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Newsflash: Government to set new legislation to take forward its corporate governance reforms

The Government has today set out its plans to move forward with its corporate governance reforms following its Green Paper issued last November and also the BEIS Select Committee inquiry into corporate governance which reported in April 2017. The proposals will be introduced through a number of different mechanisms including secondary legislation, changes to the UK Corporate Governance Code and other industry-led solutions.

The proposals set out in the paper issued today cover the three topics raised in the Green Paper:

- Executive pay;
- Strengthening the employee, customer and supplier voice; and
- Corporate governance in large privately-held businesses.

Executive pay

1. Secondary legislation will be introduced requiring quoted companies to:

- Report annually the ratio of CEO pay to the average pay of their UK workforce **together with** a narrative explaining changes in the ratio from year to year and setting the ratio in the context of pay and conditions across the wider workforce;
- Provide a clearer explanation in their remuneration policies of a range of potential outcomes from complex, share-based incentive schemes.

2. The FRC will be invited to revise the UK Corporate Governance Code to:

- Be more specific about the steps that premium listed companies should take when there is significant shareholder opposition to executive pay policies and awards;
- Extend the remit of remuneration committees to also oversee pay and incentives across their company and to require those committees to engage with the wider workforce to explain how executive remuneration aligns with wider company pay policy;
- Extend the recommended minimum vesting and post-vesting holding period for executive share awards from 3 to 5 years; and
- Include a proposed new provision that the chair of the remuneration committee should have served for at least 12 months on a remuneration committee unless there is a clear and valid reason why this is not appropriate or possible.

3. The Investment Association will be asked to develop and maintain a public register of listed companies encountering more than a 20% or more shareholder vote against pay awards, along with a record of what these companies say they are doing to address shareholder concerns.

The Government has considered and rejected any further measures in relation to shareholder committees, mandatory disclosure of voting records, increasing retail investor voting or adding further regulation to the existing disclosure framework for bonus targets.

Further, the Government is not convinced that long term incentive plans should be abolished but does agree that companies should avoid conforming rigidly to a standard model and should consider adopting other structures which may be more appropriate. The paper notes that this will require investors to be open to new and novel approaches put forward by companies.

Strengthening the employee, customer and wider stakeholder voice

4. Secondary legislation will be introduced requiring all companies of significant size (both public and private - suggested to be a threshold of 1,000 employees but will

be subject to further consideration) to explain how their directors comply with the requirements of section 172 of the Companies Act 2006 to have regard to employee interests and to fostering relationships with suppliers, customers and others.

5. The FRC will be invited to include a new Code principle strengthening the voice of employees and other stakeholder interests at board level when it consults on changes to the Code later this year. Further, a specific Code provision is suggested requiring premium listed companies to adopt, on the "comply or explain" basis, one of three employee engagement mechanisms: a designated non-executive director; a formal employee advisory council; or a director from the workforce.

6. The ICSA and the Investment Association will be asked to complete their joint guidance on practical ways in which companies can engage with their employees and other stakeholders at board level. In addition, the GC100 has been asked to publish new advice and guidance on the practical boardroom interpretation of the directors' duty in section 172.

Corporate governance in large privately-held businesses

7. Secondary legislation will be introduced to require all companies of a significant size to disclose their corporate governance arrangements in their Directors' Report and on their website, including whether they follow any formal code. The Government's initial view is that these requirements should apply to companies with more than 2,000 employees. A similar requirement for Limited Liability Partnerships of similar scale will also be considered.

8. The FRC will be invited to work with the Institute of Directors, the CBI, the Institute of Family Business, the British Venture Capital Association and others to develop a voluntary set of corporate governance principles for large private companies under the chairmanship of a business figure with relevant experience.

Other issues considered in the paper

Boardroom diversity – the paper acknowledges the wider work that the Government and others are undertaking to enhance and encourage corporate responsibility including the Hampton-Alexander review on gender diversity and the work of Sir John Parker and Baroness McGregor-Smith on ethnic diversity in the boardroom and the workforce. Government believes that the reforms outlined above complement these initiatives.

FRC powers – in order to ensure the most effective powers to sanction directors and ensure the integrity of corporate governance reporting, the FRC, the Financial Conduct Authority and the Insolvency Service will be asked to conclude new or, in some cases, revised letters of understanding with each other before the end of year.

Share buybacks - the Government plans to take forward its manifesto commitm to examine the use of share buybacks to ensure that they cannot be used to artificially hit performance targets and inflate executive pay. The review will als consider whether share buybacks are crowding out the allocation of surplus cap to productive investment.

Next steps

The current intention is to bring the reforms into effect by June 2018 to apply t company reporting years commencing on or after that date.

The Government intends to lay before Parliament draft secondary legislation be March 2018. Where necessary, there will be consultation on the detail of the secondary legislation.

The FRC intends to consult on amendments to the UK Corporate Governance Co in the late Autumn.

The work on developing voluntary corporate governance principles for large priv companies will commence in the Autumn.

Further information

BEIS press release

BEIS Paper (in full)

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