

NON-EXECUTIVE DIRECTOR REMUNERATION UPDATE

The Financial Reporting Council (“FRC”) recently published updated guidance on how UK-listed companies can remunerate their non-executive directors (“NEDs”) using shares in the company that engages them. This update forms part of a broader regulatory effort to increase London’s attractiveness as a listing venue (in particular when compared to the major US stock markets). The aim is to help companies attract high-calibre board members in the global market for talent while maintaining strong governance standards.

Overall, the updated guidance gives listed companies welcome flexibility. The FRC is striking a balance between giving companies the flexibility to remunerate NEDs partly in shares (and align NEDs’ interests with the shareholders they represent), and maintaining the independence needed for effective objective oversight of corporate activity. We are aware of a number of companies considering incorporating the use of shares into NED remuneration packages.

Under the new guidance, Boards may pay part of their NEDs’ fees in shares, provided the rationale for doing so and any restrictions on the shares are clearly disclosed. If companies offer NEDs options or similar rights to acquire shares, they should not be performance-related or have a meaningful exercise price that could impair independence. As an overarching principle, any share-based remuneration structures should avoid incentivising short-term decision-making, creating conflicts of interest, or compromising independence. Listed companies who take up this increased flexibility would be expected to explain their approach in their annual report.

Practically speaking, this means that companies can deliver a portion of NED fees in shares and/or grant NEDs options or similar rights to acquire shares, which allow NEDs to participate in share price growth from the time those options/rights are granted. Under the revised guidance, companies can technically source the shares they deliver to NEDs either by using some of the cash fee paid to NEDs to purchase shares on the market, or by issuing new shares.

There are a number of technical issues that need addressing when paying NEDs with shares:

1. Because NEDs are not “employees” for company or employment law purposes, awards of shares to them do not fall within the “employee share schemes” exemptions from the restrictions within the Companies Act 2006 on the issue of shares. Therefore, if companies are going to issue new shares to their NEDs, they must instead rely on the standard allotment and pre-emption disapplication shareholder authorities commonly obtained by companies at their AGM as part of their “business as usual” resolutions. When using these authorities for delivering shares to NEDs, companies should carefully track the remaining headroom available under these authorities, as using these authorities for remunerating NEDs may restrict their use for other corporate purposes (such as providing consideration for corporate acquisitions).
2. As a matter of company law, the nominal value of a share must be paid up in order for a share to be issued. Where NEDs are being delivered newly issued shares, it is common for the NED to pay up the nominal value of the shares in order for the shares to be issued to them directly. The relatively low nominal value of most shares means that NEDs picking up this cost is rarely an issue in practice. Again, as NEDs are not employees, they are usually not within the class of beneficiaries of the company’s employee benefit trust (meaning that shares cannot be delivered for free in the same way as shares are delivered in satisfaction of employees’ long-term incentive awards).

3. It is likely that a company will need shareholder approval to deliver shares to NEDs. Under the UK Listing Rules, a company cannot grant an option to a NED without shareholder approval if the exercise price for the option is less than the market value of the underlying shares at the time the option is granted (UKLR 9.3.4). Also, the company's shareholder-approved directors' remuneration policy (which applies to NEDs as well as to executive directors) will need to contain explicit flexibility to remunerate the NEDs in shares. Where the policy does not contain this wording, an amendment to the policy will be required, which necessitates shareholder approval.
4. UK-resident NEDs will be taxed as if they were employees, with income tax and National Insurance Contributions payable on any gains made on the value received under any share awards. Where there is the chance that the receipt of shares will occur during a close period, arrangements should be put in place at the outset to allow NEDs to sell sufficient shares during a close period to discharge any tax liabilities that arise in connection with their awards.

If you would like to discuss any of the issues contained in this update, please contact one of our reward experts below or your usual Slaughter and May contact.

CONTACT



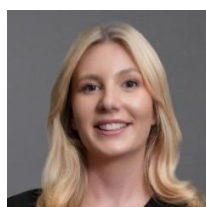
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