Vol 25 No 2 July 2012

it's our business

newspad of the Employee Share Ownership Centre

Restructured incentives a key to economic recovery

Equity incentives for senior executives must be restructured if employees and employers are to pull together towards economic recovery, Malcolm Hurlston told delegates in Paris at the opening of the Centre's 24th annual conference.

Unless executive reward architecture became more coherent, transparent and more socially responsible, the role and reputation of employee share ownership (Eso) could start to rot from the head down, like a "stinking fish," he warned.

For broad-based Eso risked being tarred with the same brush as executive reward excesses in the eyes of the public and, worse still, ordinary employees were more likely to see their role as merely filling the boots of the senior executives, said the Centre chairman.

For the recovery to take place, everyone had to be seen pulling together… **"**But **is** everybody pulling together, they ask themselves, when a minority of already well-paid directors are seemingly still 'troughing' away like there's no tomorrow?"

The strict pay quantum controls now being imposed on French state sector bosses by President Hollande were a mere foretaste of what was to come unless private sector companies controlled executive greed more effectively than hitherto, he added.

Mr Hurlston identified parachute payments and retention bonuses as being among the worst excesses of the current system and as failures of executive remuneration strategy.

He said: "If I had told you at this event five years ago that in the year 2012 a Conservative-led UK coalition government would be legislating in order to put the brakes on executive reward packages and that FTSE ceos and their company remuneration reports would be dropping like nine-pins as a result of a 'Shareholder Spring' investors' revolt, you'd have thought that I'd been hitting the sauce bottle a bit too hard the night before, but all this and more has come to pass.

"You might well ask: 'What business is this of the Employee Share Ownership Centre?' but the answer surely could not be clearer. It does no one in the business community any good to see commercial and industrial chieftains being left hanging from the yardarm over perceived excesses in their total compensation awards. In some quarters we are witnessing the whole concept of employee equity being debunked by such antics. When President Francois Hollande starts talking about abolishing stock options, no doubt holding a crucifix against his chest while doing so, we can see how far the rot has set in.

"It's sad to see employee share ownership being tarred with the same brush as alleged executive excess, because of course there's nothing wrong with share options, or deferred share awards, as mechanisms to encourage staff to focus better on their jobs and, ultimately, to raise performance levels. The Centre has never questioned the precept that outstanding rewards should follow outstanding performance by individuals or units in business, though we believe that such rewards, especially bonuses, should be paid mainly, or even entirely in equity, rather than cash, to more closely align the interests of senior executives with those of shareholders, clients and customers generally.

"Equally, however, the Centre does not support large retention bonuses, nor indeed certain other non-performance based bonuses, which, as one fund manager put it: 'Basically reward people for turning up at work.' It is clear that nowadays, the great mass of people beyond these walls will not accept these practices any more. Almost 80 percent of shareholders in Air France/ KLM voted down a €400,000 golden parachute awarded to ex ceo Pierre-Henri Georgeon, on top of a more than €1m severance package when he was ousted last October

From the Chairman

It is marvellous to see the Department of Business, the Treasury and the Office of Tax Simplification vying for our attention; employee ownership is marked clearly on the coalition map. The only question is: are they seeing enough of each other? We need a coherent and public ministerial strategy for our issues to get the oxygen they need. And at a practical level we need to watch out that the interests of the low paid and part time workers (my code for CSOP) are not obscured by new ideas, however useful. Gordon Brown's EMI is proof that top level interest yields results; let us hope for another Clegg/Lamb corker.

Malcolm Hurlston

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following the airline's poor performance. Shareholders took their lead from the French state, which holds 16 percent of the equity in Air France/KLM and which said it would vote against the leaver's bonus, despite the fact that M. Georgeon had already pocketed the cash.

"Let's examine a little more closely the seductive term 'retention bonus.' What it's really all about is stopping a key player decamping to a rival company and spilling the beans on what you are up to. Mining company Xstrata boss Mick Davis is in line for a 'retention bonus' of £28.8m to stay at the head of the business, once it has merged with commodities giant Glencore, for three years. I hope it won't be cliff-edge vesting in his case, because if I were a bank manager and someone walked into my branch waving a personal cheque for £28.8m, I'd call the police. No wonder investor institutions like Standard Life and Fidelity are hopping mad. The merger could even be called off if alarmed shareholders vote down the deal in July.

"However, a properly structured long-term incentive plan (LTIP) – with lots of deferred shares - achieves the same end because the senior executive who has an LTIP knows that if he or she leaves the company prematurely, then all or almost all of the benefits of the LTIP, possibly amounting to millions of euros, will be lost. In truth, a retention bonus is a failure of remuneration policy design.

"Both the printed and electronic media are now adept in whipping up and canalising public resentment against what are seen as astronomic annual payment increases being hoovered up by the top brass, despite sometimes very indifferent corporate performance. The Centre sees danger to our economic system, at both macro and micro levels, if growing swathes of the public believe that rank-and-file employees are working mainly or solely to fill the boots of senior executives," he told 40 delegates at the Millennium Paris Opera Hotel.

"The economic recession seems interminable in the western world; jobs are scarce, pay increases are often a distant memory and hardship is widespread. Politicians desperately searching for tangible economic growth are asking everybody to pull together, to accept sacrifices in their standard of living, to accept declining levels of public service and much more. In these circumstances, it is tempting to look for scapegoats. **Is** everybody pulling together, we ask themselves, when we see a minority of already well-paid directors seemingly still 'troughing' away like there's no tomorrow? In this situation, there is nothing more divisive and demoralising for the workforce and the community at large than the perception that there are two sets of financial rules at work – one for the factory or office worker and quite another for the 'bosses.' No wonder that fraud and sabotage are live, if hidden, issues in many manufacturing companies.

"President Hollande, not slow to spot potential political advantage, has thrown down the gauntlet to other EU governments by ordering that no state enterprise chief should earn more than 20 times the ratio of their lowest paid full-time employees. He wants their current contracts ripped up so that top pay can be cut immediately. Is there a risk that this diktat could spread to the private sector too? If so, that would be a recipe for chaos.

"This is why I believe that better organised incentives for ceos and other directors could help speed the recovery. We will be going nowhere without the goodwill of the broad mass of employees in factories, offices and institutions throughout the western world. In other words, we must regain their trust and the best way of doing that is to ensure, as far as we can, that all quoted companies submit annual remuneration reports which not only reward outstanding performance in the workplace, but display social awareness too by **not** rewarding poor or even average performance, as in an old pals act.

"The UK government appears to be handing over responsibility for this delicate issue to company shareholders, rather than to the regulators and we can applaud that, at least in theory, but sadly many companies will wait until the last minute before implementing the remuneration report binding shareholder vote clause, which sits uncomfortably in Vince Cable's mammoth Enterprise Bill," said Mr Hurlston.

"It is an integral part of my thesis - in homage to the 'trickle down' theory of wealth – that all quoted companies should try to replicate the multi-faceted equity incentive schemes which some Centre members themselves have helped devise for leading companies in recent years. I say this because, frankly, in some large companies the bog-standard 'All-employee share ownership plan,' in which all the directors participate too (just to show how on-message they are) is a convenient fig leaf, which hides a cascade of richly rewarding special incentive equity schemes, for the benefit of only the 'higher-ups.'

"But why should all rank-and-file employees be denied the benefits of such schemes, albeit – of course - on a lower scale of reward? To avoid the charge of hypocrisy, those politicians who talk incessantly about 'inclusiveness' should take this key point on board.

"The West **can** compete on the world stage – by increasing industrial and commercial productivity through company-wide equity incentives. Companies, encouraged by governments, can use employee equity to make employees see themselves as partners at work instead of wage slaves. Employees in the West should be co-opted into the design of work and into decision-making processes too – because there is no longer any other option. Employees do co-operate in taking up new processes and patterns of work when they can see there is something in it for them and their colleagues – extra financial gain, dynamic involvement in their work tasks, and of course keeping their jobs. But if there is abuse at the top and we don't stamp it out, we may find that employee share ownership/ financial participation ends up like a rotting fish."

Chairman honoured

Centre chairman Malcolm Hurlston is the new holder of the prestigious Remy Schlumberger Award for extraordinary achievement and commitment to the principles of financial participation and financial education for employees in the UK, the EU and globally.

The Award was made to Mr Hurlston in Paris by David Hildebrandt, immediate past president of the International Association for Financial Participation (IAFP) during the Centre's 24th annual conference. The peer-based award - presented only six times in the last 25 years - was made in memory and honour of Remy Schlumberger, the prominent French banker, philanthropist and founder of IAFP.

Malcolm is chairman of the Esop Centre and of its international arm, the World Centre for Employee Ownership. He founded the Centre in 1988 and has since worked tirelessly to develop it into a major educative and lobbying organization, which promotes broad-based Eso in all its various forms to governments, businesses, trade unions, universities and the media. Increasingly the Centre is playing a key role in Uk governmental policy initiatives and legislation. Strategically, the Centre involves itself in executive remuneration too, especially where employee equity is awarded as the major slice of bonus awards, rather than cash.

Malcolm is visiting professor at the University of Westminster, with reference to employee ownership, a member of the HMRC Employment Related Securities Forum and represented on the Office of Tax Simplification committee. He chairs Hurlstons - the leading political media and research consultancy, the Financial Inclusion Centre, Registry Trust and Irish Judgments. In addition, he is president of the Foundation for Credit Counselling, which he founded in 1993.

Leslie Moss of **Aon Hewitt** said that some of the adverse shareholder votes, as at Aviva, had been more about continuing poor performance than 'excessive' executive reward. However, the average total annual reward for ceos of FTSE100 companies was now £4.2m and even higher in the banks. There was growing inequality between executive and employee reward: at Barclays, for example, top pay as a multiple of average pay was 14.5 in 1980, but grew to 75 in 2011. In Lonmin the equivalent multiples were 44 in 1980 and 113 last year and in Lloyds Banking Group 13.6, which had widened to 75 last year. "What is undeniable is that the governance of executive pay leaves much to be desired and is the subject of government review." Transparency was all very well, but it had led to some reward package leapfrogging. There was concern in the industry that some of the new proposals too might have unforeseen consequences. Binding shareholder votes over executive reward might discourage institutions from ever again voting down remuneration reports, he said. Median directors' reward packages in top companies had increased by almost 16 percent last year, added Mr Moss.

Joe Saburn of **Norris McLaughlin & Marcus (US)** said that 'Say On Pay' was a major issue in the US, which stemmed from a fundamental disconnect between pay and pay for performance. All the pressure had started with the bankruptcy of Enron in 2001. The impact was like a worldwide Tsunami and the legislative reaction was the Sarbanes-Oxley Act, said Joe. People were speaking of a 'Shareholder Spring.' "But we are not in spring – this is winter – and some shareholders are feeling very cold and that's why they are trying to do something about the pay situation." So far, 41 companies had failed to get at least a 50 percent shareholder advisory vote on prior fiscal year pay practices under the Dodd-Frank Wall Street Reform & Consumer Protection Act, explained Mr Saburn. Eleven companies had been in litigation following a shareholder vote, which alleged breach of fiduciary duty by the company paying 'excessive' compensation to senior executives. Some such actions had been settled out of court because the companies involved did not want the bad publicity, he added.

"The concept of shareholder ownership rights is new in the context of executive performance disconnect and a fundamental struggle is going on all around us. Shareholder activists are asking for compensation reports to be rejected, the pay awards to be clawed back and directors put on notice to change their corporate compensation policies." Activists were arguing that awarding 'excessive' compensation that wasn't matched by good performance was a breach of fiduciary duty by the directors. Thus all directors who had approved the contentious reward packages were finding themselves named as defendants in law suits.

Patrick Neave, senior remuneration analyst at the **Association of British Insurers,** which has in membership seven of the top ten institutional investors, said there had been a recent "change of tone" at the ABI about executive compensation packages. Patrick said that he dealt with up to 200 draft remuneration schemes from corporates per year. There were major concerns at present – reward for failure, the fact that many executive long-term incentive plans (LTIPs) were "racing away," whether companies should buy out executive rewards from previous companies and whether share matching should be discouraged. He called for better consultations with companies over key reward aspects, such as the calculation of performance criteria, which could lead to changes in the guidelines. The ABI-IVIS bottle top remuneration plans rating system has resulted in 12 percent red tops – where there were strong concerns about the rewards, or even outright breaches of best practice; 25 percent amber – where there were some concerns, which could be ironed out after consultation and the rest blue tops, which indicated that they were OK in the ABI's view.

While the ABI liaised with the remuneration consultants' group, which had a code of conduct over executive pay reports, some members were critical of the role played by consultants in the escalating executive reward drama. The ABI supported the principle of high pay for high performance, but shareholders were increasingly worried about the dilutive effects of repeatedly high annual equity reward packages, said Mr Neave.

David Hildebrandt of **Kirton & McConkie (US)** and **Eric S Smith** of **Consultation Services Support Corp (US)** discussed the opportunities and obstacles facing the 'perfect' global share plan. "In this economic environment we need to encourage share ownership schemes, but how will they evolve?" said David. We should focus on 65-year-old men with lots of stock tied up in the participation or retirement plans of one single company, because that could be very dangerous financially speaking, he added. The penalties for regulatory lapses and fiduciary breaches were extremely heavy in the US: fines by the IRS could reach 20 percent of the plan's total assets. Caterpillar Corporation was ordered to pay $16.5m compensation to participants in its 401 (K) plans because for ten years the company had offered them a group of mutual funds that were advised by a wholly owned Caterpillar subsidiary, creating a clear conflict of interest, leading to higher fees for participating employees. 'Tag along' lawsuits against companies that had failed to tell Eso employee participants about the true financial state of the organisation had cost Global Crossing five out of court settlements totalling $325m, added Mr Hildebrandt. Co-speaker Eric S Smith said that under-performing investment funds was a huge issue in the US, where most employee equity plans permit highly diversified investment. There were "scandalous relationships" between money managers and investment houses, which led to plan participants paying high fees every year for 'professionally advised' portfolios which consistently under-performed passive benchmark indices, he said. In one case, a trustee of a $150bn Eso fund was sent to prison after a corrupt relationship was exposed, he added. Employee plan participants in most cases had no way of knowing how certain investment managers were chosen to run their funds, rather than others. True universal market access to all available money managers allied to a transparent process would enable fiduciaries to cut through all the marketing hype and spin, said Mr Smith.

Graeme Nuttall, partner at **Field Fisher Waterhouse LLP** and independent share schemes adviser to the Coalition government, talked about identifying barriers to employee ownership in the UK and how to surmount them. For example, many company articles did not mention the existence of employee benefit trusts and business schools in the main did not talk about employee ownership or employee share ownership as business solutions. Lack of awareness about Eso was a problem which needed fixing, he said, but there were questions about other problems: Was the lack of finance for employee buy-outs one of these? Should there be a tax incentive for owners selling a controlling stake to an employee benefit trust? Should Channel Island based EBTs be changed into "meaningful" vehicles for collective ownership of companies? Should employees be given a new universal right to request shares? and so on.

Deputy PM Nick Clegg would preside over a summit to launch the government's proposals to reform employee ownership on July 4, said Mr Nuttall, but there was no silver bullet. "There will be a matrix of measures. We are at the start of something new in the UK," he told delegates. "Employee ownership now has unprecedented government support." EO and Eso fitted into the growth agenda and new companies were getting interested in implementing such plans. He intended passing on feedback from the conference to share schemes minister Norman Lamb. Accompanying him was Jane Bateman, a senior official from the Department for Business, Innovation & Skills (BIS). Mr Nuttall said that Nick Clegg had got in before David Cameron on employee ownership, to the latter's irritation. It was a huge agenda because state organisations were now being mutualised. "You need a collective voice to drive home company improvements," he said.

William Franklin of Pett, Franklin & Co. LLP asked whether the main obstacle to the further spread of employee ownership was that it required altruism from the entrepreneur. Usually, he or she could get more money by disposing of the business in a trade sale. How to finance employees getting, say a 20 percent stake in the business, to start with?

Caroline Labregere, of **Schneider Electric,** which employs 130,000 people, delivered a case study about the company's worldwide Esop. Employee owners in this global specialist in energy management now hold 4.55 percent of the total equity and have seven percent of the voting rights. Once participating employees had held their shares for more than two years, they got double the voting rights over these shares, she said. Participation in this plan was offered to around 80 percent of its full-time employees in 60 countries. A 15 percent discount was offered to French employees as a purchase incentive and a 20 percent discount to employees elsewhere. In addition, the company offered matching rights for the number of shares each employee bought – in order to recognise the risk employees took in buying the shares, which are then locked up for five years. The plan was so successful that the average employee participation rate worldwide was now 47 percent, added Caroline. The key to success was on-going communication, which included: quarterly financial results explained to all employee participants, with messages from the ceo; a quarterly employee shareholders letter; election of employee representative on a company supervisory board, advance explanation of resolutions presented to the agm and meetings with fund manager.

Mike Pewton, of **GlobalSharePlans**, outlined some of the pitfalls facing companies who were over-ambitious about what their Esop could do. He told of one such company which ended up with only 22 participants from 18 countries! Employees in parts of Africa and even Asia might not have the confidence to

buy their company's shares and so a basic free share plan might prove a better introduction to Esop for them, said Mike. "There will be countries where you can't run a share plan, or it will be very difficult. A worldwide plan is not all about translating the documents into 16 different languages, its about overall communication of sometimes difficult concepts locally. Document filing costs in China can work out at £40,000 per participating employee! And the cost of the shares never gets talked about," he added. Companies who achieved 20 percent employee participation should feel happy in these circumstances.

Colin Kendon of **Bird & Bird** gave an update on the EU's Prospectus Directive. The big problem was that there was still no blanket share plan exemption from the Directive and, as a result, many US based companies hadn't bothered to extend their share schemes to Europe as it would prove too costly to do so, he said. Though the Amending Directive had been published in December 2010, only the UK and Germany were ready to implement it this month, with France a few months behind and the rest of the 27 member states nowhere, said Mr Kendon. So for the next few years, different member states would have different limits to the amounts which could be offered to employees and the European Commission would have to resolve this, he added. Share options were outside the scope of the Directive and executive options weren't covered either. The key concession was that total relevant equity offers to employees within the EU could from now on escape the prospectus requirement provided they totalled no more than €5m and the number of employees involved not top 150 at a time.

Henri Malosse, leading candidate for presidency of the European Economic & Social Committee, said that he intended making employee financial participation (Eso) a key theme, to encourage other EU institutions like the Commission and Parliament to develop best practice and spread the message more effectively. EFP/Eso could create much more trust between employers and employees and it could help SMEs to get access to capital, when it was difficult to get bank loans. "I express my total support for this movement and I look forward to working with the Centre and others to make these ideas more concrete," said Mr Malosse. "We must have strong leadership in the Commission, but it is difficult to find someone to take the lead. On the political side, we are working closely with the European Parliament, where there is growing support for EFP/Eso initiatives and projects," he added. Mr Hurlston intervened to say that Eso should be part of the Commission's Enterprise Directorate, rather than being a down-table item in the Employment & Social Affairs Directorate.

Jacques Sasseville, head of the tax treaty unit at the Organisation for Economic Co-operation & Development (OECD) spoke about the tax aspects of cross-border secondment of senior employees. International tolerance about schemes where no employee taxation resulted had gone down dramatically. "While we're going to be sure that there will be no double taxation of the same employee, equally we're going to be sure that there are no 'No Tax' situations permitted, he warned. India was a major tax flashpoint because many multinationals continually used services provided by dedicated offshore private companies, but tried to maintain that the employees were not theirs. Test cases included Morgan Stanley, Verizon and Whirlpool, which had won its case in the Indian courts – although the workers in question were formally employed by Whirlpool, in reality they worked for the Indian company.

Stock option awards and maturities were an issue when an employee was resident in one country, but taxed in another. Was there a capital gain or was it employment income? Double taxation reared its head when, say, country R taxed at grant, while S taxed on exercise. R taxed the whole gain as a capital gain, while S taxed it as income. The OECD had developed principles to deal with this – "We allow refund systems – one country will have to refund the tax," said M. Sasseville. But the OECD could not order a country to, say, tax at grant if its tax point was currently at the exercise or vesting of stock options, he added. Other principles were that where an employee moved to different countries within a few years, the income gain relating to the share/stock plan should be strictly time apportioned and that the amount of tax withheld by one country regarding one or a group of employees should *never* exceed the estimated amount of tax that normally would be due over the period.

Alasdair Friend of **Baker & McKenzie LLP** looked at the increasing tax authority scrutiny of EBT based arrangements. "We have a problem of perceived fairness," said Alastair, citing the example of an executive receiving a small base salary and a huge top up in the form of a company 'loan' to a trust. Some EBTs might be classified as either the good, the bad or the ugly - the latter including vehicles to turn earnings into tax-free loans. HMRC was now using the Disguised Remuneration legislation to stop such arrangements, but it was very broad and appeared to catch legitimate deferred bonuses in share schemes, he said. The use of EBTs to hedge equity awards created the risk that shares were "earmarked" for certain employees, thus potentially falling foul of the legislation. HMRC was increasingly investigating EBTs, which – via complex and inventive structures - had been used to defer salary or pass value to employees in a form other than earnings. What was at stake was hundreds of millions in potential lost PAYE and NICs revenues. The EBTs used by Glasgow Rangers soccer stars were in the spotlight, though the court verdict on their legitimacy had been delayed. If HMRC won the case, that could "radically change the game," said Alasdair. Was it significant that HMRC had taken down whole sections about EBTs and Inheritance Tax from its website, he asked? "Something is happening, but what?"

"Lots of benefits derive from the use of EBTs, but now that HMRC is questioning whether all are *true* EBTs, in some respects it's beginning to look like a can of worms. For instance, HMRC might start asking; 'Well *who* exactly has benefited from these arrangements?' added Mr Friend.

Malcolm Hurlston said that the unions and Eso had not gelled this side of the Atlantic in contrast to the US, where airline and later steel worker unions had been among the first to back and sometimes lead Esop buy-outs of struggling businesses. It had been a significant milestone when BT employees had defied their unions and had accepted the free shares they were offered during privatisation. Now the giant Italian union confederation CISL, which was pushing hard for Eso to be installed in Fiat factories, was showing the way. The European Trade Union Confederation was broadly in favour of EFP and was for the first time a potential ally, said Malcolm, who reminded delegates that the trade union bank 'Unity' had first approved loans for Esops decades ago. The Centre's recent work on EFP with the EESC, in which European trade unions had participated actively, had shown that sentiment was turning in favour of employee share ownership. He anticipated meetings between ministers and the TUC, in which the Centre might hold the ring, to examine the practical issues facing companies and employees who wanted to step up the use of Eso in their businesses.

David Craddock, of **David Craddock Consultancy Services** said that Eso was the corporate glue that held employers and employees together in common interests. It was wealth redistribution through wealth creation and not through social security payments, which were often not valued by the recipients. It was sobering to remember that as far back as 1889 there had been a conference in Paris about profit sharing.

"We don't want an Eso as a figurine on the mantelpiece, good to look at but not useful," said Mr Craddock. Employee shares should carry votes collectively as a very powerful democratic device, though this would be unlikely to threaten the 75 percent support rule for company control under the Mems and Arts. He listed a shoal of recent empirical studies which showed that all-employee share ownership could stimulate productivity and profitability in companies through a combination of sympathetic management systems, improved industrial relations, the identity of interests and the promotion of employee self-sufficiency. There was reliable evidence too that broad-based Eso often improved a participating company's return on assets, share price performance, sales growth, organisation stability and total shareholder return, added Mr Craddock. Eso offered society a 'Third Way' – between capitalism and socialism.

William Franklin, chartered accountant, at **Pett, Franklin & Co. LLP,** revisited the controversy over accounting for share-based payments and in particular the flawed IFRS2 standard created by the International Accounting Standards Board (IASB). New Year's Day 2005, when IFRS2 became effective for EU listed companies, was a "Day that should live in infamy," said William. The IASB chairman Sir David Tweedie had had a 'mission' to get rid of the muddle and unfair playing field that had resulted in share awards being penalised, Mr Franklin explained. Tweedie had used the row over huge executive windfall gains from privatisation and the collapse of Enron to drive through his IFRS2, though some key people had stood on the sidelines because they knew some of its features, like truing up and theoretical values for options, made no sense. Options were now expensed, even though SAYE employee participants got no benefit when their options remained under water. So executive share options all but disappeared from FTSE100 companies and the use of Company Share Option Plans collapsed. The Black Scholes model used in IFRS2 accounting for valuing options was "the most dangerous work of fiction in the modern world, post Marx and Engels," said Mr Franklin. A book entitled '17 Equations that Changed the World', written by an eminent mathematician, included the Black Scholes formula and described its underpinning as "rubbish". FASB had got away with it – no one challenged them. William's key conclusion was that there was almost no correlation between the accounting expense for options and the actual gains made by employees. "Have accounts been improved and have shareholders and the wider economy benefited from IFRS2? – I don't think so," he added.

Sara Cohen tax partner at **Lewis Silkin LLP,** discussed the John Lewis Partnership model based on the first ever employee benefit trust it had set up in 1929. Employees' shares were held in the trust and were very difficult to sell. Last year its turnover reached £8.7bn, with its 81,000 employees working in 32 stores, 259 Waitrose shops and an online operation. All 'partners' (employees) received the same percentage share of annual profits, varying between nine and 20 percent. The employees had a strong influence on how the business was run, Sara argued. The partnership council (mostly elected by the employees) elected five of the 12 main board directors. She discussed two other successful employee-owned business, The Baxi Partnership and Make Architects, set up by Ken Shuttleworth, who worked with Sir Norman Foster for 28 years. Shuttleworth set up constitutional devices to ensure that his company could not be sold unless it was in the best interest of its employees. Make Architects is a 100 percent employee owned UK resident company, with an EBT which holds all the shares. A 'protector' had been installed, whose consent was necessary for certain key decisions once the original trustees had retired.

Sami Toutounji and **Katia Zaboussova** of **Shearman & Sterling** Paris office discussed the French exception in stock plan design. They had devised tax efficient all-employee French share purchase schemes in which employees could invest up to 25 percent of their annual base pay. All purchases were locked in for five years and the only tax they were subject to was social contributions of 15.5 percent. There was a non-taxable discount of up to 20 percent on the share price to encourage employees to participate. Employers could make matching share awards worth up to 300 percent of the employee's contribution.

Employee shares are typically held in a pool *Fond Commun de Placement* (FCPE) where they are actively managed by the supervisory board. The collective voice of the employee shareholders – often between five and ten percent – were not wasted – they received the

weight they deserved, said Sami. Some FCPEs held only the employer's shares, but others were diversified under the rules of the 'savings plan,' to avoid employees having all their eggs in one basket.
French companies had initiated innovative schemes, which guaranteed the employees' capital contribution (through buying the shares) and/or a guaranteed rate of return. Banks were brought in to help implement leveraged employee equity plans, said Mr Toutounji. Participation rates in some of these in these gold-plated employee equity schemes were between 40 and 50 percent, he added. He and Katia also discussed share purchase plans and restricted stock offers for French employees of foreign issuers.
Professor Jens Lowitzsch of the **European University Viadrina, Frankfurt,** said that after 30 years of little or no achievement, the EU institutions were finally looking at a common framework for Esop. He and others were using a 'cafeteria' approach, to identify the common elements of employee financial participation in the major member states. The European Parliament had commissioned a study to enable it later on to send an Initiative Report to the Commission, on which the latter would have to react. Commissioner Barnier had told him that if the Esop focus shifted from being negative to a positive priority, it would 'fly.' "I think that what he meant was – 'Can we add value, by having a big Eso push?' – added Jens. Experience from Hungary and Lithuania showed that the removal of political support for Eso lead to its rapid decline. While tax incentives were not a necessary prerequisite for Eso, they were a good means of promoting the spread of Eso, by improving participation rates and spreading it to other companies.
The Big Idea was to implement a 28th regime, which recommended various best Eso plan practices, within all member states, whereby companies would have the option to use either national legislation or a parallel EU-wide 28th regime as the framework for its employee equity plans, legitimised by European legislation. An SME, for instance, could use the 28th regime in its own backyard and then export the plan easily to employees in other member states, with full portability. Courts would be unable to stop it by trying to treat the 28th regime as foreign law, Prof Lowitzsch added.
Jean-Michel Content, secretary general of the **International Association of Financial Participation,** reviewed the advance of EFP/Eso in France. Despite more than 50 years of existence, EFP had won over little more than half of all employees in the French private sector. The typical employee equity participant in France gained around €1,200 per year and the total value of his or her equity holdings was around €7,500, he said. SMEs remained the poor relation of the EFP market, even in terms of cash profit-sharing schemes. "It is clear that EFP is much more difficult to implement in SMEs than in large companies," added M Content: "Although a lot has been achieved, it is unsatisfactory that almost a half of French workers live without the benefits of EFP, because we are convinced that it leads to better social dialogue and better corporate governance."

Centre Awards Finalists 2012

Chairman Malcolm Hurlston named the finalists for the Centre's 2012 *Best Employee Share Ownership Plan* Awards during the cocktail party at the 24th annual conference in Paris (see above). This fiercely contested annual competition is now in its eleventh year. The winners will be decided by a panel of three impartial judges who are experts in the field of employee equity. The winners and runners-up will be announced - and presented - during the Centre's celebrated annual black-tie Awards Dinner at the Oriental Club, London W1, on **Tuesday November 6.** Full details for this year's awards dinner can be found at http://www.esopcentre.com/event/awards_dinner_2012/ - book your table now - members pay £1,500 per table of ten or £160 per person (+VAT), which includes champagne reception and a four-course meal.

The finalists are:

1. 'Companies with more than 1,500 employees'

Two entries in particular caught the judges' eye in this category: **Shell** (advisers Computershare) and **Diageo** (Clifford Chance & Deloitte).
Regular delegates at Centre events will be familiar with the features of Shell's excellent share plan as it was presented at Davos in 2011. **Shell's Global Employee Share Purchase Plan** won our major award in 2010 and the team there, together with adviser Computershare, have been busy improving the experience for employees during the past two years. Shell offers the share plan to 15,000 employees across 80 countries every year. A vested share account has been developed, which means employees can manage their shareholdings after the share scheme has vested wherever they are across the globe and build up their stake in the company over the years.
Diageo submitted its **International Sharematch Plan** (ISMP), which provides an opportunity for employees to buy Diageo shares. Its only eligibility criteria is that employees must be employed on both the invitation and award dates, making ISMP accessible to all levels of staff across multiple disciplines ranging from the MD to bottling line operators in 29 countries to date. Employees who join the plan, launched in 2010, make an annual investment in their local currency of between the local equivalent of £50 and £3,000 to purchase shares in Diageo. In return, Diageo matches the number of shares purchased, currently with one matching share for every three purchased. The matching shares are subject to a three-year retention period in most markets. Purchased shares attract dividends, which are automatically reinvested in more shares to help employees build their Diageo shareholding and to further align the interests of employees and shareholders. Plan variants include offering a phantom version, an American Depositary Share (ADS) version and a one-year version. The plan is administered in house by the Diageo share plans team and its network of local champions around the business. It administers the plan with the support of Killik Employee Services from

whom it uses a share plans database. The plan advisers are Clifford Chance and Deloitte has provided tax advice. Collins Stewart provides share-dealing services at favourable rates for all plan participants.

2. 'Companies with less than 1,500 employees'

The three finalists in this category are:

Henderson Global Investors is extremely committed to employee share ownership. There are several plans on offer to the employees – a buy as you earn (SIP), a CSOP and a joint share option plan. In 2011 the company launched a new Sharesave plan. Henderson's online tools mean that employees can manage their portfolio across the plans with great ease. Henderson is committed to providing financial education so its employees can manage their financial obligations.

Imagination Technologieshas enjoyed phenomenal growth over the past few years, with clients including Apple. Because of this they have had some employees making almost £70,000 profit from its Save As You Earn scheme. The team have had to deal with questions of diversification and questions of CGT liability affecting many of their colleagues and did an excellent communications job around this.

The **London Stock Exchange** is the third finalist in this category, having been nominated by its advisers YBS Share Plans. Its Sharesave, which was launched in 2008, has had a second round of invitations this year, extending to employees in Sri Lanka for the first time. The UK take up of 54 percent was particularly impressive, with average monthly savings at £198. Even in Italy and Sri Lanka where these plans are rare, take up was better than expected at 29 percent and 23 percent respectively.

3. 'Best employee share plan communications'

There are three finalists in the this first-ever Centre award**:**

Flybe nominated by Capita.

Sainsburys nominated by Computershare

Whitbread nominated by YBS Share Plans

The judges said that all three finalists made excellent use of an array of media to get the message across about the plans.

Flybe took the theme '*Our future…yours to share*'. Most of the employees were not familiar with the company share schemes and how they operate, so the communications had to be simple and clear. The SIP used binoculars with the idea of keeping an eye on the company's future and the Sharesave used building blocks and building for the future.

Last year witnessed the 30th anniversary of **Sainsbury's** Sharesave plan. As part of the celebrations, 1,000 employees were given 30 free shares after a prize draw. The communications strategy was revamped after taking a survey of what employees thought about past offerings. The booklet was reduced from 16 pages to 6 and as many opportunities as possible were taken to remind employees of the invitation to join the scheme. A new MI tool allowed for more focussed targeting in stores where take-up had been below average.

Whitbread, the company behind Costa, Premier Inn and Beefeater among others, created the character WESS for its Whitbread's Employee Sharesave Scheme. The character was ubiquitous across media and brands making it clear to employees what each communication was about right from the start. The character took away some of the stigma around the scheme that shares were too complex to engage with.

Framed certificates will be given to winners and runners-up in each category.

Cable's binding pay votes to be enforced

Binding shareholder votes on executive reward in listed UK companies *will* be enshrined in law, Business Secretary Vince Cable has told Parliament.

Quoted companies who leave their remuneration policy unchanged will be required to hold a binding shareholder ballot only once every ***three*** years, but those who ***change*** their remuneration policy will be required to hold annual ballots, he announced.

The binding vote on pay policy will require the support of a simple majority of those shareholders who vote in order to pass.

Shareholder activists will be disappointed by Mr Cable's admission that in many companies a special resolution will be required in order to legitimise a binding shareholder vote on board level (see text below). This is the fly in the ointment because there is no provision in the 'Mems & Arts' of many companies to legitimise the concept of a binding shareholder vote on boardroom pay.

However, close examination of the new controls reveals that the government is weaving a restrictive net around the ability of company remuneration committees to recommend overly generous senior executive reward schemes.

Companies will be told to set out clearly in their remuneration reports how pay supports the strategic objectives of the company and include better information on how directors' pay compares to the wider workforce.

Mr Cable said: "The government intends all these reforms to be enacted by October 2013. This package of reforms will address *failures in corporate governance* by empowering shareholders to engage effectively with companies on pay. To introduce these reforms, the government will shortly bring forward amendments to the Enterprise and Regulatory Reform Bill, which is making its way through Parliament. Revised, simplified regulations setting out how companies must report directors' pay will be published at the same time. This will include measures to make pay reports clearer and more transparent for investors. We will give people the chance to comment on these regulations before they become law."

The changes in detail:

- The binding vote will be held annually unless companies choose to leave their remuneration policy unchanged, in which case it will be compulsory at least every three years. For the first time, once a policy is approved companies will not be able to

make payments outside its scope. If a company chooses to change its pay policy, it will have to put it before shareholders for re-approval. "Importantly, this will encourage companies to devise long-term policies and put a brake on annual pay ratcheting," said Cable.

- Companies will have to clearly explain their approach to exit payments, which will also be subject to the binding vote. When a director leaves, the company will have to promptly publish a statement of payments the director has received. Companies will not be able to pay exiting directors more than shareholders have agreed;
- Alongside the binding vote on policy, shareholders will continue to have an annual advisory vote on how pay policy was implemented in the previous year, including actual sums paid to directors.
- If a company loses the shareholder advisory vote, it will be required to put its overall pay policy back to shareholders in a binding vote the following year;
- In addition, the Financial Reporting Council will consult on updating the Corporate Governance Code so that companies will be recommended to make a statement when a significant minority of shareholders votes against a pay resolution;
- Companies will have to report a single figure for the total pay directors received for the year. This figure will cover all rewards received by directors, including bonuses and long term incentives.
- Companies will have to report details of whether they met performance measures and a comparison between company performance and ceos' pay.

Mr Cable added: "At a time when the global economy remains fragile, it is neither sustainable nor justifiable to see directors' pay rising at ten percent a year, while the performance of listed companies lags behind and many employees are having their pay cut or frozen. In January we kicked off a national debate aimed at encouraging shareholders to become more actively engaged as company owners in better aligning directors' pay with performance. I have been greatly encouraged by the 'shareholder spring' and I want to see that momentum sustained. That is why I am bringing forward legislation to strengthen the powers of shareholders through a binding vote on pay."

As reported by *newspad* last month, Mr Cable said originally that he had wanted to give shareholders an automatic annual binding vote on executive pay and bonuses, which would have been a radical reform from the current situation where, though shareholders have the right to an advisory vote, companies are then free to ignore even a majority vote against the remuneration report. He then lowered expectations in a *Sunday Times* interview, saying: "If investors have to do that (vote) every year with every company on the stock exchange, they could get tied up in bureaucracy". The first clue that he had tweaked his original plan came with the publication of the explanatory notes to his massive Enterprise & Reform Bill. The notes say:

Govt reaction to OTS recommendations

The government has called for further consultation on two of the main changes recommended by the Office of Tax Simplification (OTS) in order to make approved share schemes less bureaucratic and easier to operate.

The two OTS main recommendations the Treasury/ HMRC want to pursue are:

- To allow self-certification of SAYE-Sharesave, Share Incentive Plans (SIP) and Company Share Option Plans (CSOP) by the scheme sponsors and/or their advisers.
- To ask for more evidence and views on whether the CSOP has outlived its usefulness to UK businesses.

The Treasury will not be following up another major OTS recommendation - that HMRC should investigate how CSOP might be merged with the popular Enterprise Management Incentive if CSOP gets the thumbs down from UK business users.

The government's 43-page response to the OTS March report was signed by Exchequer Secretary David Gauke. It can be downloaded from:
http://tinyurl.com/7ruav6f.

Centre members have to get their responses to the consultation in by September 18. The co-ordinates are: Savings & Share Schemes Team, Room G53, 100 Parliament Street, London SW1A 2BQ or by email to: **shareschemes@hmrc.gsi.gov.uk** The lead official is Andrew Ellis of HMRC.

In all, the Treasury wants to pursue 15 of the OTS recommendations, most of them technical and of low seismic impact, eg watering down the material interest prohibition, currently defined as 30 percent in some schemes. Another is harmonise the 'good leaver' clauses across major approved schemes.

Ministers accept that restrictive operational rules need modifying and there is talk of allowing SIP participants early exercise of their employee shareholdings when there is a cash takeover of their employer by another company. Legislation is likely on some reform clauses next year and in 2014 on others.

The Centre remains vigilant over the government's refusal to rule out the abolition of CSOP. Ministers say they want the OTS to do further work on establishing who still uses CSOP and why. They want more evidence on whether it has a positive impact on productivity and economic growth.

The OTS view, as evidenced in its own report, was that the maximum CSOP award limit of £30,000 worth of options was too low for executives, but too high for rank-and-file employees and so was being used increasingly to incentivise middle managers instead.

Clause 57: Directors' remunerations: effect of remuneration report

425. Section 439(5) of the CA 2006 states that 'no entitlement of a person to remuneration is made conditional on the resolution being passed by reason only of the provision made by this section'.

426. Clause 57 will repeal section 439(5). This will remove the statutory provision which currently prevents the statutory requirement for a vote on the directors' remuneration report having the effect of making a

person's entitlement to remuneration contingent on the outcome of the shareholder resolution.

427. The repeal of this section does not automatically have the effect of making directors' remuneration contingent on the outcome of the shareholder resolution on the directors' remuneration report. As such, therefore, the repeal of section 439(5) does not, in itself, mandate a binding vote on the directors' remuneration report.

428. It will be possible for the shareholder resolution to be given that effect where the articles of a particular company state that this is to be the case. To change the articles of a particular company in order to introduce a binding vote on the remuneration report would require the approval of shareholders of that company by means of a special resolution.

So, as the legislation stands, in many companies a special resolution would be required, in addition to an adverse majority shareholder vote, before a remuneration report (carrying details of executive total reward packages) could be invalidated.

"It is up to shareholders to deal with it, but they don't have the tools to deal with it," said Tom Powdrill, of London-based shareholder pressure group PIRC**.**

Boost Eso schemes, urges stock exchange boss

Xavier Rolet ceo of the London Stock Exchange is the latest City figure to call for a 'reinvigoration' of employee share schemes. His version of Eso would allow tens of thousands more start-up business people to qualify for Entrepreneurs' (Tax) Relief – even if they award less than five per cent of the company equity to employee shareholders. He said: "We should reduce the fiscal burden for those investors who support our growth companies, by revisiting Capital Gains Tax relief. We should not be penalising the appetite for risk, it is a healthy and vital part of an economy's future. We need to reinvigorate employee share-ownership schemes, empowering a much broader spectrum of people to invest in the company they work for. For example, in order to qualify for this type of scheme we should remove the minimum requirement for five per cent of the company to be allocated to employee investors." Mr Rolet added: **"**Equity is chronically overtaxed: no less than four times – at purchase, dividend and sale, plus corporation tax. In contrast debt is tax deductible. Abolishing stamp duty for AIM and PLUS companies is the next obvious step. It will strengthen our hand." LSE has qualified for the 2012 Centre Awards.

Occupational pensions crisis worsens

The 6,500 private pension schemes tracked by the Pension Protection Fund (PPF) reported a record combined deficit of *£312 bn* by the end of May, according to the scheme's own figures.

The estimated combined deficit increased by almost £100bn during the month, said the PPF, which pays compensation to members of defined benefit pension schemes if their employers go insolvent. Of its 6,432 member schemes 5,503 are now in deficit. By contrast, the schemes collectively were in deficit by 'only' £24.5bn at the end of May last year.

The PPF index, issued monthly, is based on the combined Pensions Act 2004 section 179 liabilities of the defined benefit pension schemes potentially eligible for entry to the PPF, which broadly represent the premium that scheme would have to pay to an insurance company to cover a payout that matches the level of compensation its members are entitled to receive from the PPF - usually lower than the full scheme benefits, reported Centre member **Pinsent Masons**. The PPF is funded by eligible defined benefit pension schemes, which are schemes that promise a set level of pension once an employee reaches retirement age, no matter what happens to the stock market or the value of the pension investment. It pays compensation to scheme members whose employers have become insolvent and unable to pay the pensions they promised.

The final salary pension scheme belonging to department store **House of Fraser** became the latest high-profile casualty of unsustainable rising costs, according to the *Daily Telegraph*. Long-term staff members will retain the benefits they have earned to date under the scheme, but there will be no more accruals. They have the option of transferring to a less generous company plan. The FS scheme was closed to new staff some years ago. The record deficit had been fuelled by a sharp drop in gilt yields as a result of the Government's £125bn quantitative easing (QE) programme and turmoil in the eurozone, according to the pensions industry. Yields fell by 55 basis points resulting in a 7.6 percent increase in pension scheme liability in May alone, according to the PPF, with a fall of 173 basis points over the course of the year to May 2012.

McDo wins award

McDonald's Restaurants, Merlin Entertainments, BT and Kraft Foods were among the winners at this year's *Employee Benefits* magazine awards. **McDonald's Restaurants** took the overall grand prix prize, plus the category award for 'Most effective reward alignment strategy' for organisations with more than 1,000 employees.' It took the top honour because of its consistently pro-active approach to benefits for its workforce, said the judges, who were impressed by McDo's "well-rounded" reward strategy, which resulted in a significant reduction in staff turnover. The firm looked at the relationship between high levels of staff engagement and business results and found that engaged staff delivered a better service. This year's 'Benefits professional of the year' was Debra Corey, group compensation and benefits director at **Merlin Entertainments**. Merlin also won 'Most effective motivation or incentive strategy'. Corey is highly regarded in the benefits industry, having made a big impact on reward strategy at several organisations, including Gap, Quintiles,

Morrisons and Honeywell. The award for 'Benefits specialist of the year' went to Francis O'Mahony, head of employee share plans and share registration at **BT**, for his reputation in the industry and work with employee share plans. **Kraft Foods** scooped the gong for 'Benefits team of the year'. Its reward team had the challenge of harmonising reward and benefits after its high-profile acquisition of Cadbury in 2010. The judges were impressed with how Kraft's small reward team tackled such a huge project.

On the move

Juliet Halfhead has been made partner at Deloitte and Centre UK director David Poole sent her our congratulations. Juliet is already well known among our trustee members as a frequent speaker at the Centre-STEP Channel Island conferences.

Centre member **Norse Solutions** has changed its name to **Accurate Equity.** The employee equity advisor has thrived since its inception in 2004 and is now a worldwide business, which demanded a change of name and image. Arne Peder Blix, President, ceo and co-founder of Norse Solutions, said: "Our former name was rooted in the spirit of endeavour dating back to the Viking sagas. The name evoked an image of a people that established trade and commerce from Europe to Central Asia, and sailed as far as the Americas. They prospered in a harsh climate, where planning was the core competency, risk management was the most important skill and trust, the only true currency. We have chosen a new name that reflects our dedication to a global mission – Accurate Equity - which echoes our dedication to excellence and highlights our global mission to deliver precise and reliable equity compensation administration, record-keeping, accounting and reporting." Mr Peder added: "With the current financial turmoil, clients can no longer manage with approximate figures. They demand, require and depend on accuracy." Accurate Equity is moving the heart of its Scandinavian operations to IT Fornebu, just outside the Norwegian capital, Oslo.

CONFERENCES

DAVOS 2013: Call for speakers**:** The Centre's 14th Global Employee Equity Forum will take place on **Thursday Feb 7 and Friday Feb 8** at the five-star Belvedere Hotel, in Davos Platz. The Centre asks members who want to present at this prestigious event to contact international director Fred Hackworth: fhackworth@hurlstons.com in order to discuss your ideas for speaker topics.

Centre member service provider **speakers** will pay only **£765** and no VAT for our two nights accommodation (on a half-board basis) + conference package deal.

Plan issuer **speakers** will pay only **£465** for the same deal.

Equivalent rates for Centre member **delegates** are**:**

Practitioner (service provider) members **£899;** Eso plan issuer companies **£535**

The Steigenberger Group's MD for Switzerland, Conrad Meier, has assured the Centre that service standards at the Belvedere will be impeccable next year. Mark these dates in your diaries and get sign-off to attend from your purse-holder.

COMPANIES

Ryanair announced that it intends making an all-cash offer of €1.30 per share for **Aer Lingus**. In a statement to the Irish Stock Exchange, the airline said the offer values Aer Lingus at approximately €694m. Ryanair already owns almost 30 percent of Aer Lingus in a stake acquired over five years ago. The stake was reviewed by the European Union and has recently been referred by the UK Office of Fair Trade to the UK Competition Commission.

The Ryanair statement said that the Employee Share Ownership Trust (ESOT) no longer controls 15 percent of Aer Lingus. Ryanair pointed out that it could take control of the airline even if the government does not immediately agree to sell its shares to it. Previously, a combination of the government and the Aer Lingus ESOT could block any takeover. With the trust now dissolved, this is no longer the case.

Wolseley said in its Q3 interim management statement for the nine months to April 2012 that operating costs were 3.6 percent higher than last year, including increases in employee share scheme expenses of £4m and £2m of one-off restructuring charges.

LTIPs shake-up demanded by investor groups

UK investors Fidelity Worldwide Investments and Hermes Equity Ownership Services say banks should award shares vesting over longer periods and make dividends a primary part of executives' income. Long-term incentive plans should stipulate that shares vest when an executive leaves the company, creating better alignment with shareholders' interests, said Dominic Rossi, chief investment officer of equities at Fidelity, the world's second- biggest mutual fund manager. "Career shares, which require an executive to retain equity that has vested until he or she leaves the company, should become a standard element of LTIPs," Rossi said. "They align the executive to the long-term wealth creation of the company and they highlight to management the value of a dividend stream." **Barclays, Aviva, Trinity Mirror** and **Prudential** were among UK companies to come under pressure in a surge of protest from investors against remuneration reports in the past two months. Shareholders have criticised the pay, the complexity of share-based compensation plans and bonus payments for departing executives. "This is not only a reward for failure but a failure of the reward system and is unacceptable," Hermes, which advises clients with £89 bn of assets under management, said in a discussion paper advocating changes to executive pay. "Long-term incentives should be longer term. Three years is used as a proxy for long term but this is at best a medium-term measure, particularly in larger companies." HSBC Holdings, Europe's biggest bank, last year implemented a plan that allows shares to vest

over five years rather than the three years more commonly used and could be withheld during that time frame. Rossi cited London-based HSBC's compensation structure as a model for the rest of the industry in an interview with the *Financial Times.* **Goldman Sachs** is the only other major bank which operates a similar LTIP policy, forcing its 431 partners to retain one quarter of their share awards (not cashed in) until retirement.

Investors in the world's biggest advertising agency **WPP** rejected ceo Martin Sorrell's £6.8m pay award, after he sought to defend a big rise, unlike some other UK bosses who have taken cuts. Almost 60 percent of shareholders voted against WPP's remuneration report at the WPP annual general meeting (agm) in Dublin, in the latest example of 'Shareholder Spring.'The revolt came after Sir Martin, who has built WPP into the world's biggest advertising group, worth nearly £10bn, accepted a 30 percent increase in his total compensation package to nearly £13m last year. He and the chair of WPP's remuneration committee, Jeffrey Rosen, have been defiant in their defence of the company's pay policy, insisting it is rewarding WPP's directors 'appropriately' for performance. Sir Martin claimed he does not receive a substantial pay package because most of it is on shares he has bought with his own money, and has said he was "irritated" by persistent controversy over his remuneration. However, Philip Lader, chairman of the group, signalled more willingness to revise WPP's pay report. Sorrell, who has built a business with 160,000 employees across 108 countries and has much of his personal wealth tied up in it, is expected to survive, given that investors widely accept the success of his leadership. "Ultimately, the market will decide. The shareholders have spoken and obviously we're disappointed with the vote. We're taking the result into consideration and the board will be consulting with shareholders," he said.

Standard Life Investments (SLI) added its voice to the growing chorus of complaints and disbelief over the planned remuneration of executives behind the £50 bn merger of **Glencore** and **Xstrata**, whose boss Mick Davis is in line to pick up £28.8m as a retention bonus to stay at the head of the business for three years. In all, £172m will split among 72 senior staff (including Mr Davis) to keep them on for two years. Mr Davis may receive a potential £75m payout as head of the company created from the miner's proposed merger with commodity giant Glencore. The rest of his package comprises the £9.8m he could get per year in salary, bonus and benefits. He is in the running too for another £6m a year, via a long term incentive plan if he hits targets and the scheme remains the same.

David Cumming, head of equities at SLI, believes the merger deal should be opposed. He said: "The proposed remuneration payments, the payout of existing service contracts, the vesting of outstanding incentive awards and the excessive retention payments to ensure the commitment of a management team who are supposedly supportive of the deal, all without any requirement in terms of performance conditions to deliver anything for shareholders, is unacceptable." Dominic Rossi, global chief investment officer of equities, at **Fidelity**, said: "In effect the interests of management have been placed ahead of those of shareholders."

If the retention awards are not approved by at least 50 percent of shareholders at their July 12 vote, the merger will not take place. Sir John Bond, Xstrata's chairman, said its non-executive directors considered the incentive plans "very carefully ... in the light of the heightened public debate about executive remuneration". The stability of Xstrata's leadership has been "integral" to its success, he told shareholders. However, rumours began to circulate that Mr Davis might have to stand aside in order for the deal to go through.

ICAP, the inter-dealer broker led by Michael Spencer, has cut executive pay and overhauled its remuneration system amid fears it could face a shareholder rebellion at its agm this month (July 12). The company, which saw 33.5 percent of shareholders reject its pay package last year, said directors will in future have to clear "substantially higher hurdles" to get their bonuses. The move follows extensive talks with investors, led by chairman Charles Gregson. Other changes will see bonus payments linked to profit growth rather than the total profit figure. Mr Spencer, the former Tory Party treasurer, will have to hold shares worth five times his salary. The news came as the company revealed that Mr Spencer's total reward was £5.5m last year, compared with £7.6m a year earlier. Executive director John Nixon received £3.4m, compared with £4.9m a year earlier, while Iain Torrens, finance director, gained £1.9m – up from £584,000 in 2010, when he joined the company. In its annual report, ICAP said executives had failed to meet some of their internal targets. The total bonus pool for directors fell to £8.5m, from £11.3m the year before.

Angela Ahrendts, the chief executive of **Burberry**, received £16m last year in pay, bonuses and long-term incentive schemes that bore fruit in 2011. She is one of the best-rewarded female bosses in the UK thanks to the stellar performance of the luxury group. Burberry, famous for its distinctive red, black and beige check, has been one of the best performers in the FTSE 100 under her leadership.

Marks and Spencer's directors missed out on an additional bonus payment last year after a key profitability target was not met, meaning that its ceo's total pay was more than halved. Under M&S rules, all executive directors have group profit before tax (PBT) targets tied to their bonuses, the High Street retailer explained in its annual financial report. "For there to be any payment under the group PBT measure in 2011/12, there was a requirement not only for year-on-year group PBT growth but also out-performance of the operating plan." M&S said that its underlying PBT of £705.9m, down one percent year-on-year, did not meet the minimum target, resulting in no bonus payment under the group PBT element (which accounts for 60 percent of the directors' total bonus). For this element of the bonus, if the group was to outperform these targets then each director could have been in for payout worth up to 120 percent of their basic salaries; instead, they received nothing. Nevertheless, it wasn't all doom and

gloom for the directors, as the remaining 40 percent of their bonus potential was tied to other 'individual objectives.' These still saw ceo Marc Bolland net £663,000 in bonus pay – equal to 68 percent of his basic salary of £975,000. Half of the bonus earned is paid in cash while half is deferred into shares. When combining 50 percent of Bolland's bonus, his basic salary and other benefits (such as pension supplement, car allowances and dividend payments), his total remuneration in the year ended March 31st totalled £1.68m. This was well under the £4.38m he got paid the year before. Total pay for M&S executive directors was £7.80m compared with £8.48m the previous year.

Lloyds Banking Group may claw back some of the £375m in bonuses paid out to top bosses last year after it was forced to set aside £3.57 bn over mis-sold payment protection insurance.

Anthony Watson, Lloyds Bank's senior independent director and chairman of the remuneration committee, told the Treasury select committee that no decision had been taken, "but of course we have to consider it" as the provision had triggered a £3bn-plus loss for the year. "I can assure you it will be part of our deliberations," Watson said.

In February the bank announced it was clawing back nearly £1.5m in bonuses from top executives, including former ceo Eric Daniels, for "accountability" for the PPI mis-selling. The bank stressed there was no wrongdoing involved.

A Lloyds spokesman said after the hearing – on corporate governance and remuneration in the financial services sector - that any further bonus clawback related to the issue remained "hypothetical." It came as a survey was published reigniting the row over executive pay, which showed that rewards for blue-chip bosses rose 12 percent to an average of £4.8m last year. That far outstripped the 1 per cent average rise for employees in 2011, according to the report by proxy voting agency **Manifest** and remuneration consultancy **MM&K.**

Shareholders of **Air France-KLM** and **Safran** voted against big pay-offs for chief executives at the part French state-owned groups as public resistance to lucrative executive pay grows on a continent traumatised by financial turmoil, reported Reuters. Four-fifths of Air France-KLM shareholders opposed about €400,000 paid to ex-ceo Pierre-Henri Gourgeon, who also received $1.39m when he was ousted in October following the airline's poor performance. The stock lost 71 percent of its value last year. Economy minister Pierre Moscovici said that M. Gourgeon had a "moral obligation" to repay the bonus which had been voted down, but it was unclear whether the ex-ceo would oblige. A representative of the French state, which holds almost 16 percent of the loss-making Franco-Dutch carrier, opposed Gourgeon's payout at a shareholders meeting, the minister said in a statement.

Just over half of shareholders in aerospace group **Safran** voted against awarding chairman and ceo Jean-Paul Herteman two years of pay and an extra pension when he steps down. He was paid $1.77m last year.

Elected promising to curb the privileges enjoyed by France's wealthy, Socialist President **Francois Hollande** will limit senior executives' salaries to a maximum of **20 times** that of their lowest-paid employee. His government then announced an annual ceiling of €450,000 (£363,000) on the salaries of ceos of state-owned enterprises. "We are working on plans for pay at public companies to be cut," Finance Minister Pierre Moscovici told journalists. While restricted to state-controlled firms, the French pay limit affects a number of listed companies including nuclear power plant builder Areva and utility EDF, whose ceos earn far more than the new limit. Both declined to comment on the plan.

Government spokeswoman Najat Vallaud-Belkacem said it was normal for the heads of public companies to accept pay curbs after the presidential and ministerial salaries had been cut on Hollande taking power. "The measure will apply equally to contracts in place today. Waiting for contracts to end would equate to kicking the can down the road when the urgency of the crisis means we need to act fast," she said.

With a wave of layoffs feared by unions now that the presidential election is out of the way, executive pay has become an increasingly sensitive subject, with some corporate high-flyers seen as enjoying generous severance packages.

EMI holds hands with ER

The increase in the EMI individual options limit to £250,000 went live on June 16 and the extension of Entrepreneurs Relief to EMI option shares will be enacted by the Finance Act 2013 - to take effect for options exercised on or after April 6 2012. The draft legislation extending ER to EMI is due to be published in September, but the extension of ER to EMI is not as generous as it at first appears, wrote Centre member **Bird & Bird**.

Individuals who qualify for ER are taxed at the favourable rate of ten percent on capital gains up to a lifetime limit of £10 million. The relief is available for disposals of securities (or interests in securities) if throughout the period of one year prior to disposal:

- the company is the individual's personal company;
- the company is either a trading company or the holding company of a trading group; and the individual is an officer or employee of the company or one of more companies in the same group.

The requirement for the company to be the individual's "personal company" will be dispensed with for individuals who acquire shares pursuant to the exercise of EMI options. Individuals will, however, still be required to hold the EMI option shares and remain a director or employee for at least a year **after** exercise in order to qualify for ER. Most private companies operate "exit only" EMI plans in which options can only be exercised immediately before an exit. Option-holders in these circumstances will be ineligible for ER (assuming the option-holder sells his option shares on exit for cash). It would be far better if the one-year ER holding period were to run from **grant** rather than exercise (as it did under the old business asset taper relief regime).

The Government is being lobbied on this point but if the changes are enacted as proposed, how can existing EMI option-holders benefit from ER?

Route 1: Exchange option shares for Loan Notes on Exit

If the company achieves an exit and the purchaser is prepared to offer loan notes, it would be possible to exercise EMI options immediately before an exit and to exchange option shares for loan notes. So-called 're-organisation' treatment will usually apply to the loan notes with the effect that any gains will be postponed until sale or redemption of the loan notes. The loan notes are treated for CGT purposes as if they were acquired when the option shares were acquired and for the same base cost. Bird & Bird has requested confirmation from HMRC that the one year ER holding period will continue to run on the loan notes issued in these circumstances and that the personal company requirement will not apply to securities issued in exchange for EMI option shares. Assuming HMRC confirms these points, EMI option-holders could sell or redeem the loan notes 12 months after completion and claim ER on the gains. It would be possible for option-holders to realise some cash on completion by selling some option shares without incurring CGT by using annual exemptions etc. If the cash raised is insufficient to fund the exercise price, option-holders may require temporary loans to fund the balance of the exercise price due (which could be repaid out of the loan note redemption monies).

This strategy will only be effective if:

- the purchaser is prepared to offer loan notes (many US purchasers are not);
- the participant remains an employee or director for at least one year post completion;
- the purchaser is a trading company for ER purposes; and
- HMRC frames the legislation so the one year holding period continues to run on loan notes issued in exchange for EMI option shares and so the personal company requirement does not apply to the loan notes (the draft legislation is due to be published in September 2012).

This strategy is attractive because:

- companies with outstanding EMI options need do nothing now; and
- a corporation tax deduction should be available by statute on the full spread on exercise (i.e. the difference between the exercise price and the net present value of the option shares on exercise calculated by reference to the deal value).

It should be said, however, that participants only receive the bulk of their cash 12 months following completion and they risk the purchaser defaulting on the loan notes.

Route 2: Grant Replacement Options and Exercise Early

If existing EMI options are not exercisable, participants could be granted replacement options in exchange for the surrender of their existing options. The replacement options would allow exercise at any time. The option-holder could be required to enter into a contingent purchase contract (CPC) which would give the company a call option to purchase unvested shares at cost if the option-holder leaves or if any performance targets are failed (i.e. so as to put the participant in a similar position as if he remained an option-holder). If an exit occurs more than a year after exercise, the option shares could be sold for cash and the participant would potentially qualify for ER on the disposal. If an exit occurs within a year of exercise, the participant could exchange some of his option shares for loan notes as in route 1 above. Alternatively the option terms could be altered to allow early exercise but HMRCs regard this (based on case law) as a change to a fundamental term amounting to the grant of a new option. If a new option is granted (whether as a replacement option or because an existing option is amended), fresh form EMI 1s will need to be submitted to the Small Companies Enterprise Centre within 92 days of grant for the new option to qualify for EMI tax relief. There are a number of drawbacks with this strategy:

- If existing options are "in the money" and the new option is granted over the same number of shares at the same exercise price, the new option will be granted at a discount. EMI options granted at a discount are subject to income tax on exercise on the amount of the discount on grant. If the option shares are readily convertible assets at the time of exercise, PAYE and NIC will apply.
- If the exercise price is substantial, the option-holder would have to fund it and will incur real commercial risk.
- Even if the strategy works as planned, the employing company will lose out on corporation tax relief, since a deduction will only be available for the (lower) spread on exercise as opposed to the spread on exit.
- The company's articles may need to be amended to allow the call options in the CPCs to operate and it is not necessarily straightforward for the company to purchase and cancel its own shares (particularly if it has no distributable profits).
- Participants will become shareholders thereby acquiring minority shareholder rights / potentially diluting other shareholders below the five percent threshold.

"It seems to us in the context of existing options, route 1 is likely to be more attractive than route 2 in most cases," added Bird & Bird.

Future EMI Option Grants: Companies wishing to grant EMI options in the future may wish to consider granting options over a new class of "growth shares" which have no rights other than to participate in a liquidation or in exit consideration achieved above a threshold (so it is possible to agree a low upfront value for the growth shares with HMRC for EMI purposes).

Taxing share options in France

Two tax instructions dated March 2, 2012 (BOI 5B-10-12 and BOI 14A-3-12) clarify the method of taxing gains and employment benefits resulting from stock grants realised by French tax residents or by non French tax residents who are, or were, in an international mobility situation at any moment between the grant date and the taxable event. Gains resulting

from both "qualified" and non-qualified plans are covered by these instructions.

Tax instruction BOI 14 A-3-12 clarifies the method of taxation of these gains and benefits in application of tax treaties, said lawyers Landwell:

- The tax authorities adopt OECD principles (report published in 2004) and qualify gains resulting from the grant or the acquisition of stocks as employment income (article 15 of the tax treaty model).
- The right to tax gains between States must be apportioned by (i) establishing the activity for which the awards were granted (« reference period»), and (ii) determining the States in which the activity was exercised.
- A distinction is made between grants compensating past services and grants compensating future services (or both). If the grant compensates past services, the reference period is the date of grant. If the grant compensates future services, the reference period is the period of time between the date of grant and the date the beneficiary's rights vest.
- If the professional activities are exercised in several States during the reference period, the tax authorities have adopted the sourcing principle of the gain based on the number of working days in each State during the reference period. This calculation is made based on a calendar day approach (365 days per year) by taking into account the date as from which the employee is sent to the concerned State.
- For French qualified plans, any capital loss realised upon sale of the shares cannot be deducted from the acquisition gain if the employee is not a French tax resident at the date of the taxable event.
- Finally, the tax instruction specifies the methods to avoid double taxation, especially when there are timing issues with respect to taxation.

Tax instruction BOI 5 B-10-12 comments on the new withholding tax obligation created under article 182 A ter of the French Tax Code applicable to French-source gains realised by non French tax residents:

- The tax authorities confirm the scope of the withholding tax obligation, which applies to French source gains resulting from qualified or non-qualified plans and realised as of April 1, 2011. Benefits or gains realised before April 1 2011 are not subject to the withholding tax under article 182 A of the French Tax Code, even if the sale of the shares occurs thereafter. Also, gains on stock options granted before June 20 2007 are not subject to withholding tax.
- The withholding tax applies only to the French portion of the gain, that is, the portion of the gain that rewards an activity exercised in France during the reference period as defined in tax instruction BOI 14 A-3-12 above.
- The tax instruction provides additional details on the taxable event, on the taxable basis and the withholding tax rates applicable to the French source portion of the gain for both qualified and non-qualified plans. For French qualified plans subject to a specific flat rate of taxation, further information is provided concerning the procedure to opt between these specific flat tax rates and rates applicable to employment income. If the gain is subject to tax as employment income, the annual withholding tax rates and brackets are applicable, regardless of the duration of the activity in France during the reference period.
- Concerning the paying agent of the withholding tax, the tax authorities confirm that, for French qualified plans, the paying agent is the person transferring the cash proceeds to the beneficiary. It is either the employer if the plan is managed internally or the firm to which the employer entrusted the management of the plans (this does not apply to record keepers, this firm should have a brokerage activity), or the firm in which the beneficiary transferred his shares. For any excess discount, the paying agent is the person in charge of assessing the benefit (in general, the employer). For non-qualified plans, the paying agent is the person delivering the shares to the beneficiary (in general, the employer or an outside provider if the employer outsourced the transfer the shares to a third party). The administration clarifies that it is the paying agent that must withholding tax even if located abroad. The tax must be withheld and paid to the Treasury, with form 2494 bis, no later than the 15th day of the month following the taxable event.

As an exception, for gains that are taxable between April 1 2011 and March 31 2012, tax instruction BOI 5 B-10-12 allowed for payment of the withholding tax until **May 15 2012** without application of any penalties. Moreover, the reporting obligations for stock options and free share awards have been modified (decree n° 2012-131 and decree n° 2012-130). For French « qualified » free shares, which vested in 2011, the deadline to provide the beneficiaries and the tax authorities with the individual statement was April 30 2012.

Employee share schemes: reminder on submitting Form 42

Deloitte issued a reminder that employers are required to notify HMRC of events relating to employee share schemes, eg shares issued to employees, share option exercises etc. Reporting can be complex, particularly where employers have an internationally mobile workforce or company transactions have occurred during a tax year. The relevant return, on HMRC Form 42, needs to be submitted by **July 6** following the year to which the events relate.

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