11 Executive directors

Introduction

EDs combine their role as director of the board with their position within the executive management of the organisation. NEDs perform the functions of director, only without any executive responsibilities. The interests of EDs are therefore likely to differ from those of NEDs.

The focus in this chapter on the role of the CEO and EDs must not distract from the underlying principle of the unitary board. EDs have the same responsibilities and duties as NEDs; these extend to the entire business of the organisation, not just their own specific portfolio.

The role of executive directors

Unlike NEDs, outside of their board role EDs are full-time employees of the organisation, with executive management responsibilities. Management is responsible for running the business operations and is accountable to the board of directors and the CEO.

For the EDs, there is a tension between their role as members of the board, 'one step down from the stakeholders' and their role as senior operational directors, 'one step up from management'.

This can manifest in different ways. There will be times when individual EDs and/or the CEO are held to account for their executive performance by fellow EDs, acting alongside NEDs as a unitary board. This can raise tensions – especially if the CEO is being held to account – and highlights the critical role of the chair in maintaining an effective board.

On the other hand, EDs and the CEO may want to present a united front to the rest of the board to justify what the management team has done and achieved, or what it would like to do. However, if the EDs come together with a united opinion, this raises doubts in their ability to provide effective challenge in discussions on strategy. Independent NEDs should not have this problem, which is why they should be more effective in providing effective challenge in board discussions, encouraged by the chair.

The issues for EDs are, therefore, that they may be inclined to support the views of the CEO on all matters, including strategy, and they may mistrust the NEDs as 'outsiders' who do not know much about the organisation and its business.

In recognition of this problem, the FRC Board Guide suggests that EDs should welcome constructive challenge from NEDs as an essential aspect of good governance, and encourage their non-executive colleagues to test proposals in the light of their wider experience outside the company.

ICSA: The Governance Institute's guidance note, the Governance Challenge for the NHS Executive Director, sets this out quite neatly by suggesting EDs ask, 'Which hat am I wearing?' to retain an appropriate balance between the varying roles for which they are being paid. These include:

- leadership and management of their particular section or department;
- being a member of the senior operational management of the organisation;
- wider leadership and management responsibility within the operational environment;
- ensuring the organisation remains focused on delivering its core business objectives; and
- governance and strategic responsibility from the board perspective.

The governance role is different to the management role. An ED's governance role along with the other members of the board is to:

- ensure that sufficient assets are aligned against the operational objectives being set though also guarding, maintaining and nurturing those same assets;
- debate, determine and set the strategy for the organisation; and
- monitor progress towards its fulfilment.

In contrast, the management role is to utilise the assets of the organisation in the fulfilment of the operational objectives of the organisation and to deliver the strategy determined by the board. The publication *New Voices, New Accountabilities: A guide to wider governance in foundation trusts* states:

> 'Boards of directors will increasingly have to operate as corporate entities, not sounding boards, in a world of contestable service provision ... Executive directors must make the transition from operating as functional heads of service to members of a corporate board, bearing the full weight of the fiduciary responsibility that falls on their shoulders and contributing fully to the strategic decision making of the trust.'

The appointment of executive directors

The nomination committee has a key role to play in the appointment of EDs, as discussed in Chapter 7. The CEO will bring recommendations to the committee on succession planning and appointment, but the board will delegate

the responsibility for appointment to these committees (which are essentially composed of NEDs). The key principle about the appointment of EDs is that it is the responsibility of the chair and the NEDs, acting under the remit of the nomination committee. The exception worth noting relates to the appointment of the NHS CEO, which is covered below.

Induction of an executive manager as an executive director

The induction process for a new ED who is already an executive manager of the organisation needs a specific focus. A senior executive of the organisation should already be familiar with many aspects of the organisation's operations (although their induction might include visits to parts of the organisation they have not worked with before).

An executive manager 'promoted' to the board is more likely to lack knowledge and experience about being a director and governance, although some larger organisations try to give their senior executives experience as a director by allowing them to take a position as a NED in another organisation.

An induction programme for an ED may therefore need to focus on matters such as:

- the role of the board, including matters reserved for the board and oversight of management;
- the powers and duties of directors, and the rights of shareholders/stakeholders (the new director should be given a copy of the organisation's constitutional documents);
- the role of board committees and their membership;
- the role of the board in monitoring risk and internal control (see also Chapter 16);
- membership of the board and its committees, how the board operates and the role of the company secretary;
- frequency of board meetings;
- what the new director will be expected to contribute;
- who the major shareholders/stakeholders are and their relationship with the organisation;
- compliance with governance requirements;
- the potential liabilities of directors;
- directors' liability insurance;
- organisation policy on public involvement and sustainability; and
- arrangements for monitoring the performance of board members.

NHS Providers offers an ED induction programme, which was developed following requests from new board EDs for a deeper understanding of their board role as part of a unitary board and of the wider context within which the role is set. The programme includes:

- understanding the developing NHS environment and what that means for the leadership of foundation trusts and trusts;
- governance, risk and assurance in the provider sector;
- what your chief executive expects of you;
- the Care Quality Commission (CQC) and regulation;
- NHS Improvement (NHSI) – the way forward;
- your board role vs your ED role;
- working with commissioners; and
- your responsibilities and accountabilities.

This list is not exhaustive, although in some cases it might be considered too long. The main point is that an executive manager appointed as a director needs to learn about the differences in the roles of manager and director, and that they have not been appointed as a director simply to be a 'high level' executive of the organisation.

The role of the CEO

The FRC Board Guide says the CEO is the most senior ED on the board, with responsibility for proposing strategy to the board and for delivering the strategy as agreed.

Consequently, the CEO's relationship with the chair is a key relationship that can assist board effectiveness. The CEO leads the executive team, is responsible for the executive management of the organisation's operations and is the senior executive to whom all other executive managers' report. Other executive managers might also be directors of the organisation, but the CEO is answerable to the board for the way the business is run and its performance.

The CEO has, with the support of the executive team, primary responsibility for setting an example to the organisation's employees and communicating to them the expectations of the board in relation to the organisational culture, values and behaviours. The CEO is also responsible for supporting the chair to make certain that appropriate standards of governance permeate through all parts of the organisation and will make certain that the board is made aware, when appropriate, of the views of employees on issues of relevance to the business.

In order to improve the standard of boardroom discussion, the CEO should also act as a spokesperson for the executive team in board discussions, explain the views of the executive team to the rest of the board and explain in a balanced way any differences of opinion within the executive team.

The chief executive is also responsible for ensuring that management fulfils its obligation to provide board directors with:

- accurate, timely and clear information in a form and of a quality and comprehensiveness that will enable it to discharge its duties;

- the necessary resources for developing and updating their knowledge and capabilities; and
- appropriate knowledge of the company, including access to company operations and members of the workforce.

The UK Code states that the differing responsibilities of the chair and the CEO should be set out in writing and agreed by the board. Particular attention should be paid to areas of potential overlap.

The role of the accountable/accounting officer in the NHS

At a macro level, the DHSC accounting officer (AO), as principal AO, has overall responsibility in government for the proper and effective use of resources as voted by Parliament for the health and care system, including the NHS.

The majority of resources are allocated annually to NHSE. Its CEO, as AO, is responsible for the effective use of these resources. There is a robust system in place to allow the AO to discharge their responsibilities by providing assurance about the commissioning of NHS care and the provision and regulation of services. This system entails the appointment of accountable officers (for NHS trusts and CCGs) and AOs (for FTs).

For NHS trusts, the accountable officer is the CEO, who is accountable to Parliament via the DHSC AO and the SoS. The NHSI AO is responsible for the appointment of accountable officers for each NHS trust. In clinical commissioning groups (CCGs), the accountable officer is either the chief officer or the chief clinical officer (CCO). They are accountable to Parliament via NHSE's AO (the CEO, as designated in the Health and Social Care Act 2012 (HSCA 2012)) and the SoS. In NHS FTs, AOs are directly responsible to Parliament.

The accountable officer memorandum for chief executives of NHS trusts sets out the responsibilities as follows:

- ensuring there are effective management systems in place to safeguard public funds and assets and assisting in the implementation of corporate governance;
- ensuring value for money (VFM) is achieved from the resources available to the trust;
- ensuring the expenditure and income of the trust has been applied to the purposes intended by Parliament and conform to the authorities which govern them;
- ensuring effective and sound financial management systems are in place; and
- ensuring annual statutory accounts are prepared in a format directed by the Secretary of State, with the approval of HM Treasury, to give a true and fair view of the state of affairs as at the end of the financial year. This should include the income and expenditure, recognised gains and losses and cash flows for the year.

The CCG accountable officer is responsible for ensuring that the CCG fulfils its duties to exercise its functions effectively, efficiently and economically

– thus ensuring improvement in the quality of services and the health of the local population though maintaining value for money. They will ensure that the regularity and propriety of expenditure is discharged, and that arrangements are put in place to ensure that good practice is embodied (as identified through the head of the National Audit Office, the Comptroller and Auditor General). They will also ensure that funds are safeguarded through effective financial and management systems.

The CCG accountable officer, working closely with the chair of the governing body, will ensure that proper constitutional, governance and development arrangements are put in place to assure the members of the CCG's ongoing capability and capacity to meet its duties and responsibilities. This will include arrangements for the ongoing development of its members and staff. The individual who takes on the accountable officer role for a CCG will be proposed by the governing body of the CCG and formally appointed to the role by NHSE in accordance with the NHSE guidance CCG Guidance on Senior Appointments including Accountable Officer (2017). In circumstances where the lead clinician undertakes the accountable officer role, they will be known as the CCO. When a manager undertakes the role, the individual will be known as the chief officer. The accountable officer may not be the chair of the governing body or the chief finance officer (CFO). The involvement of NHSE does not create an employment relationship between the accountable officer and NHSE; instead, the accountable officer is an employee of the individual CCG.

Each FT has an AO, who has responsibilities for ensuring regularity, propriety and value for money, including signing the trust's accounts, annual governance statement and annual report. The National Health Service Act 2006 designates the CEO of an NHS FT as the AO. The NHS Foundation Trust Accounting Officer Memorandum (2015) sets out the role as responsibility for the overall organisation, management and staffing of the NHS FT and for its procedures in financial and other matters, and ensuring:

- there is a high standard of financial management in the NHS FT as a whole;
- the NHS FT delivers efficient and economical conduct of its business and safeguards financial propriety and regularity throughout the organisation; and
- financial considerations are fully taken into account in decisions on NHS FT policy proposals.

The FT AO has a particular responsibility to see that appropriate advice is tendered to the board and to the council of governors on all matters of financial propriety and regularity and, more broadly, as to all considerations of prudent and economical administration, efficiency and effectiveness. The NED-led appointments committee appoints the AO and the appointment is approved by the council of governors.

In all three settings, if the board or the chair is contemplating a course of action that the accountable/accounting officer considers would infringe the

requirements of propriety and regularity, they should set out their objections (and the reasons for it) in writing to the chair and the board. If the decision is still taken to proceed, a written instruction to take the action in question should be issued. The audit committee, which has specific terms of reference and delegated powers to inquire into matters of propriety and regularity, should receive a copy of the objections.

If the board is contemplating a course of action that affects the responsibility for obtaining VFM from the organisation's resources, then the accountable/accounting officer should draw the relevant factors to the attention of the board. If the accountable/accounting officer is overruled, despite clear advice to the contrary, then the accountable/accounting officer should refer their concerns to their appointing body. In all such cases, the accountable/accounting officer should, as a board member, vote against the course of action rather than merely abstain from voting.

The accountable officer, together with the director of finance, is responsible for ensuring that the accounts of the trust presented to the board for approval are prepared under principles and in a format directed by the SoS with the approval of HM Treasury (as set out in the NHS Finance Manual and in 'The Role of the Director of Finance in the NHS' – EL(94)18). These accounts must disclose a true and fair view of the trust's income and expenditure; cash flows; gains and losses; and of its state of affairs. The accountable officer will sign these accounts, along with the director of finance/CFO, on behalf of the board.

In FTs, the CEO, as the AO, should sign and date the statement of financial position and annual report after adoption by the board as evidence of this. As AO, the CEO should also sign the foreword to the accounts, the annual governance statement and the remuneration report. Once the annual report and accounts have been approved by the external auditors, the AO or director of finance must sign a certificate that states that the FT consolidation (FTC) schedules are consistent with the annual accounts.

The role of the director of finance or chief finance officer

NHS trusts and FTs are required to have a director of finance (DoF) on the board and CCGs are required to have a CFO on their governing body.

Though financial management is the corporate responsibility of the board, and the individual responsibility of the CEO/CO as the accountable officer, the DoF has both a professional and corporate role as a board member. The DoF ensures that systems are in place so that the organisation is properly governed in terms of financial transactions, financial reporting, financial performance, financial planning and in securing value for money. They also must also maintain assurance processes to ensure that internal controls and checks are working properly (such as engagement with clinical and non-clinical staff holding

delegated financial budgets). These systems also include ensuring that 'treasury management' systems are in place to manage cash flow and liquidity.

The key responsibilities for finance directors are to provide business and commercial advice for the board as well as financial governance and assurance, and to fulfil their corporate responsibilities as a board member. A key requirement for NHS organisations is sustainable financial viability; the DoF has to involve and inform the board in assessing all the options in terms of strategic financial risk, including a 'worst case' scenario.

The DoF should be a professional accountant, and as such is required to behave with confidentiality, integrity, objectivity, professional competence and due care as mandated in the International Federation of Accountants (IFAC)'s Code of Ethics. They must also comply with professional quality standards, especially those relating to professional ethics, continuing professional development, and national and international external reporting requirements. The conduct and behaviour of a DoF must be within the law and, as a professional accountant, they also have a 'public interest' role. However, as a board member, the DoF's contribution is not, and should not be, limited to finance as a specialist area.

The National Health Service (Clinical Commissioning Groups) Regulations 2012 require that the CCG's governing body must also include an employee who has a professional qualification in accountancy and the expertise or experience to lead the financial management of the CCG, to be known as the CFO. If the governing body's membership includes two or more individuals of that description, the CCG must designate one of them as the CFO. They should be an individual with a recognised professional accounting qualification, as well as significant experience and skills. The CFO cannot be the chair of the governing body nor may they undertake the accountable officer role. The role may, however, be combined with that of chief operating officer (COO) in circumstances where a CCG has a COO (for instance, in CCGs where the clinical leader is also the accountable officer). In these circumstances, the role is known as 'chief finance and operating officer'.

Other executive director roles

There are several other key ED roles that are an important part of an NHS board.

The roles of medical director and director of nursing (or chief nurse or executive nurse) are mandatory roles for a legitimately constituted board. Again, as board members, these roles should not be limited to their areas of professional expertise and they are required to contribute across the breadth of the organisation.

In a CCG, the lead clinician is the individual recognised by the CCG as the clinical voice of its members. This individual is either the chair of the governing body or undertakes the role of accountable officer as chief clinical officer. In circumstances where a CCG chooses to appoint a clinician to the chair of the

governing body and nominate a clinician for the role of the accountable officer, then the CCG should identify one of them to be known as the lead clinician.

The remuneration of executive directors

The remuneration of EDs and other senior executives in the corporate sector is a contentious issue, partly because of the amounts paid to top executives in some companies and partly because remuneration for senior executives has generally risen by a much larger percentage than increases in pay for other employees.

While remuneration packages should be sufficient to attract and retain executives of a suitable calibre, they should not be excessive. Such packages should also reward executives for successful performance, in both the short term and the longer term, because pay incentives are expected to encourage executives to perform better. A further area of concern to the corporate sector (and to the NHS) is the payment of large 'rewards for failure'. Contracts of employment for senior executives should try to minimise the risk of these severance payments when a senior director fails to perform to a satisfactory standard and is dismissed.

The remuneration committee is the critical mechanism for governing executive remuneration.

Remuneration in the corporate sector

This has become a hot topic concerted focus of government and industry discussion. Total pay for the CEOs of FTSE 100 companies quadrupled between 1998 and 2015, according to the Department for Business, Energy and Industrial Strategy (BEIS) analysis, largely due to the growth in annual bonus payments and long-term pay incentives. It far outstripped growth in average pay in the UK in the same time period. According to the High Pay Centre, in 1998 the ratio of average FTSE 100 CEO pay to the average pay of full-time employees in the UK was 47:1. This ratio increased to 132:1 in 2010 and stood at 160:1 in 2018.

The remuneration of EDs and senior executives was not seen as a major problem of corporate governance until the 1990s in the UK and early 2000s in the US. A sense that something might be wrong began when the general public, alerted by the media, criticised some top executives for being paid far more money than they were worth and investment institutions criticised directors for receiving ever-increasing rewards even when their company performed badly.

In many listed companies in the UK during the 1980s and early 1990s, the CEOs and executive chairs were involved in deciding their own remuneration package. Concern about remuneration has grown in other countries, particularly with regard to the banking crisis in 2007–09 and the high rewards earned by senior bankers in spite of the large amounts of public funds provided to prevent banks from financial collapse.

As can be seen from the statistics above, the remuneration of top corporate executives rose rapidly regardless of company performance, the effects of global

recession, and at a faster annual rate than the remuneration of other company employees. This seemed counter to the principle of good corporate governance that remuneration should be linked to some extent to company performance, so that a director will earn more if the company does well, but less if it does badly.

Government reforms in 2013 introduced new shareholder controls and oversight over executive remuneration. The reforms gave shareholders a binding vote on pay policies (at least once every three years) and an annual advisory vote on the actual pay awards made to directors under the shareholder-approved pay policies. They also introduced greater clarity in the reporting of executive pay. There are concerns, however, that these reforms have not had sufficient impact.

The Government Green Paper on Corporate Governance Reform (November 2016) includes a section on further reforms to executive remuneration and sets out the following options for further discussion:

- Make all or some elements of the executive pay package subject to a binding shareholder vote.
- Introduce stronger consequences for a company losing its annual advisory vote on the remuneration report.
- Require or encourage quoted company pay policies to (a) set an upper threshold for total annual pay (from all elements of remuneration), and (b) ensure a binding vote at the annual general meeting (AGM) where actual executive pay in that year exceeds the threshold.
- Require the existing binding vote on the executive pay policy to be held more frequently than every three years.
- Strengthen the Corporate Governance Code to provide greater specificity on how companies should engage with shareholders on pay, including where there is significant opposition to a remuneration report.

The Enterprise and Regulatory Reform Act 2013 (ERRA 2013) contains amendments to the Companies Act 2006 relating to quoted companies' disclosure of directors' remuneration and shareholder approval of quoted company directors' remuneration reports. The key changes made by ERRA are as follows:

- The directors' remuneration report must include a forward-looking remuneration policy report.
- Shareholders have been given a new binding ordinary resolution vote on the remuneration policy report (and retain their existing advisory ordinary resolution vote on the implementation report).
- Any subsequent changes to the remuneration policy must be agreed by shareholders and, even if no changes are made to the remuneration policy, it must be approved by shareholders at least every three years.
- If shareholders did not approve the advisory vote on the implementation report at the company's previous AGM, the remuneration policy must be put to shareholders at the next AGM.

- All remuneration and loss of office payments to directors must be consistent with the approved remuneration policy.
- Unless a payment has been separately approved by shareholders in advance, any unauthorised payment is held on trust by the party that received it (usually this will be the director themselves). Directors who authorised the payment will be liable for any loss to the company unless they can demonstrate that they acted honestly and reasonably.

A directors' remuneration report in the new format must be put to shareholders in the first financial year to begin on or after 1 October 2013. Though these regulations apply to companies, not to NHS organisations, the principles they contain are applicable and should still be considered by NHS boards.

NHS remuneration

NHS organisations are subject to a greater level of remuneration regulation than the corporate sector but pay levels for senior management have still come under close public scrutiny – especially as all public sector wage rises have been seriously constrained since April 2013. Indeed, on 2 June 2015, the SoS wrote to the chairs of all NHS trusts, FTs and CCGs urging restraint over very senior managers (VSM) pay and announcing a range of initiatives, including:

- a requirement for ministers to see all proposals for VSM pay above £150,402 before appointments are confirmed (£150,402 being the salary of the Prime Minister);
- the development of a national framework for VSM pay in the NHS; and
- the introduction of a limit on the daily rate payable to an off-payroll interim VSM and request for rigorous compliance with Her Majesty's Treasury guidance on off-payroll engagements.

The Secretary of State set out their expectation that there should be no significant difference in the terms and conditions of senior leadership teams and those working on the front-line and their view that it is not acceptable that some senior managers experience high levels of pay, with year-on-year increases, as a matter of course.

Guidance on pay for very senior managers in NHS trusts and foundation trusts issued in March 2018 requires the approval of NHSI and the DHSC and Her Majesty's Treasury for all VSM pay review decisions.

This process covers:

- all on-payroll appointments (substantive and fixed term) for VSM roles in NHS ambulance and community trusts until this is replaced by the new pay framework;
- on-payroll VSM appointments (substantive and fixed term) in all other NHS trusts and in all NHS foundation trusts where the annual salary is £150,000 or above (irrespective of whether or not the new salary is an increase);

- acting-up arrangements, promotions/pay rises for individuals already in post and earning £150,000 or above, and NHS secondments and conversion of off-payroll interims into on-payroll arrangements;
- directors who by virtue of their qualifications and the requirements of the post are eligible to be on the standard NHS consultant contract; and
- CEOs or EDs who plan to resign and take their pension benefits when they reach pensionable age, and then return to work.

There are established pay ranges for all such appointments in the NHS. Examples for a CEO are given in Table 11.1.

Chief executives	**Lower quartile**	**Median**	**Upper quartile**
Small acute NHS trusts and foundation trusts (£0–£200 million turnover)*	£141,000	£167,500	£182,500
Medium acute NHS trusts and foundation trusts (£200–400 million)*	£160,000	£182,500	£202,500
Large acute NHS trusts and foundation trusts (£400–£500 million)	£190,000	£197,500	£230,000
Very large acute NHS trusts and foundation trusts (£500 million +)	£195,000	£225,000	£267,500

Note: * Specialist trusts can apply for a 15% premium.
(NHSI, 2018)

Table 11.1: Pay ranges for CEOs

The framework, when published, will be informed by the Rose Review (June 2015). Sir Stuart Rose, the former Chairman of Marks & Spencer, was commissioned by the SoS to review the NHS leadership challenge and identified the following three areas of concern:

1. **Vision:** There is a lack of One NHS Vision and of a common ethos.
2. **People:** The NHS has committed to a vast range of changes; however, there is insufficient management and leadership capability to deal effectively with the scale of challenges associated with these.
3. **Performance:** There is a need for proper overall direction of careers in management across the medical, administrative and nursing cadres.

Consequently, CCGs, NHS trusts and NHS FTs are no longer free to determine their own rates of pay for VSMs – CEOs, EDs and others with board-level responsibility who report directly to the CEO.

VSM pay in DH arm's-length bodies (ALBs) such as NHSE, Monitor, the CQC and the NHSI is subject to two national pay frameworks, one set in 2006 and

the other in 2012. Performance-related pay is available to VSMs within ALBs on either of the existing national pay frameworks, although it is currently restricted by the government to the top 25% of performers and to a maximum of 5% of reckonable pay.

Pay data for CCGs analysed by e.reward.co.uk in 2015 identified that more than two-fifths (43%) of chief officers in CCGs servicing the largest populations (more than 500,000 people) collected pay above the £120,000 to £130,000 recommendations. These decisions were taken despite strong encouragement from NHSE to make lower pay awards to senior executives. NHSE had proposed three pay ranges for chief officers and CFOs, based on the population sizes of CCGs (see Table 9.2).

CCG level	Population size	Pay range for chief officer	Pay range for CFO
Level 3	At or over 500,000	£120k–£130k	£95k–£110k
Level 2	150,000 to 499,000	£105k–120k	£85k–£95k
Level 1	149,000 or below	£90k–£105k	£75k–£85k

(NHSE, 2018)

Table 11.2: CCG pay ranges

All other posts within the NHS are governed by the Agenda for Change system, which allocates posts to set pay scales using a job evaluation scheme. All FTs have the freedom to use local terms and conditions when setting pay for all employees, yet continue to be guided by VSM and to operate Agenda for Change for their staff.

The ongoing period of austerity for the public sector will restrain remuneration levels in the public sector; however, corporate sector remuneration will also influence NHS remuneration levels, as suggested by the response of the NHS Confederation:

> 'NHS organisations are large and complex in nature and require the right managerial skills to be led effectively. A large city hospital could have a budget of between £500 million and £1 billion and employ as many as 10,000 staff – comparable to many FTSE 250 companies. Because of the challenging nature of a chief executive's role, NHS boards must consider a range of factors, including pay, to encourage the best candidates in to these positions. The NHS is looking to involve more clinical staff in top management positions. Given that a number of hospital doctors will be paid more than NHS chief executives, this factor must be taken into consideration when making a decision on pay.'
>
> David Stout, Deputy CEO, NHS Confederation

Public attitudes

Public attitudes about remuneration within the NHS are somewhat contradictory. This fact was recognised, although not specifically, in the Hutton Review of Fair Pay (2011) in the public sector (covered in more detail later):

> 'Success [of the public sector] would be a fundamental building block in supporting economic growth and social well-being, but it cannot be done without motivated, high calibre public servants, along with managers to lead them.
>
> But while the British public is very sympathetic to front line delivery staff, it is hostile to the public sector managers responsible and accountable for the effective deployment of resources – and even more hostile to their pay. In the eyes of some, they are the quintessential "burdens" on the rest of us.'

The review set out that some of this public reaction is quite reasonable, since public sector managers have also benefited from significant earnings growth at the top remuneration levels, particularly in the early 2000s. However, some balance is required. As the Hutton interim report demonstrated, only £1 of every £100 earned by the top 1% of earners in the UK is earned by public sector employees.

Even so, the perception remains that the public sector is no less awash with 'fat cats' than the private sector; indeed, in one poll, a quarter of respondents thought that public sector executives earned more than their private sector counterparts. Regardless, Hutton maintains that: 'the public has the right to know that pay is deserved, fair, under control and designed to drive improving public sector performance'.

Rewards for failure

In the UK, there was institutional investor concern, supported by widespread media coverage, about large remuneration packages for senior corporate directors where the size of the reward did not seem sufficiently linked to performance, and large severance payments (payments on dismissal) to outgoing senior executives who had been ousted from their job following poor company performance.

High severance payments to unsuccessful directors were seen as 'rewards for failure'. Following the global banking crisis of 2007–09, there was also widespread criticism of remuneration in banks, whereby top executives and traders received large bonuses even though their bank may have been close to collapse or in need of government financial support to remain in business.

Similar problems of rewards for failure have been seen in the NHS and raises very clear issues of health service governance.

The problem of inappropriate remuneration policies for senior executives is now well recognised within both the NHS and the corporate sector, but a satisfactory solution has not necessarily been found. However, a distinction should be made between the unethical 'corporate greed' of some senior executives, and a reasonable desire by senior executives to be well remunerated for what they

do. Similarly, it is important to make the distinction between high rewards that are justified by performance, and high rewards that are earned in spite of poor performance.

Why is remuneration a governance issue?

Remuneration of senior executives is a governance issue for several reasons.

- Excessive remuneration for senior executives that is not clearly linked to good performance breaches the requirement for economy, efficiency and effectiveness which underpins the NHS.
- Executives should not be rewarded for failure.
- Large organisations need to attract and retain talented professionals to provide them with effective leadership. Top executives are attracted and retained by the remuneration packages they are offered.
- Organisations need effective boards and senior executive management. Remuneration incentives can be used to motivate executives to perform better and to achieve better results, however, remuneration incentives should be designed carefully to align the interests of the organisation and executives as much as possible, in both the short term and the longer term.
- The remuneration of senior executives may antagonise employees (and employee representatives), when it appears that senior executives are paid excessive amounts in comparison with their own pay. A sense that benefits or rewards are unfairly distributed could lead to industrial unrest within the organisation.

A further reason relates to the stability and continuity of the board. A study by Income Data Services in February 2016 found that while median salary levels had flatlined, boardroom turnover across all parts of the NHS was running at high levels. Overall, the attrition rate stood at around 30% with some variations according to country and trust type. In fact, turnover in non-FT boardrooms was 35% in the year to March 2015 and 27% in foundation trusts. This contrasts with March 2012 when board turnover levels were around 25% and this was considered substantial because they followed the initial stages of change that resulted from the Health and Social Care Bill 2011. Additionally, Will Hutton identified in his 2011 review on fair pay that there were real concerns about director tenure in the NHS, where the average tenure of NHS acute trust chief executives was just two years and four months, compared with the average tenure for FTSE 100 chief executives at 5.9 years. He went on:

> 'Such short tenures not only compare unfavourably with the private sector (average tenure for FTSE 100 chief executives is currently 5.9 years) but are also not conducive to successful management: business management research suggests that most chief executives need an average of 30 months to complete their learning curve upon taking up a new role.'

This is backed up by research by the King's Fund in 2018 that found that the median tenure of an NHS provider chief executive was three years and the mean average was four years. Previous research has suggested that there are positive links between how long senior leaders remain in organisations and the performance of the organisations they lead. The NHS Leadership Academy has suggested that chief executives should ideally stay in post for at least five years to give organisations the stability they need for effective strategic planning. The impact of a high turnover can be strategic paralysis, a loss of organisational memory and diminished credibility of leaders.

Principles of executive director remuneration

Principles of remuneration are now included in the corporate governance codes of many countries. In a system of good governance, the remuneration of directors and key senior executives should be sufficient to attract and retain individuals of a suitable calibre. At the same time, the structure of an individual's remuneration package should motivate the individual towards the achievement of performance that is in the best interests of the organisation and its stakeholders, as well as those of the individual.

The UK Code states as a principle that:

> 'Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to company purpose and values and be clearly linked to the successful delivery of the company's long-term strategy.'

It is widely accepted that senior executives should be able to earn a high level of remuneration in return for the work they do and the responsibilities they carry. If a company does not offer an attractive package, it will not attract individuals of the required calibre. It is also generally accepted that the level of remuneration should be linked in some way to satisfactory performance. If an executive performs well, they should receive more rewards than if they perform only reasonably well.

The central issue for good corporate governance is concerned with the link between pay and performance. In the corporate sector, the remuneration package should include a performance-related element. If the director successfully achieves predetermined levels of performance, they will be rewarded accordingly. There could be some debate as to how much remuneration should be performance related, but there is a view that a substantial part of a director's total potential remuneration should be linked to performance. Linking remuneration, wholly or in part, to performance is not an easy task, however, as the following shows.

- Unsuitable measures of performance may be selected, so that although the individual executive succeeds in achieving targets that earn high rewards, the organisation does not obtain a comparable benefit.

- Many performance measures are based on the short term, possibly linked to annual results. This may not be in the interests of the organisation's longer-term development and performance.
- Remuneration systems are normally designed to provide the reward after the performance has been made. This time delay means that if the organisation has poor results in the current year after having done well in the previous year, an executive may be paid high remuneration (for the previous year) at a time the organisation is doing badly.

The UK Code requires that the responsibility for setting the remuneration of EDs (and possibly other senior executives) should be delegated by the board to a remuneration committee. The remuneration committee is explained in more detail later in this chapter and the FRC Guidance on Board Effectiveness (2018) sets out provisions for the design of the performance-related elements of a remuneration package that the remuneration committee should apply. These provisions offer a useful insight into how incentive schemes may be structured and approved.

If it is not an easy task for corporate governance, then it becomes even more difficult for health service governance. As this handbook has already demonstrated, there is significant diversity and complexity amongst stakeholders and their objectives for NHS organisations. Finding suitable measures of performance is a challenge that was highlighted in the Hutton Review (see below). For health service governance, a key principle relates to the public scrutiny and transparency of the remuneration package and the accountability of the ED.

Hutton Review of fair pay in the public sector

The Hutton Review was published in March 2011 and sets out a Fair Pay Code for senior pay, to be adopted by all organisations delivering public services, on a 'comply or explain' basis based on the principle of fairness as due desert – namely, reward should be proportional to the weight of each role and each individual's performance. The Code also required pay levels to be set according to a fair process, though recognising that an organisation's success derives from the collective efforts of the whole workforce.

The review also set out 12 recommendations to the government that together form the framework for fairness.

1. Using pay multiples to track executive pay against that of all employees: the government should not cap pay across public services but should require that from 2011–12 all public service organisations publish their top to median pay multiples each year to allow the public to hold them to account.
2. Informing the public debate through annual Fair Pay Reports: to support citizen accountability, the government should commission the Senior Salaries Review Body to publish annual Fair Pay Reports, starting from 2011–12.
3. Re-calibrating the pay of non-departmental public body chief executives.

4. From disclosure to explanation – ensuring complete transparency over executive roles and remuneration: to enable citizens to understand executive remuneration and the nature of executive responsibilities, from 2011–12 the government should require that all organisations delivering public services disclose in precise numbers the full remuneration of all executives, alongside an explanation of the responsibilities of each role and of how executives' pay reflects individual performance.
5. Enabling citizen analysis of executive pay: from 2011–12, the government should require public organisations to submit executive pay data through an online template, and make this data available on data.gov.uk, to allow citizens to access and analyse this data and thus have the information required to hold public service organisations to account.
6. Abandoning arbitrary benchmarks for public service pay: once this framework of recommendations is in place, the government should refrain from using the pay of the Prime Minister or other politicians as a benchmark for the remuneration of senior public servants, whose pay should reflect their due desert and be proportional to the weight of their roles and their performance.
7. Preventing rewards for failure through earn-back pay for senior public servants: to allow pay to vary down as well as up with performance, all public service executives should have an element of their basic pay that needs to be earned back each year through meeting pre-agreed objectives with excellent performers who go beyond their objectives eligible for additional pay.
8. Extending earn-back pay to high performing middle managers.
9. Sharing the rewards of greater productivity: to prevent executives monopolising the rewards of productivity increases, and allow all employees who have contributed to share the benefits, government departments should identify ways of offering gainsharing schemes linked to achievement of the efficiency aspects of their business plans.
10. Opening up opportunities for future generations of public service leaders: to increase the supply of candidates for top positions and reinforce public service management as a career, the government should facilitate greater opportunities for managers to move across different public services.
11. A Fair Pay Code: to embed fairness principles and ensure fair process in executive remuneration, all public service organisations should adopt the Fair Pay Code proposed by this Review. Government departments should, by July 2011, bring forward proposals for the application of this code to all bodies and sectors in which they have an interest.
12. Tracking pay multiples across the economy: to make tracking pay multiples normal practice across the economy, as part of its commitment to improve corporate reporting, the government should require listed companies to publish top to median pay multiples in their annual reporting from January 2012.

The component elements of executive directors' remuneration

The remuneration package for a senior executive in the corporate sector is likely to consist of a combination of: a fixed-pay element – remuneration received regardless of performance, such as a fixed salary and payments made into a salary-related pension scheme – and a variable pay element. This might consist of performance-related incentives, which might be tied to short-term performance such as an annual bonus, and longer-term incentives such as share option awards. In addition, executives might enjoy a number of other perks such as free private medical insurance, a company car and the use of a company plane or apartment. The major issue for the corporate sector in negotiating a remuneration package with an executive is deciding on the balance between the fixed and the variable elements, and to agree on measures of performance as the basis for deciding on how much the performance-related payments should be. Short-term incentives are based on annual performance targets. Long-term incentives may be awarded each year but are linked to performance over a longer period of time, typically three years (or longer). Another problem in deciding a remuneration package is to find a suitable balance between short-term and longer-term incentives.

Admittedly, this is less of an issue for the NHS, where a senior executive remuneration package usually consists of a fixed salary and a final salary-related pension. The FTN Remuneration Survey of executive pay confirms this, although some FTs are now adding a car allowance or lease car to their remuneration packages.

There is also evidence that some FTs offer a performance-related pay scheme in connection with the achievement of trust corporate objectives. These schemes, however, are still in their infancy and small in number.

The remuneration committee

It is a well-established principle of 'best practice' in governance that there should be a formal procedure for deciding on remuneration for directors and senior executives, and no individual should be involved in setting their own remuneration. This is made clear in the UK Code. This means that EDs should not be involved in setting their remuneration packages (although they can negotiate with the individuals who make the decision) and NEDs should not decide their own fees.

The remuneration of EDs was recognised as an important governance issue in the UK in the 1990s with the work of the Greenbury Committee, whose recommendations were subsequently incorporated into the UK governance code in 1998. Health service governance has adopted these principles, either in the constitution of an FT or the founding regulations and statutory instruments of other NHS organisations. It is therefore worth considering the provisions of the UK Code, as they underpin the provisions of health service governance. Specimen terms of reference for NHS Remuneration Committees can be found on the ICSA website.

The requirement for a remuneration committee

The UK Code states that 'the board should establish a remuneration committee ... [which] should make available its terms of reference, explaining its role and the authority delegated to it by the board'.

The remuneration committee is responsible, therefore, for both developing remuneration policy and for negotiating the remuneration of individual directors. Although these two matters are related, they are different. According to the UK Code, the remuneration committee in the corporate sector should consist entirely of independent NEDs. In larger companies, the committee should consist of at least three members, and in smaller companies (i.e. companies below the FTSE 350) at least two members. The company chair may be a member of the committee, but not the committee chair, provided that they were considered to be independent on appointment as company chair. The remuneration committee should have delegated responsibility for setting the remuneration for all EDs and the chair (including pension rights and any compensation payments or severance payments). The remuneration committee should also recommend and monitor the level and structure of remuneration for senior management. The definition of 'senior management' is a matter for the board to decide, but it will normally include the first level of management below board level.

The composition and main duties for a remuneration (and terms of service) committee for are set out more fully in Chapter 7.

Evaluation and appraisal of executive directors

Both the FT Code and the UK Code state as a main principle that the board should undertake a 'formal and rigorous annual evaluation of its own performance and that of its committees and individual directors'. This includes the EDs in their board member roles. The performance of individual EDs as executive managers is not dealt with by a governance code, because individual executive performance is not a governance issue. For governance purposes, the evaluation of performance relates to performance as a director.

Good workforce management would require the EDs to undergo an annual appraisal with the CEO as their line manager in respect of the portfolio of management responsibilities that they undertake. However, this appraisal should also take into account the board level responsibilities that they carry, and the chair of the board should be asked to participate in this aspect of their appraisal.

The chair of the board will appraise the CEO, and this appraisal will include both their management and board role responsibilities. The remuneration committee should then consider the appraisals of the EDs in considering any annual pay review decisions.

Use of remuneration consultants

Companies and NHS organisations often use remuneration consultants, who give advice to the remuneration committee on remuneration packages, including

basic salary levels for senior executives. Consultants should not be given responsibility for deciding remuneration; this responsibility should remain with the remuneration committee of the board. Consultants may use competitive pay data to recommend a basic package for senior executives. Competitive pay data is simply information about the rewards that are being paid to senior executives in other top companies. It is essential that there is a robust tendering exercise for the appointment of such consultants in order to demonstrate their independence and objectivity.

Practice and process

There is no set requirement for the frequency of meeting of the remuneration committee; however, it needs to meet at least annually to approve the remuneration report for the annual report and accounts. Other meetings are likely in order to consider the remuneration policy required by ERRA 2013, any annual reviews of executive remuneration, and decisions on individual EDs as they are appointed. It is routine practice for non-members to be invited to attend the committee as required by the business of the meeting (e.g. the CEO, director of workforce or employment lawyer). The company secretary (or someone from the company secretary's department) should act as secretary to the remuneration committee, because it is the company secretary's responsibility to ensure that the board and its committees are properly constituted and advised. The company secretary can also play a role as intermediary and co-ordinator between the committee and the main board.

The FRC Board Guide makes it clear that whilst the board may make use of a committee to assist its consideration of remuneration, it still retains responsibility for, and makes the final decisions on, all of these areas. The chair should ensure that sufficient time is allowed at the board for discussion of these issues and for allowing the remuneration committee to report on its activity and decisions. As with all board committees, the effectiveness of the committee and its terms of reference should be reviewed annually.

Severance payments

Most EDs have employment contracts with their organisation that provide for an annual review of their remuneration and a minimum period of notice in the event of dismissal. When an organisation decides to dismiss a director, it is bound by the terms of the employment contract. There are various reasons why an individual might leave the company – for instance, they might be regarded as having failed to do a good job, and someone else should do the job instead. In this instance, a high severance payment would be seen as 'rewarding failure'. Alternately, there may have been a disagreement or falling out between directors, resulting in one or more of them being asked to leave; in this instance any severance payment needs

to be fair and not calculated to prevent whistleblowing disclosures or reputational damage.

The employment contract of a director might provide for the payment of compensation for loss of office. Alternatively, an organisation might be required to give the individual a minimum period of notice, typically one year or six months in the UK. If an individual is asked to leave, they might be paid for the notice period without having to work it out. In addition, the individual may be entitled to further bonus payments under the terms of their remuneration package – in spite of being considered a failure in the job.

Shareholder concerns, and the wider public concern in regard to public sector organisations, arise particularly where the severance payment is paid even though an individual is being dismissed for having performed badly. In the past, severance payments have been high for executives who have been seen to have failed. A large compensation payment can seem annoying, because it seems that the individual is being rewarded for failure. Large severance payments reduce company profits and returns to shareholders; in the public sector, they are viewed as the improper use of public sector monies.

Remuneration committees should consider whether the organisation should retain an entitlement to reclaim bonuses if performance achievements are subsequently found to have been materially mis-stated. Contracts of employment should not provide for compensation payments to senior executives in the event of a change of control over the organisation (a takeover).

Remuneration committees should also ensure that the benefits of mitigation are obtained when an individual is dismissed. This should include a contractual obligation of the dismissed individual to mitigate the loss incurred through severance by looking for other employment. The contract should provide for the severance payment to be reduced in circumstances where the individual finds alternative employment.

The former NHS TDA (now NHSI) published guidance in June 2014 set out the processes NHS Trusts are required to follow in agreeing severance payments. The guidance aims to ensure appropriate governance to protect the reputation of the NHS and ensure probity and value for money. It does not cover FTs who should seek guidance directly from NHSI.

This guidance applies to:

- all severance payments (contractual or non-contractual) to CEOs and EDs of NHS Trusts;
- non-contractual severance payments to all staff; and
- contractual payments over £100,000 to all staff including CEOs and EDs.

Severance payments in excess of or outside of statutory or contractual entitlements or payments that are novel and/or contentious should be exceptional and require HM Treasury approval. HM Treasury define a ‘special severance payment’ as one paid to employees, contractors and others above normal statutory or contractual

requirements when leaving employment in public service whether they resign, are dismissed or reach an agreed termination of contract.

Once such approval has been obtained and the employer is satisfied that termination of the employee's employment, together with making a severance payment, is in the best interests of the employer and represents value for money, then a proposal for the remuneration committee, as appropriate and in line with its terms of reference, should be prepared containing the business case for the severance payment.

This document should be created in order to take legal effect and should be marked as such. In addition to the preparation of the proposal, the following steps should be taken:

- Written advice from the trust's auditors and legal advisers should be taken on the proposed business case and severance payment. Advice should also be sought on the proposal and, if appropriate, a settlement agreement should be drafted.
- The legal advice about the draft proposal, together with the audit advice and the proposal itself, should be put before the remuneration committee of the employer for approval.

In the event the remuneration committee approves the business case, further approval should be sought from NHSE or NHSI (as applicable). If a settlement agreement is to be used, the approving body and HM Treasury will need reassurance that it does not include a confidentiality clause which prohibits an individual raising a concern covered under the Public Interest Disclosure Act 1998 (PIDA 1998). If the appropriate national body approves the business case, it will seek HM Treasury's approval on behalf of the employer.

The remuneration committee, operating in accordance with its terms of reference, should satisfy itself that it has the relevant information before it to make a decision and should conscientiously discuss and assess the merits of the business case. It should then consider the payment or payment range being proposed and address whether it is appropriate, taking into account the issues set out under initial considerations. The committee should only approve such sum or range which it considers value for money, the best use of public funds and in the public interest. A written record must be kept summarising its discussions and its decision (remembering that such a document could potentially be subject to public scrutiny in various ways – such as by the Public Accounts Committee (PAC)).

It is only once all of the above steps have been taken, and the necessary approvals received, that the employer should enter into the appropriate agreement to terminate the employee's employment and make the severance payment. In addition, the Small Business, Enterprise and Employment Act 2015 legislated that highly paid public sector executives who receive redundancy payments only to return to work within a year will need to repay some or all of it. In brief, the

Act means that individuals earning more than £100,000 who take a new job in the same part of the public sector within 12 months of being made redundant will have to repay all of it. The proposals will mainly affect NHS and local government administrators, many of whom have taken redundancy payments only to go back into the public sector. The precise amount of the repayment will be pro-rated depending on the length of time between exit and re-employment. The legislation will require the old employer to inform the individual of their obligation to repay the exit payment. Any new employer would be unable to engage with the individual until recovery arrangements for the money have been agreed.

Disclosure of directors' remuneration details

Directors' remuneration report

Under ERRA 2013, companies are required to publish a remuneration report, which includes three sections:

- a statement from the chair of the remuneration committee;
- a forward-looking remuneration policy report (not subject to audit); and
- an annual report on remuneration (audited) which includes both how the policy has been implemented in the year under review and how it will be implemented in the forthcoming year.

Shareholders have a binding vote on the policy report at least every three years, or whenever any changes are made, in addition to an annual advisory vote on the annual remuneration report. The report must set out the total remuneration of individual executive members disclosed as a single figure in the financial statements (including base pay, bonuses, dividend equivalents, pensions etc). The Act does not, however, make a distinction between EDs and NEDs and information about both must be included in the report.

The remuneration report must be approved by the board and signed on its behalf. A copy must be circulated to shareholders in the same way as the annual report and accounts, and it is normal for the remuneration report to be included in the same document. The auditors must state whether in their opinion the report has been prepared properly in their audit report (see Chapter 19). For companies, a signed copy of the report must also be filed with the Registrar of Companies, in the same way as the annual accounts, directors' report and auditors' report.

The remuneration committee should also be available at the annual general meeting to assist in answering any questions put to the board on any aspect of the remuneration report or generally on remuneration principles and practice.

Items to be included in the committee chair's statement include the key messages on remuneration, the context in which decisions were taken and any major changes during the year. This places the chair of the remuneration

committee in the spotlight with regard to the organisation's approach to executive remuneration.

The remuneration policy must include an explanatory table, with detailed notes, setting out the approach taken to directors' remuneration in the period covered by the policy. This must be supplemented with a bar chart showing illustrative scenarios. It must also include a section on the approach to remuneration for new directors recruited to the board, as well as details of the policy on payments for loss of office. An explanation of the extent to which the views of employees' and shareholders have been taken into account is also required.

The annual report then sets out how the remuneration policy was implemented in the previous financial year. A new requirement in this report is the obligation to include a single total figure for the remuneration of each director. The aim is to provide comprehensive disclosure on all types of remuneration – fixed and variable elements, as well as pension provision – in a consistent format. There is also a focus on including a breakdown of payments for loss of office. Any such payment, in addition to being included in the annual report, will also need to be published on the company's website 'as soon as practicable' after the payment has been agreed. These details will need to be kept available until the next annual report is published.

The NHS FT annual reporting manual (NHS FT ARM) and the NHS Finance Manual both require a similar report to be made in the organisation's annual report. This report should include all exit packages, including those paid to senior managers.

Governance checklist

- Are the EDs aware of their wider role as a board member? Does their induction and ongoing development support them in their board role?
- Does the CEO or chief officer enhance board effectiveness by ensuring high standards of board/committee reporting?
- Is there evidence of the CEO implementing board decisions and lead on delivering best practice in governance across the organisation?
- Is the DoF an effective partner with the CEO with the required professional and corporate experience to both support and challenge the CEO?
- Does the remuneration committee have the necessary skills for its role and is it sufficiently independent of the EDs?
- Is there evidence of the committee eliciting the appropriate professional advice as and when required?
- If remuneration consultants are retained, then has there been a robust rendering process to ensure their independence and objectivity?
- Has the committee determined a coherent policy on directors' remuneration, which is regularly reviewed to ensure it remains 'fit for purpose' and in line with best practice?

- Does the committee apply the policy to its decisions, taking account of appropriate benchmarking information?
- Do the EDs' employment contracts address issues relating to rewards for failure on termination?
- Does the committee fulfil its responsibilities with regard to the reporting requirements on remuneration?
- Does the committee make itself available at the annual meeting or on other occasions for scrutiny and challenge by the shareholders/stakeholders?

Summary

- The matter of executive remuneration will continue to be a contentious issue both in the corporate and public sector. Ongoing debate and discussion continue to surround shareholder voting on executive remuneration in the annual round of corporate AGMs.
- It is clear that the greater degree of regulation in the NHS, combined with the attitude of largely well-motivated public servants – including senior managers – is currently providing control and restraints on NHS ED remuneration. Public perception is unlikely to reflect this; however, therefore boards and their remuneration committees will continue to have to balance the need to attract high calibre appointments, the morale of the wider workforce and the reputation of their organisation.