CLIFFORD CHANCE

Employee Benefits News

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Government proposals for the reform of executive remuneration

After months of speculation the Government has finally announced the outline of its proposals on executive remuneration following the publication last year of its consultation and discussion paper on this topic. Although some details remain relatively thin, the broad scope of the Government's proposed reforms is now clearer and will provide remuneration committees with much to chew over in the coming months. The Secretary of State for Business, Vince Cable announced a package of measures in four areas: (1) greater transparency in company reporting; (2) more shareholder power; (3) best practice led by business and the investor community and (4) more diverse boards and remuneration committees. More details on the proposals can be found here in the special client briefing which we released when the announcements were made in January.

It is understood that a further Government consultation is to be issued within the next few weeks. In addition, draft regulations amending the company reporting requirements will be issued shortly. We understand (although this is yet to be officially confirmed) that the new reporting requirements will come into effect in relation to reporting periods commencing on or after 1 October 2012.

Unsurprisingly, the proposals have divided opinion. Vince Cable has declared himself "happy" with the scope of the proposals, although some aspects (which he was previously thought to favour), such as including an employee representative on the remuneration committee, have seemingly been abandoned. Others are less happy, with one Conservative MP describing the proposals as "liberal, left-wing clap-trap".

Some of the practical implications of the proposals for executive share plans are outlined below.

Key issues

- Government's proposals for the reform of executive remuneration
- The single-figure disclosure
- Claw-back for share plans?

The "single figure" disclosure

Under the Government's proposals there will be two separate remuneration statements: a forward looking statement on proposed future remuneration policy and a backward looking statement reviewing the current year. The "current year" statement will require a number of new disclosures, including a single figure for the total remuneration of each director.

It is expected that (as proposed in last year's consultation) this figure will have to include all aspects of the remuneration package, including share options, LTIPs and pensions. Some obvious questions arise. For example:

- When should the value of the share option/LTIP award be included? Should an award only "count" once it has vested or should it count at the point of grant?
- How should the "value" be calculated? There is no obvious figure to be used for options and LTIP awards. Should the figure be based on e.g. the fair value figure used for accounting purposes or something else?

- How much additional explanation will be required of how the aggregate figure has been calculated?

Anomalies will obviously arise if different companies use different approaches and as a result it may be difficult to make meaningful comparisons.

Claw-back for share plans?

Vince Cable has stated that he is to ask the Financial Reporting Council to amend the UK Corporate Governance Code to require large quoted companies to include "claw-back". The concept of claw-back is relatively unfamiliar outside the financial services sector, although in recent months there has been an increasing expectation that it should be adopted in all sectors. For example, the revised ABI Guidelines issued in September 2011 now explicitly state that shareholders expect to see claw-back (and malus) provisions included in incentive arrangements and for those provisions to be enforced when appropriate.

It is currently unclear how the Government expects any "claw-back" to operate in practice. For example:

- Is it intended that it should apply to options/LTIPs or just to cash bonuses?
- In what circumstances is claw-back expected? Would this be limited to circumstances which require e.g. a material restatement of accounts or only if there is serious misconduct by the executive?

Certain practical difficulties may also arise in the case of clawing back shares/cash from executives. The claw-back will need to be carefully structured in order to be enforceable against the executive. Even if enforceable, the executive may not have the necessary funds/assets to repay the company immediately. The position is also complicated by the fact that the executive will already have paid tax and NICs in relation to the award but claw-back may be required on a gross (i.e. pre-tax) basis. It is currently unclear whether the executive could claim this tax back/claim an employment income tax loss in respect of the clawed-back remuneration. HMRC are aware of this as an issue and are considering it.

Next steps

We will send you an update once the Government has issued further details on these proposals. In the meantime, if you have questions or would like to discuss the proposals, please do get in touch.

Revised PAYE requirements for ex-employees from 6 April 2012

HMRC has announced that they will be changing the PAYE withholding requirements from 6 April 2012. The change will mean that the "0T code" must be applied to share-based payments made following the issue of an ex-employee's P45.

As we reported last year, from 6 April 2011 employers have generally been required to operate PAYE on post-P45 payments using an "0T" code. The "0T" code means employers must withhold tax at the basic, higher and additional rates as appropriate, on a non-cumulative basis. However, a last minute reprieve for share plans meant that PAYE withholding on share-based payments continued to be operated at the basic rate ("BR") only, with the employee accounting for any higher/additional rate tax through self-assessment in due course. This meant that many higher and additional rate tax payers continued to enjoy a cash flow advantage.

Following a further change of heart, HMRC have now decided to remove the share plans exemption from the 0T Code, so that as from 6 April 2012 the 0T code will also apply to share-based payments.

In making this change, HMRC have stated that they are responding to feedback from some share plan administrators (amongst others) that, for administrative ease, they would prefer to apply a single code to all payments of PAYE income. It does of course also mean that HMRC will now have the cash flow benefit previously enjoyed by some taxpayers. Ex-

employees who pay too much tax through PAYE as a result of the 0T Code will have to claim it back through self-assessment.

HMRC have published the draft changes to the PAYE regulations. These are open for comment until 16 February 2012.

Employers will need to ensure that PAYE is operated on the correct basis and that they have sufficiently robust processes in place in order to recover the correct amounts of PAYE from ex-employees. Note also that this change only affects PAYE income tax. The NICs treatment of shares delivered to ex-employees is not changing.

If you have any questions or would like to discuss this proposed change further, please get in touch.

EU Prospectus Directive – update on changes for companies offering employee share plans

In our October 2011 newsletter we reported that two helpful changes to the EU PD exclusions/exemptions, which companies may use for employee share plans, had been implemented in the UK (as from 31 July 2011):

- the exemption which applies to offers made to fewer than 100 individuals per member state has been increased to fewer than 150 individuals per member state.
- the exclusion which applies where the consideration for the offer over a period of 12 months is less than Euro 2.5 million (across the EU) has been increased to less than Euro 5 million (across the EU).

More recently, on 13 December 2011, the FSA and HM Treasury published a joint consultation on how it intends to implement the remaining changes which must be implemented by EU Member States by 1 July 2012. These changes include amendments to the scope of the specific employee share plans exemption. The changes will mean that the exemption is extended to all companies whose head office or registered office is in the EU (regardless of whether or not they are listed). In addition, companies which are "established" outside the EU will qualify for the exemption if they are listed on an EU regulated market (as is the case under the original exemption wording) or if they are listed on a "third country market" which has been approved by the EU Commission.

It now seems very likely that these changes will be in place by (but not before) 1 July 2012. For unlisted companies whose head office or registered office is in the EU, this should mean that they can, for the first time, rely on the employee share plans exemption once it is implemented in the UK (and in the other EU Member States).

However, the position is less straight forward for non EU companies listed on a third country market. This is because of the additional requirement that the EU Commission must first have approved the relevant third country market for this purpose. The EU Commission has charged the European Securities and Markets Authority ("ESMA") with designing "equivalence criteria" under which the EU Commission can determine whether a third country exchange can qualify for approval. Although ESMA is due to consult on such criteria, no consultation has yet been issued and it seems very likely that consideration of the equivalence criteria (and, in turn, the approval of any third country exchanges by the EU Commission) will not occur in time for 1 July 2012.

We are continuing to contribute to lobbying efforts on this issue in order to encourage implementation as early as possible and we will let you know when there are further developments.

Government to give a boost to employee share ownership?

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In a speech delivered at the Mansion House last month, the Deputy Prime Minister, Nick Clegg, announced that he would be appointing an independent adviser (who is yet to be named) to review what barriers currently exist to wider employee share ownership. The remit of the review will be extensive, to include both the tax and regulatory aspects of employee share plans, and will culminate in a "summit" to be chaired by Nick Clegg in the summer.

Nick Clegg's speech even suggests the possibility of giving employees an "automatic" opportunity to enter into a share plan, in order to encourage take-up, although he acknowledges that this may not be feasible for all companies.

At this stage, it is not entirely clear how this initiative will interact with the work being done by the Office of Tax Simplification (OTS). As reported in our October 2011 newsletter, the OTS has been charged with reviewing the tax treatment of employee share plans. The project is in two parts – focussing initially on tax-approved plans and then considering unapproved plans. The OTS will be producing a report and recommendations on approved plans in time for the 2012 Budget, which is on 21 March 2012. We therefore expect that the Government will propose some simplification measures for approved share plans as part of its 2012 Budget announcements. However, it likely that any radical ideas/changes will be reserved for Mr Clegg's new initiative.

We will update you as soon as there are any further developments.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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