



House of Commons

Business, Energy and Industrial  
Strategy Committee

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**Corporate governance:  
Government Response  
to the Committee's  
Third Report of Session  
2016–17**

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**Second Special Report of Session  
2017–19**

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## Business, Energy and Industrial Strategy Committee

The Business, Energy and Industrial Strategy Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department for Business, Energy and Industrial Strategy. The Committee's name was changed, from the Business, Innovation and Skills Committee, on 17 October 2016.

### Current membership

[Rachel Reeves MP](#) (*Labour, Leeds West*) (Chair)

[Drew Hendry MP](#) (*Scottish National Party, Inverness, Nairn, Badenoch and Strathspey*)

[Stephen Kerr MP](#) (*Conservative, Stirling*)

[Peter Kyle MP](#) (*Labour, Hove*)

[Mr Ian Liddell-Grainger MP](#) (*Conservative, Bridgwater and West Somerset*)

[Rachel Maclean MP](#) (*Conservative, Redditch*)

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[Mark Pawsey MP](#) (*Conservative, Rugby*)

[Antoinette Sandbach MP](#) (*Conservative, Eddisbury*)

[Anna Turley MP](#) (*Labour (Co-op), Redcar*)

### Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via [www.parliament.uk](http://www.parliament.uk).

### Publication

Committee reports are published on the Committee's website at [www.parliament.uk/beis](http://www.parliament.uk/beis) and in print by Order of the House.

Evidence relating to this report is published on the [inquiry publications page](#) of the Committee's website.

### Committee staff

The current staff of the Committee are Chris Shaw (Clerk), Ben Sneddon (Second Clerk), Ian Cruse (Committee Specialist), Jeanne Delebarre (Committee Specialist), Becky Mawhood (Committee Specialist), James McQuade (Senior Committee Assistant), Jonathan Olivier Wright (Committee Assistant) and Gary Calder (Media Officer).

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## Second Special Report

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The Business, Energy and Industrial Strategy Committee published its Third Report of Session 2016–17, Corporate governance (HC 702) on 5 April 2017. The Government's response was received on 11 September 2017 and is appended to this report.

In the Government response the Committee's recommendations are shown in **bold** type; the Government's response is shown in plain type.

## Appendix: Government Response

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### Introduction

The Government welcomes the Business, Energy and Industrial Strategy Committee's inquiry into Corporate Governance. As the Committee report noted, corporate governance is there to support effective decision making by companies for their own long-term success. It provides a framework of law, rules and practices by which company boards balance the interests of shareholders with other stakeholders, including employees, customers, suppliers, creditors and others.

The Government strongly believes that one of Britain's biggest assets in competing in the global economy is our reputation for being a dependable and confident place in which to do business. Our legal system, our framework of company law and our standards of corporate governance have long been admired around the world.

One of the reasons why we have maintained this reputation is that we have kept our corporate governance framework up to date with reviews and improvements being made from time to time.

The Government's green paper of last November followed in that tradition, looking at specific aspects of corporate governance – executive pay, corporate governance in large privately-held businesses and the steps that company boards take to engage in a more transparent manner and listen to employees and other groups with an interest in corporate performance – where the Government saw particular scope to build on the current framework.

The green paper generated a wide debate and a big response from a cross-section of business and society. These responses, together with the work of the House of Commons BEIS Committee provided the Government with a solid basis on which to act.

The Government Response to consultation on the green paper, published on 29 August 2017<sup>1</sup> set out a package of measures designed to:

- Address concerns that a minority of companies are not responding adequately when they encounter significant shareholder opposition to levels of executive pay. Remuneration committees will also have to do more to engage with the workforce to explain how top pay relates to wider company pay policy. And pay

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1 [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/640631/corporate-governance-reform-government-response.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/640631/corporate-governance-reform-government-response.pdf)

ratio reporting comparing the remuneration of the CEO with their company's average UK employee pay will be introduced for quoted companies to help set executive pay in the wider company context;

- Drive change in how our largest companies engage at board level with employees, customers, suppliers and wider stakeholders to improve boardroom decision-making, deliver more sustainable business performance and build wider confidence in the way businesses are run; and
- Encourage large private companies to adopt stronger corporate governance arrangements, reflecting their economic and social significance, through the development of a set of corporate governance principles; and introduce new measures to require companies, both public and private, of a significant size to disclose their corporate governance arrangements.

These measures are in line with the UK's approach of strengthening corporate governance proportionately: through changes to the UK Corporate Governance Code overseen by the Financial Reporting Council and voluntary business-led action where possible, and legislating where necessary. They align closely with a number of the Committee's recommendations.

At a time when investment and competitiveness are key, it is right that we build on our corporate governance strengths to equip us for the economic opportunities and challenges that lie ahead.

## Promoting good corporate governance

### *Recommendation 1<sup>2</sup>*

**We recommend that the FRC amends the Code to require informative narrative reporting on the fulfilment of section 172 duties. Boards must be required to explain precisely how they have considered each of the different stakeholder interests, including employees, customers and suppliers and how this has been reflected in financial decisions. They should also explain how they have pursued the objectives of the company and had regard to the consequences of their decisions for the long term, however they choose to define this. Where there have been failures to have due regard to any one of these interests, these should be addressed directly and explained.** [page 19, para 34]

The Government supports this recommendation. We agree that companies should be required to explain how their directors have met the duty in section 172 of the Companies Act 2006 to have regard to employee, supplier and other non-shareholder interests and how this has influenced decisions.

The Government considers that this form of reporting is so important that it intends to go further than the Committee recommendation for a Code change and make it a formal, legal requirement. The Government therefore plans to introduce secondary legislation to require all companies of significant size (private as well as public) to explain how their

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2 Note that the recommendations in the Committee's report were not numbered – numbers have been added in this response document for ease of reference.

directors have had regard to the employee and other non-shareholder interests set out in section 172. Further details will be set out in a draft statutory instrument which will be published later this year.

## Recommendation 2

**We recommend that the FRC works with business organisations to develop appropriate metrics to inform an annual rating exercise. This should publicise examples of good and bad practice in an easy to digest red, yellow and green assessment. Companies must be obliged to include reference to this rating in their annual reports.** [page 20, para 40]

This is a recommendation for the FRC to consider as they have responsibility for the UK Corporate Governance Code. The Government, however, has some concerns that this recommendation, if implemented, could have the effect of forcing companies into “tick-box” compliance with the Code, rather than applying it intelligently on a comply or explain basis. Whilst most companies are expected to meet the provisions in the Code, there can be circumstances where a different approach is appropriate for a particular company provided it is properly justified to shareholders. This is a key part of the UK’s “comply or explain” approach to corporate governance. A formal annual rating exercise risks undermining this valuable and legitimate flexibility.

## Recommendation 3

**We recommend that the Government brings forward legislation to give the FRC the additional powers it needs to engage and hold to account company directors in respect of the full range of their duties. Where engagement is unsuccessful, we would support the FRC in reporting publicly to shareholders on any failings of the board collectively or individual members of it. If companies were not to respond satisfactorily to engagement with the FRC, we recommend that the FRC be given authority to initiate legal action for breach of section 172 duties. Given the broader powers we have recommended in this Report, the Government should consider re-establishing, renaming and resourcing appropriately the FRC to better reflect its expanded remit and powers.** [page 21, para 42]

Government recognises the concern which the Committee has raised as to whether the FRC has the powers, resources and status to undertake its functions effectively. These are important issues since the FRC plays such a central role in the UK’s corporate governance framework.

It is important to recognise, however, that the FRC is one amongst a number of bodies with powers and functions relating to corporate behaviour and the conduct of directors, some of which overlap. The Financial Conduct Authority, for example, is responsible for enforcing the Listing Rules, which includes the requirement on listed companies to state whether it has complied with the provisions in the UK Corporate Governance Code. The Insolvency Service has powers to investigate companies and disqualify directors. Effective co-ordination between these bodies is vital.

The Government has asked the FRC, the Financial Conduct Authority and the Insolvency Service to work together to identify whether there are any significant regulatory or

enforcement gaps. In the light of this work, the Government will consider whether further action is required. In the short term Government has asked these bodies to conclude new or, in some cases, revised letters of understanding with each other before the end of the year to ensure the most effective use of existing powers to sanction directors and ensure the integrity of corporate governance reporting. The Government will also keep under review the resources and status of the FRC to ensure that it continues to operate effectively.

#### **Recommendation 4**

**We recommend that the Investor Forum seeks to become a more pro-active facilitator of a dialogue between boards and investors by engaging in regular routine dialogue in order to pick up on any widespread concerns, for example those identified by the new FRC rating system.** [page 23, para 47]

The Government agrees with the Committee that investors have a key stewardship role in encouraging and driving improvements in corporate governance and tackling poor practice where it exists and would support further development of the role of the Investor Forum.

The Investment Association and other representative bodies offer additional means to facilitate dialogue between investors and company boards and the government would be ready to talk to investors about any further steps or initiatives that might be taken.

#### **Recommendation 5**

**Stakeholder advisory panels can be a useful forum in which meaningful collaboration, consultation and dialogue with all stakeholders can take place. We urge companies to consider establishing such bodies. We recommend that the Code should be revised to require a section in annual reports detailing how companies are conducting engagement with stakeholders.** [page 25, para 54]

The Government agrees that companies should be required to explain how they are engaging with stakeholders. As mentioned in the response to recommendation 1 (above), the Government intends to 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 non-shareholder interests. It is envisaged that, as a part of this, companies should explain the mechanisms they have used to engage effectively with stakeholders. Further details will be set out in a draft statutory instrument which will be published later this year.

The Government has also invited the FRC to consult on the development of a new Code principle establishing the importance of strengthening the voice of employees and other stakeholder interests at board level as an important element of running a sustainable business. As a part of developing this new principle, and in relation specifically to the employee interest, the Government has invited the FRC to consult on a specific Code provision requiring companies to adopt, on a “comply or explain” basis, one of three robust employee engagement mechanisms: a designated non-executive; a formal employee advisory council; or a director from the workforce.

The Government also envisages that, in due course, guidance will be available to business on the best practice mechanisms that company boards can adopt to comply with the new principle, including the use of advisory panels to ensure that boards are listening to all their key stakeholders. The Government's recent response to Green Paper consultation pointed out that ICSA (the Governance Institute) and the Investment Association are already developing practical guidance on boardroom engagement mechanisms and plan to publish it shortly. The involvement of the Investment Association in this work underlines the significance many institutional investors now attach to seeing the companies they are invested in engaging effectively with stakeholders as an important component in running a sustainable business.

### **Recommendation 6**

**We recommend that the FRC reviews its Stewardship Code with a view to providing: more explicit guidelines on what high quality engagement would entail; a greater level of detail in terms of requirements; and an undertaking to call out poor performance on an annual basis.** [page 25, para 55]

This recommendation is for the FRC to consider as they have responsibility for the Stewardship Code. The Government understands that the FRC intends to carry out a review and consultation on amendments to the Stewardship Code during 2018. The Committee's recommendations can be considered in that context.

The Government agrees that institutional investors have a vital stewardship role in relation to the companies in which they are invested and welcomes ideas for strengthening this role.

### **Recommendation 7**

**We recommend that the Government consults upon new requirements on listed and large private companies to provide full information on advisors engaged in transactions above a reasonable threshold, including on the amount and basis of payments and on their method of engagement.** [page 27, para 59]

The Government agrees that companies' use of advisers should be subject to appropriate transparency and accountability. The Government, however, believes that the current legal and regulatory framework is robust in this area and is mindful that any new requirements should be proportionate. It is therefore not planning to introduce further requirements on private companies at present, but this might be an area for consideration by the group which is being established to develop corporate governance principles for large private companies.

The Government will also consider a number of the points raised by the Committee, as part of the process of transposing the Shareholders Rights Directive<sup>3</sup> in the UK. The Directive focuses on listed companies, where shares are often held through complex and at times inefficient chains of intermediaries, and aims to improve the flow of information.

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3 Directive (EU) 2017/828: [http://eur-lex.europa.eu/legal-content/EN/TXT/?toc=OJ%3AL%3A2017%3A132%3ATOC&uri=uriserv%3A0J.L\\_.2017.132.01.0001.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?toc=OJ%3AL%3A2017%3A132%3ATOC&uri=uriserv%3A0J.L_.2017.132.01.0001.01.ENG)

New measures will reinforce the principles already addressed in the UK by the FRC's Stewardship code and introduce specific requirements, in order to encourage shareholder long-term engagement and increase transparency.

The new measures aim to help institutional investors and asset managers to be more transparent on their shareholder engagement policies, which will describe how they integrate stewardship in their investment strategy.

In view of their role in influencing investors' voting behavior, proxy advisers will be subject to corporate governance and transparency requirements.

### **Recommendation 8**

**We recommend that the FRC includes in its revised Stewardship Code stronger provisions to require the disclosure of voting records by asset managers and undertakes to name those that subsequently do not vote.** [page 27, para 60]

This recommendation is primarily for the FRC to consider as they have responsibility for the Stewardship Code. Changes to the Code would be subject to consultation.

The Government's green paper, in fact, invited views on a stronger option to make disclosure of fund managers' voting records a mandatory, legal requirement. Responses to this option were mixed. Those in favour – primarily wider society groups and private individuals – argued that it would drive better stewardship and provide greater accountability by asset managers to asset owners on the approach they are taking on executive remuneration and other issues. Investor groups, some companies and some think-tanks, however, opposed mandatory disclosure of voting records, arguing that disclosure has improved significantly over the past three years and is already required on a 'comply or explain' basis under the FRC's Stewardship Code. Investor groups also expressed concern that mandatory disclosure could lead to greater reliance on proxy vote advisory services.

The Government concluded that significant progress was already being made through business-led action with 72% of UK institutional investors now disclosing their voting records in full. The Government believes that a non-legislative, Code-based approach remains appropriate, but will continue to monitor progress.

### **Recommendation 9**

**We recommend that the FRC includes best practice guidance on professional support for non-executive directors when it updates the Code and that companies include training of board members as part of reporting on their people or human resources policy.** [page 28, para 64]

This is a recommendation for the FRC to consider as they have responsibility for Code. However, Government supports actions which boost the strength and effectiveness of non-executive directors and is ready to discuss possible approaches with the FRC and other interested bodies if needed.

### **Recommendation 10**

**We recommend that the FRC updates the Code to provide guidance on how companies should identify clearly and transparently the roles of non-executive directors where they have particular responsibilities and how they should be held to account for their performance.** [page 29, para 65]

This is a recommendation for the FRC to consider as they have responsibility for the UK Corporate Governance Code. Government supports actions which boost the strength and effectiveness of non-executive directors and is ready to discuss possible approaches with the FRC and other interested bodies if needed.

### **Recommendation 11**

**We further recommend that NEDs should be required to demonstrate more convincingly that they are able to devote sufficient time to each company when they serve on multiple boards.** [page 29, para 65]

Specific provisions in the UK Corporate Governance Code already require non-executive directors to undertake that “they will have sufficient time to meet what is expected of them” and that other significant commitments should be disclosed to the board before appointment. Government agrees that companies should consider this robustly before appointing NEDs.

## **Private companies**

### **Recommendation 12**

**We recommend that the FRC, Institute of Directors and Institute for Family Business develop, with private equity and venture capital interests, an appropriate Code with which the largest privately-held companies would be expected to comply. They should contribute to the establishment of a new body to oversee and report on compliance with the Code.** [page 32, para 74]

The Government shares the Committee’s view that good corporate governance is relevant to all companies, not just those with a public listing. The conduct and governance of large companies, whatever their legal status, has a sizeable impact on the interests of employees, suppliers, customers and communities. Most privately-held businesses already understand the benefits of having an effective corporate governance framework in place. Some have already adopted good practice or borrowed the relevant principles from sector-specific codes or guidance.

The Government agrees that an appropriate Code or set of principles should be developed. Its recent response document announced that it has invited 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. This will be taken forward under the chairmanship of a business figure with relevant experience to be appointed in due course. We expect this work to commence this autumn.

Government considers that application of the new principles should be voluntary. This will allow companies to continue to use other industry-developed codes and guidance, such as that developed by the BVCA for private equity-owned businesses if they are more appropriate. It will also allow companies to adopt, or continue to use their own preferred approaches. However, Government will ensure that there is more transparency about corporate governance arrangements in large private companies through the introduction of legislation to require companies to disclose their corporate governance arrangements in their directors' report and on their website, including whether they follow any formal code.

This reporting requirement will apply to all companies of a significant size unless they are subject to an existing corporate governance reporting requirement. Our current view is that reporting obligation should apply to the largest companies, with at least 2,000 employees. Further details will be set out in a draft statutory instrument which will be published later this year.

### **Recommendation 13**

**We further recommend that the new Code includes a complaint mechanism, under which the overseeing body could pursue with the company any complaints raised about compliance with the Code. The scheme should be funded by a small levy on members. Should this voluntary regime fail to raise standards after a three year period, or reveal high rates of unacceptable non-compliance, then a mandatory regulatory regime should be introduced.** [page 32, para 74]

The Government does not envisage making compliance with a Code (or set of principles) mandatory and considers that large private companies should continue to be able to adopt the arrangements that suit them best. In these circumstances, a formal complaints mechanism would be impractical because there will be no single set of principles against which to monitor compliance.

However, the new requirement for large private companies to report annually on their corporate governance, including whether they follow a Code, will allow the FRC, government, employees and others to monitor the progress that companies are making towards having effective corporate governance arrangements in place.

## **Executive pay**

### **Recommendation 14**

**We recommend that companies make it their policy to align bonuses with broader corporate responsibilities and company objectives and take steps to ensure that they are genuinely stretching. Policy in this respect would be considered by the FRC in their corporate governance rating system.** [page 38, para 86]

The Government agrees with the Committee that bonus and other executive remuneration should ensure that directors are incentivised to take decisions that support good corporate governance and the long-term success of the company.

This is, however, primarily a recommendation for the FRC to consider as they have responsibility for the UK Corporate Governance Code.

The Government announced in its response to consultation on the green paper that it would be inviting the FRC to extend the recommended minimum vesting and post-vesting holding period for share awards from 3 to 5 years to incentivise directors to focus on longer term outcomes. It also intends to introduce secondary legislation to ensure that executive remuneration policies are clearer about the range of potential outcomes from longer-term, share based incentive schemes.

### **Recommendation 15**

**We recommend that the FRC consults with stakeholders with a view to amending the Code to establish deferred stock rather than LTIPs as best practice in terms of incentivising long-term decision making. Overall, we recommend that this consultation should develop guidelines for the structure of executive pay with the following features:**

- a) **A simpler structure based primarily on salary plus long-term equity, to divest over a genuinely “long-term” period, normally at least five years, without large steps;**
- b) **Limited use of short-term performance-related cash bonuses, which should be aligned, where possible, to wider company objectives or corporate governance responsibilities;**
- c) **Clear criteria for bonuses: they should be genuinely stretching and be aimed to provide incentives rather than just reward.** [page 41, para 95]

The Government agrees that executives should be incentivised to build up long-term equity holdings in the companies they lead, to align personal success to the long-term success of the company. We note the dominance of the LTIP model and the criticism that LTIP structures can be over-complex and sometimes lead to remuneration outcomes not expected by investors. We also note the concerns from a number of investors that simpler equity award models, such as ‘restricted share awards’, may not sufficiently align pay to performance. The Government believes that companies should continue to have the flexibility to choose the long-term share remuneration policies and models that they put to investors for approval, which are subject to a binding vote. They and shareholders, however, should be more open to alternatives to the currently dominant LTIP model.

We agree with the Committee that long-term share-based remuneration should divest over at least a five year period, and have invited the FRC to consult on this as part of its review of the Corporate Governance Code. We have also proposed to bring forward secondary legislation that will require companies to set out the impact of share price growth on share based remuneration models that operate over multiple years.

### **Recommendation 16**

**We recommend that the FRC revises the Code to include a requirement for a binding vote on executive pay awards the following year in the event of there being a vote against such a vote of over 25 per cent of votes cast. This requirement should be included in legislation at the next opportunity.** [page 45, para 106]

The Government agrees that more can be done to address the small minority of companies who receive significant shareholder dissent on executive pay. We have invited the FRC, as part of its forthcoming review of the Code, to consult on more specific and transparent remedial measures that companies receiving such dissent should take. We have also asked the Investment Association to implement its proposal to maintain a public register of companies experiencing shareholder dissent of more than 20% in any reporting year.

We do not intend to legislate to introduce a binding vote. However, the Government will monitor the impact of the proposed Code changes and the Investment Association's register carefully once they are in place. We will consider further action at a future point unless there is clear evidence that companies are taking active and effective steps to respond to significant shareholder concerns about executive pay outcomes.

### **Recommendation 17**

**We recommend that any Chair of a remuneration committee should normally have served on the committee for at least one year previously. To further incentivise strong engagement, we recommend that the Chair of a remuneration committee be expected to resign if their proposals do not receive the backing of 75 per cent of voting shareholders.** [page 46, para 109]

Most respondents to the green paper thought that the chair of the remuneration committee should have at least 12 months' prior experience of sitting on a remuneration committee before taking up the role of chair. However, a majority of business and investor respondents felt this should be introduced on a 'comply or explain' basis through the UK Corporate Governance Code rather than through legislation. They thought that some flexibility was required to take account of the limited circumstances where it might be appropriate to appoint someone with less experience. Examples provided included circumstances where a fresh approach was needed to remuneration policy, or where a company was finding it difficult to find a non-executive director who was a good fit with their business and already had 12 months' experience of a remuneration committee.

The Government agrees with the Committee's recommendation that companies should consider the experience of candidates before appointing a Chair of a remuneration committee. They should also consider whether the Chair should stay on in the event that their proposals do not receive 75 per cent of voting shareholders. These are, however, matters for individual companies to consider on the strength of the particular circumstances. The Government will continue to monitor developments.

### **Recommendation 18**

**We recommend that companies should set out clearly their people policy, including the rationale for the employment model used, their overall approach to investing in and rewarding employees at all levels throughout the company, as well as reporting clearly on remuneration levels on a consistent basis. The FRC should consult with relevant bodies to work up guidance on implementing this recommendation for inclusion in the Code.** [page 47, para 112]

The Government strongly agrees that the remuneration committee should have broader oversight of pay and reward across the company. Many respondents to the Green Paper were keen for enhanced engagement between the remuneration committee and the workforce in setting executive pay. This was particularly driven by views that disproportionate attention was paid to the company board as opposed to employees, and that the committees did not meaningfully discharge their existing obligations introduced in The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 to take account of pay and employment conditions elsewhere in the company when setting executive pay.

To this end the Government has invited the FRC to consult on a revision to the UK Corporate Governance Code and its supporting guidance to give remuneration committees greater responsibility for demonstrating how pay and incentives align across the company, and to explain to the workforce each year how decisions on executive pay reflect wider pay policy. This consultation will provide an opportunity to seek best practice examples from those remuneration committees that already engage proactively with the wider workforce, while enabling current work in this area by a number of prominent think-tanks to be taken into account.

### **Recommendation 19**

**We recommend that the FRC works with other relevant stakeholders on the detail and amends the Code to require the publication of pay ratios between the CEO and both senior executives and all UK employees. We further recommend that the Government requires that equivalent pay ratios should be published by public sector and third sector bodies above a specified size.** [page 48, para 115]

The Government supports this recommendation. We agree with the Committee that there is value for investors and the company itself in setting out and explaining the relation between average workforce pay and pay at the top of the company.

Government therefore intends to introduce secondary legislation to require pay ratio reporting which will compare CEO remuneration to average pay in the wider company workforce. The Government envisages the ratio being set out alongside a narrative explaining any changes to the ratio from year to year and setting the ratio in the context of pay and conditions across the wider workforce. This requirement will apply to companies already subject to the existing executive remuneration reporting requirements (i.e. quoted companies as defined in the Companies Act 2006).

This proposal is intended to increase transparency in setting executive pay, whilst providing a useful tool that will enable shareholders and stakeholders to consider whether executive pay levels at a company are appropriate given the performance of the business, and rewards for the general workforce.

Further details will be set out in a draft statutory instrument which will be published later this year.

The publication of pay ratios by the public and third sectors is, in many instances, already required. The Hutton review of Fair Pay in the Public Sector, for example, recommended mandatory reporting of top earner to median pay ratios in all Civil Service departments Annual Reports. These details were published last year for the first time by Cabinet Office.

There is also a requirement in section 38 of the Localism Act 2011 for local authorities to publish information about pay multiples on their websites. This includes an obligation on the authority to produce Pay Policy statements outlining policy on pay dispersion within the organisation. In addition, since 2011–12, the Government Financial Reporting Manual (FRM)<sup>4</sup> has required organisations which handle public funds, including NHS organisations and Foundation Trusts, to publish their top to median pay ratio in their annual accounts.

In relation to pay in the university sector, the Government will ask the Office for Students (OfS) to introduce a new ongoing condition of registration requiring the governing bodies of Approved and Approved (fee cap) providers to publish the number of staff paid more than £100,000 per year and to provide a clear justification of the salaries of those paid more than £150,000 per annum. It has also called on the sector to work through the Committee of University Chairs to develop and introduce their own Remuneration Code. This Code should encourage greater independence of remuneration committees, the publication of the pay ratio of top to median staff pay, and explanations of top pay increases that are greater than increases in average pay.

## Composition of boards

### *Recommendation 20*

**We believe that the aims and targets of the Hampton-Alexander Review should go further and, in support of the Equality and Human Rights Commission’s objective, we recommend that the Government should set a target that from May 2020 at least half of all new appointments to senior and executive management level positions in the FTSE 350 and all listed companies should be women. Companies should explain in their annual report the reasons why they have failed to meet this target, and what steps they are taking to rectify the gender inequality on their Executive Committees.**  
[page 53, para 127]

The Hampton-Alexander Review set a target in November 2016 that 33% of FTSE 350 board members as well as 33% of Executive Committees and their direct reports in the FTSE 100 should be women by 2020. This would require approximately 40% of new appointments to these roles going to women. We believe this is stretching but achievable target and will be monitoring progress against it over the next three years. While we support the Committee’s goal of gender parity in senior appointments, our view is that we will achieve most progress by focusing on the current target before setting the next one.

### *Recommendation 21*

**For companies seeking a competitive advantage, the directors and non-executives running them, and those setting the strategic context in which they operate, should be**

4 <https://www.gov.uk/government/publications/government-financial-reporting-manual>

**empathetic to the needs and requirements of all those involved, including employees, workers, suppliers and customers. It makes business sense to recruit directors from as broad a base as possible, across the demographic of the UK. We recommend that the FRC embeds the promotion of the ethnic diversity of boards within its revised Code. At the very least, we recommend that wherever there is a reference to gender, the FRC should include a reference to ethnicity, so that the issue of ethnic diversity on boards is made explicit in the revised Code, and is given as much prominence as gender diversity.** [page 54, para 132]

This is a recommendation for the FRC to consider as they are responsible for the Corporate Governance Code. The Government agrees with the Committee that it makes business sense to recruit directors from as broad a base as possible across the demographic of the UK, and agrees with the recommendation to make explicit the issue of ethnic diversity.

### ***Recommendation 22***

**In accordance with the spirit of the McGregor Smith review, we recommend that the Government should legislate to ensure that all FTSE 100 companies and businesses publish their workforce data, broken down by ethnicity and by pay band.** [page 54, para 133]

The Government has already responded to Ruby McGregor Smith recommendation that Government should legislate to ensure that all listed companies and businesses employing more than 50 people publish workforce data broken down by race and pay band. The Government's preferred approach is to set out the value of employing a diverse workforce to companies and institutional investors in order to increase demand for such information. We have said that we believe a non-legislative solution is the right approach for now, but will monitor progress and stand ready to act if sufficient progress is not delivered.

### ***Recommendation 23***

**The more similar that individual directors think, act, and look, the more likely it is that they are not going to challenge each other, or innovate, or think imaginatively. Directors should not be appointed to the board solely on the basis of one particular background or area of expertise. Greater cognitive diversity promotes more effective challenge and more informed decision-making and we recommend that the FRC works with others to provide improved guidance on this aspect of diversity in the context of board membership.** [page 55, para 136]

This is a recommendation for the FRC to consider. The Government agrees with the Committee on the value of cognitive diversity, and would welcome efforts by the FRC and others to improve guidance on this.

### ***Recommendation 24***

**The revised Code should have the issue of board diversity as a key priority and there should be a public explanation of the reasons why members are part of the board. The Code should require boards to cover in their annual reports information diversity on their boards and in the workforce, covering diversity of gender, ethnicity, social mobility, and diversity of perspective. Annual reports should be required to include**

**a narrative on the current position, and an emphasis on what steps the company has taken, and will continue to take to enhance the diversity of the executive pipeline, with agreed targets. This narrative should include how accurately the board mirrors the diversity of both the workforce and the customer base.** [page 56, para 139]

The Government has noted the Committee's recommendations for further company reporting on diversity issues, including more reporting on the steps that companies are taking to enhance the diversity of their executive pipeline. The Government will continue to work closely with the FRC and others to ensure that diversity disclosures are effective in helping drive further progress. The recommendation in relation to the revised Code is a matter for the FRC to consider.

### ***Recommendation 25***

**The detailed narrative of board diversity in annual reports should be a working document throughout the year, informing the board, the Nomination Committee, middle and senior managers, and the workforce and other stakeholders, about the seriousness that companies are taking diversity and succession issues. The revised Code should make this requirement explicit.** [page 56, para 140]

This is a recommendation for the FRC to consider when consulting on the revised Code.

### ***Recommendation 26***

**We recommend that companies should be recruiting non-executive and executive directors from the widest possible net of suitable candidates, which should include recruiting internally. Successful companies, both here and abroad, have shown that this can work for the benefit of the company as a whole, and we encourage more companies to appoint workers on boards. We believe that, just as the drive for women directors has overcome initial doubts, it should become the norm for workers to serve on boards.** [page 57, para 146]

The Government agrees with the Committee that companies should be doing more to ensure that they are recruiting directors from the widest possible pool of potentially qualified candidates. The Government believes that greater diversity within the boardroom can help companies connect with their workforces, supply chains, customers and shareholders.

### ***Recommendation 27***

**We recommend that the revised Code states explicitly that the procedure for the appointment of new directors to the board should be by open advertising, and by an external search consultancy, and detailed explanations should be given if one or both of these requirements is not met.** [page 58, para 151]

The Government notes the Committee's recommendation, which is for the FRC to consider in their consultation on the revised Code. We note that a similar recommendation has also been made by the Equalities and Human Rights Commission (EHRC).

***Recommendation 28***

**We recommend that the FRC should be given the extra role of overseeing the rigour of the evaluation process to ensure that it is genuinely independent, thorough and consistent across companies. The FRC should highlight best and worst practice among Nomination Committees.** [page 58, para 152]

The Government agrees with the Committee on the importance of rigorous, externally facilitated board evaluations and that boards should, as provisions in the UK Corporate Governance Code require state how “performance evaluation of the board, its committees and its individual directors has been conducted”. However, the Government considers that it is primarily for shareholders who are invested in a company to satisfy themselves about the rigour of the boardroom evaluation process. It is not convinced that FRC should provide a separate layer of monitoring and scrutiny.

The Government considers that there could be value in a periodic exercise to analyse annual reports to assess how companies have approached boardroom evaluations and to draw out examples of best and worst practice. This might be carried out by the FRC or another independent organisation. The Government has asked the FRC to give this further consideration.