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it's our business

newspad of the Employee Share Ownership Centre

Centre workshop sends UK message to Europe

Small and medium sized enterprises (SMEs) all over Europe can look forward to a boost from the European Union if they wish to install employee share ownership schemes, chairman Malcolm Hurlston told a Centre workshop in London.

Organised at the request of the European Economic & Social Committee project: *'Promoting EFP in the EU 27,'* the workshop was hosted by Centre member **Travers Smith** at its London HQ near Smithfield.

More than 40 representatives from SMEs, employee equity advisers, academics, trade unions and the media heard Mr Hurlston praise the EESC initiative, aimed at stepping up pressure on the EU Commission and Council of Ministers to beat the drum more loudly for Eso, especially in the SME sector.

One outcome could be an EU Directive ordering member states to offer better incentives to companies to get them to introduce or expand employee share ownership within their businesses, delegates heard from the EESC project co-ordinator.

Another is that the Centre will be invited to present evidence on how to advance the Eso cause to a parliamentary select committee, just as soon as it can push the subject onto its agenda, an MP said.

Feedback from the Centre workshop – and the seven other Eso workshops in other European capitals – will be presented to experts and companies during a week of Eso conferences and celebrations in Brussels in October.

Four members of HMRC's employee share schemes team attended the workshop. Their spokesman Andrew Ellis, from the statistics section, said that HMRC was still looking for concrete proof that employee share ownership resulted in higher productivity in those companies that had installed such schemes. Assistant share schemes director George Rowing also attended.

Pilots' union delegate John Moore said that he was looking for information on different types of share option schemes for BALPA members.

Among the SME delegates was David Pritchard, owner of a design and print publishing company, who said that he was looking for a potential employee share ownership solution to a looming business succession problem. Sadly there was little or no useful advice and guidance about Eso to be had from local British chambers of commerce, some of which were "struggling" to cope in the current economic crisis, he added.

Dermot McCarthy of Bournemouth University said that a lot of work was in progress at his and other UK universities on employee share ownership and that many post-graduates and lecturers needed to keep abreast of Eso developments.

Speaker Iain Wilson of Computershare said that for many employee participants – eg in the big supermarket chains – share or share option holdings were their biggest asset apart from their homes. "A lot don't have any savings or other assets," he said.

Mr Hurlston said that in previous years the EU had been keen to look at Eso through questionnaires to member states. Projects in this sector had resulted in *round robin* messages and reports circulated to member states, but sometimes the results had been difficult to collate. Another long-standing problem for Eso was that it had been pigeon holed within the EU Commission as a social and employment issue and had not really been linked with enterprise.

Multinationals, when asked in an earlier Centre initiative, gave more coherent answers than SMEs about what to do with employee share ownership, so it was right now to focus on the latter, as the EESC was doing. However, the Esop Centre, like everyone else, had

From the Chairman

The years have produced much academic support for the efficacy of employee ownership but puddled in percentages little of it has resonated outside narrow and supportive circles. The work undertaken by Computershare which was unveiled at our workshop for the European Union was ground-breaking first in its focus and secondly in the fact that it involved world leading institutions in the London School of Economics and National Institute for Economic and Social Research. You will be hearing a great deal more about it - not least from the Centre in its tireless work to gain appreciation for what we all do.

Malcolm Hurlston

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found that making progress - by getting Eso installed in SMEs - very difficult, he added.
"The tax-aid packages provided by UK governments have never quite fulfilled their purpose. Unless you have a formula which makes Eso attractive to company owners, it just won't happen – you'll end up with trade sales instead and that usually means the new owners cherry picking the sites they want to keep open" said Mr Hurlston. "That in turn means many closures in the regions – so Eso can be a very important in maintaining local work."
"I am delighted that the Centre was asked by the EESC to be its UK partner in this project, which has its feet firmly planted in the enterprise, as opposed to the social, camp," he added. The Committee has the power to make both the EU Commission and the Council of Ministers sit up, take notice and respond, said Mr Hurlston.
He praised the role of Prof Jens Lowitzsch, project co-ordinator, as Jens was "bridging the gap between the Anglo-Saxon concept of employee share ownership and the more social and corporatist ideas which have held sway on the continent.
Jens has encouraged me to think we are on a pathway towards something concrete and I have great hopes that this initiative will succeed."
Adrian Bailey MP (Lab & Co-op), chairman of the House of Commons Business Innovation & Skills select committee, said that although Eso had made great strides, it had not got the profile it deserved. Eso had been widely seen as an idiosyncratic element within the corporate financial structure, but was now seen by government as a driver of business productivity, better quality of service and ultimately better profitability. "I hope my committee in parliament will look at Eso and measure its progress and I hope the Esop Centre will contribute to our work," said Mr Bailey. As for efforts to mutualise parts of the public sector, the new Mutuals Information Service, comprising Co-operatives UK, Local Partnerships and the Employee Ownership Association, had so far received 230 enquiries, mostly from local government.
Prof Jens Lowitzsch, of the **University of Frankfurt,** said that this EESC project would restore the momentum, which had been lost since 2004. "EFP is not only social policy, it is also part of industrial and economic policy," said Prof Lowitzsch. "It's not just a give-away or a benefit – it's much more than that." The EESC was ready for talks with the Commission and the Council of Ministers in order that they should take action on the project report's main recommendations. Despite the different names for elements of Eso in different countries, there were more or less the same features in place: *Tax incentives, except in Germany. Tax harmonisation was difficult but why not have mutual recognition instead? Finance ministries should be asked to give the same or similar tax treatment for local employees of foreign companies; *Eso was a source of capital participation in a crisis. Employee share ownership had helped save companies, even if wage cuts had sometimes been necessary; *Business succession could be helped by Eso, as an alternative to company liquidation or trade sales. Almost 700,000 companies within the EU were likely to have succession problems within the next few years. Even if EFP was used in one percent of these cases, almost seven thousand companies might be saved from the scrap heap; *Better communication between company management and the workforce was often achieved through Eso, he added. During the week of Employee Share Ownership in Brussels October 17-19, the project would be looking for Eso models. The challenge was to get everyone talking about it and how to install and operate such schemes, especially in the SME sector.
Iain Wilson, of **Computershare Plan Managers**, spoke about Computershare's innovative online survey work with the National Institute of Economic and Social Research and the London School of Economics to examine the attitudes and behaviour of Computershare's own employees in many countries towards employee share schemes. The main results of this mass survey were: Eso participation is associated with: *Motivational and productivity-enhancing behaviour; *Increased employee loyalty to the company; *Greater tendency for employees to feel like co-owners and to share company values than non-participants; *Lower average absence from work rates and *Less 'clock-watching'. These traits were more evident when there were high levels of Eso participation, but sometimes absent in units with lower levels of employee participation. No negative effects of Eso were identified. The survey work had helped raise participation levels by five percent among core Computershare employees, he said.
Mike Landon of MM&K spoke about the advantages and limitations of employee share ownership: *The pros included*: *Enabling companies to give valuable rewards to key people without exhausting their cash reserves (especially NB in small high tech companies); *Long-term incentives were a good excuse for companies to communicate more with their employees; *State-approved Eso was tax advantaged for participating employees; *A source of new capital and *A means of trying to raise employee involvement and (hopefully) higher productivity. However, *Share schemes were sometimes more complex to administer than cash incentives, especially when international share plans were concerned; *They could be costly to set up; *The size of the rewards was unpredictable; *There was no differentiation in basic share schemes for individual performance; *Eso needed strong and on-going communication to keep it alive and * Unwise for an employee to have a lot of cash locked up in employer's share scheme, as there was a risk of loss if shares had to be bought by participating employees (eg Share Incentive Plan).

S*ociety could gain from Eso too:* *There was a good chance of better productivity and hence more wealth creation; *Improved industrial relations; *More social cohesion as employees feel they have a stake in capitalism and *The possibility of a fairer distribution of wealth, said Mr Landon. Successive UK governments had been good in giving employees tax reliefs on Eso participation, but not so good at removing regulatory obstacles, nor harmonising legislation. Recent Treasury draft legislation on disguised remuneration was a case in point, added Mr Landon.

David Craddock of Craddock Consulting described the tax concessions for participating in HMRC-approved share schemes, praising both the Share Incentive Plan "much under-estimated in the SME sector" and the stock options based Enterprise Management Incentives, so good that it was one for the rest of the EU to study and implement.

Geoffrey Bond of RM2 Partnership spoke about avoiding the pitfalls of Eso. Companies, like one that had promised employees big equity rewards three years ago, but was then sold only months after the promise, could create unwittingly hugely inflated tax bills. There could be restrictions over employee shares; establishing an internal shares market was not always easy; employee benefit trusts had to be understood and set up and the company Mems & Arts had to be consulted, permissions obtained and so on. There were many hurdles to overcome before Eso could be installed in companies: there were accounting standards and other regulatory guidelines to adhere to, company, employment, trust and tax law and Eso could be costly and was certainly dilutive. The company had to have, or create, quoted shares. HMRC's valuation department had been helpful in responding quickly to advisers' suggested values for about-to-be-issued company shares, said Mr Bond.

David Craddock then discussed the use of Eso as a succession planning tool. This had started with the Kelso Model from California in 1956 when a local newspaper group owner wanted his employees to takeover the business after his retirement, rather than have to sell it to a larger group. Louis Kelso had helped the owner achieve this by setting up the first Esop structure – allowing the employees to buy the owner's exit shares gradually, through a share trust mechanism, sometimes with a bank loan involved. The employee share trust arranged the progressive release/transfer of shares to employees, sometimes based on the achievement of performance conditions. Employee share trusts also helped leading players in the company to buy it through an MBO (management buyout) usually with rank-and-file employees being offered smaller stakes in the equity – of the company whose owner wanted an exit. SME owners needed to understand that Eso did not necessarily mean the loss of control - provided employees' equity stakes in the business did not exceed 24 percent, added Mr Craddock.

Craig Dearden-Phillips MBE, founder MD of Stepping Out, outlined the evolution of new UK public sector spin out social enterprises and employee owned mutuals. The Coalition Government was pushing for social enterprise and staff-led mutuals to be formed from the public sector. Diversity of provision was on the agenda as local authorities were providing less and less. 14 Pathfinder Mutuals had already been announced and at least 14 more were due this year, including several branches of local councils and health authorities. The aim was to set-up employee-led MBOs in the public services, said Mr Dearden-Phillips. The 'Right to Request' allowed NHS staff to request the removal of their division from the public sector. NAVIGO, a company spun off from the NE Lincolnshire Care Trust Plus was one such. NAVIGO's ceo had ensured that real ownership was available for employees by issuing paper shares for staff and users. Employees had full rights to vote for both the member and main boards. It had a three-year supplier contract with the NHS, but what would happen after that? By 2013, the forecast was that 60 NHS orgs would have become social enterprises. There was opposition from the trade unions and lack of capability in some LAs to achieve this.

"Trying to create common endeavour in the UK public sector is a big problem. One is cutting away at the baggage. However, organisations and people change when they are put into a marketplace and asked to be responsible for their own futures," said Mr Dearden-Phillips.

Mahesh Varia, partner at lawyers **Travers Smith,** gave two client case histories of SMEs who had adopted employee equity schemes. One was a start-up, which used the EMI share options award scheme because of its generous award limits – up to £120,000 worth of options per employee, within an overall limit of £3m in outstanding options for each company. There was no income tax to pay provided the options are held for the required time period, but CGT was payable on the growth in value of the shares. This small company was sold some years later for £70m and each employee received an average pay-out of more than £100,000 after tax. But companies employing more than 250 employees or holding gross assets worth £30m or more cannot qualify for this generous state-aided Eso/EFP scheme for SMEs. The EMI had been very, very successful, he added. Mahesh's second case history involved an MBO backed by a private equity investor. This Eso plan could not be approved by HMRC, because more than half the equity was owned by the private equity (PE) investor. The Eso operated alongside an employee benefit trust, which warehoused unallocated shares, acquired shares from leavers and funded bonuses. This was working well and the PE owner and managers aim to exit after three to five years, said Mahesh.

Paul Maillard, honorary president of FONDACT, (French Association for the Promotion of Management and Employee Financial Participation) explained the three main French Eso systems: INTERESSMENT - collective based cash distribution to employees on a

voluntary basis. The contract states precise targets to trigger awards and criteria for distribution. Exempt from social contributions and from tax - if employee invests the proceeds in a savings scheme. The company is not taxed on the value of the awards to employees. COLLECTIVE PROFIT-SHARING PLAN- compulsory for companies who employ more than 50 employees and who get good results. It can be used by smaller companies on a voluntary basis. A legal formula determines the basis for profit-sharing. Employees can invest the proceeds into mixed portfolios (eg mutual funds) or they can receive a cash bonus, which they must hold for five years PLAN D'EPARGNE - savings schemes, involving different mixed funds in which employee savings can be invested. The managing board of the fund contains employee reps.

Now other choices were available to companies – they could award stock options, free shares and they could offer a retirement plan called PERCO, said M Maillard.

Prof Jens Lowitzsch said: "It maybe that we need a Directive at the end of this project." Company constitutions might have to be amended to allow companies to provide financial assistance to their own employees and the constraint on them buying back their own shares could be lifted if the purpose was to give them to their employees within 12 months, he added. "We are re-formulating policies on Eso for 2020, especially for the SMEs" said Jens.

What could the EU get out of Eso? - The answer was: a helpful aid in business succession; regionalism to preserve jobs, without being protectionist; an increase in purchasing power for millions of EU employees, plus improvements in productivity and competitiveness of EU based enterprises. "The ground for advancing the penetration of EFP must be prepared," he said. The EESC project would go online shortly with its own website, so that SME owners and managers could find something about EFP availability in each of the 27 EU member states.

Annual conference Cannes July 7 & 8

An international employee equity plan case study from leading world education group Pearson is one of the highlights of the Centre's 23rd annual conference in Cannes on Thursday July 7 & Friday July 8 at the five-star Majestic Hotel. Pearson's plan is: modelled on the UK SAYE scheme; involves 17,000 eligible employees; has been into 87 countries, using 11 languages, six external vendors; uses employee nominee accounts and has a separate plan in the US, based on ESPP.

The speaker is **Steve Leimgruber**, Pearson Group share plans manager and his presentation is entitled: *"The challenges of operating an international all-employee share plan from the perspective of an in-house share plans manager"* Centre member Pearson owns the *Financial Times* and the book publishers *Penguin.*

Angela Gibson of YBS Share Plans will talk about the advantages of out-sourcing global share plans, using a client plan case history. She will cover: The planning process; rational for jurisdictions launched; Plan design and consideration; Employee engagement programme and its successes; On-going administration and continual improvement.

Patrick Neave, senior remuneration analyst at the Association of British Insurers (ABI), which represents insurance companies and key investment houses, will discuss the ABI's latest guidance and concerns about executive remuneration incentive reward schemes. The ABI is worried about the complexity of some schemes, the increased use of discretion, uncapped incentive schemes, significant increases in base salary, short-termism and reward for failure. Institutional shareholders are increasingly demonstrating their stewardship responsibilities, sometimes by voting against controversial remuneration reports at company agms. Delegates look forward to being able to question him on the implications of its remuneration guidelines and in private, about specific cases.

Louise Jenkins of Ernst & Young will speak about 'Executive remuneration trends in the financial services sector in the current regulatory environment.' Louise will examine the new requirements imposed by the FSA Remuneration Code (and European equivalents, following the introduction of CRD3) and how these are impacting design and practice in executive compensation strategy.

Centre international director **Fred Hackworth** will moderate a 40-minute open debate on the regulation of executive equity incentives. He will ask delegates for their views on whether: *Risk is being factored out of the game by raising base salaries and reducing the role of performance-based equity bonuses? *Whether the regulators gone too far? *Can claw back for under-performance ever work? *Reward schemes – the new benchmarks. A very lively discussion is promised. Other speakers include **Sara Cohen** from Lewis Silkin LLP, who will talk about impacts of the pending *disguised remuneration* legislation on employee equity plans; **Justin Cooper** from Capita Registrars, who will give delegates the latest on the menacing US Foreign Account Tax Compliance Act, which comes into effect from December next year; **Professor Jens Lowitzsch** of Frankfurt University; **Richard Nelson** of Howells Associates; **David Craddock,** who runs a UK share scheme consultancy and Centre chairman **Malcolm Hurlston**.

Service providers and corporate plan issuers are invited to this key event, for which two speaking opportunities remain. Speakers benefit from our reduced package deal attendance price, which includes two nights (July 6 & 7) accommodation in the Majestic Hotel, plus breakfasts, lunches, refreshments and cocktail party invitation for **£895** per person (no VAT added). This package deal,

comprising hotel room for two nights (July 6 & 7), conference facilities, breakfasts, lunches and the cocktail party, cost the Centre £625 per delegate. If speakers bring with them a plan issuer client, to deliver a joint plan case history, the package deal charge for a co-speaker *issuer* will be only **£525**, or the client can attend ***free of charge,*** provided he/she finds and funds his/her own accommodation.
Centre service provider delegates pay **£995** (no VAT) each. Non-member service provider delegates pay **£1,450** each for the same package. Centre member *issuers* pay **£599** each as delegates or **£780** if non-members. The programme contains equity plan case histories; executive reward trends in both the EU and USA under the new regulatory regimes; the impact of government intervention, disguised remuneration, corporate governance, options expensing and other accounting issues, cross-border tax strategies, EBTs, trusteeship, communication strategies, aspects of plan administration and wealth management. For updates, go to the Centre website at: www.hurlstons.com/esop and click onto 'news' and 'events.' The brochure, which can be downloaded from the events window, is co-sponsored by leading provider of offshore legal, fiduciary and administration services **Appleby Global** and by **RBC Corporate Employee & Executive Services**, a leading global provider of employee benefit plans and private equity and property fund administration. RBC CEES manages more than 600 plans for 450 corporate client groups, including companies listed on major stock exchanges and privately-owned businesses worldwide. This conference provides an ideal forum for reviewing latest employee equity developments, forging new business opportunities and networking.
Please email Fred at: fhackworth@hurlstons.com to reserve a delegate place or a late speaker slot and copy in esop@hurlstons.com.

Conference dates for your diary:
Dates have been set for the Centre's key annual events in the Channel Islands. Guernsey will host on **Friday September 9** and Jersey on **Friday December 9**. The programmes in each jurisdiction will ask: *"What now for EBTs after the disguised remuneration legislation?"* and will cover questions: *Can EBTs continue to be central to ESOPs? *How will L-TIPs function under the new regime? *How will JSOPs be affected? *What constitutes 'earmarking' with regards to trustees? and *Are treasury or new issue shares the answer?
Speakers include STEP Guernsey chairman Alison MacKrill, David Craddock of David Craddock Consultancy Services, Juliet Halfhead of Deloitte and William Franklin of Pett, Franklin & Co. LLP.
Centre members who wish to speak at either, or both, these events should contact Centre assistant director Dave Poole asap with a brief summary of what their topic presentation would look like. Although several speakers at each event will concentrate on the fall-out from the disguised remuneration legislation, other topics, especially of interest to trustees, will be covered. Dave's co-ordinates are: dpoole@hurlstons.com and tel: +44 (0)20 7239 4971

Happy returns on SAYE scheme
Hundreds of staff at property company LSL will be able to buy shares in the company at less than half price following the closure of its first save-as-you-earn scheme. The scheme enabled staff at LSL, parent company of Your Move and Reeds Rains estate agency chains, to save up to £250 per month for the past three years. Staff have the option to use these savings to buy LSL shares at a discounted price of £1.15, which compares to the current share value of around £2.75. It means those who invested the maximum £250 per month – £9,000 in total – could now get £22,000 worth of shares. Simon Embley, ceo of LSL, said: "As a plc we are obviously delighted to have been able to offer this opportunity to staff – something many of our competitors simply can't do – and enable them to celebrate the ongoing success of the group and of course their contribution to it. We've already opened a new scheme for staff to take part in and very much hope that in a few years' time we'll be able to report a similar good news story."
Tesco announced its biggest ever 'Shares in Success' payout to staff, with more than 225,000 employee colleagues across the UK receiving a share of a £110m-plus bonus pot.

On the Move
Danielle Pass (Francesca Wilson's replacement) has started work at Centre member **Cyril Sweett** , the worldwide consulting engineers.
Sarah Pickering, former md at Alvarez & Marsal Taxand UK and previously a partner in Ernst &Young's human capital division, is making a new life for herself on the Caribbean island of St Lucia. Newspad has learned that Sarah and her partner plan to set up a water sports business there.
Michael Richards, client relationship director at **RBC CEES**, tells the Centre that he's busy doing deferred compensation EBTs and international pension plans. He suspects that a larger number of share plans will be used from now on – as a result of the new FSA Code.
Carine Schneider is now ceo at **Equity Administration Solutions Inc**. (or EASi). She is a still a director at Global Shares, but made this switch in the last few weeks. Carine, an employee equity industry pioneer, was co-founder and former ceo of Global Shares and a former PricewaterhouseCoopers HRS partner. She chaired the advisory board of the Santa Clara University equity professionals certification programme. You can reach Carine by e: **carine.schneider@easiadmin.com** or by phone at + 925 730-4343
Centre legal member **Pett, Franklin & Co. LLP** has

moved to larger offices in Birmingham. Its new address is: **Victoria House, 116 Colmore Row, Birmingham B3 3BD.** The new office phone number is: 0121 348 7878 You can contact David Pett or William Franklin on their mobiles (07836 657 658 for David, or 07889 72 67 67 for William). Their e-mail addresses remain unchanged.

Clawback

Banks face a legal minefield if they try to claw back bonuses from executives involved in the PPI misselling scandal, according to industry insiders. Leading banks are considering whether to invoke clawback powers on executives who oversaw retail operations when Payment Protection Insurance sales were at their height. Compensation to customers mis-sold policies is expected to run into billions – yet bankers pocketed millions of pounds in bonuses during the years in which the mis-selling took place. **Lloyds Banking Group**, which is partly owned by the government, said publicly that it may try to claw back some bonuses from top executives after it had to set aside £3.2bn after giving questionable advice to some customers. It would be the first time a British bank has cut the amount it awarded in deferred remuneration to senior managers, a tool introduced by the financial regulator last year to link executive compensation closer to company performance. Lloyds said that it put aside the money to pay customers who bought a type of personal loan insurance. Chairman, Win Bischoff, told shareholders at the agm that the company was looking into taking back some pay. "The implications on compensation are being considered by the remuneration committee and will be determined by the board in due course," Bischoff said. Top executives who were in charge when the insurance products were sold include Eric Daniels, the former ceo, who retired in March; he received a 2010 bonus of £1.45m in stock, deferred for three years. Brian Hartzer, head of **Royal Bank of Scotland's** retail division, said RBS would consider bonus clawbacks, as did **HSBC** and Centre member **Barclays.** The Financial Services Authority requires that at least 40 percent of remuneration should be deferred and that bonuses may be subject to clawback if deals turn bad. But one source said: 'There is no legal mechanism to claw back money already handed out, so only deferred bonuses can be touched. We think only bonuses directly related to the mis-selling would be liable to clawback.' PPI policies, which were designed to provide borrowers with a way to keep up debt payments in the event of illness or redundancy, were widely mis-sold between 2005 and 2010. The banks have now agreed to compensate victims.

Northern Rock to be re-mutualised?

Those arguing for **Northern Rock** to be returned to the mutual sector as a born-again building society, including many MPs from all parties, feel their case is reinforced by results from the biggest building society, **Nationwide,** whose underlying profits were up 30 percent to £276m. Nationwide's balance sheet, on paper at least, is stronger than that of any of the big banks, with loss-absorbing core capital equivalent to 12.5 percent of risk-weighted assets, 2.5 percentage points higher than the banks' capital ratios. There has been a significant shift in attitude towards the mutualisation of the Rock at HM Treasury, wrote *BBC business editor Robert Peston*. "Just a few months ago, the Treasury was saying that what mattered most was that the taxpayer should receive the maximum possible financial return from the eventual privatisation of the Rock, but mutualising the Rock flunked that test. That's not what the Treasury is saying now. A lot of work is going on to evaluate whether the stated desire of the Coventry Building Society and Centre member **Yorkshire Building Society** to buy the Rock could be made to work. Chancellor George Osborne may be prepared to facilitate the transfer of the Rock to one of these. It is still not clear how building societies that - by definition - can't raise equity capital from investors are going to finance the takeover. There has been talk about creating a financial instrument (so-called mutual paper) that would serve as a proxy for equity capital for building societies and that could be sold to investment institutions or even retail investors. The problem is that even if the regulatory obstacles could be cleared, the finance raised in that way would almost certainly be prohibitively expensive for the societies," claimed Peston.

Disguised remuneration

Centre member **Pett, Franklin & Co. LLP** is holding an early evening seminar on disguised remuneration on the 23rd of this month. Substantive amendments have been made by HMRC to the legislation currently before Parliament, but which have effect from April 6 2011. David Pett writes: "As the rules are in a near final form, we are now able to determine more clearly what changes companies, trusts and individuals should make to existing arrangements, and how to plan against falling foul of the new anti-avoidance charges. To bring you up-to-date on these complex rules, we are, in association with Meis, again hosting an evening seminar on this topic." This will take place at The Grange Hotel, 40 Godliman Street, near St Paul's in London on **Thursday June 23**, from 6 – 7.30pm. In addition to this update on the new remuneration rules, Meis will review recent trends in Executive Remuneration including the structuring of deferred pay.

The Chartered Institute of Taxation (CIOT) believes that the Government's approach to counter attempts to avoid tax through payment of 'disguised remuneration' is far too complex.

The Finance Bill includes extensive legislation targeting arrangements involving third parties and which defer or avoid income tax on rewards from

employment or avoid restrictions on pensions tax relief. Colin Ben-Nathan, Chairman of the CIOT's Employment Taxes Sub-Committee, said: "We support the Government in tackling tax avoidance involving rewards paid via third parties but we think the legislation in the Finance Bill is far too complicated and risks creating problems as well as solving them." Although the Government has amended the draft legislation originally released last December, the scope of the new rules remains extremely wide and the new exclusions that have been included are intricate and heavily qualified. Altogether the new legislation now runs to some 59 pages (compared with the original 25 pages), it is highly prescriptive and includes some 14 separate tax avoidance tests governing when and how the new exclusions will apply. Ben-Nathan added: "We think that employers will face real difficulties in trying to assess how they stand with this new legislation and that they are likely to need to take advice to arrive at a considered view. Even then that does not necessarily mean that HMRC will agree with the view that has been taken, leaving employers open to potential uncertainty on whether or not tax charges arise and at what point. We suspect many employers will want to seek clearance from HMRC on their particular arrangements and we wonder whether HMRC has the resources to cope and what the turnaround time will be. The new legislation is penal and it overrides the longstanding rules under which benefits-in-kind are normally taxed. Notwithstanding the new exclusions, we think it could still impact in mainstream situations involving some employee share plans, some pension schemes, joint ventures, private equity arrangements, smaller businesses, earn-outs and, notably, international businesses looking to locate employees in the UK. Even if these problems are addressed, the approach taken by the legislation risks creating new problems and loopholes" he added.

Top pay surveillance

The Association of British Insurers wrote to FTSE 350 companies warning that the ABI's investor voting advisory service, IVIS, will monitor and highlight significant salary increases and that ABI members will robustly challenge any unjustified changes. Hugh Savill, the ABI's acting director of investment affairs, wrote: "ABI members have noted restraint amongst many companies over the last few years in relation to executives' salaries. This restraint has been welcomed by investors in light of the challenging economic conditions. ABI members continue to believe it is the duty of remuneration committees to set executive salary levels commensurate with the roles undertaken, but to do so with due regard to company performance, with sensitivity to pay and conditions elsewhere in the business, and with awareness of wider economic circumstances. ABI members will continue to support well-reasoned executive remuneration policies and structures that have a clear link to strategy. However, they will robustly challenge unjustified changes, particularly in relation to quantum. To this end they have asked the ABI's IVIS service to monitor significant salary increases and highlight these where appropriate." Three signals in such deals, which will set alarm bells ringing for investors, are:

- Diluting the holding of existing shareholders and resulting in an 'excessive level of value' being paid to directors.
- Plans that are not capped overall on the number or value of company shares that can be awarded to scheme participants.
- Targets that may not be sufficiently robust or appropriate.

However, minimal, if any, increases in base pay this year will be the order of the day for FTSE 350 executives, according to a **PwC** survey of senior reward professionals and an accompanying analysis of company reports and accounts. Almost a quarter of companies are planning to apply a pay freeze at executive director level. Salary increases, where given, are expected to be around three percent, marginally higher than last year (2.8 percent), but significantly below the six percent increases of 2007 and 2008. Sean O'Hare, reward partner at Centre member PwC, said: "Shareholder activism on pay has stepped up substantially over the last few years and seems to be having an effect. It looks like 2011 will be the third consecutive year of pay rise restraint, with increases lower or in line with national average earnings after years of rising much faster. The difficulty for remuneration committees will be managing executives' expectations, which are rising again post-recession." Pressure to ensure executives remain motivated in the face of pay freezes may explain why 30 percent of companies are planning to increase the maximum potential bonus. Last year the average (median) maximum potential bonus for FTSE 100 ceos rose for the first time in three years, from 150 to 175 percent of base salary. Actual bonus payments also increased substantially in 2010. The average (median) actual bonus payment for a FTSE 100 ceo was 111 percent of base salary, almost 30 percent higher than the previous year.

O'Hare added: "Increasing the potential bonus opportunity will cause shareholders to focus on how tough the targets are. Last year a number of companies recovered more swiftly than expected meaning that bonus targets were comfortably exceeded. A third of companies are consequently amending performance conditions this year, with 17 percent increasing the level of performance required to achieve maximum pay out. They'll need to get it right as a significant increase in bonus payments will result in difficult conversations with shareholders, who feel that the moderation in bonus levels caused by the recession was rather short-lived. But it won't be easy. Choosing robust performance targets that are aligned to business strategy and understood by the individual was the

most frequently cited challenge by the reward professionals we surveyed."

Half of the companies planning to increase the maximum potential bonus this year are implementing a new deferred bonus plan, which will include some compulsory deferral. PwC's analysis shows that 72 percent of FTSE 100 and 58 percent of FTSE 250 companies now have deferred bonus plans, and for 65 percent of these the entire deferral is compulsory. Typically in such plans, 50 percent of the bonus will be deferred. The survey showed that FTSE 350 companies are taking other steps to ensure a clearer link between risk and reward this year. Some 20 percent of respondents are planning to introduce claw-back, on top of the 20 percent that already have. Claw-back methods being considered include scaling back deferred bonuses and long term incentives, but also reclaiming cash bonuses in certain situations.

Bonus corner – Bookies' runner

More than a third (38 percent) of shareholders voting at bookmaker **William Hill**'s agm either opposed last year's pay awards to directors or withheld their votes. In one of the biggest revolts this year at a major British company, holders of 176m shares voted against director remuneration, while owners of 331m were in favour and a further 25m withheld, a statement from the company revealed. Shareholders also expressed their displeasure at the company's auditors, with about 12 percent failing to back their reappointment and voting against auditor remuneration or withholding their votes. Ceo Ralph Topping received £1.65m in pay, benefits and bonuses last year, an increase of 56 percent on 2009. The increase came after William Hill achieved a seven percent rise in 2010 operating profit, at the top end of market expectations. However, its shares fell by eight percent during the year. Fellow bookmaker **Ladbrokes** suffered an even bigger shareholder revolt when more than 40 percent of investors either voted against its remuneration report or withheld their support at its agm. They had been angered by a £350,000 retention bonus awarded to Brian Wallace, the outgoing finance director, who was paid £1.58m last year. Ladbrokes offered Wallace a bonus worth 70 percent of his pay after he told the board he wanted to leave, but as soon as he got the bonus, he left anyway. The vote was a major embarrassment for the company headed by Richard Glynn, which recently broke off £240m takeover talks with web casino and poker group 888.

Shareholder activist groups have long been opposed to retention payments on the grounds they are not linked to the a firm's financial performance.

Ladbrokes defended the decision, claiming the bonus was awarded at a time when it had just lost its ceo Chris Bell and did not want to lose a finance director as well. Ladbrokes said: "We have noted the disquiet expressed by some of our shareholders and have recorded it for future reference."

The biggest shareholder revolt so far this year came at budget airline **EasyJet,** where 55 percent of votes, including those of shareholder and company founder Stelios Haji-Iaoannou, were either cast against the directors' remuneration report or withheld. Almost 40 percent of shareholders protested over back payments to directors at the agm of set-top box maker **Pace**. Some bonuses to British bankers were partly paid using government aid supplied to the beleaguered industry, John Vickers, chairman of the **Independent Commission on Banking,** has admitted. Pressed by MPs at a Parliamentary hearing, Mr. Vickers said that it was true that "Some of the bonuses have been financed that way. Much of the very understandable public feeling about bonuses is in the context where the taxpayer has been manifestly on the hook for the banks and yet some of those working in banks have been extremely handsomely rewarded by way of bonuses and otherwise. So I think there is a link and that is another reason why it needs to be ironed out as far as possible." Vickers is a former chief economist at the Bank of England. The ICB is not directly responsible for recommendations on whether to regulate bonuses. It was set up in June 2010 to consider changes to the banking sector that would make it more stable and competitive. Final proposals are due in September.

Chief executive officer pay continues to rise, quadrupling over the past 12 years, according to the Executive Director Total Remuneration Survey 2011 by Centre member **MM&K** and Manifest, which found poor correlation between remuneration, performance and shareholder value. Remuneration committees are struggling to maintain their independence from their ceos and are adopting increasingly expensive, short-term reward strategies, the survey report said. It revealed that while the median remuneration of a ceo in the FTSE top 100 companies was up 32 percent in 2010 from 2009, the FTSE 100 index only rose by nine percent over the same period. MM&K identifies a shift from longer-term incentives— typically over three years — to annual bonuses, mirroring the approach that caused so many problems in the banking sector. Furthermore, as most remuneration strategies now involve the use of medium-term incentive plans, reward horizons have shortened to only three years. A decade ago, the horizon average was seven to ten years. According to MM&K and Manifest, "management myopia" is accentuated among larger employers where complex schemes contain multiple reward thresholds. This means that the typical ceo enjoys rewards for even the most basic levels of performance regardless of whether they attain an exceptional outcome for the company with many requiring, to vest the maximum award, only EPS growth of RPI plus nine percent pa. The survey analysed deferred bonuses in detail for the first time and found that bonus deferral has become increasingly common. The Walker Report strongly recommended this for the financial sector. However

the practice had already become increasingly prevalent in the non-financial sector well before that. 74 percent of FTSE 100 companies are estimated to have a deferred bonus plan and 52 percent of FTSE 250. Mostly these plans have been introduced at that same time as bonus levels have also been increased, so the impact on executives' cash earnings have been mitigated and over the long run considerably enhanced. The MM&K report added: "There are many reasons why deferral is a good idea. It helps retention. It ensures that payment is only made if performance is maintained in the future (if the rules are so written). It can provide malus if future performance declines so providing (some more) alignment with shareholders. It enables claw-back of bonus in the case of malfeasance (strictly speaking a claw-back clause will allow bonuses that have been paid, to be clawed back from executives. However such clauses will always be open to legal dispute). The benefit of deferral is that it is much easier to claw-back that part of bonus that has not already been paid out. In the new 50 percent taxation regime the deferral of bonus (and other pay) is potentially attractive if the executive thinks that when he/she ultimately receives the pay he/she will be taxed at a lower tax rate. We are seeing increased growth in the use of nil cost options to defer income.

Cliff Weight, director, MM&K said: "The key determinants of a successful incentive remuneration strategy revolve around choosing the right blend of short and long-term performance criteria together with rigour and toughness in the target setting."

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The UK's top earners are taking a bigger slice than ever of the national income, said an interim report from the **High Pay Commission**, a left-of-centre inquiry into top pay in the private sector. *'More for Less'* said that if current trends continue, by 2025 the top 0.1 percent of earners will take home ten percent of the national income, according to the Labour Research Department. The commission said there were a number of reasons for top pay far outstripping those of other employees in recent years. Among them are bonuses in the banking industry; complex pay arrangements for top executives, which supposedly link their pay to company performance; and alleged 'cronyism' among non-executive directors and pay consultants who set pay levels for top executives. The report said there was much scepticism about whether performance-related pay actually works — with one expert in executive remuneration arguing that performance-related pay only works half of the time.

The report scotched the argument about executives being poached by international competitors if employers don't pay well enough, by pointing out that only one of the top FTSE 100 companies had its ceo poached by another firm recently and that was by another UK company. The point is reinforced by executive search companies who report no growth in client demand for global searches. The multiple between the average earnings of a ceo and the average employee, as shown in the Annual Survey of Hours and Earnings, has widened over the past ten years. By 2009, the multiple had reached 145 times average pay, it said. The average ceos' total remuneration, including long-term bonuses such as equity awards, was £4.2m in 2010.

Tesco has radically altered its remuneration policy for its top executives following an investor rebellion at the supermarket group's agm last year. The supermarket giant has removed executive share options - replacing them with a performance share award - and will ditch its four current long-term incentive plans and replace them with a single plan. The company said that all executives, including the ceo and the US ceo, will participate in the same plans from now on. Phil Clarke, Tesco's new ceo, has had his base salary pruned under the new scheme. He will receive a base salary of £1.1m, which is 23 percent lower than the £1.4m base salary that his predecessor Sir Terry Leahy received last year. However, even under the new scheme Mr Clarke could still receive a maximum pay package of £6.9m this year. Tesco said that the simpler system had been implemented "following an extensive review and consultation with shareholders". The move reflected a collegiate approach to remuneration, it added. The new approach, revealed in the retailer's annual report, will see the scrapping of an incentive scheme previously enjoyed by Tim Mason, Tesco's US boss. His pay became the focus of much of last year's shareholder ire, with investors arguing it was excessive considering the big losses being racked up by Tesco's US start-up, Fresh & Easy. Tesco said that it was making changes after a review and consultation with shareholders. The annual report stated: "In light of the renewed focus on a collegiate approach to remuneration, together with Mr Mason's appointment to the roles of deputy ceo and chief marketing officer, it has been agreed that Mr Mason will no longer be eligible for awards under the US annual or long-term incentive programmes. He will therefore no longer participate in the US Long-Term Incentive Plan and the 2m shares granted to him in 2007 will lapse." While Tesco's previous plans used five separate measures to determine success, the new plan will use just two performance measures; return on capital employed and earnings per share. The number of performance measures that Tesco uses for its annual bonus will also be reduced, from more than 20 to seven. The changes follow last year's stormy agm when 47 percent of voting shareholders refused to back its remuneration report. The retailer said that the new scheme ensures alignment both with

shareholders' interests and Tesco's business strategy and would entail an increase in the directors' shareholding guidelines.

HSBC suffered an embarrassing investor revolt over the alleged excessive levels of boardroom bonuses. During a marathon agm, about a fifth of shareholders failed to endorse HSBC's executive pay policies. This was despite the board presenting a plan to cut executive salary multiples from a maximum of 12 times base earnings to ten times. Private investors attacked the contrast between lavish director deals and the mediocre returns they have had in recent years. There was further setback for Doug Flint, who appeared to bear the brunt of the widespread 'dismay' over a messy boardroom putsch last year, which elevated him from finance director to chairman. Flint admitted that shareholders had every right to be disheartened by the "disappointing and inadequate" returns that HSBC had delivered since the credit crisis struck in 2007. The maximum annual bonus award for HSBC's most senior managers will be cut from four times their basic salary to three, while the multiple of long-term share awards they can be granted will fall from seven times salary to six. The bank will increase the vesting period for any share awards from three years to five and institute a new rule that will prevent the shares once they have vested from being sold until an employee retires from HSBC or leaves the banking industry.

FSA Remuneration Code: compliance deadline July 1 2011

Those financial groups who fall within the scope of the new FSA Remuneration Code must comply by **July 1,** said lawyers Nabarro. The Code, which came into effect on January 1, applies to all banks and building societies, firms subject to the Capital Adequacy Directive (CAD) and UK branches of firms headquartered outside the EEA. It replaced the previous code, which only applied to the 26 largest UK banks, building societies and broker-dealers. More than 2,500 firms will be subject to the new Code. Pay in the EU is now more restricted than the rest of the world, with the UK leading the pack, claimed Nabarro. This could make recruitment and retention of top talent problematic for UK banks, because those operating in Asia, South America and the US would be at a competitive disadvantage, particularly as there are no restrictions on pay in the US.

The Code applies to all banks and building societies, CAD firms and UK branches of firms headquartered outside the EEA. CAD firms include investment banks, UCITS investment firms, most asset managers, some brokers and some corporate finance and VC firms. Many asset managers will escape the Code because they are 'exempt CAD' or 'MiFID exempt' firms. The Code also applies to all branches of a firm in any jurisdiction in the world and all members of a UK consolidation group and a "non-EEA sub-group."

Employers should apply the following principles in the packages of staff to whom the Code applies:

- Individual, business unit and firm-wide performance must be taken into account. At least 40 percent of any bonus must be deferred over at least three years and for staff whose total remuneration exceeds £500,000 the deferral rate rises to 60 per cent.
- At least 50 percent of any bonus must be paid in shares, share-linked instruments or other equivalent non-cash instruments. This should be applied equally to the deferred and undeferred portions of the bonus. Guaranteed bonuses must be exceptional and limited to new hires for the first year of service.
- Unvested, deferred bonuses must be reduced if the firm or business unit suffers a downturn in its financial performance or a failure of risk management. The same applies in cases of misbehaviour or material error on the part of the employee.

The Code identifies four tiers of firm. For those in Tiers 1/2, all rules in the Code apply and Tier 1 firms are subject to an annual FSA review. Most of the rules in the Code do not apply to firms in Tiers 3/4.

Code Staff are defined as those who have a material impact on the firm's risk profile, including risk-takers, staff who perform a "significant influence function", senior managers, staff whose total pay takes them into the same bracket as senior management and risk-takers, heads of support and control functions, including compliance, legal and investment research.

Code Staff whose total pay is less than £500,000 and for whom no more than 33 per cent of that total is bonus will not be subject to the rules on bonuses (including deferral, payment in kind and guaranteed bonuses). For example, the Code will not apply to an employee earning £100,000 (including pension and benefits) with a bonus of £25,000.

Many existing employment contracts do not comply with the new Code, so firms are required to establish appropriate contracts by the end of 2011. The FSA can treat as void any bonus arrangements agreed after January 1 this year, which are not Code-compliant.

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