The Executive Remuneration Review

Eleventh Edition

Editor
Michael Albano

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THE

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Editor
Michael Albano

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PREFACE

Executive remuneration encompasses a diverse range of practices and is consequently influenced by many different areas of the law, including tax, employment, securities and other aspects of corporate law. We have structured this book with the intention of providing readers with an overview of these areas of law as they relate to the field of executive remuneration. The intended readership of this book includes both in-house and outside counsel who are involved in either the structuring of employment and compensation arrangements or more general corporate governance matters. We hope that this book will be particularly useful in circumstances where a corporation is considering establishing a presence in a new jurisdiction and is seeking to understand the various rules and regulations that may govern executive employment (or the corporate governance rules relating thereto) with regard to newly hired (or transferring) executives in that jurisdiction.

The most fundamental considerations relating to executive remuneration are often tax related. Executives will often request that compensation arrangements be structured in a manner that is most tax efficient for them, and employers will frequently attempt to accommodate these requests. To do so, of course, it is critical that employers understand the tax rules that apply in a particular situation. To that end, this book attempts to highlight differences in taxation (in terms of both the taxes owed by employees and the taxes owed – or tax deductions taken – by employers), which can be the result of:

a the nationality or residency status of executives;
b the jurisdiction in which executives render their services;
c the form in which executives are paid (e.g., cash, equity (whether vested or unvested) or equity-based awards);
d the time at which executives are paid, particularly if they are not paid until after they have 'earned' the remuneration; and
e the mechanisms by which executives are paid (e.g., outright payment, through funding of trusts or other similar vehicles, or personal services corporations).

In addition to matters relating to the taxation of executive remuneration, employment law frequently plays a critical role in governing executives' employment relationships with their employers. There are a number of key employment law-related aspects that employers should consider in this context, including:

a the legal enforceability of restrictive covenants;
b the legal parameters relating to wrongful termination, constructive dismissal or other similar concepts affecting an employee's entitlement to severance on termination of employment;

c any special employment laws that apply in connection with a change in control or other type of corporate transaction (e.g., an executive's entitlement to severance or the mechanism by which an executive's employment may transfer to a corporate acquirer); and

d other labour-related laws (such as laws relating to unions or works councils) that may affect the employment relationship in a particular jurisdiction.

The contours of these types of employment laws tend to be highly jurisdiction specific; therefore, it is particularly important that corporations have a good understanding of these issues before entering into any employment relationships with executives in any particular country.

Beyond tax and employment-related laws, there are a number of other legal considerations that corporations should take into account when structuring employment and executive remuneration arrangements. Frequently, these additional considerations will relate to the tax or employment law issues already mentioned, but it is important they are still borne in mind. For example, when equity compensation is used, many jurisdictions require that the equity awards be registered (or qualify for certain registration exemptions) under applicable securities laws. These rules tend to apply regardless of whether a company is publicly or privately held. In addition to registration requirements, it is critical for both employers and employees to understand any legal requirements that apply in respect of executives' holding, selling or buying equity in their employers.

Given the heightened focus in many jurisdictions on executive remuneration practices in recent decades – in terms of both public policy and public perception – the application of corporate governance principles to executive compensation decisions is crucial to many companies. The covid-19 pandemic presented novel challenges for companies and resulted in renewed scrutiny on executive remuneration practices. Decisions about conforming to best practices in the field of executive remuneration may have substantial economic consequences for companies and their shareholders and executives. Corporate governance rules principally fall into two categories. The first category concerns the approvals required for compensatory arrangements. A particular remuneration arrangement may require the approval of the company's board of directors (or a committee thereof). Many jurisdictions have adopted either mandatory or advisory say on pay regimes, in which shareholders are asked for their view on executive remuneration. The second category concerns the public disclosure requirements applicable to executive remuneration arrangements. Companies should be aware of any disclosure requirements that may become applicable as a result of establishing a new business within a particular jurisdiction, and in fact may wish to structure new remuneration arrangements with these disclosure regimes in mind. In recent years, there has also been increased legislative and shareholder focus in many jurisdictions on environmental and social governance issues, such as the gender pay gap, tying executive compensation to environmental and social goals, and diversity initiatives.

We hope that readers find the following discussion of the various tax, statutory, regulatory and supervisory rules and authorities instructive.

Michael Albano
Cleary Gottlieb Steen & Hamilton LLP
New York
September 2022

Chapter 6

FINLAND

Johanna Haltia-Tapio, Joakim Frände and Anniina Järvinen[1]

I INTRODUCTION

Remuneration of companies' senior executives and the appropriateness of such remuneration has, over the past few years, been increasingly discussed in Finland. In 2022, the main discussion themes have been the delayed introduction of the economic employer concept into Finnish personal income taxation, as well as the planned exit tax for wealthy individuals. Also, the effects on the use of post-contractual non-competition obligations of the new obligation to compensate for such restrictions has been a hot topic.

II TAXATION

i Income tax for employees

Residents[2] and non-residents are treated differently for tax purposes. The worldwide income of persons resident in Finland is subject to taxation in Finland. Non-residents are taxed only on Finnish sourced income. The applicable tax rates are also different.

Resident individuals are always taxed for their employment income regardless of where the employer is situated. Resident individuals are not taxed for earned income if a tax treaty removes Finnish taxing rights or the individual works continuously abroad for longer periods of time, provided that certain criteria are met. Non-resident individuals are taxed for income from employment only if it is considered to be Finnish sourced income. Salary is sourced in Finland if the employer is a Finnish entity[3] and if the employment has been physically carried out in Finland completely or for the most part. Employment income is not Finnish sourced (and hence not subject to tax if received by a non-resident) if an employer is a foreign entity and the non-resident person does not exceed the six-month threshold for becoming resident in Finland. The same applies even in the case of a Finnish employer if the work has mainly

1 Johanna Haltia-Tapio is a specialist partner, Joakim Frände is a counsel and Anniina Järvinen is a managing associate at Hannes Snellman.

2 An individual is deemed a resident of Finland if the permanent home and abode of such a person is in Finland or if such person stays in Finland for a continuous period of more than six months. A Finnish citizen who has moved abroad is considered to be a resident of Finland until three years have passed from the end of the year of departure, unless it is proven that no substantial ties to Finland existed during the relevant tax year.

3 A Finnish permanent establishment of a foreign entity is treated similarly to a Finnish entity in this respect. Specific rules apply in respect of the taxation of individuals employed by the government or other Finnish entities of public administration.

been carried out abroad.[4] Remuneration paid to members of the board of executives of a Finnish company is taxable in Finland irrespective of whether the meetings have been held in Finland or overseas.

Currently, Finland does not apply any economic employer concept. However, a government proposal is expected to introduce the economic employer concept in Finnish legislation with effect from 2023. The government proposal has twice been circulated for comments but not yet been delivered to the government for approval. The economic employer concept would grant Finland significantly wider rights to tax non-resident individuals who work only for short periods in Finland. Hence, any structures where work is conducted physically in Finland but for a legal employer that is situated abroad would have to be reviewed carefully.

Finland has traditionally not had any exit tax rules for individuals, except one special regime targeting tax-exempt share swaps and an extended tax liability for Finnish nationals. At the end of 2021, the government announced that in 2023 it will introduce a new exit tax rule intended for wealthy individuals moving abroad from Finland. On 12 August 2022, the first draft of the government proposal was circulated for comments. According to the draft, the tax would apply to individuals with a combined wealth of €500,000 (excluding real estate) with unrealised gain of €100,000. These thresholds would be examined at the time when the individual becomes non-resident for domestic tax purposes in Finland or when the individual receives tax treaty residence in another tax treaty country. In most cases, the taxpayer could request the Tax Administration to postpone payment of the tax (30 to 34 per cent) until actual surrender of the assets, subject to fulfilment of an annual reporting obligation. If assets are surrendered after seven years from the end of the emigration year, no exit tax would be due. Exit tax would apply also to foreigners staying in Finland for four years during a 10-year period. The current proposal is considered problematic. The proposal is not final and may be subject to changes. It is estimated that the introduction of the exit tax will significantly impact any tax planning relating to cross-border movement.

The earned income of a tax-resident individual is taxed at progressive tax rates of up to about 55 per cent depending on the municipality of residence, whereas salaries paid to a non-resident are subject to a flat withholding tax of 35 per cent, if subject to tax in Finland.[5] The capital gains and other capital income of Finnish tax residents are taxed at rates of 30 per cent for capital income up to €30,000 and 34 per cent for capital income exceeding €30,000 per year. Capital gains received by non-residents are, in many cases, exempt from Finnish taxation (a few noteworthy exceptions are capital gains from immovable property, as defined in the Finnish Income Tax Act).[6]

Generally, there is a broadly applicable substance-over-form principle in the taxation system, and progressive employment income taxation covers any payments regarded as compensation for employment. It is therefore difficult to structure a compensation plan in such a way that the compensation would qualify for taxation as capital income. Capital income taxation should be applicable only in genuine arm's-length investments (e.g., in the employer company's shares) by employees.

4 The assessment of whether the majority of the work has been carried out in Finland is made separately for each salary payment period (typically monthly).

5 However, it is possible under certain conditions for non-residents to request for their earned income to be taxed at progressive tax rates instead of the 35 per cent flat tax at source.

6 1535/1992.

Qualification of the executive share ownership under the capital income taxation regime has sometimes been sought through arrangements involving heavily leveraged holding companies. Such a holding company would be owned by the executives, often receiving loan funding from their employer company and investing in the employer company's shares. Such a management holding company arrangement by a listed company has been considered tax avoidance in a Supreme Administrative Court ruling, leading to earned income taxation of the benefits received from the arrangement.[7] However, in a recent ruling by the Supreme Administrative Court, a management holding company arrangement was not requalified when the financing was drawn directly by the management and not the holding company (i.e., the management carried de facto the investment risk). In any case, such management holding company arrangements need to be analysed carefully from a tax perspective.

Taxable income is, as a main rule, triggered in the taxation of individuals when the income is paid to the individual or when the individual gains control over the income in question. Employees gain control over deferred income items: for example, when they have the opportunity to choose, upon salary payment, whether certain items are paid directly to them as cash payments or into deferred account arrangements. If there is no possibility to opt for a cash payment or otherwise dispose of the funds, a tax-effective deferral of the income item may be accepted if properly structured. Taxable income is triggered only at the point when the deferred income is paid to an employee.

	Option	**Restricted stock**	**Restricted stock unit (promise to deliver stock in the future)**
Tax treatment upon grant	None	Fair market value at grant taxable as earned income at progressive rates*	None
Tax treatment upon vesting	None	None	None
Tax treatment upon delivery	Spread taxable as earned income at progressive rates	None	Fair market value taxable as earned income at progressive rates
Tax treatment upon sale of underlying shares	Capital gains taxation at rates from 30 per cent to 34 per cent. Amount taxed as earned income deductible as acquisition cost	Capital gains taxation at rates from 30 per cent to 34 per cent. Amount taxed as earned income deductible as acquisition cost	Capital gains taxation at rates from 30 per cent to 34 per cent. Amount taxed as earned income deductible as acquisition cost

* Typically, there is no possibility for downward adjustment if the share price decreases. If restricted stock is conditional on continued employment and, for example, reaching a set share price goal, the rules described for options and restricted stock units would be applicable.

ii Social taxes for employees

Persons covered by Finnish social security are generally subject to Finnish social security contribution obligations. Employees covered by the social insurance system of another state and seconded to Finland may be exempt from Finnish social security contributions. The contributions applicable to employment in Finland are uncapped. Lately, the rates have increased almost every year. The currently applicable payment percentages are as follows (2022 figures).

7 It is yet to be seen whether similar disputes will arise even in companies related to private equity funds, where similar co-investment arrangements have also been used. Carried interest paid in the private equity fund context has, in some cases, been considered to not constitute salary income. There were, however, some specific circumstances in these cases, and the outcome could be different in future cases if the circumstances differ.

Employer	Healthcare charge	1.34 per cent
	Pension insurance contribution in the average	17.4 per cent
	Accident insurance contribution in the average	0.7 per cent
	Unemployment insurance contribution	0.5 per cent to 2.05 per cent
	Group life insurance contribution in the average	0.062 per cent
Employee	Pension insurance contribution	7.15 per cent (for employees who are 17 to 52 years of age or 63 to 67 years of age); 8.65 per cent (for employees who are 53 to 62 years of age)
	Unemployment insurance contribution	1.5 per cent
	Employee's healthcare charge (included in tax withholding percentage)	Zero per cent to 1.5 per cent
	Employee's daily allowance contribution (included in tax withholding percentage)	1.18 per cent

Benefits from share-based incentive plans may, in many cases, be exempt from most social security contributions in Finland, if the underlying plans are constructed correctly.[8] This exemption may apply to benefits from an employment stock option plan or a phantom option plan. It may be applicable also to shares awards granted to employees, provided that certain criteria are met, for instance that the shares granted are listed on a stock exchange, and there is a vesting period of at least one year between the promise of the award and the actual award of the shares to an employee. There are also employee share subscription plans, which may be beneficial from a social security perspective, even if shares are subscribed below fair market value, provided that certain criteria are met.

iii Tax deductibility for employers

Costs accrued because of employment are generally fully deductible for employers, even in cases where costs are a result of employment of the senior management of a company. The employment cost item is deductible in the corporate income taxation of the employer company in the tax year during which the work in question was carried out. The year of payment of the compensation item does not determine the tax year applicable to the deduction in the employer's corporate income taxation.

Special rules govern deductibility of costs for shares used to settle share-based incentive plans, considerably limiting employers' right to deduct such costs. The issue of new shares to settle an incentive plan does not give rise to a deductible cost in the corporate income taxation of the Finnish employer company issuing the shares. If existing shares of the company are used to settle the benefits under the plan, a deduction may be available if the shares used have been obtained from the stock exchange.[9] However, a recharge of costs of a share-based incentive plan paid by a Finnish employer company to a group company abroad operating the plan should, as a starting point, be fully deductible, regardless of whether new or existing shares of the foreign group company have been used.

8 An employee's healthcare charge is, however, always payable at a rate of 1.5 per cent.

9 In cases where a deduction is available, there are, furthermore, specific rules limiting the maximum deductible amount.

iv Other special rules

There is a specific 32 per cent flat rate tax regime applicable to expert-level expatriates moving to Finland that may apply during the first 48 months of their stay in the country. The applicability of the regime has to be carefully planned, as non-fulfilment of the technical requirements[10] for qualifying may easily prevent the applicability. In contrast to the normal progressive taxation of employment income, no deductions are allowed under this regime.

Pension benefits of executives that exceed the mandatory pension cover are normally arranged by means of a collective pension scheme, which generally allows fairly flexible insurance terms and full deductibility of the pension insurance payments by an employer in calculating its corporate income taxation, while not triggering any taxable income to executives prior to the payment of the pension benefits to them upon retirement. At least two persons must be covered by the pension insurance for this tax treatment to be applicable.[11] In addition, individual pensions can be provided by the employer; however, certain criteria need to be met, and the annual tax-exempt payment per person is limited to €8,500.

A voluntary health insurance plan taken out by employers for the benefit of employees generally gives rise to taxable income to insured employees unless the insurance covers all employees and offers all employees benefits at a similar reasonable level. Life insurance payments paid by an employer for the benefit of employees do not generally trigger taxable income for the employees if the insurance is purely risk insurance. Insurance payments made to a unit-linked life insurance policy constitute taxable income for the insured employees.

III TAX PLANNING AND OTHER CONSIDERATIONS

Personal service company arrangements and other similar structures are used to some extent in Finland in the tax planning of remuneration paid to senior executives. There is, however, a quite well-established practice in Finland to pierce through minor consultancy firms and to tax consultancy proceeds as the salary (or board fee, as the case may be) of the person carrying out the consultancy tasks in practice, if the arrangement is considered as de facto employment of the consultant by the client company. This may be the case especially if the person carrying out the consultancy tasks has previously been employed by the company purchasing the consultancy services, if the consultancy firm has no other clients of importance or if the consultancy firm is very small. According to Supreme Administrative Court case law and tax

10 The requirements to qualify for the regime include a monthly cash salary of at least €5,800, the non-Finnish nationality of the employee in question and a specific application that has to be filed within 90 days of the beginning of employment in Finland. The actual paid cash salary has to meet the €5,800 threshold each month, which has to be taken into account, for example, when planning unpaid leave or benefits in kind.

11 It should be noted that the tax benefits discussed above may be denied in cases where the arrangement has the characteristics of tax avoidance or of substituting taxable salary payments by means of pension insurance contributions (e.g., if the amount of the insurance payments made by the company is disproportionately high in comparison with the taxable salary paid to an executive). Granting additional pension benefits to executives may in some circumstances also include a negative publicity risk, as such arrangements have been scrutinised and viewed very critically in the Finnish press recently. The government has also issued a general guideline that no new additional pension benefit arrangements should be made to executives in state-owned enterprises.

authorities' guidelines, remuneration for services as a CEO or a board member may not be accepted as income of a consultancy company but is personal earned income of the CEO or board member.

There may also be planning possibilities when determining the timing of entry into Finland and departure from Finland. According to the Finnish rules, foreign income referring to the part of the year prior to the commencement of tax residence or after the cessation of tax residence enjoys full exemption and is not taken into account when determining the progressive tax rate applicable to the income taxable in Finland. A well-planned timing of arrival and departure may hence significantly cut the progressive tax rate applicable to the part of income taxable in Finland in the year of arrival or the year of departure. In addition, various split salary arrangements may offer planning opportunities if executives are working only a part of their working days in Finland and the other part, for example, in another Scandinavian country. Due to the economic employer concept potentially being introduced shortly, even working short periods in Finland for a foreign employer may trigger taxation. Cross-border work should therefore be carefully planned to avoid unwanted tax exposure. Furthermore, the exit tax introduction will limit any form of tax planning through outbound movement.

In the start-up and growth company segment of non-listed companies, a special benefit is granted for employee share offering. The regime allows employees to subscribe for the employer company's shares (not for any other company's shares) at low prices without triggering taxation on the discount at the time of subscription. Instead, taxation is postponed until disposal of the shares. At disposal, the income is considered as capital income (not earned income, which is taxed progressively). The regime can be applied only if numerous requirements are met. The old tax regime for employee share offerings, which is significantly less beneficial, remains in force in parallel with the new regime. The old regime is, however, broader in its scope of application.

IV EMPLOYMENT LAW

i General

The Finnish Employment Contracts Act (ECA)[12] is applicable to most employment relationships in Finland. Managing directors of limited liability companies are, however, excluded from the scope of the ECA. The terms of assignment for managing directors are determined by the service contract between a director and a company. In addition, the Finnish Companies Act[13] regulates the managing director position as an organ of a company. In practice, most of the agreed terms of assignment of managing directors do not, however, differ to a large extent from those of other executive directors.

The ECA provides for a loyalty obligation for employees, according to which employees must avoid everything that conflicts with actions reasonably required of an employee, considering the employee's position. In addition, the ECA explicitly prohibits competing activities. During the term of employment, an employee must not work for other employers or engage in activities that would apparently cause harm to the employer as a competing activity contrary to fair employment practices. The nature of the work and the position

12 55/2001.

13 624/2006.

of the employee are taken into account in this assessment. In the event of a breach of a non-competition obligation, the employer may claim damages from the employee for any losses caused by the breach. Furthermore, an employer may be liable to pay damages jointly with a new employee if the employer knew on recruitment that the new employee was precluded from working on the basis of a non-competition covenant.

ii Post-contractual non-competition and non-solicitation obligations

The ECA sets limits to non-competition undertakings applicable after expiry of employment. Under the ECA, a non-competition undertaking may limit an employee's right after the end of an employment relationship to conclude an employment contract with an employer engaged in operations competing with their previous employer, and also to be otherwise engaged in competing operations, either directly or indirectly.[14] A non-competition obligation should always be supported by particularly weighty reasons to be valid.[15] In practice, a non-competition clause is typically included in management-level contracts.

When assessing the particular weight of the reason for a non-competition clause, one of the criteria taken into account is the nature of an employer's operations and the need for the protection of trade secrets.[16] Special training given to an employee by their employer and the employee's status and duties must also be taken into account.

The prohibited activities may be restricted to cover only a certain geographical area or certain parts of the employer's business. It is also possible to limit the restriction to cover activities with specified competitors, or to cover specific products or services of the employer.[17]

The ECA was amended as of 1 January 2022 and the new rules will, after a transitional period of one year, apply also to non-competition restrictions concluded before the entry into force of the amendments.

As before the amendment of the ECA, a non-competition clause may restrict an employee's right to conclude a new employment contract or to be engaged in the trade concerned for a maximum of 12 months. However, following the amendments, an employer is now obliged to pay compensation to the employee for the full duration of the restricted period, irrespective of its length. The level of compensation is 40 per cent of the employee's salary for any restricted period lasting no more than six months, whereas the compensation

14 As the ECA does not generally apply to managing directors, the terms of non-competition obligations can be agreed more freely.

15 Employers have the burden of proving that the specific, weighty reasons relating to an employee's position, or the company's operations, do exist. The reasons need to exist both at the time when the non-competition obligation is agreed and at the time when the employer refers to the obligation: that is, when the employment relationship has been terminated. The fact that weighty grounds exist at the time of termination is not sufficient if, at the time of entry into the agreement, the grounds were not considered weighty enough.

16 Based on recent case law, the existence of an extensive confidentiality obligation in force also after the expiry of employment may in certain cases be considered a sufficient means for protecting the employer's interest, as a consequence of which weight grounds for enforcing a non-competition undertaking have not been considered to exist.

17 In addition to actual competing activities, preparations for such activities, such as the establishment of a company intended to be involved in competing activities, may also be prohibited. For preparatory actions to be considered prohibited competing activities, an intention to harm the employer is usually required.

is at least 60 per cent of the salary in cases of a non-competition undertaking longer than six months. The compensation must be paid on the customary paydays of the employee during the restricted period, unless otherwise agreed with the employee at the time of resignation.

In cases of a breach of the non-competition covenant, an employee may be liable to pay either damages for loss or, alternatively, the agreed contractual penalty. The provisions regarding consequences for a breach have not been altered. The level of penalty remains at an amount corresponding to salary received by the employee for the six months preceding the end of the employment relationship.

According to the ECA, a non-compete clause that does not comply with the above is void. If the duration of the restriction or the amount of contractual penalty exceeds the maximum amount provided by law, the restriction does not apply for the part by which it exceeds the limits set by the ECA.

The restrictions relating to the duration of a non-competition undertaking and the maximum contractual penalty do not, however, apply to employees who, in view of their duties and status, are deemed to run an enterprise or an independent part thereof, or to have an independent status comparable with such managers. Even if the restrictions on the duration of the non-competition undertaking and the level of contractual penalty provided for in the ECA are not applied to the aforementioned managers, terms unreasonably restricting competition are prohibited under the Finnish Contracts Act.[18] Therefore, a contract under which a person, in order to prevent or restrict competition, has undertaken not to engage in a certain activity or not to conclude an employment contract with another person engaging in such activity, may not bind a party who has made such a promise to the extent that it unreasonably restricts their freedom. In practice, the non-competition undertakings applicable to managers rarely exceed 12 months in duration; the amount of contractual penalty is also usually within the range set in the ECA. Managing directors of large companies form an exception to this rule.

The term of a non-competition undertaking applicable after employment is calculated as of expiry of the notice period. Therefore, a release from duties during a notice period does not, unless otherwise agreed, affect the duration of the non-competition undertaking. A non-compete clause is not, however, applicable if the employment relationship has been terminated for reasons deriving from the employer: for example, in the case of collective redundancies.

The amendments to the ECA introduced provisions concerning the right for the employer to renounce the non-competition agreement. This allows the employer to serve notice of termination of the non-competition undertaking during the employment relationship in case of, for example, a change of the circumstances of the employer, by observing a notice period corresponding to one third of the agreed restricted period, but not less than two months. However, no unilateral right of serving notice of the non-competition undertaking would exist in case of a resignation served by the employee.

Contrary to many other countries, the compensation paid for a non-competition restriction is paid for the limitation of the employee's freedom of action, not possible damages or lower income caused by implementation of the restriction. Therefore, it is not possible to deduct any other income earned by the employee during the restricted period, but the employee may well start in new non-competing employment and at the same time continue to be entitled to the compensation paid based on the non-competition restriction.

18 228/1929.

The objective of the amendment was to steer employers to consider whether and to what extent the use of restrictive post-contractual covenants are necessary, and in this way to reduce the use of post-contractual restrictions and to increase the flexibility of the labour market. Based on experience of the past year, employers have noted the change and started to weigh the actual overall need and duration of restrictions against the cost relating to such restrictions. Also, the right to compensation for the duration of the non-competition undertaking is likely, to some extent, to affect voluntary severance arrangements in connection with a termination.

Finnish law does not recognise the concept of non-solicitation, and no provisions regarding restrictions relating to non-solicitation are expected to be included in the aforementioned new regulations either. Based on legal practice, however, a non-solicitation clause restricting the solicitation of clients or employees of a former employer has been considered to correspond to a non-competition undertaking. Therefore, a non-solicitation obligation can be enforced only when particularly weighty reasons relating to the operations of the employer are at hand, and the restrictions regarding its application correspond to those set for non-competition covenants.

In the case of a transaction, non-competition covenants applicable in the employment relationship remain in force as such. However, the presence of the particularly weighty reasons referred to above is determined on a case-by-case basis (see footnote 16). Based on recent legal practice, courts tend to interpret non-competition obligations restrictively, or even conclude that the weighty reasons needed for a non-competition obligation to be possible do not exist. A non-competition obligation should therefore always be drafted carefully to suit the particular case in question.

In situations where an employee is also a shareholder, or where a former shareholder continues to be employed by a company after the sale of their shares, the shareholder agreement or transactional documentation may impose a non-competition undertaking exceeding the limits in duration and the maximum contractual penalty set by the ECA. The assessment of the fairness of the restrictions relating to the separate non-competition undertakings in shareholder or transactional agreements must then be made on a case-by-case basis, based on the general prohibitions of unfair terms of contract and restricting competition. To the extent that the non-competition obligation in such an agreement binds an employee, and the obligation is directly linked to the termination of the employment relationship, it is likely that such restriction would be considered in light of the mandatory provisions of the ECA.

iii Termination of service relationship

Managing directors of Finnish companies are not covered by the restrictions relating to the termination of employment of employees. All other employed executives are covered by applicable employment legislation and the provisions on termination of employment relationships.

An employment relationship can be terminated based on an agreement or based on a notice from either party. Employment legislation in general does not regulate termination of an employment relationship with an agreement. Owing to the mandatory nature of provisions in the ECA, a company cannot, however, freely agree with an employee on all issues relating to termination of employment.[19] Instead, general standards of reasonableness will limit the contents of such an agreement regarding both managing directors and employees. A typical clause of such an agreement is a release of claims against the employer.

For an employer to be able to terminate an employment contract legally, valid and weighty grounds for termination are required, which may be either organisational or relating to an employee. When assessing whether sufficient grounds for termination exist, the situation is always evaluated as a whole, taking all relevant factors into account.

Organisational grounds relate to the economy, production or organisational change of the employer company. Employment can be terminated if work available has diminished materially and permanently. Valid organisational grounds are not considered to exist in a situation where an employee can be offered other duties that are suitable for their training and skills, or where an employee can reasonably be trained in new duties.[20] The ECA also lists other situations where valid organisational grounds are not deemed to exist.[21]

Regarding termination grounds relating to an employee, the grounds for termination must be weighty and proper. The concept is not defined in the ECA; rather, the ECA includes a list of reasons that do not fulfil this requirement. Employees who have neglected their duties or have breached their terms of employment may normally not be given notice before they have been specifically warned and have thus been given a chance to change their conduct.[22] The warning should specifically refer to the possible termination of the employment relationship if similar problems continue.

Constructive termination or voluntary termination for good reason as concepts are not defined in the ECA, but the issue is recognised.[23] Cases of voluntary termination for good reason are, once an employee has shown it probable that a good reason for terminating the employment relationship exists, treated as cases of unfair dismissal. The number of cases where voluntary termination for good cause is claimed to exist has been on the rise during recent years. Likewise, the number of cases relating to harassment and unfair treatment of employees in general has risen.

Severance payments to employees are not mandatory under Finnish law. Often, an employer will pay voluntary severance in addition to salary for the notice period. The

19 Regarding an executive in the position of an employee, based on legal practice, it is not possible to agree that the company will not have the re-employment obligation (exceptionally, this would be possible under specific collective bargaining agreements). The re-employment obligation relates to situations where employment has been terminated for organisation-related reasons.

20 A company's size and other factors are taken into account when evaluating what is reasonable, but in general the training would amount to only a few days or, at the most, weeks.

21 These include an employer having employed, either before or after the notice of termination was given, a new employee to carry out tasks similar to those that a redundant employee had, even though there has not been a material change in the operating circumstances relating to the company, and where the reorganisation of the work at the company has not led to the work at the company actually diminishing.

22 If the breach is so serious that an employer cannot reasonably be expected to continue the employment relationship, no warning needs to be given. In even more serious cases where the breach is so severe that the employer cannot be expected to continue the employment relationship even for the notice period, the employer may terminate the employment without notice. This would typically relate to serious violence at the workplace, theft or similar breaches.

23 The situation arises when an employee terminates the employment relationship without notice and claims that the employer has breached its obligations relating to the employment relationship so severely that the employee could not reasonably be expected to work even for the length of the notice period.

amount of severance varies greatly depending on the position of the employee and the type of business in which the employer operates, and also depending on the general economic and organisational situation of the company.

Change of control as such is not a ground for terminating employment contracts. In a transfer of business, however, employees are entitled to terminate employment relationships applying a specific, shorter notice period.[24] The transfer of employment to a new owner in connection with a corporate transaction will not give rise to a severance payment if an employee terminates the employment relationship, and no custom regarding payment of such severance exists.

All companies that employ at least 20 employees in Finland[25] on a regular basis must follow a specific negotiation process before decisions to terminate employees' contracts are taken based on economic or organisational reasons.[26] There is no limit regarding application of the process based on the number of employees who would be given notice of termination, and this process must thus also be followed when the organisational reason relates to just one employee in a senior executive position. The process does not relate to termination of employment, which is made based on agreement between the employer and the employee.

V SECURITIES LAW

The EU Prospectus Regulation (PR)[27] provides that an issuer of securities is responsible for preparing and publishing a prospectus when offering shares to the public or listing shares on a stock exchange. There are exemptions from the obligation to publish a prospectus that relate, inter alia, to the offering of shares to directors or employees. The publication of a prospectus is generally not required if securities are offered to existing or former directors or employees by their employer or by an affiliated undertaking, provided that a document containing information on the number and nature of the securities, as well as the reasons for and details of the offer, shall be made available and, if seeking admission of such shares to trading on a regulated market, provided that the said securities are of the same class as the securities already admitted to trading on the same regulated market. The issuer of the shares is still required to make adequate information available to all offerees regarding factors that may affect the value of the offered securities, so that they are able to reasonably assess the feasibility of the investment.

There is no legal requirement in Finland for an executive to hold stock of their employer, but shares or option rights commonly form part of executive remuneration. Executives buying or selling shares of their employer entity on the public market must comply with the relevant public trading rules. In particular, executives who have been defined by listed companies

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24 Employees are entitled to terminate the employment relationship to end on the date the business is transferred to the new owner if they have received information on the transfer at least one month before the transfer date. If an employee has received the information later, they may terminate the employment relationship to end either on the transfer date or on another date, not being more than one month from the date on which the employee received the information about the date of transfer.

25 The managing director of a company is not counted as an employee.

26 The process is specified in the Finnish Co-operation Act (1333/2021). Under the Act, a company risks paying compensation of a maximum of €35,000 to each employee whose employment has been terminated or changed to part-time employment without following the negotiation process provided for in Chapter 3 of the Act (see Chapter 6, Section 44).

27 1129/2017.

as persons discharging managerial responsibilities under the EU Market Abuse Regulation (MAR)[28] must comply with the rules regarding closed-window and insider trading.[29] In addition to the members of the board of directors and the managing director, such persons usually include the chief financial officer and other senior executives, as deemed appropriate.

According to the MAR, all persons discharging managerial responsibilities and their closely associated persons must notify a company of every transaction relating to that company's shares, options and other financial instruments. The company, in turn, is required to disclose such information as a stock exchange release. The company is responsible for maintaining a list of such persons.

There are no specific short-swing trading or anti-hedging rules relating to executives in Finland. However, many listed companies recommend that the persons discharging managerial responsibilities do not actively trade in the shares or financial instruments of the company or engage in short-term trading or speculative transactions, but rather make investments in the company on a long-term basis.

In addition, according to the Finnish Securities Markets Act (SMA),[30] executives and the company are subject to an obligation to publicly disclose a flagging notification if their holding in the company reaches, exceeds or falls below the thresholds set by law.

There are no restrictions regarding executive shareholding in private companies.

VI DISCLOSURE

The SMA, the MAR and the rules of Nasdaq Helsinki Ltd regulate the disclosure obligations of listed companies. In addition, the Finnish Corporate Governance Code 2020 (the Code) includes provisions regarding, inter alia, the disclosure of information relating to remuneration. Even though the Code is based on the comply or explain principle,[31] no departures from reporting of the required information are allowed. The provisions of the Code apply to listed companies, irrespective of their size.

In accordance with the Code, which was revised in 2020 due to the new EU Shareholders' Rights Directive (SHRD),[32] listed companies shall prepare an annual remuneration report that provides a comprehensive overview of the remuneration, including all benefits, awarded over the past financial year to the members of the board of directors and the managing director and their deputy, and present it to the annual general meeting. The disclosure shall include, inter alia, the fixed and variable remuneration components (short-term and long-term incentives) and information on their proportional shares, information on how the predetermined performance measures have been applied in variable remuneration components, and information on share-based remuneration schemes, supplementary pension contributions and other financial benefits. The remuneration report must also describe how

28 596/2014.

29 The MAR, related EU regulations and the Guidelines for Insiders of Listed Companies issued by Nasdaq Helsinki Ltd contain more detailed provisions on the insider issues.

30 746/2012.

31 Companies must comply with the recommendations of the Code or disclose a possible departure from an individual recommendation together with an explanation for the departure.

32 2017/828.

the fees paid to the directors and managing director have developed over at least the preceding five years compared to the development of the average remuneration of employees and to the company's financial development over the same period.

According to the Code, listed companies must also provide on their website information on the principles for the remuneration of the board of directors, managing director and the rest of the management team. Remuneration of the directors must be disclosed pursuant to the resolutions of the latest general meeting. In respect of the managing director, the website must provide up-to-date information on the amount of the managing director's fixed salary, description of long- and short-term remuneration systems, and other main terms of the managing director's service contract. The same information on the rest of the management team needs to be disclosed on an aggregate level. There is no requirement to keep the agreement with the managing director publicly available in its entirety as long as the required information is made publicly available in accordance with the Code.

In addition, the company must, in accordance with the rules of Nasdaq Helsinki Ltd, disclose a decision to introduce a material share-based incentive programme by way of a stock exchange release, setting out the most important terms and conditions of the programme.

VII CORPORATE GOVERNANCE

The Finnish Companies Act and the articles of association of a company set the basis for the corporate governance of both public and private companies. The Code also seeks to maintain and promote good practices of listed companies and harmonise the procedures with regard to corporate governance and remuneration. Finnish companies listed on Nasdaq Helsinki Ltd must comply with the Code, but a company with a domicile other than Finland shall generally follow the corporate governance recommendations that are applied to it in its home state.

The body that appoints a person to their position must decide on their remuneration. Thus, the general meeting of shareholders decides on the remuneration payable for board and committee work as well as on the basis for its determination. The board of directors decides on the remuneration and other compensation to be paid to the managing director. Companies must specify the decision-making procedure for the remuneration of the other executives; this is usually the responsibility of the board of directors. If remuneration is to be granted in the form of shares or option rights, the general meeting of shareholders must either approve such issue of shares or option rights or authorise the board to do so. According to the Code, the board of directors may establish a remuneration committee to prepare matters pertaining to the remuneration of the managing director and other executives as well as the remuneration principles observed by a company. The remuneration committee must have at least three members who must have the expertise and experience required by the duties of the committee; the majority of the members of the remuneration committee must also be independent of the company. The managing director or other persons in the management team of the company may not be appointed to the remuneration committee.[33]

According to the regulations and the Code, in line with the requirements of the SHRD, listed companies are required to prepare a remuneration policy concerning the decision-making process and principles of remuneration of the board of directors and the managing director and their deputy and submit it to an advisory vote at the general meeting.

33 Recommendations 15 and 17 of the Code.

The remuneration policy shall include principles regarding remuneration components and their proportional shares of overall remuneration, grounds for determining any variable remuneration components, other key terms applicable to the service contract, and terms for deferral and possible clawback of remuneration. The remuneration policy shall also include information on how the remuneration policy contributes to the business strategy and long-term interests of the company. The remuneration policy must be submitted to an advisory vote at the general meeting at least every four years and always in the case of a material change in the policy.

In Finland, there are no union or works council approval requirements that need to be met in relation to remuneration of executives. Further, there are no specific legal provisions relating to clawback or recoupment of remuneration previously paid. However, remuneration that has been paid out without grounds should be reclaimed in accordance with the general regulations on returning an unjust enrichment.

VIII SPECIALISED REGULATORY REGIMES

i State-owned companies

The state is the majority owner or a significant minority owner in many Finnish companies. The Ownership Steering Department of the Prime Minister's Office makes decisions on most issues concerning ownership steering and the use of shareholder authority; government approval of executive remuneration arrangements is thus not required. The government has, however, in recent years been interested in the remuneration policies applied in state-owned companies and has issued guidelines in that respect.[34] The remuneration in state-owned companies should support the long-term financial performance and overall success of a company, and the remuneration paid to management should be target based and take into account criteria relating to corporate sustainability. According to a survey conducted by the Ownership Steering Department at the Prime Minister's Office in May 2022, corporate sustainability incentives account for about one quarter of the total remuneration paid by state-owned companies, the most common sustainability incentives relating to emissions reductions and job satisfaction among personnel.

Based on the guidelines, remuneration should be transparent and moderately aligned with the nature and size of the company's operations and the varying business environments. In addition, the total amount of variable remuneration should have a maximum limit calculated from the fixed annual remuneration. All bonuses shall include conditions according to which they can be cancelled or adjusted. The government also expects that companies shall describe their remuneration policy, justify the realised performance bonuses and report on realisation of the company's sustainability targets at their annual general meetings. The government also encourages management and personnel to buy shares in their own company. Although decisions on remuneration are made by companies, the state does not approve of the use of options or other measures requiring the issue of new shares or supplementary pension benefits.

34 On 8 April 2020, the government updated its resolution on state ownership policy to set the strategic guidelines and describe the policies regarding ownership steering.

ii Specific business sectors

There are specific rules relating to executive remuneration in the financial sector, generally based on EU-level regulations. The Finnish rules apply to most financial institutions, such as credit institutions and investment service firms in general, as well as to mutual fund management companies and alternative investment fund managers. Generally, the rules restrict the awarding and payment of variable remuneration to senior management of regulated entities, as well as persons who, in their position, may materially affect the risk profile of the relevant entity, personnel in control functions and persons who receive remuneration of at least the same magnitude as senior management and risktakers.

Awards and payment of variable remuneration to the above-mentioned members of staff must be aligned with the performance of the relevant entity and the performance of the relevant staff member. Generally, the entity must have in place remuneration policies and practices whereby the payment of a significant part (such as at least 40 per cent) of variable remuneration must be deferred for a period of between three and five years of the end of the period during which the remuneration was earned, at least half of the remuneration must be paid other than in cash (e.g., in financial instruments linked to the entity in question) and the disposal of such instruments must be subject to a lock-up period.

IX DEVELOPMENTS AND CONCLUSIONS

Remuneration of top executives and tax-beneficial arrangements relating to high remuneration continue to be topics subject to sharp discussion in the Finnish media and by politicians, even in cases where there is no question that such an arrangement is legally acceptable. Furthermore, transparency of executive remuneration programmes in listed companies has increased as the remuneration policy needs to be presented to the annual general meeting at least every four years. In addition, the remuneration report stating the remuneration paid and due for the financial year needs to be presented to the annual general meeting each year. Going forward, corporate sustainability-related criteria in variable remuneration can be expected to gain more prominence and scrutiny in line with the increased interest in the topic from different stakeholders. Another interesting change is the recent legal amendment imposing an obligation to pay compensation for the duration of the non-competition undertaking. This has already made employers consider more carefully whether the enforcement of a restricted period is essential for the protection of the employer's interests.

Appendix 1

ABOUT THE AUTHORS

JOHANNA HALTIA-TAPIO

Hannes Snellman Attorneys Ltd

Johanna Haltia-Tapio is a specialist partner and heads the employment law practice at Hannes Snellman. She is a recognised expert in employment law, advising clients on all aspects of employment law. Ms Haltia-Tapio's expertise encompasses both employment law-related issues in transactions, outsourcings and corporate restructurings, as well as manager contracts, termination agreements, redundancies and consultation procedures. She also advises clients on the harmonisation of employment-related benefits, pensions, incentive programmes and personnel policies.

Ms Haltia-Tapio graduated from the University of Helsinki in 1999 and joined Roschier Holmberg Attorneys Ltd the same year. She joined Hannes Snellman in 2005 and was appointed specialist partner in 2018.

JOAKIM FRÄNDE

Hannes Snellman Attorneys Ltd

Joakim Frände is a counsel in the Hannes Snellman tax group. He advises clients particularly on matters relating to private wealth, cross-border relocation and tax litigation.

Mr Frände has worked at the University of Helsinki as a doctoral student and lecturer in fiscal law, with a special focus on international taxation of individuals. He graduated as a Master of Laws in 2005 from the University of Helsinki and as a Doctor of Laws in 2013 with a published doctoral dissertation concerning situations of dual residence in the taxation of individuals. He also has past experience as a tax adviser at KPMG Finland.

ANNIINA JÄRVINEN

Hannes Snellman Attorneys Ltd

Anniina Järvinen is a managing associate in Hannes Snellman's M&A group. She specialises in corporate and securities market law. Ms Järvinen has experience in advising clients, inter alia, in relation to general corporate governance and capital markets matters.

Ms Järvinen graduated from the University of Helsinki in 2012 and joined Hannes Snellman the same year. Prior to joining Hannes Snellman, Ms Järvinen worked for the Finnish Financial Supervisory Authority in the conduct of business supervision department. She has also worked at Cleary Gottlieb Steen & Hamilton LLP in London.

HANNES SNELLMAN ATTORNEYS LTD

Eteläesplanadi 20
00130 Helsinki
Finland
Tel: +358 9 228 841
Fax: +358 9 177 393
johanna.haltia-tapio@hannessnellman.com
joakim.frande@hannessnellman.com
anniina.jarvinen@hannessnellman.com
www.hannessnellman.com

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