Slaughter and May Podcast
Redundancy in focus: Pensions and incentives implications

Clare Fletcher	Hello and welcome to the fourth in our series of Slaughter and May podcasts "Redundancy in focus". I'm Clare Fletcher, a professional support lawyer in the Employment team, and today I'm joined by Richard Goldstein, our Head of Pensions Knowledge, and Ian Brown, our Incentives Senior Counsel. Today's episode looks at the pensions and incentives aspects of redundancy. There are five key points that Richard and Ian will discuss: 1. The potential for generous defined benefit pension treatment on redundancy 2. Some tax issues to bear in mind for redundancy pension benefits 3. The implications of redundancy for all employee share plans 4. How the position differs with executive awards 5. What approach the employer may want to take to incentivising survivors of a redundancy process. So Richard can I ask you to start on the pension's aspects. If an employee is fortunate enough to still benefit from a form of defined benefit accrual, what implications might there be if they are made redundant?
Richard Goldstein	Thanks Clare, you're right defined benefit accrual is quite rare these days and is really rather the exception to the rule. Although we do see defined benefit accrual coming up sometimes in the context of redundancy exercise. If the employee is lucky enough to have defined benefit accrual, you do need to check the pension schemes rules to see what is provided on redundancy. Sometimes on redundancy, there are very generous benefits provided and that can particularly be the case for employees formerly employed in the public sector. These more generous benefits are not typically funded for in the ordinary course for the pension scheme so there may be an immediate and significant cost to the business if these redundancy benefits are granted. A few other points to note are that it can be unclear on the face of some schemes rules whether these more generous benefits apply, and legally advice therefore may be needed. It can also be difficult in some cases to amend the scheme rules to change this generous benefit. We have been advising in a few cases recently for employers trying to amend out these more generous provisions and in practice this is quite difficult to achieve.

Clare Fletcher	So certainly something to think about for defined benefit schemes. In terms of tax though, there are some issues to consider for both DB and DC schemes?
Richard Goldstein	Yes, so I wanted to raise two quite unrelated tax points. One to the advantage of the employee and one perhaps to the disadvantage to the employee, and as you say these relate to both defined contribution (DC) and defined benefit (DB) accrual. So firstly, there may be a tax advantage for an employee, if you use a salary sacrifice arrangement. The way that the salary sacrifice arrangement would work would be that rather than the employee receiving the redundancy payment and paying potentially significant tax on a large part of it, the employee can instead make a contribution to the pension scheme. And employee contributions to a scheme can be quite a tax efficient in the hands of the employee. The one thing to note on this approach though is that there are limits on the amount of contributions that can be made to a pension scheme. The limits are referred to by reference to the annual allowance, and that ties in with the second point I wanted to make which is perhaps more of a disadvantage, particularly for higher earners. The disadvantage is that the redundancy payments itself can take the income of the higher earner above the annual allowance, above the tapered annual allowance. So where income of high earners is above a certain level, the actual annual allowance that you can make as way of employee/employer contributions to a pension scheme reduces or tapers down. So this could be rather unfortunate for the employee in question in that they end up paying tax on both the redundancy payment itself and also on the pension contributions they've made in that tax year, because the redundancy payment itself has taken them above the level of income required for the tapered annual allowance.
Clare Fletcher	Thanks Richard. Turning now to the incentives implications of redundancy, what are the key share plans issues that you see coming up Ian?
Ian Brown	Well, to a certain extent that depends on whether you're talking about an all employee or an executive plan. Let's deal with the all employee plans first. If you've got an HMRC approved all employee plan like a Sharesave plan or Share incentive plan, then 99 times out of 100 redundancy will be an explicit good leaver event. What that means in practice is that SIP participants will retain all of their plan shares and Sharesave participants will have 6 months from their cessation of employment to exercise their options using the savings that they've made up to the time of exercise. Now the relevant tax legislation exempts any gains that the employees makes under Sharesave or SIP from income tax and national insurance contribution. So that is one little piece of good news for people going through what is generally a less than ideal situation.

Clare Fletcher	Yes absolutely so, how does that compare with what you see on, say, a LTIP or deferred bonus award?
Ian Brown	The position on executive awards is a bit more complicated. That's because in many modern plans, redundancy is not explicitly referred to as a good leaver event.
Clare Fletcher	And why is that?
Ian Brown	Because companies have tended to move away from redundancy as an explicit good leaver trigger, as some departures are colloquially referred to as "redundancies", even though the individual is actually being managed out. In those circumstances, companies don't want there to be an inadvertent entitlement to the share awards by virtue of that person being deemed to be redundant.
Clare Fletcher	So without an explicit redundancy trigger, how would a company go about making somebody a good leaver in a redundancy scenario?
Ian Brown	The remuneration committee or the remuneration committee's delegate for below board employees will have to exercise the discretion that's commonly found in plan rules to treat the departing employee as a good leaver on a case by case basis. Now, when that happens, there are a couple of other discretions that the remuneration committee will need to think about as well. Firstly, when is the individual going to receive the shares underlying the award? Normally we'd expect the default position under executive plan rules to be that the award to pay out at the normal time, as if the individual hadn't cessed employment. But sometimes the flexibility to accelerate that vesting. Delivering the shares at the time of cessation of employment is one of the company's easy "gives", that the company can deliver to the employee at a time when money otherwise might be tight. Of course, if you are accelerating vesting and the award is subject to performance conditions, then the company will need to work out the basis on which those performance conditions can be assessed early.
Clare Fletcher	And would there also need to be some thought about pro-rating of awards?
Ian Brown	Yes, remuneration committees will want to consider whether it is appropriate to apply or disapply the default time pro-rating of awards that you will usually find in share plan rules. And as we've discussed in previous podcasts, the disapplication of pre-emption rights discretion as well as how you're going to assess the performance conditions, those discretions all need to be operated in a legally

	compliant way by the remuneration committee which will involve taking into account all relevant factors and following a fair process.
Clare Fletcher	So we've talked about those individuals who are actually made redundant. What happens to the awards granted to those individuals who are remaining with the company?
Ian Brown	It's a really good point. The focus when a company is going through a redundancy exercise is always principally going to be on those sadly having to leave the company, but that doesn't mean you should forget about the other employees either. At a technical level, there will often be the flexibility for the performance conditions applicable to long term incentive awards to be adjusted to reflect the more challenging economic circumstances that are likely to have led to the redundancy situation but, as you will appreciate, remuneration committees will need to handle those provisions with care from both an investor relations and an employee relations perspective. One of the things a company may consider following a redundancy exercise is an all employee share award to bind people together and incentivise those remaining with the company who may, very reasonably, be feeling a certain amount of survivors' guilt.
Clare Fletcher	Presumably in circumstances where there has been redundancies, the company is unlikely to want to expend much cash on these sorts of arrangements?
Ian Brown	Absolutely, these types of awards will normally be satisfied with new issue shares, as the issue of new shares to satisfy awards will be most cost effective way of sourcing shares for the company. Now that means if the company is listed in London, the plan under which these share awards would be granted would need shareholder approval. So, from a planning perspective, when you're putting a new share plan in place, it is worthwhile looking at including this sort of flexibility to grant these types of one-off awards so they can be made in these circumstances, like a post redundancy one.
Clare Fletcher	Thanks Ian and thanks Richard - that brings us to the end of today's podcast. We have one more episode in this redundancies series, which we will be publishing next week – and that one will pick up on the theme of survivors of redundancy that Ian and I have just been discussing. And just as a reminder, you can find all of our podcasts via the Slaughter and May website. Thank you and goodbye for now.