Business, Energy and Industrial Strategy Committee

Oral evidence: Corporate Governance: delivering on fair pay, HC 928

Tuesday 22 January 2019

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Watch the meeting

Members present: Rachel Reeves (Chair); Drew Hendry; Stephen Kerr; Peter Kyle; Sir Patrick McLoughlin; Albert Owen; Mark Pawsey; Antoinette Sandbach; Anna Turley.

Questions 553 - 654

Witnesses

I: Paul George, Executive Director, Corporate Governance and Reporting, Financial Reporting Council; Janet Williamson, Senior Policy Officer, TUC; Catherine Howarth, CEO, ShareAction.

II: Kelly Tolhurst MP, Minister for Small Business, Consumers and Corporate Responsibility, Department for Business, Energy and Industrial Strategy; Sanude Lima, Deputy Director, Corporate Governance Reform, Department for Business, Energy and Industrial Strategy.
Chair: Thank you very much to the three of you for coming in to give evidence to our Committee today. This is the last of our sessions on executive pay, and we appreciate your time. After this session, the Minister is coming in to give evidence. We will try to rattle through the questions so we can make time for that session as well.

Q553 Anna Turley: Good morning, everyone. Catherine, can I start with you? Welcome. Could you tell us whether there is a growing sense, generally, that executive pay levels have become unjustifiably high? Have you seen any shift, particularly in the last couple of years, in the approach taken by shareholders?

Catherine Howarth: There is a very widespread sense in the country at large, and among workers in the UK whose own pay has been stagnant for a long period or very restrained, that pay at the top of UK companies is, to use a populist phrase, somewhat out of control. It has been rising very significantly, even in the last two or three years, when there has been so much attention, so much debate and so many policy-led measures from the Government and other actors to try to get the situation under control. That leaves all of us in this field quite flummoxed as to what might in fact be effective.

Institutional shareholders have many powers, and have been given many powers by policymakers, to engage and attempt to ensure that pay at the top of firms is well aligned with the long-term interests of underlying shareholders, who of course are pension savers, in very large part, who are themselves on these modest pay arrangements. They have the powers, but shareholders do not, in our view, have enough incentives in this. It is really worth noting that the asset management industry is probably the highest-paid sector in the UK. Pay in asset management is higher than in investment banking, and the gender pay gap is particularly notable in the asset management industry. As we know, the gender pay gap in the UK as a whole is 18%, but it is 27% in asset management.

We have put in charge of overseeing executive pay a group of people who have quite a range of challenges around pay in their own sector. That is one issue that leads to the conclusion that asset managers struggle, somewhat, with using the powers they have been given to oversee pay at the top of firms and to ensure that it is both reasonable and well judged, in terms of quantum, but also well aligned for the long term in ensuring that corporate directors are really thinking about long-term wealth creation, human capital management in their own companies and so on. Those are some of the challenges. Shareholders are more engaged with the problem than they have been, but we still see lots of fund managers voting through pay arrangements. We saw very few rebellions last year on pay policies that were put to the vote. We saw relatively modest levels of rebellion at pay reports, which shareholders also have a vote over.
There is no clear evidence that the asset management industry and shareholders are fully getting to grips with the problem or using the powers they have been given.

**Q554 Anna Turley:** Thank you. That is really helpful. I will move on to our other guests, if I may, for the next part of this question. Looking at the structural reasons for this, could you both give your views on the structural drivers? Have we seen, for example, a high proportion of pay linked to bonuses? What are some of the drivers that have meant the last two years of concerted interest and focus on this have not made a difference?

**Janet Williamson:** The incentive element of pay has largely driven the escalation of executive pay over the last two decades and continues to drive that excessive increase in executive pay. It is the incentive element that has contributed most to the growing gap between the pay of the workforce within companies, and across the economy more broadly, and those executives. That is a significant element of the problem. We would support a move away from the reliance that we have at the moment on incentive pay to a greater reliance on basic salary as a much larger component of executive pay.

**Paul George:** I agree with a lot of what has been said already. There are some structural challenges. The first thing to be clear about is that the UK’s corporate governance code applies to 800 premium listed companies, and high remuneration, or disproportionate remuneration from some to the many, is not isolated to the large public companies. If you look at private equity, the entertainment industry, there are lots of examples. Hedge funds are another example. The issue is broader than large UK public companies, but it is large UK public companies that tend to get a lot of the focus.

Catherine’s articulation of the role of shareholders is right. The primary objective of the institutional investors, the fund management community, is to deliver a return to the beneficiaries. The beneficiary—and we often lose sight of this—is wider society, because a significant proportion, as Catherine has said, is used to satisfy pension benefits and to pay out on life insurance policies. It does contribute to wider society. Their focus is primarily to derive a return; it is not necessarily to police excessive remuneration. That creates some structural challenges.

**Q555 Anna Turley:** Coming back to Janet, do you think the reforms of 2014 have had any impact? Have you seen any shift or any change?

**Janet Williamson:** They have had very little impact on the actual practice of setting executive pay awards. They have had an impact on the context, on public awareness, but not nearly enough on those who are responsible for setting executive pay, the remuneration committees, and also not enough on those responsible, in the current system, for monitoring executive pay, who are shareholders.
**Paul George:** You also need to think about the reforms that have come in since then. We have made a significant revision to the corporate governance code. Many of the revisions to the corporate governance code focus on remuneration, and some of those are likely to have a positive impact over time: for example, the emphasis on discretion; the greater emphasis on reporting, particularly in the context of remuneration committees comparing the remuneration of their executives to other organisations; and pay ratios within the company itself. There are some things there that will have a positive impact, but it is focused in on a small cadre of companies with high remuneration.

**Q556 Mark Pawsey:** Could I follow that point up, Mr George? The new code was published in July 2018. Can you tell us why the changes were brought about? What did you change, and why?

**Paul George:** I will focus on remuneration. There are a lot of other changes beyond remuneration, but I will focus on some of the changes in respect of remuneration. One, which I have already mentioned, is in respect of discretion. An unintended consequence—and often there are unintended consequences of well-intended legislation, regulations, whatever it might be—of the binding vote on the remuneration policy is that, in my view, too many remuneration committees have applied the policy arithmetically, rather than stepping back to consider whether the outcome of applying the policy is appropriate. That is one of the reasons we have emphasised the importance of remuneration committees exercising discretion.

The second one is engagement with the wider workforce. The third is an explanation of the reporting by remuneration committees—while many large public companies had remuneration committee reports, we have only now introduced a formal reporting requirement—including much more context and explanation on pay ratios, the gender pay gap and other diversity-type issues.

**Q557 Mark Pawsey:** In your view, did those revisions go far enough? Might they have gone further?

**Paul George:** You have to appreciate that the corporate governance code is a code. It is designed to apply to a variety of different companies, largely global companies. We are blessed with our capital markets, in many ways, in that the companies listed there are largely global, and they compete on an international stage, both for capital and, more importantly, for resources. Therefore, one has to put it in that context. If you want to go further, one has to consider legislative changes, because a code cannot deliver all the responses to all of society’s challenges.

**Q558 Mark Pawsey:** It does not have powers, but it creates a framework. Are there ways in which it might have gone further? There was an opportunity there to effect some change. Are you happy with the level of change that the code brought forward?
Paul George: Yes, we are. Perhaps I should make a couple of other points on the changes. We have put greater emphasis on remuneration committees looking at the level below the top tier of executives and at the policies affecting the wider workforce. Those things are quite important, as are a number of things about the nominations committee, to do with succession planning and executive pipeline.

Q559 Mark Pawsey: If I might come to Catherine and Janet, do you think this new code is going to make any difference to the way remuneration committees work?

Janet Williamson: From our point of view, the best way of making changes in a workplace situation is through workforce voice. We would have liked to see the code have a provision to include workers on remuneration committees. As Paul has said, the code requires remuneration committees to take into account workforce practices, but in fact many remuneration committee members have little experience of workforce practices and are not necessarily very expert on employment relationships. It would be highly beneficial for the committees, in taking workforce practices effectively into account, to have workers from the company on them, who can speak to those issues and can bring a dose of common sense to decisions on executive pay. We would have liked to see that included.

Q560 Mark Pawsey: Yes, but do you think in practice remuneration committees are going to do anything different as a consequence of the changes to the code?

Janet Williamson: It is very difficult to say at this point in time. The context has shifted; Paul has talked about the revisions to the code. The thing that will make a difference to the context in which remuneration committees are making their decisions is the pay-ratio reporting, which is public reporting, and that is a requirement. The context has shifted. We do, however, have two decades’ worth of experience of remuneration committees being required to take into account pay and conditions elsewhere in the company and failing to do so, alongside shareholders failing to hold companies to account for that. The track record to date is very poor, but there are changes, I suppose, in the decision-making context that we hope will make a difference.

Q561 Mark Pawsey: Catherine, you told us earlier that asset managers were not using their powers. What about remuneration committees?

Catherine Howarth: I would echo that there are some positive changes in the new corporate governance code. It is really important to get across to the Committee this morning that there are two codes, and they need to work together: there is the corporate governance code and then there is the stewardship code. That is also a voluntary code, but it is the one that guides investors as to how they should oversee what is going on in corporate boardrooms, including in remuneration committees.
We are about to see the stewardship code review begin, and that is an enormously important opportunity to ensure that everything that emerged in the new corporate governance code about taking account of the wider workforce and thinking about pay in the round within the company is reinforced, with investors having very clear guidance that they should take an interest not just in pay among a tiny elite of the executive directors of the company but in all these issues. In some companies, once you get to a certain level, you are really competing with other people, because the jump up to the next layer of management involves a 200% pay rise. These big disparities in how a company manages its workforce can undermine a sense of solidarity in the company, and ultimately productivity and success.

Q562 **Mark Pawsey:** I will bring you back to the role of remuneration committees. The changes that the FRC brought about were intended to give more power to remuneration committees. I know it is early days yet, but is there any evidence that they are using those?

**Catherine Howarth:** No, there is no evidence, because it is the first year since that came in. We might see some evidence this year. We should be closely on the lookout for it.

Q563 **Mark Pawsey:** Is your assessment that the new code will be helpful?

**Catherine Howarth:** The new code is helpful, yes. The new code will not deliver what many hope it might without a strongly reformed stewardship code, because the power to oversee and to vote members in and out of remuneration committees sits with investors in the company. Investors have to be aligned with the new direction of the corporate governance code if we are going to see the change we wish.

**Paul George:** Catherine has mentioned, two or three times, the consultation on the stewardship code. We consulted at a very high level on our plans for the stewardship code at the same time as we consulted on the corporate governance code. We will be issuing a full consultation on the code shortly. That code raises considerably the expectations we have of the investment community’s engagement with companies and the outcomes from that engagement. We are significantly shifting the focus of the stewardship code from reporting against policies to reporting not only against policies but on the activities and outcomes. I would urge Catherine and others to respond to that consultation because it is an opportunity.

However, I should emphasise, again, that the responsibilities of shareholders are not limited to remuneration. There are a number of other things that we want shareholders to engage with companies on: their business model, their strategy, their approach to climate sustainability, lots of different things. Remuneration is important, but it is not the only issue.

Q564 **Drew Hendry:** Paul, carrying on from consultations, what did you learn
from the consultation on the new stewardship code about the views of investors on pay?

**Paul George:** It was mixed. To some extent—and this may come back to Catherine’s point about whether they are the right policemen on pay—there is a degree of fatigue in terms of remuneration having too much of a focus on the performance of companies, as against matters such as the business model, the strategy and sustainability. There is outrage at some aspects of remuneration, where it is not justified by underlying performance. There is a recognition that they need to play their part on engagement, but there is a concern that some companies are not engaging as well as they could with their investors around their remuneration policies.

Q565 **Drew Hendry:** From the practical point of view, will the revised code contain stronger provisions in relation to pay? Is it realistic to expect investors to become more engaged and to reach common views on executive pay?

**Paul George:** It covers stronger provisions of engagement more generally, including in respect of remuneration, matters around escalation and the like.

Q566 **Drew Hendry:** Do you believe they will reach common views?

**Paul George:** I suspect there will be a variety of responses to the consultation. Not every investor is the same, and therefore that is always a challenge. We are seeking to create a market for stewardship, so the asset owners are engaging with fund managers who are clear on what their purpose and objectives are, so they can better align with the interests of the ultimate beneficiaries. We have not been very good at making that link between the ultimate beneficiaries—wider society, by and large—and the work of the fund management industry.

Q567 **Drew Hendry:** Janet, how effective can the code be in affecting behaviour? Do you agree with Kingman that it should be abolished, if not improved? What powers do you think could be more effective?

**Janet Williamson:** I would agree that the stewardship code has not been very effective to date. It has had very limited impact on practice, on what investors actually do in terms of engagement with companies. It has been much more about policies. I would support a shift away, within the corporate governance system, from reliance on shareholders as being the main mechanism of monitoring companies anyway. In terms of the stewardship code, you could have much stronger provisions, for example, on reporting on voting disclosure; they are very weak in the current code. You could move it away from being just about policies to being much more about practice, about what investors have actually done and, critically, about the outcomes of that practice: how they have engaged with companies or voted in a particular way that has had an impact on something that is actually happening within that company. If it were
focused much more on practice and outcomes, and less on policies, it could be a more effective code than it is at the moment.

Could I make one point on the previous discussion about investors and executive pay monitoring? If you moved to a much simpler system of executive pay and had fewer incentive elements, it would be automatically much easier for investors—and other stakeholders, for that matter—to engage on executive pay and to understand it, and for the public to understand it. Everybody, including remuneration committees, would ultimately benefit from a shift away from the very complicated systems we have at the moment towards something much simpler, much more similar to the pay packages of other workers within the company, more based on basic pay and a simpler structure overall. There is a lot of support for that now.

Q568 **Drew Hendry:** Catherine, is stewardship working? How effective are institutional shareholders in driving change, and what specific changes would you like to see in the new code?

**Catherine Howarth:** When they want to be, investors are very well equipped with some serious powers. Notably, they can ultimately vote directors on and off the boards of companies. But stewardship is not working as well as it might, despite the fact that—this is very important to say—there are some fantastic investors in this country who do a really good job, are very engaged with what is going on and are increasingly willing to use the powers they have. There is also a long tail of very inert and apathetic investors who do not use their powers.

Almost all of the big fund management companies have signed up to the stewardship code. It is therefore a bit disappointing that the outcomes are not what we might like to see. The Financial Reporting Council has done, in many ways, a really good job of raising the issues of the stewardship code, but it lacks power. There is almost no sanction in the system for investment management companies that have signed up to the stewardship code and then not complied or not used the principles to keep a real eye on what is going on in companies. One of the things we would really like to see, as part of this review, is a much clearer sanction mechanism for companies that have signed the code and then not complied with it or used it to further the interests of their real clients, who, just to re-emphasise the point, are ordinary working people in the UK with pension savings. That would be one really important part of the review process: we need stronger sanctions.

We also want to see a much broader approach to what stewardship is for. Currently, it is very narrowly focused on a small range of corporate governance issues, including remuneration, and does not look at the wider range of factors that lead to a company's long-term success, such as thinking about productivity, environmental performance, managing risks relating to climate change and, crucially, thinking about how the workforce is managed in a positive and sophisticated way, to get the best out of people and ensure that they are well rewarded. All of these things
could be embedded in the new code: a closer focus on environmental, social and governance issues.

Those are some of the changes that we will be promoting as part of the review process, and we are optimistic that we will end up with a better code. But we are not confident that we will end up with a better regime overall unless we have this stronger element of enforcement and sanction. I just want to flag that there is an important potential role for the Financial Conduct Authority here. It is the regulator that really oversees the asset management community in the UK and has real powers. We would like to see the FCA more embedded in the system, to ensure that the stewardship code really works and delivers on its objectives.

**Q569 Stephen Kerr:** Catherine Howarth mentions the FCA; I am going to turn to the FRC. Paul George, what do you see as the role of the FRC in encouraging companies to adopt particular structures or limits on executive pay?

**Paul George:** Our responsibility is to set the corporate governance code; it is not to run companies. This links back to aspects of what Catherine said about the role of the stewardship code. I think Catherine will be positive when she sees what we will be consulting on, but, as she also rightly points out, we do not have any powers to enforce the stewardship code. The stewardship code gets its force through the FCA rules, which require the fund management industry to explain whether they have signed up to a relevant stewardship code.

**Q570 Stephen Kerr:** Let me ask Catherine Howarth the same question. It sounds like it is a matter of issuing guidance and codes, and then seeing what people do. Is that how you see the FRC’s role?

**Catherine Howarth:** That is the FRC’s role, but I would draw attention to the challenge given in Sir John Kingman’s review of the FRC on stewardship. He acknowledged the hugely important role of investor stewardship in the economy but was quite scathing about how the current regime is operating. In fact, he said that if it is not improved it ought to be abolished because, in a sense, it provides a fig leaf.

**Stephen Kerr:** I think he called it a “ramshackle house...built on weak foundations”.

**Catherine Howarth:** Some very important proposals have been put forward. Kingman’s report is very light on what needs to happen next around the stewardship code. That might be an area for questions, if you have him in to talk about his work. Our view is that the Financial Conduct Authority, which, as I said earlier, is a powerful regulator that is responsible for overseeing and regulating UK asset managers, but also insurance companies that offer pension products, could clearly play a more central role in ensuring that stewardship works in the UK, including over executive pay, but also on the wider regime.
Paul George: Thank you for reading out that quote, which is clearly a very good headline-capturing quote. If you read into the detail of the report, it sets out a much more positive roadmap to give the successor body to the FRC the powers to meet the expectation that underlies many of the questions that are being asked today, particularly around powers to monitor corporate governance statements. We believe we were already addressing Sir John's comments about the stewardship code. As I say, the consultation will be out shortly.

Q571 Stephen Kerr: He does not recommend renovation; he recommends demolition and complete replacement, does he not?

Paul George: That is not quite how I read the report. He wants Government to set up a proper authority, with proper statutory powers.

Stephen Kerr: Yes, something much more muscular.

Paul George: It would be largely staffed by existing FRC employees and clearly have the powers to do the job.

Stephen Kerr: He talks about the talent that is needed to staff a proper, muscular organisation.

Paul George: Yes.

Janet Williamson: We would welcome a stronger stewardship code, but I would not raise our expectations too high. The majority of the shares of UK companies are now held by overseas investors, and fund managers generally hold the shares of hundreds, if not thousands, of different companies, with which they are meant to engage on an ever-increasing range of issues. While I agree with what Catherine says about our expectations of investors, being realistic, they have limited resources with which to carry out this role. We need to be thinking of other ways of reinforcing and monitoring our corporate governance system and not relying wholly on shareholders, as the current system does.

Q572 Stephen Kerr: Let me go back now to Catherine Howarth. How can shareholders be encouraged to think of longer-term considerations, not just financial ones but others, as opposed to short-term financial considerations, which seem to be the driving force behind many of their views?

Catherine Howarth: One issue that deserves much closer examination is remuneration within the asset management industry. It is an industry with a huge level of incentive-based pay. Fund managers, portfolio managers, are typically very well rewarded with big bonuses if they outperform against a benchmark index in a 12 or 24-month period. This drives them, and it is completely rational, to focus on short-term corporate performance. The relationship between remuneration in these two interconnected sectors is one really important thing.

It is also very important that, under the regulatory regime for pension funds and for fund managers, there is very explicit wording on focusing
on the long term. I would like to commend the Department for Work and Pensions for introducing new pension investment regulations in the last few months. They will come into force in October. They require UK pension funds to have stewardship policies. Those stewardship policies will be heavily guided by the new stewardship code, soon to emerge. If the new stewardship code wording focuses on the long term and makes it quite explicit that the stewardship of companies should be about the long term, that will certainly help and it is very much achievable in the next few months of this review process.

To come back to the FCA, overseas asset managers could have within their rules—and they have hard rules, not codes—wording that emphasises that, insofar as asset managers act on behalf of clients, and those clients are working people with 20, 30 and 40-year horizons until they collect their pension, it is essential that good asset management is asset management about long-term wealth creation. That could also be embedded in the wording of the rules.

Q573 **Stephen Kerr:** Thank you for that. Janet Williamson, I have one quick question for a response from you, please. This is to do with what impact you would expect a shift away from LTIPs to restricted shares, in terms of bonuses, to have. What effect would it have on executive pay and behaviour? What is your assessment?

**Janet Williamson:** It is hard to know, but a simpler structure would be much more predictable in terms of what people are receiving at the end of every year. It would be very important to make sure it did not go hand in hand with massive increases in basic salary, but it would be an improvement on the current situation. It would be much more transparent, easier to understand and we would support that. We do not support payment in shares either, but it would be an improvement on the current LTIP situation.

**Paul George:** The Investment Association has just issued some revised guidance to remuneration committees, which picks up on this topic. It is quite clear that there are differing views among the fund management industry as to the merits of restricted stock versus LTIPs. Your question was about how we can make the fund management industry deliver these things. It is a responsibility for asset owners, in setting their mandates, to make sure their fund manager is thinking about the long-term issues as well.

Q574 **Albert Owen:** I am conscious of time. Could I briefly ask, first of all, a question of both Catherine and Janet? How much of a problem is excessive pay in private companies as opposed to the listed sector? Will the recommendations of the Wates review help?

**Catherine Howarth:** Remuneration in private companies is an issue as well. It is very similar to public companies. Certain parts of the non-listed sector, for example the private equity industry, have a particularly extreme problem. It is not helpful, because a lot of people who work in
very senior roles within public companies think they are really underpaid compared to the pay available in the private equity or hedge fund sectors. That is a challenge. The Wates review was an important step forward, but it could have been much stronger on this particular area.

**Janet Williamson:** We know less about pay in private companies, because their reporting requirements are so much weaker. We would support them being the same for private companies as for listed ones. But there clearly is a big problem with very excessive pay in some private companies. Private companies are such a big range of companies. You are going from quite small, family-owned businesses to enormous private equity funds and many in between.

Q575 **Albert Owen:** The Wates review had a threshold. It was looking at the larger ones.

**Janet Williamson:** The Wates review had a threshold, but your first question was whether there is a problem. There clearly is, in particular parts of it. The Wates review addresses remuneration, and it is actually quite similar to how the corporate governance code was before the round of revisions that has happened in recent years. It asks the companies to take into account pay and conditions elsewhere in the company in setting executive pay. It is weak on reporting. It does not beef up reporting.

Q576 **Albert Owen:** You say it is weak. Is that because there is a lack of effective enforcement mechanisms in the principles that it adopted?

**Janet Williamson:** No, the code itself does not call for private companies to report any detail on their remuneration arrangements. It will not necessarily generate additional information in the public domain about what is happening in terms of pay within private companies. It is a first step. It is the first time there has been a corporate governance code for private companies. That is a very important first step. In my view, the remuneration principle is not the strongest of the principles in the Wates review.

Q577 **Albert Owen:** Mr George, why is the guidance on remuneration different in the corporate governance principles for private companies and listed companies?

**Paul George:** Janet worked alongside the FRC and others in pulling together the Wates principles. We borrowed a lot of material that was in previous versions of the code. It is a moving feast. We have to be clear that the Wates principles are not underpinned by significant levels of legislation. The legislation introduced requirements around large private companies to explain their corporate governance arrangements or whether they follow a particular code. We developed the Wates principles on the basis that companies would use that and, therefore, there was an element of thinking, “Let us get large private companies to come with us on the journey of doing these things”. Had the Wates principles been prescribed in legislation, I suspect one could have gone a little further.
Q578 **Albert Owen**: Should they have been prescribed in legislation?

**Paul George**: It would have been helpful, whether it was the Wates principles or some other principles, because at the moment there is too much flexibility in what companies can do and then there is the flexibility in the code itself.

Q579 **Albert Owen**: Can I move on to bonuses and incentives? Paul and Catherine, do you agree with the TUC that there is an overreliance on incentive pay in packages? It recommends a 10% limit. What are your views?

**Catherine Howarth**: I strongly agree with that. A strong case can be made that incentive arrangements have hindered companies from achieving the success and long-term wealth creation shared by all, which it is possible to achieve in our economy. It has been a massive sink of time. There is very interesting academic evidence emerging that when CEOs have vesting periods approaching, they cut R&D in their company so they can get the maximum possible outcome from that. It is providing all sorts of unhelpful personal incentives that are not in the interests of corporate success.

**Paul George**: One also needs to think about what is being driven by the owners of companies. The owners of companies have been pushing more and more to incentive-based schemes over a long period of time. Janet mentioned the interaction between the private equity sector and the publicly quoted sector. They are heavily incentivised. Therefore, if you are trying to recruit talent, you want to mirror their incentives to some degree.

Q580 **Albert Owen**: Is there an overreliance here?

**Paul George**: There is no doubt that the greater uncertainty in the remuneration a CEO is likely to earn has increased the range of outcomes.

Q581 **Albert Owen**: You are describing it well. The question is this: is there an overreliance on incentives in your opinion?

**Paul George**: Incentive schemes can be good. There is too much volatility in them, which is causing some of the outrage that is around.

**Janet Williamson**: If by “owners of the companies” one means fund managers, I would agree that they have driven or certainly been very supportive of this overreliance on incentive pay. If one means ordinary workers and pension fund members, I have yet to meet one who supports the way that incentive pay is prioritised and managed at the moment.

Q582 **Albert Owen**: I have a question for you. Should profit-sharing schemes including all employees, including CEOs, be encouraged more strongly? I will ask the others to comment briefly as well.
Janet Williamson: Yes, absolutely. That is an inclusive scheme that moves away from the "one rule for us, one rule for them" type approach. Everybody is in it on the same terms. If there is going to be an incentive-related scheme or ways of people benefiting from companies’ success in a particular year, that is the thing to do.

Q583 Albert Owen: Can you give us examples of very competitive companies that do this?

Janet Williamson: Tesco has one. The John Lewis scheme is not called a profit share, but it is basically equivalent.

Q584 Albert Owen: Catherine, you have touched on this. Do you want to comment?

Catherine Howarth: I very much agree with the idea that, if you have an incentive scheme, it should be one for everyone. That is very intuitive. As Janet says, there are a number of companies providing evidence that that works. I just wanted to make a broader point on the information that shareholders have about the workforce. They have quite a lot of information on pay at the top, thanks to quite often extremely lengthy remuneration reports as part of annual reports, but very weak, poor information about issues elsewhere in the workforce.

Although I have been quite harsh in what I have said about fund managers today, they are coming together in an initiative called the Workforce Disclosure Initiative with 120 investors all over the world to request much richer and comparable data out of public companies about the workforce as a whole, including in supply chains. This sets the scene for investors to play a much more constructive and positive role, not just focusing obsessively on executive pay but really trying to think about the role of pay and workforce management across the employee base. I definitely agree with the TUC on that.

Q585 Albert Owen: Do you agree with the TUC, briefly and finally?

Paul George: Yes.

Q586 Peter Kyle: Catherine, is the code’s requirement for better reporting, such as on alignment throughout the company, going to give shareholders more information? Is it going to help better decision-making? Is it going to lead to better outcomes?

Catherine Howarth: This is the corporate governance code.

Peter Kyle: Yes, indeed.

Catherine Howarth: Yes. Better information is a prerequisite for better decisions, but it does not always necessarily drive them. I said earlier that investors have the powers. They also have much but not a complete set of information that is useful. Do they have the incentive and drive to lead to change in behaviour? That is another question. The gender pay gap is a really interesting example. Investors now have very rich
information about the gender pay gap, which they did not have a year ago. Are they going to use it and use the powers they have with companies to drive changes in behaviour? We are yet to see.

Q587 Peter Kyle: You are gently nodding, Paul. Is there anything you want to add to that?

Paul George: I would add to it by drawing on Sir John Kingman’s report, which says that the FRC should have had some powers to monitor corporate governance reporting and the information that those who own the shares vote on.

Q588 Peter Kyle: Janet, it could be said that these new requirements are going for the low-hanging fruit, and yet there are some very difficult pockets of hard-to-reach groups of people in the workforce who may not be affected by some of these requirements. I was reading some data from the Young Women’s Trust, for example, which showed that one in five women were being offered work for less than the minimum wage. When you look at the totality of this new policy drive, do you think it is going to make a difference, for example, for young women in the workforce?

Janet Williamson: We have been talking about reporting on workforce issues. One of the problems we have at the moment with the regulatory requirements is that, where there are requirements for reporting on those issues, it is always couched in terms of employees, reporting on employee numbers and so forth. There really needs to be a shift towards a focus on the workforce, the workforce as a whole, including young people who may be on very insecure or precarious contracts and who may therefore be illegally paid lower than the minimum wage.

There is a huge problem here. Quite often, companies can tell quite a good story about their core workforce and yet may be using an indirect workforce, which is contributing to their products, services and profits, but is not accounted for anywhere inside company reports and not enough inside company decision-making. It does not really filter through to the investor engagement because, to be fair to the investors on that one, the information is not there.

There really needs to be more focus, across the whole corporate governance piece, from decision-making in the boardroom to reporting, looking at pay and all the rest of it, on the whole of the workforce, including those who are employed through intermediaries or on zero-hours contracts who have no control over their working hours. Everybody should keep those people in mind when looking at whether these changes are working. They need to work for all working people.

Q589 Antoinette Sandbach: Paul, in terms of the Investment Association’s register of shareholder dissent, some people have argued that it acts as a disincentive to reform or innovation in pay, and disincentivises efforts to reduce pay. Do you agree with that?
**Paul George:** No, I am not sure I entirely agree with that. The public disclosure of greater than 20% dissenting votes will have, over a period of time, an impact on companies, because they will not wish for it to be disclosed that they have had such votes against them. It is important to look at that level of transparency alongside the escalation procedures that we have built into the revised corporate governance code and what companies should be doing if they have had a significant adverse vote against. There is also engagement that takes place before the vote. Quite a lot of schemes fail before they get as far as a vote.

Q590 **Antoinette Sandbach:** We have heard evidence about that in previous sessions. What would you like to see happen where there is continued failure by what I would call repeat offenders: those that are getting numerous dissenting votes and still not changing their approach?

**Paul George:** We introduced annual election of directors in the corporate governance code a few years ago. Those voting shares should, for repeat offenders, exercise their rights and duties to vote off directors who are not paying appropriate attention to shareholder concerns.

Q591 **Antoinette Sandbach:** But we have heard that it is quite a cosy little club. Many directors will be on remcos in other firms and so on. How do you break that if shareholders are not acting in the way you suggest they should?

**Paul George:** There should be better succession planning on all boards. We have strengthened the code there. We have strengthened the requirements for length of tenure on boards. A greater focus in nominations committees on diversity is a good thing. I am not so sure about the idea of the cosy club. Perhaps that was a fair criticism five or 10 years ago. I think that is changing.

Q592 **Antoinette Sandbach:** Can I bring Catherine in? Do you agree with that?

**Catherine Howarth:** Remuneration committees have failed in practice and failed, in a way, as a structure. They have not resulted in pay that seems to have improved UK corporate performance.

Q593 **Antoinette Sandbach:** Do you use the Investment Association register?

**Catherine Howarth:** It is relatively new feature. It cannot be a bad thing at all that the Investment Association is keeping a list of companies that had a strong rebellion one year, two years or three years in a row.

Q594 **Antoinette Sandbach:** Sorry, can I just ask you to answer that? Do you use it when you are looking at companies?

**Catherine Howarth:** Yes.

Q595 **Antoinette Sandbach:** Do you think other investors are doing that too?

**Catherine Howarth:** Yes, there is widespread awareness of which companies have suffered a serious rebellion on pay votes. When investors
have signalled challenge, if they do not get reform and change, we would like to see them escalate the process. Escalation is part of the stewardship code principles. For example, you move to voting against the chairman.

Q596 **Antoinette Sandbach**: Catherine, I have to stop you, because we have very limited time and a number of questions. Janet, I wanted to ask you about the publication of pay ratios. Is that going to have an impact? Should there be a cap on the maximum pay ratio that there can be between the highest and lowest paid in the company?

**Janet Williamson**: The publication of pay ratios is a very helpful measure. It shines a spotlight on the issue of pay gaps within companies, which is something we have been trying to draw attention to for years. It puts all that information into the public domain. It at least forces remuneration committees to look at that data in making their decisions. It gives the public and all stakeholders a way in to see those pay gaps in practice.

Whether it makes a difference will depend on the remuneration committee members and how much they start to look at those pay ratios as something they need to take into account in setting the levels of executive pay. It comes back to the investor piece and how much investors start using those pay ratios as part of the information for monitoring companies and performance on executive pay. But it is a helpful step in the right direction.

Q597 **Antoinette Sandbach**: Could you envisage any unintended consequences if there was a legally binding maximum pay ratio or in the publication of it?

**Janet Williamson**: I do not know quite how that would work. It would be quite complicated. I am not quite sure how it would work, in truth. It is not something we have a policy on ourselves. We have continually called for the publication of the ratios and for much smaller pay gaps, but we have not called for them to be legally binding.

Q598 **Sir Patrick McLoughlin**: Do you publish your own pay ratio?

**Janet Williamson**: All of our pay is in the public domain, and our ratios are less than 10 to one.

Q599 **Sir Patrick McLoughlin**: So we would know what a cleaner was paid in your headquarters.

**Janet Williamson**: I am not sure whether the cleaning staff’s pay is published, but the top level of pay is published and is in the public domain.

**Paul George**: A cap is a blunt instrument that should be used very carefully. The obvious unintended consequence is that companies will outsource the lower-paid activities in order to massage the outcome of their pay ratios. There were statistics showing that some companies you
might think were extremely high payers, investment banks for example, ended up having the better pay ratios. It is something one would only want to use as a last resort.

Q600 **Antoinette Sandbach**: Because pay ratios and executive pay fluctuate from year to year, how meaningful is the publication going to be?

**Paul George**: It has to be set in context. For large public companies, there is an opportunity for remuneration committees to explain that in a way that shareholders can vote against. It is probably slightly harder in some smaller companies, because the pay ratios come down to anybody who employs more than 250 employees. I suspect they are less sophisticated in their ability to report all the different things they need to report. Yes, the FRC reports its pay ratios, even though it has less than 250 employees.

Q601 **Antoinette Sandbach**: Catherine, will pay ratios be a useful tool in restraining executive pay?

**Catherine Howarth**: They will be of value, but limited value without reforms that require institutional investors, which ultimately have sanction and oversight powers, to use their powers in a way that results in pay policies across companies that drive long-term wealth creation.

Q602 **Antoinette Sandbach**: How do you deal with Janet’s evidence to us that, in effect, a lot is now being asked of investors? Increasing demands are being made. How would you deal with that point?

**Catherine Howarth**: It is absolutely true. Almost too much is asked of investors in the current regime. In fact, other stakeholders need to have more purchase and influence over companies in this respect and others. Having said that, we live in a regime in which shareholders have stronger rights than any other stakeholders. Reforms to ensure that shareholders use those powers in an enlightened way, and are accountable for their use to those on whose behalf they act, are critical. We can quite easily put them in place through, in part, the reformed stewardship code and, in part, the improved rules and regulations for the Financial Conduct Authority, which regulates asset managers.

Janet’s point is absolutely well taken. We have to be careful about over-relying on shareholders, but to the extent that we rely on them we must expect and hold them accountable to a different set of behaviours and standards.

Q603 **Chair**: Can I ask one final question to Paul George? We have Stephen Haddrill coming in to give evidence next week on the future of audit, but we have now had the review, which has been mentioned already this morning, by Sir John Kingman. It sets out a large number of interim steps that could be taken by the FRC without waiting for a Government response. Are you implementing any of those already?
Paul George: We are seeking to implement some of them. A number of the steps that it says one can implement immediately rely on support from BEIS. I believe BEIS will be consulting shortly on the overall response. We can get on and do more of the same types of activities in terms of our monitoring, but we need to raise money in order to do that, and at the moment it is probably quite a difficult time to do that.

Chair: I am looking at some of them here: “Ensure that all board, committee and senior posts are openly advertised”. That is something I would have thought an organisation like the FRC was doing anyway. Is that happening now?

Paul George: Yes, it is, and it depends on the form of advertising. We advertise roles on things like LinkedIn, which did not meet Sir John’s definition of “sufficiently open”. On that particular point around the board, the future board of the successor organisation to the FRC will be appointed by Government. Therefore, it is a matter we have to take forward with them.

Chair: “Ensure that Board is able to exercise stronger ownership of the FRC’s enforcement functions.” Is change happening on that front?

Paul George: The information provided to the board is quite clear. We cannot get the board to take decisions where, in our disciplinary schemes, the right body to take a decision is elsewhere. If we do not follow our due processes, we get judicial reviewed, and we will not be able to complete an investigation effectively. Yes, we want to take forward that recommendation, but we cannot go as far as Sir John has recommended in the report without changes to the schemes.

Chair: As I say, we will be taking evidence from Stephen Haddrill next week and from the Minister after that. Thank you very much for that glimpse of what is happening already. Thank you very much, all three of you, for coming to give evidence this morning.

Examination of witnesses

Witnesses: Kelly Tolhurst MP and Sanu de Lima.

Chair: Good morning, Minister. Good morning, Mr de Lima. I am sorry that we are a little later starting than we had planned. As you know, this session is on executive pay. This is the final evidence session we are taking on this. We appreciate you giving up your time today.

Drew Hendry: Good morning, Minister. Are executive pay levels still too high?

Kelly Tolhurst: First of all, I would like to thank the Committee for the work you have been doing so far in this area and your ongoing work over a period of time. Thank you for inviting me to attend. In response to your
question on the levels of executive pay, my answer to that would be, in some parts, yes.

Q607 **Drew Hendry:** On what basis?

**Kelly Tolhurst:** Companies need to look at the wider impact of their levels of pay and the concerns that may be raised in the community, in their organisations and by shareholders. In some parts, yes, but, ultimately, it is a decision for those companies.

Q608 **Drew Hendry:** How should we judge fairness, with reference to local or international competitors or with reference to internal differentials in the workforce? Can we do both?

**Kelly Tolhurst:** If we look at what the Government are bringing forward with the introduction of the pay ratios, the objective of that is, for our largest companies and our quoted companies, to give shareholders, the wider public and their workforce an idea of the gap between the top executives, the CEOs, and the lowest paid across the whole organisation. That enables transparency. In effect, it brings questions and gives tools for shareholders to hold the board to account for its ideas, proposals and policies.

If you look at our executive pay as it stands in relation to Europe, we are currently on par with Germany and just a little above Switzerland. It also needs to be considered that the companies quoted in the UK are much larger than some of those in other European countries, so it might be acceptable to say that some UK companies may have a higher level of pay.

Q609 **Drew Hendry:** If pay is closely linked to performance, should we welcome the increase in total pay as a sign of company success or should we move away from performance-related pay to exercise restraint?

**Kelly Tolhurst:** Fundamentally, the way pay is devised is still a matter for those individual companies. We now require remuneration committees to give a breakdown of how those salaries are compiled in regards to basic pay, pensions and the long-term or short-term incentive plans. That is a requirement. Fundamentally, it is down to individual companies to decide on that.

There is nothing wrong with moving away from those principles, but it will come down to what the shareholders require, taking that into consideration around the whole pay structure of the organisation.

Q610 **Drew Hendry:** Is it high pay or pay inequality that most concerns you? Is it high remuneration for executives or pay inequality?

**Kelly Tolhurst:** It is the whole environment. In some parts, executive pay is too high. That may be in relation to the level of pay throughout an organisation. One of the things this Government are doing, which comes under my portfolio in regards to national minimum wage enforcement, is ensuring that those people at the lower end of the income scale are
protected. Yes, inequality levels are of course a concern and something that we would always seek to look at.

Q611  **Drew Hendry:** What impact does pay inequality have on social cohesion?

**Kelly Tolhurst:** We have seen recently, and I welcome, the measures the Government have brought forward around transparency and the work that has been done for the wider public. The wider public now have a much clearer understanding of what executives’ pay is compared to the workers within those organisations. Some of them are household names. The media spotlight on those organisations, the transparency information that is now available, the measures the Government have put in place and, to be honest, the work of Committees such as this one definitely enable the public to ask those questions.

Q612  **Drew Hendry:** If the public are asking those questions, what is the role of Government in seeking to influence the levels of executive pay? What is the rationale for intervention? For example, is it to promote fairness, reduce inequality, improve productivity or reputation? What would it be? What is the rationale?

**Kelly Tolhurst:** It is all of that. We want the UK to remain a great place to work, to set up a business, and we want people to thrive. It is right that we look to those large organisations to make sure they—

Q613  **Drew Hendry:** Sorry, if I can interrupt, what is the core rationale, though? Where do you see the main purpose? Obviously, everybody would like all those things. What is at the core of the Government’s intervention?

**Kelly Tolhurst:** Some of the interventions we have done are around enabling transparency and giving shareholders the tools to hold boards to account. I do not think there is one element. It is around how we expect our large companies to—

Q614  **Drew Hendry:** There must be a core purpose there.

**Kelly Tolhurst:** It is a range of things. Fundamentally, for me it is around those large companies that have a big part to play in our communities. It is not just in regards to executive pay. It is about how they operate in a range of areas. The things we are bringing forward are to make sure they are considering the impact of their decisions on their wider workforce but also in the communities in which they operate. That is what the public and I as a Minister would like to see: our organisations showing strong leadership, corporate responsibility and acting fairly within the UK.

Q615  **Drew Hendry:** I have one final question, then. In 1980, according to the Centre for Economic Performance, the median pay of a FTSE 100 company CEO was 11 times the pay of a median worker. By 2010, this had risen to 116. From all accounts, it seems to have gone up even further now. Is that good enough?
Kelly Tolhurst: You are quite right. There was a sharp rise in executive pay, which brought it up to big levels. If you look at the statistics, over the last five to nine years, it has levelled off. It is not showing an upward trend.

Drew Hendry: It is not going down.

Kelly Tolhurst: Some of that can be attributed to changes in how the pay is structured. Without looking at the stats on the way the pay structure has changed—and please correct me if I am wrong—in the 1990s, we did not have as much remuneration through long-term incentive plans. If you look at the graph of how pay has increased in line with the breakdown of pay, you will see that over the period, even though it has levelled off, a lot of that difference has been made up by the increase in pay-outs from long-term incentive plans.

Q616 Drew Hendry: Are you happy with that situation?

Kelly Tolhurst: In regards to the way that pay is broken down, as I have already outlined, it is still a fundamental decision for those companies as to how they operate their pay structure. One of the things we have implemented in the corporate governance code is asking shareholders and remuneration committees to look at simplifying pay so it is not as complex. For example, if your long-term incentive plans are related to shares, we are asking them to state what a 50% increase in the share price would mean for executive pay, so it is looking forward and not just looking back. The idea behind it is transparency and giving shareholders the tools to hold the board to account and to make those decisions.

Q617 Mark Pawsey: My question is probably targeted at Mr de Lima. It is really to ask about the changes that came in during 2014, when companies were required to have votes on executive pay. How is that going? Is it having any effect? Are there any stats to show that it is acting in a beneficial way?

Sanu de Lima: Yes, there are. I should just add that our most recent corporate governance reforms build on those and use, for example, the single figure of total remuneration that was introduced as part of those reforms when it comes to pay-ratio reporting. One of the earlier reforms was around introducing a remuneration policy, the triennial policy, on which shareholders would have a binding vote.

Q618 Mark Pawsey: Sure. My question is this: is there any evidence that that is starting to have any effect? Is it too early?

Sanu de Lima: I would argue that there is some evidence.

Q619 Mark Pawsey: Can you point to any particular companies that may have taken action as a consequence?

Sanu de Lima: I would not mention particular companies, but I would mention the Investment Association’s public register of significant shareholder dissent. We see institutional investor activism when it comes
to scrutinising and voting against—expressing dissent—remuneration policies or, indeed, remuneration reports that they find unsatisfactory.

Q620 **Mark Pawsey:** Minister, if executive pay continues to go the way it is going, are there any circumstances under which Government might be motivated to intervene?

**Kelly Tolhurst:** On the back of the reforms we are bringing in this year, we will keep that under review. I still remain very much of the opinion that we are here to give shareholders the tools to hold those boards to account, as I have outlined. We will keep that under review. As I have already outlined, we want our large companies to have corporate responsibility and social responsibility if they are operating in the UK. Fundamentally, I am of the opinion that those decisions lie with individual companies around the scale of pay, but there may be things that we can bring forward. With these reforms coming forward now, we would like a period to review them and see how they work.

Q621 **Mark Pawsey:** Minister, as well as acting responsibly, we want UK companies to be able to attract the best talent. To what extent is our ability to influence these issues affected by international competition? Interestingly, Mr Henry spoke about UK executives being paid 116 times the median worker. I understand in the United States that is now 271 times and has increased six-fold in the last three decades. To what extent is our ability to act here limited by the international dimension of highly mobile chief executives or executives?

**Kelly Tolhurst:** This is why it should rest solely with companies to decide where they set their pay. It is for Government to put measures in place to aid transparency. They need to explain now, as part of these new reforms, how their pay policy relates to their wider workforce.

Q622 **Mark Pawsey:** If there were to be a call for Government to take action, might that restrict the ability of UK companies to bring in the brightest and best to run businesses?

**Kelly Tolhurst:** We operate on an international scale. We have to recognise that we have some really successful businesses and large quoted businesses here in the UK. A lot of these individuals, as we well know, are operating in an international marketplace. It is right that that flexibility is there to enable our companies to attract the right talent. I do not personally see a time when we would want to intervene to restrict that.

Q623 **Mark Pawsey:** How about the structure of executive pay? We heard a proposal in evidence that there should be a limit of 10% on the amount of bonus that an executive should get. Is that an area that the Government should be getting involved in?

**Kelly Tolhurst:** As I outlined to Mr Hendry, it is not really Government’s place to dictate to those organisations how their pay structure is put in place. It is for them, ultimately, to have regard to their shareholders.
There has been mention of the wider implications, but it is not for Government to dictate that. We welcome changes and anything that would bring pay in line with the wider payment practices across the organisation, but fundamentally it is not the Government’s role to step in to change that or to specify how pay structures should be dictated.

Q624 **Mark Pawsey:** Are there dangers for either the Government or the FRC in taking a more prescriptive approach and trying to set out to businesses the nature of the remuneration packages they can offer to their senior executives?

**Kelly Tolhurst:** I do not believe it is Government’s role to dictate how companies should be structuring their pay packages. Fundamentally, that is where I stand on that. I believe that is where the Government are. It is for us as a Government to do what we are doing around protecting workers and transparency. As I highlighted, it is right that the media and others look at what is happening and scrutinise what is going on in those organisations, but in regards to legislation and regulation it is not for us to dictate how companies can structure their pay packages. That is something that rests with shareholders and directors.

Q625 **Albert Owen:** You mentioned that the responsibility lies with the shareholders, but, given that many of them are short-term shareholders, is it realistic to think they can hold the company to account and restrain executive pay?

**Kelly Tolhurst:** I disagree with that point. There are many responsible shareholders who take an active role in the running of the companies in which they are shareholders. The new Investment Association register shows dissent in votes on things like pay policies and on other things.

Q626 **Albert Owen:** There have been very few rebellions, have there not? I am not talking about Parliament. I am talking about shareholders.

**Kelly Tolhurst:** Out of the 141 participants in the register this year, 60 lost votes on executive pay. When those binding votes have been lost, the company has to come back within a year with a new pay policy. That shows that shareholders are taking that seriously and they are moving in that direction.

Q627 **Chair:** Of those 60 lost votes, how many were binding votes?

**Kelly Tolhurst:** They were binding votes. Those 60 were binding.

Q628 **Chair:** How many pay packages for chief executives or boards actually fell because of those votes?

**Kelly Tolhurst:** I do not have that particular detail on the 60. If we hold that information, I am more than happy to share it with you.

**Sanu de Lima:** I could clarify for the record. The Minister is right that, where the vote goes against the policy, the company, the board, needs to bring back a revised policy the next year. When we are talking about the
Investment Association’s register, significant shareholder dissent is 20%.
That is not necessarily a definitive vote against, but a portion of the 63
that the Minister mentioned could well have been rather significant.

Q629 Chair: What do you mean by “could well have been rather significant”?

Sanu de Lima: Where it was over 50% of the vote, the company would
need to return to the shareholders with a revised policy.

Q630 Albert Owen: There is a bit of an issue here with the numbers, but
basically, Minister, are you encouraged by the recent shareholder revolts?
Is that the direction of travel? Are they taking ownership more and are
they flexing their muscles to hold companies to account?

Kelly Tolhurst: It is twofold for me. First, having this register helps to
highlight what is going on within those companies and hopefully people
will be encouraged to look at the register, which is accessible, to see
where shareholders are exercising their rights, so to speak. Hopefully
that will encourage others to do so.

Secondly, some of the other measures we are bringing in, with the
revised corporate governance code and the advent of pay-ratio reporting,
aid that transparency by giving those tools to shareholders and giving
them more information to express their displeasure or not. There are
those two elements, but it is a moving picture. We are going to keep it
under review, especially with the pay-ratio reporting.

Q631 Antoinette Sandbach: We have seen a number of shareholder revolts,
but some of the evidence to us was that we are expecting too much from
institutional investors in terms of oversight. How can I, as a member of
the public whose pension fund is investing on my behalf, feed into that
process and make that voice heard?

Kelly Tolhurst: Retail shareholders will have their investors who take
the votes. There is evidence that they are engaged, but it would be for
individuals to make sure they are in discussion—

Q632 Antoinette Sandbach: Minister, has your pension company ever
contacted you and asked you how you would like it to exercise its vote on
your behalf? I do not think I have ever had a pension company do that.
Even as an individual investor, that is taken away, because a lot of
companies now hold in nominee accounts rather than in the names of the
individual investors. I am concerned that the voice of the small
shareholder is being lost.

Kelly Tolhurst: Yes, that is an element. That might be the individual
voice, but we have seen that those investors are taking an active role
within the role of the shareholders.

Q633 Albert Owen: To come back to the stewardship code, it has been
indicated that significant numbers of signatories to the code are not
declaring their records. Can we expect reform of the code? Are you going
to abolish it and look at it again? Is reform an avenue you wish to go
Kelly Tolhurst: The FRC will be holding a review of the stewardship code, which is coming soon. The FRC will do that, and there will be a consultation into that. We look forward to seeing what the outcomes of the consultation are before the potential changes that there may or may not be to the stewardship code.

Albert Owen: But you cannot be happy with a number of signatories to the code not even declaring their records.

Kelly Tolhurst: That is one of the reasons that we are having a review of the stewardship code.

Chair: Minister, do you agree with suggestions from the previous panel this morning that reporting requirements should be broader to include things like the payment terms to suppliers, the use of agency staff, payment of the living wage, environmental considerations? Should the reporting requirements be widened in that way?

Kelly Tolhurst: That is an interesting question. Not having considered those particular elements and whether they should be included, I would say that those things absolutely have an impact on how companies are judged by their customers and suppliers. I could not give you a definitive answer on whether we would need to include them in regards to financial reporting.

Not having heard the previous evidence session, I will say that it is quite right, where companies are not good payers or do not adhere to good payment terms—and we may be questioning those companies on their executive pay—for that to be considered in the wider context of their operations. That is why I welcome transparency. Having those things out there in the open makes it clear how they are operating. It gives the public and individuals the opportunity to hold them to account and to make decisions about whether they want to be a customer or supplier of those organisations.

Chair: That is exactly why some people are arguing—and we are also hearing this in the work we are doing on the future of audit and corporate governance—for wider reporting on, for example, how promptly a firm pays its suppliers, whether it pays the living wage and some of those things. Having that information out in the public domain would make it easier for people to judge whether they want to do business with or invest in a company like that. That is worth looking at further.

Kelly Tolhurst: Yes, I am not ruling it out. That is a really good point. It is massively important in regards to how we view those organisations. I just cannot give you a definitive answer today.

Chair: We have heard, both in the evidence this morning and in the evidence we took last week on the future of audit, that we are perhaps—Antoinette and others have raised it this morning—asking investors to do
too much. The fact is that investors do not have unlimited resources, whether that is individual investors or indeed asset managers. Your responses today have suggested that it is up to shareholders and investors to demand more from businesses.

In Sir John Kingman’s review into audit, he said that the stewardship code is near to worthless. If the stewardship code is not working sufficiently and if investors are not doing their job, I wonder whether you have any alternatives to just falling back on this line. In an ideal world, Minister, we would agree with you, but it is just that it is not happening. If it is not happening, how else are we going to ensure better corporate governance?

Kelly Tolhurst: It is a legitimate point that you raise. We are hoping that the publication of pay ratios will have an impact and encourage investors to look at this seriously. We have also made changes in regards to the narrative that needs to go around that. We need to keep it under review. I am looking forward to the review and consultation on the stewardship code. That is really important. We need to assess how these measures are working and then introduce new things, if that is required. I am not against that. It is one of those things: we have made some changes; I understand some people would like us to go further in certain areas, but I feel we are acting proportionately at this time and doing the things we need to do. Obviously, it is under review continuously.

Chair: In this Select Committee we have taken evidence from some fantastic companies doing great things. We have also taken evidence from companies and remuneration committee chairs who are paying huge amounts to a few people in those organisations while others have to rely on benefits to make ends meet. We took evidence from Persimmon, where the chief executive was paid £75 million. It does not pay a living wage to its employees, although I believe this month it is beginning to do so, in part because of pressure from this Committee and from others. We took evidence from GKN Melrose; Melrose has now taken over GKN. We had three people from that business come to give evidence. Between the three of them, last year they took home £120 million. We took evidence from the chair of the Royal Mail remuneration committee, which paid the incoming chief executive more than £5 million just for taking the job.

All of us around the table on this Committee had strong feelings after taking evidence from those people. How do you feel, Minister, about those sorts of pay-outs, especially when some people in those organisations might not be earning a living wage? For example, a postman or a postwoman working for the Royal Mail would not take home, even in their whole lifetime, anything like the £5 million the chief executive has got.

Kelly Tolhurst: For anyone sitting there, taking evidence from an organisation that is paying its top chief executive millions and millions of pounds, and not paying its lowest paid worker the living wage, that is a concern. In the particular example of Persimmon, the chair of the
remuneration committee and the CEO have resigned from the organisation. That is a clear indication of the discomfort about this. For me, it is a wider point. It is about organisations that have big roles within our society. Whether they are housebuilders or anything else, we are all their customers. We would all expect these companies to be operating well.

Most people would not be against senior officials who run successful organisations that have due regard to the communities in which they operate, and are operating well, with good social responsibility, being remunerated for creating jobs and creating good companies. But, where we feel the performance of their organisation is below par and they do not appear to have due regard to other workers in the organisation, it is quite right that those wider questions are asked. I would probably have felt the same way as you when you were taking evidence.

Q639 Chair: Would you join me, Minister, in urging these companies to rein in their pay for chief executives and pay more people in their organisations wages that they can afford to live on?

Kelly Tolhurst: Yes, absolutely, in the sense that we should be encouraging organisations to pay those wages. If the company is successful and the company is benefiting, it is right—I would expect this, and I would say that most people in the country would expect this—for all workers to benefit from the success of an organisation. The good companies that do that are probably some of our most successful companies.

Q640 Chair: Yes, it is just a shame that more companies do not do it. Can I ask you one thing about the new rules coming in about pay ratios? The requirement to publish applies to UK listed companies with over 250 employees. It will not, therefore, apply to the big four accountancy firms or the law firms, because they are not publicly listed; they are partnership organisations. We also had issues with the gender pay gap, where partners did not need to be included. Our Committee recommended changes so they were included. The Government have rejected those changes. Should the big four accountancy firms, which between them employ thousands of people, and the big law firms not also be publishing their pay ratios?

Kelly Tolhurst: We have not extended pay ratios to private companies or partnerships, as you have outlined. They are required under the new corporate governance code to outline how their pay policies impact on the wider workforce and the wider community in relation to the company’s values. There is a new element for those large companies to report on. But, in regards to the pay ratio, this is around those quoted companies in the UK. We have set it at the 250-employee mark, so they report on their median.

Q641 Chair: I know. You are just telling me what the rules are. I know what the rules are, Minister. I am saying that, for the gender pay gap, at least
it was all organisations employing more than 250. For the pay ratios, you have limited it to quoted companies. Why not ask all organisations employing more than 250 people, whether they are quoted or not, to publish their pay ratios?

Kelly Tolhurst: Fundamentally, the pay-ratio reforms were around giving another tool to shareholders to enable them to have more transparency around those companies.

Q642 Chair: But you just made a wider point, Minister, that it is also about operating in society and firms doing important work, as auditors do. We know that through some of the inquiries we have done. When audit fails, there can be huge repercussions for society. Should we not also know what the pay ratios are at the big four accountancy firms, which are so important in our economy, whether we work there or not?

Kelly Tolhurst: Yes, absolutely, in the sense that it is great to have a good understanding, but they are different. They are private limited companies. They do not have a shareholder board. It is slightly different for them. It is right that questions can be asked of them, but at the moment we have the pay ratio brought in for that part; we have not extended it beyond that. That might mean there are examples where certain companies have been highlighted for the rates of pay at a higher level and at a lower level, but they do not fall under this particular new policy.

Chair: I know, and that is disappointing.

Q643 Antoinette Sandbach: The point the Chair is trying to make is that we know gender pay inequality is illegal. We know that it is illegal for women to be paid less than men. Some of this reporting is not applying to partnership firms when it does apply to limited companies. The concern, therefore, is that it allows that practice to be hidden. Would you be willing to look at that going forward and potentially extend the reporting requirements to partnerships that have, for example, 250 or more employees in the organisation?

The concern is that this kind of reporting, both on pay gaps and inequality on boards, is being avoided. At least, the transparency that applies to listed companies does not apply to partnerships, which include accountancy firms and law firms. They are big areas in the City worth huge amounts of turnover. We want to see women succeed and highlight where that failure may be.

Kelly Tolhurst: I am more than happy to look at that going forward with regard to how we are reviewing and looking at the data that is coming through. Yes, absolutely, I can say that I am happy to do that.

Chair: Thank you very much, Minister.

Q644 Anna Turley: Minister, earlier in your evidence, you said very clearly that it is not for Government to dictate on pay, but, conversely, we have the Financial Reporting Council. Is it the role of the Financial Reporting
Council to dictate on pay? Obviously it has guidance and principles, but why have a code at all if we are not going to try to shape this?

**Kelly Tolhurst:** We have the rules in place around financial reporting and there have been changes in pay policies. Fundamentally, I do not believe it is for Government or the FRC to tell companies what level of pay they can award to the people within their organisations.

Q645 **Anna Turley:** What happens if a company breaches the code? This will now appear on the Investment Association register. What should be the sanctions for that? What should be the redress? Why have a code if there is not going to be some follow-up action?

**Kelly Tolhurst:** If we are talking about information that is not correct or has not been submitted correctly, if there has been a complaint or a highlight, Companies House will give those organisations an opportunity to sort out the deficiencies. In some cases, if necessary, the Insolvency Service criminal enforcement team will take prosecutions on behalf of the Secretary of State. In the Companies Act, it says quite clearly that the information needs to be correct. There are opportunities to take action against those companies if they are not reporting the information they are meant to.

Q646 **Anna Turley:** That is breaking the law and not reporting things. In terms of the code itself, and the principles and guidance in there, why have them if there is not going to be any redress?

**Sanu de Lima:** May I help? As part of the FCA’s listing rules, companies must apply the principles of the corporate governance code. You just had Paul George before you, and he might have spoken about, on remuneration for example, principles P, Q and R, which talk about a company developing remuneration policies in line with its longer-term strategy and taking other factors into account. Those are very serious principles. They are rather broad, understandably. The provisions, which are “comply or explain”, are a bit more specific. But the principles nonetheless are to be applied. When it comes to the provisions, it is for the regulator, for shareholders and for stakeholders to see and scrutinise whether the company is following the provisions of the code, to challenge it on that, and then to find redress in the ways the Minister outlined.

Q647 **Anna Turley:** Are you happy with the level of the power and redress the FRC has on this?

**Kelly Tolhurst:** As you will know, we have had the John Kingman review of the FRC. The Government at the moment are looking at that. In my view, anything that can be done to strengthen enforcement is a good way forward. It has to be proportionate and we have to consider what the outcomes could be but, definitely, where there are gaps it is right that we look at ways to fill those gaps.

Q648 **Peter Kyle:** Minister, why did the Prime Minister and Government roll back from the commitment to have workers on boards? It was such a
totemic statement when she made it in the first place. It was widely recognised as being a landmark announcement and an aspiration for the Government. What evidence would compel her and Government to roll back from something that had such national significance when she made it?

Kelly Tolhurst: I believe the obligation we have now introduced enables that, given the changes we have made to the UK corporate governance code in regards to requesting that there is either a worker director or a worker non-exec director, or that there is a worker advisory council. The evidence we have seen from companies is that they are looking at ways to exercise or fulfil that requirement. I believe that is fulfilling the—

Q649 Peter Kyle: Workers on boards is quite specific. Bear in mind that there are countries, neighbouring countries, countries within the European family, that actually have this and it works. We know what she meant when she said it, and it did imply having workers on the main board of a company. What we have is quite considerably less than that, with the steering towards appointees to remco. If the Prime Minister announces something, a lot of work and thinking goes into it in the first place, so when a Prime Minister climbs down from something there has to be an overwhelming amount of evidence to enable that climb-down. Where is the evidence that she was wrong to make that statement in the first place?

Kelly Tolhurst: I would argue that the changes we are making meet that part. The thing, for me, that needs to be considered is that that is very prescriptive. It is very prescriptive that there should be a worker on the board. There is a whole load of questions that go around that as to the skillset of the individual, whereabouts in the organisation they come from, what quartile they come from. Fundamentally, the way we are doing it in the corporate governance code is to make sure it is flexible for organisations to do it in the best way.

Q650 Peter Kyle: If a company does not want to have a worker on its board from any point of the company, it does not have to now, does it?

Kelly Tolhurst: We have a provision in there, a requirement for them to have a worker director, a non-exec director or an advisory council. We have some examples—

Q651 Peter Kyle: If a company does not want to have a worker on its main board, there is nothing compelling it to do so, so it does not have to. Is that correct?

Kelly Tolhurst: That is correct.

Q652 Peter Kyle: So it is a climb-down. It is not what was announced in the first place. We just want to know why. Do not dress it up as something it is not.

Kelly Tolhurst: No, I am not dressing it up. I take the point, but, as we all know, there are differences between organisations in how they are
formed, how they are set up and the sectors in which they operate. It is right that we have options for organisations, and we are clearly saying that we want workers to be considered in those wider policies. That is right. We have implemented that commitment in the best and most proportionate way possible, taking into account—

Q653 **Peter Kyle:** The partnership approach you are taking, listening to the concerns of businesses, is one that we as a Committee would recognise, but is it not true to say that the companies that would benefit most from workers on boards are the ones that are least inclined to do it voluntarily?

**Kelly Tolhurst:** As always, bad companies are bad companies. That is why we brought in these measures.

Q654 **Peter Kyle:** Bad companies are not going to do it unless they are made to do it. That is the point.

**Kelly Tolhurst:** With these changes, they will now have to give narrative to how they have taken into consideration their pay policies in relation to the wider workforce policies. I take your point, but we need to review it; we need to monitor it. As I have tried to highlight to the Committee, this is not an endgame, in the sense that we will keep these things under review; we will keep working to make our companies the best they can be, with the aid of Government, acting in a proportionate way. I understand your point. I think the measures we have implemented meet that. As I hope I have highlighted, we will review it. Especially for officials within the Department, this is a real focus within what we are doing in the corporate governance area.

**Chair:** Thank you very much, Minister and Mr de Lima, for coming to give evidence today. Our report will follow shortly. I hope you find that useful for your ongoing work in this area.

**Kelly Tolhurst:** Yes. I would like to say thank you for the questions today. Thank you for the work the Committee is doing in this area. I would just finish off by committing that we want to have good UK companies; we want workers to be protected. Going forward, I am more than willing to work with the Committee on any of these areas.

**Chair:** Thank you very much.