

Incentives Bulletin

October 2019

Welcome to the October edition of our Incentives Bulletin, updating you on the latest developments in remuneration and share schemes. This month, we look at the **Investment Association's** latest guidance on **executive director pension provision**, HMRC's Employment Related Securities Bulletin 33, the **FCA's** letter to level 1 firms in relation to the **2019/20 remuneration round** and the updated **GC100 and Investor Group** guidance on **directors' remuneration reporting**. We end with a timeline of **key dates** in employee incentives coming up in the near future and, with the **2020 AGM season** around the corner, we have also included a list of key issues to consider for **2020 remuneration policies**.

Investment Association's guidelines on executive director pension provision

Summary and key practice point: On 27 September 2019, the Investment Association announced new [guidelines](#) on executive director pension provision for the 2020 AGM season. This more restrictive guidance highlights the focus that major investors are placing on the size of directors' retirement benefits as part of their overall fixed pay package.

The new guidelines follow changes to the UK Corporate Governance Code and the IA's updated Principles of Remuneration on executive pension contributions. The IA's guidance set out investors' expectations to see executive directors paid pension contributions in line with the majority of the workforce. The IA says that, as the next step, for companies with year-ends on or after 31 December 2019, the IA's Institutional Voting Information Service (IVIS) will:

- "Amber top" (flagging to investors a serious issue to be considered) any company with an existing director who has a pension contribution of 25% of salary or more, as long as they have set out a credible plan to reduce that pension to the level of the majority of the workforce by the end of 2022. If there is no credible plan, the company will be "red-topped" (the highest level of warning).
- "Red top" any company who appoints a new executive director (or a director changes role) with a pension contribution out of line with the majority of the workforce, or seeks approval for a new

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remuneration policy which does not explicitly state that any new director will have their pension contribution set in line with the majority of the workforce.

The guidelines also note that:

- IVIS will highlight those companies that do not disclose in their remuneration report the pension contribution rate for the majority of the workforce. The Remuneration Committee should also explain how this rate has been derived - e.g. average of all employees, UK employees only or rate for all new joiners.
- Companies should consider the pension contributions provided to all employees, not just executive directors. IVIS will highlight those companies that have increased pensions contributions for all employees.
- IA members do not consider fixing the monetary value of pension contributions over time to be a credible action plan to bring the pension contributions in line with the majority of the workforce.
- For defined benefit pension schemes, companies are expected to confirm that future accrual is open to other employees on the same terms as the executive directors. If they do not, the remuneration report will be amber topped.
- Where companies pay a cash supplement in lieu of further accrual above an earnings limit, companies should confirm that cash supplements are also paid to other employees on an equivalent basis. Without this confirmation, the remuneration report will be amber topped.

HMRC Employee Related Securities Bulletin 33

Summary and key practice point: On 3 October, HMRC published [ERS Bulletin 33](#), which includes updates on the grant of replacement EMI options and the reporting of net settlement of share options. The key updates are summarised in the table below.

Replacement EMI options	An individual being granted replacement EMI options must be an ‘eligible employee’ of the acquiring company at the time of grant. As one of the eligible employee requirements is the commitment of working time, a new working time declaration should be completed on the grant of replacement EMI options.
Net settlement reporting	<p>Any net settlement of non-tax advantaged awards should be appropriately reported in the ‘Other Options’ tab of the annual returns template.</p> <p>One row should report the acquisition of the actual number of securities to be awarded to the employee in column number 31.</p> <p>A separate row should report the cash cancellation or receipt of a benefit (by entering ‘yes’ in column 38 and the value of the cash received in column 39).</p>

Errors in EMI options	In respect of notifying HMRC of mistakes with respect to notification (not to the underlying grant), ERS Bulletin 33 corrects the guidance in ERS Bulletin 31 and notes that a mistake noticed after 92 days but within nine months of notifying HMRC of the grant (rather than within nine months of the grant) , if there is a reasonable excuse, can be notified by obtaining a reasonable excuse code from HMRC (and the originally issued incorrect options should be cancelled when the ERS annual return is completed and filed). For the full update on notification of errors to HMRC, see our March edition .
SAYE extended savings holiday period	The bulletin provides a reminder of the SAYE extended pause from 6 to 12 months, which is available to all who participate in the scheme. More information is available in the Employee Tax Advantage Share Scheme User Manual .

Association of Tax Technicians (ATT) and Law Society comment on changes to off-payroll working rules

Summary and key practice point: The [ATT](#) and the [Law Society](#) have published further comments on the draft Finance Bill 2020 legislation published on 11 July 2019, which extends the off-payroll working rules (IR35 rules) from the public sector to the private sector from April 2020. Both the ATT and the Law Society provided submissions to the Government consultation on the changes which closed in May this year.

From 6 April 2020, when a medium or large private sector client engages a worker via an intermediary (usually a personal service company), the client will be responsible for determining that worker's employment status and, if the IR35 rules apply, for making deductions for income tax and NICs. The expansion of the rules will create a significant compliance burden for affected private sector clients. HMRC's online tool (CEST) can assist with determinations by providing a view, on an anonymous basis, on whether IR35 applies to a particular arrangement. Our [March edition](#) contains a fuller analysis of the proposed IR35 changes.

The main points raised by the ATT and the Law Society are as follows:

- 1. Transferring liability:** Under the expanded IR35 rules, liability for unpaid tax and NICs will pass down the labour supply chain as each party satisfies its IR35 obligations. HMRC will potentially have the power to transfer unpaid liabilities of a party lower down the chain to the client at the top, where it has not been possible to recover the amount from the non-compliant party (even where the end client has fulfilled all its IR35 responsibilities).

Both the ATT and the Law Society are concerned about the lack of detail in the draft legislation about when these transfer provisions will be used, and say that the detail should be included in the primary legislation (not secondary, as is proposed). The Government's consultation response in July confirmed that the provisions were not intended to transfer liability in cases of "genuine business failure, where deliberate tax avoidance has not occurred". The Law Society suggests either that those clients who exercise reasonable care and use the CEST tool should not be at risk of non-compliance or that there should be further detail in the legislation about the factors officers would have to use prior to exercising this power.

2. **Disagreement over status:** The IR35 rules provide for a dispute resolution mechanism where the service-providing worker does not agree with the client's determination of their IR35 status. The ATT are concerned that the draft legislation does not contain sufficient detail about what a status determination statement should cover, so extensive guidance will be required.
3. **Inadequacy of CEST:** Although HMRC direct clients to the CEST tool to assist with making their determinations, the ATT's submission notes that the tool is not particularly sophisticated, and should be enhanced to deal with more complex arrangements and to provide more reliable results. The ATT further suggest that the HMRC helpline should also be better resourced to support clients who are not able to attain a clear response using CEST.

Directors' remuneration - updated GC100 and Investor Group reporting guidance

Summary and key practice point: On 22 July 2019, GC100 and Investor Group published their updated guidance on directors' remuneration reporting following the [Companies \(Directors' Remuneration Policy and Directors' Remuneration Report\) Regulations 2019](#) (the Reporting Regulations) coming into force on 10 June 2019 to implement the Shareholder Rights Directive (SRD II). The update focuses in particular on the increased obligations to compare executive remuneration with the wider workforce. Given the changes in the obligations it is likely that narrative explanations will be required to allow meaningful year-on-year analysis.

The guidance assists companies in satisfying their reporting requirements under the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) (2008 Regulations). The Reporting Regulations amend the Companies Act 2006 and the 2008 Regulations. The SRD II changes are described in more detail in our [April edition](#) and our [June edition](#).

Further details: The key updates are as follows:

1. When calculating the percentage change in directors' remuneration compared with the wider workforce, the company can no longer choose a comparator group to use and must extend the group to include all employees of the company. For a parent company, the comparator group includes the employees of the parent company only and not the whole group, although if the parent company only employs a small proportion of the workforce, that company can voluntarily choose to use a wider comparator group.
2. Where a remuneration policy explains the decision-making process followed for its determination, review and implementation, a description must now be included of any measures taken to avoid or manage conflicts of interest.
3. The scope of the Reporting Regulations and the guidance now applies to those individuals acting as CEO and deputy CEO, even where those individuals are not formally appointed as directors (although in practice it will be unusual to find individuals in this position).

Ahead of the 2019/20 remuneration round, the Financial Conduct Authority (FCA) publishes letter to level 1 firms

Summary and key practice point: The FCA has published an open [letter](#) to the Remuneration Committee Chairs of level 1 firms with a survey of the 2018/19 remuneration round and an explanation of how the FCA

will assess firms throughout the 2019/20 remuneration round. Risk adjustment remains a key theme as well as changing the culture of the financial services sector.

During a remuneration round the FCA and PRA review firms' remuneration policies and practices against the Remuneration Code (SYSC 19). In the 2019/20 remuneration round the FCA say they will be focusing on:

1. **Ex-post risk adjustments:** Where firms adjust awards to reflect poor performance and misconduct, the FCA finds that sufficient justification is often not provided for those adjustments. The FCA wants firms to apply adjustments robustly, consistently and in a timely fashion.
2. **Diversity and inclusion:** The FCA will engage with Remuneration Committee Chairs to see how remuneration policies at each firm positively influence diversity and inclusion.
3. **Remuneration Policy Statement (RPS):** For the upcoming remuneration round, in addition to submitting an RPS, level 1 firms will need to submit:
 - a. a summary of the key points in their RPS (with cross-references to the full RPS), in particular highlighting any significant changes made last year; and
 - b. an explanation of how the firm's remuneration policies drive behaviour that reduces potential harm (to consumers and markets).
4. **Transforming culture in financial services:** The FCA will review incentives practices to see whether culture is being driven in a positive direction. Increasingly, the FCA will look at non-financial drivers and incentives, such as individuals' motivations and the use of recognition of reward. The FCA are looking to Remuneration Committee chairs to lead cultural change.

Horizon scanning

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

31 October 2019	European Union (Withdrawal) Act 2018 expected to take full effect
Mid November 2019	Findings and recommendations of the independent review into the disguised remuneration loan charge are expected to be reported to the Government
1 January 2020	UK-incorporated quoted companies must start reporting their CEO pay ratios
6 April 2020	All termination payments above £30,000 threshold will be subject to employer class 1A NICs
6 April 2020	Off-payroll working rules come into force for the private sector
5 July 2020	HMRC deadline for filing annual share schemes returns for 2019-2020

ISSUES FOR 2020 REMUNERATION POLICIES

Remuneration Committees

Which discretions can you (explicitly) exercise under your directors' remuneration policy?

How can existing executive directors' pension contributions be brought in line with the wider workforce?

What approach should be taken when considering whether to override the formulaic out-turns of performance conditions applicable to variable pay?

Company Secretaries / General Counsel

Does your remuneration policy provide the flexibility to deal with departing directors appropriately (such as payments in lieu of notice)?

How can you structure executives' post-cessation shareholding requirements to ensure they are observed?

Do enforceable malus and clawback provisions exist for all the circumstances when remuneration committees may want to apply them?



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