PENSIONS AND LIFETIME SAVINGS ASSOCIATION

11 January 2019

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Ethnicity Pay Reporting team
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Dear team,

CONSULTATION RESPONSE: ETHNICITY PAY REPORTING

About the PLSA
We're the Pensions and Lifetime Savings Association; we bring together the pensions industry and other parties to raise standards, share best practice, and support our members. We represent over 1,300 pension schemes with just over £1 trillion in assets under management and over 400 supporting businesses, including asset managers, investment consultants and other service providers. Our mission is to help everyone achieve a better income in retirement.

Our response
As long-term investors, pension schemes recognise that the composition, stability and engagement levels of investee companies' workforces are key determinants of their long-term performance and, ultimately, of the value of scheme members' savings. The 2017 McGregor-Smith Review also found, for example, that more diverse workforces could add £24bn a year to UK GDP.

Fair pay policies are necessary (but not sufficient in themselves) to ensure good employee morale, while companies which fail to recognise the potential of all their workers are less likely to achieve the best possible performance. Pay discrepancies[1] based on issues such as gender or ethnicity can also be a signifier of wider problems with a workplace's culture and processes.

Pension scheme investors therefore require clear, consistent and accurate information about the business model and sustainability of the companies they invest in, to get a better insight into the risks and opportunities presented by a firm's approach to workforce remuneration and diversity.

[1] Investors are also interested in broader indicators of employee well-being and satisfaction; it should be noted that a fair salary structure could still mask dissatisfaction, harassment and disengagement in the workplace. We hope that disclosure initiatives like those on gender and ethnicity pay will encourage a broader move towards holistic reporting of workplace issues.

How well companies disclose workforce issues is something the PLSA has explored in depth through the research we undertook with Lancaster University Management School on disclosure of employment practices by the FTSE 100[2]. We also note that where disclosure on pay gap issues has been voluntary, companies have been slow to act. For instance, the Think, Act, Report initiative in 2011 on gender pay gap information had minimal success, in comparison to the recent mandatory gender pay gap disclosure. Voluntary disclosure can also result in inconsistent methodologies and metrics, making it harder for investors and civil society to compare approaches and make decisions.

We also believe that an onus on companies to publicly disclose their ethnicity pay gap would focus minds and result in tangible action being taken by companies. We therefore support the government's intention to take a mandatory approach to ethnicity pay reporting. However, we believe balance must be maintained between ensuring any information is useful and that additional reporting requirements do not place a disproportionate burden on firms.

Our other comments are below:

- For disclosures to be useful to investors in their decision-making, they must be *consistent* and *comparable* i.e. standardised as far as possible. There must also be sufficient *context* given on issues such as, for instance, how a company has changed or intends to change its approach. However, to be meaningful, there should be scope and space for innovation and for companies to adopt narrative practices which best suit their circumstances. We think expectations regarding narrative disclosures could be set out within non-statutory guidance.

  We are aware that there have been some concerns about the quality and incidence of the narrative disclosures on the gender pay gap so far, in the absence of prescriptive requirements. However, we believe that this will improve over time as the policies 'bed in' and as investors use the existing information in their dialogue and engagement with companies.

- As with gender pay gap reporting, we believe that the largest companies are best equipped to adopt ethnicity pay gap reporting in the near-term. It makes sense for the threshold for firm size (in terms of number of employees) to be aligned with the gender pay gap reporting methodology.

- There is little value for investors in the publication of a single pay gap figure as this would provide insufficient granularity to be meaningful and allow further exploration of

[2] For further details, please see our 2017 *Hidden Talent: What do companies' annual reports tell us about their workers* and our 2016 *Worth of the Workforce: A stewardship toolkit for pension funds* reports.

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the issue with the company. As with all metrics, it is important that any figures are based on accurate data and a sufficient sample size to be statistically robust. Careful consideration must also be given to ethnicity categories to allow comparability without being misleading.

- We continue to believe that reporting timescales on gender and ethnicity pay gaps should be produced for each firm's financial year, rather than firms being compelled to take snapshots each April. This would reduce the burden on companies and be more convenient, as they would be able to undertake the calculations together with other figures compiled for their annual report. We also believe that this would encourage companies to publish the information in their annual report, which would better enable investors to hold their companies to account.

In 2019, the PLSA will be building upon our previous work to help pension funds assess how investee companies approach the issue of human capital. This will include research on company disclosure of gender and ethnicity pay specifically, as well as exploring broader themes such as the skills agenda, productivity and employee well-being. We would be happy to discuss this in more detail if this would be of interest.

Yours sincerely

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Policy Lead: Investment and Stewardship

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