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it's our business

newspad of the Employee Share Ownership Centre

Positive HMRC report gives boost to EMI scheme

There was mixed news in recent weeks for the thousands of small gazelle-like UK companies, which have been using the government's Enterprise Management Incentive share option scheme to motivate their key employees during the past six years.

First the good news - publication by HMRC of its EMI Evaluation Report, 'Use of EMI and its Perceived Impact,' which in general terms gave the scheme a clean bill of health. This will make it much harder for the government to further cut the scope and benefits of EMI, a move rumoured to be under consideration some months ago because of the mounting tax relief bill. The report is based on the results of two quantitative surveys carried out by researchers IPSOS-MORI among employers and among employees who have been granted EMI options.

But the bad news was the realisation that one of the keystones of the EMI scheme, the ten percent Capital Gains Tax taper relief band, is about to disappear in a few weeks time. This will reduce the appeal of the EMI scheme considerably, since the effective rate of CGT payable by risk-takers in such companies will go up by 80 percent - from ten to 18 percent. It remains to be seen how many EMI option-holders will be able to cash in their options and sell the shares before the new 18 percent flat CGT rate bites from April 6.

Around 925 employers and 1189 employees either answered phone calls or filled in questionnaires in last June and July to answer questions about the EMI scheme or to give their views on its effectiveness. More than 90 percent of employers interviewed said that staff retention was a key reason for adopting the EMI scheme. Only two percent of these employers viewed it as a staff recruitment tool. EMI's tax advantages were seen by employers as an important plus-point and other key reasons for using it were to improve staff motivation and to engender a feeling of ownership. However, 62 percent of employees surveyed said they had been unaware for months on end that their employer used the EMI.

About 40 percent of employers had already touched or neared the £100,000 individual limit on the award of EMI options, but the majority had come nowhere near issuing the maximum £3m (outstanding) share options allowed by the scheme.

Almost 80 percent of employers surveyed said that EMI had been most successful in retaining key or skilled employees and 71 percent said that using EMI had helped improve their company's overall performance.

From the Chairman

Chancellor Alistair Darling heard our pleas on behalf of EMI - equally he may have been influenced by Lady Vadera, the new Brownie at BERR, or even the clean bill of health from HMRC, our lead story this month. In any event the EMI, wtihout doubt a world-leading esop incentive scheme, perhaps former Chancellor Brown's best gift to the sector, has benefited from the Budget. In the first increase since 2000 the grant limit for options under the scheme will rise on April 6 from £100,000 to £120,000. At the same time schemes will be limited to companies with fewer than 250 full-time staff...but by then they are already straying beyond gazelle status. Let us hope this points to a new influence of enterprise on policy. The esop sector does not need more government incentives...it needs them well directed, with government and experts working together.

Malcolm Hurlston

Mr Darling used his Budget to change the EMI scheme rules, but only slightly. He raised the individual limit on the vale of options awarded from £100K to £120K, the first increase since the scheme began. In addition, in order to comply with EU guidelines on state aid, he banned from using EMI options: companies employing more than 250 people and companies in the shipbuilding, coal and steel industries. However, since there are few companies with the qualifying gross asset value of less than £30m who employ more than 250 people and few in the banned industries who use EMI, the effects of his ruling will be slight.

David Pett, tax partner at Pinsent Masons, a Centre expert on EMI, told the government after studying the EMI evaluation report: "Overall, the report supports the view that, at least in the case of those companies known to be eligible, here is a legislation which is achieving its objectives - I cannot see anything in it to suggest that users are screaming for change or objecting strongly, or at all, to the way in which the tax relief is targeted.....and if it ain't broke, please don't fix it !!" He said it was disappointing that the researchers were not able to ask of a wide range of companies which, whilst prima facie eligible, had not reported the grant of EMI options, why they have not made use of it. Those ineligible because of a lack of independence were, of course, also likely to be ineligible for the CT relief - a 'double whammy' said Mr Pett. The report's findings suggested that practitioners, as well as HMRC and

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others, were not doing nearly enough to promote the benefits of EMI - a point they, through the ESOP Centre and other lobbying groups, had long been making, he added.

Centre chairman Malcolm Hurlston welcomed the report as "ammunition for Lady Vadera the new minister at BERR if she wants to do enterprise a good turn."

CENTRE IN DUBAI TALKS

The Centre is in advanced talks with the Emirates National Bank of Dubai about organising a long-term programme of conferences and seminars aimed at bringing Esops and related plans to the Gulf and neighbouring states. The first such event is scheduled for late autumn of this year and there will be a target audience of 150, of which a third will be from the EU.

Sponsorship opportunities will soon be on offer and Centre members who wish to sponsor and/or speak should contact fhackworth@hurlstons.com

SHARESAVE BONUS RATES TO BE SLASHED NEXT MONTH

The race is on! Sponsoring companies and their advisers have only a few weeks left in which to issue new SAYE prospectuses at the current bonus rates in order to avoid cuts of up to one third in employee savings' bonuses. HBOS Employee Equity Solutions has relayed to Newspad HMRC's notification of a new SAYE prospectus, which is being introduced very quickly. Last September's prospectus is being withdrawn from 4 April this year, so invitations must close before that date to benefit from the current bonus rates. The reduced bonus rates are: Three year - 1.6 percent (currently 2.4) percent; Five year - 5.1 percent (7.2) and Seven year - 9.8 percent (13.3). One insider commented: "Bonus rates needed to come down as margins were being squeezed too much and banks are already under enough pressure." The 'early closure' interest rate is being reduced from 3 percent to 2 percent, but there are no other major changes to the existing prospectus.

NORTHERN WRECK - EXCLUSIVE

Around 4,000 employee shareholders in Northern Rock are worried that their free share allocations in the Share Incentive Plan may turn out to be worth little more than the computer print-outs on which they are notified regularly of their holdings.

Although there was relief that the now nationalized mortgage company had not asked employees to buy any Partnership Shares, some employees are worried that they may be 'cheated' out of the value of their SIP free share allocations in the wake of the nationalisation of the stricken mortgage bank.

Newspad has learned that the special dividend pay-outs these employees would normally be due on their employee shares may turn out to be rather lower than would have been the case had Northern Rock started to pay out before its shares were suspended. They are wondering how long will it take Northern Rock and its new political masters to establish shareholder compensation levels, post an independent valuation process. For the Government may have no option other than to cancel all the shares, including employee shares. Otherwise it would be another four years before the free SIP shares could be theoretically cashed in without tax penalties, but how much would they get for each share?

There is doubt too about the future of NR's executive option plans, though this is hardly likely to worry the branch staff.

By contrast, there are only 500 Northern Rock employee participants remaining in the SAYE Sharesave as there was big SAYE scheme maturity late last year, which was well-timed, as far as employee shareholders were concerned. The remaining Eso participants can get their money back either when the new scheme matures, or if all the shares are cancelled, regardless of whether NR has been sold back to the private sector during the next few years, because they can choose the savings + interest hand-back option.

Capita is the registrar and share plan administrator of Northern Rock and its Eso business boss Justin Cooper explained that his staff had briefed its staff call centres with detailed Q & A information for worried employees: What happens to our employee share schemes? "The Government has announced it will be acquiring all Northern Rock's shares through legislation. Share trading has been suspended following the Government's announcement of its plan to bring Northern Rock into temporary public ownership. The Govt will provide details of the independent valuation process that will be established to assess compensation due to shareholders. Employees will be advised as soon as possible how this announcement will affect the various employee share schemes."

REVENUE RUBBISHES PROSHARE CGT CLAIM

HMRC has rubbished claims from ProShare that up to 270,000 employee shareholders could suffer losses during the next few years from the impending change in the CGT regime. The 'Revenue' told the Daily Telegraph that employees wanting to sell shares they purchase from successful Sharesave schemes can stagger their matured scheme share sales across different financial years in order to eradicate any CGT liability. The potential CGT burden facing employee shareholders will effectively rise by 80 percent in the new tax year on any gain above the annual £9,200 exemption limit. But the Revenue is briefing that employees can enjoy an effective exemption limit of £18,400, provided their share sales are staggered between the current fiscal year ending April 5 and the next one, which starts the day afterwards. Nevertheless, the Chancellor's only concession to Eso was to end the two-year holding rule, so that holders of matured SAYE options who decide to buy the shares can then sell them at any time without loss of tax privileges, said Deloitte.

Centre member Clifford Chance said: "The post Pre-Budget Report period saw an unprecedented period of lobbying and the Chancellor indicated that he would be willing to re-consider some of the detail of his proposals. However, there was no hint that this might include any special relief for Esops, with Treasury officials suggesting that the changes would have "very little impact" on employee shareholders. Unsurprisingly, therefore, the Chancellor's revised proposals for CGT reform, announced on 24 January, contained no specific relief for shares acquired under Eso plans." The proposed CGT changes include (1) the introduction of a single rate of CGT of 18 percent to replace the ten percent band and (2) abolishing taper relief in respect of disposals of assets on or after 6 April. Moreover, no rank-and-file employees are likely to benefit from the new concession, known as Entrepreneurs' Relief, for those owning at least five percent of the company equity. Many directors and other senior employees will want to "cash in" their shares before 6 April this year. Companies operating share plans should review their employee communications and re-consider share plan design (particularly if they were designed to maximise taper relief - e.g. “pure” restricted share plans) now that the proposed changes have been confirmed.

ON THE MOVE

Centre speaker Henk Potts of Barclays Stockbrokers is naturally the star of his Facebook appreciation society – in the Just for Fun -Fan Clubs section. Description: This man with his immaculate pin stripe suit, if you have been lucky enough to see him on the box, is a legend. However it’s his tones that shape the morning on the way to work with his knowledge of business and all-round day-to-day information that is so valuable. His club has 840 members. How do you do it, Henk?

Centre member legal firm Pinsent Masons changed its company status, as of 1 March, into that of a limited liability partnership, following a conversion vote among the partners. It is now Pinsent Masons LLP.

MORE D11 SHARESAVE TERROR

Nearly two years after the proposals were first published for consultation, the International Accounting Standards Board has finally issued formal amendments to IFRS2 Share-based Payment Directive, which will affect, in particular, companies operating Sharesave and similar share purchase plans. Despite intense lobbying from companies and the employee share plans industry, the IASB has adopted the treatment proposed in its original consultation document. Under these amendments to IFRS2, where employees cancel their savings contracts and therefore lose their options, this will be treated for accounting purposes as a cancellation and the company will have to recognise immediately the outstanding accounting charge that would otherwise have been spread over the remaining vesting period. This is the case even though the employee does not ever acquire any shares. In addition, any new options granted to an employee will give rise to the ‘normal’ IFRS2 accounting charge, even though these are in effect simply replacing the cancelled options.

This ruling puts many companies in a quandary. Normally, if their share price drops below the option ‘strike’ price offered to employee shareholders, they issue new Sharesave options at a lower level, allowing participants to hop from the underwater scheme to the new one. But from next January this route could be costly for plan sponsors, if they have to take a heavy accounting charge on the chin for all those employees who ditch the earlier scheme in favour of the new one.

In applying this treatment, the IASB has rejected the widely-held view that a cessation of savings by the employee should be treated as a failure to meet a non-market-based “vesting condition” (i.e. a forfeiture which should result in no further accounting charge and a write-back of earlier charges). Instead, the IASB has defined vesting conditions very narrowly as being only service conditions and performance conditions. The IASB has stated that the amendments will apply to all share-based payments within the scope of IFRS2 for annual accounting periods beginning on or after 1 January 2009 (although earlier application is permitted) said Clifford Chance.

HMRC announced changes to the information required in the annual returns form EM140 for the Enterprise Management Incentives scheme. Details of options granted are no longer required and if nothing has happened to options in the year only the last page needs completing. The deadline for presenting the completed form is July 7.

The US Securities and Exchange Commission released a new Staff Accounting Bulletin (SAB) to help public companies value stock option grants to their employees for income statement purposes. As a result of the new SAB 110, smaller public companies may continue to use a simplified method for estimating the expense of stock options if their own experience isn't sufficient to provide a reasonable basis. Without this, they would have lost the option to use the simplified method. Under the Financial Accounting Standard which requires the expensing of employee stock options, companies may rely on algorithms such as the widely used Black-Scholes-Merton pricing model to determine the amount of stock option compensation expense. The Black-Scholes-Merton model, like others, demands that the company be able to estimate the expected term of an option grant. For companies that don't have access to adequate historical data about employee exercise behaviour in order to do this, the SEC issued SAB 107 in March 2005 that allowed them to use a simplified approach, but only until December 31 and now that deadline has had to be extended as the detailed information about employee exercise behaviour in other companies had not arrived.

CONFERENCES

MONTE CARLO IN CANNES

Though General De Gaulle failed to absorb Monaco into the French state, Monte Carlo will come to Cannes on Thursday June 5 when William Franklin of Pinsent Masons and Jon Stanfield of Kepler Associates debate the relative merits of the Black-Scholes and Monte Carlo valuation methodologies, which can be used when accounting for share based incentive awards to employees. This debate will be one of the highlights of the European Centre’s 20th anniversary conference, which takes place at the world-famous Majestic Hotel on the Cannes seafront on June 5 and 6. Other speakers include: Grant Barbour (Bedell Group); Justin Cooper (Capita Registrars); Mike Kemsley (Cyril Sweett plc); John Daughtrey (Equiniti); Quentin Digby (Freehills Australia); Maoiliosa O'Culachain (Global Shares); Joe Saburn & Eugene Weultjes (GT Law –US); Sheila Raybone (Hays plc); Leslie Moss (Hewitt Bacon & Woodrow); Sara Cohen (Lewis Silkin); Rashree Chhatrisha (MM & K Ltd) Victoria Goode (Sanne Group) and Alan Judes (Strategic Remuneration). Get your sunglasses ready and register for this Centre flagship event now. The Centre will organise your room reservation in the Majestic Hotel for the two nights on half-board basis + conference package deal. You can click onto the ‘events’ tab on the Centre website: www.hurlstons.com/esop. Alternatively, register by email to: fhackworth@hurlstons.com The Centre pays for your hotel room and food etc from the admission fee. Almost 40 people had registered by the end of February.

CENTRE-STEP JERSEY TRUSTEES

The Centre, in association with STEP Jersey, will hold an extended half-day conference for trustees on Friday, July 11 at the Royal Yacht Hotel. We aim to focus this event on the impact of legislative changes in trustee work and responsibilities for employee share plans. We are looking primarily for presentations examining the impact of recent legistlative/regulatory changes, such as Jersey company law, CGT changes, IASB, EU 3rd Money Laundering Directive. Case studies demonstrating the practical impact of any of these changes and any measures that have been undertaken in response are especially welcome. If interested , please contact Joel Lewis: jlewis@hurlstons.com or Tel: + 44 20 7436 9936 asap

CENTRE-IOD CONFERENCE FOR SMES

We are now open to submissions from Centre members for this year's conference with the Institute of Directors. The conference regularly attracts over 100 delegates from SMEs interested in setting up or running Eso schemes. There are always more people who wish to speak at this conference than there are speaking opportunities available, so you are advised to contact the Centre as soon as possible if you are interested. Contact Joel Lewis (details as above)

COMPANIES

BIFFA's 4,000 binmen are set to collect at least £1,000 each after the waste disposal group recommended a £1.2bn bid by a private equity consortium. According to the terms of their employee share scheme, the staff will share the windfall if either a bid from the private equity bidders, led by Montagu Private Equity, or another from a number of other potential predators is successful. After BIFFA said that it was recommending a 350p per share cash offer from the Montagu consortium to buy the waste disposal group, two potential rival bidders emerged - private equity house Terra Firma, CVC Capital Partners and French industrial group Suez. There was speculation that BIFFA had received a counter-bid worth £1.5bn from the infrastructure fund of one of the world's largest companies, General Electric.

Cyril Sweett plc announced that during the quarterly accumulation period ended 31 December, its trustee of the HMRC approved Share Incentive Plan transferred 171,522 ords of 10p each to participants leaving the plan. The SIP is a discretionary trust for the benefit of employees and holds ords acquired and/or awarded under the partnership, matching, free and dividend shares sections of plan. During a quarterly accumulation period, eligible participating employees purchase partnership shares, which are matched on a two-for-five basis. Dividends on shares held by the SIP are re-invested to purchase dividend shares. After the quarterly accumulation period, 124,192 ords were awarded to participants in the plan on 7 January, after which the Cyril Sweett Trustee Company Ltd held 9,732,370 ords.

The Royal Bank of Scotland applied to the London Stock Exchange and the UK Listing Authority for a new block listing of 205m ords of 25 pence each. These shares were admitted to the Official List upon allotment to satisfy the RBC's obligations under various Eso schemes, including the 2007 Sharesave scheme; the 1997 Sharesave scheme; the 1999 Executive Share Option Scheme and the SIP. Participants in these employee share schemes have or will become entitled to these new shares following the exercise of options or allocation of share awards.

Telekom Austria Group announced the issue of the first tranche of its stock option programme ESOP 2008+. Around 4.4m options with an option life until the end of May 2012 were allocated at an exercise price of €19.39. ESOP 2008+ is oriented towards the management board and other key managers “making a strong impact on the success of the company.” The allocation covers only 330 employees within the Group. In order to qualify for the options award, participants are required to hold company shares throughout the entire period. For every Telekom Austria share held by the members of the management board, they receive 25 options and the other participating managers receive 30 options. Management board members receive 120,000 options with a maximum individual investment of 4,800 shares. ESOP 2008+ continues to be focussed on the company’s profitability. Subject to authorization by the AGM, the company can choose to serve options with either repurchased treasury shares or by cash compensation.

FRENCH OPTIONS RUMPUS

The French Senate has introduced the payment of social security contributions on qualified share options and free shares. Social security contributions are due on options and free shares granted on or after 16 October 2007 irrespective of whether the qualifying conditions are met, reports Deloitte. An employer social security contribution at a flat rate of ten percent will be due at grant. An employee social security contribution of 2.5 percent assessed on the exercise gain/fair market value of the free shares at vesting will also be due. The date of payment for the employee is not yet clear but it is anticipated that this will not be due until sale. Louis Gallois, ceo of the European Aeronautic Defence and Space Company (EADS), plans to abolish share options for the company's management, according to an insider. This is seen as a move to restore the group's reputation, as France's financial market regulator, AMF, is still investigating possible insider dealing by former and current managers (who are accused of selling EADS shares ahead of a bad news announcement) as well as by major shareholders Daimler and Lagardere. Mr Gallois suggested that share options could be regulated by a new clause ruling that any shares bought after exercise could not be sold for as long as their holders remained in their management posts. The affair has hardened President Sarkozy's resolve to crack down on share options. Business is opposed to the move but the rumpus has made it more difficult for corporations to be heard at the highest levels of government. Laurence Parisot, president of Medef, the employers' organisation, said France already imposed some of the heaviest taxes on stock options in western Europe: "Increasing this would restrain the move towards greater worker participation in the success of their companies," she told Les Echos.

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