Executive Compensation Briefing

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Expert Updating and Guidance on Reward & Corporate Governance

Contents

Justifying High Remuneration

Executive remuneration has reached levels which are hard for the general public to comprehend; in this article, Hermann Stern and Candace Cheng of Swiss financial research firm consultancy Obermatt explain how they believe their approach can make a difference.

Remuneration committees, who want to reward good performance with good pay, are losing their freedom to do so. One of the core elements of corporate leadership – pay for performance – is becoming paralysed. But, as we propose here, this should not be the case.

Lower Pay Or More Complex Remuneration Not The Answer

What can be done to re-establish public acceptance for executive remuneration? We cannot just pay less. There is too much competition for talent. More metrics and more disclosure will not help either. It is hard to see why the public should have greater faith in more complex systems and reports when they already have great difficulties understanding today's. Understanding is an important element of trust. And it is even more important in an economic downturn.

A Sporting Solution?

Why do we criticise compensation for chief executives who are responsible for creating billions in returns to public and private pension funds when we are perfectly happy with star athletes who earn higher sums and provide less wealth to society? What is different in sports?

We see three main differences:

- In sports, there are clear rules for measuring performance.
- Performance measurement is completely transparent.
- Last but not least, performance is supervised by an independent referee.

In business, the situation is rather different:

- There is little agreement on performance measurement (and methods change frequently).
- Companies keep important performance data confidential.
- Executives do not want a third party supervising their performance measurement.

Looking at these differences, it is no wonder that there is little public trust in self-stated, opaque and possibly biased executive performance and the resultant performance pay. But this doesn't need to be.

The Power Of Peers

Business can actually learn something from sports: measuring performance relative to peers. This allows measurement to become rule-based, transparent and supervised by an independent third party. Then, remuneration committees can pay executives what they deserve – even if the amounts are high. After all, who would deny a truly high-performing CEO truly deserved high pay? On the other hand, without a trusted standard, there is little hope that the public will ever have trust in high pay.

We believe that the Obermatt Ranking provides just such a standard: an independent ranking of company performance compared with their relevant peers. If executives are measured against the competition, then this is where they will focus their attention – and not on distracting and time-consuming internal bureaucracy.

We need fewer metrics that are more trusted. Because of the need for a broad basis of trust, the Obermatt rankings use transparent and objective rules and are published for everyone to scrutinise. This is the only way to build trust in company performance measurement. Self-declared performance can never achieve this; yet, this is exactly the direction the industry is heading.

Working With Consultancies

The way to regain public acceptance of executive remuneration may be through relative performance measurement. But the Obermatt indices only provide the measurement results. It is the remuneration experts and consultants who are the critical factor in bringing the solution to life. Companies will need their remuneration experts to design remuneration systems so that final pay-outs are in line with performance and to help them explain, promote and integrate the indexed approach into their organisations.

How It Works: A Look At the FTSE 100

Rank	Company	Combined Rank 2008-2010	Remuneration Realised 2008-2010	Deserved Remuneration 2008-2010	Excess Remuneration 2008-2010
1	Reckitt Benckiser	67%	150,118	11,554	138,564
2	ICAP	52%	39,781	8,157	31,624
3	BG Group	59%	39,740	9,409	30,332
4	Xstrata	48%	37,566	7,653	29,912
5	Tullow Oil	52%	33,643	8,215	25,427
6	BHP Billiton	65%	34,448	11,119	23,330
7	Tesco	61%	33,543	10,285	23,258
8	Schroders	67%	32,406	11,537	20,869
9	GlaxoSmithKline	43%	20,389	6,616	13,773
10	SabMiller	64%	21,280	10,873	10,407
11	Experian	68%	20,125	11,575	8,550
12	BAE Systems	51%	16,050	8,130	7,919
13	Vodafone	49%	15,488	7,656	7,833
14	Shell	58%	16,689	9,101	7,588
15	Randgold Resources	54%	15,806	8,547	7,260
16	RSA Insurance	52%	15,016	8,159	6,857
17	Standard Chartered	70%	18,582	11,776	6,807
18	BAT	67%	16,149	11,551	4,598
19	Prudential	49%	11,840	7,664	4,176
20	Pearson	71%	16,027	11,973	4,054

All in £000

More details of the ranking online at http://obermatt.com/rankings/uk

How we measure relative performance

Each company is compared to a hand-picked group of peer companies. Banks are compared to banks, mining companies to mining companies, etc. Additionally, Obermatt creates a peer group for each major business segment if they are in separate markets and indexes performance on segment levels, too.

The comparison is based on the two performance measures: "like-for-like" profit growth and total shareholder return. Profit growth is compiled from quarterly reporting to match the financial years of the company and its peers. Performance is measured as a percentile rank of outperformed peers. Three ranks are defined: operating rank (profit growth), investment rank (on total shareholder return) and combined rank (the average of the two). A combined rank of 67 per cent in the table means that the company was better than 67 per cent of its peers based on both metrics over the past three years.

The method is explained in more detail online at: http://obermatt.com/ranking/method

How we measure pay

CEO remuneration is used as a proxy to assess the company's remuneration policy. We use "realised total remuneration" because we compare it to realised performance. Realised pay creates the correct incentive: to design remuneration systems so that they pay for performance in the end. For CEOs, this method allocates on average the same amount as in the past. As a group, CEOs remain as wealthy as they are today. And for shareholders, pay will be based on independently measured performance with the right incentives to outperform.

How we measure pay-for-performance

The rule for pay matching performance is simple: the percentile rank for performance should match the percentile rank in pay. We use the Obermatt Combined Rank as the performance percentile rank to calculate deserved pay: the percentile value of FTSE 100 CEO pay that matches the Combined Rank. For example, a FTSE 100 CEO with a Combined Rank of 67 per cent should have realised total remuneration in the 67th percentile of FTSE100 total remuneration of the same period (e.g. £ 11.5 million for 2008-2010). Excess pay is the difference between realised pay and deserved pay.

Obermatt rankings are available online for publicly quoted companies in Switzerland (SPI), Germany (DAX), UK (FTSE) and US (S&P500):
http://obermatt.com/rankings

Realised Or Granted Pay?

We believe it is realised remuneration that should reflect performance and not granted (or expected) remuneration. After all, we compare it to realised (and not expected) performance. But even more importantly, if granted pay were used for a pay-for-performance standard like the Obermatt ranking, it would result in a disadvantage for underperforming companies. They would be prohibited from granting the same remuneration as their better competitors. This would force them to use more leveraged pay structures which could result in riskier management practices and new peaks in realised remuneration in case of good future performance - not really in the interest of shareholders. Even worse, using granted pay for the rating would lead to approval for above average grants to outperforming companies which will later result in further peaks of realised remuneration. This is exactly what happens today and should be avoided to regain public trust. Outperformers should have higher realised pay. Expected (or granted) pay should not be higher.

What The Figures Mean

From what we hear, Bart Becht has done a marvellous job since Reckitt Benckiser was created in 1999. Nonetheless, his pay is out of line with the rest of the FTSE 100 companies. This may be due to factors out of his control. Remuneration systems have become increasingly complex yet not designed for the extreme market fluctuations we've experienced in recent years. But, there is public money invested in Reckitt Benckiser. In public companies; executive compensation should be fair.

When evaluating remuneration, the performance rank must match the pay rank. In the case of Bart Becht, Reckitt Benckiser's performance ranks in the 67th percentile for the past three years. This means that his pay-out should also be in the 67th percentile. But his pay is in the 100th percentile. That's why we see a mismatch.

The same applies *mutatis mutandis* to the other companies listed.

Neutralising the Market

Indexed bonus plans are more stable because indexing neutralises external factors that often distort bonus plans today. With indexed remuneration, there is less need for manual bonus plan corrections and bonus plan reviews after external surprises.

This is especially true in times of recession, when there is no real alternative to indexing pay. The boom years of the last two decades allowed companies to get away without indexing, and as such, indexed compensation didn't take off. The future looks very different. Market volatility is a strong motivator to index performance.

The Role Of Remuneration Experts

Obermatt is an index provider like Dow Jones or Standard & Poor's, but Obermatt indexes measure performance tailored to executive remuneration. It sells its data as an independent third party and does not offer consulting or remuneration system design. For design and implementation, companies work with their existing remuneration consultants. Obermatt's aim is to help remuneration experts and consultants make performance pay transparent, fair and accepted.

Remuneration consultants are the most critical players in the game. Executives turn to them for their expert opinion on remuneration; as the economy gyrates, there will be many questions and concerns around compensation. This is the opportunity to introduce indexing. Indexing stabilises remuneration systems and helps steer companies through turbulent times.

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Dr Candace Cheng is member of the executive board at Obermatt. Before joining Obermatt in 2010, she held communication positions at UBS and SwissRe.

For those interested in more detail, a paper *Cycle-Proof Performance Measurement and Executive Bonus Plans* is available free at SSRN:
http://ssrn.com/abstract=1807965

Executive Pay To Rise Unless Turbulent Markets Take Toll - PwC Survey

Executive pay will rise in 2012, according to 79 per cent of senior reward professionals across the FTSE 350 recently surveyed by PwC. The findings come ahead of proposals expected this autumn from Business Secretary Vince Cable on executive compensation. As noted elsewhere in this issue of ECB, the High Pay Commission is also expected to report further on the issue.

Pay increases are most likely to be to base salaries. Of those firms expecting executive pay to rise, 65 per cent will increase base salaries only, while a further 30 per cent will lift salaries along with other components such as long-term incentives. Salary increases are expected to be between2-4%, broadly in line with 2011 rates.

But the picture is far from even, with pay freezes likely in around a fifth (13 per cent) of companies. Likewise, brakes are being put on bonuses, with 85 per cent of respondents expecting no increase in these.

Sean O'Hare, reward partner at PwC, commented: "Even moderate pay increases in line with inflation are likely to prove controversial given the building public and political pressure to address the widening gulf between the highest and lowest earners, compounded by tough economic conditions. But whether anticipated salary rises play out next year will depend on whether markets improve. Increases that are not aligned to company and share price performance are likely to meet strong resistance from shareholders."

Bonus pay-outs in particular will depend on whether executives meet performance targets, which are likely to become more stretching. PwC data show that bonus performance metrics are focusing more on company revenues, profits and strategy.

O'Hare commented: "One of the biggest causes of shareholder concern has been bonuses paying out even when company performance has been disappointing, as was sometimes the case in 2010. Toughening up executives' targets and ensuring they reflect business strategy has become a major focus."

Shareholders may also be reassured by measures that could see companies reclaiming chunks of executives' pay in certain situations. A significant 30 per cent of firms are planning to introduce so-called claw-back in 2012. Most of these firms say this would take the form of reducing outstanding deferred shares or other long-term incentives.

O'Hare said: "Whether tougher performance measures will mollify shareholders, politicians and the public will depend on whether they're seen to work. Shareholders don't object to top performers being well paid, the problem is sifting these from the mediocre ones.

"Companies on their part need to get better at explaining why people are being paid particular amounts. Ultimately you don't want people to feel beaten up for generating wealth."

PwC surveyed senior reward professionals, mainly reward directors and heads of HR, in FTSE 350 companies. The findings are based on 76 responses.

A full PwC report on executive pay levels for 2011 will be published later this year, but data for 2010 shows base pay among FTSE 350 executives rose by 2.8 per cent on the previous year. Bonuses increased more steeply: the median bonus for a FTSE 100 CEO was almost 30 per cent higher.

HMRC Issues Draft NI Regulations, Guidance, On Disguised Remuneration

HMRC has published draft regulations that mean disguised remuneration will be treated as earnings for National Insurance contributions purposes. It has also issued explanatory notes.

Any comments or questions on the draft regulations must be with HMRC by 23 September 2011.

HMRC has also published draft guidance on disguised remuneration. The matters discussed in its FAQs, covered extensively in ECB, most recently in July, have been included in the draft guidance but are not separately listed as such.

TUC PensionWatch Report Fuels Call For Change

The TUC's ninth annual PensionsWatch analysis looks at the pension arrangements of 362 directors from FTSE 100 companies, showing that the average transfer value (pension pot) for a director's defined benefit pension is £3.91 million, providing an annual pension of £224,121. The biggest pension pot in this year's survey is worth £21.5 million.

The average director's pension is 23 times the average occupational pension (£9,568), and 34 times bigger than the average public sector pension (£6,497).

Despite the move away from DB pensions for most people, the majority of companies (58 per cent) still provide these schemes to at least some of their directors. For the first time, however, a minority of directors (145) are in DB schemes.

The most common accrual rate - the proportion of pay that a person receives as pension for each year they have been in the scheme - is 1/30ths for directors. The commonest accrual rates for most scheme members are 1/60ths or 1/80ths.

As more directors move to defined contribution schemes, the average company contribution has increased by £26,000 on last year to reach £161,149. For executives with the highest contribution in the company the average amount paid in is £211,859.

The most common normal retirement age is 60, with three times as many directors able to retire at 60 than 65. The most common NRA for ordinary scheme members is 65, expected to rise for most public and private sector workers.

Many directors receive cash payments instead of participating in company pension schemes. The average cash payment was £138,436, an increase of £17,530 on last year. The biggest cash payment was £620,700.

The TUC is calling for the mandatory disclosure of accrual and contribution rates. With pay and bonuses increasingly under public scrutiny, it says it is crucial that shareholders are also able to examine directors' pension arrangements.

General Secretary Brendan Barber also called for ordinary staff members to have a voice on remuneration committees "so that company schemes work in everyone's interests, and not just those at the top."

Institutions Slow To Engage On Remuneration

From a survey carried out for The Times by online trading specialist London Capital Group, it seems that institutional investors are still not joining forces to address governance issues, including remuneration. Asked how many times they had pursued collective engagement with other shareholders in the past 12 months, well over half (57 per cent) said not at all and another third had done so up to three times. One in ten had done so four times or more.

London Capital Group chief executive Simon Denham commented: "The UK has never been the natural home of collective shareholder engagement, with the US being at the forefront of this. Over here, it is clear that the vast majority of fund managers are still believers in the 'hands off' model beloved of [Business Secretary] Vince Cable and the supporters of his 'long termism agenda'. That said, if we find ourselves in a double-dip recession, shareholder activism will rise – partly out of a desire to deliver value and partly to inveigh against the suggestion that they have been 'asleep at the wheel'."

When asked specifically if boardroom pay mattered more or less than it did 12 months ago, just under a third said it mattered more, nearly two-thirds said about the same and 6 per cent actually said it mattered less.

The Times quoted Robert Talbut, chief investment officer of Royal London Asset Management (and incidentally a member of the High Pay Commission), as saying that most institutions prefer to engage on their own terms. An unnamed "seasoned activist" was quoted as saying that "the first reaction of institutions when they don't like what a company is doing is to sell the shares."

FTSE 100 Directors' Bonuses Up 187 Per Cent In Last 10 Years – HPC Report

The average annual bonus for a FTSE 100 director has increased by 187 per cent in the last 10 years, yet the average year-end share price of FTSE 100 companies has declined by 71 per cent in the same period, casting doubt, says the High Pay Commission, as to whether high pay is a reward for strong company performance.

The report What Are We Paying For? Exploring Executive Pay And Performance was compiled by Incomes Data Services on behalf of the HPC, reveal that in the past 10 years, both monetary and share-based rewards for FTSE 350 directors have grown rapidly, outstripping company performance. Key findings include:

- In 2002, for on-target performance, FTSE 100 lead executives received a bonus worth 48 per cent of salary. In 2010, for the same level of performance, a FTSE 100 lead executive's bonus was worth 90 per cent of salary.
- The increase in bonuses has not come at the expense of absolute rises in salary, with salaries increasing 63.9 per cent over the last 10 years.
- In 2002, the median maximum grant of shares that a FTSE 100 lead executive could be awarded was 100 per cent of salary. In 2010, this had risen to 200 per cent.
- The average value of LTIP awards paid out to lead executives across the FTSE 350 has gone up over 700 per cent since 2000.

Looking at the banks in particular, the report reveals that average total earnings of directors in the state-supported banks were just under £4 million in 2010, compared to £1.7 million in 2000 – an increase of 130 per cent.

HPC chair Deborah Hargreaves said: "All we've seen is things getting much more complicated – in many ways masking the real value of what executives get paid. Corporate governance reforms attempting to link pay with performance, appear to have done little more than add to the huge complexity of executive packages, reward schemes and bonuses that make up the pay of FTSE 100 directors."

A further report is expected from the HPC in November.

Share-Based Payments

In a recent bulletin from Company Reporting, it was noted that Bunzl has disclosed that it has converted its cash-settled share options to equity-settled options. It transfers the outstanding liability in relation to cash-settled options of £4.3 million to equity.

US Think Tank Links Tax Evasion To High Remuneration

The left-leaning Institute for Policy Studies, based in Washington, DC, asserts that "corporate tax dodging has gone so out of control that 25 major US corporations last year paid their chief executives more than they paid in federal income taxes."

The 18th annual IPS Executive Excess report explores what it describes as the "intersection between CEO pay and aggressive corporate tax dodging."

ECB Readership Survey

Your opinion is valuable to us - and this is your chance to help us make ECB even more relevant to you and your organisation's needs. Below is a link to a short survey, which should take no more than a few minutes to complete.

Knowing more about what you want to see in ECB will allow us to keep the publication squarely in line with your requirements, so you will benefit directly from your investment of time. And as a thank-you, we will extend the subscription of all responders by a full month.

You can be assured, of course, that all answers will be entirely confidential and used for statistical purposes only.

If colleagues also read ECB, do please ask them to participate as well.

TAKE SURVEY HERE

http://www.esurveyspro.com/Survey.aspx?id=19b03781-8497-4d06-b8f5-920f21696505

Pay Increases For FTSE 100 CEOs At 13 Per Cent

The latest report from remuneration consultancy MM&K and corporate governance and proxy voting specialist Manifest makes interesting reading.

The median chief executive total remuneration awarded, defined as the total of salary, cash bonuses, benefits-in-kind and the expected value of share options and other share awards granted in the year, has surged in the past year by 13 per cent in FTSE 100 and 12 per cent in FTSE 250 companies. Upper quartile company rates of increase were 42 and 38 per cent respectively.

But salaries only rose by a median of 2 per cent (FTSE 100 and FTSE 250).

Bonuses are much higher than in 2009, reflecting the bounce back of profits. The rate of increase in is 12 per cent for FTSE 100 and 7 per cent for FTSE 250 companies.

Different companies have increased different parts of their remuneration packages. So while the median values of each component of pay have not increased significantly, the total effect (although this may appear counter-intuitive) is large. Below we show the median and upper quartile changes:

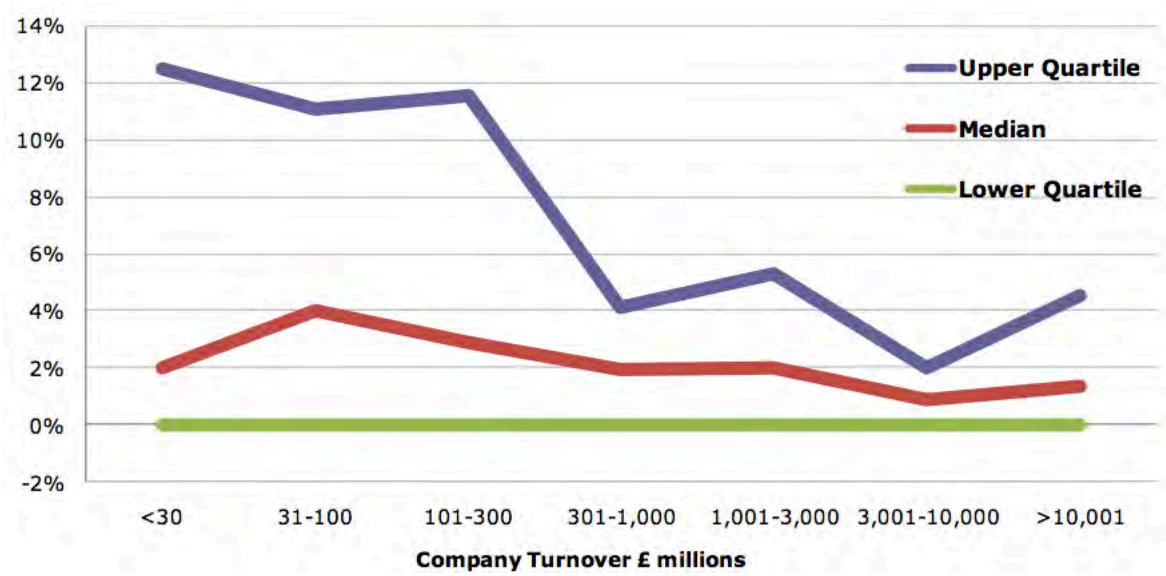
Increases In The Past Year - CEOs

	Median		Upper Quartile	
	FTSE100	FTSE250	FTSE100	FTSE250
Salary	2%	2%	5%	5%
Pension	0%	0%	9%	9%
Bonus	12%	7%	42%	70%
Deferred Bonus	0%	0%	39%	0%
Long term Incentives (Expected Value of awards in year)	4%	4%	41%	60%
Total Remuneration Awarded	13%	12%	42%	38%

The above figures are for CEOs. The median increases for other directors' total remuneration are higher for FTSE 100 companies and lower for FTSE 250 companies.

Potential rewards are strongly linked to performance. An outstanding performance will lead to a doubling of total remuneration eventually received (see figure 3 below).

Salary Increases Are Increasing And Vary By Size Of Company
Figure 1: CEO Salary increases of all listed companies - latest data (September 2011 report)



This is quite a bit higher than the results from their May survey, so shows quite a change in company practices. Pay freezes seem passé - about a third reported pay freezes compared to nearly half in the May report.

Figure 1a: CEO Salary increases of all listed companies – data from May 2011 report

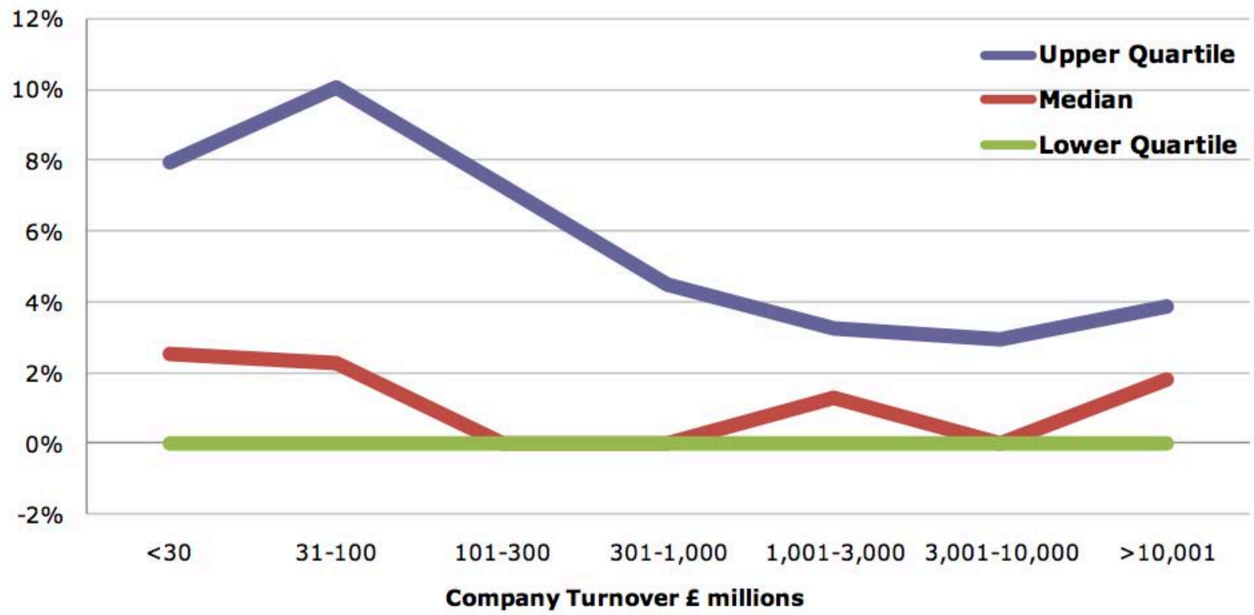
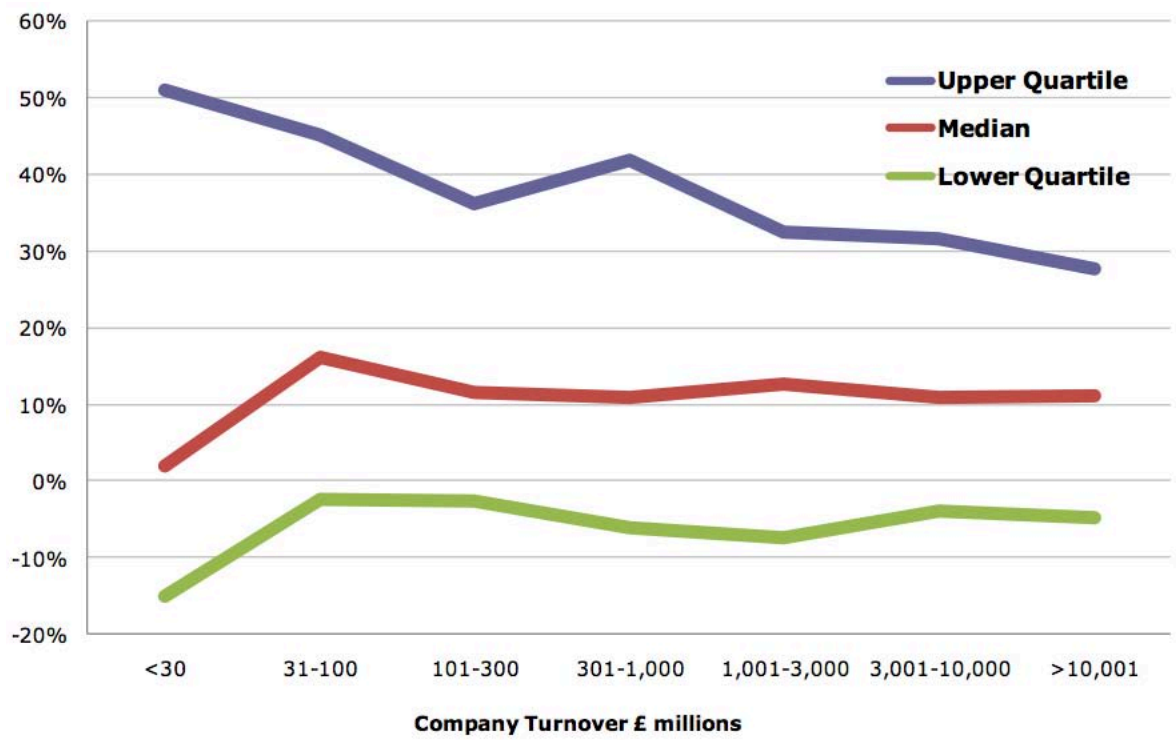


Figure 2 Total remuneration awarded: CEO increases – latest data

The variation in total remuneration awarded is larger for companies with lower turnover.

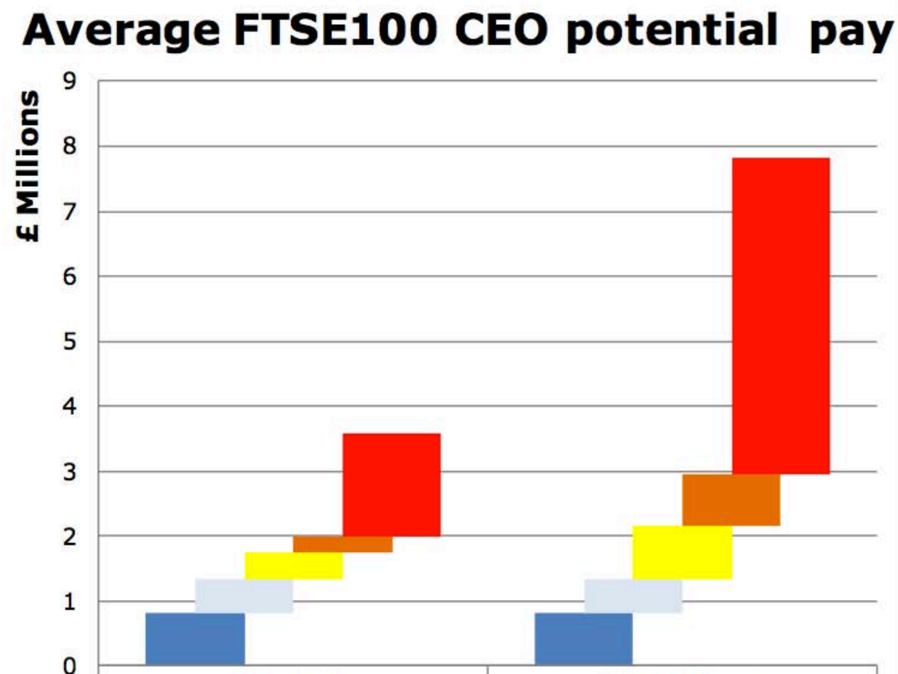
In their May 2011 survey, smaller companies had increased total remuneration awards at a lower rate than larger companies. They now seem to have caught up and total remuneration is increasing at 10 per cent or more at all sizes of company, except the very smallest in our sample (those with turnovers of less than £30 million p.a.).



Incentive Pay Forms A Significant Part Of Total Remuneration

The following chart is based on the average pay package of a FTSE 100 CEO and shows how much extra the CEO will receive if they and their company perform at an outstanding level. It also illustrates how much of the package is now paid out several years in the future and is strongly dependent on share price performance. The amounts refer to pay awarded in one year, although much of pay awarded this year will not be received until several years in the future.

Figure 3 Average FTSE 100 CEO potential pay by level of performance



	Target £	Outstanding £
LTIP (paid in 3 years)	1,571,491	4,873,047
Deferred Bonus (paid in 3 years)	259,829	805,704
Annual Bonus	412,521	825,041
Pension	499,000	499,000
Salary	825,000	825,000

Target assumes 50% of maximum bonus and LTIP of 50% of award level and share price growth of 8% p.a.

Outstanding assumes maximum bonus and full vesting of LTIP and share price growth of 25% p.a.

Most bonuses and LTIPs are subject to stretching performance criteria. MM&K director and ECB editorial board member Cliff Weight commented: "The above diagram clearly demonstrates the importance of remuneration committees attaching sufficient rigour to setting targets to incentive plans. Soft targets generate payouts that are not deserved. Remuneration committees and shareholders need to be vigilant in this respect."

At "target", performance pay makes up over 50 per cent of total remuneration. At "outstanding", performance pay is over 80 per cent of total pay.

For more information, or to buy the survey (price £500), contact:

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020 7283 7200

Chairmen Disallowed From Voting Undirected Proxies In Australia

This month, the team from independent corporate governance and proxy voting service Manifest looks at what to do when shareholders elect not to vote on a resolution.

Recent legal developments in Australia have raised interesting questions about the common practice of the chairman voting undirected proxies in support of say-on-pay resolutions.

Australian corporate law, under the Corporations Amendments (Improving Accountability on Director and Executive Remuneration) Act 2011, now prohibits board chairmen from voting undirected proxies on the remuneration report at their discretion. The limitation is only temporary, however, pending an amendment to be introduced later in the year.

In the majority of markets with developed shareholder voting procedures, shareholders have three choices to make regarding each proposal: to vote for, against or abstain. Alternatively, shareholders may actively elect for the chairman to direct their votes at his or her discretion, known as a "directed proxy". However, where the shareholder has not made a choice in any regard (an undirected proxy), it is common for the chairman to exercise discretion in these cases as well. In anything but exceptional circumstances (such as internal board struggles), it is to be expected that these votes will be directed in favour of management proposals.

It is clear that this arrangement might create conflicts of interest whereby chairmen have the power to direct discretionary votes on resolutions in which they have a personal interest, such as the approval of the remuneration report or the overall fee ceiling of directors.

It will be instructive to observe the effects of the new legislation on Australia's 2011 peak season, which is imminent. Given that remuneration report resolutions are commonly among the most contentious issues proposed at AGMs, the restriction on the chairman's discretionary voting powers in regards to say-on-pay could potentially lead to an upsurge of dissenting proxies and the possibility of an increased number of such votes being defeated. Many companies would no doubt wish to see the back of this recent restriction, as it will only serve to drive up overall dissent (and in turn negative publicity) in all but the most exceptional circumstances.

Interestingly, the regulator, the Australian Securities and Investments Commission, has not voiced concerns over the decision to restore the chairman's power to vote undirected proxies and has gone so far as to publish guidance for those companies intending to hold an AGM in the interim before the repeal of the restriction.

One solution to the issue might be an opt-out mechanism, whereby it would be explicitly stated on the proxy card that undirected votes will be left to the discretion of the chairman. This would seem to be the simplest solution for all parties, involving only a minor administrative change, and would not put an undue burden on companies, shareholders or proxy voting agents. It should also be made clear to shareholders that they retain powers to nominate any proxy they wish – including the chairman – as well as any other directors or non-management personnel, to vote their shares. These arrangements would enable to shareholders to clearly see the consequences should they decide not to direct their vote.

Companies can apply to the ASIC for relief from the current probation, with the ASIC deciding on wherever it is considered appropriate for the chairman to vote undirected proxies on a company-by-company basis. This stopgap would seem rather more circuitous, and cuts out shareholders altogether.

Manifest recognises the routine nature of chairman voting undirected proxies, but notes the potential conflict of interest. Rather than supporting the automatic prohibition of chairman voting undirected proxies on say-on-pay, as is to be temporarily the case in Australia, Manifest considers that the clear detailing of how proxies might be directed should they not be voted is the most transparent and effective solution to the dilemma.

Of the four companies with the highest average dissent levels, none saw a remuneration report defeated, though there have been some close votes among this group. Without Glencore's 34 per cent stake in Xstrata, for instance, the company surely would have lost at least one vote and would easily take the top spot in the list.

The figures also show that average dissent on remuneration reports for 2011 to date (9.6 per cent) is only slightly higher than the historical average of 9.4per cent. At the opposite end of this list sits Centrica, parent company of British Gas, which has averaged the highest approval rate on executive pay (excluding companies with controlling shareholders), with an average dissent of only 3.2 per cent over the period.

Manifest is currently drafting its Proxy Voting Review 2011, which will cover this and other voting trends as they relate to prevailing remuneration issues across the global markets. The research will be published later this year.

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International Tax and HR Update

UK – Immigration and employment-related settlement

The government has launched a major new consultation paper on employment-related immigration, stating that it wants only the "brightest and the best" workers to stay permanently in the UK and obtain settlement.

The paper addresses the following areas:

- Clarification of Tier 2 requirements (for skilled workers coming to the UK with a job offer) mainly as a temporary route to the UK with no automatic right to settlement. Tier 2 migrants should have no automatic right to settlement, with exceptions being considered such as people earning over £150,000 or sports people.

The Government may consider introducing a new category, which the most exceptional Tier 2 migrants can switch into after three years and go on to apply for settled status. However, robust selection criteria will apply and there could potentially be a cap on the number who will be allowed to switch to the settlement category. The expectation is that Tier 2 migrants who do not, or cannot, switch to the settlement category will leave the UK after five years.

- Limiting settlement rights for Tier 1 migrants (highly skilled workers without a sponsor).

- Reforming Tier 5 (temporary workers). The government will consider whether to restrict the maximum period of leave for Tier 5 temporary workers to 12 months (currently 24 months) and increase the minimum level of skill for the 'government authorised exchange' subcategory, to university graduate level (currently NVQ Level 3). This will bring the category in line with the skill level requirements of Tier 2.

Consideration will also be given to whether migrants under the Tier 5 temporary workers category will be allowed to bring dependents to the UK, and whether their dependents will have the right to work.

- Increasing English language requirements for dependants of migrant workers who plan to make the UK their permanent home.

The main aim of the consultation paper is to define all visas as either temporary or permanent and only allow migrants who have permanent visas to apply for settlement. Perhaps the point that gives rise to the most concern is that the government intends to apply the new settlement rules retrospectively to all those entering the UK under the points-based system from April 2011. This could cause hardship to those migrants who arrived in the UK after April 2011 with the expectation that they would be able to remain in the UK and proceed to settlement. If instigated, we expect the move would be challenged in the courts.

Actions to be taken

Organisations will need to ensure that they carefully assess how the proposed changes may affect planned recruitment and mobility in the coming year, particularly in relation to longer term assignments and how the UK will function within overall talent development and deployment going forward.

US – Tax credit allowable for UK remittance basis charge

A welcome ruling by the IRS has confirmed that a tax credit is allowable for the £30,000 UK remittance basis charge. The ruling qualifies the RBC as an income tax, making it an allowable tax for foreign credit purposes. HMRC previously announced that the RBC would be available as a credit against US tax liabilities, yet uncertainty remained as to whether the IRS would allow individuals to claim full relief for the RBC.

This ruling applies to UK non-domiciles who claim the remittance basis of assessment. The remittance basis of tax applies where individuals are taxed on UK source income and gains but foreign income and gains are only subject to UK tax if they are remitted or received in the UK. The RBC applies to individuals aged 18 or over who have been resident in the UK for any part of seven out of the past nine tax years who elect the remittance basis of assessment.

Although as little as £1 can be nominated for the purposes of the RBC, it is interesting to note that where a foreign tax is predominantly based on imputed income, the tax would not meet the Internal Revenue Code requirements of a foreign tax. This means that if insufficient income or gains are nominated, the tax base would only include imputed income.

The ruling states it cannot be relied upon if the UK legislation is amended in any material respect. It is unclear whether the IRS would consider the proposed increase to the RBC to £50,000 per annum for individuals with 12 or more years UK residency to be a material amendment.

Actions to be taken

US citizens and green card holders may be advised to nominate sufficient income or gains to generate £30,000 of UK tax to allow making a claim under the UK/US double taxation treaty.

Ireland - Employee share awards: exemption from PRSI

As readers will be aware from our previous updates, the introduction of employee pay related social insurance in respect of share awards in Ireland has been fraught with changes.

A further announcement imposes a significant restriction on the exemption from employee PRSI on share awards which were evidenced in writing prior to 1 January 2011. The exemption will now only apply to share based remuneration arising from such awards which is received in the current year, ending 31 December 2011. All share based remuneration received post 1 January 2012 will be subject to employee PRSI contributions, regardless of when the original award was made. The exemption from employer contributions will continue to apply.

This change in policy will impact employees holding legacy awards (i.e. those granted before 1 January 2011) that vest after January 2012 and on those who exercise share options after January 2012. The additional liability will be 4 per cent of the taxable value of the awards.

The statement also gives details of the process by which employers and employees who have paid PRSI on pre January 2011 share awards, prior to the March announcement, can claim repayment of such contributions.

Actions to be taken

Individuals affected by the announcement, together with their employers, may wish to give consideration to accelerating the vesting/exercise of pre January 2011 share awards or options before 31 December 2011 in order to take advantage of the exemption from employee PRSI contributions.

France – New tax measures to reduce debt

New austerity tax measures have been announced by the French Government. In addition, the 2011 Amended Finance Act, previously discussed in our June bulletin, has been adopted. A number of these measures may potentially impact expatriate employees and their employers.

The key new measures proposed include:

- An exceptional 3 per cent tax will be levied on individuals with taxable earnings in excess of €500,000 per year. This will increases the highest marginal tax rate from 41 to 44 per cent. The exceptional tax will remain until France's deficit returns to 3 per cent of GDP.
- The additional social contribution rate on passive income will be increased from 12.3 to 13.5 per cent.
- A change to the rule under which if a taxpayer owns a French property which is not their principal residence, they may benefit from a 10 per cent capital gains reduction each year after the initial five years of ownership. Effectively, after 15 years of ownership, the gain is reduced to nil and no capital gains tax is payable. This "fifteen year rule" will be removed but an adjustment of the purchase price for inflation will be introduced. This applies to sales concluded on or after 24 August 2011.
- Effective 1 January 2011, French wealth tax threshold increased from €800,000 to €1.3 million. An exemption applies for individuals resident five years or less whereby only the value of assets located in France count towards the tax threshold.
- For taxpayers departing France after 3 March 2011, an exit tax on unrealised capital gains may be due if they own at least 1 per cent of the stock of a company or any shareholdings exceed €1.3 million. However, the exit tax will not be charged where the departure results from a job move i.e. professional mobility, subject to certain conditions being satisfied.
- The 20 per cent tax on capital in the event of death has been increased to 25 per cent on capital exceeding €902,838. Previously non resident contracts would receive a 20 per cent exemption, but this has been limited to situations where all parties are non-residents at the date of the subscriber's death.
- The top rate of inheritance and gift duties will be increased from 40 to 45 per cent and the 35 per cent rate increased to 40 per cent.

Actions to be taken

Individuals and employers with employees who are residing or working in France should consider whether these legislative changes may impact them or their employees.

2011 wealth tax returns should be filed by the postponed deadline of 30 September 2011.

The Netherlands – Recent developments for executives of Dutch companies

The Dutch senate recently passed new legislation with respect to "governance and supervision" expected to enter into force on 1 January 2012. Under the legislation, the contractual arrangements of newly-appointed board members of listed companies or qualifying large companies will no longer be regarded as an employment relationship for civil law purposes. The proposed legislation does not indicate what the nature of the new agreement will be, though it is expected that this will be classed as a management or service agreement.

The new legislation refers to new board members of companies residing in the Netherlands and also applies to the re-appointment of current board members. The legislation will not have wage tax, income tax or national social security consequences for affected board members. The relationship between a new board member and a listed company will qualify as a "notional" employment agreement and hence any remuneration will be taxed accordingly.

The Dutch authorities are currently considering whether new board members of listed companies will still be regarded as qualifying employees for the employee insurance schemes (which cover disability and unemployment), and if so, whether specific legislation is required in that respect.

With respect to pension accruals, the Minister of Social Affairs and Employment has announced a rule that for the purposes of the Pension Act, board members of listed companies will be treated as regular employees of the listed company. This means that board members can continue to participate in the current pension plans.

Other, non-tax related elements of the new legislation are:

- Legal provisions for a one-tier board are introduced.
- A limitation is introduced for the number of appointments as member of the supervisory and/or managing board of large and listed companies.
- New rules are introduced for instances where there is a conflict of interest within the board.
- At least 30 per cent of the managing and supervisory board should be male and at least 30 per cent should be female. If not, the company should explain the reason for this in the annual report, as well as the intended measures to reach this level of representation.

Severance payments

In the Netherlands, a severance payment is normally taxed at the time of payment. However, it may be possible to defer the payment over a number of years and potentially reduce the overall tax liability. For executives, it is also the case that a so-called golden parachute is included in the employment agreement between the executive and the company (i.e. the executive is entitled to a lump-sum payment in the event of termination of the agreement).

The Dutch tax authorities recently published a new policy that the existing tax deferral available for severance payments cannot, in general, be applied to golden parachute payments. If the employer does pay a contractual severance payment by making use of the tax deferral mechanism and consequently does not withhold wage tax and national insurance contributions, it may be held liable for the wage taxes and national insurance contributions due. This will lead to additional costs for the employer, if the employer is unable to recover these costs from the former employee.

Actions to be taken

Employers who have contractual severance arrangements should take action to address the tax authorities' new policy regarding these. In order to avoid issues resulting from the recently published policy, the tax authorities have suggested two solutions:

1. Include an entitlement to an annuity in the employment agreement in the event of termination.

2. Detail the amount of the severance payment in the employment agreement. However the means of payment (in cash or via an annuity) will be agreed upon at the point of termination.

The second solution may be preferable, as this provides more flexibility for the employee. Employers may also wish to consider amending the terms of golden parachute payments in existing employment agreements.

Where organisations have currently mobile personnel and for whom severance payments might be a consideration, careful attention will need to be paid as to how the new policy might impact the interaction between Dutch taxation and that of other jurisdictions.

Europe - Introduction of a Blue Card Directive for skilled migrants

The EU has the objective of becoming the most competitive and dynamic knowledge-based economy in the world. As part of this initiative, the Council of the EU adopted the Blue Card Directive in 2009 with the aim of attracting highly-qualified third-country nationals and to facilitate their mobility within member states. The EU blue card has now been introduced and is a fast-track procedure for issuing a special work and residence permit across 24 EU Member States.

Denmark, the UK and Ireland are not taking part in the Directive. The other 24 member states must transpose the directive in to domestic legislation by 19 June 2011. At this stage, some countries have yet to implement the directive in to domestic law but indicate it will be done within six to twelve months.

Applicants must meet the criteria below to apply.

- They must have an employment contract (for at least one year) for a job in the specific EU member state where the blue card is applied for.
- The applicant's gross monthly wage must not be inferior to a national level defined by the specific member states which shall be at least 1.5 times the gross monthly or annual average wage level in the member state concerned.

- Applicants must possess higher education or higher professional qualifications.

- Applicants must have sickness insurance for all the risks normally covered in the host country.

- Applicants must not be considered a threat to public policy, public security or public health.

The card will allow third-country nationals (and their family members) to work and reside in the EU member state that issued the blue card. The card can be renewed but is initially granted for a period of one to four years.

Advantages of the blue card include:

- After two years blue card holders can apply for independent resident permit and work permission without a sponsor.

- The blue card holder can be unemployed for up to three months without jeopardising his residency status.

- Period of residence can be accumulated in different member states allowing the card holder to obtain the status of EU long term resident.

It is important to note that the EU blue card does not enable the holder to work everywhere in the EU. However, it does facilitate intra-EU mobility, a benefit for the individual and employer. After 18 months of legal residence in one member state the EU blue card holder may move to another member state for the purpose of highly qualified employment (provided certain conditions are met).

Actions to be taken
Employers in participating member states should consider the EU blue card when employing third-country nationals and when structuring international assignments within the EU.

Canada – Advice on changes to the Canada Pension Plan rules

The Canada Revenue Agency has published welcome advice to employers with respect to the upcoming changes to the rules for deducting Canada Pension Plan contributions that will come into effect from 1 January 2012. The rules impact all employers whose remuneration strategies may be influenced by the costs and benefits of CPP coverage. The legislative amendments do not affect employees who are considered to be disabled under the CPP or the Quebec Pension Plan, nor do they affect employees who have reached 70 years of age.

Currently, if an employee is receiving CPP/QPP benefits and decides to continue to work or go back to work, they are not required to make contributions to the CPP on their salary or wages. In addition, under the current rules once an employee begins receiving CPP/QPP benefits, they are not required to make any further contributions to the CPP, nor would they benefit from any further contributions made.

From 1 January 2012, new rules will apply to the CPP payroll withholding for employees who are at least age 60 but under 70. For an employee who is under the age 65 and receiving CPP/QPP benefits and continues to work, the employee and employer would be required to continue to contribute into the CPP.

If the employee is at least age 65 but under 70 and receiving CPP/QPP benefits and continues to work, the employee and employer are required contribute unless the employee elects to stop making CPP contributions. However, if the employee chooses to continue contributing to the CPP, the employer is also required to contribute. These contributions will result in increased CPP benefits even though the employee is already receiving benefits from the CPP or QPP.

Actions to be taken
Employers should communicate the impact of these changes to their affected employees prior to 1 January 2012. While not mandatory, employers may wish to identify employees who are eligible to discontinue contributing to the CPP and provide those individuals with instructions. Existing payroll and human resource processes should also be reviewed to reflect the impact of these changes.

Vietnam – Work permits not getting any easier

The Vietnamese government are continuing their efforts to protect their local workforce and ensure that those coming to work in Vietnam do so legally. With this aim in mind, they have issued Decree 46 on the employment and administration of foreigners working in Vietnam.

The key changes introduced by the decree are set out below.

- An exemption from applying for a work permit has been introduced for specified foreign workers in the following categories:
  - Chief representative of a representative office.
  - An internal transfer providing specified services detailed in the schedule of specified commitments on services in accordance with the World Trade Organisation Accession.
  - Technical and professional consultants.
  - Individuals accredited to work in the sectors of information or press in Vietnam by the Ministry of Foreign Affairs.
  - Other cases in accordance with the Prime Minister's decision.

- The Ministry of Public Security has been instructed not to issue visas to foreigners to work in Vietnam if they have not been issued with a work permit or if their work permit has expired or is invalid.

- The Decree contains strict rules regarding the recruitment of foreign employees to work for foreign contractors in Vietnam. Investors must include specific regulations on labour under which the employment of local nationals is prioritised. Where the employment of foreigners is required, the foreign contractor must include their plan for using foreign employees in the bidding documentation.

Actions to be taken

The decree takes effect from 1 August 2011 and, if a foreigner working in Vietnam has not applied or obtained a work permit within six months from then (i.e. by 1 February 2012), they may be deported. Employers and employees should review the changes introduced by the Decree carefully to ensure that their work permit obligations are met.

Those responsible for immigration within organisations with operations in Vietnam should carefully monitor how the immigration system evolves in practice over the coming months and maintain close contact with their business operations to ensure that any disruption caused by these changes can be kept to a minimum.

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