THE EXECUTIVE REMUNERATION REVIEW

EIGHTH EDITION

Editors
Arthur Kohn and Janet Cooper

THE LAWREVIEWS

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CONTENTS

PREFACE

Executive remuneration encompasses a diverse range of practices and is consequently influenced by many different areas of the law, including tax, employment, securities and other aspects of corporate law. We have structured this book with the intention of providing readers with an overview of these areas of law as they relate to the field of executive remuneration. The intended readership of this book includes both in-house and outside counsel who are involved in either the structuring of employment and compensation arrangements, or more general corporate governance matters. We hope this book will be particularly useful in circumstances where a corporation is considering establishing a presence in a new jurisdiction, and is seeking to understand the various rules and regulations that may govern executive employment (or the corporate governance rules relating thereto) with regard to newly hired (or transferring) executives in that jurisdiction.

The most fundamental considerations relating to executive remuneration are often tax-related. Executives will often request that compensation arrangements be structured in a manner that is most tax-efficient for them, and employers will frequently attempt to accommodate these requests. To do so, of course, it is critical that employers understand the tax rules that apply in a particular situation. To that end, this book attempts to highlight differences in taxation (both in terms of the taxes owed by employees, as well as the taxes owed – or tax deductions taken – by employers), which can be the result of:

a the nationality or residency status of executives;
b the jurisdiction in which executives render their services;
c the form in which executives are paid (e.g., cash, equity (whether vested or unvested) or equity-based awards);
d the time at which executives are paid, particularly if they are not paid until after they have 'earned' the remuneration; and
e the mechanisms by which executives are paid (e.g., outright payment, through funding of trusts or other similar vehicles, or personal services corporations).

In addition to matters relating to the taxation of executive remuneration, employment law frequently plays a critical role in governing executives' employment relationships with their employers. There are a number of key employment law-related aspects that employers should consider in this context, including:

a the legal enforceability of restrictive covenants;
b the legal parameters relating to wrongful termination, constructive dismissal or other similar concepts affecting an employee's entitlement to severance on termination of employment;

c any special employment laws that apply in connection with a change in control or other type of corporate transaction (e.g., an executive's entitlement to severance or the mechanism by which an executive's employment may transfer to a corporate acquirer); and

d other labour-related laws (such as laws related to unions or works councils) that may affect the employment relationship in a particular jurisdiction.

The contours of these types of employment laws tend to be highly jurisdiction-specific, and therefore it is particularly important that corporations have a good understanding of these issues before entering into any employment relationships with executives in any particular country.

Beyond tax and employment-related laws, there are a number of other legal considerations that corporations should take into account when structuring employment and executive remuneration arrangements. Frequently, these additional considerations will relate to the tax or employment law issues already mentioned, but it is important they are still borne in mind. For example, when equity compensation is used, many jurisdictions require that the equity awards be registered (or qualify for certain registration exemptions) under applicable securities laws. These rules tend to apply regardless of whether a company is publicly or privately held. In addition to registration requirements, it is critical for both employers and employees to understand any legal requirements that apply in respect of executives' holding, selling or buying equity in their employers.

Given the heightened focus in many jurisdictions on executive remuneration practices in recent decades – both in terms of public policy and public perception – the application of corporate governance principles to executive compensation decisions is crucial to many companies. Decisions about conforming to best practices in the field of executive remuneration may have substantial economic consequences for companies and their shareholders and executives. Corporate governance rules principally fall into two categories. The first concerns the approvals required for compensatory arrangements: a particular remuneration arrangement may require the approval of the company's board of directors (or a committee thereof). Many jurisdictions have adopted either mandatory or advisory say on pay regimes, in which shareholders are asked for their view on executive remuneration. The second concerns the public disclosure requirements applicable to executive remuneration arrangements: companies should be aware of any disclosure requirements that may become applicable as a result of establishing a new business within a particular jurisdiction, and in fact may wish to structure new remuneration arrangements with these disclosure regimes in mind. In recent years, there has also been increased legislative and shareholder focus in many jurisdictions on environmental and social governance issues, such as the gender pay gap, tying executive compensation to environmental and social goals and diversity initiatives.

We hope that readers find the following discussion of the various tax, statutory, regulatory and supervisory rules and authorities instructive.

Arthur Kohn
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New York
August 2019

Chapter 20

UNITED KINGDOM

Mahesh Varia[1]

I INTRODUCTION

Brexit continues to dominate the political landscape in the UK, with the departure date now set for 31 October 2019 (unless a withdrawal agreement is ratified earlier). If the UK and the EU are unable to agree the terms of the UK's withdrawal then, unless there is a further delay to the Brexit process, the UK will become a third country for EU purposes from that date. A no-deal Brexit will have implications for the securities laws, data protection rules and social security charges that relate to executive remuneration, and companies are having to prepare for this possibility. Meanwhile, in the corporate governance arena, many UK companies are having to think about new reporting obligations that came into effect this year. Of particular note is the requirement for companies with more than 250 UK employees to disclose pay ratio information that will compare their CEO's earnings with the average pay of employees at set levels. The 2019 annual general meeting season has seen the usual resistance to excessive levels of executive pay, with high pension contributions for directors a particular focus. The new UK Corporate Governance Code stipulates that pension contributions (or payments in lieu) for executive directors should be aligned with those of the general workforce, and this year a number of companies have reduced the level of contributions payable in respect of existing directors as well as for new hires. Finally, companies in the private sector that engage workers through intermediaries such as personal service companies are starting to assess the impact of new tax rules applicable from April 2020 under which they may have to withhold tax from payments to such intermediaries (in effect treating such workers as employees for tax purposes).

II TAXATION

i Income tax for employees

The rules determining an individual's residence for UK tax purposes are complex and depend on the person's particular circumstances. In the United Kingdom, individuals' liability to tax is determined by whether they are resident and domiciled in the country. The underlying principle is that those with the strongest links to the United Kingdom should pay more tax than those with weaker connections.

1 Mahesh Varia is a partner at Travers Smith LLP.

Historically, the concepts of residence and domicile were not defined by statute; however, this changed significantly from 6 April 2013 when a statutory residence test was introduced and the pre-existing concept of ordinary residence was effectively abolished.[2]

Broadly speaking, individuals who are UK-resident and domiciled in the United Kingdom are subject to UK income tax on their worldwide income, whereas those who are not pay tax only on income with a UK source. Special domicile rules mean that individuals who are UK-resident for more than 15 of the past 20 tax years are deemed to be UK-domiciled for tax purposes. Further, individuals with a UK domicile of origin and a UK place of birth will be deemed UK-domiciled for UK capital gains and income tax purposes whenever they are resident in the United Kingdom. The rates of income tax for the 2019–2020 tax year[3] (generally above a personal allowance of up to £12,500) are as follows:

	Bands	**Rate**	**Tax on band**
Basic rate	Up to £37,500	20%	£7,500
Higher rate	£37,501 to £150,000	40%	£45,000
Additional rate	Over £150,000	45%	N/A

Generally, all compensatory payments are subject to income tax at the rates referred to in the above table. There are, however, certain forms of tax-advantaged share plan under which benefits are taxed as capital rather than income, provided specified statutory criteria are met. Capital treatment is more favourable than income treatment for a number of reasons. To begin with, the highest rate of capital gains tax for most assets[4] is currently 20 per cent. Further, individuals are able to utilise an annual exemption from capital gains tax in respect of gains of up to £12,000 (for the tax year 2019–2020). The tax-advantaged plans commonly used for executives are the company share option plan (CSOP) and enterprise management incentives (EMIs). One particular feature of EMIs is that the disposal of shares acquired pursuant to them can benefit from a lower capital gains tax rate of 10 per cent.[5]

Companies have to self-certify their tax-advantaged plans as meeting the necessary HMRC requirements. All share incentive arrangements (including those that are not tax-advantaged) must be registered with HMRC and an online annual return filed by 6 July.

Plans under which participants' own shares from the outset remain popular and can give rise to growth that is taxed as capital. The government continues to be mindful of arrangements that seek to disguise remuneration as capital, and has introduced a number of anti-avoidance measures to combat them.[6] In recent years, the judicial view of tax-avoidance arrangements has moved, with the result that HMRC has won some important cases in this area.[7] The UK income tax rules for non-tax advantaged stock options, restricted share

2 Finance Act 2013, Sections 218 and 219 and Schedules 45 and 46.

3 The UK tax year runs from 6 April to 5 April.

4 There is an 8 per cent surcharge on disposals of chargeable residential property and receipts of carried interest.

5 Entrepreneurs' Relief: Taxation of Chargeable Gains Act, Section 169I(7A)–(7R). Note that changes have been made to entrepreneurs' relief as it applies to EMI for disposals on or after 6 April 2019 (Finance Act 2019, Section 39, Schedule 16).

6 For example, Income Tax (Earnings and Pensions) Act 2003, Part 7A.

7 For example, *UBS AG v. HMRC and DB Group Services (UK) Limited v. HMRC* [2016] UKSC 13 and *RFC 2012 Plc (in liquidation) (formerly The Rangers Football Club Plc) v. Advocate General for Scotland*

acquisition plans and restricted stock units are set out in the table below. It should be noted that in the United Kingdom it is common for restricted stock units to be structured as nil-cost stock options, as these offer greater flexibility over when income tax becomes payable and enable employers' social security obligations to be transferred to employees.

	Option	**Restricted stock acquisition plans**	**Restricted stock units (structured as a nil-cost option)**
Tax treatment upon grant	No tax	No tax if unrestricted market value paid; otherwise, income tax on discount if being taxed on grant is elected	No tax
Tax treatment upon vesting	No tax	Income tax may arise on lifting of restrictions if unrestricted market value is not paid or if no election is made to be taxed on grant	No tax
Tax treatment upon exercise	Income tax on the difference between market value of shares on exercise and exercise price paid	N/A	Income tax on the difference between market value of shares on exercise and exercise price paid
Tax treatment upon sale of underlying shares	Capital gains tax payable on the difference between share sale price and market value of shares on exercise	Capital gains tax payable on the difference between share sale price and market value of shares on acquisition (if no tax paid on vesting)	Capital gains tax payable on the difference between share sale price and market value of shares on exercise

Special rules apply to share-based incentives held by internationally mobile employees. These provisions require employers and employees to monitor the award-holder's residence over the life of the award. In the case of a share option, this will generally be from the date of grant until the award vests.

As a matter of good corporate governance, it is becoming increasingly common for part of a bonus paid to an executive to be deferred, either on a voluntary or compulsory basis. The deferred element of the bonus is usually provided in the form of an option that vests after a period of time. Sometimes executives are given a matching award in the form of a stock option exercisable after two to three years, subject to the satisfaction of performance criteria.

Where remuneration is deferred or waived, care needs to be taken to ensure that an income tax charge is not inadvertently triggered before such deferral or waiver can take place. Charges can arise under the disguised remuneration legislation if a third party, such as an employee benefit trust, earmarks cash or assets to individual executives. Recent Finance Acts have included amendments that widened the scope of these anti-avoidance provisions.[8]

The use of clawback to recover payments made in the event of misconduct or misstatement is starting to gain popularity and is compulsory for certain companies within the financial sector. Following a 2014 Upper Tribunal decision in which a taxpayer successfully sought tax relief in respect of a bonus that was subject to clawback, HMRC published guidance on the circumstances in which such a claim can be made.[9]

[2017] UKSC 45.

8 Finance Act 2017, Section 15, Schedule 6 and Finance Act 2018, Section 11, Schedule 1.

9 *HMRC v. Julian Martin* [2014] UKUT 429 (TCC) and HMRC Employment Income Manual EIM00800-00845.

ii Social taxes for employees

In most circumstances, where income tax is payable, the employer is required to account for tax under the pay as you earn (PAYE) collection system. Failure to recover this tax from an employee can lead to additional costs for an employer and further tax liabilities for the employee. To guard against this, it is important that incentive plans contain appropriate indemnities. Where tax is payable under PAYE, social security charges (national insurance contributions (NICs)) will also be due. For the 2019–2020 tax year, employee NICs are charged at 12 per cent for earnings of between £166.01 and £962 per week. Above this threshold, they are uncapped at a rate of 2 per cent. Employers also have to account for NICs at a rate of 13.8 per cent in respect of employees with weekly earnings above £166. These are also uncapped, and create an additional uncertain liability for an employer. In recognition of this, it is possible for employer NICs to be transferred to an employee in certain limited circumstances, such as the exercise of share options.

Many employers are able to reduce their employer NICs by £3,000 every year by applying the employment allowance; however, this is no longer available for companies where the only employee is the director of that company, and from April 2020, it will be restricted to those organisations with an employer NIC liability of less than £100,000 in the previous tax year.

iii Tax deductibility for employers

Under UK law, the general rule is that a corporation tax deduction is available for expenses incurred wholly and exclusively for the purposes of a trade. Generally, employee salaries and associated costs such as employer social security contributions will be deductible under such principles. An exception to this is where the salary is paid more than nine months after the end of the period of account for which the deduction is claimed.[10] In these circumstances, any deduction is deferred until the accounting period in which the salary is actually paid.

A statutory corporation deduction is available in respect of employee share acquisitions and the exercise of share options provided certain conditions are met.[11] The conditions relate to the type of business carried on, the nature of the shares acquired and the employee's tax position. Anti-avoidance legislation restricts the availability of corporation tax deductions for contributions to employee benefit trusts to the point at which qualifying benefits or expenses are paid out of the contributions and within certain time limits.

iv Other special rules

A change in control (such as a takeover or share sale) can affect the statutory corporation tax relief available to a company on the exercise of options over its stock. Most plan rules state that options become exercisable following a change of control. One of the preconditions to claiming corporation tax relief in respect of such exercise is that the stock acquired is in a company either listed on a recognised stock exchange or not under the control of an unlisted company. Because an acquisition or takeover by a private or AIM-listed company[12]

10 Corporation Tax Act 2009, Section 1288.

11 Ibid., Part 12.

12 AIM is a sub-market of the London Stock Exchange.

might mean that this condition ceases to be met, a statutory provision was introduced to give corporation tax relief for a period of 90 days following a takeover by an unlisted or AIM company.[13]

When CSOP options are exercised within three years of grant, they can only receive favourable tax treatment in prescribed good leaver circumstances. These include injury, disability and redundancy, and cessation of employment within a group following a business sale or a sale of the subsidiary for which an individual works. Tax relief is also available when CSOP options are exercised in the event of certain cash takeovers. Some companies have historically experienced difficulties with their CSOP options on a takeover as their shares often cease to satisfy the statutory requirements following a change of control. To remedy this, legislation specifically preserves income tax relief where the plan rules permit options to be exercised 20 days either side of a change of control.[14]

In the United Kingdom, the tax rules for benefits can be complex. While some are taxable under a statutory regime known as the benefits code,[15] others are subject to their own special rules. Some benefits (such as employer contributions to registered pension schemes, within prescribed limits) are exempt from tax altogether. In the past, payment in the form of benefits in kind has been used as a means of avoiding social security contributions. This is less prevalent now that most benefits attract NICs. Some companies offer their employees a range of benefits from which they can make a selection to suit their particular circumstances. These are known colloquially as 'cafeteria' or 'flex' schemes, and usually involve the allocation of points or credits that can be spent in purchasing benefits. Under salary sacrifice arrangements, employees are allowed to give up a proportion of their taxable pay in exchange for a tax-exempt benefit such as employer pension contributions or childcare vouchers. These need to be structured carefully to ensure that the desired tax result is achieved. Following concerns that these optional remuneration arrangements were being used too widely, measures were introduced to restrict the benefits that can attract tax and NIC relief through salary sacrifice to pension, childcare and certain health-related benefits.[16]

A tax exemption exists for qualifying business expenses that are paid or reimbursed by an individual's employer.[17] Certain forms of termination payment can benefit from a £30,000 tax-free allowance[18] (and escape social security contributions in their entirety). Following a review of the tax and NICs treatment of termination payments, legislation was introduced in the second Finance Act of 2017 to provide that from 6 April 2018, all notice pay (whether contractual or otherwise) is subject to income tax and social security contributions as earnings.[19] From April 2020, termination payments above the £30,000 allowance will be subject to employer social security contributions as well as income tax.

13 Corporation Tax Act 2009, Section 1016(1A).

14 Income Tax (Earnings and Pensions) Act 2003, Schedule 4, subparagraphs 25A(7A) to (7F).

15 Ibid., Section 63(1).

16 Ibid., Section 69A.

17 Income Tax (Earnings and Pensions) Act 2003, Section 289A.

18 Ibid., Sections 401 to 416.

19 Finance (No. 2) Act 2017, Section 5(3).

III TAX PLANNING AND OTHER CONSIDERATIONS

An individual coming to work in the United Kingdom who is not domiciled here can claim to be taxed on the remittance basis in respect of their overseas earnings. These are broadly earnings with a foreign employer (i.e., one that is non-UK-resident) where the duties of an employment are performed wholly outside the United Kingdom (it should be noted that duties performed in the United Kingdom that are merely incidental to those carried out abroad are ignored for this purpose). To be taxed on this basis, some individuals enter into dual contracts under which their UK and non-UK employments are separated, although the circumstances in which the remittance basis of taxation will be available under such arrangements are limited.

Where individuals do not have separate employments, they might be able to claim overseas workday relief on their non-UK duties. Overseas workday relief is only available to individuals who are non-UK-domiciled and based here for fewer than three years.

It is not possible to avoid UK tax simply by providing services through a personal services company. Legislation exists that deems payments made to service companies to be employment income if, were it not for the existence of the service company, the relationship between the client and worker would be one of employment.[20] If a worker is within the charge of UK income tax, these anti-avoidance rules apply wherever the company is incorporated or resident. The government recently modified the rules applicable to agencies, and the Finance Act 2017 introduced anti-avoidance legislation applicable to off-payroll workers in the public sector.[21] From April 2020, these rules will be extended to the private sector.

The United Kingdom has a wide network of double taxation treaties, most of which are based upon the OECD Model Convention. These usually include a tie-breaker clause to determine the residence of an individual, and articles dealing with taxing rights over employment income and the avoidance of double tax. In circumstances where there is no double taxation treaty, UK domestic law can give unilateral relief for overseas tax as a credit against an individual's UK tax liability.

In September 2013, an additional form of employment status, the employee shareholder, was introduced.[22] An individual adopting this status exchanged certain employment rights for tax advantaged shares in the business for which they worked. The tax reliefs given to this status were reduced with effect from 17 March 2016[23] and were removed completely for shares acquired in consideration of employee shareholder agreements made on or after 1 December 2016.[24]

IV EMPLOYMENT LAW

i Non-competition covenants

In the United Kingdom, the use of non-competition covenants in employment contracts for executives is commonplace. While historically their value has tended to be found in their being a form of deterrent rather than an enforceable right, in recent years the courts have

20 Income Tax (Earnings and Pensions) Act 2003, Part 2, Chapter 8.

21 Finance Act 2017, Section 6, Schedule 1.

22 Growth and Infrastructure Act 2013, Section 31 and Finance Act 2013, Section 55 and Schedule 23.

23 HM Treasury: Budget 2016, Paragraphs 1.126 and 2.193.

24 Finance Act 2017, Sections 12 to 14.

perhaps shown a greater willingness to uphold non-competition covenants. In each case, the courts will look carefully at whether a covenant is necessary to protect the relevant business. Covenants are only enforceable to the extent that they go no further than is necessary to protect the legitimate interests of a person's employer.

ii Non-solicitation covenants

Non-solicitation covenants are more likely to be successful if they relate to existing rather than potential customers. Other relevant factors will be the individual's role in attracting the business in question, his or her level of seniority, whether the individual had previously dealt with the particular customers in question and the loyalty of customers within that particular sector. As regards poaching employees, although there is no prohibition on an employee choosing to follow a former colleague, the courts have held that there are circumstances in which an employer has a legitimate interest in maintaining a stable workforce.[25]

iii Enforceability of restrictive covenants

Generally, the courts will also consider the geographical reach and time duration of restrictive covenants to ensure they go no further than is necessary. In light of the increasing globalisation of business, courts are perhaps more willing to enforce covenants with a wider geographical reach provided this is necessary to protect a business's interests.[26] There is no set time period, as in each case it is necessary to look at how long a covenant is needed to protect a particular business; however, six to 12 months is generally regarded as the upper limit of enforceability. If the employee in question is placed on garden leave (i.e., he or she is retained as an employee during his or her notice period, but not required to come into the workplace), this will affect the period of restriction the court is prepared to enforce. Recent case law has demonstrated that account will be taken of the time taken on garden leave when determining how long a post-termination covenant can last.[27]

Restrictive covenants in documents, such as share acquisition agreements and shareholders' agreements, are subject to the same rules on restraint of trade as those that appear in an employment contract. The courts are sometimes more willing to enforce broader restrictions contained in commercial documents that have been negotiated at arm's length. Any payments made to individuals for entering into restrictive covenants outside the terms of the employment contract are taxed as employment income. Usual practice is to allocate a specific proportion of any consideration to the restrictive covenant rather than leave it for the UK revenue authorities to attribute a larger sum.

iv Termination of employment

Where an executive's employment is terminated, there are a number of claims that he or she might bring against his or her former employer. A claim for wrongful dismissal can be made where an employer terminates a contract in breach of its terms. Usually this happens where an

25 See *Dawnay Day & Co Ltd v. D'Alphen and others* [1997] IRLR 285, where a one-year non-solicitation covenant in an employment contract applicable to directors and senior employees was held to be enforceable.

26 See, for example, *Egon Zehnder Ltd v. Mary Caroline Tillman* [2017] EWHC 1278 (Ch). The case was subsequently appealed to the Supreme Court on different grounds.

27 *Tullett Prebon plc and others v. BGC Brokers LP and others* [2010] EWHC 484 (QB).

employer does not give adequate notice of termination. If an employer amends an employee's contract without his or her consent or otherwise fundamentally breaches the contract, the employee might be able to resign and claim that he or she has been constructively dismissed.

An employee who has been unfairly dismissed may be able to bring a statutory claim either instead of or in addition to any claim for wrongful dismissal. In most cases, the employee must have worked for a minimum period of time to be eligible for such remedy, although there are exceptions. A claim must usually be made within three months of the dismissal, and the levels of compensation are in most cases limited by statute. Currently the compensation limit is the lower of £86,444 and a year's gross salary, plus a basic award of up to £15,750 (giving a maximum limit of £102,194), although this is revised every year.

An executive who has been singled out for whistle-blowing or because of their gender, age, race, religion, belief, sexual orientation, gender reassignment, marital status, pregnancy or maternity or disability could also have a claim in respect of which there is no limit on the compensation that can be awarded.

An employer seeking to effectively settle statutory claims brought by an employee can do so by entering into a settlement agreement. This is a binding agreement between the parties that has to meet certain statutory requirements, including a condition that the employee has received independent legal advice in relation to the agreement.

Companies incorporated in the United Kingdom might need to obtain shareholder approval in respect of termination payments made to directors. Such approval is also required where the payment is in connection with a transfer of a company's business or a takeover. There are exceptions for payments made pursuant to existing legal obligations or as damages, so these provisions generally apply to payments that are *ex gratia*.

Representative bodies of institutional shareholders, such as the Investment Association, produce guidelines on best practice for listed companies in respect of severance payments. Such companies will generally take these guidelines into account, as they can influence the way in which key shareholders will vote.

UK-incorporated companies whose shares are listed on the London Stock Exchange are subject to additional requirements in respect of termination payments. The Companies Act 2006 (see Section VII) requires quoted companies to submit their policies on termination payments to a shareholder vote at least once every three years. Any payments subsequently made in accordance with this policy must then be announced to the market.

V SECURITIES LAW

UK securities rules need to be taken into account when structuring share-based executive remuneration, and can primarily be found in the Financial Services and Markets Act 2000 (FSMA 2000) and the Prospectus Rules, which form part of the Financial Conduct Authority's (FCA) Rules and Guidance.

i The Prospectus Regulation Rules

The Prospectus Regulation Rules were introduced by the FCA to reflect the EU Prospectus Regulation,[28] which has applied in full from 21 July 2019. Under these Rules, it is unlawful

28 Regulation (EU) 2017/1129 which repealed the former Prospectus Directive 2003/71/EC.

for a company or firm, wherever incorporated or registered, to make an offer of transferable securities to employees in the United Kingdom unless a prospectus approved by the FCA (or the competent authority of another EEA state) has been published, or an exemption applies.

The starting position is the same for both private and publicly traded entities. In particular, transferable securities are defined as those that are negotiable on the capital market. Capital market is not defined and is given a broad interpretation.[29]

In the United Kingdom, the grant and subsequent exercise of an employee share option will not generally give rise to an obligation to publish a prospectus. This is because the FCA takes the view that employee share options (whether nil-cost or otherwise) that cannot be assigned or transferred by an employee to a third party (as is usually the case) are not negotiable on the capital market and, therefore, are not transferable securities. The FCA also considers that the exercise of an employee share option is not an offer of the underlying shares to the public. Whether private company shares are negotiable on the capital market is a matter of fact, depending on the rights of the shares in question.

There are a number of exemptions from the need to file a prospectus. For example, an offer currently falls outside the requirements of the Prospectus Rules if the aggregate consideration payable under the offer across the whole of the EEA is less than €8 million (increased in the UK from €5 million following the coming into force of the relevant provisions of the Prospectus Regulation) calculated over a period of 12 months,[30] or if the offer is made to fewer than 150 people in each EEA Member State.[31] Even where none of the above exemptions is available, a prospectus will not be needed for an offer made to employees provided certain conditions are met.[32] Instead, an employee information document will have to be made available to employees receiving the offer that contains information on the number and nature of the securities offered, and the reasons and details of the offer.[33] Historically, the exemption only applied to offers of securities to directors and employees of companies with a head office or registered office in the EEA, and to non-EEA companies with securities traded either on an EEA regulated market or a non-EEA market that was deemed by the European Commission to have an equivalent legal and supervisory framework.[34] Since 21 July 2019 (following changes made by the Prospectus Regulation[35]), the employee offer exemption ceased to be limited in this way, and it now applies to all companies wherever they are based and wherever their securities are traded.

ii The financial promotion regime

The financial promotion regime governs the circumstances and manner in which a company or firm can communicate an invitation or inducement to engage in an investment activity

29 For further information see the published non-binding guidance of the European Commission (in the form of questions and answers) on the interpretation of the Markets in Financial Instruments Directive, which contains further discussion of the definition of transferable securities.

30 Section 86(1)(e) of FSMA 2000 as amended. The threshold is calculated on an EEA-wide basis.

31 Section 86(1)(b) of FSMA 2000.

32 Prospectus Rules 1.2.2R(5) and Section 85(5)(b) of FSMA 2000.

33 For further guidance on the contents of the information document, see Paragraphs 173 to 176 of the European Securities and Markets Authority and Committee of European Securities Regulators guidance on the consistent implementation of Commission Regulation (EC) No. 809/2004 implementing the Prospectus Directive.

34 Prospectus Directive Amending Directive Instrument 2012 (FSA 2012/29).

35 Regulation (EU) 2017/1129.

to the public (including employees) in the United Kingdom. In particular, unless an exemption from the regime is available, any such communication must be made by a person authorised by the FCA or the Prudential Regulation Authority (PRA), or the contents of the communication must be approved by a person authorised by the FCA or the PRA. Breaching the financial promotion regime is a criminal offence.[36]

Communications to employees regarding the acquisition or sale of shares, and the grant or exercise of options, are likely to be caught by the application of the financial promotion regime. There is, however, a fairly broad exemption for participation in employee share schemes.[37] In particular, the restriction on financial promotions does not apply to any company or firm (or any member of the same group as such company or firm) where the communication is for the purposes of an employee share scheme.[38] As such, particular care must be taken to ensure that this exemption is available, and advice should be sought, especially when third parties (including in the context of a takeover) wish to communicate with employees of an unconnected company or firm regarding their share-based remuneration arrangements.

VI DISCLOSURE

This section summarises the requirements for disclosure of share dealings by directors and senior employees in the context of share-based executive remuneration. It should be read in conjunction with Sections VII and VIII.

i Private companies

For private companies and companies (wherever incorporated) whose shares are not admitted to trading on the Main Market of the London Stock Exchange or AIM, there are no requirements under English law for the disclosure of directors' or senior employees' interests in their shares. Companies may, however, be required to make certain disclosures in the directors' report forming part of their annual report and accounts, and the level of detail will depend on the accounting standards being used as well as the size of the company concerned.

ii Listed companies

The Listing Rules are published by the FCA and set out the minimum requirements for securities listed on the Official List. Chapter 5 of the Disclosure Guidance and Transparency Rules within the FCA Handbook provides that at the end of every calendar month during which an increase or decrease in the issued share capital of the company takes place, the company must disclose to the market the total number of shares in each class that it issues.

The EU Market Abuse Regulation[39] (MAR) came into force on 3 July 2016 and has had direct effect in the UK from that date. MAR replaced the UK's civil law rules on insider dealing (although not the criminal offence). It also prescribes when certain individuals may deal in a company's securities, and imposes disclosure requirements on those individuals and those closely associated with them. Although in broad terms the principles of disclosure and

36 Sections 21 and 25 of FSMA 2000.

37 Paragraph 60 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001.

38 See Paragraph 60(2) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 for a definition of employee share schemes.

39 Regulation (EU) No. 596/2014.

insider dealing remain very similar, MAR applies to AIM-listed companies as well as those whose shares are admitted to trading on the Main Market of the London Stock Exchange. Article 19(1) of MAR requires all persons discharging managerial responsibilities (PDMRs) (defined in the same way as FSMA 2000) and persons closely associated with them (PCAs) to notify both a company and the FCA of all transactions in the company's securities or financial instruments conducted on their own account or for the account of a third party. The notification must be made within three business days of the transaction, and the company must announce the transaction within the same time limit. Under MAR, companies must tell PDMRs about their disclosure obligations and keep a list of both the PDMRs and their PCAs. PDMRs must, in turn, notify each of their PCAs in writing of their disclosure obligations.

MAR imposes additional restrictions on when PDMRs can and cannot deal in shares and securities. Although there is no requirement for companies with shares on the Official List to have a dealing policy, as a matter of good practice, most companies choose to have such a policy to ensure PDMRs and their PCAs comply with their obligations under MAR.

PDMRs of companies whose shares are admitted to trading on the Main Market of the London Stock Exchange by way of standard listing must comply with MAR.

Companies whose shares are admitted to trading on AIM must, as well as complying with MAR, comply with the AIM Rules for Companies. The AIM Rules impose a requirement for AIM companies to have a reasonable and effective dealing policy.

VII CORPORATE GOVERNANCE

The UK corporate governance regime comprises a mixture of statutory rules, codes and investor guidelines. The extent to which these apply to a company will often depend upon where the company is incorporated, whether it is a quoted company, the size of the company and, in some cases, the type of activity undertaken by it.

i Statutory controls

The Companies Act 2006 sets out rules that apply to UK-incorporated companies, including requirements that:

a details of directors' remuneration are disclosed in a company's annual report and accounts;[40]

b shareholder approval is obtained for certain termination payments made to directors;[41] and

c service contracts lasting longer than two years are approved by shareholders.[42]

UK-registered quoted companies[43] are subject to an additional requirement to produce an annual report on their directors' remuneration, which is subject to a shareholder vote. Since 1 October 2013, the directors' remuneration report has been split into two parts. The first part comprises the policy report. This sets out the company's current and future policy on

40 Companies Act 2006, Section 412.

41 Ibid., Section 217.

42 Ibid., Section 188.

43 Broadly, those whose equity share capital is included in the FCA's Official List, officially listed in an EEA state or admitted to dealing on the New York Stock Exchange or NASDAQ. This does not include companies traded on AIM.

executive remuneration, and is subject to a binding vote (i.e., 50 per cent approval is required) at least every three years. The second part of the report sets out how the policy has been implemented during the year and is subject to an annual advisory vote. If the implementation report is not passed, a vote on the policy report is required at the next AGM. The company's approach to exit payments needs to be included in the remuneration policy, and is therefore subject to a binding vote.

The Companies (Miscellaneous Reporting) Regulations 2018 were published on 17 July 2018. The Regulations contain various new reporting requirements for public and private companies that will require them to more clearly explain decisions on executive pay. One of the key changes is a new requirement for UK-registered quoted companies with more than 250 UK employees to report pay ratio information comparing the remuneration of their CEOs with the 25th, 50th and 75th percentiles of the full-time equivalent remuneration of companies' UK employees. The new requirements apply in relation to financial years starting on or after 1 January 2019: this means that reporting will begin in 2020, covering activities undertaken and information collected in 2019. On 22 May 2019, the Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019[44] were published, and those Regulations came into force on 10 June 2019. They introduce amendments to the UK's reporting requirements necessary for compliance with the EU Shareholder Rights Directive II.[45] One key change is the extension of the reporting requirements to people who are not on a company's board of directors but are carrying out the function of a CEO or deputy CEO.

ii Regulatory controls

The Financial Reporting Council (FRC)[46] publishes the UK Corporate Governance Code (Code), which sets out standards of good practice in relation to board behaviour, including remuneration, accountability and the board's relationship with shareholders. The Code is technically voluntary; however, all companies with a premium listing of equity shares in the UK, whether incorporated in this country or not, are required to report on whether they have applied the Code and explain areas of non-compliance.[47]

The Code requires executive directors' remuneration to be designed to promote the long-term success of the company. It states that the performance-related elements of directors' remuneration should be 'stretching' and applied rigorously and, where appropriate, companies should consider using non-financial performance metrics, such as customer satisfaction, as well as financial measures. It also includes a requirement that performance-related plans for executive directors include provisions that enable a company to recover sums paid or withhold the payment of any sum (i.e., *malus* and clawback) but leaves it to the remuneration committee to determine the circumstances in which this should apply.

44 Statutory Instrument 2019 No. 970.

45 Directive (EU) 2017/828.

46 The FRC is the independent regulator in the UK with responsibility for promoting good corporate governance.

47 A company with a premium listing on the Official List must meet the most stringent standards.

In July 2018, the FRC published a revised UK Corporate Governance Code that takes effect for financial years beginning on or after 1 January 2019.[48] One key change is that the Code stipulates that a company should engage with its workforce through one or a combination of the following: appointing a director from the workforce, creating a designated non-executive director or establishing a formal workforce advisory panel. If the company does not choose one of these methods, it should explain what alternative arrangements are in place and why it considers them to be effective.

iii Institutional investor guidelines and the Stewardship Code

Shareholders of listed companies are encouraged to use their voting powers to ensure good corporate governance. Institutional investors (such as pension funds and insurance companies) are represented by investment committees, many of which publish guidelines for best practice on share-based remuneration. The respective guidelines issued by the Investment Association, the Pension and Lifetime Savings Association and the Pensions and Investment Research Consultants Ltd are often considered by firms as relevant.

The Stewardship Code was first published by the FRC in 2010 and revised in 2012. Following a consultation in January 2019, the FRC expects to publish a substantially revised Code in October 2019. The Code sets out good practice for institutional investors when engaging with companies listed in the United Kingdom, and remuneration is one of a number of things that must support their stewardship activities. The principles within the Stewardship Code apply on a comply or explain basis, and state that institutional investors should have a clear policy on voting and should vote all the shares they hold. The FRC is keen to encourage overseas investors holding shares in UK-listed companies to comply with the Stewardship Code, and for UK institutional investors to apply it to their overseas holdings. An FCA rule requires each authorised firm that manages investments for professional clients (other than venture capital firms) to disclose clearly the nature of its commitment to the Stewardship Code or, where it does not commit to that Code, its alternative investment strategy.

iv The Listing Rules

The Listing Rules provide that certain forms of incentive arrangement require prior shareholder approval before they can be implemented. These include employee share schemes involving the issue of new shares, and long-term incentive plans in which directors are entitled to participate.[49]

v AIM and private companies

Private companies and companies with securities traded on AIM do not need to comply with the Listing Rules, but have their own rules and source of corporate governance guidelines, such as the Corporate Governance Code published by the Quoted Companies Alliance, the Corporate Governance Policy and Voting Guidelines for Smaller Companies published by the Pensions and Lifetime Savings Association, the Institutional Shareholder Services UK and

48 Financial Reporting Council: the UK Corporate Governance Code – July 2018: www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf.

49 Listing Rule 9.4.1.

Ireland Proxy Voting Guidelines and the European Corporate Governance Guidelines. Since 28 September 2018, AIM companies have been required to adopt a corporate governance code,[50] and to explain compliance with, and departure from, that code. In December 2018, the Wates Corporate Governance Principles for Large Private Companies were published, and they apply in relation to financial years starting on or after 1 January 2019.[51] Although the Principles apply only to very large companies, they are intended to be a structure for helping private companies of all sizes to adopt good practices in corporate governance.

VIII SPECIALISED FINANCIAL SERVICES REGULATORY REGIMES

In common with many other developed countries, the remuneration of staff who work in the UK financial services sector has been subject to an increasing degree of scrutiny and regulation in recent years. This has been heavily shaped by EU legislation. Generally, the strictest and most well-developed regulations have been applied first to systemically important banks, with similar provisions gradually extended to the wider financial services sector. From 2013 onwards, there has been a significant increase in the number of different remuneration codes applied by the FCA and PRA to different types of financial services firms, reflecting the implementation of various EU regimes and the separation of responsibility between the two regulators. The current set of codes is shown below:

Short title	Basic scope	Location	Applied from
CRR Firms Remuneration Code	Banks, building societies and PRA-designated investment firms. Previously, these firms were covered by the IFPRU Remuneration Code	Remuneration part of the PRA Rulebook for CRR firms	2015
IFPRU Remuneration Code	IFPRU investment firms	Senior management arrangements, systems and controls (SYSC) 19A in the FCA Handbook	2014 (but successor to the FSA Remuneration Code)
AIFM Remuneration Code	Managers of alternative investment funds (AIFMs)	SYSC 19B in the FCA Handbook	2013
BIPRU Remuneration Code	BIPRU investment firms	SYSC 19C in the FCA Handbook	2014 (but successor to the FSA Remuneration Code)
Dual-Regulated Firms Remuneration Code	Banks, building societies and PRA-designated investment firms. Previously these firms were covered by the IFPRU Remuneration Code	SYSC 19D in the FCA Handbook	2015
UCITS Remuneration Code	Management companies of undertakings for collective investment in transferable securities (UCITS)	SYSC 19E in the FCA Handbook	2016
Remuneration and Performance Management	MiFID investment firms, firms benefiting from the Article 3 MiFID optional exemption Insurance distributors	SYSC 19F.1 in the FCA Handbook SYSC 19F.2 in the FCA Handbook	2018

50 AIM Rule 26.

51 https://www.frc.org.uk/news/december-2018(1)/wates-principles-to-improve-corporate-governance-s.

PRA-regulated insurers that are subject to the Solvency II Directive must comply with remuneration rules in the Solvency II Delegated Regulation, but as these are directly applicable, they have not been transposed into the PRA Rulebook.

Whatever happens with regards to Brexit, these EU-driven remuneration requirements will continue to apply in the UK.

i General principles

Broadly, the general principle of the codes is that firms should establish and maintain remuneration policies and practices that promote sound and effective risk management. Some firms may find that they are subject to more than one code.

The codes are generally divided into a number of principles, some of which apply to the whole firm and others of which apply only to staff whose activities have a material impact on the firm's risk profile (known as code staff). In certain cases, other requirements attach to senior managers and groups.

Although many of the requirements in the different codes are similar and reflect broadly correlative EU standards across industry sectors, there are nonetheless key differences between them that may make applying some codes more onerous. For example, the CRR Firms Remuneration Code, the IFPRU Remuneration Code and the Dual-Regulated Firms Remuneration Code each contain a specific bonus cap requirement derived from the CRD IV Directive. This requires that the variable remuneration of code staff must not exceed 100 per cent of fixed remuneration, or 200 per cent if shareholder consent has been obtained. The other codes do not apply a hard numerical cap of this nature.

The SYSC 19F.1 code is designed to implement the MiFID II remuneration requirements in the UK.[52] It is considerably shorter than the other codes, and contains provisions that are generally less prescriptive (but see below as regards the new EU prudential regime for investment firms, which will introduce stricter requirements in due course). Broadly, SYSC 19F.1 imposes an overarching obligation on relevant firms to ensure that when they are providing MiFID investment services to clients they do not remunerate or assess the performance of staff in a way that could create a conflict with the duty to act in clients' best interests. The code applies to all sales staff and also to other individuals, including senior management, to the extent that their remuneration could create a conflict encouraging them to act against the interests of clients. The SYSC 19F.2 code contains additional remuneration requirements applicable to firms acting as distributors of insurance products. These requirements are very similar to those that apply to MiFID services under SYSC 19F.1, essentially requiring firms to ensure that they do not use remuneration structures, sales targets or other arrangements that could conflict with their duty to act in their clients' best interests, or that could incentivise staff to recommend particular insurance contracts when other products would better suit their clients' needs.

In late 2020 or early 2021, a new regulation on prudential requirements for MiFID investment firms (IFR) and an accompanying Directive (IFD) will become law. This package will include stricter remuneration requirements for MiFID investment firms, which are modelled on those in CRD IV/CRR (but without the bonus cap). The FCA will implement the IFD's remuneration requirements into its Rulebook.

52 Directive 2014/65/EU.

From time to time, European regulators issue guidance on the EU legislation underpinning certain codes, which may require the FCA and PRA to reassess the UK domestic implementation of those rules. For instance, the European Banking Authority (EBA) issued guidelines in 2015 that emphasised that role-based allowances (which a number of British banks had paid as fixed remuneration to avoid the bonus cap) must be considered to be variable remuneration unless they meet strict criteria to be classified as fixed remuneration under rules implementing CRD IV.

Where a firm breaches an applicable remuneration requirement, the FCA or PRA (or both) may take appropriate enforcement action.

ii Proportionality

Not all firms have to give effect to the remuneration requirements in the same way and to the same extent. Each of the codes (with the exception of those in SYSC 19F) contains the concept of proportionality, under which firms must comply with the requirements in a manner and to the extent that is appropriate to their size, internal organisation and the nature of their activities. The FCA and PRA have produced guidance for many of the codes explaining the relevant factors in determining how proportionality applies. Firms of greater significance and posing the greatest risk to financial stability fall within the highest proportionality level and will have the greater levels of compliance.

Proportionality has been a key political issue, and in this regard things are changing. In February 2016, the FCA and PRA refused to apply the EBA's interpretation of proportionality under the CRD IV regime with the result that, except for the largest banks, relevant UK firms did not have to apply the bankers' bonus cap or apply the payout process rules regarding variable remuneration. However, the application of proportionality under the CRD regime will now be subject to revisions set out in the CRD V Directive, which was published in the Official Journal in June 2019 and which must be transposed by Member States by 28 December 2020. Broadly, these changes will have the effect of applying the bonus cap to all material risk-takers within a firm, whatever its size. The pay-out process rules governing payment of variable remuneration in instruments and deferral of variable remuneration will only apply to identified large institutions and other firms with more than €5 billion of assets; however, the requirement for *malus* and clawback will apply to all firms. This represents a marked change from the current UK approach, and it remains to be seen how the UK will implement these requirements against the backdrop of Brexit.

Proportionality is also a relevant issue as regards the remuneration requirements under the forthcoming IFD regime for MiFID investment firms. While there will not be a bonus cap, the pay-out process rules will be similar to those under the CRD V regime, although they will be disapplied in the case of firms with assets of €100 million or less. As with the banking regime, *malus* and clawback will apply to all.

iii Remuneration policies, record-keeping and reporting

Firms must ensure that their remuneration policies and practices are clear and well-documented, and that proper records are kept to evidence compliance with the applicable codes. Certain firms may also be required to report remuneration details to the FCA or PRA on an annual basis for comparison and benchmarking purposes, and to make public disclosures of certain aggregated remuneration data.

IX DEVELOPMENTS AND CONCLUSIONS

It will be interesting to see how the new corporate governance changes impact on executive remuneration over the next few months. In its response to a recent cross-party report on executive pay that calls for further reforms, the government stated that its immediate priority is to focus on the effective implementation and assessment of the most recent changes before taking any more significant steps. With Brexit continuing to dominate Parliament's time (and a general election not out of the question), it remains the case that large-scale legislative developments in the field of incentives and remuneration cannot be expected. For private sector clients hiring workers through intermediaries in the gig economy, the changes to the off-payroll rules are bound to have an impact on how they structure such engagements going forward.

Appendix 1

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