I am writing to set out the FRC’s role, views and proposals on gender pay reporting and executive pay in the context of our fundamental review of the UK Corporate Governance Code, which the Committee may find helpful as part of its current inquiry.

Diversity
I should like to emphasise the FRC’s commitment to promoting diversity through our responsibilities, particularly for corporate governance, and as an organisation.

In your letter of 7 February 2018 in reply to our consultation on the UK Corporate Governance Code you proposed that the Code should build on the gender pay regulations. The draft Code highlights the importance of workforce policies and practices which includes the company’s approach to investing in and rewarding its workforce and, for example, its approach to pay ratios and pay gaps. It also emphasises the need for effective succession planning to ensure a diverse pipeline of candidates for more senior roles.

The consultation closed on 28 February and we have received a very high level of responses, which we have been analysing. We expect to publish the new UK Corporate Governance Code in July which applies to accounting periods beginning on or after 1 January 2019. We are considering how best the Code and its associated guidance can more directly encourage boards to challenge themselves on how workforce policies and practices promote diversity, including addressing gender pay issues. I will report back to you about this when we have finalised our proposals.

Although listed companies have to report on their adherence to the Code on a ‘comply or explain’ basis as a requirement of the FCA Listing Rules, our powers to monitor and challenge company reporting do not extend to the diversity disclosures in the Code. We believe this should be rectified.

We are keen, however, to ensure that we do all we can with or without powers to improve diversity and inclusion in UK companies, to stimulate greater transparency and improve company reporting. As such, we are undertaking research with leading academics that will monitor and track top companies’ standards of performance and compliance with the current Code’s requirements on diversity. This will go beyond gender and include ethnicity and other protected characteristics. The research will provide us with a strong evidence base indicating how far (or not) businesses have come since similar research was conducted in 2014; what best practice looks like; and the extent to which existing frameworks can tackle the challenge that remains.
Given our role as standard setter and regulator for accounting and audit, it is also appropriate that we closely assess the accounting profession’s approach to diversity and inclusion. As such, we are enhancing our annual Key Facts and Trends publication to include more extensive data collection and analysis on wider diversity, including social mobility and ethnicity. We are asking the accountancy bodies and audit firms for information about how they monitor the diversity of the profession and their own organisations and to provide data in these areas. This work is vital as the accountancy profession is often a pipeline to senior business roles.

As well as publishing our own gender pay gap report, we are signatories of the Women in Finance Charter and have published our pledges. We have established an internal FRC Diversity and Inclusion Committee and have delivered compulsory unconscious bias training to all our employees (including our board). I am keen that we do much more to ensure we have a more diverse workforce across the FRC, and as such we have reviewed our pay structures and are reviewing our hiring practices.

Executive pay
Section 5 of the revised Code focuses on remuneration. Fundamentally, there should be a demonstrable link between executive remuneration and the long-term performance of a company; this is reflected in the revised Code. Remuneration levels should also not be excessive or reward poor performance. The Code already includes a provision that executive remuneration schemes must include malus and clawback provisions and specify the circumstances.

We propose to strengthen the role of remuneration committees to give them broader responsibilities to take workforce pay and incentives into account when determining directors’ remuneration. The revised Code also states that remuneration committees should explain what engagement with the workforce has taken place and how executive remuneration aligns with wider company pay.

In addition, we believe that the way boards engage with shareholders when they experience shareholder opposition to resolutions can be improved to encourage greater understanding and dialogue. As such, the revised Code contains proposals to ensure boards are more specific about actions they will take when they encounter significant shareholder opposition to a resolution, which includes those on executive pay policies and awards.

I hope this has been useful for you and the Committee. Should you like any further information or have any questions, please do not hesitate to contact me.

Yours sincerely,

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