Vol 20 No 4 April 2009

it's our business

newspad of the Employee Share Ownership Centre

G20 clamps down on executive bonuses and tax evasion

The end of light-touch regulation heralded by the G20 summit will lead to major changes in the conduct of business in the City. Bankers face caps on the large bonuses they earn, whilst hedge fund managers will have to start disclosing their positions or strategy. 'Supervisors will assess firms' compensation policies as part of their overall assessment of their soundness,' world leaders agreed.

The summit agreed three broad principles to ensure that boards of directors play an active role in the design of compensation schemes, that bonuses properly reflect risk by being tied to long-term performance, and that companies disclose full details on pay schemes to make them accountable to shareholders.

The European Commission will update recommendations for better boardroom behaviour and pay, particularly in the financial sector, on April 21. Corporate-governance experts from across Europe, led by Bertrand Collomb, the ex boss of the cement maker Lafarge, called for remuneration consultants to be reined in. At a Commission round-table on salaries, corporate-governance expert Risk Metrics said that median executive cash reward at large EU companies rose by 74 percent between 2003 and 2007 — the equivalent of a compound annual increase of 15 percent. Employee earnings at the same companies over the same period rose 10.5 percent — or 2.5 percent per year. The gap gets wider when the value of share grants is added – up from 75 percent of salary to 125 percent at UK companies, said Risk Metrics.

Within days of the summit, France announced a decree banning stock options and limiting executive bonuses at companies that receive state bailout money, in response to public outcry. The decree, which lasts until December 2010, applies primarily to several banks, automakers and state companies that have struggled in the crisis. It bans stock options at state-aided companies, and bans bonuses if a company is undergoing large-scale layoffs. Otherwise, bonuses are allowed but must be publicly approved by the board and based on performance, not linked to a company's stock price. Severance packages for executives at state-controlled companies are limited to two years' salary and banned if the company is going through serious economic difficulty or if the departing executive hasn't met pre-established performance criteria.

From the Chairman

Bankers are reported to be angry but what caused this mess in the first place - insanely short-term, unchecked, bonus-driven NINJA mortgage deals (No Income No Job) contracted by subsidiaries of US finance houses, which became toxic debt packaged and sold around the world. Nobody really checked what was in the parcels because their bonuses for selling them on were so high. The impact on the ESO world has been severe - tens of thousands of trusting share scheme participants who left their matured options in the company - in the form of purchased shares - are the worst losers as panic set in after the collapse of Lehman Bros and shares plummeted. Next to suffer have been share scheme service providers as new launches have been substantially reduced. Some hard-pressed SAYE participants have withdrawn their savings and some have lost their jobs due to the downturn. This is why the Centre is asking the government to bring in emergency measures to slash share scheme bureaucracy and to ease both the savings and participation rules generally. As for the bankers, contrition and humility would not come amiss, however innocent they may feel about personal involvement in the economic debacle.

Malcolm Hurlston

President Obama joined French President Sarkozy in trying to crack down on the offshore so-called 'tax havens', but the Chinese prevented Hong Kong being named and shamed. Nevertheless, Monaco - for one - could be in for a tough time. Heavy fines and other sanctions are threatened for those who refuse to publish account details. The Swiss government reached an agreement to partially relax its banking secrecy rules - with the Organisation for Economic Co-operation and Development (OECD), which sets rules on bank data sharing. The Swiss had previously said that they would not compromise long-standing banking secrecy principles. Andorra, Liechtenstein, Austria and Luxembourg agreed to sign up to OECD rules too. Switzerland said it would only respond to "concrete and justified" requests for account information and that it would still protect banking customers from "unjustified watching from abroad." By contrast, both Jersey and Guernsey are already fully compliant with OECD rules.

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Meanwhile, Centre chairman Malcolm Hurlston complained to the Association of British Insurers that the executive reward Code of Practice issued by the Financial Services Authority would unwittingly encourage a rapid upward spiral in the basic salary element of executive remuneration. The ABI, which represents City investment institutions, immediately gave support to the chairman's stance.

Mr Hurlston told the ABI: "We have a number of concerns about the text, but there is one in particular which sticks in the gorge – The fixed component of remuneration should be a sufficiently high proportion of total remuneration to allow the company to operate a fully flexible bonus policy. If the fixed component (base salary) is low the firm will find it difficult to cut or eliminate a bonus in a poor financial year. A measure of the effectiveness of this principle would be the ability of a firm to be able to pay no bonus in a year in which the firm makes a loss.

"Parts of this FSA Code of Practice appear to be rolling back the frontiers on incentive based reward in favour of a higher proportion of reward being given in the form of fixed salary," said Mr Hurlston "Is this what we are all being marched up the hill for? How will your member pension funds feel about the huge increase in consolidated pay - immediately pensionable and very costly at a bad time?

"There is considerable interest among many of our members, one of whom said to me after reading the 'FSA Code of Practice': 'While I understand that the imbalance between basic and bonus can skew behaviour towards short term results ..at least it influences behaviour. A fat basic won't! The problem is not the imbalance - it's the performance conditions attached to the bonus,' added the Centre chairman.

The media reported that banks were already starting to double the salaries of middle range and senior executives in order to get round the impending curbs on bonuses. Travel or home allowances may be offered on the quiet, although cash is a preferred option.

The ABI's head of investment affairs, Peter Montagnon, told the chairman: "I agree with you that they (the FSA) don't properly understand the implications of clamping down on variable pay. This is a point we will be raising in the consultation process."

The ABI, worried that the Government may be misled into taking unwise measures as a result of the FSA Code of Practice, will spell out its concerns about executive reward to delegates at the Centre's 21st annual conference in Cannes on July 9 & 10.

SAY ON PAY

Employees or trade unions may yet gain a voice in helping to fix boardroom pay, hinted Lord Myners, Financial Services Secretary. Remuneration committees needed to be more open to a wide range of views. "Should they, for instance, consider formally seeking views from investors, employees and their representatives?" he said. From this month companies have to report how they have taken company-wide pay and employment conditions into account when fixing directors' pay. Lord Myners, addressing the National Association of Pension Funds, said: "For too long we have seen remuneration consultants being used by companies to ensure that their executive pay is above the median or in the upper quartile of the sector. All this does is drive pay upwards without any attendant link to performance." He echoed earlier pleas from Hector Sants, ceo of the Financial Services Authority, for institutional investors to take a tougher approach in their dealings with companies holding their funds. Failures by institutional investors to scrutinise and monitor board decisions and hold management accountable had contributed to the breakdown of corporate governance, particularly in banking, and the need for change. Sants told the UK finance industry – "Be afraid of us" - signalling the end of the 'light touch' regime. Myners suggested the formation of shareholder coalitions to produce a united front in boardroom representations: "Evidence suggests that shareholders are often too passive, just accepting the decisions management make. But passivity is no longer an option. Disengaged investors lead to ownerless corporations and the risk of unaccountable executives and boards running amok." Myners said pension fund trustees needed to re-examine relationships with fund managers and hold them more accountable, and asked: "Are your fund managers too close to those they are expected to monitor?"

He mentioned the issues being tackled by Sir David Walker in his Treasury review of corporate governance in banking. They include whether the UK should introduce the US model and give professional investors a legal responsibility to enhance the quality of investment. Professional qualifications for non-executive directors coupled with whether they should have banking qualifications are his agenda. Walker is considering whether they should have support to help them act independently of management. The review has recommended measures to improve the corporate governance of UK banks, particularly with regard to risk management. The review is examining board management of risk (including the effectiveness of risk and audit committees), incentives to manage risk in bank remuneration policies, the competences needed on bank boards, board practices and structures, and the role played by institutional shareholders. Preliminary conclusions will be given to commissioning ministers in the autumn and final recommendations by the end of the year.

COMPANIES

Admiral Group, which provides insurance cover for six percent of private cars in the UK, reported an 11 percent jump in full-year pre-tax profits to £202.5m. Ceo Henry Engelhardt, who is an Eso believer, said: "For the fifth year out of five since becoming a listed company, Admiral delivered record profits and the 2008 dividend will be the biggest in our history." Admiral is attempting to grow its business outside the UK and is selling insurance in Spain, Italy and Germany. Its staff will be

awarded the maximum pay out of shares in its employee scheme, totalling £4.5m worth of stock.

Group4Security was notified that the following ords of G4S plc were acquired by directors and managers as result of a vesting of shares awarded under the company's performance share plan. The value of the shares was £1.89 per share: Directors Nick Buckles 201,240 shares, Trevor Dighton 121,964, Grahame Gibson 174,423; Senior managers. Irene Cowden 75,236 shares, Søren Lundsberg-Nielsen 64,032, Ken Niven 80,039.

Fears grow for employee share ownership at **HBOS** as there are no plans left in place after the axe fell on existing plans on 19th January this year. HBOS's 70,000 employees are bereft of all share related incentives and keen to learn what Eso opportunities will be made available in the future.

Pearson is planning an international SAYE launch before July this year. Pearson reported a pre-tax profit of £585m for 2008, up from £468m in 2007. Sales grew by 8 percent to £4.8bn

Societe Generale's top executives agreed to give up their share option awards following condemnation by French President Nicholas Sarkozy. Less noticed was that 4,800 Soc Gen employees benefited from the March 2009 award of share options plus free shares. Of these, almost half were receiving either options or free shares for the first time. Only younger and less experienced employees received free shares with no performance conditions attached.

A wave of US companies is suspending contributions to staff 401(k) retirement plans in a bid to cut costs. The legal group **AARP**, plus **Saks, GM, McClatchy, J.Crew, FedEx, UPS, Coca-Cola Bottling, Reader's Digest, Motorola, Regions Financial** and **Sprint Nextel** all suspended contributions in recent months. This threatens the viability of 401(k) plans, which were introduced 30 years ago as the main way that Americans should save for retirement, replacing defined benefit pension plans. Companies offer to match employee contributions up to five percent of annual salary. The average 401(k) plan at the end of 2007 held about $65,000, but half of them held less than $19,000, according to a trade group, the Investment Companies Institute. Stock market falls have reduced these savings. Individuals can continue to contribute to their plans, but their companies will not. AARP which has 40m members aged 50 plus, has fully matched staff contributions up to three percent of annual salary. "We have taken a temporary suspension for the remainder of the year to help with cost containment measures," said a spokeman. Companies have become less likely to enrol new workers automatically in their 401(k) plan, citing costs as the main reason, said a study by Hewitt Associates. "The continued bleak economic outlook is forcing many companies to make difficult decisions with respect to their retirement benefits," said Hewitt, which estimates that only five percent of large companies would halt 401(k) contributions in 2009, but that could rise to more than ten percent in 2010.

ON THE MOVE

Senior Associate **Jane Jevon** has left the Birmingham office of lawyers Pinsent Masons LLP. Her mobile phone number is +44 (0) 7870 208 029

Bernie Madoff, the man who relieved investors of $50bn worth of funds, pleaded guilty to all 11 charges against him, which included four counts of fraud, three of money laundering, making false statements, perjury, making a false filing to the US financial watchdog and theft from an employee benefit plan. He was removed from his Manhattan penthouse to jail.

Qantas Captain Ian Woods is the new president of the **Australian Employee Ownership Association**. He has led pilot union's negotiations with airlines and has been active in lobbying the Oz government. His e-address is ian.w.woods@gmail.com

CONFERENCES

Guernsey: Bookings are coming in fast for the Esop Centre and STEP (Society of Trust and Estate Practitioners) extended half-day conference about latest market and regulatory impacts – including the G20 summit - on trustees and share scheme work. Register now to secure your place at this topical event: the OECD report following the G20 summit shows that Jersey and Guernsey are already fully compliant with its rules and have substantially implemented the internationally agreed tax standard. This conference is being held at the Old Government House Hotel in **St Peter Port** on **Friday April 24**. The Centre and STEP co-host successful Channel Islands conferences, allowing largely trustee audiences to learn and share knowledge about the use of trusts in employee share ownership plans. The speakers are: Catherine Gannon – Gannons; Karen Cooper - Osborne Clarke & Kevin Lim - RBC cees; Graeme Nuttall - Field Fisher Waterhouse; Rosemary Marr - Investec Trust and Chairman, STEP Worldwide; William Franklin -Pinsent Masons and Rashree Chhatrisha - MM&K Ltd. Their topics can be studied on the Centre website: www.hurlstons.com/esop (click onto 'events') where you can register yourself and/or colleagues. Centre and STEP members pay only £295 for admission. Delegates attending this conference will gain three hours CPD credit from the Law Society. For more info, contact Anna Burgess at: T 020 7436 9936 or email-aburgess@hurlstons.com

ESOP/WORLD CENTRE'S 21ST - JULY 9 & 10

The Association of British Insurers, which speaks for key City institutions, will explain latest executive reward guidelines at the Centre's 21st annual conference at the Majestic Hotel in Cannes on Thursday July 9 and Friday July 10. Patrick Neave, the ABI's senior remuneration analyst, will update delegates as controversy mounts worldwide over executive bonuses and other forms of incentive reward. The ABI is concerned that the Government is not getting the right advice from some quarters about reform of executive reward structures. An intriguing case study from Centre member Pearson plc will be another highlight. Pearson's share plans manager Gabbi Stopp will tell delegates what issuers, such as this global media group, look for when they conduct their

'beauty parades' - putting out to tender the administration of their new share schemes. There will be a joint presentation by Alvarez & Marsal Taxand UK LLP and by Garrigues of Spain about the impact of post-recession regulation on Spanish employee equity plans. The speaker list comprises: Sarah Pickering -Alvarez & Marsal Taxand UK LLP; Patrick Neave -Association of British Insurers; Colin Kendon -Bird & Bird LLP; Cato Wille- Capital Analytics; Justin Cooper -Capita Registrars; John Daughtrey - Equiniti; Jaime Sol Espinosa de los Monteros - Garrigues (Spain); Maoiliosa O'Culachain -Global Shares; Jeff Mamorsky -Greenberg Traurig (USA); Leslie Moss -Hewitt Associates; Rosemary Marr - Investec Trust Group & chairman of STEP Worldwide; Robert Collard -Macfarlanes LLP; Gabbi Stopp -Pearson plc; Alan Judes - Strategic Remuneration and Malcolm Hurlston - Chairman, Esop Centre. There will be an open floor debate on executive reward issues. Register either online at: www.hurlstons.com/esop - click onto 'events' and find Employee Equity: Responding to the Crisis and the 'book this event' box and/or at: fhackworth@hurlstons.com

The Employee Ownership Association (EOA) and **Baxendale**, the consultancy division of Baxi Partnership Ltd have produced a valuable research study into how UK co-owned businesses manage the people aspects of employee ownership. Making Employee Ownership Work is a benchmark guide, based on 25 case studies, which examine key issues such as employee engagement, management systems and reward, governance and employee voice, employee ownership culture and ethics/social responsibility. The participating companies included Arup, Cyril Sweett, John Lewis Partnership & Tullis Russell. EOA and Baxendale accept that while a strong employee voice is crucial to a company's success, managers must be allowed to manage. Employee shareholding, through employee benefit trusts, is the most popular tool for improving employee engagement, the study concludes. The EOA represents a UK co-ownership sector worth £25bn in annual turnover. **Employee-owned** companies under-performed at the close of 2008, dropping almost 23 percent compared to the FTSE All-Share, which was down 11 percent in the last Q of 2008. Over the long-term however, employee owned companies continue to outperform FTSE All-Share companies, revealed the UK Employee Ownership Index (EOI) published by law firm Field Fisher Waterhouse's equity incentives team. It monitors the share price performance of listed companies, comparing FTSE All-Share companies with those more than 10 percent owned by employees. Of the employee owned companies in the EOI, only 25 percent outperformed the FTSE All-Share, due to the large number of financial services companies in the EOI. Despite the drop in performance, employee owned companies have outperformed FTSE All-Share companies each year by on average ten percent during the past 17 years. An investment of £100 in the EOI in 1992 would at the end of December 2008 have been worth £453 while the same investment in the FTSE All- Share Index would be worth £172.

BONUS CORNER

GlaxoSmithKline revamped the pay deal for new ceo Andrew Witty, who took over last May, following past controversies over remuneration at Europe's biggest drugmaker. In future, GSK will benchmark both its ceo and cfo's pay primarily against a cross-industry group of UK-based multinationals, rather than global rivals as has been the case. It plans to stop granting share options. Instead, long-term incentives for the group's CEO and CFO will be focused on the award of shares tied to performance – measured from shareholder returns over a period of up to four years. For UK-based GSK executives share options will be replaced by share awards. The company has promised to claw back any bonuses paid in the past that prove to have been based on performance that was less good than first appeared. To demonstrate the long-term nature of pay awards, half of the share awards will be assessed over the conventional three years and the other half over four years. Witty's base salary is £1m, up from £850,000. In 2003 GSK shareholders famously voted down a £22m payout for then ceo Jean-Pierre Garnier.

The Government allowed **RBS** to award chairman Sir Philip Hampton £1.5m worth of share options, on top of a salary of £750,000 a year. The Government, which has a 70 percent stake in RBS, and now 68 percent in Lloyds TSB, could not stop former ceo Sir Fred Goodwin keeping his £700,000 a year pension but used its new state bank overlord UK Financial Investments to vote down the RBS remuneration report at the AGM. RBS later faced claims that it had misled investors over its exposure to bad debts, after it was reported that more than £30bn of toxic sub-prime mortgages were bought for RBS by traders in 2007 without the board being informed - a claim denied by the bank. A prominent Labour Peer claimed that some RBS non-executive directors had been bullied into not asking searching questions about its financial affairs. **LloydsTSB** ceo Eric Daniels said that he will not take his £2m plus bonus due for last year's performance. As public and media anger grew, Lloyds' five executive directors all voluntarily agreed to forego any bonus they may have been entitled to for 2008.

The Chancellor resisted calls to cap executive pay in the banks bailed out by the Government and said that the UK had already gone further than the US in curbing bank bonuses. Alistair Darling told the Treasury Select Committee it was essential that the banks were able to retain key staff if the state was going to be able to sell them back to the commercial sector. When it emerged that one of the Treasury's decisions would be to pay bonuses to staff below board level, popular anger was stirred. The PM wants bankers to consider waiving their right to bonuses. He said that executives should "consider whether they actually receive" bonuses, even if they we legally entitled to them. Earlier Mr Brown said that the culture of rewarding failure was being ended. UKFI gave its blessing in principle to the payout, although it pledged to subject each bonus payment to intense scrutiny. Some bonuses in RBS's global banking and markets division

were seen as unavoidable due to guarantees given for payment as these employees had generated huge profits in the past.

However, there is a call for the rules operated by the FSA to be altered so that banks that base rewards on short-term deal making will be penalised. New executives immediately seek out ways to radically cut costs in order to increase their bank's profits and earn instant rewards. This is implemented through job cuts to streamline the workforce, which may raise efficiency levels but is often undertaken at the expense of costly longer-term strategies so that senior executives are rewarded handsomely for improvements to the bottom line. By contrast, in some large overseas banks, in Europe and in particular in emerging markets, senior management tend to stay in their roles for longer, which allows the bank to pursue longer term, coherent strategies especially in IT and systems integration.

HSBC chairman Stephen Green attacked "perverse" pay practices in banking and called for a "more sober and reasonable approach to compensation" as it emerged the bank paid two senior employees almost £25m last year. In total, HSBC's five top-paid bankers received £33.6m in guaranteed bonuses and inducements to join, the full-year results revealed. At the same time, Mr Green said: "The industry needs to recover a sense of what is right . . . the contributors to the crisis were, in some cases, among the biggest beneficiaries." Asked if he would make such payments now, Mr Green said: "The world has changed a lot in the last 12 months." However, he declined to commit to a reform of HSBC executive remuneration, which sees directors get up to 11 times their salaries. Under the scheme, ceo Mike Geoghegan can earn £3.64m in cash and another £9.2m in stock each year.

Troubled **ITV** is amending its performance share plan for 130 top staff following its decision to freeze the pay of all those earning above £60,000. The new three-year plan could result in a £2m payout in company shares for Grade, Cresswell and group FD Ian Griffiths. The maximum amount payable has been reduced from 150 percent of salary to 100 percent. ITV's last incentive plan was paid in shares and was hit by the dramatic decline in their value over recent years. The Times said that nil-cost share options awarded to Grade in 2007 with a face value of £6m are now worth little more than £1m, though he will not qualify for all of them because of performance targets. At **Channel 4** senior managers are taking pay cuts, according to Kevin Lygo, director of television and content. Lygo, who earned more than £1m last year, has already agreed to waive his bonus and his £750,000 basic pay is being cut by 25 percent. Overall pay freezes have been announced at: **BT** affecting 100,000 staff, **National Express, Tate & Lyle** and many more. State-owned **Northern Rock** is seeking a new FD following the departure of Ann Godbehere, who received almost £1m for spending 11 months in the job. Her package included travel expenses for commuting from her home in Switzerland to Newcastle, via London. Bankers' bonuses this year will be 70 percent down on their 2007 peak, claimed the Centre for Economics & Business. Simon Culhane, ceo, Securities & Investment Institute said: "We need to differentiate between the modest incentive payments of about ten percent of salary that are made to ordinary banking staff, such as cashiers, and the significant money paid to senior management."

Nine out of ten top **AIG** executives agreed to give back their $1m + bonuses to the US insurance company, which had to be rescued by US taxpayers after reporting a loss of $61bn during the last three months of 2008 - the biggest quarterly loss in corporate history. President Obama called the bonus payments an outrage. "It's hard to understand how derivative traders at AIG warranted any bonuses, much less $165m in extra pay," he said. But it later emerged that AIG had paid out even more - $218m (£150m) after accepting bail-out cash, according to a senior US official. 73 top staff got more than $1m each while five received more than $4m. US Treasury Secretary Tim Geithner said that the bonuses would be deducted from state funds due to be paid to the insurer. AIG was saved from bankruptcy with an $85bn lifeline from the government, which has since pumped billions more into the troubled insurer. Some bonus winners have been tracked down by angry members of the public and menacing letters were sent to their homes. The US House of Representatives voted to impose a 90 percent surtax on bonuses granted to employees who earn more than $250,000 at companies that have received at least $5bn from the government's financial rescue programme, but President Obama was not keen. He favoured the Senate plan that was less punitive, but would tax a larger number of employees and firms. That bill, jointly crafted by Democratic and Republican leaders of the Senate Finance Committee, would impose a 70 percent surtax on most bonuses -- half paid by employees and half by firms.

Wall Street firms last year paid more than $18bn in bonuses in New York City to thousands of employees. Eight banks – Citigroup, J.P. Morgan Chase, Wells Fargo, Bank of America, Goldman Sachs, Morgan Stanley, PNC Financial Services and U.S. Bancorp -- have each received more than $5bn from the government's Troubled Asset Relief Plan, known as TARP. The troubled mortgage giants Fannie Mae and Freddie Mac, which have received federal funds from a different programme, would suffer similar reward curbs. "It's terrible public policy with respect to trying to bring institutions back to health," said Robert Sedgwick, head of the executive compensation practice at law firm Morrison Cohen in New York. "These institutions are under siege and their primary asset is their people," Sedgwick said. Congress agreed to drastic curbs capping senior bankers' bonuses at a third of their salary.

The Employee Share Ownership Centre Ltd is a members' organisation which lobbies, informs and researches on behalf of employee share ownership.