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it's our business

newspad of the Employee Share Ownership Centre

Credit crunch threat to Eso schemes

The Esop Centre plans an autumn campaign to help restore the image of broad-based employee share ownership in the wake of the worldwide credit crisis.

"The Eso movement must now fight its corner if employee share ownership is not to be mired in a tide of misleading propaganda," said Centre chairman Malcolm Hurlston.

"We must not let two decades of hard work in building up the employee share ownership movement waste away due to excessive greed and irresponsibility in certain parts of the US financial sector. We should not forget that millions of rank-and-file employees worldwide have been justly rewarded for their efforts through shares and options – whether as participants of tax-approved schemes or – at the top end - recipients of special incentives for high performance, " he said. "Confidence in the system has taken a battering and the hunt is on for scapegoats. Understandably, there is anger and a cry for revenge in the air. But the proverbial baby must not be thrown out with the bathwater, for it would make no sense to savage equity incentives, which are still major tools in the drive to distinguish and encourage the pathfinders and innovators in the workplace,"

He spoke as it became clear that the 'self-policing' strategy preferred by the industry lay in tatters. Legislation/further regulation is promised in the US and France and possibly the UK too before Christmas on banking regulation and remuneration structures. Lord Adair Turner, new chairman of the Financial Services Authority, said regulators had a right to ask whether banks were paying too much for "unreal" profits and trading practices that stored up problems for the future.

Mr Hurlston said: "Governments and regulators have to act together carefully to fine tune the reward system." The latter are now considering whether to: *Enforce a delay in bonus pay-outs eg use restricted stock (and even force companies to rescind some bonuses) for 'high performance' which turns out to be nothing of the kind *Declare null and void golden parachute payments for chief and senior executives if the company fails within two years of payment *Punish companies which award excessive bonuses to executives, (The FSA may ask banks to put up more capital if their pay structures are dangerously risky). *Lehman Brothers dished out $6bn in incentive payments against profits of only $4bn in one recent year* and *Oblige listed companies to prosecute directors who take unwarranted risks.

Many of the 2.5m Britons with Sharesave contracts are now finding it difficult to keep up their regular savings, according to reports reaching the Centre. Financial pressures in particular from housing and utilities are leaving less in the household budget. Many employee share options are under water - the shares currently worth less than the price at which they can be bought under the three or five year Sharesave contract. The Centre asks members to remind Sharesavers that they all have a six-month period of grace during which they can suspend payments and continue without interruption.

In a separate move, the chairman is writing to the Chancellor Alastair Darling, asking him to stretch the period of interrupted savings grace to 12 months to help Sharesavers during these troubled times: "It makes no sense to terminate Sharesave contracts for short-term reasons, either for the saver or for national well-being since Sharesave aligns employees and businesses in improving productivity," said Mr Hurlston. "The extra six months grace would help a lot of Sharesave participants who now find themselves temporarily strapped for cash. Share-saving employees should consider taking a breather while they are temporarily stressed and resume

From the Chairman

Amid the crunch and the election John McCain has found time to endorse Esops, through which Americans "work for themselves". Let us hope Gordon Brown and his friends can do something too by responding to our call to back Sharesave and shed the outdated restrictions on EMI. From the Conservatives we shall hear at our black tie dinner on October 14 at the Oriental Club. Shadow financial secretary Mark Hoban is the guest of honour, awarding the Esop Institute's first prize as well as marking the European Centre's winners. Bookings are still being accepted but call the Centre now to celebrate achievement and to hear about the future.

Malcolm Hurlston

The ESOP Centre Ltd, 2 Ridgmount Street, London WC1E 7AA
tel: 020 7436 9936 fax: 020 7580 0016 e-mail: esop@hurlstons.com
www.hurlstons.com/esop

their regular saving when the pressure has eased, rather than cancel altogether."

Extreme markets volatility may nudge some companies toward further reducing the weight of stock options in their executive compensation portfolios. Once almost the sole compensation tool for motivating performance, options have declined in importance, as new accounting rules, regulatory requirements, and shareholder unrest push many companies to add restricted stock, performance shares, and even cash to the mix. "The perceived value of these awards has taken a huge hit," Derrick Neuhauser, senior manager in BDO Seidman's comp and ben practice (and Centre conference speaker), told *CFO.com*. "Employees will view stock options as a less attractive compensation tool because of market volatility. Companies will have to work a lot harder at convincing them of the value of holding onto their awards and sharing their upside." But there is no better way to tie an executive's pay to his or her long-term performance than granting options, said Richard Smith of Sibson Consulting.

Questions are being asked regarding the role the bonus system in leading banks played in fuelling the bubble. Dick Fuld, ex ceo of Lehman Brothers, the biggest bankruptcy in corporate history, earned a total of $500m during his watch there. Fuld's basic salary was modest by corporate standards - $750,000 - less than the base salary of several Irish bank executives. The sale of sub-prime mortgages in the US, some *Ninjas* (no income, no job), yielded hundreds of millions in bonuses for brokers in the front line of sales. Investment banks bought financial instruments that were based on bundling these mortgages together. As they were sold on, commissions, profits and subsequently bonus payments were made to middle and senior-ranking executives.

Most employees at Lehman Brothers, as at Bear Stearns, took a hit from a plummeting stock price before the end because they received much of their compensation in stock and stock options and those executives and rank-and-file employees who hung on until the end found their equity holdings to be almost worthless. Worried employees might take note and in future prefer cash bonus schemes.

William Lazonick of Massachusetts Lowell Univ. told the *Financial Times* that US executives have developed a passion for buybacks. Total share repurchases surpassed total dividends in 1997 and have kept on going. The firms in the S&P 500 stock index bought back $600bn of shares in 2007, up from $120bn in 2003. Shareholders other than management benefited from the buyback, but the money could have been put to far better use, like saving the companies from oblivion. Lehman repurchased $5bn of shares in the year before it went under. In 2006 and 2007, Merrill's repurchases came to $14bn. Prof. Lazonick concluded the buybacks represented "a huge manipulation of the stock market" that helped to bolster executive pay packages.

Gordon Brown spoke of "unacceptable" features of the City bonus system that failed to take account of long-term performance and called for new international rules governing rewards. "There's been a great deal of irresponsibility, " he said. "Mistakes have been made in the City. There's an element of the bonus system that is unacceptable. Everyone knows there is going to have to be changes in that."

How many employee equity schemes will disappear as a result of: Washington Mutual being sold to JPMorgan Chase; Lehman Brothers collapsing; Merrill Lynch being taken over by Bank of America; Wachovia, the fourth-largest US bank, being bought by larger rival Citigroup; while in the UK, Bradford & Bingley has gone; carved up between Banco Santander (which gobbled up stricken Alliance & Leicester) and the UK government, with the HBOS-LloydsTSB merger next in line?

Although the Association of British Insurers has proposed no major changes to its current guidelines on executive remuneration, it warned of increasing institutional focus on corporate under-performance, reported **Linklaters**. The news came in a letter to remuneration committee chairmen, which gave clues as to the issues on which investors will focus in the coming year.

NEW SUPPORTERS FOR DUBAI AS EMIRATES CHANGES TACK

The Centre has gained the support of the **Dubai International Financial Centre** and the **Dubai FSA** for its ground-breaking event in the Gulf on November 17 and 18. This follows the surprise decision by Emirates NBD to close its esop arm and consequently withdraw from the conference. The co-sponsors and the Centre took the view that the rationale for the event was unimpaired and were impressed by the local support from official sources. Interest for 2009 has been expressed from Qatar.

In the meantime a strong local marketing plan has been devised which will kick in after the Eid festival is over.

CLEAR LEADER

HBOS Employee Equity Solutions is expected to continue operations in much the same shape as before, when the group is merged with Lloyds TSB, Richard Nelson, MD of HBOS EES, told *newspad*: "The combined group will have more than 30m customers and will be the clear leader in mortgages, savings and investing and banking. It will have real strength in the corporate business as well. Both HBOS and LTSB have great brands and the intention is to continue to use these brands. I can assure you that colleagues within EES will remain focused in the months ahead. We will continue to go about our business the way we always do. This deal gives customers and colleagues an opportunity to be part of the largest financial services company in the UK."

CENTRE MEETS MINISTRY

A Centre delegation met senior officials from the Department of Business, Enterprise & Regulatory Reform to request urgent reforms to the rules governing the share options based Enterprise Management Incentive scheme for SMEs. The Centre was represented by Kevin Thompson and Sally Robinson of Clifford Chance and

Centre Esop manager Anna Burgess. Richard Lomas from the British Venture Capital Association joined the delegation, together with Tim Hughes from PwC and Kathleen Russ from TraversSmith.

They met Lady Vadera's policy adviser, Emma Ward. The Centre team introduced an SME businessman who cannot access EMI because of its very restrictive qualifying rules. PloughShare Innovations/DSTL (Defence Science and Technology Laboratory) is a joint venture spin-out between a government department and a private equity fund. Andy Tulloch of Ploughshare Innovations Ltd said: “We received a warm and friendly reception and I believe it may have helped move our cause forwards.” His problem, shared by many others, is the block on EMI access to the private equity backed companies. Clifford Chance discussed the issues the Centre is raising with the Treasury: *Private equity owned companies cannot qualify for tax-approved share plans because they fail the control test; *A look-through test (as an alternative to the control test for private equity backed companies) has been suggested to the Treasury, which wants some concrete examples of companies unable to implement EMI schemes; *The control test is now unnecessary because legislation has tightened to prevent manipulation of a subsidiary’s value; *After a take-over, it is unfair that employees are often no longer eligible for the tax-approved share plans already in place (for example the Boots take-over by KKR).

BERR is supportive of the Centre’s efforts to promote the EMI scheme for example through the Centre’s new EMIsphere online enquiry service- website: http://www.emisphere.co.uk/. In the EMIsphere, firms interested in EMIs can discuss problems and opportunities among themselves and the Centre's experts can come in to answer questions and give guidance.

THE NEED FOR ESOPS

Almost one in three UK employees have little or no savings to rely on if they were made redundant, according to new research* by JLT Benefit Solutions Ltd. The findings reinforce the Centre’s call for the further spread of Eso throughout the UK workforce, despite current stock market volatility. Despite increased media coverage about the need for financial planning and the growing pressure of inflation, 31 percent of UK employees in companies with 10+ employees have little or no savings to tide themselves over should they be made redundant and more than half (56 percent) have less than four months salary saved. *The research was carried out in August this year by YouGov Plc. The online sample was 2,013 employees working in organisations with 10 or more employees.

NEW MEMBERS

Ashurst LLP is an international law firm with offices throughout Europe, the Middle East and Asia and in the United States. Ashurst's incentives practice, headed by Paul Randall, encompasses the design, implementation and operation of local and international share acquisition plans for executives, consultants and employees throughout the world, employee benefit trusts, long-term incentive plans, bonus and incentive arrangements and performance related remuneration. Far from being a narrow specialisation, members of Ashurst's incentives team advise on all aspects of relevant law and regulation such as tax, company/securities law, financial services, employee trusts, data protection, Stock Exchange Regulations and institutional investor guidelines and sentiment. The main contacts are Paul Randall, partner and head of practice, on +44 (0)20 7859 1298, and at paul.randall@ashurst.com, and Barbara Allen, partner, on +44 (0)20 7859 1312, and at barbara.allen@ashurst.com. Further detail on Ashurst is available at www.ashurst.com.

Abbiss Cadres is a multi-disciplinary practice focused on helping clients make the most of their people in the UK and internationally. An important and central part of that offering is employee share scheme work. Internationally, we work with an established network of firms it has built up relationships with over many years. Founder Guy Abbiss writes: “We have been up and running since May this year and it really has been a great success. We have won some wonderful projects for great new clients, including for example, rolling out an international plan across eight jurisdictions in Europe for Japan's largest pharma company. We became an LLP on the first of October when I was joined by a new partner to add to the consultants we already have on board. We are continuing our search for more people as we expand." Guy Abbiss D: +44 (0) 203 051 5714 M: +44 (0) 797 959 4099 Address: 15 Old Bailey London EC4M 7EF.Web: www.abbisscadres.com http://www.abbisscadres.com

EVENTS

There is still time to book your seat or table for the Esop Awards Dinner: Tuesday October 14 at the Oriental Club in the West End. Mark Hoban MP, shadow Treasury minister will be the keynote speaker at this black-tie event and awards will be presented to the winners and advisers of the European Centre Awards, in addition to the Esop Institute's 'Student of the Year'. Contact Holly Bruce at the Centre: hbruce@hurlstons.com 020 7436 9936

The joint **Centre – Institute of Directors Esops conference on September 17** was again a great success with a strong turnout of almost 100 SME companies. Delegates interested in Enterprise Management Incentives and other employee equity plans heard presentations from an array of Centre speakers. After an introduction by Centre chairman **Malcolm Hurlston**, the raison d’etre of employee share schemes and what could be gained from them was explained by **Mahesh Varia** of Travers Smith. **Catherine Gannon** of Gannons discussed *Implementing share plans: possible traps and pitfalls*. **Robert Postlethwaite** of Postlethwaite: *Making it real - how to ensure your employees feel like owners* explained the importance of communication in employee share plans. Other speakers included **Guy Abbiss** of Abbiss Cadres, who explained *share incentives – how to make them work for you*; **David Craddock** of his eponymously named consultancy, who gave four illuminating *EMI case studies*; **Maoiliosa O’Culachain** of Global Shares, explained: *How to extend share schemes to employees* *outside the UK*. He told delegates: "When it comes to extending your share scheme to your overseas employees, having experienced service providers to guide you through the minefield of regulation and compliance, culture and language is invaluable. More than that, it is essential." **Juliet Halfhead** of Deloitte spoke about: *Accounting for ESO plans*; **Colin Kendon** of Bird & Bird: *Making a share market work for an SME*; **Graeme Nuttall** of Field Fisher Waterhouse: *Employee Buy-outs – a neat solution for private companies* and **David Pett** of Pinsent Masons: *What if your company does not qualify for EMI?* - who outlined innovative Eso plan structures. The event finished with a Q & A session. Mr Hurlston announced the launch of an internet discussion forum, the EMIsphere (http://www.emisphere.co.uk), where businesses can benefit from the advice of the panel speakers online. The forum is open to all IoD delegates, as well as to Centre members.

Davos February 5 & 6: Speakers lined up so far for the tenth Global Equity Forum at the Steigenberger Belevedere Hotel in Davos on Thursday February 5 and Friday February 6 include: Paul Stoddart (HBOS Employee Equity Solutions), Jean-Nicolas Caprasse (Riskmetrics Group), Kevin Lim (RBC Corporate Employee & Executive Services), Euan Fergusson (White & Case LLP) and Caroline Labregere (Schneider Electric). More speaker proposals – whether plan case studies or reports on technical issues - are sought from Centre members. Davos speakers will pay only £695 (and no VAT) for the conference and two-day hotel package deal, instead of the normal Centre member practitioner fee of £875. Please email Fred Hackworth at: fhackworth@hurlstons.com to summarise your proposed presentation now.

Diary note: Cannes 2009: The 21st annual conference of the European Centre in Cannes will take place on **Thursday July 9 and Friday July 10** at the Majestic Hotel. The usual conference plus accommodation package deal Majestic Hotel bednights will be Wednesday July 8 and Thursday July 9.

ON THE MOVE

Michael Richards left Lloyds TSB Offshore Trust Co after 13 years with the Group to take up a new role as associate director in the Human Capital division of Centre member Sanne Group, the Jersey based international fiduciary services group. Michael started at Sanne on 1st September and can be contacted on 01534 750504 or at michael.richards@sannegroup.com "I will be seeing my contacts to spread the word about Sanne and our capabilities as an offshore trustee and administrator. My role combines new business acquisition and managing the share plans administration team based here in Jersey so it should keep me busy for the foreseeable future," said Michael. Peter Mossop has taken up his position with Sanne, as reported briefly in last month's Newspad and can be contacted on 01534 750550 or at peter.mossop@sannegroup.com

John Meehan's new post is head of client management, senior vp, Global Stock Plan Services, at Citigroup Global Markets. He works at Canada Square, Canary Wharf. Tel:+44-20-7986-5435 Mobile:+44-780-289-8622 E:john.meehan@citi.com.

PERFORMANCE PAY

At a **MM & K** client dinner, company chairman, ceos and chairmen of remuneration committees discussed whether performance related pay is really working and *how to make performance related pay achieve its objectives*. The 2008 *Executive Directors Total Remuneration Survey*, produced by MM&K and Manifest revealed that ceos of the biggest public companies saw their pay packages rise by 33 percent last year, far faster than average wages across the UK. The median total reward for the head of the 30 companies with market caps above £10bn rose by 33 percent to £4.6m. The study uses the projected value of long-term incentives and stock options granted in a particular year – as well as base salary, pension and other payments – to make its calculations. Around 100 companies buy the survey each year. The linkage of strategy and pay is even more important midst the credit crunch and probable recession, said director Nigel Mills: "Retaining and motivating key executives is crucial. There have been high profile cases where pay is out of line with performance and this has generated highly negative press: this piles even more pressure on the company and its directors, but could have been avoided by a properly thought through remuneration strategy." The updated website is at: www.mm-k.com and the Share Option Centre has updated its website too: www.TheShareOptionCentre.com.

COMPANIES

ING Group NV sold 6,350,000 (depositary receipts for) ords on the open market at an average price of €21.60 per share last month for its delta hedge portfolio, which is used to hedge employee options. ING does not issue new shares to cover employee options.

The **Islamic Bank of Britain** has established an HMRC approved Company Share Option Plan (CSOP) under which options to subscribe for the company's 1p ords have been awarded to certain employees. At 30 June, 3,200,469 options were outstanding.

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