



WITH **TOM FLANAGAN CONSULTING**

Positive steps for positive outcomes

A response to HM Government's
Consultation on Draft Regulations

“Mandatory Gender Pay Gap Regulations”

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This response is prepared jointly by :
THP HR Consultants in association with
Tom Flanagan Consulting

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Summary/General

Following a public consultation in mid-2015 the Government has produced Draft Regulations for the Mandatory Gender Pay Gap Reporting and is seeking further consultation.

We applaud the aim of the Government to try to “*tackle the complex drivers of the pay gap*” and produce proposals which will be “*Proportionate and effective*” (quotes from Nicky Morgan in the Foreword to the current Consultation).

However, we regret that the outcome so far – the draft Regulations which are the subject of this Consultation – appears to us to be disappointingly simplistic.

Whilst we understand that this is only part of the story, any requirement to report should be an effective tool to help achieve the overall objectives which should be to identify the nature of any gender pay gap(s) within the relevant business and, more importantly, take steps to try to eliminate it/them.

We know that there are gender pay gaps and that it would be useful to measure them. Reporting the measuring exercise could help the aim of tackling the underlying causes of the gaps. The objective of the reporting of comparative gender pay should be primarily to make employers aware of any inconsistency of pay arrangements and outcomes within their business based on gender. This knowledge can then be used by the employer, in conjunction with many other factors, in reducing such inconsistencies and ensuring that they are compliant with any relevant Equal Pay and anti-discrimination legislation.

See the section about Regulation 4 below for further comments on this.

It must also be borne in mind that currently that “the Market” is the key determinant of pay

- i. Salary is determined by level and role
- ii. Bonus levels are normally determined by level, role and performance.
- iii. Benefits are normally determined by level and role.

Our analysis of the proposed regulations considers whether the reporting is sufficient to meet the objectives and, if not, what changes should be considered to better inform the company and any other observer.

It is noted that reported data will be made public and therefore it is essential for all employers to use similar methodologies to calculate the data for comparative purposes.

The publication in itself will not automatically lead to change as the required figures are just a snap shot summation of the work that has gone into producing them and indeed as things stand there is a disconnect between transparency and the intention to see the differences between male and female pay reduced.

We should remember that there are different audiences for the Reports being produced, both internal and external. The internal audience is split between employees/their representatives who will want to bring pressure to bear on the other internal group - management, whose role will be to do something about it, perhaps in conjunction with the employees. The external audience is also divided between different functions – a simple comparison between companies which might be helpful in itself and the potential peer pressure which could be created by that comparison.

Only by taking all these audiences into account and producing meaningful information can the overall objectives be addressed properly, of identifying gender pay gap(s) and taking steps to reduce and eliminate the Gender Pay Gap.

In our response to the first Consultation, we produced a bullet point summary of what we believe to be the proper focus of this exercise. We attach that, now, as Appendix I because we are concerned that the overall aims cannot be met by the somewhat simplistic approach taken in these draft regulations.

To the extent that this suggested approach appears to make life more complicated for employers, thus perhaps not to be exactly fulfilling Nicky Morgan's aim of proportionality, we would say that it is better to get this right than do something which will still cause some work and disruption but to little effect. Besides, we do suggest ways to produce tools to help employers to comply.

In short, we believe that there should be less rigorous attention paid to technical reporting (useful but not an end in itself) and more focus on tackling the problem.

We will now turn to specific issues arising out of the draft regulations.

Commentary on Draft Regulations

Regulation 1: Definitions

The definition of a “relevant employee” is rather loose as it includes someone who ordinarily works in Great Britain (Not Northern Ireland) and whose contract is governed by UK legislation. A lot of UK employment legislation does not, strictly, govern the contract of employment but provides additional, statutory, rights such as unfair dismissal, or it implies terms into contracts of employment such as minimum notice or an equality clause,

The definition should also include – but probably does not, by definition - a raft of professional individuals who, unlike Directors, are partners in Limited Liability Partnerships (LLP) and are treated as self-employed.

Shouldn't it also include expatriates whose primary contract may be abroad but they may be paid from a UK company and be subject to PAYE and some UK employment legislation such as unfair dismissal?

There are those in the category of “worker” for the purposes of various UK employment statutes who do not have a contract of employment.

Which legislation is to govern the reporting: United Kingdom, Great Britain, England, Scotland, the Channel Islands, the Isle of Man, all of which have some different approaches to employment legislation?

This definition needs a bit of attention if only to avoid the unintended result of satellite litigation about who is covered by it.

Regulation 2: Defining Pay

We consider that the only way that you can see the real differences between male and female pay is *total remuneration* as per the requirements for executive directors.

Whilst the burden on companies to compile this information is significant, solely focussing on salary (fixed pay) and bonus (variable annual and long term) misses the loophole that only recent developments on executive director pay have driven out.

Currently the values of Expenses and Benefits are excluded but they are measurable and should be costed.

Restricting it to pay and bonus as per the definitions of using ONS and ASHE and incentive payments made in the reporting period miss considerable value including:

- a. Benefits, particularly pensions are indirectly biased against women. There are, for instance, unforeseen consequence of closing final salary schemes to new entrants (women who have had to take career breaks lost out if they returned to work for any other reason than maternity).
- b. Participation, awards and payments are very different.

Pay is said to include maternity pay but no mention of paternity pay.

It also includes paid leave but excludes overtime pay. However, based on recent caselaw it is clear that holiday pay itself is based on a number of items which could include overtime pay.

Bonus Pay

We believe that this section requires more work to compute a series of meaningful and comparative data.

Its limitations begin by including only those bonuses that are actually paid and the proportion of men and women who receive bonuses. We believe that a better measure is to show the numbers of each gender who are eligible to participate in the bonus pot, the proportions of each actually receiving the award and the award levels. One could include any potential maximum bonus.

This type of award will often be based on a mix of corporate, team and personal objectives, as well as, possibly, discretionary elements. The ability to participate will often dictate differences in receipts.

Long Term Incentives

The draft regulation is right to determine the LTI as the payment received by the participant but a caveat should be added that it is when the benefit is realised by the participant. This is because some schemes (particularly share option schemes and performance share schemes using nil priced options) have a window (normally several years) for participants to exercise. The award should be determined at the date the award is realised. This is normally when tax (income tax and/or capital gains and or National Insurance) on the award is determined. Otherwise you risk reporting LTI which do not reflect the value that is received. If men are receiving larger awards and can afford to delay exercising then you will not see the true discrepancy between the sexes.

There are also schemes which include payment of part of the award in cash, immediately or over stages, with the balance subject to performance measures which could reduce or eliminate that balance over a period of years.

There are several accepted methodologies for computing the value of LTIPS but only one should be accepted as the standard for this reporting.

In effect, the real differential between genders often lies in the opportunity to earn under bonus and LTIP schemes, as much as the actual sum earned.

See also Appendix II below.

Regulations 3, 8 and 9: Duty to Publish

The Reports should be published to employees and their representatives, as part of a consultation process which would include tackling the Gender Pay Gap through co-operation between employees and the employer. They will need to have available informed information which will help them to do so. The simplistic approach of the mean/median comparison will not, in our view, be a useful enough tool to help businesses to achieve the overall objectives set out above.

The time limit of one year appears feasible for the first reporting but, particularly if a Report is accompanied by an action plan, it should be reviewed and updated only every two years thereafter, in order to give time to effect the changes necessary to put the plan into action.

Regulations 4-5: Calculating gender pay gaps

Use of hourly pay rate – this is meaningless to a large proportion of the working population. Trying to shoehorn all types of employees into this bracket which is irrelevant to them in the way proposed could create some odd unintended consequences.

Take a working example of two professional employees, one male, one female, working for a promotion (partnership or similar). Both have similar contracts with a provision for basic working hours but the obligation to work without additional pay for as long as the duties reasonably require. The male is paid more than the female, although they have similar roles. As a matter of practice – let us say because he is single, compared to the woman who is married, with children – the man regularly works longer hours. On the analysis suggested by the regulations, dividing the pay by the hours worked, the man's pay is actually deemed to be lower than the woman's largely because of his longer hours. This, of course, distorts reality. (The situation would then be exacerbated were he then to be promoted earlier than she partly because of working longer hours!). This is a cliché but shows how the simplistic model does not serve the purpose.

In any event, this is not just a reporting exercise. A report in itself is of little value unless its content is meaningful and is accompanied by an action plan. This ought to consist of a short commentary explaining the output of the Report and agreed steps which will be taken to address the gaps identified. The next report should then include an assessment of how the business has put the plan into action and with what results, if any.

One of the most important considerations, in our view, is that the analysis of pay should be meaningful, in the context of the business, in terms of its size, structure, job types, pay arrangements. As we identified in our response to the first Consultation, a median or mean approach to numbers may give an attractively simple view of the business but by its nature it is largely irrelevant to the actual pay figures within most businesses. It is our view, therefore, that whilst the mean/median approach suggested by the current draft Regulations should form part of the Report, it should also include a meaningful analysis of pay differentials by reference to the way in which the business operates. (Recent high profile examples of voluntary published reporting refer to different sets of numbers – the traditional median model and then an actual comparison of gender pay within groups of employees who can meaningfully be compared with each other; organisations such as Camden Council, Deloitte, Intel have all used both the broad and the detailed analysis approach).

In this way, if there are underlying issues such as some jobs or part of the business dominated by higher earning men, or predominantly part time and mainly women, or the impact of the use of zero hours contracts, then those issues are more likely to be identifiable by the more detailed analysis than by a general median comparison which is not sophisticated enough to identify root causes.

In fact, without the sort of meaningful comparison which we are advocating, there is a risk that the well-intentioned but limited aims of the current draft regulations could actually impede transparency by creating an environment in which businesses produce only that which is required, which does not assist the aims of identifying and tackling underlying causes.

Regulation 6: Calculating bonus differences

The Draft Regulations state that only those employees who receive bonuses should be included in the calculation with the relative proportion of male and female employees receiving the bonus shown.

See above under Regulation 2 for comments on this approach.

Additional investigation

Our opinion is that more work should be done on disclosure of what roles women take up.

This is key.

We need to break male market bias and reporting on pay and bonus will not change the market unless we address the reason why the female work force varies by market and job family. Address these issues and we think you will see a closing of the gap.

If “the market” (e.g. Banking or Construction) is the prime determinant of pay then

Professional (should be no bias at all)

- a. *HR* – female dominated today, save at the most senior level, particularly where there is an HR presence on the board. Possibly the least professional of all the professions. (Fewer examination requirements and no CIPD does this mean that the HR profession tolerate career breaks better?).
- b. *Finance* – where are the female CFO’s (very few). Is it the hours?
- c. *Legal* – where are the female partners and CLO’s (to be fair there are a few)
- d. *IT* – where are female CIO’s. Geek image?

Engineering – traditionally male

- a. Why do graduate females drop out after a couple of years?

Construction – traditionally male

- a. Why don’t companies recruit and train female workers? Answer women don’t want to do those roles?

A random observation is that female colleagues are far more loyal to one organisation than male colleagues. (If you want to progress your pay you cannot work for one organisation. Graduate salary of £30k to CEO on a £1million—with limited pay budgets. It’s mathematically impossible over 40 years.) By moving around more males will end up earning more. Another indirect reason for the pay gap.

Career breaks

It has been suggested that career breaks can interrupt a career progression. Dr Sally Davies of the Women’s Medical Federation has said “Anything more than 12 months is a detriment – you will not be looked at in quite the same way, sadly, when you return”. As these breaks are more likely to be taken by women then career and therefore pay progression may be adversely affected.

But are career breaks per se the factor? Could it be the same for people (irrespective of sex) who take sabbaticals, have health related issues, work from home or even take assignments away from the normal place of work?

Appendix I

Bullet Point Summary of the Proposed Focus

The proper focus of this exercise should be to:

- analyse the causes of any gender pay gap and address them, with a view to changing culture and practice in order to reduce the gap;
- assist employers in this process, produce appropriate tools; this should not be done by job evaluations and equal pay audits, which will carry legal and political baggage; new, relevant tools are necessary but those existing tools might help to inform the nature of a gender pay gap audit;
- propose methodologies to correct any gender pay imbalance;
- recognise that, in order to give time to implement plans to effect change, a report should be required no more frequently than every two years;
- publish to employees, or their representatives, which could form part of an information and consultation process, perhaps pursuant to the ICE Regulations
- agree that there is no inherent value in publication – “transparency” is not an end in itself but it is only one of the possible mechanisms of achieving a reduction in the gender pay gap. The extent to which any report should be published will depend on individual circumstances but there can be some general guidance;
- recognise that whilst the metrics should probably include the existing median approach, they should also include separate analyses for different parts of a business or group, so as to compare like with like;
- remove the emphasis on the negative, legalistic mechanisms of rules, publication, shaming, remedies and penalties and focus on encouraging the good work done so far in reducing the gender pay gap, but at a quicker pace;
- avoid a “one size fits all” regime of regulation;
- turn a costly chore into an important management tool
- help identify, retain and promote talent of whatever gender;
- comply with existing equality legislation, where relevant;
- ensure that any “Enforcement” should be with a light touch.

Appendix II

Valuing Long term Incentive Plans (LTIP)

There are several accepted methodologies for computing the value of LTIPS.

1. Face value. The gross value before tax in GBP at
 - a. the date of award
 - b. the date of vesting (when an award can first be realised)
 - c. the date of exercise (when the participant exercises the award)
 - d. the date where the award attracts tax (the tax point).

2. Expected value
 - a. The value accrued for accounting purposes
 - b. The value communicated by the company to participants
 - i Normally based on a “Black Scholes” derivatives valuation model
 - ii Value reported over the lifetime of the award will vary based upon the performance of the company and individual.

3. Taxable value
 - a. Revenue approved schemes are highly beneficial to participants (face value doesn’t disclose this advantage and will make intercompany comparisons invalid).
 - b. Unapproved schemes are more likely to be performance linked and of greater value to participants due to the limitations of Approved Schemes

The major issue however of making comparisons between LTIPs is the deferral period where you do not exercise. This is where the Rules of the LTIP schemes allow deferral of exercise to allow participants to maximise value and increase alignment of participants with shareholders. These include:

- a. Share option schemes
- b. Nil priced option based performance share plans

Or where:

- c. There is a requirement to hold shares in the company to participate in the scheme (you can't realise the value)
- d. Deferral to achieve matching share rules (mandatory and voluntary)

When you exercise is key to value. Normally the longer you can hold an award the higher the value of the equity and the greater any tax breaks. This is driven by circumstance but "if" men are wealthier and are less likely to need "the money" now, the more likely they are to defer. In those circumstances there will be bias against the poorer (need the money now) and if that is women then there is an indirect bias against women. The legislation should capture both awards paid out and awards which are still held which Executive Reporting requires to ensure that proper comparisons are made.

Appendix III – Who we are

This report is produced by an association of two consultancies

THP HR Consultants Limited. (THP)

THP is a team of senior HR practitioners from major corporate and consultancy backgrounds offering tailored and pragmatic HR consulting advice and support.

Our Directors have worked with and for many of the UK's most successful businesses. Our core expertise is in:

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- Pensions and other employee benefits including Flexible Benefits
- Employee/Industrial relations
- Employee communication
- International remuneration, strategy, benchmarking and mobility
- Performance and Talent management
- Corporate restructuring, grading and TUPE
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Our Associates include UK and international employment and pensions lawyers, benefits brokers, share plan, communication and organisation effectiveness specialists. THP can deliver for you across the HR spectrum and also advise internationally.

Chancery House, 30 St John's Road, Woking, Surrey, GU21 7SA.
Registered in England and Wales No.9318652.
T: +44 (0)20 8868 9898 (THP Office Number)

www.thehrpartners.com

Contact: john.nichols@thehrpartners.com or Adam.phillpot@thehrpartners.com

Tom Flanagan Consulting

Tom Flanagan is one of the UK's leading employment lawyers of over 30 years' experience. Now retired he is an Independent Consultant providing strategic employment advice mainly in the areas of:

- Change management, including harmonization and variation of contract
- Trade Unions and Collectivism, including European Works Councils
- TUPE, mainly in the context of outsourcing and offshoring
- Restrictive covenants, confidentiality and team moves
- Investigations, as an independent analyst of sensitive employment/HR issues
- as well as providing support and advice on developing and implementing strategies for business development and growth.

Tom is experienced in helping to develop employment law policy. For example, he advised the Conservative Party in Opposition on the formation of employment law policy much of which became "the Employment Law Review", advised on and co-authored the employment law content of the Conservative Party Manifesto for the 2015 General Election, including a strategy for reforming the law on industrial relations. He is co-author of the think tank, Policy Exchange's Report "Modernising Industrial Relations" and contributed to the strategy which gave rise to the Trade Union Bill.

Tom Flanagan Consulting

T: +44 (0)7885 951097

tom.flanagan@tfc.uk.net

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