

U.K. Proposes Binding 'Say on Pay' and a Limitation on Executive Severance Arrangements

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The U.K.'s implementation of "say on pay" in 2002 is widely considered the harbinger of mandatory "say on pay" in the United States. So far, in both countries, the shareholder advisory vote on executive compensation has been non-binding on companies and their boards. Now, the U.K. appears to be moving toward a binding regime. Earlier this spring, the U.K. government's Department of Business Innovation & Skills (BIS) published a [consultation paper](#) setting out a range of measures, including:

- An annual *binding* vote on *future* remuneration policy;
- An increase in the level of support required on votes on future remuneration policy (up to 75% of votes cast);
- An annual advisory vote on how the company's pay policy was implemented in the previous year (same as the status quo); and
- A *binding* vote on 'exit payments' of more than one year's salary - with 'exit payments' including not only cash severance payments, but also the vesting of equity compensation, continuation of benefits, etc.

How This Differs from Current Practice

Currently, the U.K.'s "say on pay" vote is limited to a shareholder advisory vote on the compensation of the executive directors (by approving the directors' remuneration report). The vote is retrospective in that it relates to the prior year's compensation. Under the proposal, the retrospective vote would remain advisory; however, there would also be a binding vote on future pay, where an affirmative vote would require a supermajority. Companies would be required to propose, at the start of the year, a pay policy for the upcoming year, including potential payouts and the performance measures that would be used. This proposal would then be put before shareholders. If, for some reason, the binding vote were lost, the company would be required to fall back to the last policy to be approved or hold another shareholders meeting so that shareholders could vote on a revised proposal.

To facilitate this binding vote on future remuneration, the U.K. government intends to publish draft regulations later this year, which will prescribe the content of remuneration reports. The regulations are likely to state that the section of the report that discloses the company's future remuneration should include the following elements:

- The composition and potential level of pay for each individual executive director;
- How proposed pay structures reflect and support company strategy and key performance indicators;
- What the performance criteria are, how performance will be assessed and how this will translate into total level of reward for each individual under different scenarios (e.g., on-target and stretch performance);
- How and why the company has used benchmarks and other comparison data to inform pay levels and structures;
- How employee pay and views have been taken into account; and

- How shareholders views have been sought and taken into account, including the results of the previous year's votes on remuneration.

In addition, there would also be a binding vote related to any severance arrangements for an executive director exceeding the equivalent of one year's base salary. A company proposing to pay a higher amount would be required to provide detailed information explaining the proposed amount, how it was calculated and why it is deserved. This proposal would then be put to shareholders. If the vote were lost, the company would not be able to pay the exiting executive more than the basic limit. Existing arrangements would be required to be amended prior to legislative effectiveness (as noted below, currently slated for October 1, 2013).

What to Expect Next

Already, this spring has been a tumultuous one for U.K. public companies. Three major companies - including, most recently, Aviva, Britain's largest insurer - have witnessed the departures or imminent departures of their CEOs, in connection with compensation arrangements that drew shareholder ire. And, just before their annual shareholders meeting, Barclays announced that a portion of the bonuses for the CEO and Finance Director would be subject to performance criteria. An unanswered question is whether these developments will serve to embolden shareholder activists, or whether they are Exhibit A that shareholders already have the ability to exert their will in compensatory matters.

As a formal matter, the consultation period closed on April 27, 2012, and our understanding is that a number of market players, including trade and business organizations, have commented on the proposals. The consultation paper notes that the government will consider the comments received and confirm the exact measures it proposes to take forward in primary legislation later this year, subject to parliamentary time being available.

Subject to the parliamentary process, the government expects legislation on new shareholder voting rights and revised reporting requirements to come into force in spring 2013. These provisions would take effect for companies whose reporting years end after October 1, 2013, and for executive directors whose contracts are terminated after that date; thus, this would impact shareholders meetings held after October 1, 2013.

It is contemplated that, in the first instance, these changes will be adopted via amendments to the U.K. Companies Act (analogous to the general corporation law of many U.S. states). Thus, they would apply to all U.K. public companies (the consultation paper notes that there are over 1,000 U.K.-incorporated companies listed on the London Stock Exchange's Main Market as of January 31, 2012, plus another 100 or so U.K.-incorporated companies listed on the NYSE, Nasdaq or in a European Economic Area state).

However, given the perceived anti-competitive effect that this could have on U.K.-incorporated companies (who might even seek to redomicile elsewhere), it remains to be seen if any changes along these lines will be implemented more broadly through other means, such as through the requirements of the UK Listing Authority or the index inclusion rules.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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