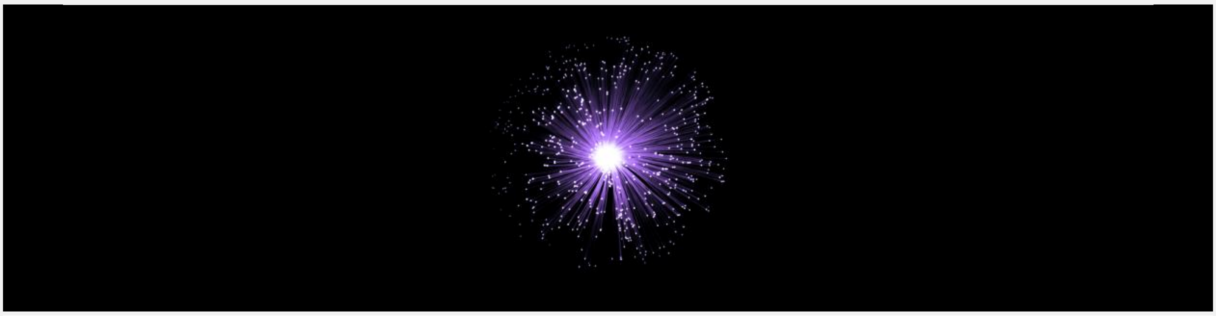

HM Government

Green Paper on Corporate Governance

29th November 2016

The Government has today published a Green Paper on Corporate Governance, which launches a consultation on a range of policy proposals. The paper has an introduction from the Prime Minister which states that the focus of the Green Paper is on ensuring that executive pay is properly aligned to long-term performance, giving greater voice to employees and consumers in the boardroom and raising the bar for governance standards in the largest privately-held companies.

The Government is seeking responses to a series of questions on the reform of the following areas of the corporate governance framework:

- Executive pay
- Strengthening the employee, customer and wider stakeholder voice
- Corporate governance in large privately-held businesses

The various options proposed for each question are not mutually exclusive and a combination could be adopted. The Green Paper states that the Government does not have preferred options at this stage and welcomes other suggestions. **The consultation closes on 17th February 2017.**

Executive pay

1. Do shareholders need stronger powers to improve their ability to hold companies to account on executive pay and performance?

Introduce a binding vote on all or some elements of the executive pay package. A binding vote could apply to the full remuneration report or only to variable pay awards. A vote could be applied to all companies on an annual basis or only to companies that have encountered significant shareholder opposition to the remuneration report.

Introduce stronger consequences for a company losing the advisory vote on the remuneration report. For example, where a company loses an annual advisory vote, the company could be required to win the backing of a 'supermajority' of shareholders to approve the next pay policy. Alternatively there could be a requirement to hold a binding vote on pay in the following year.

Require or encourage pay policies in quoted companies to (a) set an upper threshold for total annual pay and (b) require a binding vote at the AGM where actual executive pay in that year exceeds the threshold.

Require the existing binding policy vote to be held more frequently. The remuneration policy could be subject to an annual vote or, alternatively, allow shareholders to bring forward a binding vote on a new policy earlier than the three year deadline.

Strengthen the Corporate Governance Code on how companies should engage with

shareholders on pay. Options might include setting out a process for remuneration committee engagement with shareholders and employees before the annual remuneration report is presented to the AGM. Stronger guidance could also be included on how companies should engage with shareholders following significant opposition to a remuneration report.

2. Does more need to be done to encourage institutional and retail investors to make full use of their existing and any new voting powers on pay?

Mandatory disclosure of fund managers' voting records at AGMs and the extent to which they have made use of proxy voting. Existing guidance could also be strengthened to encourage institutional investors to publish more detail on the rationale for their voting decisions.

Establish a senior 'shareholder' committee to engage with executive remuneration arrangements. This refers to the model laid out by Chris Philp MP and the High Pay Centre in their report entitled *Restoring Responsible Ownership*.

Consider ways to facilitate individual retail shareholders to exercise their rights to vote on pay and other corporate decisions. More could be done to clarify and publicise existing options for individual investors to vote. The Companies Act could be amended to require brokers to offer underlying investors the option to opt-in to voting and wider information rights.

3. Do steps need to be taken to improve the effectiveness of remuneration committees, and their advisers, particularly to encourage them to engage more effectively with shareholders and employee views before developing pay policies?

Require the remuneration committee to consult shareholders and the wider company workforce in advance of preparing its pay policy. This could be achieved through more specific guidance in the Corporate Governance Code. If companies designate a NED to be responsible for representing the interests of the workforce (see below), this individual could also sit on the remuneration committee.

Require chairs of remuneration committees to have served for at least 12 months on a remuneration committee before taking up the role.

4. Should a new pay ratio reporting requirement be introduced?

Introduce disclosure of the ratio comparing the pay of the chief executive to pay in the wider company workforce. Boards could be required to explain to shareholders and wider stakeholders why the ratio is appropriate in the context of the performance of the business and rewards for the general workforce.

5. Should the existing requirements to disclose performance targets for the annual bonus be strengthened? How can this be done without compromising commercial confidentiality?

Non-legislative pressure could be increased by shareholders and the remuneration guidance in the Corporate Governance Code could be strengthened.

Retrospective disclosure of all bonus targets within a specified timeframe could be a reporting requirement.

6. How could long-term incentive plans be better aligned with the long-term interests of quoted companies and shareholders? Should holding periods be increased from a minimum of three to a minimum of five years for share options awarded to executives?

The Government is seeking views on the options below and any other proposals on ways to simplify and increase the effectiveness of long-term pay awards.

Restricted share awards as an alternative to LTIPs. These would not involve complicated performance criteria. The paper notes the criticism that these are a form of guaranteed reward but also the suggestion that the level of these awards would be set much lower (around 50%) than current LTIP awards.

Extension of holding periods to a five year minimum. The requirement in the Corporate Governance Code could be revised from the current minimum of three years to five years. This option could be combined with increased shareholding requirements (the paper notes 2x gross salary) to help encourage a focus on long term value creation.

Strengthening the employee, customer and wider stakeholder voice

The aim of the proposals in this section is to build confidence that Section 172 of the Companies Act (the duty of a director to promote the success of the company) is properly understood and applied.

7. How can we strengthen the way in which the interests of employees, customers and wider stakeholders are taken into account at board level?

Create stakeholder advisory panels. This would allow directors to hear directly from key stakeholders. Directors could seek views on particular issues and/or panel members could be invited to board meetings to offer views. Panel members could also initiate discussions. Panels could be tailored to the needs of the business. While not giving a direct input into board decisions, a stakeholder panel would create more transparency and introduce a dialogue between the board and its stakeholders.

Designate specific non-executive directors to ensure that the voices of interested groups, particularly employees, are being heard at board level. Providing an independent and clear voice for interested groups as a formal part of the board structure would allow that voice to be heard at boardroom discussions. Designated NEDs would need to find practical ways of gaining a good understanding of the company's stakeholders and would have flexibility to determine the most appropriate communication channels. One approach might be to create one or more stakeholder panels.

Appoint individual stakeholder representatives to company boards. This can bring a new perspective to board discussions but may also lead to greater conflict and delayed decision making, or potentially shifting the decision making away from the boardroom. There are additional challenges in choosing the representative(s). The Government is not proposing to make this option mandatory but considers that companies should determine whether this model would suit their business.

Strengthening reporting requirements relating to stakeholder engagement. Companies, other than small companies, have to prepare an annual Strategic Report which provides shareholders with information on how the directors have performed their duties under Section 172 but there are no details as to how this should be done and disclosures are often unclear. Stronger reporting requirements could be designed to provide greater confidence that boardroom decisions take wider stakeholder interests into account. The Government is looking for suggestions on how additional requirements could be introduced.

8. Which type of company should be the focus for any steps to strengthen the stakeholder voice? Should there be an employee or other size threshold?

The Government is seeking views on the scope of any reforms i.e. which companies the reforms should apply to.

9. Should any reforms be introduced by a legislative, code-based or voluntary approach?

Companies to take active steps to ensure stakeholder interests are properly taken into account. The most flexible approach would be a principle, or high expectation, on companies to take active steps to ensure stakeholder interests are accounted for. This could be backed by legislation or by a change to the Corporate Governance Code, or a combination of the two. The paper references the Davies Review of women on boards which set targets but not legal requirements but which has led to a doubling of female representation on FTSE 100 boards in less than five years.

Corporate governance in large privately-held businesses

The consequences for stakeholders of privately-held businesses when things go wrong can be equally as severe as in quoted companies. Good corporate governance is important for all companies, helping to build reputation and long-term success.

10. Should the corporate governance framework be strengthened for the UK's largest, privately held businesses? What would be the benefits and what are the risks?

11. What businesses should be in scope? Where should any size threshold be set?

12. How should any strengthening be achieved – should this be legislative or

voluntary? How should compliance be monitored?

Extending the scope of the existing Corporate Governance Code. The drawback to extending the Corporate Governance Code to encompass privately-held businesses is that the Code has been designed for premium listed companies and some of the provisions are not appropriate for privately-held companies. The comply or explain principle could overcome this, as companies could choose not to comply with those provisions which are not appropriate. However if too much of the Code is explained away this could lead to a loss of credibility.

A separate governance code. This could be tailored specifically to the needs and challenges faced by privately-held businesses. Adoption of the principles of such a Code could be voluntary, or there could be a strong expectation that companies would apply the formal elements of a code, or it could be a more formal comply or explain approach. Different approaches could apply to companies of different sizes.

13. Should non-financial reporting requirements be applied on the basis of a size threshold rather than the legal form of a business?

Some of the new reporting requirements introduced recently apply to all companies above a certain size irrespective of their legal form or status. This includes requirements to report on steps taken to prevent modern slavery, gender pay and prompt payment practices. The Government is seeking views on whether a similar approach should be applied to all future non-financial reporting requirements.

Other issues

Finally the Government is seeking views on whether there any other ideas which could be explored which would strengthen the UK's corporate governance framework.

14. Is the current corporate governance framework in the UK providing the right combination of high standards and low burdens? Are there any other improvements which could be considered?

The Green Paper and online submission form can be found here:
https://www.gov.uk/government/consultations/corporate-governance-reform

Responses to the consultation must be made by 17th February 2017.

People to contact

Stephen Cahill
Vice Chairman
020 7303 8801
scahill@deloitte.co.uk

Helen Beck
Partner
020 7007 8055
hebeck@deloitte.co.uk

William Cohen
Partner
020 7007 2952
wacohen@deloitte.co.uk

Sally Cooper
Partner
020 7007 2809
sgcooper@deloitte.co.uk

Nicki Demby
Partner
020 7303 0083
ndemby@deloitte.co.uk

Anita Grant
Partner
011 8322 2861
anigrant@deloitte.co.uk

Juliet Halfhead
Partner
0121 695 5684
jhalfhead@deloitte.co.uk

Nick Hipwell
Partner
020 7007 8647
nhipwell@deloitte.co.uk

Rob Miller
Partner
020 7007 9631
robemiller@deloitte.co.uk

Mitul Shah
Partner
020 7007 2368
mitulshah@deloitte.co.uk

Anne-Sophie Blouin
Director
020 7007 1669
ablouin@deloitte.co.uk

John Cotton
Director
020 7007 2345
jdcotton@deloitte.co.uk

David Cullington
Director
020 7007 0899
dcullington@deloitte.co.uk

Clare Edwards
Director
020 7007 1997
clareedwards@deloitte.co.uk

James Harris
Director
020 7007 8818
jamesharris@deloitte.co.uk

Katie Kenny
Director
020 7007 2162
katkenny@deloitte.co.uk

Dennis Patrickson
Director
020 7007 1996
dpatrickson@deloitte.co.uk

Ali Sidat
Director
020 7007 2818
asidat@deloitte.co.uk

Julie Swann
Director
012 1695 5081
jswann@deloitte.co.uk

Shona Thomson
Director
020 7303 4965
shthomson@deloitte.co.uk