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UK Quoted Companies With More Than 250 UK Employees to Report Pay Ratio Information From 2020

As part of a wider initiative on corporate governance reporting, and in a move intended to hold larger companies to account for the salaries that they pay, the UK government has published draft regulations which include a requirement for UK quoted companies with more than 250 UK-based employees to disclose annually the gap ("pay ratio") between their chief executive officer's (CEO) total remuneration and their median employee's full-time equivalent (FTE) pay and benefits.

In this context, median means the middle value of the FTE pay and benefits where the values of the FTE pay and benefits of all the company's UK employees are listed in numerical order, from least to greatest. The median value is referred to as "Y50" in the regulations. Reporting companies will also have to disclose the pay ratios between the CEO and the employees who are on the 25th ("Y25") and 75th ("Y75") percentiles of that list. Y25, Y50 and Y75 must be calculated no less than three months before the end of the relevant financial year. Where the reporting company is a parent company, the pay ratio information must relate to the whole group and not just the parent company.

The pay ratio information must be disclosed in the directors' remuneration report for the relevant financial year, along with a narrative explaining any changes in the ratios from year to year and, in the case of the median ratio, whether (and, if so, why) the company believes this ratio is consistent with its wider policies on employee pay, reward and progression.

The draft regulations set out in detail how the ratios should be calculated and reported, and include three options on the methodologies for determining the ratios, two of which – in a helpful gesture by the government – permit companies to use previously calculated gender pay gap information as a starting point. The methodology used must be specified by the company, along with an explanation as to why that methodology was chosen.

As has been the case with the first cycle of gender pay gap reporting, initial reported pay ratio information is likely to be the subject of much scrutiny by the media and companies will need to focus as much on the reported figures as on the explanations they provide with them. There could be a number of factors that cause the ratios to be particularly high or to vary from year to year, including:

- **The size of the company** – larger companies may have higher ratios, as the median employee is from a larger pool of employees
- **Sector** – some sectors employ a much higher proportion of highly-skilled, well-paid employees (e.g., the financial services sector) and, therefore will have a lower pay ratio, whereas others (e.g., retail) have large numbers of relatively less well-paid employees; CEO remuneration can also vary across sectors
- **Changes in CEO pay** – ratios could vary from year to year within a company if there is pay volatility at CEO level attached to the share price or other financial indicators, whilst pay within the wider workforce remains stable

In addition to reporting pay ratios, relevant companies will have to:

- Report on how their directors take employee and other stakeholder interests into account
- Show what effect an increase in share prices has on executive pay and use this to inform shareholders when voting on long-term incentive plans

Once approved by Parliament, the regulations will apply to corporate financial years beginning on or after 1 January 2019, meaning that the first reporting will take place in 2020.

In the meantime, companies caught by the new requirement should:

- Ensure that the internal infrastructure is in place to comply with the new reporting requirement (steps already taken in relation to gender pay gap reporting should help)
- Consider carrying out a dry run ahead of the first reporting requirement so as to flag up potential issues that will need to be dealt with in the reporting explanations.

The government has produced some questions and answers to assist reporting companies with their preparations.

We will be publishing detailed information on the reporting process in due course. In the meantime, please speak to your usual contact in the Labour & Employment team if you have any questions.

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31000/06/18