

Policy update: Government Announces Corporate Governance Reform Package

Today (29th August) the Government set out its “world leading” package of [corporate governance reforms](#) designed to increased boardroom accountability and enhance trust in business. The reforms focus on three areas: Executive pay, employees’ voices and corporate governance in privately held businesses. The announcement follows a wide-ranging consultation which ended in February – UKSIF’s submission to the consultation [is available here](#).

The 9 key reforms announced by the Government are as follows.

Executive pay

The Government has sought to address the issue of executive pay, and its response highlights that it has risen faster than corporate performance. The Government intends to:

- (i) Invite the Financial Reporting Council (FRC) to revise the UK Corporate Governance Code (the “Code”) to:
 - Be more specific about the steps that premium listed companies should take when they encounter significant shareholder opposition to executive pay policies and awards (and other matters);
 - Give remuneration committees a broader responsibility for overseeing pay and incentives across their company and require them to engage with the wider workforce to explain how executive remuneration aligns with wider company pay policy (using pay ratios to help explain the approach where appropriate); and
 - Extend the recommended minimum vesting and post-vesting holding period for executive share awards from 3 to 5 years to encourage companies to focus on longer-term outcomes in setting pay.

- (ii) Introduce secondary legislation to require quoted companies to:
 - Report annually the ratio of CEO pay to the average pay of their UK workforce, along with a narrative explaining changes to that ratio from year to year and setting the ratio in the context of pay and conditions across the wider workforce; and
 - Provide a clearer explanation in remuneration policies of a range of potential outcomes from complex, share-based incentive schemes.

- (iii) Invite the Investment Association to implement a proposal it made in its response to the green paper to maintain a public register of listed companies encountering shareholder opposition to pay awards of 20% or more, along with a record of what these companies say they are doing to address shareholder concerns.

The Government also announced it will commission an examination of the use of share buybacks to ensure that they cannot be used artificially to hit performance targets and inflate executive pay.

Strengthening the employee, customer and wider stakeholder voice

The Government sets out three key proposals for reform to strengthen the voice of employees, customers and wider stakeholders in boardroom decision-making.

Section 172 of the Companies Act 2006 already requires the directors of a company to have regard to wider interests in pursuing the success of the company, but a large number of respondents thought that this aspect of the legal framework could be made to work more effectively through improved reporting, Corporate Governance Code changes, raising awareness and more guidance. The Government therefore intends to:

- (iv) Introduce secondary legislation to require all companies of significant size (private as well as public) to explain how their directors comply with the requirements of section 172 to have regard to employee and other interests;
- (v) Invite the FRC to consult on the development of a new Code principle establishing the importance of strengthening the voice of employees and other non-shareholder interests at board level as an important component of running a sustainable business. As a part of developing this new principle, the Government will invite the FRC to consider and consult on a specific Code provision requiring premium listed companies to adopt, on a “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; and
- (vi) Encourage industry-led solutions by asking ICSA (the Institute of Chartered Secretaries and Administrators: The Governance Institute) and the Investment Association to complete their joint guidance on practical ways in which companies can engage with their employees and other stakeholders. The Government will also invite the GC100 group of the largest listed companies (FTSE100 General Counsels) to complete and publish new advice and guidance on the practical interpretation of the directors’ duties in section 172 of the Companies Act 2006.

Corporate governance in large privately-held businesses

The Government sets out two proposals for reform regarding the corporate governance of large privately-held businesses, in addition to the new requirements in relation to section 172 set out above. The Government intends to:

- (vii) Invite the FRC to work with the IoD, the CBI, the Institute for Family Businesses, 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; and
- (viii) Introduce secondary legislation to require 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. This requirement will apply to all companies of a significant size unless they are subject to an existing corporate governance reporting requirement. The Government will also consider extending a similar requirement to Limited Liability Partnerships (LLPs) of equivalent scale.

Other issues

Section 4 of the green paper provided respondents with an opportunity to raise other aspects of corporate governance not covered in the earlier sections. Consultation revealed questions over whether the FRC has the powers, resources and status to undertake its functions effectively.

- (ix) To address this the Government will ask the FRC, the Financial Conduct Authority and the Insolvency Service to conclude new or, in some cases, revised letters of understanding with each other before the end of this year to ensure the most effective use of their existing powers to sanction directors and ensure the integrity of corporate governance reporting. The Government will also consider, in light of this work, whether further action is required.

Next steps

The Government says that the FRC intends to consult on amendments to the UK Corporate Governance Code in the late autumn. The Government intends to lay before Parliament draft secondary legislation, where required, before March 2018. Where necessary, there will be consultation on the detail of the secondary legislation. The work on developing voluntary corporate governance principles for large private companies will commence in the autumn.

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