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it's our business

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Government gives bankers' bonuses a haircut

Chancellor Alistair Darling revealed that bonuses at Royal Bank of Scotland (RBS) are being cut to shreds by government order. The Chancellor said that the bonus pot at RBS — in which the Treasury now has a near 70 percent stake — would be cut from the £2.5bn last year to £340m this year, which includes £175m for investment bankers and £165m for lower-paid staff. He said that the only cash bonuses paid by RBS this year would be to staff who were legally entitled to one. He acted days before RBS announced the largest ever loss in UK corporate history - £24bn last year, including a £16bn assets write down, largely arising from its purchase of Dutch bank ABN Amro in 2007.

Mr Darling said: "There will not be any bonuses or pay rises for people on the board and pay freezes for most senior staff. Where the low paid are concerned, yes, they will be looked after. In addition to looking after low-paid in the bank — people who had nothing to do with problems at the bank —but we will make sure future payments are linked to performance." So bonuses in future would be paid not in cash but in bonds — to give staff a long-term incentive. He added: "We want to see a cultural change where short-term bonuses are replaced with incentives for the longer term. The culture in those banks which encouraged short term behaviour was extremely damaging, and not just at RBS - that's got to change."

He warned Lloyds to adopt a similar approach to that of RBS on bonuses: "In relation to Lloyds and bonuses, the same principles I have set out will apply — we don't reward failure. That's as good for Lloyds as it is for RBS." The state holding company UK Financial Investments, which owns 43 percent of LloydsTSB, then told the bank to modify plans to pay staff about £120m in bonuses because UKFI felt that the proposed bonuses did not include adequate conditions relating to future performance.

PM Gordon Brown reinforced this message by saying that as a condition for the banks being bailed out with taxpayers' money, they had "to end the short-term bonus culture". He insisted that the aim was not to undermine banking staff. "But we must also be clear that the old excesses, the one-way bets, have to be consigned to the past." Bonuses could be clawed back if a bank employee's improvement in performance was not sustained, he added.

From the Chairman

In the 60s, perhaps in the 70s, the concept of felt fairness came into play when judging the merits of the varied pay claims of say policemen and nurses. I often regretted its passing. The fall of the banks has once more given popular voice to how people feel about pay, with politicians wisely invoking the court of public opinion. Without doubt in the financial sector, where they trade in money as greengrocers trade in carrots, too much has stuck to the hands of the adipose felines. It is time for a wash and brush-up as well as a haircut.

Malcolm Hurlston

John Varley, Barclays' ceo, said it was right and proper that he shouldn't receive a mega-bonus - but it would be wrong for him to deprive mortgage advisers and branch staff of a £2,000 if they hit their targets. His executive directors waived their bonuses for 2008 but other big hitters at Barclays have been given undisclosed bonus pay-outs. Varley has promised to shake up Barclays' remuneration structures: senior bankers will have to take more of their future bonuses in shares and in deferred compensation, based on performance over several years.

The Financial Services Authority said that bonus pool calculations should take into account current and future risk. The financial watchdog said that firms shouldn't assess performance solely on the results of the current financial year. Non-financial factors, such as adherence to risk management and compliance with regulations, should form a significant part of performance assessment, it added. "We have already outlined the work we have been doing on remuneration during the last 12 months," FSA ceo Hector Sants said in a statement. "The code of practice we have published is the next stage in that work and clearly lays out the framework we expect firms to adopt," he added. The FSA said it would launch a consultation process this month on the code and further proposals for remuneration policy.

Meanwhile, President Obama said that basic salaries at banks needing rescue funds from the US government should be capped at $500,000 (£350,000). Any extra pay awarded to senior bankers must be in the form of shares and share options, which would only vest once those

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banks had repaid government loans. Golden Parachutes – payments to bankers joining from rival banks – would be forbidden, he added.

Safestore Holdings, the storage group, claimed it had become the first UK quoted company to include a clause in its directors' contracts forcing them to pay back bonuses earned for any additional profits which turned out not to be genuine. Safestore could "at any time" demand repayment of bonuses or performance share plan awards if the performance had been "manifestly inaccurate."

RBS Group reached agreement with the Government on pay parameters for the current financial year. No Reward for Failure was said to be the guiding principle, but these words seemed empty after former RBS ceo Sir Fred Goodwin refused the government's plea to hand back some of his £703,000 a year pension award. No bonuses or pay increases would be made to staff associated with the major losses suffered in 2008, claimed RBS. Executive directors would receive no bonus for 2008 performance and no pay increase in 2009. There would be a pay freeze for group directors and executives worldwide and for most staff in the US and the global banking & markets division. On average, non-senior staff would receive below inflation pay rises. No discretionary cash bonuses would be paid in 2009 for performance in 2008. Only legally binding guaranteed bonuses would be paid. Cash bonus payments for 2009 would total £175m, down by more than 90 percent. The profit share bonus scheme worth ten percent of salary would not be paid for 2008 and would be terminated for future years. The RBS Share Incentive Plan looked in danger of the chop because it was regarded as part of the annual staff bonus scheme. Essential staff who might otherwise leave and who remained with RBS would receive a deferred award for 2008. Bonuses awarded to key staff would be paid in stages from 2010 and would no longer be paid in cash, but in corporate bonds, worth up to £600m. Up to 100 percent of some deferred awards would be subject to clawback at the discretion of the remuneration committee if future losses arose in relation to their 2008 activities. Awards would be based on sustained long-term performance, not on short-term revenue generation, promised RBS. The group was reviewing its approach to future remuneration to ensure that incentives were well aligned to the interests of shareholders over the long-term.

CENTRE TEAM MEETS HMRC

Claire Gough of HMRC, who now has responsibility for HMRC's employee share schemes unit, was a welcome visitor to the Centre last month where she faced searching questions from members of the Centre steering committee. She promised Anne Croft of Linklaters that she would investigate why various share schemes are treated differently in terms of the ability to make a transfer into a pension fund. An option, as opposed to a share, cannot be placed directly into a pension fund – the option holder has to wait until he/she can exercise it, before it can be transferred into a pension pot, said Anne. Kevin Thompson of Clifford Chance said that the Treasury had been unrealistic seeking examples of private equity-owned companies that were unable to recruit because they could not implement Enterprise Management Incentive schemes. Companies could always recruit if they increased salaries or paid large bonuses etc. Rather than being a recruitment problem, it was a question of fairness. He said that following the Boots takeover by private equity firm KKR, about 60,000 employees previously eligible to participate in approved share schemes were no longer able to do so because Boots was now owned by KKR. The problem concerned the structure of private equity companies and how they fell foul of share scheme regulations, said Kevin. Centre chairman Malcolm Hurlston briefed Claire about the Centre's history and its work with the Business, Enterprise & Regulatory Reform department and the Treasury on EMIs. He gave her a Centre paper about the possibility of creating tax-approved personal Share Incentive Plans. She said she would consider it but her initial reaction was that legislation might be difficult. Paul Stoddart said that HBOS had witnessed very high take-up rates for new Sharesave offers, due to low exercise prices under the new offers. On the other hand savings carriers had all seen a significant increase in participants' savings withdrawals. Administrators' margins were being squeezed and swap rates were coming down, but if administrators charged for an SAYE scheme, they would become less attractive to small companies. Companies might instead look to reduce costs by other means e.g. switching to electronic communications. Paul suggested taking Sharesave contributions out of gross pay to make it more attractive (as currently happens with the SIP) but eliminating the 20 percent discount as a quid pro quo. This would make it more or less tax neutral and would also help reduce accounting charges, but Claire expressed no view on this. Ms Gough's team deals with policy and technical matters for approved and unapproved schemes, as well as the operational and compliance aspects of approved schemes. It works with the Small Companies' Enterprise Centre in Cardiff on EMI and Venture Capital Trusts. She plans to meet the Centre team again before summer.

GUERNSEY

Register now for the Esop Centre and STEP (Society of Trust and Estate Practitioners) joint extended half-day conference about latest regulatory and market impacts on trustees and share scheme work. This event is being held at the Old Government House Hotel in Guernsey on Friday April 24. The Centre and STEP have co-hosted a series of successful Channel Islands conferences, allowing a largely trustee audience to learn and share knowledge about the use of trusts in employee share ownership. The Centre has assembled a mix of mainland and local speakers, namely: Catherine Gannon – Gannons; Karen Cooper - Osborne Clarke & Kevin Lim - RBC cees; Graeme Nuttall - Field Fisher Waterhouse; Rosemary Marr - Investec Trust and Chairman, STEP Worldwide; William Franklin -Pinsent Masons and Rashree Chhatrisha - MM&K Ltd. Their agenda topics can be studied on the Centre website: www.hurlstons.com/esop and click onto 'events.' Centre and STEP members pay only £295 for admission. Delegates attending this conference will gain three hours CPD credit from the Law Society. For more info, contact Anna Burgess on 020 7436 9936 or email-aburgess@hurlstons.com

CANNES

An intriguing case study from Centre member Pearson plc – publisher of the Financial Times - will be one of the main highlights of the Centre's 21st annual conference, which takes place in Cannes on Thursday July 9 and Friday July 10. Pearson's share plans manager Gabbi Stopp will inform delegates how major issuers such as media group Pearson conduct their 'beauty parades' - when tendering for the administration of new share schemes. Gabbi told Newspad: "I think the tender process will make a stimulating topic, for delegates from the issuer side of the fence as well as providers. Participating providers will be anonymised, of course." Other confirmed Cannes speakers to date include: Colin Kendon - Bird & Bird LLP; Maoiliosa O'Culachain - Global Shares; Jeff Mamorsky - Greenberg Traurig; Leslie Moss – Hewitt Associates; Robert Collard - Macfarlanes LLP and Alan Judes - Strategic Remuneration. Those interested in speaking (and thereby obtaining a £160 admission price reduction) should email Fred Hackworth at: fhackworth@hurlstons.com and outline their proposed presentation topics. The first 12 organisations to register delegates or speakers can upgrade at least one attendee each to a sea-view room at no extra charge.

ON THE MOVE

John Challis has moved to another role within Centre member BT. He is now Head of Project Acorn & Corporate Restructuring: Tel: 020 7356 4086 Fax: 020 7356 6793

More news on former Cyril Sweett CFO Mike Kemsley, who has joined Baker Wilkins and Smith Ltd (BWS) as CFO based at its HQ in Reigate, Surrey. BWS is a UK-based construction consultancy that now trades only in the Middle East. His new (business) e-mail address is mkemsley@bakerwilkins.com and his mobile number is 07824 556710. Mike told Newspad : "It's a much smaller business than Cyril Sweett, employing only 100, but it suits me; I was the best part of 15 years with Cyril Sweett and needed a new challenge." As Mike took Cyril Sweett to flotation and had introduced a broad-based Eso plan, Newpad asked him about Eso prospects at his new berth. Mike replied: "BWS is undoubtedly a candidate for ESO because there are currently just two shareholders. I'm on the case…."

Chancellor of the Exchequer Alistair Darling will deliver his Budget statement on Wednesday April 22.

COMPANIES

Irving Picard, the trustee liquidating Bernard Madoff's investment firm, said there was no evidence that Mr Madoff bought any securities for clients in at least 13 years. He said Madoff's broker-dealer division and the investment-advisory unit, which was at the centre of the alleged $50bn pyramid scheme, didn't appear to operate distinctly from each other. "They were one," he said. The fraud damages the credibility of the fund industry's responses to those who seek to blame them for the credit crunch: that it was the banks and not the funds which were at fault; that light and flexible disclosure-based regulation was sufficient to protect investors; and that there were relatively few instances of fraud and in small numbers. All these arguments have been weakened by Madoff's fraud. The knock-on effect will be to spur on the regulatory changes that have been threatened by a variety of authorities.

A small shareholder of AIM-listed oil and gas explorer BowLeven reacted angrily to news that directors were to receive shares worth up to 80 percent of their basic salary. "I've no problem with directors buying stock but this is pretty outrageous," the writer said. "The directors have handed themselves four percent of the company when the shares are down 92 percent from their highs! That shows quite staggering chutzpah." Under the company's LTIP, BowLeven annually awards directors and key staff shares worth up to 200 percent of salary, to encourage improved operational performance. These shares mature after three years. Shareholders approved the LTIP in 2006.

The board of UniCredit, Italy's largest banking group, will propose a new 2009 share ownership plan for group employees in order to reinforce their sense of belonging and commitment to achieve corporate goals, in line with what has been implemented during 2008. The plan gives group employees the opportunity to invest in UniCredit ords on favourable terms. No capital increase is envisaged to implement this plan.

PAY CUTS

General Motors announced a "temporary" pay cut for a majority of US salaried employees from 1 May to the end of the year, when it will be reviewed. Executives' pay will be cut by ten percent while many others will see reductions of between 3-7 percent, the carmaker said. Other countries are currently reviewing comp and benefits for salaried employees, GM said. IBM has cut the base salaries of its salesmen worldwide by 15 percent, but it has raised the performance based variable element in their reward structures. In France, where it is sometimes possible to reject such a contractual change, salesmen who do so lose all the variable part of their salary structure.

DAVOS:

Speakers and delegates who met in Davos for the World Centre's tenth global forum on international employee equity sensed a future sea-change in the nature of capitalism. "It won't be possible to put Humpty Dumpty together again in the same way," warned Centre chairman Malcolm Hurlston when he opened the conference at the Steigenberger Belvedere Hotel. As some companies were nervous about launching new share schemes, it was wasimperative that the Centre and its members "make as much noise as we can to get the tax environment supporting Eso improved and the more ludicrous new accounting rules, such as IFRIC D11, changed" said Mr Hurlston. It was surprising that representative shareholder bodies such as the Association of British Insurers had got off so lightly from the great banking disaster when they had been complicit in the reckless greed of senior executives who had thrown out common sense in order to grab every bonus available. However, the Government needed to avoid excessive regulation and the Centre would draft a letter to FSA chairman on the importance of the free market. A new 'Puritan culture' was emerging in the private sector, where suddenly it looked wrong to be getting huge pay and incentive rewards. "We have to keep employees interested in Eso because despite the big falls in share prices worldwide, employee equity won't go away," added the chairman. The Centre hoped to hold a follow-up conference in the UAE zone later this year and, working with STEP Worldwide, it was examining prospects for a joint conference in either Hong Kong or the Cayman Islands, said Mr Hurlston.

Sarah Pickering of **Alvarez & Marsal Taxand** examined what role Eso can play in performance improvement. Employee share awards can play a major role in corporate survival strategy, she said. Some companies were asking employees to sacrifice part salaries for more shares, or freezing basic pay. Benchmarking was being increasingly applied to top people's pay, but the question this time was: "Are our top executives overpaid?" said Sarah. The banking industry job cuts surgery after takeover had gone too far sometimes and a few finance houses were forced to rehire the only employees who had understood the complex derivative instruments they had traded. Expat employees were a target - they were perceived by employers as enjoying too many benefits. Could share awards to them reduce the overall cost of such packages? Risk would be a hot topic for the next few years, added Sarah.

Julie Withnall of **Watson Wyatt Worldwide** outlined the perfect storm that had engulfed executive remuneration. It was hard to believe, she said, that when the RBS board had authorised large bonus awards to its executives it was unaware of at least some of the huge losses it would have to write down shortly afterwards. "Did nobody know?" she queried. There was a need for a more holistic view of pay and performance. Watson Wyatt was discussing with US clients how to think about risk and how to define performance in the round. The crisis had exposed some remuneration committees as not being on top of the job. More pre-meetings were needed to iron out controversial elements before they reached the boardroom, she said. Companies had started to change their stance on incentive rewards during the first half of last year. Deferred performance awards had become popular and more amendments were being made to incentive schemes generally – after 18 Red Top and Amber warnings were issued by the ABI regulator about executive reward. "I think we'll see a lot more clawback coming in, though a collapse in the share price is itself a form of clawback," added Julie.

Alan Judes of **Strategic Remuneration** said that there was now a danger that governments were going to try and run their economies themselves, starting with executive pay. But history suggested that state control over pay and prices did not work and there were often unintended consequences. It was "fascinating, but not helpful" that regulators like the Financial Services Authority were commenting on reward packages. The fault lay more with the big bank Boards- they had not understood what they had got themselves into. The markets were better regulators – even ex RBS ceo Fred Goodwin had deferred all his incentive awards into shares and he had suffered accordingly when RBS went belly up. The 'Say On Pay' shareholder activist movement was to be applauded for forcing companies to maintain a better dialogue with their shareholders, said Alan.

Jean–Nicolas Caprasse of **RiskMetrics Group** (which serves institutional investors) said he expected increasing shareholder scrutiny because some companies now wished to modify their previously set performance targets. Approval of executive remuneration packages was increasingly a shareholder prerogative in Europe. In Nordic countries it was mandatory that shareholders vote on remuneration policy. Shareholder dissent was growing – institutions wanted more disclosure – to know the performance criteria and what executive severance terms are. There was a trend towards using shares and options as key incentive reward mechanisms, rather than cash, for rank-and-file staff as well as executives.

Paul Stoddart of **HBOS Employee Equity Solutions** said that the financial health of most UK employees was decidedly poor – there had been a 50 percent fall in UK occupational pension provision during the past year alone. The value of pension holdings had fallen drastically and that mattered now that final salary pension schemes were fast disappearing. Paul said he was getting calls from company FDs asking how the cost of their Eso plans could be reduced and some wanted proof that Eso actually worked. HBOS had a workplace programme aimed at improving the financial education of its employees. They could ask for an FSA written CD Rom entitled 'Making the most of your Money.'

Euan Fergusson of **White & Case LLP** and **Kevin Lim** of **RBC Corporate Employee & Executive Services** discussed the restructuring of employee incentives in various EU states, including France, Germany and Italy, where the tax rates on incentive rewards was ever increasing. Some regulatory and tax exemptions had been removed and the benefits which individuals had received from equity awards were being eroded. Their first case study concerned an all-employee plan they had put into an oil & gas company in Khazakstan and the second concerned an executive reward plan for a Russian bank. The Khazak option plan was under deep water but it was difficult to amend it. Re-pricing share options was much easier in the US, and the speakers suspected that companies and their shareholders might soon revolt against the ABI's ban on option re-pricing strategies. What was the right model to focus on for performance norms which encouraged the 'right' behaviour among executives – was it Total Shareholder Return, or something else, they asked?

Marcus Wallman of laywers **Al Tamimi & Co** delivered the Centre's second ever presentation from Dubai. He spoke of "shoe-horning" employee equity arrangements into companies which operate in Dubai. There were few regulatory restraints but there were legal obstacles, such as the requirement for a minimum 51 percent majority share ownership by UAE nationals in local companies. Yes, there was an appetite for Eso within the United Arab Emirates and Al Tamimi & Co had received recent instructions to help install another Eso plan locally, having done a dozen already, including Long-Term Incentive Plans. "Awareness of Esop has grown in the UAE during the past few years, but local companies want simple plans," said Marcus. Most early Eso plans in Dubai had focussed on senior executives alone, but there was growing interest in broad-based plans of up to 150 employees in family owned companies, he added. Though EBTs were not known about in Dubai, Special Purpose Vehicles could be set up to hold a pool of shares on behalf of share scheme participants.

David Pett of **Pinsent Masons** gave delegates a UK legal update, outlining directors' new duties under company law. The Government's Pre-Budget review had confirmed that HMRC would not challenge the tax treatment of the ExSOP joint ownership plans devised by Pinsents. Mobile ex-pat employees and their employee equity plans was a "horrendous" area for companies because the Government had changed the residence and domiciliary rules again. This gave rise to remittance and PAYE issues. There were nasty tax traps lurking - many senior employees in Europe had to meet tax bills on now almost worthless shares.

Peter Mossop of **Sanne Group** said its human capital solutions division had seen a notable increase in the number of customer enquiries in the wake of the credit crisis. These enquiries ranged from amendments to existing arrangements to incorporate new requirements in future awards, all the way to the introduction of new schemes designed to address current guidance from external bodies and future tax treatment. The use of EBTs would play an important role in the effective delivery of many of the new types of schemes, which included jointly owned equity plans, bonus deferral in the form of shares in the employer or interests in managed funds, staggered vesting of cash bonuses subject to past and future performance and the operation of claw back provisions for both cash and share awards. If plans could not vest because share prices had dropped, then trusts could end up with more shares than they needed, but selling into a falling market was like trying to catch a knife, he added.

Rosemary Marr of **Investec Trust** and **Grant Barbour** of **Bedell Group** examined the new pressures on offshore trusts, which had grown, said Rosemary, because things had gone wrong 'onshore.' Political chatter about ending 'tax havens abuse' played well in the gallery but Channel Island governments had kept enhancing local legislation - Jersey had passed anti-money laundering laws of a "very high standard" and its courts had a good reputation internationally, though compliance costs had grown as local salaries were high. The number of trust companies had declined but the Channel Islands had diversified and had found extra business worldwide. Grant outlined latest changes to the Trusts (Jersey) Law of 1984, including more protection for local trusts from foreign interference. He discussed the new Jersey Foundation, which looked like a company but acted like a trust. It was an orphan structure with no shareholders and held assets for the purposes set out in its Charter. The beneficiaries, if any, had no interest in the Foundation's assets and were not owed any fiduciary duty. Grant forecast that the Jersey Foundations would be used by EBTs and would interest Middle East businesses seeking greater confidentiality.

Dale Giedd and **Ulrich Semmler** of **UBS** explained how the banking giant advises executives internally on how best to manage their incentive rewards (in the context of wealth management). Their department could not survive on income from plan administration alone, so the 'reinvestment' side of the business = wealth management, was their future. They had obtained good early results from Swiss and German UBS executives, most of whom had not really appreciated their share plans. Executives can be participants in up to six different employee equity plans, but many had no time to read the documents properly. Whilst Dale and Ulrich could not influence grant award dates, they could and did influence exit timings. They admitted that there might one day be a conflict if UBS wanted executives to hold onto their shares while advisers suggested diversifying their portfolios.

Sara Cohen of **Lewis Silkin** discussed unusual roles for EBTs in the current recession. Nil-paid and partly-paid shares were likely to become more common incentives now that world share prices had fallen, she said. They would be kept in EBTs until the employee bought them for full market value maybe three years down the line, or on sale or on quitting the company. She said that the new UBS executive performance plan offered rewards between 0-200 percent, depending on economic profit + TSR measured over 3 yrs from award timing. But participants had to keep 75 per cent of their cumulative awards whilst still employed by UBS and an EBT was the obvious mechanism for enforcing the retention requirement. Trustees faced pressure from liquidators who tried to call in the total participant deferred share purchase price value of a collapsed Esop plan. But the trustees could advise the employees not to pay up, she said.

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