

KPMG's Guide to Executive Remuneration 2010



KPMG's Guide to Executive Remuneration 2010, which has just been published, analyses salary, bonus and long-term incentives for executive directors of FTSE 350 companies.

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Many companies have continued to take a cautious approach to pay and avoided making drastic changes to remuneration policies and strategies. However, across the board, total remuneration increased compared to the previous year. Basic salary increases were marginal (where made), so this suggests a return of payouts under long term incentives and bonuses.

Median total remuneration

The following table summarises the median basic salary, total cash and total actual earnings in the year for FTSE 100 and 250 chief executives, finance directors and other executive directors (2009 data in parentheses).

	Basic salary (£000s)	Total cash (£000s)	Total remuneration (£000s)
FTSE 100			
Chief Executive	828 (788)	1,743 (1,414)	2,307 (2,095)
Finance Director	475 (475)	1,060 (833)	1,356 (1,153)
Other Executive Directors	474 (458)	939 (815)	1,454 (1,199)
FTSE 250			
Chief Executive	440 (425)	747 (689)	992 (886)
Finance Director	282 (277)	482 (432)	591 (552)
Other Executive Directors	270 (253)	444 (416)	603 (540)

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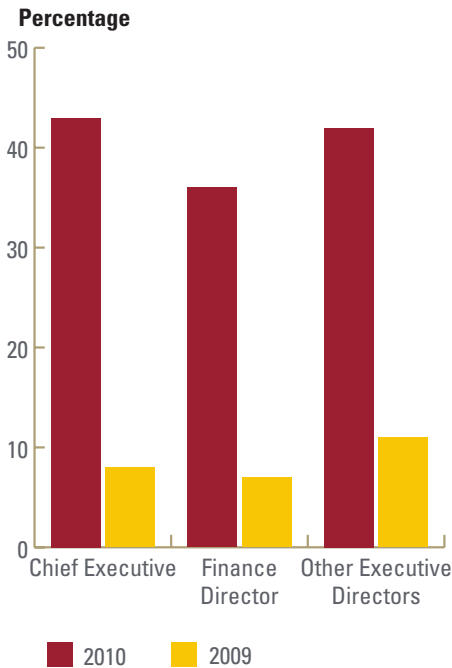
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Basic salary freezes and reductions

Median salary increases have been in the range of 0 to 3 percent, a reduction again from last year with many companies freezing pay for a second year at executive director level. There has been a significant increase in the number of companies implementing a pay freeze (in some instances decreases), as shown by the following graph.

FTSE 350 basic salary freezes and decreases

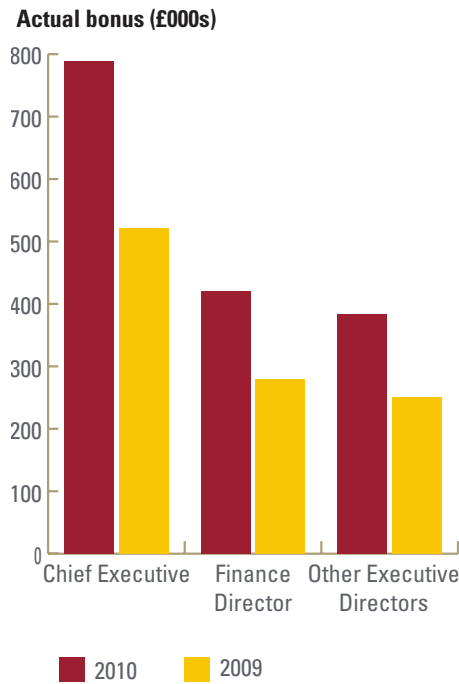


Actual bonus payouts

Analysis of actual payments made under annual bonus plans shows that these have increased from 12 months ago. This is perhaps surprising given continuing difficult economic circumstances, but this may reflect the recalibration of performance targets in light of the economic situation, meaning that achievement in difficult circumstances has been rewarded. There has also been some increase in the use of more subjective strategic and individual targets for annual bonus plans.

The graph opposite shows actual bonus payments made in FTSE 100 companies; the data for FTSE 250 companies shows a similar trend of increasing payments. The level of potential maximum bonuses has remained broadly stable.

Actual bonus payments made in FTSE 100 companies



Long-term incentive plans

The size of awards under long-term incentive plans, as a percentage of basic salary, has also remained steady, and the number of new and amended plans put to shareholders for approval has fallen. This again points to caution on the part of boards and remuneration committees and also suggests that current economic uncertainty makes long-term planning harder to do in a meaningful fashion.

There has been an increase in shareholder activism over the period, with a significant increase in the number of companies which had a vote against the directors' remuneration report of more than 20 percent. The main focus of shareholder unease has been around annual bonus plans, where limited disclosure and lack of clarity can mean shareholders struggle to understand the exact nature of the achievements which are being rewarded.

The vote on the remuneration report is an advisory one, but it is an important reputational issue for companies and the level of scrutiny is unlikely to reduce over the coming year. Shareholder engagement remains key to ensuring that the rationale and approach to pay is understood, even where companies are not planning any major changes.

Some companies who have delayed remuneration reviews and/or the implementation of new share plans due to the state of the economy will now be thinking about longer term remuneration strategy. The issues faced by companies over the last 12 months have highlighted more than ever that there is no one right approach to remuneration. The increasing debate and media focus on the level of executive pay, as well as the growing influence of short-term investors and changes in the tax and regulatory environment, all form part of the mix that will ensure remuneration committees have a busy 2011.

Subscribers will receive a copy of the 2010 guide shortly.

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Round up of recent developments

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Pensions changes

The government announced the following changes to the rules on pensions tax relief on 14 October 2010:

- From 6 April 2011 the annual allowance (AA) for tax privileged pension saving will be £50,000 (decreased from £255,000). The AA will be frozen at this level for the next three years.
- Defined benefit (DB) schemes will be particularly affected. The factor for valuing defined benefits for AA purposes will be 16 (increased from 10). Where an individual has a DB scheme, a relatively modest pay rise could use up his annual allowance.
- There will be a three-year carry forward of unused AA to mitigate against accrual 'spikes' (for both DB and defined contribution plans).
- Contributions in excess of the AA are to be taxed at an individual's marginal rates.
- From 6 April 2012, the lifetime allowance (LTA) will be £1.5 million (decreased from £1.8 million).
- The factor for valuing defined benefits against the LTA will be maintained at 20.

The new rules are to be included in the 2011 Finance Bill and are proposed to take effect from 6 April 2011.

Anti-forestalling rules have applied since April 2009. Individuals whose total pension savings exceeded £20,000 and who earn £130,000 or more (from December 2009) in the tax years 2007/08, 2008/09 and/or 2009/10 have been potentially affected. There are opportunities for those caught by anti-forestalling and whose tax relieved pension contributions were restricted to £20,000 or £30,000 to effectively over pay in 2011/12 and have the limits for each tax year increased to £50,000 (with up to 50 percent relief on these through the carry forward mechanism).

Legislation will also be brought forward to ensure that funded employer financed retirement benefit schemes (EFRBS) are 'less attractive than other forms of remuneration'. This draft legislation is expected towards the end of 2010 with these changes to come into effect from 6 April 2011. HMRC have said that this legislation will not be retrospective, i.e. transactions undertaken now should not be re-characterised, but that once the draft legislation is published it may contain anti-forestalling rules which would apply to EFRBS from that point.

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FSA remuneration code

The Financial Services Authority (FSA) remuneration code of practice (the Code), published in August 2009, requires firms to 'establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote effective risk management'. The Code sets out a number of principles related to fixed versus variable pay, deferral periods and linking variable pay to appropriate measures of performance.

In July 2010, the FSA issued a consultation paper on proposed changes to the Code to take account of the Capital Requirements Directive provisions affecting remuneration (CRD3) as well as the Financial Services Act 2010 and recommendations from the Walker Review. The final Code is due to be issued in December and will start to come into force from 1 January 2011 for remuneration paid in respect of 2010 performance.

One of the most significant proposed changes to the Code is the expansion of its scope from only 26 firms to around 2,500 banks, building societies, asset managers, brokers and other financial sector firms. Some existing guidelines have been reframed as rules, including proposed new rules on deferral for senior managers and 'risk takers'.

These require 40 percent of variable remuneration to be deferred over a period of at least three years (60 percent for amounts above £500,000). At least 50 percent of total variable remuneration is to be in the form of shares or similar instruments and clawback of deferred awards in certain circumstances is also required.

However, the principle of proportionality will apply to many newly affected firms in line with the nature of the firm, its internal organisation, scale, scope and complexity.

At the time of publication, further guidance has also been issued by the Committee of European Banking Supervisors (CEBS) which goes further than the revised draft Code. CEBS proposes that where there is a requirement to pay bonuses or other variable remuneration in cash and non-cash (usually shares) on the basis of a 50:50 split, a bank cannot pay cash first and then provide the shares as the deferred element. The FSA had previously indicated that it was prepared to see shares paid subsequently so that the prized cash element could be received first. The FSA will presumably have to fall in line with this guidance if it is included in the final version of the CEBS guidelines.

FSA consultation on remuneration disclosure

An FSA consultation paper on remuneration disclosure was published on 10 November with a consultation period ending on 8 December 2010. A policy statement on remuneration disclosure is due to follow in mid-December.

Under the Financial Services Act 2010, the FSA has the power to require certain FSA authorised firms to produce an Executives' Remuneration Report in addition to any Directors' Remuneration Report. Draft regulations on the Executives' Remuneration Report were published in March. These are presumably superseded by the current consultation, which is based on CRD3 and CEBS guidance.

The FSA consultation paper sets out details of both qualitative and quantitative information that will need to be disclosed. The qualitative information covers the remuneration decision making process, the link between pay and performance, the most important design characteristics of the remuneration system, performance criteria for remuneration and the main parameters and rationale for variable compensation and other non-cash benefits. Quantitative information covers the level of remuneration, the split between fixed and variable remuneration, detail on deferred remuneration and new sign-on and severance payments. Quantitative information is to cover senior staff and other staff with a material impact on risk profile.

There is to be proportionality with four tiers of firms each having different levels of disclosure. Only the first tier (the 26 firms currently covered by the FSA remuneration code) will need to make full disclosure. It is envisaged that most affected firms will be in the fourth tier and will need to disclose only basic qualitative and quantitative items. The FSA is consulting on whether to extend disclosure requirements to non-EEA firms operating in the UK. The FSA consultation paper is available [here](#).

Tribunal decision on bonus planning

The recent First Tier Tribunal case of UBS AG v HMRC (TC00648) concerned tax planning for bonuses. If upheld, it could have wider implications for employee incentive arrangements. It looks at when PAYE income tax and NIC arise on an employee bonus, and considers the definition of restricted securities in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) and the application of the Ramsay line of tax avoidance cases. A two page summary of the case can be accessed [here](#).

SAYE scheme bonus rates reduced

With effect from 12 September 2010, the Save As You Earn (SAYE) scheme bonus rates will be reduced as shown opposite (previous rates are shown in brackets). This will not affect employees with existing savings contracts. The early leavers' rate will remain at 0 percent.

Contract type	Bonus rate	Annual equivalent rate
3 year	0 x monthly payments (0)	0% (0%)
5 year	0.9 x monthly payments (1.8)	0.59% (1.16%)
7 year	3.2 x monthly payments (4.9)	1.15% (1.74%)

NAPF guidelines and AIC Code

In September 2010, NAPF published a draft updated version of its Corporate Governance Policy and Voting Guidelines, due to take effect for financial years beginning after 30 June 2010. The policy has been updated to take account of the publication of the UK Corporate Governance Code and can be accessed [here](#).

The UK's Association of Investment Companies has also recently updated its Code of Corporate Governance for investment companies which can be accessed [here](#).

What's happening abroad?

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France

The French government has announced proposals to raise additional tax revenue, including a proposal to increase the social contributions on share options. Currently, there is an employer contribution on the grant of qualifying stock options set at 10 percent and based on either 25 percent of the value of the underlying shares (i.e., an effective rate of 2.5 percent) or the fair market value of the option under IFRS 2 principles (i.e., 10 percent of the fair market value of the option). This is set to rise to 14 percent. There is also an employee contribution equal to 2.5 percent of the exercise gain when the shares are sold. This is set to increase to 8 percent. This means that the level of taxes paid on share options by the beneficiaries will be at a level equivalent to those on wages, since the increased contributions will be added to the already existing levies on stock options equal to 12.1 percent (CSG, CRDS, and other levies). The same charges apply to RSUs. The increased charges will only apply to new grants. The legislation has yet to be enacted, and the effective date is not yet known.

In a separate development, a recently published case of the Administrative Court of Paris has implications for internationally mobile employees with stock options. If the ruling is upheld, where the five year holding period since grant is met, the option gain will be treated as a capital gain. It was held that under the UK/France double tax treaty the gain was therefore taxed in full by reference to the location of the employee at sale, without any apportionment for time spent in the other country over the life of the option — so fully taxed in France with no double tax relief if the employee is in France at sale and not taxed at all in France if the employee has left France at the date of sale. The case has already been appealed, so the final outcome remains unknown. Further details can be accessed [here](#).

South Africa

The South African Revenue Service (SARS) has issued a 'limited scope audit questionnaire' to some employers covering employee share incentive plan participation over the last five years of assessment. In addition to interest charges, penalties of up to 200 percent could apply to any shortfall of employee tax identified by SARS as a result of the audit process. It could also trigger a wider audit of other payroll tax compliance.

Trinidad and Tobago

The recent budget proposals announced by the Minister of Finance included welcome proposals relating to qualifying employee share ownership plans. On withdrawal of shares from a plan, tax will only be charged by reference to the value of the initial investment (so that any appreciation in the value of the shares is not taxed). Current rules require that at least 40 percent of an annual bonus must be allocated to the plan for this qualified tax treatment to apply. It is proposed that this be reduced to 25 percent. Also, employees of subsidiary companies will be able to participate in the parent company plan if the proposals are enacted.

Hong Kong

Although the UK has a very comprehensive list of double taxation agreements, a notable exception is Hong Kong. This omission is due to be rectified as a double tax agreement (DTA) between the UK and Hong Kong was signed on 21 June 2010. The DTA will enter into force once both countries have completed their legislative procedures. The provisions of the DTA will then take effect from the next calendar year.

Canada

As previously covered [here \(at page 6\)](#), significant changes to the taxation of share options in Canada were announced in the 2010 federal budget. In August, the Department of Finance released draft legislation to implement the proposals. Related explanatory notes were also released in September. Employers with share plan participants in Canada should review option plans, related grant documentation and payroll withholding processes and consider whether any amendments are desirable as many of the proposals, once passed into law, will be effective from 4 March 2010.

United States

IRS Notice 2010-6 allows certain failures in employee share plan documentation to be corrected to avoid or mitigate tax penalties and interest under section 409A of the US Internal Revenue Code of 1986. There is a deadline of 31 December 2010 for corrections to benefit from the more generous 'transition relief' (which essentially avoids penalties rather than mitigating them). Companies who have not done so already may therefore want to consider what, if any, corrections should be made.

Individual US taxpayers may have interests in foreign trusts that give rise to special income inclusion rules and reporting obligations (although these rules do not generally apply to an individual participating in UK-style employee benefit trusts established by the employer). These rules have been amended by the recent Hiring Incentives to Restore Employment (HIRE) Act. Under the HIRE Act, the penalties that apply for reporting failures have been increased.

The HIRE Act also introduces a number of changes to the 'grantor trust' provisions that apply to deem a US person the owner of the trust for federal income tax purposes if that person transfers property to a foreign trust and the trust has a US beneficiary. These grantor trust provisions will be of wider application as the HIRE Act widens the circumstances in which a trust will be treated as having a US beneficiary.

The proposed increase in Medicare rates by 0.9 percent for certain high earners, due to take effect from 31 December 2012, could also affect some US share plan participants. This increase applies just to the employee portion of Medicare and is subject to employer income tax withholding on employees with compensation in excess of \$200,000.

Public companies that have to comply with US reporting requirements will also need to consider the new Dodd-Frank legislation, which incorporates some corporate governance changes to executive compensation, such as a requirement to seek additional shareholder input.

Portugal

Law 15/2010 revoked the previous tax exemption for capital gains resulting from the disposal of shares held for more than 12 months, effective from 27 July 2010. The first EUR 500 of gains remain exempt, as do shares in certain small unlisted companies. In addition, Law 12-A/2010 introduced an increase of 1.5 percent in the top five marginal income tax rates for the years 2011 to 2013 (the first three marginal rates increase by 1 percent each). The top marginal rate, due on taxable income above EUR 150,000, will now be 46.5 percent from 1 January 2011.

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