

Proposed UK Corporate Governance Reforms Target Executive Pay Justification, Employee Engagement

IN SHORT

The Situation: The UK government has proposed several corporate governance reforms in an effort to improve transparency and accountability in private and public employers.

The Result: If approved, the proposals would result in heightened scrutiny of executive pay, more involvement for worker representatives in large employers and an extension of corporate governance principles to large privately held companies.

Looking Ahead: The government's suggestions are only proposals at this stage. Plans are in place for secondary legislation to be approved by March 2018 with new regulations potentially coming into force in June 2018.

According to the British Prime Minister, a small number of companies have damaged the public's trust in "big business". The Government has therefore published a package of proposed corporate governance reforms with a view to improving transparency and accountability in both private and public employers. At the moment, these are only proposals, and the Government has asked bodies such as the Financial Reporting Council, the Investment Association and the GC100 to prepare advice and guidance on a number of points. The Government plans for secondary legislation to be approved by March 2018, with a view to coming into effect in June 2018 for financial years starting after that date. Further consultation may be necessary on the contents of that legislation. The headline points are below.

Executive Pay in Listed Companies

The Government proposes to require quoted companies, on an annual basis, to publish and justify the ratio of CEO pay to the average pay of their UK workforce. This is likely to affect approximately 900 listed companies. In addition, a number of changes will be made to address the concern that shareholders do not have enough power to hold to account companies that face significant opposition to executive pay.

The Government will: (i) invite the Investment Association to maintain a public register of listed companies where at least 20 percent of shareholders oppose the level of executive pay; (ii) invite the Financial Reporting Council ("FRC") to revise the UK Corporate Governance Code to specify the steps listed companies should take when executive pay policies are significantly opposed; (iii) require remuneration committees to engage more fully with the workforce and explain how executive pay reflects the wider pay policy; and (iv) reform the "poorly designed or explained" long-term incentive arrangements by, for example, extending the recommended minimum vesting period for executive share schemes from three to five years to encourage more long-sighted goals.



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"Strengthening the Stakeholder Voice" Outside the Boardroom

In respect of both private and public companies of "significant size", directors will be required to explain how they have met their responsibilities toward employees, suppliers, customers and the wider society. In addition, the Government will invite the FRC to consider a requirement for premium listed companies, on a "comply or explain" basis, to adopt one of three "employee engagement mechanisms". These companies would be required to: (i) assign a designated non-executive director to represent employees; or (ii) establish an employee advisory council; or (iii) appoint a director from the workforce. The government's "initial view" is a threshold of 1,000 employees should be used to determine applicability, but this is subject to further consideration. All company directors already have a duty to promote the success of the company (s.172 of the Companies Act), so in principle a wide range of companies could be within scope. The government recognises that a proportionate approach is needed as this is a new reporting requirement.

Corporate Governance of Large Privately Held Businesses

Concerns were raised that only companies listed on the London Stock Exchange are subject to corporate governance reporting requirements. The Government has decided that this form of reporting should be broadened to all UK companies of significant size. The Government's initial view is that the threshold should be application to companies with more than 2,000 employees, but further consideration will be given to this. Companies subject to an existing corporate governance requirement (like the UK Corporate Governance Code) would be exempt. The Government will invite the FRC to develop voluntary corporate governance principles for private companies. It will also implement legislation that requires such companies to publicly disclose their corporate governance arrangements and whether they follow any formal code. The Government is considering whether to extend this principle to limited liability partnerships of an equivalent scale; large professional services firms may therefore be affected.

Boardroom Diversity

This was an issue raised in the course of the consultation leading to these proposals. The Government has decided not to act at this stage but to continue to monitor progress toward voluntary goals (33 percent of directors in listed companies to be women by 2020) as well as monitoring ethnic diversity, with a view to acting through legislation if ratios do not improve.

THREE KEY TAKEAWAYS

1. If approved, reform measures proposed by the UK government would require quoted companies annually to publish and justify the ratio of CEO pay to the average pay of their UK workforce.
2. In another provision, the Financial Reporting Council is invited to consider and consult on the introduction of a specific provision in the Corporate Governance Code that would require premium listed companies, on a "comply or explain" basis, to adopt one of three "employee engagement mechanisms".
3. Corporate governance principles could also be applied to large privately held companies, "with the threshold initially proposed at companies with more than 2,000 employees unless they are subject to an existing corporate governance reporting requirement."

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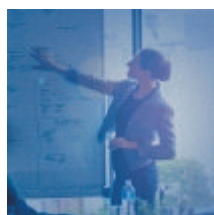


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