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A legal update from Dechert's Corporate and Securities and Employment Law Groups

UK High Pay Commission Publishes Final Report on 'Excessive' Executive Pay

"There's a crisis at the top of British business and it is deeply corrosive to our economy. When pay for senior executives is set behind closed doors, it does not reflect company success and is fuelling massive inequality. It represents a deep malaise at the very top of our society."

– Deborah Hargreaves, High Pay Commission Chair

The independent High Pay Commission (the "HPC"), a non-governmental interest group established by Compass, concluded its final report on executive pay on 22 November 2011. The report followed a year-long inquiry into high pay and boardroom pay across the public and private sectors in the UK, focusing in particular on executive pay in listed companies (and other publicly quoted companies). In the report, the HPC sets out its analysis and commentary on recent executive pay inflation, in addition to 12 recommendations for reforms to corporate governance and disclosure requirements (including proposals to amend the UK Corporate Governance Code (the "Code")).

The HPC inquiry makes similar recommendations to proposals raised in a recent discussion paper entitled "*Executive Remuneration*" published on 19 September 2011 by the Department for Business, Innovation and Skills (BIS) which addressed issues surrounding executive pay (the "BIS Discussion Paper"). The BIS Discussion Paper invited feedback on these issues by 25 November 2011.

Key Findings

The HPC reported that the average wages in the UK have increased 300 per cent in the last 30 years, whereas "stratospheric" pay increases to top executives have soared by more than 4,000 per cent in that period, undermining productivity and "damaging" trust in British business.

The report also pointed out that John Varley, Barclays' top executive in 2010, earned £4.36m last year, constituting 169 times the earning of an average British worker, whereas in 1980 top pay at Barclays was only 13 times the national average.

The HPC report concluded that pay packages have become increasingly complex, damaging relations with shareholders and creating confusion, and it calls for "a radical simplification of executive pay" and additional solutions based on the key principles of transparency, accountability and fairness.

Key Recommendations for the UK Corporate Governance Code

The independent report recommended the following amendments to the Code:

- Simplification of executive pay: executives should be paid a basic salary, with remuneration committees awarding one additional performance-related element only where absolutely necessary.
- Companies should publish an anonymised list of their top ten highest paid employees outside the boardroom.
- Remuneration reports should be presented in a standardised format, and companies should publish a single figure for the total

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package for each executive and the method of calculation.

- All publicly listed companies should publish annually a statement of the distribution of income over a period of three years, showing percentage changes in total staff costs, company reinvestment, shareholder dividends, executive team total package, and tax paid. The HPC proposes that further research be undertaken to consider the extent to which the distribution statement could be subject to a shareholder vote.

- All publicly listed companies should publish fair pay reports as part of their remuneration reports (setting out the ratio of highest to median pay within the company and changes to this ratio over three years).

Other recommendations in the report include:

- Shareholder votes on remuneration should be cast on remuneration arrangements for three years following the date of the vote and that such arrangements include future salary increases, bonus packages and all hidden benefits. The HPC does not consider the vote should be binding at this stage.

- Companies should implement a defined and structured talent pipeline to ensure and all listed companies should publish how they encourage talent in their annual report.

- Recruitment of non-executive directors should be openly advertised.

- Companies should publish the extent and nature of all the services provided by remuneration consultants.

- Full disclosure of all voting decisions on corporate governance should be made by institutional investors and fund managers, including executive remuneration.

- Employees should be represented on remuneration committees. The HPC notes that there are concerns that this will alter the UK's unitary board system, but it considers that the unitary board system is not effectively holding the executives to account in the long-term interests of the company over issues of pay. It proposes that the measure be voluntary, with the threat of legislation or fines if not implemented within a three-year period.

- A permanent national body should be established by government to, among other things, ensure company legislation is effective in ensuring transparency, accountability and fairness in pay at the top of British companies.

Next Steps

In general, the HPC recommends that implementation of its proposals should first be attempted through revisions to the Code, or otherwise through voluntary adoption by companies and shareholders, with legislative enforcement only if necessary.

Comment

Unsurprisingly, the report has received significant media coverage and politicians have been quick to welcome the HPC's findings in a tough economic climate where the general public views executive salaries as 'out of control'. Business Secretary Vince Cable commented that many of the options the government is consulting on in connection with the BIS Discussion Paper are reflected in the HPC report and has said repeatedly in recent weeks he would like to introduce legislation next year to curb executive pay. Currently, Cable's office (BIS) are weighing up which of the suggestions contained in the BIS Discussion Paper need fresh legislation or whether the majority of reforms can be simply inserted into codes of practice such as the Code but either way, it is likely that the HPC's recommendations will be implemented in one way or another given the current public disenchantment with top earners in the City.

Practice group contacts

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