



## Corporate Governance Reform

### Government announces package of reforms on executive pay

29 August 2017

Following the consultation undertaken at the end of last year, the Government has now announced a number of legislative and business-led measures designed to maintain the UK's reputation for being a 'dependable and confident place in which to do business' and to 'ensure that the largest companies are more transparent and accountable to their employees and shareholders'.

The measures include:

#### Pay ratios

As anticipated, the Government will introduce secondary legislation to require all listed companies to publish pay ratios between their chief executive and their average UK worker. This should be accompanied by narrative explaining any changes to the ratio and how the ratio relates to pay and conditions across the wider workforce.

The methodology for calculating the ratio will be considered but it is currently expected that this will be based on the single figure for the chief executive relative to the average total remuneration of the company's UK workforce.

#### Long term incentive arrangements

**Disclosing a range of outcomes** - secondary legislation will also be introduced to require companies to provide a clearer explanation in the remuneration policy of the range of potential outcomes from share based incentive plans under a range of scenarios, including significant share price growth. The Government will also ask the Financial Reporting Council (FRC) to seek views on whether, and how, new principles or guidance on share based incentive plans could be included in a revised UK Corporate Governance Code.

**More tailored approaches** - the Government is not convinced that long term incentive plans should be abolished but does agree that companies should avoid conforming rigidly to a standard model and should consider adopting other structures which may be more appropriate. The paper notes that this will require investors to be open to new and novel approaches put forward by companies.

**Holding periods** – the Government will invite the FRC to consult on a proposal to increase overall time horizons of long term plans from three to five years.

### **Broadening the role of the remuneration committee**

The Government will ask the FRC to consult on revising the UK Corporate Governance Code to give remuneration committees greater responsibility for demonstrating how pay and incentives align across the company, and to explain to the workforce each year how decisions on executive pay reflect wider pay policy.

The FRC will also be asked to include in the consultation a proposed new provision that the chair of the remuneration committee should have served for at least 12 months on a remuneration committee unless there is a clear and valid reason why this is not appropriate or possible.

### **Steps companies will have to take where they experience significant opposition from investors to executive pay policies and awards.**

The FRC will be asked to revise the UK Corporate Governance Code to be specific about the steps that a premium listed company should take when they encounter significant opposition to pay policies or awards. This will form part of the FRC's review of the Code and companies, investors and other stakeholders will be invited to give their views on what the provisions should look like. This might include requiring companies to respond publicly within a certain timeframe or to put the policy to a shareholder vote at the next General Meeting. Views will also be sought on whether the new measures should cover all premium listed companies or just FTSE 350 companies.

A public register will list the names of companies where 20% of investors have objected to executive pay packages. This scheme is to be set up later this year and will be managed by the Investment Association.

### **Stronger focus on the interests of employees, customers and other stakeholders**

**Ensuring the interests of employees are better represented in the boardroom** – the Government will ask the FRC to consult on the development of a new principle in the UK Corporate Governance Code to establish the importance of strengthening the voice of the employee and other non-shareholder interests at board level. As part of developing this principle the Government will invite the FRC to consider a specific Code provision requiring companies to adopt, on a comply or explain basis, one of three mechanisms:

- Assign a non-executive director to represent employees
- Create an employee advisory council
- Nominate a director from the workforce

**Complying with section 172 of the Companies Act** - secondary legislation will be introduced which will require all companies of a significant size (private as well as public) to publicly explain how directors take into account the interests of employees and other stakeholders. The initial view is that the size threshold should be 1,000 employees but this will be subject to further consideration.

The Government will also ask ICSA and the Investment Association to complete their joint guidance on ways in which companies can engage with their employees and other stakeholders at board level and will invite the GC100 to complete the work it is undertaking to prepare and publish new guidance on the practical interpretation of the directors' duties in section 172 of the Companies Act.

### **Other measures related to executive pay**

The Government has considered and rejected any further measures in relation to shareholder committees, mandatory disclosure of voting records, increasing retail investor voting and adding further regulation to the existing disclosure framework for bonus targets.

## Private companies

The FRC will also be asked to work with the Institute of Directors, the CBI, the Institute for Family Business, the British Venture Capital Association and others to develop a set of voluntary corporate governance principles for large private companies.

Secondary legislation will be introduced to require all companies of a significant size (currently anticipated to be companies with more than 2,000 employees) to disclose their corporate governance arrangements in their Directors' report and on their website, including whether they follow any formal code. The Government is also considering whether to extend this to Limited Liability Partnerships of equivalent size.

## Share buybacks

In addition to these proposals the Government plans to take forward its manifesto commitment to examine the use of share buybacks to ensure that they cannot be used to artificially hit performance targets and inflate executive pay. The review will also consider whether share buybacks are crowding out the allocation of surplus capital to productive investment.

## Board diversity

The Government's green paper did not cover diversity issues. However, the issue was raised in many of the responses and a number of recommendations were included in the report of the BEIS Select Committee. The Government is not proposing any legislative changes at this time but notes that it is undertaking a broad range of activity to help achieve greater gender diversity and is also taking steps to support ethnic diversity. Steps include the Business Diversity and Inclusion Group, set up to make sure government and industry work more closely to remove barriers in the workplace.

## Timing

The Government is intending to bring legislative reforms into effect by June 2018. The FRC intends to consult on amendments to the UK Corporate Governance Code in late autumn with a view to publishing a revised code by mid-2018 which would apply to most companies from 2019.

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