

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Twelfth Delegated Legislation Committee

DRAFT COMPANIES (DIRECTORS'
REMUNERATION POLICY AND DIRECTORS'
REMUNERATION REPORT) REGULATIONS 2019

Wednesday 15 May 2019

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Sunday 19 May 2019

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The Committee consisted of the following Members:

Chair: SIOBHAIN McDONAGH

Crausby, Sir David (*Bolton North East*) (Lab)
 † Dhesi, Mr Tanmanjeet Singh (*Slough*) (Lab)
 † Esterson, Bill (*Sefton Central*) (Lab)
 † Freeman, George (*Mid Norfolk*) (Con)
 † Green, Chris (*Bolton West*) (Con)
 † Gyimah, Mr Sam (*East Surrey*) (Con)
 † Harrington, Richard (*Watford*) (Con)
 † Harris, Rebecca (*Lord Commissioner of Her Majesty's Treasury*)
 † Kyle, Peter (*Hove*) (Lab)
 † Nandy, Lisa (*Wigan*) (Lab)

† O'Brien, Neil (*Harborough*) (Con)
 † Smith, Nick (*Blaenau Gwent*) (Lab)
 Stephens, Chris (*Glasgow South West*) (SNP)
 † Stewart, Bob (*Beckenham*) (Con)
 † Timms, Stephen (*East Ham*) (Lab)
 † Tolhurst, Kelly (*Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy*)
 † Tredinnick, David (*Bosworth*) (Con)

Anwen Rees, *Committee Clerk*

† **attended the Committee**

Twelfth Delegated Legislation Committee

Wednesday 15 May 2019

[SIOBHAIN McDONAGH *in the Chair*]

Draft Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019

2.30 pm

The Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy (Kelly Tolhurst): I beg to move,

That the Committee has considered the draft Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019.

It is a pleasure to serve under your chairmanship, Ms McDonagh. The draft regulations will add certain new requirements to the reporting of directors' remuneration by publicly quoted and traded companies. They will give shareholders more information to assess how the rewards to directors match performance, for example by requiring companies to provide more detail about the award of company shares to directors.

The new requirements are contained in new European directive 2017/828, which is more commonly known as the revised shareholder rights directive and is due to be transposed into UK law by 10 June 2019. The draft regulations will implement articles 9a and 9b of the directive, which cover the reporting of directors' remuneration, to the extent that they do not already have effect in UK law. Other parts of the directive are being implemented by Her Majesty's Treasury, the Financial Conduct Authority and the Department for Work and Pensions. For example, the FCA and the DWP are implementing new obligations for asset managers and pension funds to report on how they engage with the companies in which they invest on behalf of their clients.

The draft regulations will add a small number of requirements to the directors' remuneration policy and the directors' remuneration report that publicly quoted companies are already required to produce under the Companies Act 2006.

The main change to the directors' remuneration policy is that companies will be required to provide additional detail about the arrangements under which directors can eventually exercise their shares. The Government believe that that will be a valuable addition to the existing framework for executive pay reporting. The award of company shares to directors is of great interest to shareholders because it has the potential to better align the interests of directors with the long-term success of the company. The draft regulations also provide for the remuneration policy to set out more information on directors' service contracts and highlight key changes introduced since the previous policy.

Mr Tanmanjeet Singh Dhesi (Slough) (Lab): How will the draft regulations affect the deplorable and widening gap between the highest and lowest paid within companies, or the unsatisfactory gender pay gap? What are the Government doing to tackle those issues?

Kelly Tolhurst: As I had started to outline, the draft regulations, which implement the shareholder rights directive, will require more information to be included in remuneration reports so that shareholders have more information when they vote and make decisions on policy. As hon. Members know, we implemented ratio reporting last year, the whole idea of which is to give shareholders more transparency on what executive directors are earning in comparison with the rest of the organisation's employees, so that they have more information to exercise their votes.

Mr Dhesi: And the gender pay gap?

Kelly Tolhurst: That is a wider conversation. The draft regulations relate to remuneration reports, whereas the gender pay gap is part of a wider discussion.

I will make some progress on detailing the draft regulations. The main new requirement proposed for the remuneration report is for companies to compare the annual change in directors' remuneration with the annual change in average employee pay over a rolling five-year period. This will provide greater transparency on how pay in the boardrooms of quoted companies aligns with pay and reward across the company as a whole. It will also complement a new obligation introduced by the Government last year for quoted companies to disclose and explain each year the ratio of their chief executive officer's total annual pay to the average pay of the company's UK employees. The draft regulations additionally propose that future remuneration reports show the split between fixed and variable pay for each director in each year. Taken as a whole, the new measures will further strengthen confidence that the UK's executive reporting framework is based on transparent, consistent and accessible public reporting to shareholders.

I will also highlight two provisions that will ensure the compatibility of the new measures—which, as I have said, originate from the revised shareholder rights directive—with the UK's existing company law framework. The first concerns the scope of the companies covered by executive pay reporting. The UK's existing executive pay regime applies to quoted companies, whereas the shareholder rights directive that the draft regulations will help to implement applies to traded companies. In practice, the vast majority of traded companies are also quoted, meaning that their shares are both tradeable on the regulated markets and quoted on the FCA's official list. The draft regulations address this small technical difference in company definitions between the directive and UK company law by providing for executive pay reporting to apply both to quoted and to traded companies, whether or not they are quoted on the official list.

The second provision, which will ensure compatibility between the new measures from the directive and existing UK law, is a small procedural change to the Companies Act to allow shareholders to retain their existing right to a binding vote on any proposed payments to directors that would otherwise be outwith the terms of the directors' remuneration policy. This procedural change provides that shareholder approval for any payments to directors outwith the remuneration policy result in an amendment to the policy for the purpose of those payments. In this way, UK law will be compatible with the requirement in the directive that all payments to directors must be in line with a shareholder-approved remuneration policy.

George Freeman (Mid Norfolk) (Con): I am grateful to the Minister for introducing this measure. It is all about the transparency of pay, which we should all believe in because it helps shareholders to hold directors to account on our behalf. Some smaller technology companies are concerned about employee share option schemes, which the Minister knows are a key way of rewarding people in tech start-ups. Can she reassure me that there is nothing in the draft regulations that will in any way change a company's ability to set the strike price at a level that rewards directors or employees? I believe that may be in some other measure, but I just want to check that it is not contained in the draft regulations.

Kelly Tolhurst: My hon. Friend is quite right that a part of the particular sector to which he refers has concerns about potential future restrictions. However, this measure is about transparency and making sure that when shareholders are asked to vote, they have access to that information, and also that that information is publicly available. It is all about transparency and shareholders being able to exercise their rights and having the right information to make informed decisions.

On the impact of the draft regulations, the Government believe that the additional cost to business will not be significant. The UK's executive pay reporting framework is already one of the most robust in the world, and the draft regulations propose only targeted enhancements to the existing remuneration policy and remuneration report. The Government tested the draft regulations in advance with a wide range of interested parties, including business groups, investors and civil society representatives. No significant concerns were raised, and a small number of technical comments helped to inform the final drafting of the regulations before they were laid in Parliament.

Much of the shareholder rights directive provisions on executive pay are already enacted in UK law, following previous rounds of Government reform on executive pay domestically. I pay tribute to Parliament and in particular the Select Committee on Business, Energy and Industrial Strategy for the active and constructive role that MPs have played in supporting and informing the ongoing reform process.

Most recently, the BEIS Committee has produced a number of recommendations following its recent fair pay inquiry, and I was glad to appear before it and give evidence. The Government will respond to the Select Committee's report very soon. In the meantime, and to sum up, the draft regulations will increase further the ability of shareholders to scrutinise how directors are rewarded for their performance. In doing so, the draft regulations will enable the UK to implement articles 9a and 9b of the revised shareholder rights directive covering executive pay, to the extent that they are not already given effect in the UK. I hope that the Committee will approve the draft regulations.

2.40 pm

Bill Esterson (Sefton Central) (Lab): It is a real pleasure to serve with you in the Chair, Ms McDonagh, and it gives me the opportunity to congratulate you on the fine work you have done over the years in fighting for workers' rights on a number of occasions. [HON. MEMBERS: "Hear, hear."] I am glad to have had the opportunity to say that.

The draft regulations remind us of how promises to curb executive pay used to have a prominent place in this Government's agenda, along with issues such as having workers on boards. It was encouraging to see Julian Richer give employee ownership a vote of confidence yesterday, with his announcement about the future of Richer Sounds. I might also add that that was a welcome endorsement of Labour policy. It is in the context of long-running debates between both parties represented here this afternoon about worker and shareholder democracy that we are considering the draft regulations.

We do not oppose the draft statutory instrument, but we do not think it goes far enough in tackling the gap between the high pay of a handful of senior executives and the pay of everyone else.

The Institute for Public Policy Research North report that was published yesterday was a timely reminder of the income inequality that sees one in four workers in the north of England being paid less than the living wage, with many worse off than 10 years ago. Similar challenges and income inequalities exist right across the country.

The draft regulations state that the directors' remuneration report must be made available, free of charge, on the company website for 10 years, showing any split or fixed and variable payment to directors. Crucially, reports must compare the annual change in directors' pay with the yearly change in the pay of company employees, including over a five-year rolling period.

That sounds broadly fine but, as noted by the Secondary Legislation Scrutiny Committee and the House of Lords, the directive and draft regulations introduce other responsibilities that cut across a wide range of bodies, both departmental and non-departmental. The Minister referred in her opening remarks to those measures relating to the Treasury, the Financial Conduct Authority and the Department for Work and Pensions. When she responds, will she update us on whether other Departments will need to introduce regulations and, if so, when we can expect to see them? I ask that because the deadline to incorporate the EU directive into UK law is 10 June, so if additional regulations are required the Government will have to get a move on. That also gives rise to the question as to why it has taken until today to bring these draft regulations to Committee. Were the Government anticipating a no-deal Brexit, which would have resulted in the draft regulations not being transposed?

The essay crisis Prime Minister left office after the 2016 referendum. In his absence, I wonder if he has been replaced by an essay crisis Government. Looking at the former Minister, the hon. Member for Watford, who is sitting opposite me, perhaps I am on to something.

The High Pay Centre report shows that the Government urgently need to do more. It shows that between 2014 and 2018, the first full five years of the "say on pay" regime introduced by the coalition Government, every single FTSE 100 company pay policy put to annual general meetings was approved by shareholders. Across more than 700 pay-related resolutions voted on at AGMs over the same period, the average level of shareholder dissent was just 8.8%, and only 11% of pay-related resolutions attracted significant dissent levels of over 20%.

The intervention by my hon. Friend the Member for Slough about the challenge posed by the disengagement of owners and shareholders of large corporations is

[*Bill Esterson*]

particularly pertinent. He asked how the draft regulations address the gap between top executive pay and everybody else's, as well as the gender pay gap. The Minister has indicated, as do the draft regulations, that information is provided. What is not provided is a way not just to change the culture of shareholder disengagement, but to create a regulatory environment or teeth to address the challenge and difficulties presented by both the pay gap and the gender pay gap.

George Freeman: Does the hon. Gentleman agree that it is important to look not only at the gap between the highest and lowest paid in a company, but at the extent to which remuneration is linked to company performance overall, and the extent to which those who are being rewarded are being rewarded for taking risks and delivering above-trend growth? Does he also agree that we should look at the broader issue of wider share ownership in a company? Inequality in itself is not necessarily a problem, provided that the people who are lower paid are benefiting from the success of the company. Does the hon. Gentleman agree that that is as important a metric?

Bill Esterson: That is a very good challenge. Julian Richer is a responsible employer who has treated his employees very well over many years. He is giving a £1,000 bonus to each staff member and delivering an employee-owned future for the business.

One of the historical problems with the regime of rewarding performance is that it has rewarded apparent immediate success without taking the longer term into account. There have been scandals over many years, with some senior executives raking in enormous bonuses only for us to discover later that the apparent success of the organisations they ran was built on sand and that the true underlying performance was not reflected in the short-term results. We can all think of some very high-profile examples; Enron is one, but there have also been many in this country, which I deliberately will not mention at this stage. The hon. Gentleman's challenge is an important one, but we have to make sure that any executive remuneration is truly fair over a longer period.

To be fair to the hon. Gentleman, I think he accepts the wider point that fair pay must reflect the contributions of people throughout the organisation. There is a degree of consensus that it is extremely important for the relationship between the pay of senior executives and that of others in the organisation to be fair and balanced, difficult though attempts to achieve that may be. I welcome this debate and the fact that the draft regulations address the matter, but the question is how much further we need to go and what steps we must take to maximise the potential benefits.

When the current Prime Minister took over, she made an initial commitment to put workers on boards, but it was very quickly downgraded and appears not to have advanced. Perhaps the Minister could tell us when those sorts of measures might be introduced.

Following on from the intervention from the hon. Member for Mid Norfolk, what is the most effective way to bring up the pay of working people and combat rising inequality? The answer is to join a trade union.

The Government have failed to move beyond the union-busting mindset—that is obvious from their Trade Union Act 2016—and to look to a future that involves unions and employers working together responsibly. The Institute for Public Policy Research has shown that there is a strong correlation between high shares of income going to the top 1% of earners and low trade union membership.

Richard Harrington (Watford) (Con): I dealt with a lot of trade unions and companies in my time as a Minister. I was extremely impressed by the good relations between them in areas of the country where there has been a lot of strife in the past, for example in car manufacturing and other manufacturing industries. Does the hon. Gentleman agree?

Bill Esterson: When the hon. Gentleman was a Minister, I always enjoyed our exchanges and felt that he was sympathetic on this agenda—I mentioned that consensus. Unfortunately, Government action has not kept up with the good intentions that he highlights. He is quite right: where there are good trade union relationships with management—the car industry is a prime example—we have seen increases in productivity and worker pay, and success for businesses and workers alike.

According to the International Monetary Fund, the economies characterised by free collective bargaining, with strong trade unions and good partnership-working models, are the wealthiest, most productive and most successful. Sadly, in organisations without trade unions, where workers have less power, the richest get richer and the workers do not. The figures from IPPR North tell a story about a decline in incomes and a rise in pay inequality, particularly in the north of England, which is the part of the country that I represent.

We will not oppose the draft regulations, but this is an opportune moment to remind the Minister of Government promises and of the need to go much further. If the Government are serious about curbing excessive power, worker representation on boards and—as the Prime Minister told us a few hours ago during Prime Minister's questions—the importance of trade unions, and if the Prime Minister meant what she said on the steps of Downing Street about putting the Conservative party at the disposal of working people, they must prove it. They must go much further and invest in all of the people of our country, not just the very wealthy—invest in the future, not the past.

2.54 pm

Kelly Tolhurst: As always, I thank the hon. Member for Sefton Central for his comments. In particular, it was great to hear him recognise that there are some very good employers who are trying their absolute best to look after their employees and ensure they are sharing out the success of their firms. He is quite right to say that although this debate is about ensuring that we put transparency and scrutiny into the system for shareholders, there are some organisations that operate extremely well, with a strong sense of corporate and social responsibility.

It is true that pay for top executives quadrupled from £1 million to £4.3 million between 1998 and 2013, with pay ratios increasing from 47:1 to 132:1. The figure has since fallen to an average of £3.9 million. Although

there was a big increase over that period, executive pay has tended to stabilise. The Government maintain our commitment to implement transparency, which is why we introduced ratio reporting to make companies give more detail on their remuneration policies. They have to report on the pay ratios between executives and the lowest paid, and explain how wider considerations affect the company and its stakeholders more widely.

Quite rightly, the hon. Gentleman asked about the other parts of the directive and whether other Departments will be laying statutory instruments. DWP and HMT will lay other instruments for the implementation of the directive. I am happy to write to him with further details, if he is happy to accept that.

Secondly, the hon. Gentleman was quite right to ask why this has taken so long, because it was agreed by the European Commission in 2017. Unfortunately, the Commission had to consult on other implementation periods and processes, and that was not done until the second half of 2018. Indeed, some consultation was still going on in March, so that is why we are implementing the measure at this stage. I should also like to point out that the draft regulations will come into effect on 10 June, so it would have been slightly unfair to expect organisations to implement European directive rules a year earlier than other European Union member states.

We take wider reform very seriously. We have introduced reforms since 2013 and continue to do so. The hon. Gentleman knows about the wider corporate governance package—we spoke about it last summer—and our aspirations regarding organisational behaviour and the need to provide transparency to shareholders so that when they vote they have all the information and understand how executives formulate remuneration policies. The directive's measures will complement our own, and I am very supportive of the reforms.

In response to the hon. Gentleman's comments about worker representation on boards, we have made it clear that no one size fits all. We have outlined a number of ways to get workers' voices into organisations. We remain committed to that and to ensuring that workers' voices are heard. Obviously, we always need to go further and

to continue to review. I take that seriously in my role as a Minister. I have spoken about the issue in many debates and Select Committees, so I am well aware of some of the comments and feelings out there. Ultimately, the draft regulations implement a European-wide directive, and the Government are absolutely committed to adhering to our responsibilities as a full member of the European Union until such time as we leave.

I thank the hon. Gentleman for his contribution. To sum up, the Government's intention with the draft regulations is to provide a number of very small but important enhancements to the UK's well-established statutory framework for the reporting of directors' remuneration at public companies. In particular, by enabling greater transparency in how company share awards can be exercised by directors, and in how boardroom pay relates to the rest of the company, shareholders will have increased scope to access information on whether pay at the top is appropriate and aligned with the company's long-term success. In doing so, the draft regulations will complement and build on the important new measures on executive pay that were approved by Parliament last year.

Those measures, which are now in place, include a requirement on companies to report their executive pay ratios. Between 2017 and 2018, there was a 67% increase in the number of companies listed on the Investment Association register as having votes of more than 20% against pay policies, so the policy is having an impact, as is the obligation to state whether discretion has been exercised in the award of share-based remuneration. At the same time, the draft regulations will implement articles 9a and 9b of the revised shareholder rights directive, to the extent that those articles are not already given effect in UK law.

Question put and agreed to.

Resolved,

That the Committee has considered the draft Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019.

3.2 pm

Committee rose.

