



Remuneration committees and the wider workforce – a new perspective

Preparing for change – a practical guide

August 2018

Overview from Stephen Cahill

In recent months the UK has seen the implementation of a package of corporate governance reforms announced by the Government in August 2017, designed to maintain the UK's reputation for being a *'dependable and confident place in which to do business'*.

Under the reforms, which seek to make companies more transparent and accountable to their employees and shareholders, the role of the remuneration committee is set to change. Remuneration committees will be required to go further to demonstrate that executive pay outcomes are fair and reasonable, and that they *"take seriously enough their existing obligations to take account of wider workforce pay and conditions in setting executive remuneration"*¹.

Now more than ever, politicians, investors and the public expect remuneration committees to understand their workforce – how it is comprised, rewarded, and incentivised. Quoted companies with more than 250 UK employees will be required to publish and explain the pay ratio of the chief executive to the median, lower quartile and upper quartile UK employees, and directors will be required to explain how success sharing opportunities such as all-employee share plans are promoted through the organisation.

At the same time, the Financial Reporting Council ('FRC') has published a new UK Corporate Governance Code, to apply for accounting periods beginning on or after 1 January 2019. This includes some far-reaching changes and extends the remit of the remuneration committee to include the review of workforce remuneration and related policies, and the alignment of incentives and reward with culture.

So what does this mean for the remuneration committee agenda, and how can companies best prepare for change? In our view, over the coming months remuneration committees and HR teams must review their annual cycle, considering how relevant workforce data and context can be presented to remuneration committees in a comprehensive but practical way.

This guide is intended to provide a **high-level 'dashboard'** illustration to help remuneration committees in navigating the new reforms – to ask the right questions and ensure that decisions on executive pay are made through a broader lens.

Stephen Cahill, Deloitte LLP August 2018

¹ Government Green Paper August 2017



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Workforce demographics

How is the workforce comprised?

How are employment terms set across the organisation?

Understanding of **workforce composition by e.g.:**

- Gender, age, ethnicity
- Regional/global split
- Contractors, agency workers, remote workers
- Salary level by pay grade, national living wage demographics

- Level and source of recruitment in the year
- Redundancy/down scaling programmes
- Training and development opportunities and participation rates
- Workplace initiatives (e.g. agility)

e.g. employment status

e.g. % workforce and National Living Wage

Workforce engagement

Code Guidance – Questions for Remuneration Committees
What have we done to explain to the workforce how executive pay arrangements align with wider company pay policy?

- Oversight of employee engagement surveys and outcomes, across different grades and jurisdictions
- Consider feedback raised via 'employee voice' mechanism developed by the Board
- Consider what engagement with the workforce has taken place to explain how executive remuneration aligns with wider company policy

e.g. pulse surveys - employee engagement scores

Culture and behaviours

Code Guidance – Questions for Boards
Is the board clear on what sort of culture is needed to underpin the company's purpose and long-term success?

Sources of cultural insights (Code Guidance):

- Turnover and absenteeism rates
- Recruitment, reward and promotion decisions
- Whistleblowing, grievance and 'speak up' data
- Board interaction with senior management and workforce

- How has management communicated values and expected behaviours across the company
- Consider what behaviours are being driven when setting strategy and financial targets
- Ongoing monitoring of culture and sources of insights
- Identifying any 'hotspots and outliers' that may indicate a problem
- Understand how negative trends or behaviours are addressed

Incentives, values and risk

Code Guidance – Questions for Remuneration Committees
How do workforce incentives support our culture and encourage the desired behaviours?

Have we considered how the choice of any particular measure may encourage negative behaviour and what steps have we taken to manage such risks?

How will any financial and non-financial performance measures support long-term thinking and delivery against strategy?

- Awareness of incentives across the organisation and key performance indicators used - identify areas of risk? (see example of incentive matrix below)
- Understand approach to risk management and link to remuneration - interaction with other committees (e.g. risk, sustainability)?
- Company KPIs - aligned with executive and workforce incentives?
- Balance of financial and non-financial metrics and link to behaviours

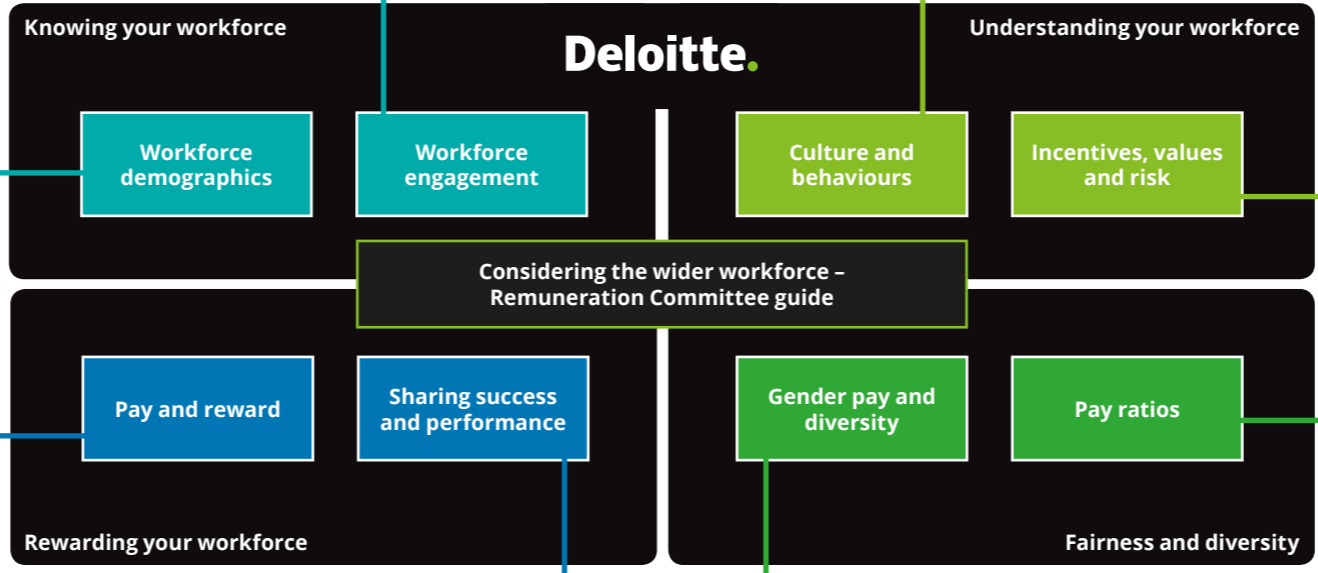
Pay and reward

Code Guidance: "The remuneration committee has a role in advising the board in respect of policies on rewards, incentives, terms and conditions and other related matters".

- Review of policies in relation to base pay, benefits, pension and incentives across the organisation.
- Understanding of pay increases and bonus distribution each year e.g.
 - % of employees receiving a salary increase
 - Average bonus across organisation (including historical data)
 - Distribution of bonus spend by performance ratings, business areas

e.g. performance ratings by grade

e.g. bonus distribution by performance rating



e.g. incentive review across organisation using matrix

	Consistency with values and purpose	Alignment with business strategy and KPIs	Alignment with company's risk appetite	Link to individual behavioural objectives?	Focus on sustainability and long-term success
e.g. Sales incentive plan	High	High	High	High	High

	1	2	3
Consistency with values and purpose	High degree of consistency with values and purpose	Generally in line with values and purpose, some areas of concern	Significant degree of divergence with values and purpose
Alignment with business strategy and KPIs	High degree of alignment with strategy and KPIs	Generally in line with strategy and KPIs, some areas for concern	Significant degree of divergence with strategy and KPIs
Alignment with company's risk appetite	High degree of alignment with risk appetite	Some potential financial or ethical risks identified	Significant areas of financial or ethical risk, inconsistent with risk appetite
Link to individual behavioural objectives?	Incentives subject to specific individual behavioural objectives	Incentives partly linked to individual behaviour (e.g. underpin)	No link to individual behavioural objectives
Focus on sustainability and long-term success	Incentives fully aligned with long-term sustainable business success	Generally in line with long-term success, some areas for concern	Incentives focussed on short-term - little or no alignment with sustainable success

- Alignment of executive and workforce pension contribution rates
- Consider impact of any executive salary increases in line with workforce on £ value of total executive remuneration

"...for example, a 3% increase to an executive's £1m salary. A £30,000 increase in salary could be worth multiple times more as typically, many other elements of an executive's pay [...] are determined as a % of salary. i.e. if executives are able to earn 400% of salary in bonus and LTIPs, the increase could result in another £120,000 to total pay" ISS written evidence in BEIS fair pay enquiry (June 2018)

- Consider pay principles to apply across the workforce?

Code Guidance: Examples of pay principles

- 'Like pay for like work'
- Living wage
- Predictability of income
- Market competitiveness
- Reward for contribution

Code Guidance: "One way that boards could consider approaching workforce pay would be to endorse clear principles for pay and reward across the organisation, against which pay policies and outcomes can be justified and benchmarked".

Sharing success and performance

Has the company introduced, maintained or developed arrangements aimed at encouraging the involvement of employees in the company's performance through an employees' share scheme or by some other means? (UK registered companies with more than 250 UK employees)

- What all-employee share plans are offered to the workforce?
- What are participation levels and how can these be improved?
- How does remuneration spend link to company performance?

e.g. All-employee plan participation rates

e.g. pay spend (excl LTIs) and operating profit

Gender pay and diversity

Code Guidance – Questions for Remuneration Committees
What interaction have we had with the nomination committee regarding the structure of the workforce and the company's plans for reducing its gender pay gap?

- What is our gender pay gap (pay and bonus)?
- What are the key drivers of our gap?
- What commitments have we made towards closing our gap?
- How are we monitoring progress against achievements?
- What initiatives are in place to improve diversity across the organisation?

e.g. pay demographics by gender

e.g. gender diversity commitments - female representation

Pay ratios

Code Guidance – Questions for Remuneration Committees
How do the company's pay policies address pay gaps and pay ratios between the different quartiles of the workforce?

- Publish ratio of CEO's 'single figure' to median, 25th and 75th percentile total pay of full-time equivalent UK employees (group basis)

Quoted companies registered in the UK with more than 250 UK employees

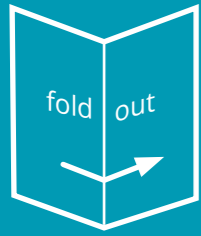
- Supporting information required includes methodology used, explanation for year on year changes, and whether median ratio is consistent with the company's wider policies on employee pay, reward and progression.
- Requirement to publish total remuneration and salary (Evalue) for LQ, median and UQ employees used in the pay ratio calculation.
- Disclose in a table in the annual remuneration report (pay ratio data will build incrementally to a ten year period going forward).

Consider early voluntary disclosure prior to 2020?

Consider pay ratio movement and link to performance. How can pay ratios be used to explain how remuneration aligns with wider company policy?

Consideration of direct peer comparisons?

	2018	2019	2020
25th percentile pay ratio	65:1	40:1	70:1
Median pay ratio	46:1	29:1 (↓)	47:1 (↑)
75th percentile pay ratio	37:1	21:1	36:1
Method	C	C	C
25th percentile pay ratio	£20,000	£21,000	£21,500
Median pay	£28,000	£29,500	£32,000
75th percentile pay	£35,000	£40,000	£42,000



Workforce
demographics

Incentives
and culture

Pay
principles

Pay ratios
and pay gaps

Values,
risk and
behaviours



Also available
in interactive format

Deloitte.

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