



Department for
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& Industrial Strategy

CORPORATE GOVERNANCE

The Companies (Miscellaneous Reporting)
Regulations 2018 Q&A

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Introduction

The purpose of this document is to help companies and interested stakeholders understand how they will be affected by new corporate governance reporting requirements in The Companies (Miscellaneous Reporting) Regulations 2018. These were made on 17 July 2018 and apply to company reporting on financial years starting on or after 1 January 2019.

This document is intended as a factual explanation of the secondary legislation. It is not intended to be comprehensive and companies should not rely on it for legal guidance on how the requirements will affect them.

The document does not cover the provisions affecting small Community Interest Companies. More information about these is available at <https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies>.

The Department welcomes feedback on this document. Please send any comments to corporategovernance@beis.gov.uk

A. Overview of the new company reporting regulations

The regulations require companies to include new content in their annual reports where they meet certain specific qualifying conditions¹. In summary:

- Large companies are required to include a statement as part of their strategic report describing how the directors have had regard to the matters in section 172(1)(a) to (f) of the Companies Act 2006.
- Companies with more than 250 UK employees are required to include a statement as part of their directors' report summarising how the directors have engaged with employees, how they have had regard to employee interests and the effect of that regard, including on the principal decisions taken by the company in the financial year.
- Large companies are required to include a statement as part of their directors' report summarising how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the company during the financial year.
- Very large private and public unlisted companies are required to include a statement as part of their directors' report stating which corporate governance code, if any, has been applied and how. If the company has departed from any aspect of the code it must set out the respects in which it did so, and the reasons. If the company has not applied any corporate governance code, the statement must explain why that is the case and what arrangements for corporate governance were applied.
- Quoted companies with more than 250 UK employees are required to publish, as part of their directors' remuneration report, the ratio of their CEO's total remuneration to the median (50th), 25th and 75th percentile full-time equivalent remuneration of their UK employees. Alongside this, companies have to publish supporting information, including the reasons for changes to the ratios from year to year and, in the case of the median ratio, whether, and if so how, the company believes this ratio is consistent with the company's wider policies on employee pay, reward and progression.
- All quoted companies are required to illustrate, in the directors' remuneration policy within their directors' remuneration report, the effect of future share price increases on executive pay outcomes. Companies are also be required to include a summary in their directors' remuneration report of any discretion that has been exercised on executive remuneration outcomes reported that year in respect of share price appreciation or depreciation during the relevant performance periods.

The new requirements apply to company reporting on financial years starting on or after 1 January 2019. The first actual reporting under the new regulations will therefore start in 2020. The one exception is the requirement for companies to illustrate the impact of share price increases on executive pay outcomes which will apply to any new remuneration policies introduced by companies on or after 1 January 2019.

¹ For more information on scope see section B.

B. Scope

Q1. Which companies do the regulations apply to?

Reporting requirement [regulation number]	Companies in scope
<p>(i) Statement in the strategic report of how directors have complied with their duty to have regard to the matters in 172 (1) (a)-(f)</p> <p>[Regulation 4]</p>	<p>UK incorporated companies already required to produce a strategic report² except those qualifying as medium-sized (see sections 465-467 Companies Act 2006) in relation to a financial year. The size criteria are that a company meets at least 2 out of 3 of the following:</p> <ul style="list-style-type: none"> • turnover of more than £36m; • balance sheet total of more than £18m; • more than 250 employees
<p>(ii) Statement in the directors’ report summarising how directors have engaged with employees and taken account of their interests</p> <p>[Regulation 13]</p>	<p>UK incorporated companies with more than 250 UK employees (as for the existing Part 4 Employee Involvement statement).</p> <p>If the company is a parent company it is the number of employees in the group and not just the company itself that is used.</p>
<p>(iii) Statement in the directors’ Report summarising how directors have engaged with suppliers, customers and others in a business relationship with the company</p> <p>[Regulation 13]</p>	<p>The same size criteria as for (i) above.</p>
<p>(iv) Statement in the directors’ Report about the corporate governance arrangements applied by the company</p> <p>[Regulation 14]</p>	<p>UK incorporated companies with either:</p> <ul style="list-style-type: none"> • more than 2,000 global employees; or • a turnover over £200 million globally <u>and</u> a balance sheet total over £2 billion globally <p>Premium and standard listed companies which are already required to report on their corporate governance arrangements under DTR (Disclosure Guidance and Transparency Rules) 7.2 are not within scope. Community interest companies and charitable companies are also exempted.</p>

² Section 414A (Companies Act 2006) requires all companies that are not small to prepare a strategic report.

<p>(v) Publication of the ratio of the CEO’s remuneration to the median, 25th and 75th quartile pay remuneration of their UK employees in the directors’ remuneration report</p> <p>[Regulation 17]</p>	<p>Quoted companies (UK incorporated) with more than 250 UK employees.</p> <p>“Quoted” as defined by the Companies Act 2006. This means UK incorporated companies who are quoted on the UK Official List, the New York Stock Exchange, NASDAQ or a recognised stock exchange in the European Economic Area. It does <u>not</u> include companies listed on the Alternative Investment Market.</p>
<p>(vi) Illustration of the effect of future share price increases on executive pay outcomes in the directors’ remuneration report</p> <p>[Regulation 18]</p>	<p>Quoted companies (UK incorporated).</p> <p>“Quoted” has the same meaning as above.</p>

More information about how the regulations affect subsidiaries and parent companies is provided in Sections D – G below.

Q2. Do the regulations apply to businesses not constituted as companies (e.g. Limited Liability Partnerships)?

No. The new reporting requirements only apply to companies.

Q3. Do the regulations apply equally across the UK?

The regulations apply in England, Wales and Scotland. They will also apply by agreement in Northern Ireland.

Q4. What are the consequences of non-compliance for a company within scope?

The regulations add to the matters that companies already need to report on in their strategic report, directors’ report and directors’ remuneration report. As for these existing requirements, if the directors of a company knowingly do not comply with any of the required provisions, or are reckless as to their compliance, they will be committing an offence.

C. Timing

Q1. When will companies have to start complying with the new reporting obligations?

The new requirements apply to company reporting on financial years starting on or after 1 January 2019. This means that, with one exception, reporting on the new requirements will begin in 2020, covering activities undertaken and information collected in 2019. The exception is the requirement for companies to illustrate the impact of share price increases on executive pay outcomes which will apply to any new remuneration policies brought forward by companies from 1 January 2019.

This timetable aligns with the Financial Reporting Council's plans for bringing the recently revised UK Corporate Governance Code³ into effect.

³ <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code>

D. Reporting on matters in section 172(1) of the Companies Act 2006

Q1. What do the regulations require?

They expand the required content of the strategic report and the directors' report.

Strategic report

In their strategic report, companies are required to include a "Section 172(1) statement" describing how directors have had regard to the matters set out in section 172(1)(a) to (f) of the Companies Act 2006 when performing their duties under section 172.

This statement also has to be made available on a website. For quoted and AIM-traded companies, this makes no practical difference because they are already required to make their annual report available on a website and the statement is a new component of this report. Unquoted companies, however, are not required to publish their annual report on a website and must make arrangement to ensure that the section 172(1) statement is available on a website. This does not need to be the company's own website – it can be one maintained by or on behalf of the company (such as the website of a parent company) provided it identifies the company in question.

Directors' report

In their directors' report, companies are required to provide a summary of how their directors have engaged with employees, how they have had regard to employee interests, and the effect of that regard, including on the principal decisions taken by the company during the financial year. This expands on the information about employee engagement matters that companies already have to include in their directors' report.

In addition, companies must provide a summary of how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the company during the financial year.

Q2. What does section 172(1) of the Companies Act say?

The law is as follows:

Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to —

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company's employees,
- (c) the need to foster the company's business relationships with suppliers, customers and others,
- (d) the impact of the company's operations on the community and the environment,
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) the need to act fairly as between members of the company.

Q3. What information should companies include in their “section 172(1) statement”?

This depends on the individual circumstances of each company, but companies will probably want to include information on some or all of the following:

- The issues, factors and stakeholders the directors consider relevant in complying with section 172 (1) (a) to (f) and how they have formed that opinion;
- The main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard; and
- Information on the effect of that regard on the company’s decisions and strategies during the financial year.

The Financial Reporting Council has recently revised its *Guidance on the Strategic Report*⁴. Section 8 of the FRC’s publication includes further guidance to help companies decide what to report.

Q4. How much detail should companies include in their section 172(1) statement?

Companies will need to judge what is appropriate, but the statement should be meaningful and informative for shareholders, shed light on matters that are of strategic importance to the company and be consistent with the size and complexity of the business.

Q5. Can the new information required in the directors’ report be provided instead in the strategic report as part of the section 172(1) statement?

Yes, where appropriate. Section 414C(11) of the Companies Act states that the strategic report can contain matters that would otherwise need to be included in the directors’ report where the directors consider them to be of strategic importance to the company. Where a company has done this, it must “state in the directors’ report that it has done so and in respect of which information it has done so”⁵.

It is expected that many companies will want to report on employee, customer and supplier issues as part of their strategic report statement. This information does not need to be duplicated in the directors’ report.

Q6. Why do the regulations add new employee, customer and supplier reporting requirements to the directors’ report when these could be covered in the strategic report section 172(1) statement?

The new directors’ report requirements ensure that company reports include information about these important aspects of the section 172(1) duty even where the directors do not judge the information to be of sufficient strategic importance to be included in the strategic report that year. They also give companies the opportunity to provide more information, for example, about how they are meeting the new UK Corporate Governance Code stakeholder and employee engagement provision⁶.

⁴ <https://www.frc.org.uk/news/july-2018/revised-guidance-on-the-strategic-report>

⁵ Schedule 7, paragraph 1A of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

⁶ Provision 5 of the UK Corporate Governance Code (July 2018).

Q7. Does the new section 172(1) statement need to be provided in a separately identifiable statement within the strategic report?

Yes. This clarity is important in ensuring that shareholders and wider stakeholders have a clear understanding of how directors have performed this aspect of their duty under section 172. Where appropriate companies can cross-refer to other parts of the report.

Unquoted companies must ensure that disclosures made by cross-referencing other parts of the annual report are included with the statement if published on a website without the rest of the annual report. This will ensure that it can be understood as a standalone statement.

Q8. Can the requirement to make the section 172(1) statement available on a website be discharged by publishing the complete annual report or the whole strategic report?

Yes. Ensuring that the statement itself is accessible on a website is the minimum legal requirement, but a company can choose to discharge the obligation by publishing its whole annual report or the entire strategic report.

Q9. Do subsidiary companies have to comply with these new reporting requirements?

Yes. All qualifying companies, including subsidiaries, need to meet the new reporting requirements.

Q10. Can a parent company or holding company fulfil the reporting obligation for subsidiaries?

No. All qualifying companies, including subsidiaries, need to report. This is the case even where the parent company is required to produce a consolidated “group strategic report” or “group directors’ report”.

Q11. Can a subsidiary company provide less information in its own statement in circumstances where policies are set by the parent company and applied throughout the group?

Judgement will be needed in deciding what is appropriate.

In practice, decisions and policies affecting employees, the environment, suppliers and so on will sometimes be made or set at the group level (with directors of each company in the group ensuring when applying those policies that they are meeting their duties to their respective companies).

Where this is the case and the parent provides a full explanation of the policy or strategy in its statements in the group reports, it may be acceptable for the subsidiary to provide less detail in its own report, where it is possible to make references to accessible parent company statements. In all cases, however, the subsidiary will need to explain how its directors have applied or reflected the policies or decisions taken at group level.

Q12. If a subsidiary company meets the qualifying conditions, but not the parent, but the parent prepares consolidated group accounts, does the parent company need to publish a section 172(1) statement as part of the group strategic report?

Yes – the parent qualifies through the process of consolidation, but this does not remove the separate requirement for the subsidiary to report on how its own directors have had regard to section 172(1).

This approach to reporting by groups and their subsidiaries is not new. Qualifying subsidiaries already have to prepare their own strategic report, even where the parent company is required to prepare a “group strategic report” under s414A(3).

Q13. What is the position when both the parent company and the subsidiary are below the qualifying conditions but, through the consolidation, the parent company meets the threshold for preparing a section 172(1) statement?

The parent company is required to prepare a section 172(1) statement which may, where appropriate, give greater emphasis to the matters that are significant to the undertakings including in the consolidation taken as a whole. The subsidiary does not need to report because it is below the relevant threshold.

E. Reporting on corporate governance arrangements in large private and unlisted public companies

Q1. What do the regulations require?

Companies in scope have to include a statement as part of their directors' report stating which corporate governance code, if any, has been applied and how. If the company has departed from the code it must set out the respects in which it did so, and the reasons. If the company has not applied any corporate governance code, the statement must explain why that is the case and what arrangements for corporate governance were applied.

Q2. Where should the statement be published?

The statement must be included in the directors' report (or alternatively in the strategic report using the flexibility in section 414C(11) of the Companies Act 2006) and published on a website maintained by or on behalf of the company.

Q3. Can the requirement to make the corporate governance statement available on a website be discharged by publishing the complete annual report or the whole directors' report?

Yes. Ensuring that the statement itself is accessible on a website is the minimum legal requirement, but a company can choose to discharge the obligation by publishing its whole annual report or the entire directors' report (or the strategic report where the statement is included there).

Q4. How much detail do companies have to provide?

Companies are expected to provide sufficient information to ensure that their corporate governance arrangements are explained.

For companies that choose to adopt the corporate governance principles for large private companies being developed by James Wates and a coalition group (see Q6 below), it is envisaged that companies should provide a short supporting statement for each principle explaining how it has been applied to achieve better outcomes. These principles are expected to be finalised before the end of 2018.

Q5. How do the regulations define a "corporate governance code"?

Regulation 25 provides a definition of "corporate governance" and explains that a "corporate governance code" means a code of practice on corporate governance.

Q6. Does the Government have a preferred corporate governance code for large private companies?

The Government hopes that the corporate governance principles for large private companies currently being developed by James Wates and a coalition group will be widely adopted (see Q7).

However, companies can choose the most appropriate code for them, or none, although if a company does not apply a code, it must explain why that is the case and what corporate governance arrangements have been made.

Q7. How does the reporting requirement relate to the Wates Principles for large private companies?

The Government has commissioned James Wates (the Chairman of Wates Construction) to lead a coalition group of industry and wider society bodies to develop specific corporate governance principles as a code of practice for large private companies. These are expected to be finalised before the end of 2018.

The expectation is that these principles will be widely adopted and become a commonly used code of practice for a broad range of private companies, including (but not limited to) those who have to meet the new reporting requirement.

Q8. Can a UK company refer to a foreign corporate governance code when reporting on its corporate governance arrangements?

Yes. Companies can choose the most appropriate code for them, or none.

Where a company chooses to refer to a foreign code it should ensure that an English language version of it is available and that this version is easily accessible via a website and free of charge. The web link should be provided. It is important that UK-based readers can readily understand the code's provisions and hence what is being applied and how.

If an English language version is not readily available, the company should explain the code's provisions as part of the statement about its corporate governance arrangements.

Q9. Do subsidiary companies have to comply with this reporting requirement?

Yes. Every company meeting the qualifying thresholds must comply with the new reporting requirement, including subsidiaries. This includes both subsidiaries of listed companies required to meet the UK Corporate Governance Code and subsidiaries of parent companies which prepare a consolidated group directors' report.

The nature of subsidiary companies and their relationships with parent companies differ widely. Some subsidiaries, such as those within a conglomerate, can be distinct and run largely independently. Others can be part of a more integrated and cohesive group structure. In practice, therefore, the detail of what companies report will depend on their circumstances.

Q10. Does the subsidiary of a premium listed company covered by the UK Corporate Governance Code have to prepare a corporate governance statement?

Yes - for the reasons given under Q9.

A subsidiary could, in principle, and if the circumstances warranted it, state that it did not apply a code because its parent applied the UK Corporate Governance Code which was applied throughout the group. This might shorten the statement, but the subsidiary would still need to explain how the Code applies to governance arrangements in the subsidiary and its directors.

Q11. Does the UK subsidiary of a listed overseas parent which applies an overseas code have to prepare a corporate governance statement?

Yes – for the reasons given under Q9.

A UK subsidiary could, in principle, and if the circumstances warranted it, state that it did not apply a code because its overseas parent applied an overseas code which was applied throughout the group. This might shorten the statement, but the subsidiary would still need to explain how the code actually applies to governance arrangements in the subsidiary and its directors. The subsidiary would also need to ensure that an English language version of the overseas code is readily available or explain its provisions (see Q7).

Q12. If a subsidiary company meets the qualifying conditions, but not the parent, but the parent prepares consolidated group accounts, does the parent company need to publish a corporate governance statement as part of the group directors' report?

No, the consolidation does not apply to this threshold.

Q13. How do the qualifying thresholds apply to group companies?

The employee threshold and the turnover and balance sheet thresholds should be calculated at an individual company level only. No consolidation across a group is required for these thresholds.

So, for example, if each individual company within the group has 2,000 or fewer employees, but the group in aggregate has more than 2,000 employees (spread across different companies), no reporting will be required. Or, if one subsidiary in the group has more than 2,000 employees and all the other group companies have 2,000 or fewer employees, only that one subsidiary, and not the parent company nor any other subsidiary will have to report.

Q14. What happens where a company's size varies from year to year above and below the relevant qualifying thresholds?

Regulation 23 provides a 'smoothing provision' which addresses this situation. It provides for a two-year time lag before a company either drops out of, or is covered again, by the requirement. So, for example:

If a company has more than 2,000 employees in the first year of reporting, it will have to report in both that year and in the second year even if it has fewer than 2,000 employees in the second year.

If the company in the third year still has fewer than 2,000 employees, it will not have to report (although may choose to do so voluntarily).

In another example:

If a company has fewer than 2,000 employees in the first year of reporting, it will not be required to report in that year or in the second year even where it has more than 2,000 employees in the second year.

If the company in the third year still has more than 2,000 employees, it will be required to report.

F. Executive pay – Pay ratio reporting

Q1. What are companies required to do?

Companies within scope must report in tabular form within their annual directors' remuneration report the ratio of their Chief Executive Officer's latest Single Total Figure of Remuneration (STFR) to:

- the median (i.e. 50th percentile) full-time equivalent (FTE) remuneration of the company's UK employees;
- the 25th percentile FTE remuneration of the company's UK employees;
- the 75th percentile FTE remuneration of the company's UK employees.

Underneath the ratios table, companies must provide some supporting information and an explanation, including:

- the methodology chosen for calculating the ratios;
- the reason(s) for any changes to the ratios compared to the previous year; and
- in the case of the median ratio, whether, and if so why, the company believes this ratio is consistent with the company's wider policies on employee pay, reward and progression.

Further detail of how the pay ratios should be calculated, and the supporting information required, is provided in the rest of this FAQ section.

Q2. Which companies are covered by the pay ratio requirement?

Only quoted companies must prepare directors' remuneration reports.

The new pay ratio disclosure requirement applies to all UK incorporated companies which have more than 250 UK employees and which (following the definition of 'quoted companies' in the Companies Act 2006) are quoted on the UK Official List, the New York Stock Exchange, NASDAQ or a recognised stock exchange in the European Economic Area. For the avoidance of doubt, the requirement does not extend to companies quoted on the Alternative Investment Market (AIM).

Q3. If a UK-incorporated and quoted company is a subsidiary of a non-UK incorporated parent, must it still report its pay ratio?

Yes, although in such a case the pay ratio reporting would relate to the pay and benefits of the CEO of the UK-incorporated and quoted subsidiary, rather than to the pay and benefits of the CEO of the non-UK incorporated parent and cover only UK employee pay and benefits at the UK incorporated and quoted subsidiary and any subsidiaries beneath it. A subsidiary that is UK incorporated and quoted should already be disclosing its CEO's STFR.

For the avoidance of doubt, non-quoted UK-incorporated companies with non-UK incorporated parents (quoted or not), are not required to report pay ratios.

Q4. How should a company determine whether it has more than 250 UK employees?

The regulations follow an existing method used in the Companies Act 2006 for determining the average number of employees throughout the company's financial year; that is:

find the number of employees for each month of the company's financial year, add them together and divide by the number of months in the company's financial year.

The new regulations provide for this method to be limited to UK employees, who are defined in the regulations as:

“... a person employed under a contract of service by the company other than a person employed to work wholly or mainly outside of the UK”.

Q5. Do agency staff, contractors and staff on zero hours contracts count towards the total?

All persons who have a contract of service with the company should be included, regardless of the hours they are contracted to work, other than persons employed to work wholly or mainly outside of the UK. This is unlikely to include persons employed under contract by another organisation, such as an agency or a contractor.

Q6. What about individual contractors or consultants who have a personal contract with the company?

Persons working as contractors or consultants for the company (whether in a self-employed capacity or not), who may also contract for services to other companies, would not typically be identified as employees under contract of service with that company.

Q7. What if a company operates as a Group? Do you count the employees in the parent company, at a subsidiary level or across the Group as a whole?

Companies should determine the number of UK employees across the Group as a whole. So, for example, if the quoted parent company has fewer than 250 UK employees but the Group as a whole has more than 250 UK employees, they will be required to report. Existing provisions in legislation that compare CEO to employee pay apply at the Group level⁷.

Q8. What if a company's headcount varies from year to year above or below 250 UK employees?

The draft regulations provide a 'smoothing provision' in paragraph 19B which addresses this circumstance. 19B(1)(b) provides for a two-year time lag before a company either drops out of, or is covered again, by the pay ratio disclosure requirement. So, for example:

- if a company is required to report its pay ratios for the first financial year in which the new regulations are in force, it will have to disclose its pay ratios for the following financial year even if it has 250 or fewer UK employees in the second year;
- if the company in the third year still has 250 or fewer UK employees, it will not have to disclose its pay ratios (although may choose to do so voluntarily);
- if the company in the fourth year has more than 250 UK employees, it will again not have to disclose its pay ratios, because it did not have to disclose in the previous year;

⁷ Paragraph 19 of Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as amended in 2013

- if the company in the fifth year still has more than 250 UK employees, it will have to disclose its pay ratios, because it has now been above the employee threshold two years in a row.

For the avoidance of doubt, if an existing company has 250 or fewer UK employees in the financial year before the new regulations come into force, it will not – under this smoothing provision - have to report its pay ratios for the first financial year in which the rules apply, even if it has more than 250 UK employees in that year. But under the same smoothing provision, it would have to report the pay ratios for the following financial year if it continues to have more than 250 UK employees in that year.

Q9. What if there is more than one CEO at the company during the financial year?

Where there has been more than one CEO, the company should use the total pay and benefits paid to anyone undertaking the role of CEO in the relevant financial year. For the avoidance of doubt, this should not include pay and benefits receivable by an individual before they assumed the position of CEO (for example, if they were promoted to the role of CEO during the financial year).

Q10. What pay ratio methodology should companies use?

The most statistically accurate way for a company to calculate the three ratios each year will be to:

- determine the total FTE remuneration of all its UK employees for the relevant financial year (that is, the financial year being reported on in the Directors' Remuneration Report);
- rank all those employees based on their total FTE remuneration from low to high; and
- identify the employees whose remuneration places them at the 25th, 50th (median) and 75th percentile points of this ranking. This is Option A in the regulations.

However, the Government recognises that companies with multiple payroll systems, many subsidiaries and large numbers of employees may face challenges in following this method. A key challenge may be collecting and verifying accurately the variable pay elements for all UK employees across many subsidiaries in the relatively short period of time available for the preparation of a company's annual report and accounts.

The regulations therefore allow some limited flexibility in calculating the pay ratios. This is provided for in Options B or C.

Q11. What is the difference between Options B and C?

Both these options allow companies to identify, on an indicative basis, their UK employees at the 25th, 50th and 75th percentiles, without necessarily having to first identify and rank in order the total pay and benefits of every UK employee.

Option B allows companies to identify the employees at 25th, 50th and 75th percentiles using their latest gender pay gap information.

Option C allows the employees to be identified at these percentiles using other existing pay data (as an alternative or in addition to using gender pay gap information), provided that this data was gathered no later than the previous financial year (that is, the financial year prior to the financial year being reported on in the latest remuneration report). For example, a company operating at a Group level may not hold gender pay gap information across the whole Group and/or may have other relevant pay data from the previous financial year which it could use to identify more precisely the employees at the three percentile points than using gender pay gap information.

For both Option B and Option C, companies must subsequently calculate the indicatively identified employees' remuneration for the financial year being reported on in the remuneration report (i.e. 'the relevant financial year' in the language of the regulations) before the pay ratios are calculated.

More information on all three options is set out later in these FAQs.

Q12: Does the Government have a preferred option that companies should use?

Option A provides the most statistically accurate method for identifying the pay ratios. Companies should use this option wherever possible and reasonable. The regulations require companies to explain why they have chosen to use Option A, B or C.

Q13. What employee pay and benefits should be used to calculate the ratios?

The intention of the regulations is that, wherever possible, the total pay and benefits of employees identified at the 25th, 50th and 75th percentiles should be used to calculate the pay ratios. Employee wages and salary must as a minimum be used for the pay ratio calculation. The following other pay and benefit components (corresponding to the non-salary STFR components) should also be used, where applicable (i.e. where such pay and benefits have been awarded), calculated in the same way as the CEO's remuneration is calculated for the purposes of the STFR (see question 14):

- taxable benefits;
- annual bonus;
- share based or other remuneration from performance or other incentive plans over multiple years;
- pension benefits.

This is set out in Paragraph 19C of the new regulations.

Q14. What if a company is unable to collect accurate employee pay data for a particular pay and benefit component in time for the latest Annual Report?

The regulations allow a company to omit one or more component of pay and benefits, other than salary, provided that the reason for any omission is explained in the supporting information accompanying the pay ratios. The regulations also allow a company to provide an estimate of a non-salary component, provided that this is stated and the basis for the estimate explained. The regulations additionally allow for a projection of salary to the end of the relevant financial year to be used in cases where a company wishes to calculate Y25, Y50 and Y75 before the end of the financial year.

Q15. If an employee pay and benefits component is omitted, should the corresponding component from the CEO's STFR also be omitted?

No. The CEO's full STFR as reported in the directors' remuneration report should be used as the numerator in the pay ratio calculation, regardless of whether an employee pay and benefits component has been omitted. It is not permissible in any circumstances to use anything other than the total STFR reported each year, for the purpose of calculating the pay ratios. Companies should wherever possible calculate total employee pay and benefits to inform the pay ratio calculations. If a company cannot reasonably include a particular employee non-salary component, the company can note in the supporting information the extent to which it believes this has impacted on the company's reported pay ratios in that year.

Q16. Is there a particular way in which these various components of employee pay and benefits should be calculated?

The regulations provide for companies to use the same methodology for calculating the employee pay and benefits as set out in the existing executive remuneration regulations for calculating the corresponding STFR components⁸. In summary, this means including the value of the annual bonus for services delivered in that year and the value of any long-term incentives whose performance period was substantially complete in the financial year.

However, if a company believes it cannot reasonably follow the STFR methodology for calculating any non-salary component, it may use a different approach to calculate that component, provided that this is explained in the supporting information accompanying the pay ratios.

Q17. How should the pay ratios be presented in the directors’ remuneration report?

The regulations require that the ratios are presented in tabular form, as below (as provided in paragraph 19C of the new regulations).

Year	Method	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
[year]	[Option A, B or C]	(X/Y25):1	(X/Y50):1	(X/Y75):1

X in the table is the STFR for the financial year being reported on in the remuneration report. Y25, Y50 and Y75 are the respective pay and benefits for the UK employees identified at the 25th, 50th and 75th percentiles of the company’s remuneration for the same financial year.

The table may be included anywhere in the directors’ remuneration report, provided that it is immediately followed by the supporting information and explanation required by paragraphs 19E, 19F and 19G of these regulations. Companies may wish for ease of reference to include the new pay ratios reporting in the same part of the remuneration report where compliance with existing paragraph 19 of the 2008 regulations is reported.

Q18. How many years of pay ratio reporting should be included in the table?

The regulations require that, going forward, the pay ratios table should cover a ten-year reporting period; that is, the disclosure will build in the table incrementally to a ten year period, with only one set of ratios therefore being disclosed in the first year of disclosure.

This includes any year or years in which the company did not need to report ratios after previously having had to report (for any such years, the company should simply note in the relevant column that it was exempt from reporting pay ratios in that financial year).

Companies can report a pay ratios table covering a longer time period if they wish.

⁸ Paragraph 7(1)(a) to (e), and paragraph 10, of Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as amended in 2013

Q19. Why must employee pay and benefits be calculated on an FTE basis for the purpose of determining the pay ratios?

An objective of the pay ratio reporting is to help enable shareholders and other interested parties to consider how executive pay relates to pay and reward across the rest of the company. The Government considers that requiring FTE employee pay and benefits to inform the pay ratio reporting will give a clearer picture of the relationship between executive and wider employee pay, regardless of hours worked by individual employees.

Q20. Should the pay of employees on leave for some or all of the year be included?

This is primarily a matter for the company. Under Option A, the pay of all employees must be calculated, although a company may choose to apply a £0 figure to such employees for the relevant financial year or their Full-Time Equivalent salary and benefits, depending on their circumstances. Companies using gender pay gap information under Option B will be aware that the gender pay gap regulations exclude employees on leave. Whatever the treatment of employees on leave, should this have an impact on the resulting pay ratios, the company can explain this in its supporting statement. Companies should ensure that their approach here is consistent, and that any change in approach is noted and briefly explained.

Summary of options A, B and C (a visual illustration of the three options is included at Annex A)

As outlined above, the regulations give companies a choice of three options - Options A, B or C - to help determine the employee pay and benefit figures that must in turn inform the three pay ratios that are disclosed each year. These are set out in paragraph 19D of the new regulations.

For all three options, the purpose is the same: to identify “Y25”, “Y50” and “Y75”, which in the regulations means the pay and benefits of the company’s UK employees for the relevant financial year at the 25th, 50th and 75th percentiles of the company’s UK employee population ranked by pay and benefits from lowest to highest.

(“Y” in this context is simply the label for denominator for the pay ratio calculation, with “X” being the label for the numerator, that is, the CEO’s STFR).

To identify “Y25”, “Y50” and “Y75”, the company must identify “P25”, “P50” and “P75”, which in the regulations means the UK employees whose pay and benefits corresponds to Y25, Y50 or Y75 respectively. Option A provides for P25, P50 and P75 to be identified by first calculating and ranking from low to high the pay and benefits for every UK employee at the company. Options B and C, by contrast, allow P25, P50 and P75 to be identified on an indicative basis, on the basis of pre-existing gender pay or other pay data, without necessarily having to calculate every other employees’ pay and benefits for the latest financial year. If P25, P50, or P75 correspond to more than one employee respectively, the company may choose from among them the employees who will represent P25, P50 and P75 and calculate their Y25, Y50 and Y75.

Before looking at how each option works in practice, it is important to note that the following applies to all three options:

- employee pay and benefits must be calculated on an FTE basis;
- one or more non-salary component may be excluded, or a non-STFR methodology used for a non-salary component, provided that this is explained;

- Y25, Y50 and Y75 must be calculated on a day no earlier than three months before the end of the relevant (latest) financial year, using a projected calculation of salary to the end of the financial year as necessary.

Option A

Step 1

Identify all UK employees in the company (within the whole group where the company is a parent company).

Step 2

Calculate on a day no earlier than three months before the end of the relevant financial year (that is, the financial year reported on in the latest remuneration report) the pay and benefits for every UK employee for the relevant financial year.

Step 3

Identify the employees (P25, P50 and P75) whose pay and benefits in the relevant financial year places them at the 25th, 50th and 75th percentiles of the company's UK employees in terms of pay benefits for that year, ranked from lowest to highest.

Step 4

Use the pay and benefits for P25, P50 and P75 to represent Y25, Y50 and Y75, and then use Y25, Y50 and Y75 to calculate the pay ratios as follows, where X is the CEO's STFR:

$(X/Y25):1$ – ratio of CEO STFR to 25th percentile

$(X/Y50):1$ – ratio of CEO STFR to 50th percentile

$(X/Y75):1$ – ratio of CEO STFR to 75th percentile

Option B (use of gender pay gap information)

Step 1

Use the most recent hourly rate gender pay gap information collected by the company to identify three UK employees whose remuneration, on the basis of the gender pay gap information, place them at the 25th, 50th and 75th percentiles of the company's UK employee population ranked by pay and benefits from low to high.

In the regulations, these three employees are referred to as "best equivalents" of P25, P50 and P75, pending step 2 below.

Step 2

On a day no earlier than three months before the end of the relevant financial year (that is, the financial year reported on in the latest remuneration report), calculate the pay and benefits for the relevant financial year for the three "best equivalents" of P25, P50 and P75 identified in step 1.

Step 3

Make any necessary adjustments to the pay and benefits identified in Step 2, in order to provide further assurance that the pay and benefits are representative of P25, P50 and P75 for the relevant financial year. For example, an employee identified as the best equivalent of P25, P50 or P75 using gender pay gap

information may receive atypical (much higher or lower) variable pay in the relevant financial year to which the pay ratios must relate. An adjustment may be necessary in such cases to avoid giving a misleading representation of employee pay and benefits at the 25th, 50th and 75th percentiles.

The pay and benefits thereby identified for P25, P50 and P75 in the relevant financial year, after any necessary adjustments, should then be used as Y25, Y50 and Y75.

Step 4

Follow the same step 4 for Option A.

Option C (use of other pre-existing pay data)

Step 1

Use other pre-existing pay information for UK employees as an alternative to, or in combination with, gender pay gap information to identify three UK employees whose remuneration places them at the 25th, 50th and 75th percentiles of remuneration of the company's UK employee population.

Steps 2, 3 and 4

Follow the same steps for Option B.

Q20. Should companies use the Full-Time Equivalent of gender pay gap or other data used under Options B or C to identify the 'best equivalents' of P25, P50 and P75?

It may be sensible to apply a FTE calculation to avoid the risk of 'best equivalents' of P25 etc based on part-time remuneration no longer being representative of P25 etc when the pay and benefits are calculated for the relevant (latest) financial year, since those pay and benefits must be calculated on an FTE basis.

In any case, companies are required by the regulations to make any "necessary adjustments" to ensure that the pay and benefits in the relevant year for employees identified as 'best equivalents' using Options B or C are reasonably representative of P25, P50 and P75 for the relevant financial year.

Supporting information required under pay ratios table

Q21. What supporting information is required?

Paragraphs 19E and 19F of the new regulations require that companies provide certain information to aid understanding of how they have calculated their pay ratios. This includes whether and how they have made use of any flexibilities provided in the new regulations, and a top-level summary of the employee pay and benefits used to calculate each of the three pay ratios

Paragraph 19E asks for the following to be provided under the pay ratios table:

- an explanation of why the company has chosen Option A, B or C for calculating the pay ratios presented in this year's remuneration report;
- if the company used a different option in the previous year (that is, from the choice of A, B or C), a short explanation of the change to a different option this year;
- the day by reference to which the company determined Y25, Y50 and Y75;
- if the company has omitted any non-salary employee remuneration component from the pay ratios calculation, the reason for the omission, and also whether this is a continuing omission from the previous year;

- if the company has used a non-STFR methodology for calculating any non-salary employee remuneration component, a brief description of the different methodology and the reason why it was used; and
- a brief explanation of any assumptions or statistical modelling used, where applicable, to convert employee pay and benefits to full-time equivalent employee pay and benefits.

The following additional information is required if the company has used Option B:

- a short explanation of why it believes the “best equivalent” employees identified using gender pay gap information are reasonably representative of the 25th, 50th and 75th percentiles of company remuneration (i.e. P25, P50 and P75) in the relevant financial year; and
- a short description of any use of estimates or adjustments used subsequently to determine the pay and benefits in the relevant financial year of the employees identified using gender pay gap information.

The following additional information is required if the company has used Option C:

- a short explanation of how it identified the “best equivalent” employees using pay data other than or in addition to gender pay gap information; and
- why it believes these employees are reasonably representative of the 25th, 50th and 75th percentiles of company remuneration (i.e. P25, P50 and P75) in the latest financial year being reported on.

Paragraph 19F additionally asks companies to provide the total employee pay and benefits figure that is used in each of the three pay ratios, and the salary and wages component of each total pay and benefits figure. i.e. the £ number that represents each of Y25, Y50 and Y75 must be disclosed, along with the salary component of that number.

Explanation of pay ratios each year

Q22. What do companies have to explain?

Paragraph 19G requires companies to explain, after the supporting information provided for 19E and 19F:

- any reduction or increase in the relevant financial year’s pay ratios compared to the previous year’s (if disclosed), including whether a reduction or increase is explained by:
 - changes to the CEO’s or employees’ pay and benefits (for example, if shares awarded to the CEO have vested in that year and/or there has been an increase in pay and benefits to employees);
 - changes to the company’s employment models (including an increase in the proportion of employees not based in the UK, or an increase in the proportion of the company workforce not employed under direct contracts of service);
 - the use of a different pay methodology option that year, from the choice of Options A, B and C.
- any trend specifically in the median pay ratio (it is at the discretion of companies when and how to identify any trend - clearly there will be no trend discernible in the first year of reporting pay ratios);
- whether, and if so why, the company believes that its median pay ratio for that year is consistent with the company’s wider pay, reward and progression policies affecting its UK employees.

Q23. How long does this explanation under paragraph 19G need to be?

The regulations do not specify how long or short the explanation should be, and investors will be interested in meaningful and relevant explanations regardless of length. A clear, concise explanation is unlikely to require more than a few paragraphs of text in the remuneration report, but companies may at their own discretion provide more detailed explanations in certain years; for example, where there have been significant changes to pay ratios compared to the previous year.

Q24. In 19G(d) what is meant by asking whether the median pay ratio is “consistent with the pay, reward and progression policies for the company’s UK employees”?

The existing regulations already require companies to state how they have taken into account the pay and conditions of all the company’s employees when setting directors’ remuneration policy.

The median pay ratio provides an additional indicator to help shareholders (and other interested parties) understand the relationship between executive pay and pay across the company’s UK employees as a whole. 19G(d) asks the company to consider this ratio and explain whether it fairly reflects and is in line with the company’s approach to employee pay and incentives taken as a whole.

G. Executive pay – Share price impact reporting

Q1. What are companies required to do?

Companies within scope are required to provide:

- in the next new directors' remuneration policy, an illustration of the possible impact of share price growth on executive remuneration outcomes that are linked to performance targets or measures relating to more than one financial year;
- in the annual directors' remuneration report, as an additional disclosure under the STFR table:
 - an estimate of the amount of the STFR that may be attributable to share price appreciation;
 - whether, and if so how, discretion has been exercised as a result of either share price appreciation or depreciation.
- in the annual directors' remuneration report, within the Remuneration Committee Chair's statement, a summary of any discretion that has been exercised on executive remuneration outcomes reported that year.

Q2. Which companies are within scope?

Those companies that prepare directors' remuneration reports, i.e. all UK incorporated companies who are quoted on the Official List, the New York Stock Exchange, NASDAQ or a regulated stock exchange within the European Economic Area.

Q3. Why does the threshold of >250 UK employees not apply for the share price impact provisions?

The >250 UK employee threshold applies only in the case of the new pay ratio reporting requirement and in doing so provides some consistency with the Gender Pay Gap Information Regulations which apply to companies with more than 250 UK employees. This is significant since the pay ratio reporting may include use of gender pay data. The Government also recognised that pay ratio reporting at quartile level may have carried risks of disclosing relative information on individuals' pay within small employee segments at companies with fewer than 250 employees.

The threshold does not apply in the case of share price reporting, since quoted companies of all sizes may award share based executive remuneration for performance targets over multiple years, whose final outcomes may be influenced by share price growth.

Illustration of share price growth in remuneration policy

Q4. How are companies meant to illustrate the impact of share price growth in the remuneration policy?

Companies must already set out in the remuneration policy the maximum remuneration receivable by each executive director under the terms of the remuneration policy after the first year of its implementation, but this provision does not allow for share price appreciation.

The new regulations provide (in paragraph 35A) for companies to consider additionally and indicate the possible impact of a growth in the company's share price of 50% on remuneration outcomes where there are performance targets or measures relating to more than one year, such as under a Long Term Incentive Plan.

Companies are required to provide a short description of the basis of their indication of possible share price impact during such performance periods. The potential impact will vary depending on the design of companies' share based performance plans; for example, whether the maximum shares receivable are limited by number or value.

Reporting on share price impact in the remuneration report

Q5. How should companies comply with this provision?

Paragraph 12 of the existing regulations already requires companies to provide the actual level of variable pay awarded to directors in respect of how they have met annual and long-term performance targets, and to state whether any discretion has been exercised in determining the actual awards.

For share-based components of these remuneration outcomes, it is possible that the outcomes would have been different depending on share price appreciation or depreciation over the performance periods. The new regulations, through amendments to paragraph 12, require companies to provide the amount, or an estimate of the amount, of awards that are attributable to share price growth.

For the avoidance of doubt, while the primary objective of this new provision is to enable investors to see the difference that share price growth may have had on variable pay awards compared to the maximum receivable envisaged in the remuneration policy, it is recognised that such awards may also depend in part on whether targets were linked to share price growth. Companies may therefore wish to provide an explanation of how share price growth may have enabled directors to meet a target, and the impact of this on the variable pay awards. The amendments to paragraph 12 also require companies to state whether discretion has been exercised on the level of the award as a result of share price appreciation or depreciation. The Government recognises that discretion need not necessarily result in pay being adjusted down. Just as significant share price growth may not always be attributable primarily to executive directors' performance, so a significant fall in the company's share price may be in spite of a strong performance by directors which a remuneration committee may wish to recognise.

Annex A – Illustration of pay ratio methodology options

OPTION A

Step 1: Determine the individual pay and benefits (based at a minimum on wages and salary) for every UK employee of the company, for the financial year being reported on in the Directors' Remuneration Report.

Step 2: Rank the pay and benefits of all UK employees from lowest to highest, and identify the employees at the 25th, 50th and 75th percentiles.

e.g. At Company X, the CEO's Single Total Figure of Remuneration (STFR) reported in this remuneration report is £1.3million, and the UK employees identified at each of the three percentile points are paid the following:



Step 3: Calculate the pay ratios by dividing the CEO's Single Total Figure Remuneration (X) with employee pay and benefits at each of those percentile points (Y). **(X/Y:1)**

Ratio of CEO STFR to the 25th percentile: £1,300,000/23,000= 57:1

Ratio of CEO STFR to the Median (50th) percentile: £1,300,000/45,000= 29:1

Ratio of the CEO STFR to the 75th percentile: £1,300,000/60,000= 22.1

OPTION A represents the most statistically accurate method for identifying UK employee remuneration at the three percentile points for the latest financial year.

However, if a company believes it cannot reasonably follow this method⁹, it may use **OPTIONS B or C** described overleaf.

⁹ For example, because of the potential challenge of identifying every employee's pay and benefits across multiple payroll systems in the relatively short period of time in which remuneration reports are prepared

OPTION B

Step 1: Do you have the most recently reported Gender Pay Gap data (based at a minimum of the hourly rate data reported under the Gender Pay Gap Information regulations)?



OPTION C

Step 1: Do you have any other existing pay data? (based at a minimum on wages and salary, and from no later than the previous financial year.)



Step 2: Rank the remuneration of the company’s UK employees from lowest to highest based on the pre-existing Gender Pay Gap and/or other pay data, and identify those employees at the 25th, 50th and 75th percentiles of the company’s UK employee population based on this pre-existing data.

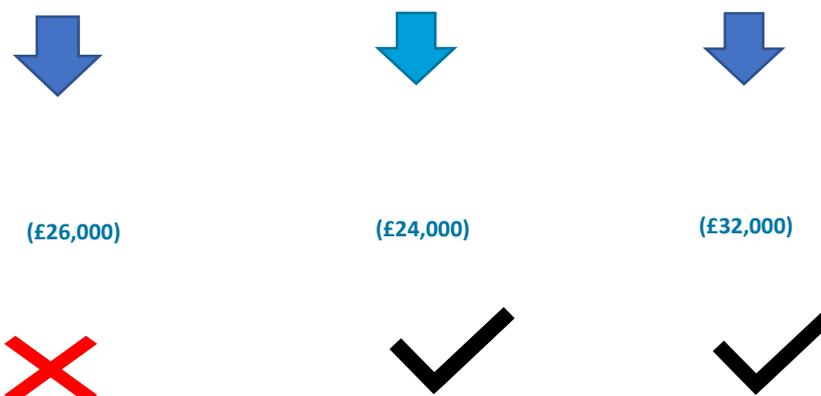
e.g. Option B: Company X identifies the UK employees at the three quartiles, based on hourly rate data most recently reported for compliance with Gender Pay Gap Information regulations.



These three employees now identified on the basis of pre-existing data are “indicative” of UK employee remuneration for the company at the 25th, 50th and 75th percentiles.

However, since that pay data may not stem from or fully cover all pay and benefits in the financial year that is being reported on in the latest directors’ remuneration report (‘the relevant financial year’), the company must next calculate the actual pay and benefits, including all relevant variable pay, of these three employees for the relevant financial year, as below.

Step 3: Calculate the three employees’ pay and benefits for the year being reported on in the Director’s Remuneration Report. The below example is used to demonstrate the need, where applicable, for a reasonable adjustment after calculation of pay and benefits for the year being reported on.



Under the above example the employee identified at the 25th quartile using pre-existing gender pay or other pay data is not now, in the company’s reasonable opinion, representative of Company X’s UK employee remuneration at the 25th percentile for the relevant financial year. This might be because the individual has received an unusually large annual bonus in the relevant financial year.

Company X now needs to make a reasonable adjustment¹⁰ to that employee’s remuneration figure for the financial year to ensure that it is representative, in the company’s reasonable opinion, of UK employee remuneration at the 25th percentile for the relevant financial year.

Step 4: Calculate pay ratios for employees at each percentile using the latest STFR and the employee pay and benefits figures identified at the 25th, 50th and 75th percentile points for the relevant financial year.

Common features of all 3 options:

- Employee pay and benefits should be calculated on the basis of the Single Total Figure Remuneration (STFR) components, where applicable, as set out in paragraph 7 (a-e) of Schedule 8 of the Regulations. The STFR methodology must be used to calculate salary. If a company uses a different method to calculate other components of pay and benefits the company must provide an explanation.
- Companies must base employee pay and benefits on wages and salary at a minimum, but any other non- salary components can be omitted if the company provides a reason for the omission.
- The employee pay and benefits for the employees identified at the 25th, 50th and 75th percentile points which are used for the pay ratio calculation, must be determined no earlier than the last three months of the financial year being reported on in the Directors’ remuneration report.
- The CEO’s STFR should be used in all cases, regardless of the method chosen for calculating employee pay and benefits.

¹⁰ Adjustments may include choosing a representative employee in the vicinity of the 25th percentile.