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Briefing note

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Incentives News

It's been a busy summer for share plans and remuneration. This edition of Incentives news brings you a round-up of some of the key developments:

- practical issues around the Market Abuse Regulation
- guidance on executive pay reporting
- consultation on proposed changes to the tax treatment of termination payments.

Market Abuse Regulation: Practical points for share plans

The EU Market Abuse Regulation (MAR) took effect on 3 July 2016 with the aim of updating and strengthening the existing EU Market Abuse regime.

From a UK perspective, the position for share plan dealings is broadly unchanged. For share plans the key impact has been the deletion of the Model Code, with the result that many of the helpful share plan exemptions no longer exist. Instead, it is a case of working through MAR to find the answer. Fortunately, in the majority of cases the outcome will be the same as before but the analysis to get to that position will be different.

Now that we are 2 months into the new regime, we highlight a few practical points that companies have been grappling with.

- **Do we need to amend our share plan rules?**

  For the majority of companies, no changes are needed to share plan rules as the company's share dealing code should state whether dealings are permitted in closed and prohibited periods. Some companies may choose to make minor changes to their plan rules, particularly around vesting of LTIP awards and sales of shares for tax (see below), and it should be possible for those changes to be made without the need for either shareholder or participant approval.

- **Can remuneration committees determine the outcome of performance conditions during a period when there is inside information?**

  There had been some suggestion that remuneration committee will need to change the time at which they considered performance conditions so that this was not undertaken during a period where there was inside information, meaning a change to the standard board timetable. In our view, that is not necessary. In many cases, the application of performance conditions will be formulaic or mechanical and the remuneration committee may have no or little judgement or discretion to exercise so it is difficult to see that there would be a "transaction" by the committee caught by MAR. Even where there is discretion, the committee may be able to evidence that their decision is not based on the inside information (although this will depend on the type of information considered).

- **Now that the Model Code has been abolished, do we still need to notify participants in tax qualifying plans of dealing restrictions?**

  HMRC has previously confirmed that the Model Code was a restriction on shares, and that participants would need to be notified of this restriction when granted tax qualifying options or shares. Many companies included reference to the Model Code in their grant documentation to deal with this.

  HMRC have confirmed that the introduction of MAR does not change the position, and companies must still notify participants of dealing restrictions such as the company's share dealing code. This does not have to be in the grant documentation itself, and it ought

to be sufficient to notify participants of their dealing restrictions separately provided this is reasonably close to the time of grant.

- **Can we still allow "blanket" clearance to deal?**

  It remains possible under MAR for blanket clearance to be given. This may be useful for regular share plan dealings such as purchases of partnership shares under a SIP or the grant of awards.

- **Does MAR offer more flexibility for share plans than the old regime?**

  On the whole, no. But one area where MAR is more flexible than the old regime is for the vesting of conditional awards/RSUs. Under MAR it is possible for awards to vest during a period when there is inside information if this vesting is truly automatic. Equally, shares can be sold following that vesting (e.g. to pay tax arising) provided this is also automatic (i.e. it is part of the plan rules or documentation or an individual has made an irrevocable agreement to sell shares in an open period).

  Although it is still early days, we are seeing mixed market practice on this point. Some companies like the thought that vesting and sales can continue regardless of whether there is inside information. Others take the view that they would not want vesting to occur during a period where there is inside information for optical reasons, particularly since this would need to be announced to the market for directors and other PDMRs. This is one for companies to consider carefully.

  Another area which is helpful is the "safe harbour" provision within MAR. This allows a company to continue with share plan dealings during a prohibited period (but not a MAR closed period) where those dealings are conducted by individuals who are not themselves insiders (e.g. authority has been delegated, during an open period, to non-insiders to grant regular awards when a company is in a prohibited period).

Updated guidance from GC100 on executive pay

The GC100 and Investor Group have published updated Directors' Remuneration Reporting Guidance for 2016. The previous version was published in 2013, shortly before the regime for UK plcs to have a remuneration report and policy voted on by shareholders came into force.

While the guidance remains similar to the original version, there are some changes and the guidance is in places worded more strongly than the original version. Key changes include:

- Remuneration committees are encouraged to apply discretion, either upwards or downwards, to ensure that pay reflects performance of the company. Where formulaic performance outcomes do not match the company's overall financial performance, the committee should give careful consideration to moderation of that formulaic outcome.
- Remuneration committees should have suitably broad discretion so that they can address unexpected developments during the life of a remuneration policy and should draft and explain it in such a way that investors can be confident that discretion will be only used in exceptional circumstances. Publishing assurances regarding the exercise of discretion (as some companies did in 2014) is undesirable.
- Companies can choose not to disclose performance targets where these are commercially sensitive and this has been an area of concern for investors. The guidance confirms that a decision not to disclose targets should not be taken lightly and that, for short-term incentives, retrospective disclosure is expected at the end of the reported year or, if still sensitive at that stage, later with ideally a specific date being given for disclosure. In addition, the full range of targets is expected to be disclosed retrospectively. For long-term incentives, investors generally expect both prospective and retrospective disclosure and where targets are not disclosed, the committee should give qualitative commentary during the performance period to give an indication of projected vesting. The remuneration report must indicate the fact that information is not included and indicate when it will be published.
- Where the percentage change in CEO pay verses a comparator group is reported, investors expect a meaningful comparator group to be used and not, for example, a narrow group of senior managers.
- The chairman's statement should emphasise the link between pay and performance and the company's strategy with close

correlation between the remuneration report and the annual strategic report.

- The guidance reinforces that a maximum should be included for each remuneration component for each director in the remuneration policy. And sub-bullets.

Termination payments: changes to tax and NICs treatment

In August, HMRC published a consultation on changes and simplification to the tax and NICs treatment of termination payments, with any changes applying from April 2018. The consultation includes draft legislation on income tax and draft NICs legislation is due to be published in the autumn.

The key changes proposed are:

- The £30,000 exemption from income tax for termination payments will be retained as will the employee NICs exemption for the entire termination payment;
- Significantly, employer NICs will be payable on termination payments above the first £30,000. This is the most significant proposed change;
- The consultation also proposes that all payments an employee would have received in their notice period should be subject to tax and NICs. This impact of this is that all PILONs, whether contractual or non-contractual, will be fully taxable and will not qualify for the £30,000 exemption;
- Foreign service relief will be removed; and
- It is proposed to clarify the exemption for payments relating to injury to confirm that this does not apply in the case of injured feelings (and only to physical/psychological injury).

The consultation closes on 5 October 2016 and if you are interested in making a submission, please let us know.

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