5
SURVIVORS EPS	100	98.7	103.5	106.5	119.3	135.8	163.2	173.0	199.0	153.9	176.5
NON-SURVIVORS EPS	100	104.6	151.2	130.2	134.5	145.6	202.1	214.6	191.5	140.3	175.0

GRAPH 7.3 CORRELATION BETWEEN BASIC SALARY AND FTSE RANKING 2000 TO 2010 (SOURCE: IDS/HPC)



CORRELATION BETWEEN PAY AND FTSE RANKING

While market performance indicators demonstrate a weak relationship with how much directors earn, company size as indicated by FTSE ranking does have a closer relationship as shown in **Graph 7.3**. In the graph, FTSE ranking is compared to the salaries of three main board positions across the FTSE 350 – lead executive, finance director and other director. As can be seen from

the graph, all correlation statistics are significant – with R² ranging from 0.675 at the weakest to 0.741 at the strongest. Similar results would be evident if the comparisons were made with other pay measures – total cash and total earnings.

Findings like this suggest that boardroom pay is not largely driven by performance but by organisational metrics such as company size.

8 | Pay for performance in finance

“The (Remuneration) Committee believes that the continuing improvement in the performance of the Company depends on individual contributions made by the Executive Directors. For this reason, the remuneration policy is designed to provide transparent, competitive packages to motivate, reward and retain Executive Directors of high quality”

Northern Rock 2006 Annual Report And Accounts

Nowhere is the link between pay and performance more questionable than when companies paying out large executive remuneration packages either fail, like Northern Rock, or need state support to survive. The finance sector, and those banks in particular which have benefited from state-sanctioned back-up packages therefore provide the opportunity for a focussed analysis of the relationship between executive pay and performance³

Although the impact of the financial crisis on other UK banks was not as calamitous as the effect on Northern Rock, a question is raised as to the efficacy of performance-related pay at publicly listed companies that need state-subsidised support. For this reason, we provide a detailed analysis of earnings in UK banks to examine what trends, if any, emerge from the relationship between pay and company performance.

Northern Rock became the first UK bank in 150 years to suffer a bank run. In the accounts preceding this event, the bank’s five directors received salaries, bonuses and benefits of £6.2 million. But Northern Rock, famously, could not weather the financial storm and, in 2008, was taken into state ownership.

For the purposes of this analysis we have defined ‘banks’ following the FSA’s definitions⁴. The following FSA-defined banks appear in our FTSE 350 dataset for the period in which there were in operation (acquired banks, for example, are relevant until takeover).

FSA-defined banks appearing in dataset

3i Group	Rathbone Brothers
Investec	Bradford & Bingley
Abbey National	Royal Bank of Scotland
Legal & General	Egg
Admiral	Schroders
Lloyds Banking Group	Halifax
Alliance & Leicester	Standard Chartered
National Westminster	HBOS
Alliance Trust	Standard Life
Northern Rock	HSBC Holdings
Barclays	

As well as FSA-defined banks, we also focus more closely on state-supported banks. For the purposes of this analysis we have taken these to be those institutions participating in the Bank of England’s special liquidity scheme, or, as it was defined by Alistair Darling in 2008, a ‘Government-supported recapitalisation scheme’. We define these in the analysis as Government or state-supported banks and they are:

- Abbey
- Barclays
- HBOS
- HSBC
- Lloyds
- RBS
- Standard Chartered

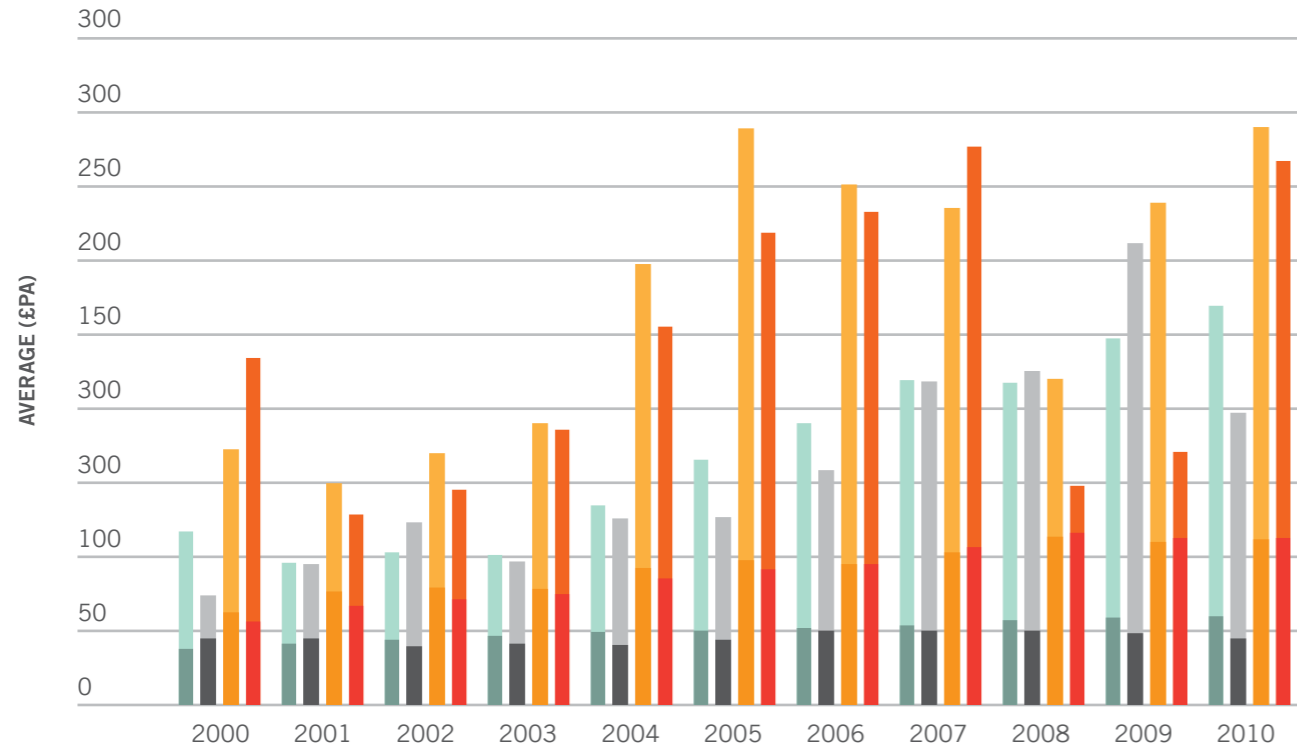
PAY LEVELS IN FINANCE

The Government-supported cohort stands out in our first analysis of salary and earning levels in FTSE-listed finance firms, in **Graph 8.1** on the following page. The graph shows lead executive average basic salaries and total earnings in all FTSE 350 companies versus those banks that signed up for Government support and those that did not. It is clear that both salaries and earnings in the state-supported banks, shown in the chart as the orange/red bars, far outstrip earnings in the rest of the FTSE 350 (green bars) and of the remaining FSA banks that did not receive state support (gray bars). The graph shows actual average salary and earnings levels and gives some indication of the ‘ratcheting-up’ of earnings over the decade since 2000. Average total earnings in the state supported banks were just under £4 million in 2010, compared to £1.7 million in 2000, a difference of nearly 130 per cent, over the period.

³ While the remuneration arrangements of other bank employees attract attention, this report focuses solely on executive board members.

⁴ Although there is no definition of ‘bank’ as such, the FSA has responded to requests and published a list of regulated firms which businesses and the public would think of as banks, similar to that which the Bank of England (until May 1998) and the FSA (from June 1998 until November 2001) used to publish under the Banking Act 1987.

GRAPH 8.1 AVERAGE SHARE INCENTIVE GAINS OF FTSE 350 LEAD EXECUTIVES COMPARED TO STOCK MARKET INDICATORS 2000 TO 2010 (SOURCE: INCOMES DATA SERVICES/HIGH PAY COMMISSION)



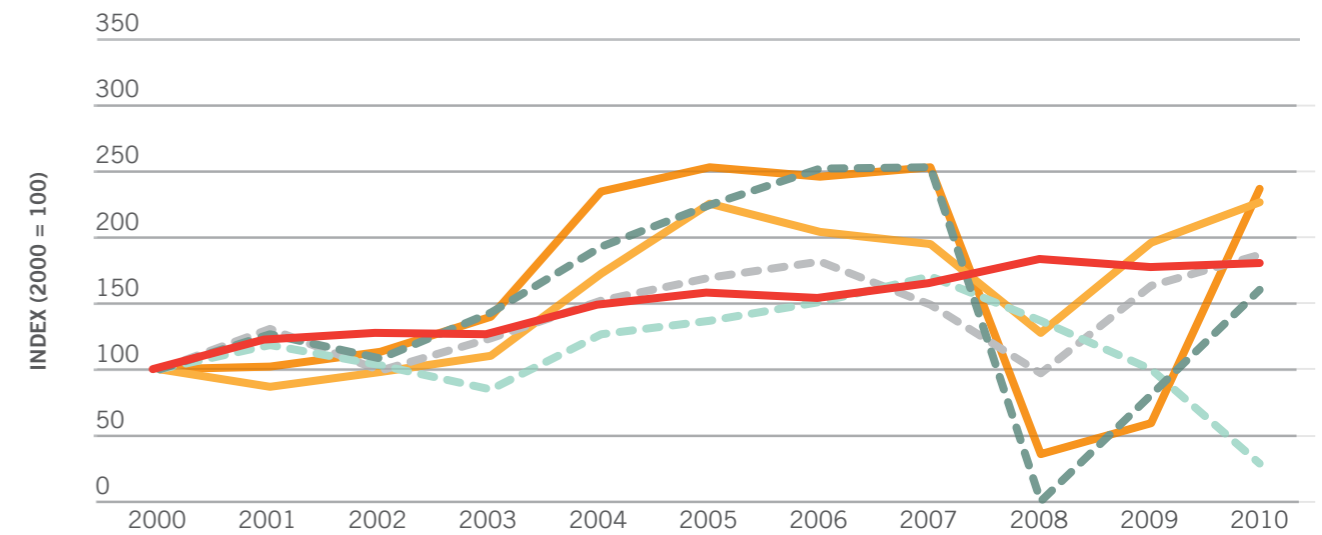
ALL FTSE 350 TOTAL EARNINGS	1,172,125	956,909	1,033,678	1,009,549	1,343,797	1,654,056	1,899,412	2,196,640	2,180,057	2,475,686	2,698,740
NON-SUPPORTED BANKS TOTAL EARNINGS	741,183	950,011	1,230,845	971,664	1,256,604	1,264,580	1,581,321	2,181,312	2,251,989	3,122,647	1,975,055
STATE-SUPPORTED BANKS TOTAL EARNINGS	1,728,687	1,493,995	1,698,396	1,904,034	2,980,749	3,894,021	3,521,107	3,360,873	2,199,116	3,391,684	3,907,232
BAILED-OUT BANKS TOTAL EARNINGS	2,341,650	1,286,500	1,449,659	1,861,146	2,559,985	3,191,181	3,330,883	3,773,279	1,477,875	1,712,530	3,678,030
ALL FTSE 350 BASIC SALARY	377,907	415,932	441,166	461,520	488,724	500,907	515,278	538,824	572,949	586,810	597,866
NON-SUPPORTED BANKS BASIC SALARY	449,617	448,333	391,333	409,188	405,625	434,767	497,488	503,456	503,922	483,858	447,023
STATE-SUPPORTED BANKS BASIC SALARY	621,167	761,400	789,433	783,628	924,270	979,299	954,005	1,028,742	1,138,854	1,099,604	1,118,000
BAILED-OUT BANKS BASIC SALARY	564,500	666,500	710,667	734,667	849,333	918,099	953,333	1,063,333	1,166,000	1,127,500	1,127,000

Finally, narrowing the focus, we look at those three banks which, in 2008, were recipients of a £37 billion new capital bail-out. This cohort, made up of HBOS (until 2009) Lloyds Banking Group and Royal Bank of Scotland, is represented by the red bars on the right whose chief executives, as the graph demonstrates, have, except for 2008, been paid at rates far higher than both FTSE 350 lead executives and non-supported FSA-defined banks. Average basic salaries in these banks are more than double

the salaries in the rest of the FTSE 350 and 2010 total earnings, at an average of £3.7 million, were more than £1.7 million ahead of earnings on offer in non-state supported FTSE 350 banks.

While these findings do not directly address the issue of the relationship between pay and performance, it is clear that earnings in state-supported and bailed-out at banks far outstrip those on offer in the rest of the FTSE 350 and in non-state supported banks.

GRAPH 8.2 SUMMARY OF TRENDS IN FTSE 350 STATE-AIDED BANKS LEAD EXECUTIVE REMUNERATION AND MARKET INDICATORS 2000 TO 2010 (SOURCE: INCOMES DATA SERVICES/HIGH PAY COMMISSION)



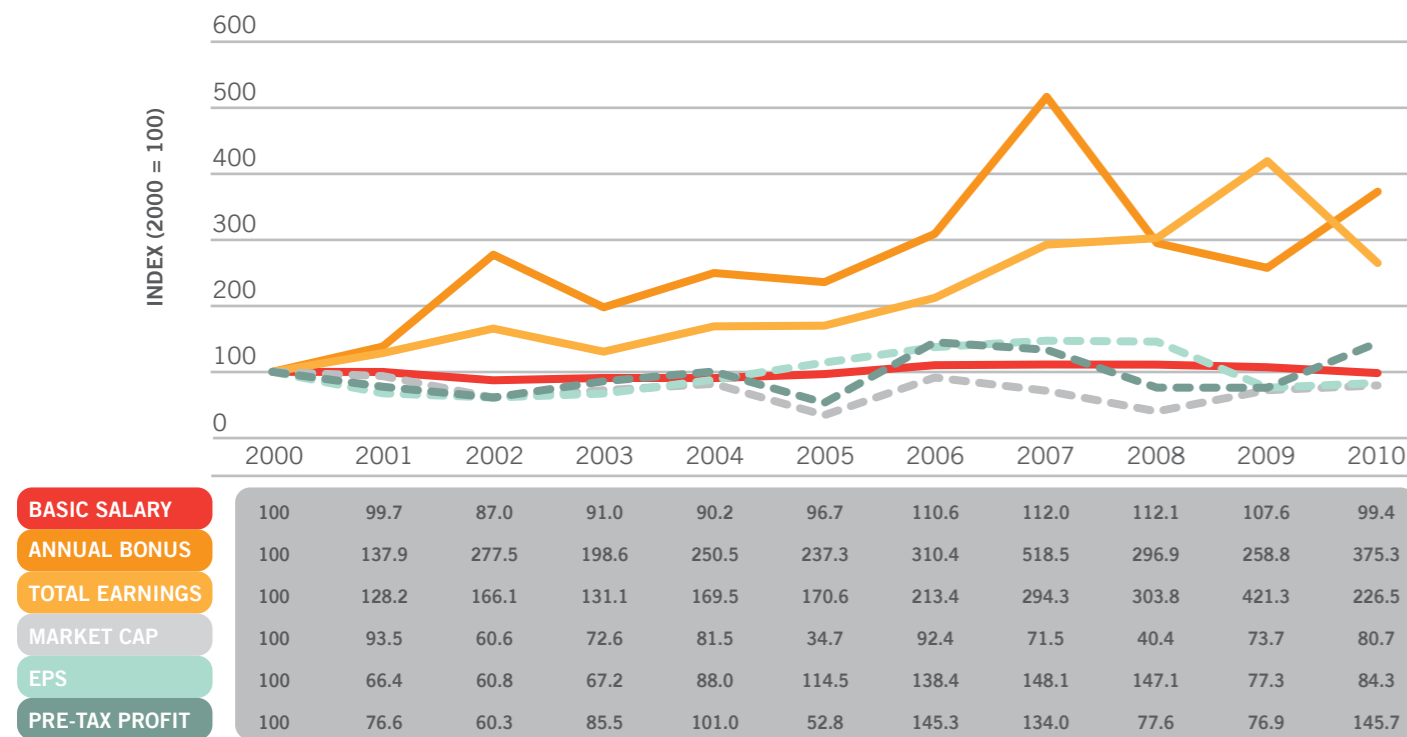
BASIC SALARY	100	122.6	127.1	126.2	148.8	157.7	153.6	165.6	183.3	177.0	180.0
ANNUAL BONUS	100	101.8	112.8	139.6	234.4	253.2	245.8	253.2	36.1	59.7	237.0
TOTAL EARNINGS	100	86.4	98.2	110.1	172.4	225.3	203.7	194.4	127.2	196.2	226.0
MARKET CAP	100	130.8	98.8	123.6	152.0	169.3	181.4	148.9	97.1	163.5	186.2
EPS	100	118.5	103.4	84.4	126.0	136.7	150.8	170.4	136.7	100.5	28.3
PRE-TAX PROFIT	100	126.2	107.9	142.9	192.4	224.5	251.7	153.3	0.0	80.2	160.5

STATE-SUPPORTED BANKS

A further example of performance-related pay in finance is shown in the **Graph 8.2**. This provides an indication of indexed salaries, bonuses and total earnings in all FTSE 350 state-aided banks as defined by the FSA. If earnings per share (EPS) is taken as a performance measure it is apparent that in 2002 there was a divergence, with both total earnings and bonus payments escalating and EPS on a downward trajectory. This remained the

case until 2003 when bonus payments and total earnings increased sharply, relative only to a more moderate increase in EPS. There appears to be a closer correlation between earnings and pre-tax profit, however, although it is significant to note that the precipitous drop in pre-tax profit in 2007 was accompanied by a far more gentle decline in indexed total earnings, which settled at more than 130 index points ahead of equivalent earnings in 2000.

GRAPH 8.3 SUMMARY OF TRENDS IN NON-STATE-AIDED FSA BANKS LEAD EXECUTIVE REMUNERATION AND MARKET INDICATORS 2000 TO 2010

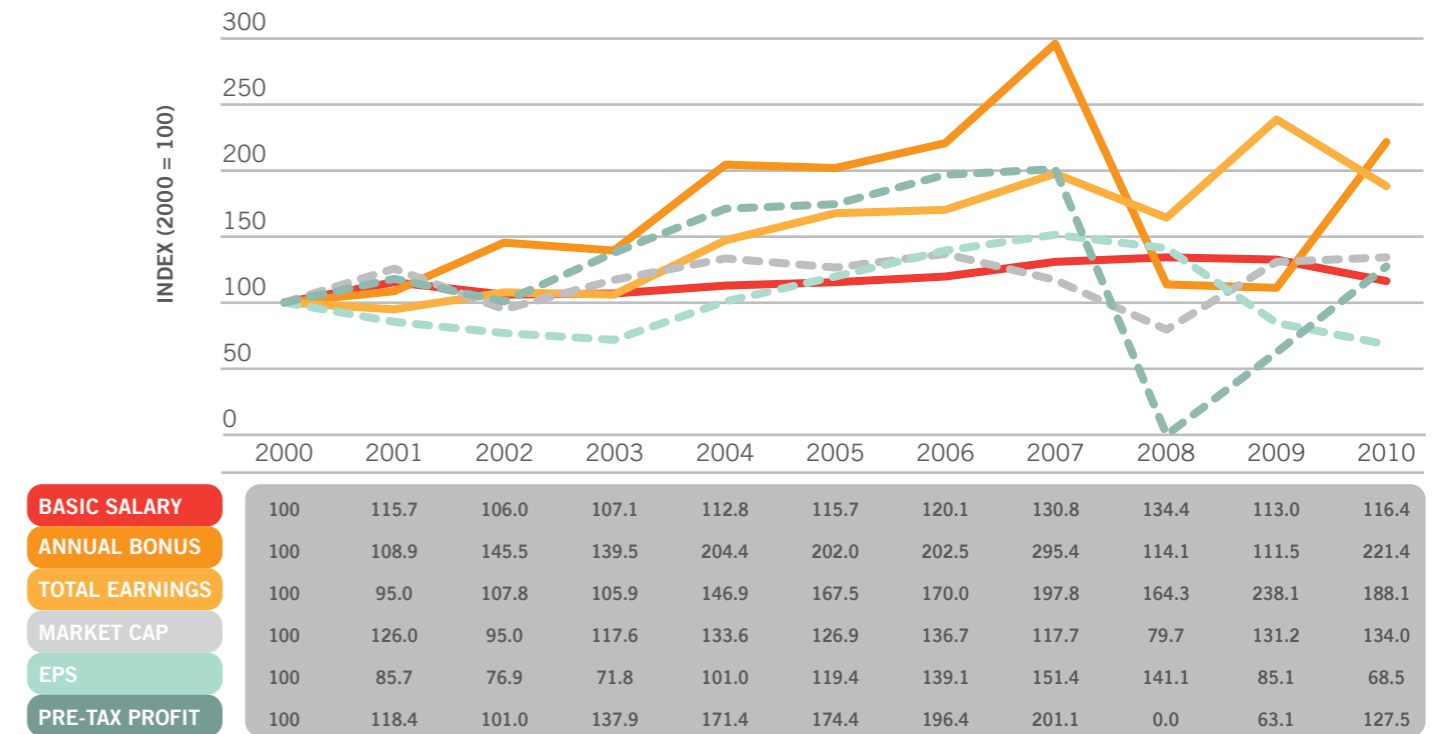


NON-STATE SUPPORTED BANKS

A similar pattern is evident in non-state supported banks as shown in **Graph 8.3** although the performance indicators of earnings per share, pre-tax profit and market capitalisation are less volatile compared to the analysis of state-supported banks. Despite this relative lack of volatility in performance indicators there is nevertheless far greater movement in lead executive bonuses and total earnings. As in state

supported banks, bonus payments peaked in 2007 at over 500 index points relative to 2000, and then dropped to a low of around 270 points in 2009. Also as in state supported institutions, there is no clear and definitive link between increases in performance indicators and lead executives' remuneration. Indeed, as the chart highlights, average total earnings, represented by the yellow line, begin rising sharply once more in 2009 with no commensurate increase in the either earnings per share or pre-tax profit.

GRAPH 8.4 SUMMARY OF TRENDS IN LEAD EXECUTIVE REMUNERATION AND MARKET INDICATORS AT FTSE 350 FSA-DEFINED BANKS 2000 TO 2010



ALL FSA-DEFINED BANKS

The final chart, **Graph 8.4**, shows indexed average lead executive salaries and total earnings in all FTSE 350 FSA-defined banks versus company performance indicators. Again, it is unclear from the charts whether there is a direct link between remuneration and performance. Around 2002, for example, both annual bonuses and total earnings begin declining, despite an associated increase in pre-tax profit and market capitalisation. Earnings per share do decline, however, so at this point there is some argument to suggest that incentive payments are more closely linked to

EPS performance. However, when, in 2008, EPS starts to decline (light green dotted line), there is an associated steep increase in total earnings.

In conclusion, the graph analyses show an inconsistent pattern, that is, where, on occasions, there does appear to be a correlation between remuneration and company performance, (in the case of 2004 EPS with total earnings in **Graph 8.4**, for example), the correlation is temporary and slight increases in company performance indicators are often accompanied by much steeper and higher increases in total earnings (**Graph 8.3**, 2003).

Appendix I: Survey details

Our report covers the companies which have ranked in the top 350 of the FTSE 500 for all or part of the ten year period from 2000 to 2010. Annual market indicators for 757 different companies were supplied by DataStream and the remuneration details of more than 5,000 named directors were assembled from data collected each year from companies' annual reports. In total, the report draws on 11,907 annual remuneration records. All remuneration analyses are based on full-year figures and aggregate data has been generated using the well-established statistics program SPSS.

By year of financial year end date	Companies no	%
2000	349	9.6
2001	331	9.1
2002	337	9.3
2003	332	9.2
2004	331	9.1
2005	337	9.3
2006	341	9.4
2007	325	9.0
2008	327	9.0
2009	306	8.4
2010	307	8.5
Total	3,623	100

By year of financial year end date	Records no	%
2000	1,316	11.1
2001	1,315	11.0
2002	1,306	11.0
2003	1,183	9.9
2004	1,176	9.0
2005	1,123	9.4
2006	1,061	8.9
2007	948	8.0
2008	951	8.0
2009	854	7.2
2010	674	5.7
Total	11,907	100.0

By year of financial year end date	Lead executive records no.	Finance director records no.	Other director records no.
2000	319	261	735
2001	300	278	737
2002	322	274	710
2003	299	267	617
2004	299	287	590
2005	312	284	527
2006	315	265	481
2007	289	243	416
2008	302	256	394
2009	277	240	337
2010	224	196	254
Total	3,258	2,851	5,798

Appendix II: Definitions

ANNUAL SALARY

Salaries are those shown in the standard emoluments table in annual reports and accounts. This salary is not necessarily the figure set at a director's salary review, but the amount received during the year. Only full-year, full-time salary rates are included in the survey.

BENEFITS-IN-KIND

These are the estimated money value of any benefits, excluding company pension contributions, received by the director. Where a cash alternative to a company car is paid, it is included under benefits. Annual bonus
Bonus is the total earned in the year, both in cash and the face value of deferred shares, but not matching shares. It may also include profit sharing and profit-related pay.

TOTAL CASH

Total cash is the sum of salary, benefits-in-kind and total bonus earned in the year.

LONG TERM INCENTIVE PLAN (LTIP)

Long term incentive plans tie the receipt of shares to corporate performance and do not require directors to lay out their own money. At the beginning of a performance cycle (usually three years) a director is awarded an initial grant of shares. Depending on how well the pre-specified performance targets are satisfied, the initial grant may vest either in part or in whole and the director will

receive a block of shares with a certain face-value. LTIP profits or gains refer to the cash value of any LTIP awards actually vesting during the year, not the value of any conditional grants that may vest sometime in the future.

SHARE OPTION

Share option schemes may grant directors the right to buy shares at a future date at the today's market price. Under current arrangements, directors usually have the right to exercise their options at any time between three and 10 years after the initial grant. When grants become exercisable, directors can profit from the difference between the exercise price (usually near the market price on the date of grant) and the market price of the company's shares upon exercise of the grant. Share option profits or gains refer to the cash value of any SAYE or executive share options actually exercised during the year, not the value of any conditional grants that may vest sometime in the future. The profit or notional gain on share options has been calculated by multiplying the number of shares exercised by the difference between the exercise price at grant and the market price for a share on the day the options were exercised. Unless a director sold shares immediately following the exercise, any gains are 'notional'.

TOTAL EARNINGS

Total earnings is total cash as defined above plus:

- the cash value of any LTIP and/or matching shares vesting during the financial year, but not the value of any conditional share awards that may vest at some time in the future;
- notional/actual gains following the exercise of executive share options during the year. It should be emphasised that unless the director has sold the shares, none of this 'profit' will necessarily have been realised in cash. Further, if shares have been sold subsequent to exercise, they may not have been sold at the same market price as was in effect at exercise;
- miscellaneous payments. These include special payments for pensions, housing assistance, one-off bonuses for particular projects and SAYE gains.

LEAD EXECUTIVE

The label 'lead' is ascribed to the one executive with the ultimate level of responsibility for a company's daily activities as well as for its long-term strategy. While in the overwhelming majority of cases this refers to the company's chief executive officer (CEO), it can also refer to an executive chairman or to any other person who bears the traditional responsibilities of the CEO.

OTHER DIRECTORS

Any other board-level executive director that is not the lead executive. For example, this group can include, but is by no means limited to, these positions: managing director or CEO of a subsidiary or division of the company; commercial director; executive director in charge of operations overseas; technical director; operations director; strategy director.