

Executive Reward Briefing

Government's (not so) final report on executive pay



Today, the Government's response to its Green Paper on Corporate Governance Reform was released. There were few surprises with many of the proposals well trailed and, indeed, passed over to the Financial Reporting Council's ("FRC") review of the Corporate Governance Code ("CGC"). It is envisaged that changes will apply to financial years commencing in June 2018 onwards (i.e. 2020 AGMs for December year-end reporting companies).

A number of reforms are anticipated to be introduced through the FRC's review and changes to the CGC. This means these will only apply to companies with a primary listing in the UK and not those which are UK incorporated but overseas listed (unlike the 2013 reforms).

The forward from the Secretary of State for BEIS summarises the purpose of the review as to:

"Address concerns that a minority of companies are not responding adequately when they encounter significant shareholder opposition to levels of executive pay. Remuneration committees will also have to do more to engage with the workforce to explain how top pay relates to wider company pay

policy."

The report comprises the following recommendations:

1. **Encouraging companies to take action to address dissent:** invite the FRC to revise its CGC to set out the steps which companies should take when they encounter shareholder opposition to executive pay. The FRC is asked to consider whether this should apply to all UK listed companies or only to those in the FTSE350. In addition, invite the Investment Association ("IA") to maintain a register of those companies which receive 20% or more opposition together with a record of what those companies say they are doing in consequence. Other ideas of introducing an annual binding vote or super majorities are not being taken forward. However, the Government has indicated that it will monitor the impact of these changes with a view to taking further action if necessary.
2. **Giving 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: again, this is to be implemented through the FRC consulting on changes to the CGC which is encouraged to look at best practice examples of companies which already proactively engage with the wider workforce.

3. **Require annual reporting of the ratio of CEO to average UK workforce pay along with a narrative explaining changes to the ratio and explaining how the ratio relates to pay and conditions across the wider workforce:** it confirms that this will follow the 'single figure' definition, be limited to UK based employees and that further details will be set out in a statutory instrument later in the year. It is unclear whether references to 'average' pay recognise the challenges of obtaining median data or are simply loose wording; we hope the former.
4. **Requiring companies to provide a clearer explanation in remuneration policies of the range of potential outcomes from complex, share-based plans:** this will probably require scenario charts to include an assumed level of share price growth. The paper specifically said that "while noting the concerns raised in some responses about LTIPs, the Government is not convinced that their abolition is justified." However, it encourages greater flexibility in pay design.
5. **Increasing holding periods to 5 years:** the FRC is asked to consult on requiring (presumably on a "comply or explain" basis) a minimum of 5 years before shares may be released. Given that a number of companies apply such holding periods to their Executive Directors but not necessarily to all LTIP participants, it will be interesting to see how the FRC takes this forward.
6. **Ensuring that the interests of employees, customers and wider stakeholders are taken into account:** new secondary legislation is proposed to require companies to explain how their directors comply with their existing obligations under s172 Companies Act 2006 and, in addition, for UK listed companies, to expand the CGC. The FRC had already commented on this aspect and seems prepared to take this forward.

7. **Developing, on a "comply or explain" basis, one of three employee engagement mechanisms (designated NED, formal employee advisory council or appointing a director from the workforce):** again, this will be considered by the FRC as a revision to the CGC. It should be noted that the following two proposals are linked to this and will provide additional guidance. It is to be welcomed that this will develop on a comply or explain basis and with a choice of models rather than a single mandated approach. However, this is clearly a new area of UK governance and companies will now need to consider what steps may be appropriate.
8. **Asking the IA and Institute of Chartered Secretaries and Administrators to complete joint guidance on practical ways in which companies can engage with their employees and other stakeholders at Board level**
9. **Inviting the GC100 to complete its work in providing advice and guidance on the practical interpretation of directors' duties under s172**

In addition, there are additional proposals regarding private companies and reiterating the Government's focus on diversity issues.

In addition, the paper reiterates that there will be a wider review of the impact of buy-backs on EPS and other measures.

Overall, there are few surprises and a long enough lead in time for companies to consider these steps. We welcome the Government's recognition that the 2013 legislative changes addressed many of these issues so further wholesale change is unnecessary.

FIT Remuneration Consultants August 2017

If you wish to discuss anything arising from this briefing, please ask your usual contact at FIT or call us on 020 7034 1111.

GENDER PAY REPORTING: we have now assisted the majority of our clients in considering their obligations and we encourage any companies which have not done so to review this.