



UK Executive Pay & Governance

The UK Government's Response to the Corporate Governance Green Paper Consultation

August 2017

On 29 August the Government published its long-awaited [response](#) to the consultation exercise conducted in late 2016 and early 2017 on its green paper proposals for corporate governance reform. As highlighted in the press, the Government's response incorporates a package of measures which is significantly more limited in scope than those suggested in the green paper.

1. Executive Pay

The Government proposes a number of initiatives to address concerns identified on executive remuneration.

Potential revisions to the UK Corporate Governance Code

- As an alternative to legislation, the Government will ask the Financial Reporting Council (FRC) to consider enhancing the provisions on remuneration as set out in the UK Corporate Governance Code.
 - First, the Government wishes the Code to be more specific about the steps companies should take when they encounter **significant opposition to remuneration-related AGM resolutions**. One option suggested by the Government is that the Code recommends that companies encountering considerable dissent should put the remuneration policy to a shareholder vote at the next AGM.
 - Second, there is a recommendation that the remuneration committee should have a broader responsibility to **engage with the wider workforce** to explain how executive pay aligns with wider company pay policy. The Government will also ask the FRC to include a provision in the Code that **the chair of a remuneration committee should have served for at least 12 months on a remuneration committee**.
 - Third, the Government is keen for the Code to include a clear recommendation that the **minimum vesting and post-vesting holding period for share awards should be at least five years** in normal business

circumstances (rather than the three years currently mentioned in the Code). The Government has not been convinced by arguments that LTIPs should be abolished.

Secondary legislation

- **Companies will be required to report on the ratio of CEO pay to the average pay of the UK workforce.** The precise methodology has not yet been finalised, but the intention is to require companies to use CEO total remuneration as defined in the "single figure", relative to average total remuneration of the UK workforce. UK employees have been chosen "for reasons of consistency and simplicity," although the Government recognises that multinationals may wish to publish an additional pay ratio covering all employees.
- Companies will be required to **include a narrative explaining year-on-year changes to the ratio** as well as set the number in the context of pay and conditions across the wider workforce.
- The legislation will also require remuneration policies to include a clearer explanation of the potential outcomes from LTIPs, including significant share price growth.

Public register of companies with high shareholder opposition on pay

- The Investment Association (IA) has been invited to maintain a **public register of listed companies which encounter shareholder opposition to pay awards of 20% or more**, with a record of what these companies have said they are doing to address investor concerns. The register will be launched later in 2017 and will apply to companies in the FTSE All Share index. AIM companies and members of the FTSE Fledgling index will be excluded.

Investigation into share buybacks

- The Government has also announced that it will take forward the commitment in the Conservative Party



election manifesto to **commission an investigation into the use of share buybacks**. This will examine the impact of buybacks on performance targets for incentive schemes as well as wider issues about buybacks as an alternative to business investment.

What is not included in the proposals

- The green paper included various suggestions which the Government has not taken forward. There are no plans for legislation to change the existing AGM voting regime for remuneration policy or remuneration report resolutions. The idea of shareholder committees has been dismissed, and no action is proposed at this stage to require investors to publish their voting records (many disclose on a voluntary basis) or legislate for increased voting by retail investors. Proposals to require enhanced disclosure of annual bonus targets have also been dropped.

2. Strengthening the Employee, Customer and Wider Stakeholder Voice

The Government has three main proposals aimed at ensuring that directors' decision-making takes into account the voice of a wide range of stakeholders.

Directors' duties

- Section 172 of the Companies Act requires directors to have regards to the interests of employees, customers and other stakeholders when acting to promote the success of the company. The Government intends to introduce secondary legislation to **require all companies of a significant size (suggested as those with a minimum of 1,000 employees) to explain how the directors comply with section 172**, e.g. how the views of key stakeholders have been sought, and how this information has influenced boardroom decision-making.

Potential revisions to the UK Corporate Governance Code

- The Government will invite the FRC to develop a new Code principle on strengthening the voice of employees and other stakeholders at board level. The Government wishes the FRC to consult on a specific Code provision (on a comply-or-explain basis) **requiring companies to adopt one of three approaches to engaging employees: (1) a designated NED, (2) a formal employee advisory council, or (3) a director appointed from the workforce.**

Industry guidance

- ICSA and the IA will be asked to complete their joint guidance on ways in which companies can engage with employees and other stakeholders. The GC100 will also be asked to complete guidance on the practical interpretation of directors' duties as set out in section 172.

3. Corporate Governance in Large Privately-Held Businesses

The Government has two main proposals to reform corporate governance at large private companies.

Voluntary corporate governance principles

- A voluntary set of principles of large private companies will be developed by the FRC, IoD, CBI, the Institute for Family Businesses and the British Venture Capital Association, under the chairmanship of a leading business figure.

Disclosure of corporate governance arrangements

- Secondary legislation will be introduced to require large private companies (i.e. those with over 2,000 employees) to disclose information on their corporate governance arrangements in their directors' report and on their website. A similar requirement may be extended to LLPs. The Government's intention is that the disclosure will include details of any UK Corporate Governance Code or other formal set of corporate governance principles that the company has adopted.

4. Timings

For those cases where the Government has invited the FRC to take forward proposals, the FRC will incorporate the potential changes within the wider consultation it plans to launch later this year reviewing the UK Corporate Governance Code.

Where secondary legislation is planned, the Government intends to lay draft legislation before Parliament before March 2018, with consultation where necessary. Among other things the draft legislation will include further details of the conclusions on pay ratio methodology.

The Government's current intention is for the overall reforms to be brought into effect by June 2018, and to apply to reporting years beginning on or after that date. In practice, this means that 2019 will be the first year in which companies with a December year-end will be impacted, with the consequent reporting implications relevant for the remuneration reports published in early 2020.



Our View

The proposals are a far cry from what was touted at the time Theresa May became Prime Minister in 2016 and what was suggested in the green paper. The Government has clearly opted to push many reforms in the direction of the FRC, with the outcome being likely amendments to the “comply or explain” approach of the UK Corporate Governance Code rather than new legislative requirements. Nevertheless, companies will have plenty to consider over the coming months:

- **Pay ratios are here.** Companies will need to work out their ratio and start to consider appropriate narrative to support the required disclosures, and whether there are benefits to reporting earlier than will be required under the new law.
- **More is being asked of remuneration committees.** Committee chairs will need to develop an effective approach to engaging with the wider workforce on executive pay, and companies’ reporting will need to

become more meaningful. Terms of reference will need to be updated.

- **New governance processes will be required.** For example, companies electing to nominate a specific non-executive director to engage with employees or those setting up formal employee advisory councils will need to determine how such changes will impact upon their wider remuneration committee and board activities.
- **Buybacks will further come under the spotlight.** Any company undertaking buybacks needs to be aware that the pending investigation will increase the media and investor focus on this area. The impact of buybacks on pay outcomes will need to be tackled head on.
- **Private companies will need to adapt.** Large private companies will need to start planning how they intend to disclose their governance arrangements publicly.

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