Executive Remuneration Landscape
September 2018

This paper summarises developments in corporate governance codes and regulations and other factors relevant to decision on directors' pay.

2018 has been, probably, the most eventful year in UK history on remuneration governance:

- The year saw the culmination of the Government's wide initiative on corporate governance reform. Reform began with a Green Paper and consultation document issued by BEIS in November 2016, following the Investment Association Working Group report in the previous July. Views were sought on a wide range of issues aimed at tackling the concerns of shareholders and the public about perceived unjustifiable increases in executive pay. The deadline for responses was February 2017.
- Whilst BEIS was digesting the responses, the Commons Select Committee which advises BEIS produced its own report and recommendations. This was published in April 2017. (The Committee announced in September 2018 that it is planning to ramp up their inquiry when Parliament is recalled this autumn.)
- The Government's own conclusions were published in July 2017. BEIS acknowledged Parliament's recommendations but laid out its own agenda, with several elements:
    - A timetable for new regulations, covering aspects of disclosure, for example, the CEO pay ratio;
    - Announcement of a new working group to consider a corporate governance code for large private companies (prompted in part by the BHS scandal) this became the Wates Principles;
    - A call on the Financial Reporting Council (FRC) to revise the UK Corporate Governance Code to strengthen various aspects of the Code.
    - A call for the Investment Association to publish a "name and shame" list of company AGM resolutions which failed to garner 80% or more of the shareholder votes in favour
- In December 2017 The FRC issued a draft new Code for comment and published the final code on 16 July 2018. The new code has been simplified and is less prescriptive. Various exemptions for smaller companies have been abolished. The most significant change is the requirements around engagement with the workforce. The Code offers three options:
    - A director appointed from the workforce
    - A formal workforce advisory panel
    - A designated non-executive director.
- The UK Corporate Governance Code is applicable to all companies with a premium listing on the London Stock Exchange, whether incorporated in the UK or elsewhere. It also sets a standard for corporate governance more generally.

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- The Government measure having a greater impact was the introduction of The Companies (Miscellaneous Reporting) Regulations 2018 in June. This statutory instrument under the Companies Act added a significant range of disclosure obligations, not just on listed companies, but on all UK companies (subject to some size exemptions), including subsidiary companies. They will apply for Financial Years starting from1 January 2019:
    - Large companies (above £36m turnover/£18m assets, 250 employees) will be required to include a statement as part of their strategic report describing how the directors have had regard to the matters in section 172(1)(a) to (f) of the Companies Act 2006 (requirement to consider stakeholders)
    - Companies with more than 250 UK employees will be required to include a statement as part of their directors' report summarising how the directors have engaged with employees, how they have had regard to employee interests and the effect of that regard, including on the principal decisions taken by the company in the financial year.
    - Large companies will be required to include a statement as part of their directors' report summarising how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the company during the financial year.
    - Very large private and public unlisted companies (£200m turnover/£2Bn assets plus and 2000+ employees) will be required to include a statement as part of their directors' report stating which corporate governance code, if any, has been applied and how. If the company has departed from any aspect of the code it must set out the respects in which it did so, and the reasons. If the company has not applied any corporate governance code, the statement must explain why that is the case and what arrangements for corporate governance were applied.
    - Quoted companies with more than 250 UK employees will be required to publish, as part of their directors' remuneration report, the ratio of their CEO's total remuneration to the median (50th), 25th and 75th percentile full-time equivalent (FTE) remuneration of their UK employees. Alongside this, companies will have to publish supporting information, including the reasons for changes to the ratios from year to year and, in the case of the median ratio, whether, and if so how, the company believes this ratio is consistent with the company's wider policies on employee pay, reward and progression.
    - All quoted companies will be required to illustrate, in the directors' remuneration policy within their directors' remuneration report, the effect of future share price increases on executive pay outcomes. Companies will also be required to include a summary in their directors' remuneration report of any discretion that has been exercised on executive remuneration outcomes reported that year in respect of share price appreciation or depreciation during the relevant performance periods.
- The FRC will also consult on a revised UK Stewardship Code later this year and it will publish, following consultation, the final version of the Wates Corporate Governance Principles for Large Private Companies. In addition, the FCA is to review its Handbook and consider any consequential amendments that are necessary in light of the changes being brought about by the 2018 Code.

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- The requirement above to report on the chosen corporate governance code applies only to very large companies. But a new AIM rule requires all AIM companies, irrespective of size, to publish similar information on their website by 28 September, which requires them, now, to decide which corporate governance code they intend to apply. The alternative to the UK Corporate Governance Code is the Quoted Companies Alliance (QCA) Corporate Governance Code, which was issued in revised form in March 2018. It is simpler and more flexible that the UK Code and a recent survey showed that 80% of AIM companies are intending to apply the QCA Code rather than the UK Code.
- Meanwhile, the Government set up in June an independent review of the future structure and responsibilities of the FRC itself, under Sir John Kingman. The call for evidence closed in August.
- Under the 2017 Equal Pay Act regulations, private and voluntary sector organisations had to publish their Gender Pay Gap reports this year by 4 April 2018. These showed the gap at the snapshot date of 4 April 2017. The Commons BEIS Select Committee has reviewed the gap outcomes and issued a series of recommendations to improve both the reporting methods in the future and to reduce the very substantial gap shown by the company reports and by the separate analysis produced by the ONS. These include a recommendation that company boards introduce Key Performance Indicators for reducing and eliminating their pay gaps and that Remuneration Committees, in reporting on pay policy, should explain how this commitment to reducing the pay gap is being reflected in their decisions.
- Pressure on listed companies to deal with unjustified pay increased with the Investment Association "name and shame" list, first published in December 2017 and recently published for the 2018 voting season. The picture is rather confused. For all listed companies the number of resolutions not achieving the hurdle dropped from 68 in 2017 to 61 in 2018. But the number in the FTSE 100 doubled from 9 to 18. Most of the "failed" votes were for the advisory vote on remuneration implementation. Only 12 in total concerned the remuneration policy. This is remarkable in a year when many companies would have been coming back to shareholders to renew the policy since the three year validity would now be up.
- The poor showing of a relatively small number of FTSE 100 companies is indicative of the intention of institutional investors to go after the high profile cases, such as WPP, Persimmon, and BT. It is no indication of a general breakdown in corporate governance: indeed the improved general voting this year suggests practice is improving.
- Individual high pay cases continue to hit the headlines – Vice Chancellor Glynis Breakwell's package at Bath University and Martin Sorrell's package at WPP. Both have left their respective institutions and new people have been appointed on much lower packages.
- The CIPD have combined with the High Pay Centre to analyse and review executive pay in listed companies using data from the annual Remuneration Reports. They published their latest report in August 2018 – with the lag in report publication the findings apply to pay in 2017. They showed that median single total figure of remuneration of FTSE 100 CEOs increased by 11% in the previous year. This is 5% higher than the findings from Minerva (prev. Manifest) published earlier this year. Similarly they reported an increase in the average (pulled up by Persimmon and Melrose) which was 5% higher – 23% from CIPD/HPC vs 18% from Minerva. The source data should be the same. But whichever way the increase is substantial.

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- These figures take into account share price gains in long-term incentives. Minerva also published the median increase in remuneration granted (the “generosity” of Remuneration Committees). The median increase was 1%. This belies newspaper headlines claiming pay decisions are out of control again. The rise is a consequence of the increase in share prices in the past three years.
- The CIPD may have made a political error getting into bed with the HPC, which is the heir of a Militant-inspired lobby group, the High Pay Commission. The CIPD chief executive, Peter Cheese, in a recent Sunday Times interview, made a virtue of taking a £19k pay cut as “an example” to other CEOs. If they notice at all, other CEOs might think that his resulting total remuneration at £263k is still high for a membership organisation with gross revenue of only £40m per annum. They may also have noticed that it was his bonus not his salary that was cut. He is in a glass house throwing stones!

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