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Performance bonuses on the rack

Executive performance bonuses are coming under widespread attack – as "not fit for purpose" – and some companies, especially in the finance sector, are starting to scrap them.

The mood music in the City has changed abruptly since new PM Theresa May demanded sweeping reforms in UK boardrooms, to increase accountability and shareholder power, especially over executive reward packages.

*One of the UK's most respected fund managers is to scrap bonuses at his firm, in a challenge to the City mantra that bonuses are essential in order to motivate staff. Neil Woodford is putting all staff at Oxford-based **Woodford Investment Management** on a flat salary this year. His move won support from another senior figure in the fund management world, Daniel Godfrey, who said his new venture will not pay bonuses.

***Deutsche Bank**'s supervisory board should discuss scrapping bonuses for top executives for a second year after Germany's largest bank put dividend payments on hold, consumer banking chief Christian Sewing said. "It's clear that if we don't pay our shareholders a dividend, then our own bonus needs to be up for debate as well," Sewing, who sits on Deutsche Bank's ten-member management board, told *Bild-Zeitung*. Deutsche Bank ceo John Cryan, 55, has sold risky assets and eliminated thousands of jobs to bolster capital buffers and boost profitability, hurt by mounting legal costs and tougher regulation. The ceo scrapped bonus – largely equity – awards for top management and suspended dividends after the lender posted its first annual loss since 2008 last year.

***Blackstone**, the US private equity giant, has scrapped equity bonuses for its top executives. Last year, after record profits, its ceo Stephen Schwarzman made nearly £550m. Yet his pay was almost entirely from dividends and profits on his personal investments in Blackstone funds. His salary was just $350,000. His dividend payout was huge because he owns 20 percent of a vast company he built from scratch. Shareholders benefit precisely when he does, and take the hit with him in the bad years such as now.

Commentators have started to argue that it might be better to give directors a chunk of shares every year and let them benefit or suffer in line with the pension funds which invest in their businesses, rather than award large bonuses which may or may not reflect actual performance.

Fund management groups until recently have been among the most aggressive payers of large bonuses, arguing that they are crucial for performance. However, rock-bottom interest rates, global debt worries and trading uncertainties have all combined to reduce most fund returns drastically – exposing mega bonuses to harsh daylight.

Woodford dismisses bonuses as "largely ineffective" which can lead to "wrong behaviours". His ceo, Craig Newman, said: "While bonuses are an established feature of the financial sector, Neil and I wanted to take the opportunity to do something different that supports the firm's culture and ethos of challenging the status quo. We concluded that bonuses are largely ineffective in influencing the right behaviours.

From the Chairman

It took a letter to Fred Hackworth from the other end of the earth to reveal the scandal that Roadchef employees are still waiting for their fair share of the proceeds, some twenty years on. Roadchef casts a long cloud over employee ownership in Britain. The vulnerability of amateur trustees is an enduring problem so Roadchef may not be a one off.

Because the final result was a settlement rather than a judgment in open court the detail is hard to come by. Reading between Fred's lines I guess the finger of suspicion points at HMRC, which is only doing its job. Perhaps it is time for the minister, Jane Ellison, to step in, solve the problem for the Revenue and see the Roadchef employees (and their descendants) get what is clearly owing to them.

Malcolm Hurlston CBE

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"There is little correlation between bonus and performance and this is backed by widespread academic evidence. Many studies conclude that bonuses don't work as a motivator, as expectation is already built in. Behavioural studies suggest that bonuses can lead to short-term decision making and wrong behaviours."

To soften the blow of cutting bonuses and to make sure staff are not hit by an effective pay cut, Woodford has given them a pay rise for the current financial year. The firm said that by paying a single salary, it will improve employee behaviour and performance – arguing that bonuses are a distraction.

Woodford's firm will be joined by Godfrey's new fund. Godfrey, former boss of the **Investment Association (IA)** – which includes the major City asset management groups – admitted that pay levels and bonuses in the industry are too high. He said: "I don't want to demonise bonuses full stop, but there are areas of the economy where pay is objectively too high but when you are in an arms race it is hard to stop it. There are areas where pay should come down, but how you get there is another matter" He wants fund manager groups to be more forthcoming in explaining pay levels and in his own venture will be paying just a basic salary and a very long-term shares package.

*The IA's Executive Remuneration Working Group, comprising several City heavyweight investment chiefs, had – in an interim report – even discussed scrapping equity-driven Long-Term Incentive Plans altogether, though it rowed back from that extreme step in its final report.

Woodford has linked the change in pay structure to academic studies which indicate that bloated pay packets at big corporations and among fund managers do not result in better outcomes for investors or customers. *Killing Conscience: The Unintended Behavioural Consequences of Pay for Performance* by Lynn Stout, found that the more that ceos get paid, the worse their companies perform over the next three years. Stout found that workplaces that rely on bonuses promote selfishness and opportunism, with the end result more uncooperative, unethical, and illegal employee behaviour.

Fund manager pay is linked to performance against targets or benchmarks – such as beating the FTSE All Share index by one or two percent, but Woodford prefers to pick and hold stocks according to their fundamental value, rather than their relative performance against a benchmark. Its main fund returned 16 percent for investors in 2015, compared to six percent for the average fund.

Woodford's firm quotes from a recent article in the specialist publication *The Journal of Corporation Law*. This said: "Financial incentives are often counter-productive as they encourage gaming, fraud and other dysfunctional behaviours that damage the reputation and culture of the organisation. They produce the misleading assumption that most people are selfish and self-interested, which in turn erodes trust."

*Meanwhile, an influential US report reached the same conclusion; that inflated reward packages do not encourage exceptional performance by ceos. Company shareholders and investors had decided decades ago that ceos should receive their primary compensation not from base salaries but from equity incentives – longer-term stock options that would give these top executives a stake in the company and its performance. That way, investors thought, ceos would have a personal interest in growing the company, wrote Monica Wang in Forbes magazine.

However, according to a recent study by **MSCI**, the corporate governance research firm, companies that paid their ceos above the median have performed poorly in comparison with those that compensated their ceos at or below the median (even though equity accounts for at least 70 percent of the typical annual pay package). This finding has held true especially in the long run. Ric Marshall, director of MSCI's corporate governance research team and a co-author of the report, said researchers looked at ten years of data for more than 800 ceos at 429 large public companies to measure the relationship between pay and performance. He explained that MSCI approached the topic from the perspective of the long-time investor. And what researchers found was that $100 invested in the top quintile of companies led by the highest-paid ceos yielded $264.76 from 2006 to 2015, while the same amount put into the bottom quintile became $367.17 over the decade. The difference between their respective average ten-year total shareholder returns, including both capital gains and dividends, was a significant 39 percent.

"The more conservative companies when it comes to incentive pay actually performed the best," Marshall told Forbes.

Researchers at MSCI were meticulous with their data measurements. They took out 17 outliers, such as Apple and Netflix, which had significantly outperformed the others and considered each of these companies on a case-by-case basis. They sorted companies based on sector and examined pay and performance in every peer group, but reached the same conclusion every time: companies that approved higher total pay with substantial equity incentives for their ceos consistently under-performed.

Marshall said ceo compensation is so complicated that shareholders can find it difficult to vote on the most effective pay structure. "There's no absolute benchmark in ceo compensation," he said, explaining that the package is often heavily influenced by the pay at the company's peers in the sector. "Our finding suggests that beyond a certain point, the higher incentive rewards are not meaningful. Instead, it might have the opposite effect [in driving performance]."

He added that companies, investors and researchers alike tend to focus too much on the short term. In fact, the total summary pay – the ceo's total compensation package, including base salary, benefits, bonuses and long-term equity incentives – must be reported in the annual proxy filings of all publicly-held American companies per SEC standards. The numbers in these statements mainly reflect short-term performance, which can lead stockholders to overlook long-term trends and make decisions based on the available data. Marshall advised investors and shareholders to take a more long-term view and consider multiple proxy statements.

The future of performance bonuses and Mrs May's call for City reforms will come under the microscope at the Centre's **Employee Equity Symposium** at White & Case, London EC2, on November 23-24. *More about this event can be read on pages 5 and 6 of this issue.*

Updated remuneration policy guidance

The GC 100 and Investor Group, a working group which brings together leading institutional investors and some of the most senior general counsel and in-house lawyers working for FTSE 100 companies, has published updated guidance on remuneration policy. It provides some additional clarification on topics including disclosure of performance targets, disclosure of maximum remuneration and the remuneration committee's use of discretion.

"This guidance is timely as companies work towards renewal of remuneration policies at the 2017 AGM," said share plans and incentives expert Suzannah Crookes of Centre member **Pinsent Masons**. "It is not surprising to see the guidance supplemented in relation to disclosure of performance targets, which has been an area of focus for the Investment Association, in particular that there should not be over-reliance on 'commercial sensitivity' as a reason not to disclose. There is further emphasis on the requirement to disclose a maximum for every component of remuneration, including salary," she said.

Since October 2013, companies have been required to include more information about how directors have been and will be paid, along with how this relates to company performance, in their annual reports.

The current rules give shareholders a legally binding vote on future pay policy at least once every three years, backed by an annual vote on implementation of the policy, which is not directly binding on the company – although a majority against will trigger a binding vote on pay policy the following year.

This means that the first policies subject to a binding vote under the new regime, and which have not previously been revised, will be due for renewal as part of the 2017 AGM season.

The changes to the guidance follow a wide-reaching consultation process conducted by the GC 100 and Investor group, which it said highlighted some areas requiring further clarification. In particular, it found that the guidance on disclosure of maximum remuneration "could be tightened in line with the regulatory intent", the group said.

The guidance has reinforced the need to disclose the maximum level of each type of remuneration payable to each executive director, and to clarify that this must be explained "in monetary terms or any other way appropriate to the company (for example, a percentage of salary)". Where companies with overseas directors pay salaries in different currencies, this will need to be clearly explained. Companies should describe the factors that the remuneration committee will consider when deciding what level of salary will be paid on an annual basis, "explaining how the basis on which pay is determined supports the company's strategic objectives", according to the guidance.

The group clarified that the remuneration committee may use its discretion "in either an upwards or a downwards direction", with the former inevitably requiring "careful explanation and in certain cases prior dialogue with shareholders". However, any operational discretions should be specified "as clearly as possible", rather than by a general statement that all components of remuneration can be adjusted at the complete discretion of the committee, according to the guidance.

"Investors are likely to have concerns about the way such a broad discretion might be used, and so find it hard to approve the policy," the group said. "Equally, companies may find such a broad discretion difficult to exercise with confidence if (as will often be the case) there is any doubt that investors will agree."

Although the regulations do not require disclosure of commercially sensitive information on performance measures or targets, any decision to rely on this carve-out "should not be taken lightly", according to the guidance. Once that information is no longer commercially sensitive, it should then be disclosed in the next annual remuneration report, according to the guidance.

The group provided further guidance on the requirement in the regulations for the remuneration report to set out the percentage change from the preceding year of the chief executive's remuneration alongside the average percentage change in the remuneration of the company's employees generally.

"If Theresa May's call, in a speech two days before she became prime minister, for the publication of the ratio between a ceo's pay and that of his/her average employee becomes law, this new requirement seems likely to replace the requirement to report ceo and average workforce increases," said executive remuneration expert Lynette Jacobs of Pinsent Masons. "Concerns over the selection of an appropriate comparator group are likely to be addressed in the drafting of any new pay ratio requirement, so this new guidance on comparator groups may then become obsolete." She pointed out that the IA Executive Remuneration Working Group had called for companies to consider whether they should redesign their long-term executive equity awards, which for some at least would mean a move away from the almost standard performance share plan with a performance period of three years or longer.

"The IA is expected to update its highly influential principles of remuneration in response to that report within the next six weeks or so," she said. "Naturally this guidance predominantly addresses the prevailing executive remuneration model. For this reason it seems likely that a further update may be needed soon, to put companies and investors in the best position to engage with each other and respond creatively to calls for reform and innovation in the 2017 AGM season."

Scandal of unpaid Roadchef employee shares compensation drags on

Almost 600 present and former staff of the motorway services chain **Roadchef** still await their payouts – long after winning a 17 year legal battle for shares which had been set aside for them in an EBT by the company's late founder Patrick Gee to reward their hard work.

Mr Gee, who bought Roadchef in a management buyout in 1983, gave instructions before his death that 20 percent of shares in his business be assigned to an employee trust. However, the 600 staff didn't receive a penny when the business was subsequently sold in 1998 to a Japanese company by Tim Ingram Hill – who had succeeded Mr Gee at the head of Roadchef.

The deal made Ingram Hill, a former pheasant plucker in the kitchens of the Savoy Hotel, more than £25m.

The legal battle on behalf of the Roadchef staff, many of whom no longer work for the business, was championed for 17 years by the Cardiff law firm **Capital Law** and its senior partner Chris Nott. It came to a successful conclusion in favour of the employees following a High Court ruling against Mr Ingram Hill early last year.

Yet despite the court ruling, present and former Roadchef staff have yet to receive a penny of what they are owed.

The scandal was reignited by Mr Andi Nichol, who works for Westpac in New Zealand. He contacted *newspad* editor Fred Hackworth to say: "Back in March 2015 you ran an article titled 'Final payout in sight for Roadchef shareholders'. My mother is one of the many people who have been advised that they may be entitled to a payout from the settlement agreed with Ingram Hill. However, I notice that nothing has been done further since the ruling was made."

Mr Nichol asked how much longer his mother and other Roadchef beneficiaries would have to wait before they were finally paid and what on earth was holding up the payment process so long.

Andrew Brown, Partner at Capital Law, told *newspad* exclusively: "I am restricted from reporting anything at this time, but rest assured that the trustees and we are working extremely hard to resolve all outstanding issues (with the best interests of the beneficiaries in mind) and to expedite distribution.

"Having fought for the beneficiaries for so long (working with determined trustees and actually only a handful of brave and helpful people like Ann Tyler) to achieve a successful outcome against Ingram Hill, we have absolutely no desire to string this out. The trustees and we are acutely aware of the passage of time – we have driven this claim from the outset, when others told us that it couldn't be done. The trustees have also updated the potential beneficiaries (where possible) at each and every stage where they have been legally permitted to do so."

However, he refused to comment on speculation that protracted negotiations with **HMRC** – over the size of the potential tax bills payable by the Roadchef victims – had been a key reason for the delay in payment.

Roadchef Employee Benefits Trustee Ltd (REBTL) was set up in 1986 for the benefit of the company's employees by the trade union bank, **Unity Trust**. The dispute largely concerned Mr Ingram Hill's acquisition of 22m Roadchef shares from a second trust which he cashed in when Roadchef was sold in 1998. Had the scheme been allowed to operate according to the wishes of Mr Gee, many qualifying Roadchef employees would have received five figure sums when the business was subsequently sold.

Although the terms of the final settlement remain confidential, it is thought that the largest payouts to Roadchef employees could be up to £20,000 per head.

Bankrolled by **Harbour Litigation Funding**, the claim contested the 1998 transfer of shares in Roadchef between two trusts, EBT1 and EBT2. EBT1 operated an employee share ownership plan for the benefit of employees while EBT2 was used to provide share incentives to senior management.

The case concerned the circumstances in which the EBT trustees granted options over the shares to Ingram Hill personally, who served in top positions in Roadchef over many years, including md, chairman and ceo.

The claimant argued on behalf of the employees that transfer of shares from EBT1 to EBT2 was void and that the transfer made was in breach of trust or breach of fiduciary duty owed to the beneficiaries of EBT1. There were further allegations that Ingram Hill dishonestly assisted in the breach, as he received the shares in the knowledge that they had been transferred allegedly in breach of fiduciary duty, though he has not been convicted of any criminal offence.

As previously reported in *newspad*, having considered whether or not the transfer of the shares was entirely valid, void or voidable, in January 2014 Justice Proudman found that, irrespective of any wrongdoing on the part of Ingram Hill, the transfer was void as it was outside the power of the trustees. Judge Proudman held that the claimant could therefore void the transfer of the shares.

The High Court found Ingram Hill liable for breach of fiduciary duty as he did not obtain the informed consent of other directors, because he did not tell them he intended to secure options over the shares. The court then ruled that Mr Ingram Hill, who had become one of Britain's wealthiest men, had to account for the profits made from his receipt of the 22m shares intended for employees.

In the years immediately following the sale of Roadchef, Ingram Hill remained a director of REBTL and the manner in which shares had been transferred out of the trust meant that the trust had no funds with which to pursue him. He ceased to be a director of REBTL in 2005 with the appointment of the current board – their primary objective being to try and recover money from Mr Ingram Hill, restore funds to the trust and to distribute it to Roadchef's current and former employees.

A turning point came in 2010 when Capital Law managed to unlock the case by taking advantage of a change in law around the funding of litigation, securing funding from leading third party funder, Harbour. The case was one of the first in the UK to be supported in this way.

In March last year, Mr Brown said: “The terms of the settlement remain confidential, but years of complex and hard-fought litigation have been brought to an end by considerable co-operation between the trustees, the Ingram Hills, and their respective legal teams. We have never lost sight of those who should have benefitted from the employee share ownership plan and we embraced the challenge of raising funding to pursue a claim at a time when the litigation funding market was in its infancy. The trustees will now need to undertake negotiations with HMRC and other parties to determine precisely how much money will be available for distribution. They will continue to work to administer the trust as swiftly as possible so that the beneficiaries can receive their respective payments without further undue delay.”

The present owners of Roadchef had no involvement in the transaction and have assisted REBTL and its lawyers for the benefit of the trust’s beneficiaries. In a statement last year Mr Ingram Hill had said: “I wish the employees of Roadchef the very best and I am obviously delighted there has been an amicable settlement.”

COMPANIES

Participating employees at **ARM Holdings**, Britain’s biggest technology company, could share a collective payout worth almost £400m, assuming Japanese group **SoftBank** completes its £24.3bn takeover attempt. SoftBank’s offer documents for ARM shows that 22.4m outstanding share awards have been granted in employee incentive schemes at the Cambridge-based company. As SoftBank’s bid is priced at £17 per share, this means that ARM employees could share as much as £380m, although the timing of the payout is likely to be spread out and could be used to encourage talented engineers to stay at the company. ARM employs 1,600 people in Cambridge and about 4,000 worldwide. Some of the biggest share awards would be made to executives at ARM, who are members of separate incentive schemes. Ceo Simon Segars could collect £11m, while Mike Muller, the chief technology officer, is in line for £21m.

Vallourec, a world leader in premium tubular solutions for the energy markets and for demanding industrial applications, announced the implementation of a new Eso offer for the ninth consecutive year. ‘Value 16’ concerns a maximum 6.6m newly-issued shares representing 1.48 percent of the company’s share capital. It will be open to Vallourec employees in 11 countries representing 95 percent of the group’s 20,000 employees. The eight previous Value offerings generated a high participation rate among Group employees and were all successful. Employee shareholders held 2.56 percent of Vallourec’s share capital on June 20 and are represented on the Supervisory Board. The share reservation period will be open to employees from September 12 to September 30. The subscription price – equal to the average opening price of Vallourec’s shares on the Euronext Paris during the 20 trading days preceding the subscription period, discounted by 20 percent for the classic formula and 15 percent for the leverage formula – will be fixed on November 7.

Two formulas will be offered in France: a classic formula (i.e. share subscription with a 20 percent discount, supplemented by an employer contribution), and a leverage formula (i.e. share subscription with a 15 percent discount, supplemented by an employer contribution). Outside France, only a leverage formula will be offered. The structure of this formula will differ from one jurisdiction to another in order to comply with local regulations and/or to take advantage of specific tax provisions that may be more favourable for employee subscriptions, while ensuring comparable economic advantages to all eligible employees. In France, Germany, Brazil, the United Arab Emirates, Mexico and the United Kingdom, the leveraged formula will be supplemented by an employer contribution in cash invested in the specific leveraged FCPEs, (Fonds Commun de Placement d’Entreprise – a French investment fund for employee shareholders) and in Canada, China, the United States, Malaysia and Singapore by a grant of free shares, newly issued or existing shares (up to a maximum of 15,000 shares), or a deferred cash bonus. The lock-up period will end on June 30 2021, except in cases of early release

CENTRE BRITISH ISLES SYMPOSIUM

The Centre has added to its line-up of top names and industry experts who will deliver topic presentations during the inaugural **British Isles symposium** on **employee equity, Brexit and shareholder democracy** starting **Wednesday November 23** at **White & Case’**s City HQ in Old Broad Street.

This showpiece event, hosted by legal giant **White & Case** has already attracted sponsorship from trustees **Bedell Trust** and **Estera** (formerly Appleby fiduciaries) and plan administrators **Equatex**. Other sponsorship opportunities are still available.

Sarah Wilson, ceo of the proxy voting agency, **Manifest**, will address executive reward reform. She will ask: *Where’s the workforce in corporate governance?*

Speakers also include: **Nicholas Greenacre** of our event hosts, **White & Case**; **Catherine Gannon** of **Gannons**; **Graham Ward-Thompson** of **Howells Associates**; **Sara Cohen** of **Lewis Silkin**; **Juliette Graham** of **Linklaters**; **Amanda Flint** of **Mercer**; **Stephen Woodhouse** of **Pett Franklin**; **Lynette Jacobs** of **Pinsent Masons**; **Jeremy Mindell** of **Primondell**; and **Peter Parry** of the **UK Shareholders Association**. Centre chairman **Malcolm Hurlston CBE** will welcome delegates and introduce the symposium, setting out the main themes.

A few speaker roles remain open at this event, particularly to those who can present a client Eso plan case history, update delegates on latest developments in the plan administration sector or explain the corporate governance issues of cross-border all-employee equity plans. Trustee speakers are sought too, as we will devote a segment of the programme to the Crown Dependencies. Speaker slots are good value – just **£250** + VAT per person, as compared to **£395 +** VAT for practitioner delegate places. Please contact Centre international director **Fred Hackworth** at fhackworth@esopcentre.com asap if you would like to speak and have a topic in mind, or to discuss co-sponsorship ideas.

You can review the draft programme to date – already formidable – at: http://tinyurl.com/zerdyke

Delegates: book before Friday September 9 to take advantage of the following early bird prices:

Members

Plan issuers: FREE (subject to £50 admin charge)

Practitioners: £395

Non-members

Plan issuers: £175

Practitioners: £595

All prices are subject to UK standard rate VAT.

To register your place, please email britishisles@esopcentre.com or call 020 7239 4971.

Tax advisers who facilitate avoidance face big fines

Accountants and financial advisers who enable tax avoidance could be fined up to 100 percent of the tax avoided, under proposals announced by the UK Treasury.

The move extends government efforts to fight tax avoidance, which have since been accelerated by Theresa May. The prime minister promised in her leadership campaign to crack down on tax avoidance. Critics have said that past government crackdowns have been unwieldy and miss the real offenders.

The Treasury's measures, part of a consultation, would apply to accountants, tax planners and advisers involved in schemes found to be avoiding tax.

They include proposals to name and shame companies that have been identified as enabling avoidance, to "alert and protect taxpayers".

Penalties would be charged not just to the designers of avoidance schemes, but also to the independent financial advisers who market them and the lawyers and bankers who facilitate implementation, the consultation proposes.

The consultation document seeks to make it easier to impose penalties when avoidance schemes are defeated, by forcing suspected tax avoiders to demonstrate that they took reasonable care to avoid errors in their tax returns. Currently the burden of proof rests with HMRC; the Treasury consultation proposes reversing that, because it "creates an incentive for tax avoiders to make it difficult for HMRC to gather evidence to show their true motives".

A new, escalating surcharge would be applied to firms that hinder HMRC's inquiries.

What most of the media missed however, was the lethal threat posed by the Treasury proposals to indemnity insurance premiums paid by those tax advisers who market such schemes.

The proposed new 100 percent tax fines, if enacted, would force their insurers to cancel indemnity policies – for fear of picking up huge HMRC bills via clients – which in turn would put a number of such tax advisers out of business.

"These tough new sanctions will make would-be enablers think twice and in turn reduce the number of schemes on the market," said **Financial Secretary to the Treasury Jane Ellison MP**. "The vast majority of their schemes don't work and can land their users in court facing large tax bills and other costs."

Alex Cobham of **Tax Justice Network**, a campaign group that has pushed for changes to international tax law, welcomed the proposal, saying, "Most of the threats do not come from individuals or individual companies deciding unilaterally to take a punt. Instead, the threats stem from schemes which are marketed widely."

However, accounting bodies warned the Treasury could end up penalising tax advisers who have not broken the law. John Cullinane of the **Chartered Institute of Taxation**, which represents tax advisers, said "the government need to be careful that in their efforts to wipe out avoidance schemes they do not prevent taxpayers from getting access to honest, impartial advice on the law". Frank Haskew of the **ICAEW**, which represents chartered accountants, said the government "needs to ensure any new rules are properly targeted only to tackle those advisers that promote aggressive tax schemes, as there is a danger that reputable professional advisers could still end up being caught in the crossfire" when advising on legitimate tax planning, "while the real targets escape any penalty".

Earlier this year, as part of a wider crackdown on tax avoidance, former chancellor George Osborne revealed plans to "shut down disguised remuneration schemes", implicating some employee benefit trusts and contractor loans, in a move the Treasury forecast would raise £2.5bn over five years.

Currently tax avoiders face significant financial costs when HMRC defeats them in court, but those who advised on, or facilitated, the avoidance bear little risk.

*The HMRC-launched consultation on tackling disguised remuneration – based on the details of the impending changes announced in Budget 2016 – closes on **October 5**, this year, said Centre member **Deloitte.** See http://deloi.tt/2aKh2vg. The ex-Cameron government announced a package of changes to tackle disguised remuneration avoidance schemes to ensure users of these arrangements pay their fair share of Income Tax and NIC contributions. The text of the final changes will appear in the Finance Bill 2017.

The 2011 legislation protected almost £3.9bn of tax, £100m more than originally expected, the Treasury claimed. HMRC gave users of those schemes a chance to settle their liability and collected around

£1.5bn from those who did the right thing and settled.

"However, disguised remuneration continues to be a significant risk to the Exchequer. There remain many who have yet to settle, and still more who have used new, more artificial and contrived schemes," said Treasury Financial Secretary Jane Ellison MP. "The government will continue its action to tackle disguised remuneration schemes regardless of the form they take. At Budget earlier this year we announced a package of changes targeting both the ongoing and the historic use of these schemes to put it beyond doubt that they do not work. This technical consultation relates to part of that package and sets out the detail of these reforms, including draft legislation. The government wants to ensure that this legislation works as intended and does not penalise any innocent arrangements that are not motivated by tax avoidance. However, we are determined to stop those who might seek to circumvent these changes, and will tighten the rules further should the need arise."

An early draft of the legislation has been included in the consultation document. It includes details of proposals to tackle similar schemes used by the self-employed, and proposals to restrict the tax relief available to employers in connection with the use of these schemes. The government wants to hear views from those affected by, or interested, in these changes, including users and promoters of disguised remuneration schemes, as well as from accountancy and tax experts. To participate, the email contact address is: employmentincome.policy@hmrc.gsi.gov.uk. Write to: HM Revenue and Customs, Employment Income Policy Team, Room 1E/08, 100 Parliament Street London SW1A 2BQ

***Tax evaders** face tough new penalties of up to three times the tax they try to evade under plans detailed by HMRC. Those individuals who do not come forward and pay outstanding taxes from offshore investments and accounts will increase their risk of potential criminal charges. HMRC will be better able to target evaders from October this year, when it starts to receive a large amount of additional data on those individuals with offshore accounts in the Crown Dependencies and Overseas Territories – one year ahead of even more data coming in from across the globe, when the Common Reporting Standard comes into force.

Zedra is new trustee member

The Centre is pleased to welcome into membership **Zedra**, independent global specialist in trust and corporate services. Based in offices across key jurisdictions, its 300-strong team of industry experts is dedicated to creating and delivering solutions to clients. Launched in January 2016, Zedra was created by the purchase – by an independent group of investors – of the **Barclays** trust business, which includes the **Walbrook** acquisition made in 2007. Zedra's employer solutions team, based in Guernsey, is a leading provider of employee benefit trust and administration services for internationally listed and private companies. Its address is: **Floor 2, Le Marchant House, Le Truchot, St. Peter Port, Guernsey, GY1 1GR**. With a dedicated team of 20 specialists, Zedra has 17 years' experience in helping companies motivate and incentivise their employees. Zedra facilitates a variety of incentive arrangements including classic share warehousing and hedging arrangements for listed entities to acting as nominee and joint owner for private companies. Zedra can help companies run international share-save plans as well as succession planning for private companies. Centre contact is Elaine Graham, director and head of the employer solutions team, who will be delighted to discuss how Zedra can help companies and their employees. **Elaine Graham Director** Direct Line: +44 (0)1481 747419 Mobile: +44 (0)7781 136710 Email: elaine.graham@zedra.com

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Movers and shakers

Centre member **Bird & Bird** has moved into new offices at **12 Fetter Lane, EC4**, just off Fleet Street. All other contact details remain as before. Tel: +44 (0) 20 7415 6000. Partner **Colin Kendon** heads the employee incentives & benefits team.

Rasmus Berglund is to head up the London office of Washington based law firm **Covington & Burling**. Moving from **Linklaters**, he is keen to keep his Centre membership alive. Centre chairman Malcolm Hurlston, sent Ras his congratulations on the move. "It looks like quite a step and I hope you will be able to bring Covington and Burling into membership of the Centre," said Mr Hurlston. Business and corporate specialist Covington has almost 800 lawyers in offices worldwide. Rasmus, who held managing associate rank at Linklaters and served on the Centre steering committee, is an expert in US and UK employee incentives.

Tony Llewellyn, former company secretary at Centre member **Imagination Technologies** is seeking new employment opportunities.

Strategic Remuneration, the business Centre conference speaker **Alan Judes** established in 2006, is joining forces with FIT Remuneration Consultants. Alan said: "After ten years as a sole practitioner in the UK, I think my clients will benefit from the broader offering and access to data available. They will continue to retain the benefit of receiving advice from an organisation that is totally independent and focused solely on providing advice to remuneration committees."

OTHER CENTRE EVENTS

Share schemes for SMEs: September 16

This year's employee share schemes for SMEs conference, jointly organised by the Esop Centre and the **Institute of Directors**, will be held at the IoD's

Pall Mall HQ on **Friday September 16.** This one-day event is designed for businesses wanting to start or develop employee ownership.

Speakers include Stephen Woodhouse of **Pett Franklin**; Robert Postlethwaite of **Postlethwaite Solicitors**; David Craddock of **David Craddock Consultancy Services**; Ann Tyler of **Lewis Silkin**; Colin Kendon of **Bird & Bird**; William Franklin of **Pett Franklin**; Garry Karch of **RM2 Corporate Finance** and Graham Muir of **Nabarro**.

The programme ranges from EOTs, EMIs and EMI alternatives through to share valuation and succession planning. The beginner and advanced panel sessions will include discussion of the implications of Brexit for SME share schemes.

Tickets for Centre and IoD members cost £385 + VAT, non-members £485 + VAT. Centre members should email Daniel Helen at: events@esopcentre.com or call 020 7239 4971 to obtain tickets at the preferential rate. IoD and non-members should book online on the IoD website.

Guernsey shares schemes and trustees: October 7

The annual Guernsey share schemes and trustees conference, organised jointly by the Esop Centre and **STEP Guernsey,** will be held at the St Pierre Park Hotel in St Peter Port on the morning of **Friday October 7**.

Deputy Peter Ferbrache, Guernsey States president of the economic development committee, is set to deliver the keynote speech. In addition, delegates will hear from Martin Popplewell of **Deloitte**; Stephen Woodhouse of **Pett Franklin**; Juliet Halfhead of **Deloitte**; Alison MacKrill of **Carey Olsen** and **STEP Guernsey**; David Craddock of **David Craddock Consultancy Services**; and Elaine Graham of **Zedra**.

Malcolm Hurlston chairman of **The Esop Centre** will kick off the event with a review of the new UK government and the opportunities presented by the Employee Ownership Trust. The other presentations will look at the Common Reporting Standard, tax planning, share valuation, the new rules for outstanding EBT loans, together with the traditional legal update for trustees. A panel discussion, to include Alison MacKrill and Elaine Graham will examine why the Channel Islands are still the jurisdictions of choice.

Tickets for Centre members cost £350, non-members £450. To register, please email events@esopcentre.com or call 020 7239 4971.

Esop Centre Awards Dinner: November 22

The Centre's fifteenth annual Awards black-tie Reception & Dinner will be held at the **Reform Club** in central London on **Tuesday November 22**, the evening before the Centre's inaugural British Isles conference. The host is sports writer and former Reform Club chairman, **Mihir Bose**. The 2016 Awards Dinner brings together employee equity professionals to recognise the best in employee share ownership. The champagne reception and four-course dinner will be hosted in the grand Italianate surroundings of the Reform Club's library. As places are limited, early bookings are recommended. A table of ten costs £1,800 + VAT. Individual tickets cost Centre members £195 + VAT each and £270 + VAT for non-members. To register, please email events@esopcentre.com or call 020 7239 4971.

Nominations

The list of early entrants was announced at our annual cocktail party during the European conference in Vienna at the start of June. There is still time to submit further entries with nominations closing on Friday September 9.

Categories:

Best all-employee share plan:

- More than 1,500 employees
- Fewer than 1,500 employees

Best international all-employee share plan

Best all-employee share plan communications

Best use of video in share plan communications

Best use of social media in share plan communications

Best financial education of employees

Best promotion of share plans as long-term investment

Best innovation in share plan administration

Best use of share plan voting rights to boost employee engagement

The categories are designed to reflect the Centre's major policy objectives.

Visit the Awards 2016 webpage for more details. Members are invited to take lead sponsorship of the Awards dinner. Please register your interest at events@esopcentre.com

Fat cat directors get the cream

The ceos of Britain's largest public companies earned an average £5.5m last year, and enjoyed a ten percent pay rise, while wages in the rest of the economy lagged far behind. Rapid inflation for the country's best paid executives is being driven by a small, all-male group at the top of the corporate tree, according to the left-leaning **High Pay Centre**, which published its annual survey on earnings at FTSE 100 companies "There is apparently no end yet in sight for the rise and rise of chief executive pay packages," said the centre's director, Stefan Stern. "In spite of the occasional flurry from more active shareholders, boards continue to award ever larger amounts of pay to their most senior executives." Leading company ceos now typically earn 129 times more – including pensions and bonuses – than their employees.

The Prime Minister has promised to rein in soar-away salaries. In a shot across the City's bows, Theresa May last month set out a series of boardroom reforms, including giving employee representatives a seat at the top table. She condemned the "irrational, unhealthy and growing gap between what these companies pay their workers and what they pay their bosses".

For the average worker, average pay rose by only two percent last year, according to the Office for National Statistics. The modest increase followed sharp falls in the wake of the financial crisis. In the meantime, top bosses' pay has soared from £4.1m in 2010 to just under £5m in 2014, to £5.48m last year.

Martin Sorrell of **WPP**, who made £70m last year, is one of six ceos who have appeared in the top 10 two years running. The others include Rakesh Kapoor at pharmaceuticals group **Reckitt Benckiser**, who took home £23m; Bob Dudley, who collected £13m for running the oil group **BP**; and the banker António Horta Osório, who was paid £8.8m at **Lloyds Group**, which is still partly owned by the taxpayer.

"Big pay is a boys' club," the report claims. No women made it into the ranks of the 10 highest earning executives in either of the last two years.

Sky television boss, Jeremy Darroch, with £17m, and Flemming Ørnskov, the Danish ceo of pharmaceuticals group **Shire**, with £14.6m, are among the new entrants.

Mrs May promised to make shareholder votes on pay not just advisory, but binding; called for all listed companies to publish the ratio between ceo and average worker pay and said that under her prime ministership, employees would have a seat in the boardroom alongside company directors.

"The High Pay Centre was delighted by Theresa May's recent intervention on this issue," said Stern. "There now seems to be political will and momentum behind attempts to reform top pay."

Under new rules introduced by the former business secretary Vince Cable in 2013, the annual vote on the pay report – which approves how much executives actually earn – is non-binding. Shareholders can make binding votes only on a company's executive pay policy, which sets out a three-year plan. But investors have complained of being asked to approve schemes without knowing enough about them. The three-year plans contain predictions for the maximum executives could earn, but these have not always proved reliable. Rewards at Berkeley, Sky, Shire and Sports Direct have all overshot predictions by some margin.

PM cuts back Westminster gravy train

According to *The Times*, the Prime Minister has capped the salary paid to special advisers, or spads as they're known in Westminster, at **£72,000 a year**, unless explicitly approved by Downing Street.

Intertrust shareholders approve Elian purchase

Intertrust, a leading global provider of high-value trust and corporate services, announced that an egm in Amsterdam had approved the acquisition of **Elian Group**, as pre-announced on June 6. The transaction is still conditional upon regulatory approvals that are expected to be in place later this year. Intertrust is a leading global provider of high-value trust and corporate services, with a network of 37 offices in 26 jurisdictions across Europe, the Americas, Asia and the Middle East. The Company focuses on delivering high-quality tailored services to its clients with a view to building long-term relationships. Intertrust's business services comprise corporate services, fund services, capital market services, and private client services. Intertrust has leading market positions in selected key geographic markets of its industry, including the Netherlands, Luxembourg, the Cayman Islands and Guernsey.

Many privately-held companies think that Eso is not for them

More than half (55 percent) of 224 companies which took part in a recent survey don't offer either share or share option based schemes, according to research by *Employee Benefits* and **Xerox HR Services**. Nearly two thirds of companies who have not installed employee share ownership said that, as they were privately held, employee share ownership wasn't for them.

More than a quarter (29 percent) of employer respondents offer shares or share options for all employees, the *Benefits Research 2016* survey, found. In addition,16 percent offer shares or share options for executive and senior-level staff.

Of company respondents who offer a share scheme, almost half (47 percent) run a long-term incentive plan. Sharesave schemes (SAYE) and company share option plans (CSOP) are popular too, with 27 percent and 22 percent of respondents offering these to staff. A fifth (21 percent) of respondents have an all-employee share incentive plan (SIP) offering matching shares, followed by a SIP offering with partnership shares (16 percent), and free shares (eight percent).

Among those respondents that don't offer shares or share options to employees, not being a listed company is the top reason for not doing so (63 percent). Just three percent of respondents that do not have an employee share offering cite a preference for cash incentive schemes as the main reason for not doing so, and 13 percent do not offer shares because they do not consider it to be appropriate.

Royal Mail final salary pensions under threat

Almost 100,000 workers at the Royal Mail and the Post Office face the threat of having their "simply unaffordable" pension schemes cut back significantly. One PO manager in his 40s was told that his projected pension at retirement would collapse from £38,000 a year to just £18,000, if the final salary scheme is scrapped.

A new alert to the crisis in occupational pension provision was sounded by pensions consultancy **JLT**, which predicted that all existing UK defined benefit schemes will close to new members by the end of the year.

More than 5,000 UK defined company benefit pension schemes are in deficit, compared to only 925 that are fully-funded to pay their pensioners what they promised, in spite of rising life expectancies and falling returns.

Royal Mail (RM) pays around £400m a year into its defined benefit scheme, which guarantees a pension based on a postal worker's average salary over his or her lifetime, rather than what happens on the stock market. The company said financial market conditions had deteriorated so much that the cost of keeping the plan fully open would balloon to £900m over the next few years.

Every new company now sets up a less generous defined contribution scheme, which puts more of the savings burden on employees.

Big cuts to final salary pensions are coming not just at former state-owned enterprises but also at the few private companies that still operate so called gold-plated schemes. **Marks & Spencer** is consulting on cuts that would affect the pensions of 11,000 longstanding shop workers. At both the RM and M&S, final salary-style pension schemes have already been closed to new joiners, but existing staff have continued to accrue benefits and retire with a pension based on their final salary. It is these future accruals that are now under threat.

The RM and PO defined benefit schemes cost the employers the equivalent of 45 percent of salary. M&S said its pension scheme costs 34 percent of salary, but that the proposed replacement would be capped at a maximum of 12 percent. Companies argue that the cost of maintaining the pension schemes has become unsustainable, in part because of big increases in longevity but also because of falls in gilt and bond yields, which mean they have to pay in more to keep them financially afloat. These gilt and bond yields have hit historic lows since the vote for Brexit, making the pension schemes even more expensive to maintain.

RM said: "We understand how much our people value their pension benefits. We committed to keep the Royal Mail pension plan open to future accrual on a career average basis for existing members without further changes, at least until March 2018.

"Early indications from the latest triennial valuation of the plan suggest that the company's contributions to the pension plan each year would have to increase from around £400m to over £900m. Such an increase in costs is not sustainable. We are talking to our unions about the future of the plan after March 2018."

Pensions experts warn that the likely outcome of a review of the RM and M&S pensions will be significantly less generous defined contribution style schemes, where the outcome is dependent on the performance of the stock market, without any guarantees on the level of income on retirement, which is why 140,000 RM employees are relieved to be part of the UK's largest all-employee share scheme.

Send your share scheme stories to newspad

The Centre is always happy to publish in newspad stories from employee share scheme sponsor companies and/or their advisers about Eso schemes which have either matured, or launched recently. Readers like to know why specific schemes were launched, whether the main objectives were achieved, whether the schemes were financially successful and what the average employee participation rate was. Please email your share scheme information to newspad editor, Fred Hackworth, at: fhackworth@esopcentre.com for publication in the next issue.

Sheltering share scheme maturities from tax

Employees from many leading companies are benefiting from maturing Save As You Earn (SAYE) share schemes this year, but what can they do to make sure that these potentially life changing amounts aren't eroded by Capital Gains Tax (CGT)?

Jonathan Watts-Lay, director of **WEALTH at work**, a provider of financial education in the workplace, supported by guidance and advice, comments; "There are a few key things that share scheme participants should consider to protect their windfall from CGT and manage it in the most tax-efficient way. Firstly, the CGT liability can often be split over two consecutive tax years, meaning that £22,200 rather than £11,100 of gains could be sheltered from CGT. Don't forget transfers to a spouse or civil partner are exempt from CGT and by doing so, you can make use their partners' CGT allowances. It should be noted that the transfer to a spouse or civil partner should be considered as an outright gift."

"Employees can carry out an 'in specie' transfer into an ISA within 90 days of exercising the option and any gain on the shares transferred is exempt from CGT. Many high street ISA providers can't facilitate an in specie transfer so employees would need to use a workplace ISA, or a specialist provider," he told *Personnel Today*

"Due to the timing of many SAYE scheme maturities, it may be possible to reduce a potential CGT liability further by doing transfers to an ISA over two consecutive tax years, so long as the 90 day period straddles the tax year end. This would potentially allow up to £30,480 of your share scheme capital to be invested into a tax efficient ISA wrapper."

"Those who want to cash in their shares can mitigate CGT by transferring shares into an ISA before selling them and withdrawing the money. However, it is important to remember that for the brief time they hold the shares, they are exposed to market risk.

"If an employer offers this type of share scheme it is usually a good idea to save into it. However, if the bulk of someone's savings are in shares of the same company for which they work, they should consider diversifying to a broader spread of investments as each scheme matures. It is often advisable to spread investments as widely as possible and thereby reduce the risk of being exposed to the movements in price of just one company. If the company were to struggle, they could lose their job and savings, as we saw during the financial crisis."

Which are the best-performing EO companies?

The EOA Top 50, launched in conjunction with employee share scheme specialists the RM2 Partnership, analyses the business performance of the UK's 50 largest EO organisations, to chart the sector's year-on-year progress and support the sector's move into the business mainstream. The organisations are ranked by the number of employees, with data around revenue and the percentage of the business that is employee-owned published

Now in its third year, the top three positions in the EOA Top 50 continue to be held by **John Lewis Partnership** (92,100 employee-owners), **MottMacDonald** (15,531) and **Arup (**12,143). However the 2016 Top 50 sees five new entrants to the list: **Agilisys, Locala, Alfa Leisureplex Group, The Nuttall Group** and **Leading Lives.**

HMRC issues late filing penalty notices

Employment Related Securities (ERS) 2015/6 late filing penalty notices have been issued, HMRC revealed in its mid August Employment Related Securities Bulletin.

Companies received a penalty notice because they have registered a share scheme or arrangement on the ERS service but didn't submit a return for the tax year 2015 to 2016 by the July 6 deadline. Once a scheme or arrangement has been registered on the service, an annual return must be submitted by the deadline. The statutory deadline for returns is always on or before the July 6 following the end of the tax year. If a return remains outstanding after this date then automatic late filing penalties are issued.

Registering a scheme or arrangement in error

Companies are advised to close the scheme by logging onto the ERS service, select View Schemes and Arrangements, select your scheme, enter a final event date of April 5 2016 and submit a 'Nil' return. Closing of a scheme can only be completed by the company that registered the scheme and not by an agent. If you registered the scheme but there have been no reportable events or if you registered the scheme for a one-off transaction which you reported in 2014 to 2015 you can either:

close the scheme by entering a final event date of April 5 2016, you will still need to submit a 'Nil' return for 2015 to 2016

keep the scheme open if you think there may be further reportable events, you will still need to submit a 'Nil' return for 2015 to 2016

If you choose to keep the scheme or arrangement open, you will need to submit returns each year until the scheme is closed.

If after following these actions, you wish to appeal against the penalty you can write to HMRC at: Employment Related Securities Room G46 100 Parliament Street London SW1A 2BQ or by email: shareschemes@hmrc.gsi.gov.uk, telling it why the return was late. Please read Disagree with a tax decision for further information. *If your return remains outstanding on October 6, 2016 a further automatic penalty of* ***£300*** *will be issued.*

US high tech cos buy-back employee shares

Venture-backed tech start-ups with big ambitions and small or non-existent profits have long sought to boost recruitment, retention and morale by offering rank and file staff share options and the promise of a major payout. However, now that many companies are delaying IPOs and staying private for longer, some start-ups are rethinking their approach to employee compensation.

There were only 12 IPOs in the second quarter of this year, according to the **National Venture Capital Association (NVCA).** While this was twice the number of IPOs in the first quarter, more than half way through the year, the industry remains well behind the past three years, when there were 81, 117 and 77 respectively, reported *The Times.*

For employee shareholders and other investors keen to get hold of shares in Silicon Valley gazelles with valuations exceeding $1bn, such as **Uber** and **Airbnb**, this can be frustrating. The average age of US technology companies that went public in 1999 was four years. Now it is eight to ten.

There are signs of change. **Palantir**, a data mining company, established in part with money from **In-Q-Tel**, the venture capital arm of the **CIA**, recently made a $250m offer to repurchase its employees' privately held shares at a premium. The company said that the offer aimed to boost staff morale by offering liquidity to employees, some of whom had been with the company (and waiting for an IPO) for more than a decade. Palantir's offer of $7.40 a share was well above the market price, despite tough times for the business. The share repurchase offer came with some tough conditions, according to *BuzzFeed,* including a requirement that current and former employees who sell their shares agree not to compete with Palantir for 12 months, nor solicit any Palantir employees during that time.

Tech companies can sell shares in the private market through exchanges that match-up sellers with buyers seeking shares in highly valued start-ups. Some brokers actively solicit shares from employee shareholders. But companies don't like the fact that such sales can lead to a dispersed shareholder base and have tried to block unauthorised share sales on the secondary market. Some are now making company-sanctioned offers for employees to cash in their shares and sell them to specially approved investors, but with more strings attached.

Airbnb recently allowed investors to purchase nearly $200m in stock from its employees, according to reports. In exchange, Airbnb employees had to agree to prohibitions on their remaining stock, including more categorical language that they could not trade or sell the shares, *The New York Times* reported. Other private companies, including **Pinterest, Elon Musk's SpaceX** and **Houzz**, a home decorating start-up valued at $1bn, are tightening up restrictions on employee share sales too.

Some Silicon Valley companies have been sold for the same amount or less than they raised from VC backers and for much less than their private valuation. This can hurt investors, but it usually hurts employee shareholders far more.

Good Technology, a mobile security start-up, was sold last year to **BlackBerry** for $425m, significantly less than its $1.1 bn private valuation. Employees' stock became worth just 44 cents a share, down from $4.32 a year earlier. Some of its employees were hit with heavy tax bills, calculated on the value of their shares at their peak, and had to use savings or borrow money to cover their tax bills.

As more struggling tech start-ups raise cash by selling shares at lower prices than they had in earlier rounds, employee shareholders suffer, as the value of their holding falls. According to industry insiders, there have been 76 such discounted share sales since 2015. When **Foursquare**, a location-sharing mobile-app company, raised $45m in a down-round in January it sold shares at a discount or more than 60 percent from their previous price and then reportedly *gave employees new shares to make up for the lower valuation.* Other start-ups are instead turning to debt as a way of raising money without setting a lower price for their equity. Either way, employee shareholders would benefit from more and easier means to sell their shares.

Addressing the frustrations of employee shareholders - as well as investors keen to invest in the private tech start-ups – is a pressing issue for many venture-backed tech companies. Retention is a big issue for an increasingly impatient workforce that thinks that five to ten years is too long to wait for a windfall.

China brings back Eso into state businesses

The Chinese government is to re-introduce employee share ownership within 200 state-controlled industries later this year in the hope that wider ownership could make them more efficient.

However, only management and high-grade technical staff will be allowed to buy shares in their state-owned employer during a two year pilot programme, according to the Chinese online newsletter *Caixin*.

The sale of equity to encourage hard work and employee loyalty is common in the Chinese private sector and was tried in state-owned enterprises too until 2005, when criticisms arose that assets owned by the people were being under-sold.

The new policy is just a "small step" toward reforming state-owned enterprises (SOEs) and motivating their workers, said Xu Yongqian, a lawyer who follows share ownership issues closely.

The policy, announced by the State Council on August 18, fleshes out a guideline on SOE reform passed by the Central Committee of the ruling Communist Party in 2013. It aimed to diversify the share ownership structure of state-controlled enterprises and make management more efficient.

Since, technically, SOEs are owned by the whole society, it is not up to any individual to decide what to do with their assets. "Because no one can really claim responsibility and take the risk, any progress has to be made with small steps, and won't have much impact," said one expert who asked not to be named.

The employee shareholder policy places restrictions on which enterprises can participate, who can buy equity shares and the percentage of shares they are allowed to hold. Only secondary or lower-level subsidiaries of an SOE, which must already have private investors, are allowed in the programme. They must also be in a competitive market, a requirement that rules out companies in the oil, electricity, telecommunications and grain supply industries.

Only higher level managers and professionals are allowed to buy equities in the state-controlled enterprises they work at, and they must hold the shares they bought for at least three years before selling, according to the policy.

The pilot Eso project will not affect the dominance of state ownership in those companies, because total employee stock ownership is limited to 30 percent, while the state's ownership must not fall below 34 percent.

There is a ceiling on employee share ownership and a floor for state holdings because "the reform is not about making the SOEs private," said Xu. To prevent any one person from gaining too much control of the enterprise through the programme, individual share ownership has been capped at one percent. Employees can buy their companies' equity shares either directly or indirectly through companies, limited partnership enterprises or special asset management plans, according to the policy.

All 31 mainland provinces, autonomous regions, municipalities directly under central government control and five special cities that are monitored separately, can choose between five to 10 state-controlled enterprises to experiment with employee share ownership. So, too, can the Xinjiang Production and Construction Corps, a military regime that shares the governance of China's northern Xinjiang region with the local government. The State-owned Assets Supervision and Administration Commission can choose another ten SOEs to join the pilot programme.

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