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Incentives Bulletin

February 2019

Welcome to the February edition of our Incentives Bulletin, updating you on the latest developments in remuneration and share schemes. This month, we look at the **Institutional Voting Information Service guidance on the new Investment Association (IA) Principles of Remuneration**, the **IA analysis of the 2018 AGM season,** the **impact of a "no deal" Brexit on EU-wide employee share schemes** and the **Government's new guidance on gender pay gap reporting**. We conclude with a timeline of **key dates in employee incentives** coming up in the near future.

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IVIS approach to new Investment Association Principles of Remuneration

Summary and key practice point: As we reported back in December, the Investment Association published new Principles of Remuneration for 2019. Following this, IA members asked the ABI's Institutional Voting Information Service (IVIS) to take a specific approach in relation to the new principles concerning pension contributions and post-employment holdings periods for 2019 AGMs. IVIS has now outlined its approach, for companies with year-ends on or after 31 December 2018.

The new IVIS guidance highlights that investors are beginning to take these issues very seriously. IVIS has made clear that it will "amber top" (flagging to investors a serious issue to be considered) or even "red top" (flagging the most serious level of concern) Remuneration Policies that fail to reflect the updated Principles in these two respects.

More detailed analysis/commentary: The new Investment Association Principles of Remuneration Principles recommend that, in respect of the UK Corporate Governance Code's new policy on post-employment shareholding requirements, such requirements should apply for at least two years at a level equal to the lower of the company's shareholding requirement in force immediately before leaving or the executive's actual shareholding on leaving. This requirement should be introduced at the earliest opportunity and by the next remuneration policy vote at the latest; and the Remuneration Committee should explain how it will ensure such requirements are enforced/maintained.

The Principles also recommend that the pension provision for executive directors should be in line with the general approach for employees as a whole or “the rate which is given to the majority of the workforce”. New joiners should be introduced on these contribution rates, and the rates for incumbent directors should be reduced over time, without compensation.

The new Institutional Voting Information Service (IVIS) guidance shows that these are issues that investors are taking seriously.

On **post-employment holding periods**:

- If there is a Remuneration Policy vote in 2019, the policy should include post-employment holding periods in line with the Principles of Remuneration; if not the Remuneration Policy will be “amber topped” by IVIS.
- If there is no 2019 policy vote, those companies not in line with the Principles will be noted.

On **executive director pensions**:

- For new appointments (including new joiners and promotions):
  - New Remuneration Policies seeking shareholder approval in 2019 should make it explicit that any new appointees will have their pension contributions set in line with the pension contributions provided to the majority of the workforce. Otherwise IVIS will “red top” the Policy Report (flagging to investors that IVIS has a serious concern).
  - If new appointees from 1 March 2019 have pension contributions at a higher level than the pension contributions provided to the majority of the workforce, IVIS will red top the Remuneration Report.
- For existing directors:
  - Approval of Remuneration Policies and Remuneration Reports where an executive director receives a pension contribution of 25% of salary or more will be amber topped.
  - Companies should disclose the pension contribution level which they consider to be the level for the majority of the workforce. Remuneration Reports should confirm if the pension contributions for new joiners, new appointees or existing executive directors are at the level for the majority of the workforce.

Investment Association analysis of shareholder dissent in the 2018 AGM season

Summary and key practice point: The IA has reported that shareholder rebellions rose by over a quarter in 2018, with opposition to individual director re-elections a key theme. Overall dissent in respect of executive pay fell slightly compared to 2017. However, in the FTSE 100, 18 pay resolutions attracted more than 20% dissent from shareholders, double the figure in 2017.

More detailed analysis/commentary: On the issue of executive pay, the Chief Executive of the Investment Association, Chris Cummings said:

> *“While executive pay declined overall as an issue, there was a deeply disappointing jump in the number of FTSE 100 companies that saw pay rebellions in 2018. Shareholders clearly remain unimpressed with the approach to pay last year, and are frustrated the message is not getting*

> *through to some boardrooms. FTSE 100 companies must do more to ensure the pay packets of their top team align with company performance and remain at levels that shareholders find acceptable"*

The increasing number of votes against the pay packages of the top executives, along with the comments from the IA, indicate a growing sense from investors that there is such a thing as "too much" pay, even when companies are performing well.

EU Prospectus rules in the event of a "no deal" Brexit

Summary and key practice point: In the event of a "no deal" Brexit on 29 March 2019, UK companies will cease to be fully exempted from the EU prospectus regime when offering shares into the EU under an employee share scheme. If it arises, this issue will only be a temporary one, as non-EEA companies (including those from the UK) will from 21 July 2019 be able to rely on a new broader employee share scheme exemption from the EU prospectus regime.

Nonetheless, in the event of a "no deal", companies offering shares into the EU under employee share schemes may need to give further thought to other exemptions that individual issuances may fall within (e.g. based on the number of participants or the total value). If it is not possible to fall within another exemption, it may be preferable to delay further grants until after 21 July 2019.

More detailed analysis/commentary: Under the current regime, the EU Prospectus Directive, EEA headquartered companies are exempted from filing a prospectus when offering shares in the EU under an employee share plan. However, non-EEA companies offering their shares to employees in the EU are currently required (in some cases) to prepare and file an EU prospectus, this is a time consuming and expensive process.

The EU Prospectus Regulation, which comes into full force on 21 July 2019, will exempt all companies, wherever their headquarters are, from the requirement to prepare a prospectus for shares offered in the EU under an employee share plan.

In the event that a Withdrawal Agreement (WA) takes effect, it is expected that the UK will for most purposes continue to be treated by EU law as a Member State during the transition period. Therefore, in the period from 29 March 2019 (or a later date on which the WA is ratified) to 21 July 2019, UK companies would be able to continue to rely on the existing exemption. After 21 July 2019, the UK will be able to rely on the new broader exemption, irrespective of whether it remains a member of the EEA in the future.

However, in the event that the UK leaves the EU without a Withdrawal Agreement before 21 July 2019, it will cease to be an EEA country before the new exemption comes into force. In this scenario, there could be a 4 month period in which UK issuers are not exempt from filing a prospectus in relation to offering shares in the EU under an employee share plan.

Government guidance to help employers close the gender pay gap

Summary and key practice point: On 8 February, the Government Equalities Office (GEO) published new guidance aimed at helping employers understand and tackle their organisation's gender pay gap. The guidance comes in two parts: "Eight ways to understand your gender pay gap" and "Four steps to developing a gender pay gap action plan". The guidance has been published ahead of the deadline for the second year of gender pay gap reporting on 4 April 2019.

More detailed analysis/commentary: **"Eight ways to understand your gender pay gap"** poses eight questions to employers in relation to the gender pay gap:

- Do people get 'stuck' at certain levels within your organisation?
- Is there gender imbalance in your promotions?
- Are women more likely to be recruited into lower paid roles in your organisation?
- Do men and women leave your organisation at different rates?
- Do particular aspects of pay (such as starting salaries and bonuses) differ by gender?
- Do men and women receive different performance scores on average?
- Are you doing all that you can to support part-time employees to progress?
- Are you supporting both men and women to take on caring responsibilities?

The guidance explains how the data collected for the purposes of gender pay gap reporting can help to answer these questions and explain the cause of a gender pay gap.

"Four steps to developing a gender pay gap action plan" is designed to help employers develop a plan to understand their gender pay gap and signal to employees and the public. The four steps the government recommends are:

- Analyse your data and identify actions – organisations should use the eight questions above to understand the causes of their specific gender pay gap and use that information to identify evidence driven actions to address it.
- Consult and engage – gain buy-in from senior people and involve a wide range of stakeholders.
- Revive, assess and embed your action plan – monitor actions and let plans evolve, embed them and ensure they become part of your 'business as usual' activity.
- Allow enough time – developing an effective action plan will take time; it is an ongoing and iterative process.

Horizon scanning

What key dates and developments in employee incentives should be on your radar?

29th March 2019	European Union (Withdrawal) Act 2018 to take effect
4th April 2019	Gender pay gap reporting deadline
6th April 2019	Extension of holding period to qualify for entrepreneurs' relief extended to two years from disposals made on or after this date
April 2019	Annual updates to employment rates and limits

Jonathan Fenn
T +44 (0)20 7090 5025
E Jonathan.Fenn@slaughterandmay.com

Padraig Cronin
T +44 (0)20 7090 3415
E Padraig.Cronin@slaughterandmay.com

Phil Linnard
T +44 (0)20 7090 3961
E Phil.Linnard@slaughterandmay.com

Ian Brown
T +44 (0)20 7090 3576
E Ian.Brown@slaughterandmay.com

Dated February 2019