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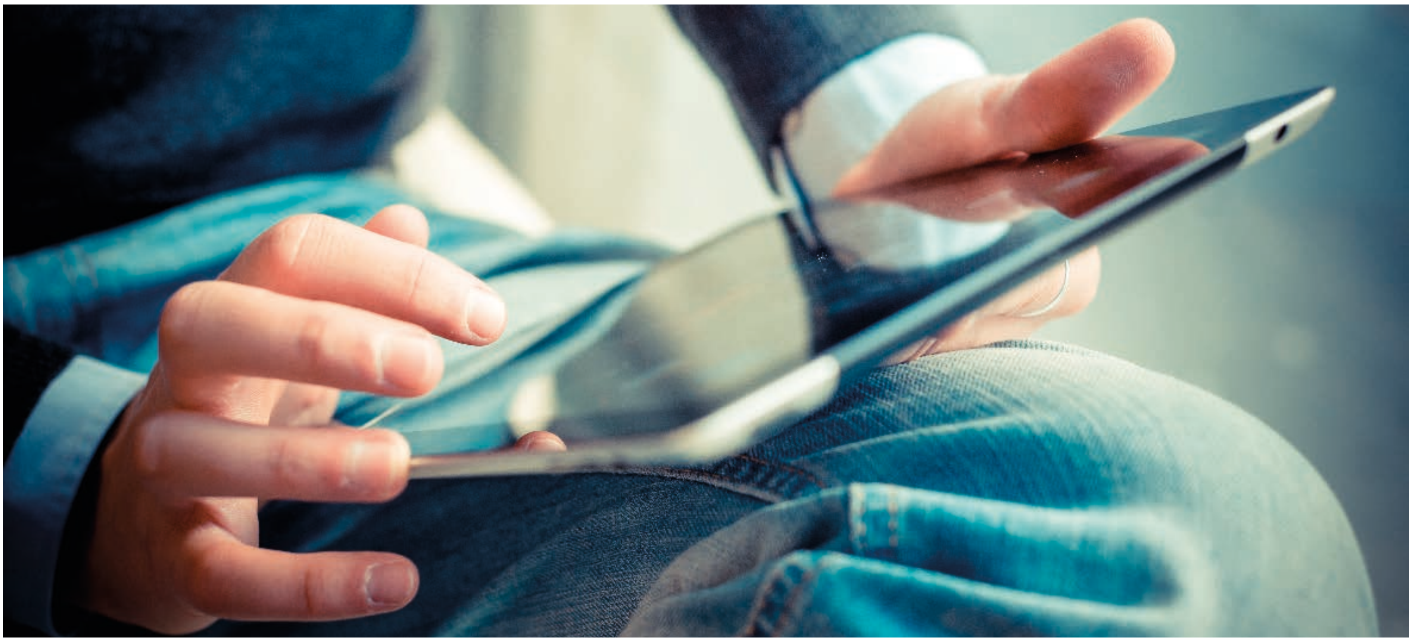

Executive Remuneration News

Listening to the employee voice

In late August 2017 the Government released its response to the green paper on corporate governance reform, setting out a package of measures to enhance governance. Much of the debate around enhanced governance has centred on how company boards take into account the views of broader stakeholders and in particular employees as part of their decision making. It was not a surprise therefore to see proposals on this as part of the response.

The revised UK Corporate Governance Code, which the Financial Reporting Council (FRC) has recently put out for public consultation, includes a new principle on the importance of strengthening the voice of the employee and other non-shareholder interests at board level. One of the provisions of the Code which supports this principle would require 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

The current drafting of the revised Code would also allow companies to specify an alternative mechanism to support the principle, provided this approach allows for meaningful two-way dialogue.

ICSA and the Investment Association have published their joint guidance on ways in which companies can engage with their employees and other stakeholders at board level and the Government has invited 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.

So what have companies done so far?

Most companies are still considering how, for their particular organisation, they might best engage with their employees. A handful of companies, however, have already disclosed information on the initial steps they have taken to listen to the views of their employees. We have provided some examples of what we have seen so far:

Company A	Company A has put in place an employee forum which works with members of management and builds upon existing employee consultative committees. The employee forum will receive updates and provide feedback and input into specific matters such as remuneration, customer service and other important operational matters. It is intended that the Chairman and the Remuneration Committee Chairman will attend the employee forum from time to time and also seek feedback on specific topics via the company secretary or other members of management as appropriate.
Company B	Company B held an 'AGM' for employees in 2017. Additionally, one of their non-executive directors has been tasked with looking at how the company can strengthen their links between the boardroom and employees.
Company C	Company C holds regular forums with employee groups and conducts an annual employee engagement survey, the results of which and follow up action plans, are presented to the Board. The Remuneration Committee Chairman will be attending the employee forum on an annual basis to answer questions raised by employee representatives concerning executive pay.
Company D	Company D runs talent breakfasts, where the board engage with a broad range of staff at various levels of seniority within the company and across all areas of the business. In 2016, discussions focused on employee learning and career development to aid the board in their understanding of talent and retention matters.

Company E	For some years, Company E has had an employee representative on the Board (elected by shareholders). The purpose of this role is intended to be broader than just executive pay.
Company F	Company F has a remuneration committee consultation forum, which is made up of elected representatives from employees and has the opportunity to input and influence Remuneration Committee agenda matters. The forum provided the Committee with its perspective on remuneration matters during 2016/17, and will be continued in 2017/18.
Company G	In Company G, the Committee consulted with selected senior employees as part of their review of the remuneration policy in 2015 and 2016. Furthermore, questions on the performance of Executive Committee members, including the Executive Directors, are included in annual employee engagement surveys.
Company H	The Remuneration Committee Chair engages with the Company H's recognised unions to ensure that the interests of all colleagues are considered when setting remuneration. Furthermore, the Group's Responsible Business Committee was also engaged in discussions on pay, to ensure the approach to remuneration aligned to Group strategy.

Our experience of discussing this topic with our clients is that the most popular of the approaches set out by the government is likely to be the establishment of some kind of an employee forum or expanding the use of the existing forum to include executive and broader employee remuneration issues.

It is worth noting that the above examples represent the first steps taken by a small number of companies – often building on frameworks they already have in place. As the new corporate governance regime is brought into effect through 2018 and 2019, it will be important for companies to take care to develop an engagement strategy which is likely to facilitate meaningful engagement. A strategy which encourages meaningful engagement should add genuine value to the Board's decision-making process. While it is anticipated that the changes to the UK Corporate Governance Code not come into force until 2019, it is worthwhile companies considering now what might be the right approach for their organisation, given the length of time that might be required to implement change in this area.

Recent publications

***Your Guide* reports published**	In October, we published our flagship reports on directors' remuneration in FTSE 100 and FTSE 250 companies. The reports provide market-leading data on all components of pay, executive pay policy and the 2017 AGM season. To request hard or interactive soft copies of the FTSE 100 or FTSE 250 reports, please ***click here***.

Corporate governance reform progress

Government announce package of reforms	Following the consultation undertaken at the end of last year, the Government 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 reforms will be enacted through secondary legislation, revisions to the UK Corporate Governance Code and other industry-led measures (see below for further details). ***Click here*** to view a full summary of the reforms.
FRC launches consultation on revised Code	The Financial Reporting Council (FRC) issued a consultation on • **Revised UK Corporate Governance Code**, which has been restructured, redrafted and simplified. • **Revised Guidance on Board Effectiveness**, which supplements the Code and has been expanded significantly, now notably including a detailed section on workforce engagement alternatives and on remuneration. • **Future Direction of the UK Stewardship Code**, which the FRC is looking to update in order to drive further improvements in best practice. The consultation incorporates a number of proposals made by the Government in the response to the Green Paper on Corporate Governance, which was published in August 2017. In addition, the FRC announced that it will finalise revisions to the Guidance on Strategic Reporting once the government has published legislative changes in respect of reporting on section 172 of the Companies Act, which is expected in March 2018. Responses to the questions in the consultation document are requested by 28 February 2018. Click ***here*** to view a full summary of the changes proposed in the consultation.
IA announces low votes register	The industry-led measures announced by the Government included the creation of a public register of companies receiving 'significant' levels of opposition from shareholders at AGM and track whether, and how, these companies are addressing the concerns of shareholders. The register is to be managed by the Investment Association (IA), which has since published further details of how the register will work. The IA has confirmed that companies who received votes of 20% against any resolution from 2017 onwards will appear on the register. Further information on the register can be found ***here***.

Guidance on engaging with stakeholders issued	The Government's secondary legislation and the revised Code will contain more stringent s.172 duties and requirements for companies on engaging with stakeholders. In anticipation of these developments, ICSA and the IA have issued guidance to help companies develop ways in which they can meet their existing and future obligations to engage with wider stakeholder groups. The guidance covers: • Stakeholder identification • Board composition • Induction and training • Board discussion of impact on stakeholders • Mechanisms for engaging with stakeholders • Reporting and feedback A full summary of the paper on the stakeholder voice in the board decision making can be found ***here***.

Other developments

Principles of Remuneration updated for 2018	Ahead of the 2018 season, the IA issued an update of its Principles of Remuneration and an accompanying open letter to remuneration committee chairs. The following were highlighted as key areas of focus for 2018: • Continued expectation that companies will show restraint in the levels of remuneration awarded • Alternative structures, such as restricted shares, will be supported where the company has successfully engaged with shareholders to demonstrate that this is the right structure for the business • Bonus payouts should be explained through full and informative disclosure, which should be disclosed within 12 months of payment • Some IA members are increasingly likely to vote against the re-election of the remuneration committee chair in response to perceived failure to take into consideration the views of shareholders. The changes to the Principles, along with full details of the letter to remuneration committee chairs can be ***found here***.
ISS consult on restricted stock	ISS published the findings from a consultation it has conducted, which surveyed the views of 74 institutional investors on their views of restricted shares. Further details are available ***here***.
FRC letter to companies on annual reporting	The FRC issued its Annual Review of Corporate Reporting and its annual letter to finance directors and audit committee chairs covering its perspective on key developments for 2017/18 annual reports. Areas of focus for 2018 relating to executive pay included explanations of relationships and linkages between different pieces of information, in particular ensuring that KPIs which linked to executive remuneration are explained in sufficient details in the strategic report. There will also be particular focus on disclosures on engaging with key stakeholders and fulfilling duties under s.172. More details on the annual review, along with further detail on the FRC's letter to companies can be ***found here***.
FS update	**Consumer Credit – FCA's Thematic Review** In July 2017, the FCA published a consultation paper on staff incentives, remuneration and performance management in consumer credit firms following a Reward Network Meetings of 98 consumer credit firms. It proposes measures to address risks that can arise from the way consumer credit firms pay or incentivise their customer-facing staff, such as by inserting new provisions into the Consumer Credit source book (CONC) requiring firms to detect and manage risks. The FCA also proposes to publish separate guidance on good and bad practice, controls and governance. The consultation closed on 4 October 2017 and the FCA expects to publish a Policy Statement in early 2018. **EBA's proposed new prudential regime for investment firms** On 29 September 2017, the European Banking Authority (EBA) published its Opinion on the design of a new prudential framework for investment firms. The proposed new regime, which will apply to all but a handful of systemic and bank-like investment firms, is intended to be a simpler and more proportionate alternative to the Capital Requirements Directive IV (CRD IV). The EBA recommends that firms subject to the new framework should, at the very least, comply with the remuneration requirements of MiFID II for sales staff and, for material risk takers in larger firms, 'partial' application of the CRD rules should apply. We understand that the European Commission aims to complete its proposals for legislation by the end of 2017. This would need to be approved by the European Commission, the European Parliament and the European Council before the Directive becomes effective (which is unlikely to be before 2019).

Contacts

If you would like further information on any of the areas covered in this newsletter, please do not hesitate to contact any of the names below:

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

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

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

Anita Grant
Partner
0118 322 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

Robert 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

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

Sonia Jenkins
Director
020 7303 7744
sojenkins@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
0121 695 5081
jswann@deloitte.co.uk

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

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