



Briefing for Lords Debate on The Companies (Miscellaneous Reporting) Regulations 2018, Monday 9 July.

Introduction and general comments

The new executive pay ratio reporting requirements are a welcome tool to help investors and civil society hold company boards to account for excessive levels of executive pay. The data gathered will undoubtedly contribute to discussions around inequality and wage stagnation.

However, while these specific provisions are welcome, as a package of reforms the regulations fall far short of what is needed.

The Miscellaneous Reporting Regulations are the government's response to growing disquiet with gross levels of executive pay and the BHS and Sports Direct scandals which revealed the serious shortcomings of the UK corporate governance framework.

The government announced its intention to bring forward this legislation in answer to the corporate governance green paper consultation last year, but in the wake of construction giant Carillion's collapse the government's response now looks inadequate. Fixing the underlying issues and restoring public trust in business will require fundamental structural reforms, not more reporting.

CORE and Oxfam call on Peers to urge the government to set out more ambitious reforms and a longer-term vision for the UK corporate governance framework.

The UK's 'enlightened shareholder' model of corporate governance was intended to balance the returns to shareholders with long-term value creation and the interests of other stakeholders, but the evidence suggests that it is not working.

In the past 20 years, CEO pay has risen from 47 to 120 times as much as their average employee,¹ and in the last 15 years, the percentage of profits returned to shareholders from the FTSE 100 has risen from 49 per cent to 60 per cent. In the 1970s it was less than 10 per cent.²

At the same time, UK-based businesses have continued to be involved in human rights abuses and environmental damage overseas, and a series of corporate scandals has led to the loss of thousands of jobs at home.³

¹ <https://economia.icaew.com/en/features/march-2017/is-there-a-better-business-model-for-executive-pay>

² <https://www.telegraph.co.uk/finance/personalfinance/investing/12006273/The-chart-that-shows-UK-dividends-are-reaching-breaking-point.html>; <https://www.ft.com/content/7d347016-32f4-11e5-b05b-b01debd57852>

³ Business and Human Rights Resource Centre, *Briefing: Is the UK living up to its Business & Human Rights Commitments?*, (2015). The BHRRC collated 303 allegations of human rights and environmental abuse against UK-linked businesses between 2005-2015. 95% concerned company operations outside Western Europe; Express & Star, *Carillion job losses top 2,400 after collapse of Wolverhampton construction giant*, July 2 2018.

To rebalance the corporate governance framework in order that companies are run in the interests of all stakeholders, the government should carry out a review of s.172 of the Companies Act 2006 and reinstate its commitment to place elected workers on company boards.

The government should consider amending s.172 of the Company's Act to instruct directors' that their duties are to the long-term success of the company and make the interests of members just one of the factors to which directors have regard.

A positive obligation should also be placed on directors to mitigate against serious harms. The effect would be to require directors to take steps to prevent the serious negative impacts companies can have on their workforce, supply chain workers, local communities and the environment.

Bringing workers onto company boards would rebuild trust between management and the workforce; encourage longer-term decision making in the interest of the company as a whole; and improve the knowledge-base and understanding amongst directors.

Specific issues with the regulations

There is no good reason why reporting on engagement with employees and how directors have had regard to employee interests should not extend to a company's global workforce.

Regulation 11 requires companies with over 250 UK employees to include a statement in their directors' report describing how directors have engaged with employees and had regard to their interests.

However, sub-paragraph 11 (3) provides that the statement need not report on workers employed outside the UK. This contrasts with the s.172 statement outlined in regulation 4 which does apply to global employees.

Workers employed by British companies outside the UK are often particularly vulnerable and companies should not be able to shirk their responsibilities to them because of a gap in the legislation.

Although the threshold of 250 UK employees mirrors existing thresholds, it makes no sense for regulation 11 to be limited in its *applicability* to UK employees.

The government should make it clear that the intention of the legislation is for companies to report on their whole workforce, not just those employed directly.

In the UK there are now an estimated 740,000 people working through an employment agency⁴, 450,000 who earn most of their income through personal service companies⁵, and 500,000 people in bogus self-employment.⁶ Because these workers are not covered by the current understanding of the term 'employee' they will not fall within the scope of the new reporting requirements.

⁴ TUC, Ending the Undercutters' Charter, 2017,

<https://www.tuc.org.uk/sites/default/files/EndingtheUndercuttersCharter.pdf>

⁵ <https://www.thetimes.co.uk/article/philip-hammond-eyes-1bn-budget-raid-on-freelancers-9bm6lsjs6>

⁶ <https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/bogus-self-employment-costing-millions-to-workers-and-government/>

The regulations should reflect modern employment practices and refer to ‘workers’ not ‘employees’. Regulation 4 should require directors to report how they have had regard to the interests of their whole workforce, and regulation 13 how directors have engaged with all their workers.

Moreover, companies are being incentivised to restructure their employment models to reduce their reporting responsibilities. The scope of the requirements should be based on a realistic notion of a company’s employment impact and include the wider workforce.

The government’s response that changing the definition of employee would require primary legislation only serves to reinforce the case for a review of s.172.

The pay ratio reporting requirement is welcome only insofar as it is effectively implemented and monitored.

One lesson learnt from recent reporting requirements is that a central registry for reports is essential for scrutiny and high levels of compliance. The gender pay gap reporting requirement – that utilised a central registry – gathered almost full compliance.⁷ Yet three years on from the passage of the Modern Slavery Act – which does not provide for a central registry – only an estimated two thirds of companies required to report under s.54 have done so.⁸

Our understanding is that creating a registry of this kind would not need further legislation, and we urge peers to call on the government to take the necessary steps.

The pay ratio reporting should also be placed within the scope of the financial audit. Concerns about the quality of data collection for the gender pay gap reporting highlighted by the Financial Times indicated the necessity of placing such sensitive disclosures under the scrutiny of the financial audit.⁹

If data produced by the requirement is to be comparable between firms, it will also be necessary for there to be convergence over time between the three methods for calculating pay ratios.

ENDS

For more information, please contact William Meade, Policy and Communications Officer at william@corporate-responsibility.org.

⁷ <https://gender-pay-gap.service.gov.uk/Viewing/search-results>

⁸ <https://www.modernslaveryregistry.org/>

⁹ Financial Times, *Cluster of UK companies reports highly improbable gender pay gap*, <https://www.ft.com/content/ad74ba76-d9cb-11e7-a039-c64b1c09b482>