

New Executive Pay Proposals Outlined by UK Government

Following responses to a consultation on executive pay by the Government, Business Secretary Vince Cable has given a speech to the House of Commons outlining new proposals for executive pay.

Background

In September 2011, the Department for Business Innovation & Skills ("BIS") issued a consultation paper on executive pay for quoted companies.¹ The paper's premise was that whilst executive remuneration is an important part of promoting growth (as long as it is well structured and provides rewards for executives that contribute to long term success), in the past decade the link between remuneration and performance has not been clear. The paper put forward various measures to strengthen the link between pay and performance with the purpose of stimulating debate and gathering evidence. BIS sought responses in particular on the subjects of remuneration reports, the role of shareholders, the structure of remuneration and remuneration committee composition.

A summary of responses to the paper was published in January 2012.² The general consensus of respondents was that the remuneration landscape should be improved; however, there were mixed views on the best methods to achieve such improvement. Over half of the respondents wanted remuneration packages to be simplified. The majority were against shareholders being given a binding vote on remuneration reports as a whole; however, some suggested that a binding vote on a future-

looking part of a report might be more practical. The majority also opposed having shareholders or employees on remuneration committees as they would not have the breadth of knowledge and overview of the company that board members have.

New Proposals

On 23 January 2012, Vince Cable announced the Government's latest proposal on executive pay.³ Four main areas were identified: transparency; shareholder involvement; diversity of boards and remuneration committees; and best practice. Mr Cable also gave a more detailed speech to the Social Market Foundation on 24 January 2012.⁴

Transparency

The Government intends to introduce secondary legislation in 2012 which will require companies to publish more informative remuneration reports. The remuneration report will be divided into one section setting out future policy on executive pay and a second setting out implementation of pay policy in the previous year.

In relation to future policy, an explanation will be required as to why specific benchmarks have

¹ <http://www.bis.gov.uk/assets/biscore/business-law/docs/e/11-1287-executive-remuneration-discussion-paper.pdf>.

² <http://www.bis.gov.uk/assets/biscore/business-law/docs/e/12-564-executive-remuneration-discussion-paper-summary-responses.pdf>.

³ <http://www.publications.parliament.uk/pa/cm201212/cmhansrd/cm120123/debtext/120123-0001.htm>.

⁴ <http://nds.coi.gov.uk/Content/detail.aspx?NewsAreaId=2&ReleaseId=422961&SubjectId=2>.

been used, how employee earnings have been taken into account and how employees have been consulted. Particular attention was drawn to the Information and Consultation of Employees Regulations 2004 which allow employees in large companies to request consultation on certain issues. Use of this mechanism was encouraged.

As for the previous year's policy, a single figure for each director's total pay will be required and an explanation of how company performance and pay awards are related. Companies will need to produce a distribution statement comparing executive pay to dividends, business investment, taxation and staffing costs.

Mr Cable also discussed employee representation on boards and pay ratios (between CEOs and average employees). He explained that whilst worker participation would be a good idea for many companies, it would be difficult for a large number of FTSE companies, whose employees are predominantly overseas. He welcomed worker participation but by a non prescriptive route. Similarly, in relation to pay ratios, Mr Cable explained that these should not be mandated or prescribed due to the discrepancy between companies that have large numbers of unskilled workers and those that outsource their unskilled labour which would produce meaningless figures with respect to ratios.

Shareholder Involvement

The Government plans to hold a consultation on specific proposals to give shareholders a binding vote on certain issues, including future pay policy, director notice periods if longer than a year and exit payments comprising more than one year's salary. The consultation will also consider the percentage of shareholder support required to pass proposals and, in particular, whether the threshold should be increased to 75%.

Diversity of Boards and Remuneration Committees

It was stated that diverse remuneration committees are needed in order to reform executive pay and that the best way to achieve this is through diversification of boards. Mr Cable suggested more appointments of public servants, lawyers, academics and those who have not previously been directors.

It was noted that approximately 6% of remuneration committee members in the FTSE 350 are also executives of other companies and that the

Government would look at mechanisms to limit this potential conflict of interest.

The Government will also request that the Financial Reporting Council (the UK's independent regulator responsible for promoting high quality corporate governance) amends the UK Corporate Governance Code so that all large public companies are required to adopt clawbacks that give them the ability to recoup pay when performance has not lived up to expectations.

Best Practice

As the fourth part of the Government's plans, Mr Cable encouraged companies and shareholders to take responsibility for changes to executive pay going forward. A new project to be launched by the chair of the High Pay Commission (see our previous On Point on the High Pay Commission's Executive Pay Report⁵) was also mentioned which will monitor "the state of pay at the top".

In relation to the 12 recommendations set out by the High Pay Commission (detailed in our previous update), Mr Cable stated that the Government is implementing 10 of these in practice or in spirit. One of the outstanding recommendations is employee representation on boards (referred to above) and the second relates to pay structure which was decided to be too impractical by the Government.

Comment

Reaction to the new proposals has, predictably, been mixed. Some commentators say that reform will leave the UK with the toughest rules on executive pay in the world, whereas others defend high executive pay arguing that it is necessary to foster competitiveness and to retain executives when a company is performing badly and in need of talented direction. It is clear that proposals such as these will ignite debate between those who are uncomfortable with the vast increases in executive pay and the differential between executive and average pay (particularly in the midst of economic difficulty) and those who believe that excessive guidance and restrictive rules will hamper the effective running of their business in a climate where business needs encouragement to grow. For now, we

⁵ http://www.dechert.com/UK_High_Pay_Commission_Publishes_Final_Report_on_Excessive_Executive_Pay_11-29-2011/.

await the finer detail of the proposals as they are fully consulted on and become legislation.



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