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Executive pay ratio reporting

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In January 2019, The Companies (Miscellaneous Reporting) Regulations 2018 (the Regulations) came into force. Amongst other reporting obligations, these introduced a requirement on Quoted Companies (as defined in the Companies Act 2006) with an average of more than 250 UK employees to publish the ratio of their CEO's remuneration to the median, 25th and 75th quartile pay remuneration of their UK employees. As these Regulations relate to relevant financial years, we will start to see the impact of this additional reporting obligation from January 2020, covering information collected this year.

So what do you need to know to be able to prepare your report?

Employee threshold

There are specific provisions within the Regulations for how average employee numbers should be calculated. There are also specific provisions included for parent companies where the average employee numbers and pay ratio information must relate to the group.

The Regulations include wording to cover situations where a company's headcount varies from year to year above or below the 250-average and provide for a two-year time lag before a company drops out of, or is covered again, by the disclosure requirements.

Where should the information be published?

The information will need to be included (in a specified tabular format) within the directors' remuneration report.

How should the ratios be calculated?

There are three different methods of calculation included within the Regulations – the company must choose (and identify) which method they are using, but can choose to use a different method in subsequent financial years:

- Option A – the company must calculate the pay and benefits of all its UK employees for the relevant financial year and identify those employees whose pay and benefits are on the 25th, 50th and 75th percentiles of pay and benefits. These should then be compared to the CEO's pay and benefits.
- Option B – this allows the company to use the most recent hourly rate gender pay gap information to identify three employee who are the best equivalents for those on the 25th, 50th and 75th percentiles. The company must then calculate the pay and benefits for these three best equivalents for the relevant financial year and make any necessary adjustments to ensure that the best equivalents are reasonably representative of the 25th, 50th and 75th percentiles.
- Option C – this allows the company to use data other than gender pay gap information to identify the three best equivalents for those on the 25th, 50th and 75th percentiles and then carry out a similar exercise as in Option B. Option A will be the most accurate and guidance issued by the Department for Business, Energy, and Industrial Strategy has stated that companies should use this option wherever possible and reasonable.

What should be included in pay and benefits?

Specific items are set out in the Regulations including (but are not limited to) salaries, bonuses and non-cash benefits. Pay and benefits should also be based on the employee's full-time equivalent pay and benefits.

What if there is more than one CEO during the financial year?

The company should use the total pay and benefits paid to anyone undertaking the role of CEO (whilst undertaking that role) in the relevant financial year.

How many years should be included?

In the first year, just that year will be needed. Going forwards, companies will need to include the previous pay ratio information, up to a maximum of ten years.

What other information is required?

The company will need to include a number of pieces of information within the directors' remuneration report after the pay ratios table including, but not limited to, why the option used was preferred, and explanations as to methodologies and assumptions relied upon. Further pay information will also need to be included for each of the percentiles.

A summary will need to be included in respect of changes in the pay ratio over the previous financial year, any trends in the median pay ratio, and whether the company believes the median pay ratio for the relevant financial year is consistent with the pay, reward and progression policies for the company's UK employees taken as a whole.

The explanatory memorandum which accompanied the Regulations referred to the strong public interest in levels of executive pay and to "a widespread perception that executive pay has become increasingly disconnected from both the pay of ordinary working people and the underlying long-term performance of companies". These reporting requirements are intended to provide shareholders with additional information with which to hold directors to account and to ensure that executive remuneration arrangements can be justified.

The memorandum states that the policy intention is not to compare ratios between different companies or prescribe 'good' or 'bad' ratios. However, this may well be inevitable consequence of this additional information being available – particularly with the publicity given at the start of the year to "Fat Cat Day". It also remains a political issue, with the Labour Party including as part of its 20-point plan for security and equality at work a commitment to roll out maximum pay ratios of 20:1 in the public sector and in companies bidding for public contracts. Supporting comments within any directors' remuneration reports to set the ratios in context are likely to be crucial in managing any PR consequences of the same.

If you would like to discuss any of the above issues further or would like any assistance in preparing your pay ratios, please contact James Tait, Head of our Birmingham Employment team.

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