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# it's our business

newspad of the Employee Share Ownership Centre

## Head-on clash looms over impending reward schemes shake up

Trouble is brewing between some major UK companies and the institutional gatekeepers over moves to redraft senior executive reward packages in the wake of bombed out share prices which, in some cases, have almost halved the notional value of their original awards.

Chief executives of Britain's blue-chip companies have seen the value of shares awarded to them during the past year fall in value by almost £20m, according to new research .The figures, supplied by the leading executive reward consultants **Towers Perrin**, underline the dilemma facing the boards of FTSE100 companies as they study the implications of plummeting share prices. So far this year, about 80 percent of these companies have seen the value of executive shares and option awards decline, reflecting the overall performance of the stock market.

"The general picture is becoming a worrying one," said Nicki Demby, a principal at Towers Perrin. "Talented managers are still talented even when economic times are hard. So remuneration committees are having to struggle with a double whammy of a drop in award values at exactly the time when it is most important to keep the business's top talent."

A large number of FTSE100 rem-comm chairmen are reviewing options for re-basing their reward schemes in an effort to keep senior executives incentivised.

HR directors and share scheme managers in companies where one-year-old employee Sharesave share option contracts are deeply under water are also wondering what to do. They worry that participating employees will become de-motivated if their Sharesave options remain under water for much longer.

However, concerted attempts to overhaul executive compensation plan structures would be fiercely opposed by groups such as the Association of British Insurers and the National Association of Pension Funds, said The Sunday Telegraph, which commissioned the research.

The ABI condemns re-pricing share options, which companies sometimes try-on in order to preserve the value of executives' performance-linked option-based incentives, which can only be cashed in one, two or three years later. In addition, shareholder activist groups too have become increasingly ratty about re-pricing options, which they deride as "Moving the goalposts."

***From the Chairman***

*The first annual Esop Centre awards dinner will take place on Tuesday October 14 at the Oriental Club in London's West End .*

*Mark Hoban MP, shadow Financial Secretary to the Treasury, will be the keynote speaker at this black-tie event, and awards will be presented to the winners of the European Centre awards and their advisers.*

*In addition, there will be a Cyril Sweett presentation to the Esop Institute's Student of the Year.*

*Invitations will go out this week. Interest in reserving tables is high, so I would encourage you to book early or risk missing out on what promises to be a hugely enjoyable evening.*

***Malcolm Hurlston***

"Executive pay is a real problem in this environment and a moral dilemma," an independent director of a FTSE100 company said. "No incentive scheme is designed to pay out every year, but on the other hand, what kind of scheme doesn't pay out for three years?"

Among the blue-chip companies which have recently proposed modifications to their reward schemes are Marks & Spencer and Next. Companies in industries dependent on consumer confidence, such as retail and media, may not see substantial upturns in their share prices until economic prospects improve, meaning boards will face pressure to rethink executive pay.

As many ceos and other senior executives have received at least part of their pay in the form of shares when equity prices were far higher than they are today, some are sitting on paper losses that look like a pay cut. At Barclays, John Varley, the ceo, either held under option or had been awarded via share plans a total 2.2m shares at the end of last year. At that time they were worth a notional £7m - itself a sharp reduction on their £12m value a year previously. However, during the rout in financial services stocks their paper value fell further to under £5m, though they have recovered a bit since then.

Dame Marjorie Scardino, ceo of publisher and education group **Pearson**, was awarded 60,287 shares last year as part of her annual bonus share-matching plan. After

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Pearson shares had fallen to 600p, the award was worth £360,000, only two-thirds of its original value, but Pearson reported a 14 percent increase in sales in the first half of the year.

Ceos and other senior board members intentionally have their remuneration tied to share price performance. If shareholders suffer, so should executives, runs the mantra. Nevertheless, some companies are resetting performance targets, or changing comparator groups, with the result that individual salaries are being increased. That pushes up executive remuneration en masse, as other companies then reset their own reward packages to remain competitive.

The London Stock Exchange used to benchmark its remuneration based on companies ranked between 31 and 150 in the FTSE. But the benchmark has now changed to companies ranked between 31 and 100 - using larger companies, which are likely to pay more, as comparators. At Legal & General, executive directors whose bonuses were once limited to 105 percent of salary now find themselves eligible for 125 percent of salary, although the company said it had set "more demanding stretch targets than are currently required in order to receive the maximum payout". At G4S, the security group, the ceo's potential payout has also increased, with the performance share plan element pushed up to 200 percent of salary.

Sir Nigel Rudd, who chairs Barclays' remuneration committee and has served as chairman of BAA, Boots, Pilkington and Pendragon, the car dealer, said: "Remuneration committees have to think long and hard about resetting performance targets. The chairman has to be careful that they don't send the wrong message to shareholders and employees."

Remuneration consultants **Watson Wyatt** agreed that new schemes were being designed differently, often setting lower performance targets. "There are a lot of changes as a result of what is going on in the market," said John Pymm, senior consultant in the firm's executive compo practice. "With base salaries becoming a smaller proportion of total compensation, and more given over to performance-related bonuses and complex long and short-term incentive plans, companies are looking at different ways to make sure the packages they offer still do what they are supposed to do. They don't want to set the bar in terms of performance so high that the target is unattainable, but they are asking, if the target is lower, whether the potential benefit should also be lower." He added: "There is concern over the design of some remuneration policies," he said. "Few companies want to stand out from the crowd in case it becomes an issue with institutions. The result may be an amorphous approach which may not offer any governance issues but which fails to properly reward success or punish failure."

### DUBAI

An exceptionally strong speaker line up is now in place for the Centre's first ever Esops conference in Dubai, which has attracted a record six co-sponsorships. Three Centre members have agreed to become senior co-sponsors of the two-day event – lead co-sponsor **Emirates National Bank of Dubai**; the global professional remuneration consultancy Towers Perrin and top legal group **White & Case LLP**. Three more Centre members have agreed co-sponsorship terms – Jersey based member **Appleby Global**, which offers employee benefit trust and share plan administration services, **Killik Employee Services**, a force in the provision of outsourced share plan administration and the latest, **Lloyds TSB Offshore Trusts**, a provider of offshore trustee services, bespoke share plan and employee benefit administration.

The conference entitled: 'The prospects for employee equity plans in the United Arab Emirates and in the Middle East' will take place on Monday November 17 and Tuesday November 18, 2008 at the luxurious Palace Hotel. The event will enable European and US employee equity plan practitioners to meet locally based businesses who are interested in the concept of employee share/stock ownership and discuss with them how best this can be adapted and used in the UAE and in the wider region generally.

There will be key topic presentations from leading employee equity practitioners, including Damian Carnell and Martin McGuigan of Towers Perrin on aspects of executive compensation; Nicholas Greenacre and Oliver Brettle of White & Case on choosing the right law for international incentive plans and Emirates NBD will describe a case history of an employee equity plan launched in the UAE. Peter Leach and Martin Osborne-Shaw of Killik Employee Services will discuss how best to communicate employee share plans. Mark McGinness of the Dubai Financial Services Authority, will talk about regulatory issues in the UAE and Malcolm Hurlston, chairman of the Esop Centre, will explain the wider benefits of Esops. Other Centre members who will speak during the conference include: Ashurt, Bedell Group, Clifford Chance and Pinsent Masons. To view the full programme, visit the Centre website at: www.hurlstons.com/esop and click onto to the 'events' tab. Download the registration form you will find there. Such is the interest this event has generated that already half of our 50 reserved rooms have been taken.

### SHARESAVE BONUS RATES ARE RAISED

The government announced new Sharesave bonus rates, starting from the first of September this year, namely: three year contracts: 4.23 percent; five yrs: 4.36 percent and seven yrs: 4.28 percent. Also, the early closure interest is up to 3 percent from 2 percent. Paul Stoddart of HBOS EES was the first to alert newspad to the changes and invites readers to access www.hbosees.com in order to obtain more detail.

Three year contracts: 2.4 x monthly contributions (existing rate 1.6)

Five year contracts : 7.0 x monthly contributions (existing rate 5.1)

Seven year contracts: 12.7 x monthly contributions (existing rate 9.8)

## HMRC REVIEWS SOME ESO TAX CHARGES

HMRC have identified a large number of possible areas for simplification. Full details can be accessed at http://tinyurl.com/6er2gh said Deloitte. One of the areas identified for review in the Budget update was certain rules about securities acquired by employees in Part 7 of the Income Tax (Earnings and Pensions) Act 2003. These include: *sale of securities purchased by instalments - removing the Chapter 3C tax charge that arises where there has been a sale or disposal of securities if the notional loan created under Chapter 3C is repaid in full; *release from obligation to pay for securities by instalments - aligning the tax treatment of notional loans arising under Chapter 3C with the beneficial loan provision in s188 ITEPA 2003 (Loan released or written off: amount treated as earnings); *sale of nil or partly paid securities - removing the Chapter 3C tax charge in relation to outstanding notional loans that arises where securities are sold by employees and that employee has paid the full market value for securities they sold; *securities acquired for less than market value subject to replacement or additional securities - extending s421D(3) ITEPA 2003 to cover securities subject to Chapter 3C so that scrip issues do not create a charge under Chapter 3C or in other cases only a proportionate amount is brought into charge; *share identification rules for employment related securities - some employees take part in different arrangements whereby they obtain shares in their employing company. Companies need to identify the shares when they are sold. HMRC have produced feedback questions about the three review areas. These can be accessed at http://tinyurl.com/655s33 Further consultation on these areas will take place at the Pre-Budget Report 2008 either PBR 2008 or Budget 2009, depending on the progress made in each review.

## CENTRE-STEP JERSEY

Jersey trustees received a fact-packed update from Centre experts at the July 11 event, held at the restyled Royal Yacht Hotel on the St Helier seafront, reported Centre chairman Malcolm Hurlston. But first they had a coded lesson in being good regulatees from Helen Hatton, deputy director general of the Jersey Financial Services Commission. Helen gave a wide-ranging and pointed talk on the vital importance to trustees of a good reputation, together with hints on what to do when things go wrong. Heidi Wilson of **HBOS** shortlisted the regulatory and legislative changes that trustees faced. William Franklin could point to the success and influence of **Pinsent Masons'** Exsop in a talk that encompassed the 2008 guidelines from the Institute of Chartered Accountants of England and Wales. Rashree Chhatrisha of **MM&K** gave a crisp and fascinating case history of a gaming company which used LTIPs with an employee benefit trust (Guernsey-based as it turned out, but that news was received stolidly); in a final tour de force **David Craddock** of his eponymous share scheme consultancy, offered innovative LTIP solutions with roles for trustees which gave rise to much scribbling among the audience.

*Copies of the Jersey papers are available for £25 from hbruce@hurlstons.com. The Centre Jersey event will now be annual, with a Guernsey event every other year. At the speakers' dinner a Centre event in Mumbai in 2009 was mooted. News on this in subsequent editions.

*Delegate handbooks from the Europan Centre's recent annual conference in Cannes are on sale for £20. Contact **Holly Bruce** at the Centre Tel 20 7436 9936 if you want to order a set.

Centre-IoD conference: Don't forget to register for the Centre's next joint SMEs share schemes conference, in partnership with the Institute of Directors, on Wednesday 17 September at One Whitehall Place, London SW1. You can book places online via the Centre's website, or through the IoD events department.

Davos 2009: The Centre invites speaker proposals for the tenth annual Global Equity Forum in Davos on February 5 & 6 next year. Email fhackworth@hurlstons.com about this.

## ON THE MOVE

**Peter Mossop** is leaving Capita Fiduciary to take up a new role as director in the Human Capital division of Centre member Sanne Group, the Jersey-based international fiduciary services group. He is due to start at Sanne early next month, taking off one jersey and putting on another, so to speak.

ifsProShare announced the appointment of Julie Richardson as its new head of employee share ownership, following the departure of Fiona Downes. Julie joined from Capita where she was head of Sharesave. Phil Hall is the new head of ifsProShare

## SHARE SCHEMES RESCUE? – THE DOG THAT DIDN'T BARK

Pressure is mounting on the Government to raise the employees' monthly savings limit in approved employee share schemes. As the Centre has frequently pointed out to Treasury ministers, the £250 limit was introduced in 1991 and has been left untouched since then. Had this figure risen in line with inflation, the monthly savings limit would now be more than £400. This is far from being academic as many recent SAYE-Sharesave contracts are under water (when even the original discounted share option price on award is above the current market price of the share). The £250 savings limit impedes the ability of employee participants to successfully migrate from an underwater scheme to a new SAYE contract with a lower option strike price, as money invested in another Sharesave contract counts towards the annual limit. The Irish Government's plan to increase the maximum monthly contribution to an Irish SAYE account from £250 to £395 for contracts launched on or after 1 February this year makes for uncomfortable reading in Whitehall. Some companies operate both UK and Irish approved SAYE plans, so being able to treat employees equally in both countries would benefit all. In June it was revealed that the UK national savings ratio fell to barely one percent, the lowest in almost 50 years. Increasing the amount an individual can save in Eso schemes would encourage more saving and would reinforce the company share price. Around 20 percent of the UK's 2.2m SAYE participants) are already investing £250 a month into an SAYE share plan. Furthermore, the £250 limit has to be shared with other approved plans. The Centre urges the Government to increase the maximum approved schemes monthly saving limit now to £450.

In its latest edition, the magazine *Employee Benefits* attacked the government for failing to introduce this and other measures to improve Eso. *"Over the past year, it is not what has changed about all-employee share schemes, that is vexing those operating in this marketplace, but rather what has not,"* wrote Sonia Speedy. The government had, however, introduced other initiatives, including the new 18 percent flat rate of capital gains tax. Whether employees would stick with Eso schemes would largely depend on employers providing both financial education and good communication for staff, she added.

Employers may be more reluctant to launch Sharesave option schemes due to the 2005 accounting charge, which has eroded some of the previous bias in its favour. Judith Greaves, head of tax at Pinsent Masons, said that as a result of the accounting charges changing again, employees who decide to stop paying into an existing Sharesave contract in favour of a new one will land their employers with a problem. They will be required to bring forward the relevant accounting charges for that employee's first contract, while having to charge the new option to the profit-and- loss account as well. "That has created an element of double counting, which gets some people very cross," she said. The magazine quoted Phil Ainsley, head of employee share plans at **Equiniti**: "As the economic climate pinches, there's going to be one or two casualties. The cost of managing plans and incorporating all the legislation from the UK, but also from the EU, into a business is huge, so I can see one or two of the players in the market not surviving." Hence the drive to reduce costs: Rashree Chhatrisha of Centre member MM&K said that companies were looking for smarter administration systems, particularly if they had staff based overseas.

Sarah Pickering, a member of the Centre steering committee, says there is a need for a discretionary share acquisition plan (like the Share Incentive Plan but with discretionary element). Perhaps interested members could get together to draft a possible structure for this sort of plan that the Centre could then present to the government

COMPANIES

**Cyril Sweett plc** announced that during the quarterly accumulation period ended 30 June, Cyril Sweett Trustee Co Ltd, trustee of the HMRC approved Cyril Sweett SIP, transferred 193,807 of the 10p ords to participants leaving the plan. Employee purchased partnership shares are matched on a two for five basis. Dividends for shares held by the SIP are re-invested to purchase dividend shares. After the end of the quarter, 262,118 ords were awarded to participants in the plan, leaving the trustee holding 9,083,178 ords.

DSG, the troubled retailer, formerly Dixons, gave senior managers share options worth more than £4.3m as part of a bonus scheme. The move comes in the wake of DSG's first ever annual loss, £193m, as it suffered from a marked slowdown in consumer spending. New boss John Browett will receive almost £1m in shares, provided he reaches certain targets by 2011. He is trying to turn around the business by improving service and internet sales.

Andreas Sperl, MD of the German aircraft component manufacturer EADS Elbe Flugzeugwerke, has criticised French justice with the alleged case of insider dealing in shares of parent group European Aeronautic Defence and Space Co (EADS). Mr Sperl was heard by French financial police last month and claims that he was treated like a criminal. Thomas Enders, head of EADS' aircraft subsidiary Airbus, recently described the procedure as a show trial. Until the autumn of 2006, Mr Sperl was head of finance at Airbus. Both he and Mr Enders count among the 17 EADS managers alleged to have violated insider trading laws through the sale of share options, allegedly during a period in which they knew or suspected major delays were occurring in the A380 super jumbo production line. This they all deny. Former Airbus ceo Gustav Humbert has been charged with insider trading for allegedly selling 160,000 EADS shares between 2005 and 2006, before the production delays were made public, recording a capital gain of €1.685m.

The eircom Employee Share Ownership Trust (ESOT) has taken a recent hit from the heavy fall in the share price of Vodafone. The ESOT owns 49m Vodafone shares which fell in total value by €12.6m on one day alone. However, it is not yet a disaster: current and former staff have already received more than €700m from the flotation.

Loch Fyne Oysters, the employee-owned seafood company, plans to expand into new markets overseas in order to increase its turnover to £50m within the next five years. It wants to open restaurants with its partners abroad and target new export markets by exploiting its famous brand. Set up more than 30 years ago by Johnny Noble, a local landowner, and Andy Lane, a marine biologist, the firm employs more than 130 people at its Argyllshire base. Recently it bought Surrey-based Simson's Fisheries to give it greater access to markets in the south-east. Loch Fyne's UK restaurant business was sold off a few years ago and then bought by the brewer Greene King for £68m last year.

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