MM&K: Remuneration Dinner – 19 March 2018. A note of the evening

At our dinner on 19 March at the RAC, we discussed "The Evolution of the Remuneration Committee: the impact of proposed changes to the UK Corporate Governance Code". Whilst we posed some questions for the table to debate, the broad nature of the proposed changes meant that the conversation ranged over a number of topics and, given the flowing nature of the discourse it is not possible to produce a verbatim note. However, having taken time to digest all that was discussed, we thought that a summary of the five key questions and answers that emerged during the evening would be of use.

1. What is the reason behind all of these changes to the UK Corporate Governance Code?
There was a strong opinion expressed, and seemingly generally supported around the table, that the changes to the code were politically motivated rather than being for the benefit of improved corporate governance. Indeed, one guest remarked that the UK code is already the "best in class" available when compared to the US or Continental models, but an issue has sometimes been that weak Boards / NEDs have not stood up to management.

Not for the first time at one of our dinners, the view was expressed that the real corporate governance issue exercising the general population (and not just the press) is pensions. There appears to be a high correlation between pension failure and corporate failure. However, this is frequently missed by both investors and proxy firms. How could it be considered acceptable for companies to pump money into dividends whilst still leaving the pension fund in a precarious position? This is something that is not expressly dealt with by the UK Corporate Governance Code or the proposed changes.

One diner complained that the FRC promised, at the time of the last update, that there would be no further changes to the Code – but has now seemingly forgotten this promise owing to the pressure/requests from the UK Government. It was felt that the Code has always been useful particularly because of its independence and therefore could be relied upon by businesses across the economy. But business confidence is likely to be undermined if the Code is being changed for political reasons.

Having addressed why people felt the changes are being introduced, and accepting that they have to be followed, the conversation moved on to consider where businesses might benefit from the changes. Even those who were cynical about the reasons for making the changes acknowledged that increased engagement with the workforce on remuneration is a good thing going forward.

2. Which of the three options are companies most likely to take when it comes to increased dialogue with the wider workforce?
Under Provision 3 of the revised UK Code, a company will need to gather the views of its workforce – three methods for achieving this are suggested (i) a director appointed directly from the workforce, (ii) a formal workforce advisory panel or (iii) a designated non-executive director.

An (unchallenged) view expressed at the table was that Option (i) would not be practicable: how could an individual taken from the workforce fulfil the independent director role as required by law – they would be similar to a delegate instead?

Similarly, if one of the non-executives has to be "the voice" of the workforce, what does that do for their independence and the ability to weigh up the needs of all stakeholders? In contrast, a number of people agreed that, as they already had employee representation groups for other purposes, this could simply be adjusted to take account of this extra responsibility.

Whilst the room was therefore generally supportive of Option (ii), it was flagged that this may not be the most practicable approach for all organisations – especially those with the largest workforces or those who have the majority of their workforce in overseas territories.

3. What is the view on the requirement for the Remuneration Committee to oversee wider remuneration practices across in the business?

There was general support voiced for the Remuneration Committee to have an input on the remuneration of those at the next level down (perhaps even the level below that as well) – with examples given of where this is already happening.

Support was also expressed for the Remuneration Committee to have oversight of the remuneration of other workers who were “key” to the business but might be outside the top levels of management. Reference was made to the US practice of publishing the remuneration of the top 5 earners in a corporation as part of a company’s annual reporting/filing. UK corporate governance strictures have led many UK companies to restricted executive directors on the board to just the CEO and the CFO.

However, a note of caution was raised in respect of non-executives becoming involved with the issues of the wider workforce, as there is a danger that this might start to blur the line between being a non-executive and an executive.

4. Which governance code will AIM companies most likely adopt going forwards?

A new AIM rule requires AIM-listed companies to publish, by 28 September, which “recognised” corporate governance code they have adopted, and how and why their practice departs from the particular code. Unless an overseas code is selected (which was considered possible but unlikely), the two choices are between the UK Corporate Governance Code or the code developed by the Quoted Companies Alliance (“QCA”), a revised edition of which is being published in April.

The overwhelming opinion was that the QCA code would be preferred as it is much less stringent and the point of being on the AIM market is that it takes a “lighter touch” to compliance.
In addition, some AIM companies use share based incentives for Non-Executive Directors and this would not be allowed if the UK Code was followed.

However, this discussion did bring to light that AIM is starting to attract more and more companies who, due to their size and complexity, would traditionally have been on the main market but are attracted to AIM’s less onerous requirements. This means that the NED role for some AIM companies is becoming as demanding as it is for main board listed companies – although this was felt to not necessarily translate into fee levels for NEDs.

5. Given all the developments, what does the future hold for Non-Executives as Remuneration Committee Chairs and Members?

A general concern was that, as these roles have become more and more demanding, the number of good candidates to fill the roles will start to fall away – as people of suitable experience will begin to consider that the increased responsibility and time commitment are not matched by the fee levels offered. When coupled with the need for one year’s experience before becoming a Remuneration Committee Chair, this could lead to many companies having issues finding and retaining suitable NEDs.

In after-dinner discussions, a number of people noted that, if the increased levels of supervision of remuneration structures were going to fall to the Remuneration Committee, there was going to be an increased need for support, either internally or through increased instructions to advisors. It was noted that this approach could help protect the independence of NEDs as the responsibility for direct contact with the workforce would fall upon the internal resource/advisor.