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Executive Compensation Around the Globe: Need for Robust Disclosure and Accountability in the 2013 Proxy Season

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Overview*

Executive compensation practices are under intense scrutiny in the wake of the global financial crisis and economic recession. Governments worldwide have increased their focus on regulation and/or public disclosure of compensation packages offered to executives of publicly held companies, based on the premise that, if a company is stagnant or not performing as well as it did in the past, then executive compensation should remain the same or be adjusted downward accordingly. During the past few years, the laws and policies surrounding executive compensation have become increasingly complex around the world, and countries are taking a variety of approaches in this respect. This article examines regulation of executive compensation on a global basis by focusing on three primary methods used across a variety of countries:

- laws/policies that provide for the public disclosure of, and often a shareholder vote relating to, certain aspects of executive compensation;
- laws allowing for certain contractual methods for companies to recover compensation previously awarded to executives; and
- laws that regulate or establish executive compensation parameters.

Through this three-prong analysis, we provide a summary of recent executive compensation legislative, policy, and tax practices on a selected global basis, survey the impact and effectiveness of such laws and policies to date, and provide insights from our securities and tax specialists globally on these issues.

Specifically, Part I of this article presents a selected global survey of laws and policies surrounding executive compensation transparency and disclosure, beginning with a brief overview of recent U.S. disclosure developments, analyzing in detail the evolution of the say-on-pay regime worldwide (including the varying approaches of the United Kingdom, United States, Australia, and Switzerland), and concluding with a short discussion of chief executive officer pay disparity rules and disclosure requirements in France and the United States.

Part II outlines the contractual methods (pursuant to regulation) that a company may use to recover compensation previously awarded to executives via clawbacks and ''malus'' conditions and the evolution of such approaches in the United Kingdom and United States.

Part III is a selected global survey of the laws establishing executive compensation parameters within France and the United Kingdom, concluding with the

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recent tax laws regarding executive compensation in the United States, France, and the United Kingdom.

I. Selected Global Survey of Laws/Policies Regarding Executive Compensation Transparency

A. U.S. Executive Compensation Background

In the United States, not much exists by way of regulations or other legal restrictions on setting executive compensation (compared to some countries, as outlined in Part III.A. below), with the notable exception of tax-related provisions, such as the $1 million limit on the tax deductibility of compensation that is not ''performance-based.''[1] In recent years, U.S. federal laws and regulations have been developed to ensure transparency of compensation paid to top executives at publicly held companies, including a requirement to list the dollar value of such compensation in a tabular format within the company's annual proxy statement distributed to shareholders and made publicly available.[2] Additional transparency requirements are afoot pursuant to the recent Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

Dodd-Frank. Dodd-Frank was signed into law July 21, 2010, primarily to regulate financial institutions in the wake of the financial crisis. The law also contains a number of provisions governing general public company oversight of executive compensation policies and procedures and gives the Securities and Exchange Commission the authority to enact rules furthering these requirements. As discussed further in this article, SEC has subsequently adopted a number of new compensation-related rules under the purview of Dodd-Frank applicable to U.S. public companies, including provisions related to say-on-pay. Other regulations mandated by Dodd-Frank, such as clawback and CEO-pay comparison provisions, are yet to be adopted by SEC.

ISS. Institutional Shareholder Services[3] has, in the past few years post-Dodd-Frank, established itself as the leading proxy advisory firm in the United States,[4] directing many institutional shareholders as to how to vote their shareholdings.[5] Studies show that, historically, a negative recommendation from ISS will, on average, influence between 13.6 percent and 20.6 percent of votes cast on management-sponsored proposals.[6] Throughout the 2011 proxy season, 12 percent of companies that received a negative recommendation from ISS failed their say-on-pay vote, whereas no company that received a positive ISS recommendation failed its say-on-pay vote.[7]

The influence of firms such as ISS may be caused by investor voting fatigue. With an increasing number of shareholder votes requiring in-depth shareholder analysis (such as say-on-pay, as discussed below), many investors do not have the time or resources to analyze each company's executive pay practices,[8] as outlined in detailed proxy statement disclosure.[9] Rather, such investors may find it easier and preferable to pay a fee for the advisory firms' reports and rely on their recommendations.[10] Thus, particularly in the arena of executive compensation, ISS's policies are closely monitored by public companies and their respective boards, because they often reflect the voting behaviors of many institutional shareholders that can frequently sway the outcome of a shareholder vote. As a result, this article also includes some aspects of the ISS 2013 corporate governance policy updates, which will impact the behavior of many U.S. public companies (although such policy updates are not law, and corporate boards should continue to exercise business judgment when setting executive compensation practices).

B. Say-on-Pay Legislation

Say-on-pay requirements are one of the most common types of regulation among countries attempting to shine light more intensely on executive compensation. Typically, the say-on-pay rules allow shareholders to cast an advisory vote on whether the shareholders ap-

[1] 26 U.S.C. § 162(m). Amounts are denominated in U.S. dollars unless otherwise stated.

[2] 17 C.F.R. § 229.402, Regulation S-K, Executive Compensation (Item 402).

[3] ISS provides corporate governance and risk management services to more than 1,700 clients in the global financial industry. It also assists with proxy voting and distribution, class action claims, and modeling tools. About ISS, http://www.issgovernance.com/about.

[4] While ISS is the largest and most influential proxy advisory firm in the United States, others such as Glass Lewis & Co. also provide these services. In part, ISS is likely more influential because, in addition to providing vote recommendations to shareholders, it also offers consulting services through which companies may receive feedback and guidance on methods to improve their executive compensation program and likelihood of a positive vote recommendation. In addition, ISS makes its recommendations available on a subscription basis such that firms, other advisers, and academics can review and research its recommendations. By comparison, Glass Lewis provides less public detail of its policy implementation, does not offer consulting services to companies, and generally does not provide access to its recommendations to academics or issuers.

[5] We note that, although there are generally voting advisory services in other countries such as the United Kingdom, they are not seemingly as influential as in the United States.

[6] Jennifer E. Bethel and Stuart L. Gillan, ''The Impact of Institutional and Regulatory Environment on Shareholder Voting,'' Financial Management, 2002, pp. 29-54; Jie Cai, Jacqueline L. Garner, and Ralph A. Walking, ''Electing Directors,'' J. of Fin. 64, 2009, pp. 2,389-2,421 (finding that firms with a negative say-on-pay recommendation obtain about 20 percent lower votes for their compensation program). See David F. Larcker, Allan L. McCall and Brian Tayan, ''The Influence of Proxy Advisory Firm Voting Recommendations on Say-on-Pay Votes and Executive Compensation Decisions,'' *The Conference Board: Trusted Insights for Business Worldwide*, March 2012, p.3.

[7] David F. Larcker, Allan L. McCall, and Brian Tayan, ''The Influence of Proxy Advisory Firm Voting Recommendations on Say-on-Pay Votes and Executive Compensation Decisions,'' *The Conference Board: Trusted Insights for Business Worldwide*, March 2012, p.3 (estimated results using ISS voting analytics data).

[8] Note, however, that large institutional investors such as Fidelity, Vanguard, BlackRock, and T. Rowe Price still assign analysts to study the compensation of their holdings, develop internal policies, and make voting determinations.

[9] Katayun Jaffari and Josh D. Bobrin, ''Dodd-Frank: Effects of Say-on-Pay Two Years Later,'' *The Legal Intelligencer*, Oct. 16, 2012, http://www.law.com/jsp/pa/PubArticlePA.jsp?id=1202574990615&slreturn=20130126110352.

[10] *Id.*

prove of the executive compensation packages offered to company executives. Rather than generally trying to reduce executive compensation, studies have shown that a say-on-pay approach is designed to, and typically effective in, aligning pay with performance.[11] (Unfortunately, in our current economy, for many companies this means reduced, stagnant, or smaller increases in executive compensation year-over-year.) Globally, there are three primary spectra of say-on-pay voting arrangements–a nonbinding shareholder vote, a binding shareholder vote, and Australia's ''two strike'' rule.[12]

United Kingdom. The first country to require a say-on-pay vote was the United Kingdom in 2003.[13] The regulation provides for a nonbinding shareholder vote at the annual general meeting (AGM) of shareholders. Section 439 of the Companies Act 2006 mandates a vote on annual director pay, and directors are expected to disclose their remuneration package in a ''Remuneration Report'' or otherwise be subject to fines.[14] Studies conducted in the United Kingdom upon the enactment of the law found ''evidence of enhanced sensitivity of CEO cash compensation to negative operating and stock performance'' following the rule's implementation.[15] Pirc, a London-based corporate governance advisory firm, published research in 2009 that found that, subsequent to the introduction of the say-on-pay rule in the United Kingdom, although overall remuneration at U.K. companies had risen, there were a higher proportion of executive pay packages that were performance-based.[16]

Members of Parliament, through the Enterprise and Regulatory Reform Bill announced in June 2012 by Minister for Business, Innovation and Skills Vince Cable, are now proposing to add a binding vote on both remuneration policy (to be obtained at least every three years) and exit payments to the currently required annual nonbinding vote on how a company's pay policy was implemented in the previous year.[17] If enacted, the bill would take effect in October. The potential switch to a binding vote could be problematic for some companies due to the results of the 2012 ''shareholder spring.'' Shareholder votes against companies' annual remuneration reports were not only frequent in 2012, but the negative votes received a significant amount of news coverage.[18] The feeling was that, as the global recession continued to bite, executives were not only unaffected, but were actually seeing disproportionate increases in pay–sometimes even getting ''pay for failure.''

It is worth noting that the United Kingdom also has other shareholder vote requirements in relation to compensation practices in U.K. listed companies beyond directors' basic pay. For example, employee share schemes that include directors must be approved by an ordinary resolution of the shareholders (meaning, a simple majority of the votes cast);[19] and an ordinary resolution is also necessary to approve any director's contract lasting longer than two years.[20]

Other Binding Vote Countries. The United Kingdom is not the first country to contemplate a binding shareholder say-on-pay vote; other countries have enacted such a requirement, which is typically tied to general compensation practices rather than specific pay. Dutch law calls for a binding shareholder vote, but the vote does not necessarily occur annually and the shareholder vote concerns compensation policies, not a retrospective pay report.[21] Following the Dutch model, Sweden and Norway, in 2006 and 2007, respectively, also enacted legislation requiring a binding shareholder vote on compensation policies.[22]

Switzerland is the most recent country to move toward a binding vote approach. Currently, Switzerland has a voluntary adoption of say-on-pay, but on March 3, in a Swiss referendum, 68 percent of voters approved a plan to require publicly listed companies to give their shareholders a binding annual vote on the compensation of top executives.[23] The measure would prohibit golden handshakes and parachutes that allow for significant compensation for executives when they join or leave a company.[24] Those who violate the rules could serve up to three years in prison and pay fines equal to up to six years of salary.[25] The Swiss government will

[11] *Say on Pay: Will U.S. Shareholders Give Executives the Thumbs Up on Compensation?* Knowledge at Wharton, Wharton School, Univ. of Pa., Jan. 5, 2011, http://www.knowledgeatwharton.com.cn/index.cfm?fa=viewArticle&articleID=2347&languageid=1.

[12] We note, however, that governments take a variety of approaches that may indeed deviate from a shareholder vote. For example, see the CEO pay disparity ratio discussion in Part III.A. of this article.

[13] Currently, per Companies Act (Eng.), 2006, § 439.

[14] In the United Kingdom, it is typical to have multiple executive directors within a company who are both executives and also on the board of directors, so director remuneration reports also address a company's key executive officers.

[15] Sudhakar Balachandran, Fabrizio Ferri, and David Maber, *Solving the Executive Compensation Problem Through Shareholder Votes? Evidence from the U.K. 1*, Nov. 2007 (unpublished manuscript) (quoted in Randall S. Thomas, Alan R. Palmiter, and James F. Cotter, *Dodd-Frank's Say on Pay: Will it Lead to a Greater Role for Shareholders in Corporate Governance?*, 97 Cornell L. Rev. 1213, 1228, July 2004.

[16] *Say on Pay: Will U.S. Shareholders Give Executives the Thumbs Up on Compensation?* Knowledge at Wharton, Wharton at University of Pennsylvania, Jan. 5, 2011, http://www.knowledgeatwharton.com.cn/index.cfm?fa=viewArticle&articleID=2347&languageid=1.

[17] Cassell Bryan-Low, *U.K. Unveils Plan on Executive Pay*, WSJ Online, June 20, 2012, http://online.wsj.com/article/SB10001424052702304765304577478172485959522.html. Also http://news.bis.gov.uk/Press-Releases/Government-announces-far-reaching-reforms-of-directors-pay-67b96.aspx.

[18] *See, e.g., Barclays stung by shareholder pay revolt*, BBC, April 7, 2012, http://www.bbc.co.uk/news/business-17860232 (26.9 percent of shareholders voted against compensation packages to Barclay's executives).

[19] London Stock Exchange Listing Rule 9.4.1.

[20] Companies Act (Eng.), 2006, § 188.

[21] *See* Regan Adamson and Daniel Lumm, Shareholder Democracy and the Say on Pay Movement: Progress, But How Do You Define Success?, 6 Wake Forest L. Rev. Working Paper Series, 2009; (see Thomas, Palmiter and Cotter, Cornell L. Rev., *supra* note 15, at 1227).

[22] *Id*.

[23] Carol Matlack, ''Swiss Limits on Executive Pay: Less Than Meets the Eye,'' Bloomberg Businessweek, March 4, 2013.

[24] *Id*. Note: Pension funds holding shares in publicly listed companies would be required to participate in votes on compensation packages. *See* Raphael Minder, ''Swiss Voters Approve a Plan to Severely Limit Executive Compensation,'' N.Y. Times, March 3, 2013.

[25] Raphael Minder, ''Swiss Voters Approve a Plan to Severely Limit Executive Compensation,'' N.Y. Times, March 3, 2013.

still need to establish rules to implement the specifics of the measure.

United States. As compared to the United Kingdom and some of the other European countries, say-on-pay legislation is relatively new in the United States. Under Dodd-Frank and subsequent SEC rulemaking,[26] U.S. publicly held companies are required, at least once every three years, to provide shareholders with an opportunity to vote (on a nonbinding basis) on the compensation of the company's named executive officers as disclosed in the company's proxy statement (generally speaking, the named executive officers consist of a company's CEO, chief financial officer, and next three most-highly compensated officers).[27] Also, at least once every six years, companies must provide shareholders with an opportunity to vote to determine whether the say-on-pay vote will be annual, biennial, or triennial (the ''say-on-frequency'' vote).[28] For most companies, both votes were to occur for the first time at the first annual meeting of shareholders on or after Jan. 21, 2011. Although early in the 2011 proxy season the say-on-frequency trend was toward recommending triennial say-on-pay votes, as major proxy advisory groups such as ISS (and, in turn, large institutional shareholders) expressed a preference for holding annual say-on-pay votes, more companies began recommending an annual vote frequency.[29] Today, a majority of U.S. companies provide for an annual say-on-pay vote.[30]

The say-on-pay results have not been as dramatic in the United States as other countries to date, with less than 2 percent of companies in 2011 delivering a negative say-on-pay vote, and approximately 2.5 percent in 2012.[31] More than 90 percent of companies passed their say-on-pay votes with at least a 70 percent approval rate (the 70 percent threshold is key because advisory firms such as ISS view the 70 percent threshold as one below which remedial action is needed).[32] The majority of companies that did not pass their say-on-pay votes in 2011 did pass their say-on-pay votes in 2012.[33] Such results potentially mean that companies are adjusting their compensation practices to meet shareholder expectations, are engaging shareholders effectively, and/or are making a decided effort to improve disclosure in the compensation discussion and analysis section of their proxy statements.

Australia. On the far side of the spectrum is Australia's two-strike rule. Australia has had a say-on-pay vote requirement since 2005, when it adopted the requirement for nonbinding shareholder votes on remuneration reports, similar to the approach in the United Kingdom. Starting July 1, 2011, however, Australian listed companies have been required to adopt a ''two strike rule''—first placing the remuneration report to a vote at the AGM. If the report receives a ''no'' vote of 25 percent or more of shareholders, it receives a ''first strike.'' If a subsequent ''no'' vote of 25 percent or more is received, it is a ''second strike'' and the members of the company's board must be put up for re-election (a so-called ''board spill'' resolution) within 90 days. Fifty percent or more of the shareholders must vote in favor of the board spill resolution for it to be carried. More than 100 Australian companies received a ''first strike'' last year. Many have taken action to either reduce the pay or bonuses, or provided additional information to the shareholders to justify the remuneration. However, a small number of companies have risked a ''second strike'' by increasing executive remuneration. This may be because such directors are confident of being re-elected due to significant voting power held by entities associated with the directors.[34]

Voluntary Say-on-Pay. Germany introduced a say-on-pay vote in 2009, and beginning in 2010, most German firms gave shareholders a vote.[35] Like other countries, such as Canada and Germany continues to have voluntary adoption of say-on-pay, without making it a legal requirement.[36]

Say-on-Pay: Next Steps. The consistent thread among the various countries' say-on-pay approaches outlined above is that, regardless of whether the shareholder vote is binding or nonbinding, voluntary or involuntary, or a ''two strike'' approach, companies (on an increasingly global basis) must be able to effectively communicate to their shareholders the connection between executives' pay and the company's performance in order to win shareholder support. Not surprisingly, in most cases within the United States in which ISS issued a negative recommendation against a company's executive compensation program, the advisory firm indicated that there was a disconnect between pay and performance. In conducting its analysis, ISS reviews the alignment of an executive's total pay and total shareholder return (stock price performance plus any paid dividends), and then compares this ratio to that of the

[26] Securities and Exchange Act of 1934 § 14A(a)(1); 17 C.F.R. 240.14a-21(a).

[27] Dodd–Frank Wall Street Reform and Consumer Protection Act § 951 (limits say-on-pay to the named executives during the prior fiscal year, which include the principal executive officer (PEO), the principal financial officer (PFO), the three most-highly compensated executive officers other than the PEO and PFO who were serving at the end of the prior fiscal year, and up to two additional individuals who would be highly compensated officers, except that the individual was not serving as an executive officer at the end of the prior fiscal year); *see also* Item 402(a)(3) of Regulation S-K.

[28] Securities and Exchange Act of 1934, § 14A(a)(2); 17 C.F.R. § 240.14a-21(b).

[29] *See The ''Say on Pay'' Frequency Vote*, Compensia News, Jan. 14, 2012, http://www.compensia.com/news_sayonpay.html (1,688 U.S. public companies have an annual vote recommendation, 83 biennial, and 1,297 triennial).

[30] *Id*.

[31] Katayun Jaffari and Josh D. Bobrin, *supra*, note 9.

[32] *Id*. For the 2012 proxy season, ISS revised its policies to provide if a company receives less than 70 percent approval of say-on-pay, ISS will review further to determine if negative vote recommendations are warranted.

[33] *Id*.

[34] *See generally* Meredith Paynter, Nicola Charston, Tim Bednall, *Directions 2012: Current issues and challenges facing Australian directors and boards*, Mallesons Stephen Jaques (Brisbane, QLD, Australia) (the ability of directors to re-elect themselves reduces the effectiveness of shareholder control but also assures corporate continuity), http://www.mallesons.com/Documents/Directions_2012.pdf.

[35] *Cleaning the Augean tables: Corporate Governance in Continental Europe Is Improving Rapidly,* The Economist (Paris), June 23, 2011, http://www.economist.com/node/18867298.

[36] David F. Larcker, Allan McCall, Gaizka Ormazabal, and Brian Tayan, *Ten Myths of ''Say on Pay''*, Stanford Graduate School of Business, Closer Look Series: Topics, Issues and Controversies in Corporate Governance, June 28, 2012, p. 2, http://www.gsb.stanford.edu/sites/default/files/research/documents/CGRP26-Myths.Say_.on_.Pay_.pdf.

company's peer group, as determined by ISS. Hence, one of the complaints from U.S. public companies has been ISS's historic selection of peer groups, which often do not match those selected by the companies themselves for their disclosure purposes.

In its 2013 Corporate Governance Policy guidelines, ISS provided various updates to its corporate governance policy, some of which are directed at its pay-for-performance analysis. In conducting such analysis, ISS previously selected a U.S. company's peer group based largely on the company's Standard & Poor's Global Industry Classification Standard (GICS), selecting 14 to 24 companies with a matching GICS that were reasonably similar in industry profile, size, and market capitalization to the particular company. This methodology sometimes did not reflect multiple business lines in which a company operates, resulting in omitting competitors of the company and/or including peers that were not appropriate for performance and pay comparisons. Moving forward under the new 2013 updates, the ISS methodology will now initially focus on an eight-digit GICS to identify peers more closely related within a company's industry. It will also incorporate information from a company's self-selected pay benchmarking group to identify and draw peers from the GICS groups represented in the company's self-selected peer group. In essence, ISS will prioritize peers that are in the company's GICS peer group, that have chosen the company as a peer, and that result in an overall peer group in which the company falls near the median. Companies are hopeful that the new ISS peer group approach will result in the ISS pay-for-performance analysis more closely aligning with the company's analysis and review.

Looking beyond the 2013 proxy season and with a global eye toward the evolution of say-on-pay in other countries, it is difficult to predict the direction that say-on-pay within the United States may ultimately take. If the state of the economy does not see an uptick in coming years, the United States could possibly move toward a binding vote requirement, much like the United Kingdom is currently considering. It is less likely that U.S. legislation and rulemaking would go so far as the Australian ''two strike'' approach; however, one could certainly envision a scenario in which ISS might incorporate such a policy in its pay-for-performance analysis.

On the other hand, if the economy improves, there may be less emphasis on the transparency of executive compensation, relaxing the disclosure approach (for example, more companies might seek and receive a triennial say-on-frequency vote). A perfect example is Hong Kong, which has had a more robust economy than most countries during the past few years. In Hong Kong, executive compensation is not as much of a concern compared to other countries, as evidenced in part by the continuous increase of executive pay.[37]

Regardless of how the future economic environment may impact say-on-pay, currently, public companies are preparing 2013 proxy statement disclosures and facing increased changes in say-on-pay regulation. Generally, such changes are designed to improve the transparency of executive compensation in proxy statements in order to allow shareholders to make informed decisions rather than just voting ''yes'' or ''no'' without understanding what their vote is about.

C. CEO Pay Disparity Ratio

France. A shareholder say-on-pay vote is not the only approach taken by governments to monitor executive compensation. During his campaign, French President Francois Hollande promised to limit the pay of CEOs of state-owned French companies to 20 times the average of the lowest salaries in those companies.[38] On June 13, 2012, the French minister of economy and finances presented a decree to the Council of Ministers to limit the compensation of state-owned companies' top managers to €450,000 which would apply in 2012 or 2013, depending on when CEO compensation is discussed by companies' shareholders.[39] Further, the French government is exerting pressure on other companies in which it has minority ownership positions to provide similar restrictions.

United States. Along a similar vein in the United States, Section 953 of Dodd-Frank requires SEC to issue rules requiring additional disclosure about certain compensation, including pay-for-performance and the ratio between a publicly held company's CEO total compensation and the median total compensation for all other employees. Although certainly not a government-imposed limit like the French approach, requiring such disclosure by U.S. public companies will likely result in some revealing disparities. That being said, many public companies suspect that this aspect of Dodd-Frank could ultimately be the most costly and time-consuming compensation-related requirement for them, depending upon the SEC approach taken. The law requires that the total compensation calculations be made pursuant to SEC proxy rules, but public companies currently only calculate that information for their named executive officers, not the entire employee pool. Further, there are nuances to consider, such as whether consultants should be included, exchange values for employee compensation in other countries, and the like. To date, SEC has not issued proposed rules in this area.[40]

II. Clawbacks/Malus Conditions: Contractual Methods for Companies to Recover Executive Compensation Previously Awarded

In addition to the disclosure and transparency of executive compensation, another primary focus in the executive compensation arena found in multiple countries is for a company or regulating entity to have the ability

[37] *See generally 2011 Mainland China and Hong Kong Executive Compensation Report*, Ernst & Young LLP, http://www.ey.com/CN/en/Services/Tax/2011-Mainland-China-and-Hong-Kong-executive-compensation-report (showing that the median of CEO's total cash compensation increase was 5 percent in 2009 during the financial crisis and 12 percent in 2010).

[38] ''Reported CEO pay levels in the U.S. are far lower than CEOs in France,'' Financial Times, May 31, 2012 (the only U.S. public company to limit pay with this type of ratio is Whole Foods. In that case, the CEO's pay is limited to 19 times the average employee wage. No such limit applies to equity compensation of the Whole Foods CEO).

[39] See ''France: Government Officials Ready CEO Public Sector Pay Limit & Discussions on Private Sector Limit,'' Towers Watson, July 2012, http://www.towerswatson.com/newsletters/global-news-briefs/7562.

[40] SEC no longer publishes a proposed rulemaking time frame.

to recover, or ''clawback,'' funds previously paid to an executive under certain circumstances.

United States. Clawbacks were first codified and became prevalent with the enactment of the Sarbanes-Oxley Act of 2002. Section 304 of Sarbanes-Oxley requires SEC to seek repayment of incentive compensation from executives in cases of financial statement fraud. Section 954 of Dodd-Frank expanded this clawback rule to cases that involve accounting misstatements, regardless of fault. The rules to be implemented pursuant to Dodd-Frank will require companies to develop, adopt, implement, and disclose clawback policies to recoup executive incentive-based compensation from former and current executives over a three-year period in the case of an accounting restatement. This clawback mandate under Dodd-Frank will likely extend beyond the typical clawback provisions that companies may already have in place, because it does not require executive misconduct in connection with the restatement. SEC has not yet issued its proposed rules on clawbacks under Dodd-Frank. As a result of the legislation and despite the lack of SEC rules, as of the end of 2011, 86 percent of Fortune 100 companies maintained and disclosed a compensatory recovery policy (up from 20 percent in 2006).[41]

Two recent high-profile scandals within the financial industry have given further color to the practical implementation of clawback policies. Both UBS AG and JPMorgan Chase & Co. were able to recoup bonuses and incentive compensation from their employees involved in the events that led to the banks' losses of $1 billion and $5 billion, respectively.[42] Despite this, a 2011 survey revealed that only 17 percent of global banks suffering recent losses actually clawed back employee compensation.[43] This raises the question of whether companies that have clawbacks in place will utilize them when appropriate because of the practical issues encountered when asking for compensation already paid to be returned to the company.

Another related approach is to include ''malus conditions'' on deferred compensation, which allows companies to revise the payment amount or not pay an executive at all if actual performance is ultimately significantly less than anticipated when the original award was established. Approximately 80 percent of global banks have introduced such malus conditions on their deferred compensation.[44]

Europe. In the United Kingdom and the rest of Europe, clawbacks have been utilized since 2009 with numerous banks, including HSBC, Royal Bank of Scotland, Lloyds Banking Group, UBS, and Deutsche Bank, being subject to significant recoupments.[45] While clawbacks are and have been a requirement for these financial institutions, the same is not yet true of the rest of the corporate market. However, the nonfinancial sector has undoubtedly begun to follow the banks' lead, even before proposed legislative provisions were contemplated. Clawback and malus provisions are not (yet) a requirement for U.K. listed entities, but their adoption continues to increase. Throughout 2012, the introduction of clawback provisions continued, with 60 percent of the FTSE 100[46] companies surveyed disclosing some form of provision under at least one plan.[47] The United Kingdom's proposed approach to regulating aspects of the disclosure of executive remuneration will require companies to explain, as part of the general policy on remuneration, whether there are clawback or malus provisions available to use against each main element of directors' pay. This will be effective for companies whose reporting years end after October 2013. In addition, the U.K. Corporate Governance Code is likely to be updated during 2013 in order to include clawbacks as part of its regime of ''comply or explain.'' As a result, companies will need to detail either how they have implemented the provisions or, if they have not, why they have chosen not to adopt such measures.

III. Selected Global Survey of Laws Establishing Executive Compensation and Related Tax Laws

A. Laws Governing the Establishment of Executive Compensation

As discussed above, some countries have focused on a variety of regulations and policies to increase transparency of executive compensation arrangements. Alternatively, some countries have focused on setting appropriate pay levels, either instead of, or in addition to, transparency aspects. In this regard, below is a discussion of how a few countries address the issue through compensation requirements.

France. In France, significant guidance on compensation best practices exists for public companies under recommendations published by the Afep, Middlenext (associations of large or listed companies) and the

[41] Equilar Inc.'s Clawback Policy Report, 2012, http://www.equilar.com/knowledge-network/research-reports/2012-research-reports/2012-Clawback-Policy-Report.php. E.g., Elizabeth G. Olsen, *Executive pay clawback: Just a shareholder pacifier?*, CNN Money, Aug. 16, 2012, http://management.fortune.cnn.com/2012/08/16/executive-pay-clawbacks/; *see also Compensation Recovery (''Clawback'') Provisions—Becoming Familiar with the Looming Requirement*, Compensia, Thoughtful Pay Alert, http://www.compensia.com/tpa_090912_clawbacks.html.

[42] Katayun Jaffari and Josh D. Bobrin, *Dodd-Frank: Effects of Say-on-Pay Two Years Later*, The Legal Intelligencer, Oct. 16, 2012, http://www.law.com/jsp/pa/PubArticlePA.jsp?id=1202574990615&slreturn=20130126110352.

[43] *Id.*, and Mercer's Financial Services Executive Compensation Snapshot Survey, Aug. 23, 2012, http://www.mercer.com/press-releases/17-percent-of-banks-clawed-back-compensation-in-2011.

[44] Rebecca Patton, *Global Banks Claw Back Staff Bonuses*, Employee Benefits Group (U.K.), Aug. 24, 2012, http://www.employeebenefits.co.uk/news/global-banks-claw-back-staff-bonuses/15585.article.

[45] Sharlene Goff and Daniel Schafer, *Banks ready to claw back more bonuses*, Financial Times.com, Aug. 27, 2012; *see also* Catherine Boyle, *Bye-Bye, Big Bonuses: Hello Claw-Backs and Caps*, CNBC.com, Jan. 3, 2013, CNBC.com, http://www.cnbc.com/id/100351325/ByeBye_Big_Bonuses_Hello_ClawBacks_and_Caps; Paul Hodgson, *It Is Time For Real Bank Clawbacks*, Forbes.com, Nov. 15, 2012, http://www.forbes.com/sites/paulhodgson/2012/11/15/it-is-time-for-real-bank-clawbacks/.

[46] The FTSE 100 generally refers to the 100 largest (by market capitalization) companies listed on the London Stock Exchange.

[47] Towers Watson, *A tale of two seasons—The 2012 reporting season*, August 2012, http://www.towerswatson.com/united-kingdom/newsletters/executive-compensation-market-watch/7744.

French employers' association, the Medef. Key provisions are as follows:

■ Remuneration generally must be fair, coherent, and understandable when measured as a whole. It must be set according to the market, financial performance, responsibilities taken on, and any particular tasks assigned.

■ Fixed remuneration must be reviewed regularly with regard to events affecting the company and must take into account variable remuneration.

■ Variable remuneration must be fixed for a stated period. It must represent a maximum percentage of fixed pay and should not depend on market conditions, but on short-term performance and the company's progress generally. Performance criteria must be precise and explicit, correspond to the company's objectives and be challenging, clear, measurable, objective, and, as far as possible, constant.

■ Finally, the Afep and the Medef recommend that performance-based criteria for termination payments (now regulated) should be challenging, and termination payments should be authorized only in the case of forced departure by reason of a change in control or strategy. Compensation should be limited to a maximum of two years' remuneration (fixed and variable).

United Kingdom. The issue of setting remuneration in the United Kingdom is regulation-light and guideline-heavy. Until the United Kingdom's reformatory proposals become law, investors continue to lead the way in U.K. guidance, with policies and recommendations being updated on an annual basis. The Association of British Insurers' (ABI) ''Principles of Remuneration'' is a key set of recommendations as to how a compensation committee and, to a lesser extent, the shareholders of a company, should determine and vote on remuneration and its structure. The ABI expects companies to comply with the Companies Act 2006, the U.K. Corporate Governance Code, and the U.K. Listing Rules, with its principles providing further, more detailed guidance. The National Association of Pension Funds also issues ''Corporate Governance Policy and Voting Guidelines,'' which touch on both the levels and components of remuneration. Remuneration consultants are another group that, alongside investors and investor bodies, has the ear of compensation committees. These independent advisers operate under their own code of conduct and will directly advise a compensation committee as to its own policies, as well as update members of the committee on market practices.

In addition, U.K. guidance is provided in the Financial Remuneration Code, which applies generally to approximately 2,700 banks, building societies, and capital adequacy directive investment firms, including broker-dealers, hedge fund managers, venture capital firms, and multilateral trading facilities. The code is directed at senior management and risk takers and staff in control functions (the latter two collectively, ''code staff'') and is intended to promote sound and appropriate risk management. Among the provisions of the code are the following:

■ At least 40 percent of code staff's bonus must be deferred for at least three years. At least 60 percent of a bonus must be deferred for the most senior management or when the bonus exceeds £500,000.

■ At least 50 percent of any bonus must be made in shares, share-linked instruments, or other noncash instruments of the firm. The shares must be subject to an appropriate holding period.

■ Bonuses must not be guaranteed for more than one year. Guarantees may only be given on extraordinary occasions to new hires for the first year of service.

■ Details of remuneration policies must be disclosed annually.[48]

B. Impact of Recent Tax Legislation on Executive Compensation

In addition to increased disclosure, transparency, and shareholder input in relation to executive compensation, tax considerations are also a factor for public companies in relation to their executive compensation programs. The impact of taxes can be a major motivator in regards to the compensation packages offered to executives globally. For instance, incentive stock options are an attractive alternative in the United States due to possible capital gains tax-favored treatment, but stock options are less likely to be an attractive alternative in France due to recent legislation to treat such gains as subject to the usual personal income tax rates. In this section, we will provide a brief overview of recent tax legislation developments and possible potential planning opportunities for multinational companies with mobile executives.

United States. On Jan. 3, the American Taxpayer Relief Act of 2012 (ATRA) was signed into law. ATRA raises federal income tax rates from 35 percent to 39.6 percent on incomes that exceed $400,000 for single taxpayers and $450,000 for married taxpayers filing jointly. ATRA also restores the Social Security withholding rate to its previous 6.2 percent from the 4.2 percent rate in effect under the so-called payroll tax holiday.

In light of these higher tax rates, some executives will want to defer the payment of compensation until a later date in the hope that lower tax rates will be reinstated. With such thoughts, taxpayers should keep in mind that any potential deferrals of compensation and bonuses of U.S. taxpayers must comply with the strict timing rules under tax code Section 409A.[49] Both the deferral election and the form of payment must be made before the calendar year in which services are performed, i.e., Dec. 31 of the year before the year in which services are to be performed. A later election—six months before the end of the performance period—may be permitted under the regulations if, and only if, compensation meets the Section 409A definition of ''performance-based

[48] FSA, *About the Remuneration Code*, http://www.fsa.gov.uk/about/what/international/remuneration/about.

[49] 26 U.S.C. § 409A (Section 409A taxes nonqualified deferred compensation when it is no longer subject to a substantial risk of forfeiture. The statute and regulations thereunder codify specific rules that must be followed if such nonqualified deferred compensation is not to be taxed with an extra 20 percent tax and potential penalties and interest. In addition, the regulations set forth certain exemptions that, if met, allow certain compensation to avoid § 409A. Some state tax systems in the United States, such as California, have their own versions of § 409A, such that the total additional tax for failure to comply with § 409A can amount to 40 percent).

pay,'' and if the amount of pay is not determinable at the time of the election.[50]

France. Recently, France enacted new legislation to raise income taxes. Key highlights include the following:

- creation of a new top rate for personal income tax of 45 percent (and a rate of 75 percent for income beyond 1 million euros is still being debated),

- dividend and interest income is subject to the usual personal sliding scale of income tax rates,

- the deemed gain arising on the acquisition of stock under stock options and restricted stock schemes (so called *actions gratuites* or free shares) are now also subject to the usual personal income tax rates without any relief for length of ownership,

- the rate of taxation of capital gains is increased from 19 percent to 24 percent, and

- computation of the 10 percent taxable portion of capital gains on the sale of shares is based on gross capital gain rather than on net capital gain.

United Kingdom. In addition, the United Kingdom introduced a wide ranging law in 2011, known as the ''disguised remuneration legislation,'' which looks to clamp down on companies remunerating employees through third parties. These rules have been introduced to counter mounting concerns over the use of third-party arrangements that allocate money or assets to employees in a way that avoids or defers any liability for income tax and social taxes. The legislation is very widely drafted and in particular can result in an employee being charged tax on assets held by an employee benefit trust even though the employee has not, and may never, receive the assets. With many normal remuneration arrangements being brought within the scope of this legislation, it is now necessary to check most types of deferred remuneration arrangements (including stock awards) to ensure that they do not trigger the legislation or that an appropriate exemption from the charge is available. The legislation has had a significant effect on unregistered pension arrangements and planning opportunities in this field have, as a result, now switched from trust arrangements to unfunded promises of retirement benefits. Conceptually, the legislation is similar to Section 409A and planners must be wary of drafting employment agreements and deferral arrangements that do not comply with the legislation.

[50] Treas. Reg. § 1.409A-1(e)(1) and (2).

IV. Conclusion

Whether it is through laws regulating or establishing direct parameters for executive compensation, laws or policies providing for public disclosure and transparency of executive compensation practices, or contractual clawback arrangements, the current global trend is to increase corporate accountability of executive compensation policies and practices at publicly held companies.[51] Essentially, good corporate governance requires disclosure of meaningful information on the company's executive compensation practices and policies relating to risk management. [52]

To address the requirements for accountability, good governance, increased transparency, and the need for robust disclosure to more closely align a company's executive compensation policies with financial performance, companies are required to stay abreast of the various rules, regulations, and policies in this developing area of law in each country in which they operate. To effectively meet these new challenges, we recommend that companies conduct an independent global review that objectively integrates executive compensation, securities, best corporate governance, and tax concerns covered in this article. Such oversight should also provide a global update on evolving rules, regulations, and policies in this area. The independent review can be structured to focus on strengthening governance procedures regarding the compensation practices of the company relating to risk management, mitigating the risk of potential misalignment of a company's compensation policies with their global platform objectives, and identifying areas at risk of compliance failure due to design, implementation, or disclosure concerns or problems.

[51] Richard Hill, ''SEC's Aguilar Says Companies Should Improve Compensation Disclosures,'' *Pension & Benefits Daily*, Bloomberg BNA (36 PBD, 2/22/13; 40 BPR 446, 2/26/13). SEC Commissioner Luis Aguilar urged corporations to disclose more information in their public filings to shareholders about compensation, leadership structure and oversight, and board diversity. Disclosure of board nominating policies regarding diversity is another disclosure provision enhanced by recent laws. Recognizing the increasingly complex global market place, Aguilar stated that diversity is a critical attribute to a well-functioning board and an essential measure of good governance.

[52] 17.C.F.R.229.402(s)

