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Pay ratios and executive pay reporting

BEIS issues legislation to deliver corporate governance reforms including pay ratios

11th June 2018

- Regulations implementing the Government's package of corporate governance reforms announced by the Department for Business, Energy and Industrial Strategy ('BEIS') in August 2017 have today been laid before Parliament.

- The regulations include new reporting requirements on **CEO pay ratios** and **long-term incentive outcomes**, as well as directors' statutory duties under section 172 of the Companies Act 2006 and corporate governance arrangements in large private companies.

- The new requirements will apply to companies reporting on financial years starting on or after 1 January 2019. **The first actual reporting under the new regulations will therefore be required for annual reports published in 2020.**

Executive pay

The executive pay changes are being implemented via amendments to the regulations governing listed companies directors' remuneration reports. These regulations apply to UK incorporated companies whose shares are quoted on the Main List of the London Stock Exchange, the New York Stock Exchange, NASDAQ or a recognised stock exchange in the European Economic Area. AIM are exempt from the new regime.

Pay ratios

- Quoted companies registered in the UK (with more than 250 UK employees) will be required to publish the ratio of their **CEO's 'single figure'** total remuneration to the **median, 25th and 75th percentile total remuneration** of their **full-time equivalent UK employees**.

- Pay ratios will be calculated on a **group-wide** basis by reference to UK employees only.

- **Supporting information** will be required including the methodology used to calculate the pay ratios. Companies will be required to **explain the reasons** for changes to the ratio year on year and whether the company believes the median ratio is consistent with the company's wider policies on employee pay, reward and progression.

- Companies will also be required to publish the total remuneration and salary (£value) for the median, 25th and 75th percentile employees used in the pay ratio calculation.

- Pay ratios will be disclosed in a table in the annual remuneration report, and will include pay ratio data that will build incrementally to a ten year period going forward. Therefore in the first year of reporting, only one set of pay ratios will be disclosed.

Pay ratio - methodology overview

- The regulations allow for three potential approaches in calculating the pay ratio. This is intended to recognise that some companies may find challenges in collecting data in a relatively short period of time.

- CEO total remuneration will be the 'single figure' disclosed for the relevant financial year.

- Employee total remuneration should include wages and salary, taxable benefits, annual bonus, share-based remuneration or other incentive plans and pension benefits. As a minimum, employee wages and salary must be used. Under the regulations, employee remuneration will be calculated on the same basis as the CEO single figure (i.e. this differs to requirements under the gender pay gap regulations).

- Employee pay data may be determined no earlier than three months before the last day of the relevant financial year (using a projected calculation of the salary component of pay and benefits).

Option A

- Option A is the 'purest' approach. Under Option A, companies determine total full-time equivalent total remuneration for **all UK employees** for the relevant financial year.

- Using this data, companies will rank the data and identify employees whose remuneration places them at median, 25th and 75th percentile.

- Three pay ratios are then calculated against CEO 'single figure' total remuneration.

Options B and C offer some flexibility in calculating the pay ratios. Both options allow companies to identify, on an **indicative** basis, three UK employees at median, 25th and 75th percentile using existing pay data such as gender pay data (Option B) or any other recent existing data (Option C), without necessarily having to perform the calculation under Option A for all employees.

For both Option B and C, companies must then **calculate** the indicatively identified employees' total remuneration **for the financial year being reported on** using the required methodology.

Other reporting requirements

Annual statement from Remuneration Committee Chair	Remuneration committees will be required to provide a summary explanation of any discretion used in respect of executive remuneration outcomes reported in the year.
Annual remuneration report – notes to single figure table	In the notes to the single figure table, there will be a requirement to provide: • an estimate of the amount of remuneration that is attributable to share price growth;

	• whether, and if so how, discretion has been exercised to determine remuneration as a result of either share price appreciation or depreciation.
Remuneration policy	In the **next** new remuneration policy, there will be a requirement to provide an illustration of the impact of potential future share price increases on executive pay outcomes that are linked to performance periods of more than one financial year (e.g. LTIP awards), assuming share price growth of 50% over the period.

Deloitte view

We support the move to ensure that remuneration committees are aware of, and take account of, remuneration levels across the wider workforce. The use of a pay ratio, and how it moves over time, is intended to help committees in considering this. Companies should focus on providing a clear narrative around how executive pay outcomes are aligned with business performance, as well as how success has been shared more widely across the organisation.

In light of the Investment Association's call for early voluntary disclosure of pay ratios last year, companies will have to decide whether they disclose their ratios prior to 2020, given that the methodology has now been published.

Companies should be aware of the greater transparency required around the actual and potential impact of share price performance on long-term incentive outcomes, as well as clearer reporting on if and how remuneration committees have exercised discretion when considering and approving executive pay outturns.

Other corporate governance reforms (overview)

Directors' duties reporting

The directors of large companies will be required to report on (and publish on their website) how their directors have discharged their statutory directors' duties (for example, how they have taken employee and other stakeholder interests and the company's environmental impact into account when running the company).

Large, private and unlisted companies

Large private and unlisted companies will have to include a statement as part of their Directors' Report stating which corporate governance code, if any, has been applied and how. Companies with more than 250 employees will also be required to explain how they have engaged with employees during the year, and had regard to employees' interests in managing the business.

The draft legislation can be viewed in full here.

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