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newspad of the Employee Share Ownership Centre

Suspend share plan accounting standard call

Pinsent Masons is urging a temporary suspension of share based payment for share options, due to market volatility. PM share plans specialist William Franklin said suspension was necessary due to a flaw in the underlying formula used to work out values of options in the current market. "Black Scholes in one form or another has long been the basis of valuations for derivative trading, but has been cast aside in current extreme market conditions. Large fluctuations in share prices have made it hard for traders to set prices for options, so they have fallen back on big spreads and very few trades are being done. We're asking whether it's right for accountants to continue using a Black Scholes approach if derivative traders have shelved it for the time being. The math is being used beyond its limitations. Some say you should disregard the recent past and continue using prices set before volatility struck the market. But if current conditions continue for longer than expected, will that provide a fair basis for accounting? It's the right time to debate the consequences of recent share price volatility, but in the meantime share based payment for share options should be suspended until market conditions stabilise." Share Based Payment Accounting Standards (IFRS2/FRS20) assume there exists a reasonable basis for calculating the fair value of options, known as option pricing theory. The Black Scholes formula has been refined and developed into different forms including a Monte Carlo and binomial version. However, whatever form Black Scholes takes, the calculation relies on certain assumptions including share price volatility, dividend yield and risk-free rates of interest and the relationships between them in the Black Scholes formula remaining valid. The standard setters believed that option-pricing theory was a reasonable approach for valuing options as the techniques were being used by derivatives traders for the setting of prices of traded options. "I would suspend the Standard for new awards and return to the way things were before - no charge for market value options. A temporary suspension would encourage companies to grant options and help them conserve cash during the recession - as they could offer options and less cash to employees. When the derivative markets start trading options again, then the Standard could be resumed," added Mr Franklin.

SAYE BONUS RATES SLASHED AGAIN

The Treasury has told SAYE carriers that current bonus

From the Chairman

As the chastened captains and kings departed Davos, we Esopians arrived with confidence and hope. Never before have companies needed corporate glue so much; never before have governments been so much in search of solutions. In the UK the Centre has conversations in train with HMRC, BERR and 10 Downing Street. In the Gulf our recommendations are shortly to be sent to governments and HM the Queen has cancelled her state visit to Dubai. Obama has lent his weight early to the pressure for appropriate reward among the high echelons. As ever we need to ensure that the perceived abuse of equity by top management does not tarnish the reputation of employee shares as a whole.

Malcolm Hurlston

rates for contractual employee savings schemes, which came in only three months ago, will be withdrawn from February 17, reports HBOS EES (www.hbosees.com). This follows recent heavy falls in the BoE base interest rate. The new SAYE-Sharesave bonus rates will be: 1.08 (2.67) percent for three-year contracts; 1.67 (3.04) percent for five years and 1.98 (3.2) percent for seven years. Previous rates are in brackets. Bonus at maturity will be 0.6 (1.5) X monthly contributions for three-year contracts; 2.6 (4.8) X mcs for five-year contracts and 5.6 (9.3) X mcs for seven-year contracts. The early closure interest rate will dive from two percent to just 0.5 percent.

CONFERENCES

The Esop Centre and STEP (Society of Trust and Estate Practitioners) will hold an extended half-day conference about latest regulatory and market impacts on trustees and share scheme work 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. There will be a mix of mainland and local speakers who will present a balanced set of topics. If you would like to register for this event, please contact Anna Burgess at: T 020 7436 9936 or email aburgess@hurlstons.com

The Centre's 21st annual conference will take place in

Cannes on Thursday July 9 and Friday July 10. Those interested in speaking should email Fred Hackworth at: fhackworth@hurlstons.com and outline their proposed presentation topics.

BOARDROOM PAY REPORT

Institutional investors are examining a draft report that should shake up boardroom pay with the aim of forcing directors to concentrate on the long-term impact of their decisions, not just the company's immediate share price. The report, written by Sir Andrew Likierman, an ex director of the Bank of England and the new dean of London Business School, is being discussed by investors and the ABI. In the report, Sir Andrew criticises current pay deals as being too attached to narrow financial data. It says: "Measurement based on past profitability will mean the link to positioning for the future is very weak. On the contrary, expenditure on many of the elements needed to benefit the future, such as brand development or talent management, are drags on current profitability." It argues that concentrating on the share price can be easily manipulated by "encouraging additional risk-taking like acquisitions and leverage". Instead, pay should also be based on efforts that are made in the other, non-financial, areas. He said: "The measure of management's success is not just to have done well for the shareholders in the past year but to manage in a way that places the company to do well in the future." Likierman shows the weaknesses in two pillars of performance measurement - earnings per share and comparative total shareholder return (TSR), meaning share price performance plus dividends paid. Financial engineers will see an invitation to over-borrow to buy back shares, to cut spending on development and to pursue acquisitions that deliver certain gains from cost-cutting but also bring uncertain long-term risks. The problem with TSR is that it is imperfect. Share prices do reflect the market's view of a company's potential, but they are also influenced by irrelevant factors such as bid prospects and the investor relations department's promotional skills. Likierman says that between 25 - 50 percent of senior executives' annual bonuses should be based on criteria designed to encourage sustainable performance. Bring on non-financial strategic targets such as progress on innovation, development of managerial talent, customer satisfaction and the engagement of employees. Tesco's 'steering wheel' scorecard for executives last year included enhancing management talent and improving relations with local communities. The remuneration committee has to measure these qualities.

Likierman's approach challenges remuneration committees to use common sense, imagination and investigation and to justify their awards to shareholders. One investor said: "During the deal boom of recent years, many bosses were highly incentivised to do deals which pushed up the share price in the short term. Sir Fred Goodwin ex ceo of Royal Bank of Scotland was in effect incentivised to do a deal like ABN Amro, rather than looking at the long-term sustainability of the company."

Directors would have to publish details of their pay,

expressed as a multiple of their own company's lowest salaries, if a Private Members' Bill now going through the House of Lords becomes the law of the land. The Companies' Remuneration Reports Bill seeks to amend the 2006 Companies Act to require every quoted company to publish the ratio between the total annual reward of the highest paid director or executive and the total average annual pay of the lowest paid ten percent of its workforce.

The UK's biggest companies are to withhold pay rises en masse from top executives for the first time in decades in a bid to combat mounting investor fury over bumper pay packets. The pay-freeze is being planned as part of a response to warnings from shareholders that boardroom pay, which has increased by as much as ten percent a year for over a decade, must be curtailed in the wake of the financial crisis. Carol Arrowsmith, of Deloitte, who advises FTSE 100 companies on remuneration, said: "Boards of the biggest companies are looking at pay at the moment and concluding that it is not appropriate to award pay rises to executives this year. This is a significant shift in policy." Other consultants said that the vast majority of their FTSE100 clients are planning to freeze pay levels for directors or only raise them in line with inflation. Rob Burdett, at Hewitt New Bridge Street, the pay consultant which advises over 40 percent of FTSE250 companies, said: "Executive remuneration is one of the key boardroom issues facing many quoted companies in 2009 - and will impact the ability of companies to weather the economic downturn. We are in uncharted territory. As the economy enters recession, remuneration packages are in the spotlight - directors need to be set achievable targets, while investors must be assured that reward levels are not excessive."

Remuneration expert MMK's recent survey showed that 75 percent of non-executive directors believed bonuses should be paid only for a continuous improvement in performance over a long period. MMK's Paul Norris said: "Bonuses will be half what they were last year. There will be movement towards rewards that look at the long term, say ten years rather than three. I also expect to see far greater simplification. Companies that have many different types of remuneration packages will undergo a huge streamlining. Larger firms will tie pay even more closely to performance. There is heavy pressure to change compensation structures in banks across financial centres around the world. The UK government said it expects the three banks it has refinanced to pay no cash bonuses to board members this year, and to review incentive schemes to avoid "rewards for failure" in the future. Similar curbs are being made by other countries bailing out their financial institutions. "Even banks like Credit Suisse, which have not been subject to a bailout so far, are moving to demonstrate that bonuses can go down as well as up," said an adviser to financial institutions. "(Banks) see that engendering goodwill among multiple stakeholders is essential," he said. The Association of British Insurers said it was calling for a Europe-wide introduction of bonus clawback clauses. If executives

refused to give their 'bogus' bonuses back to their employer, the money could be extracted from them either through their severance packages, or by denying them future bonuses. Many bonus structures have a large cash component paid immediately. That - critics say - rewards bankers for creating financial instruments that looked profitable in the short-term without caring how they performed later. Under Credit Suisse's plan, the bank's top layers will receive 70 percent to 80 percent of their deferred equity compensation in units linked to the performance of a pool of illiquid (some of them toxic, eg leveraged loans or mortgage-backed securities) assets. This 'partner asset facility' is not expected to pay out in the first four or five years. The rest of their bonus will be paid in cash, but this must be returned -- or "clawed back" -- to the bank if they quit their jobs or are made redundant within two years of the bonus award. "It looks like an interesting and innovative approach that ... is trying to align the interests of management with the interest of other investors," said George Dallas, a director of corporate governance at F&C asset managers. Sophie Black, remuneration consultant at Ernst & Young, said some banks were considering basing bonuses on illiquid assets and introducing cash clawbacks, and would perhaps now adopt such structures. "Most of the institutions I was talking to were sceptical about using clawbacks. But if Credit Suisse are using it, there will be more pressure to implement it."

The ceos of the UK's 100 biggest companies took an average hit of £4.3m in the past twelve months, due to the stock markets collapse, according to new research. A 31pc drop on the FTSE 100 during 2008 wiped over £140m off the value of their stakes, the Heartwood study found. The biggest losers were the ceos of Britain's beleaguered banks. Sir Fred Goodwin lost £12m on his share stake alone, using July 2007 as base point. As the losses from Goodwin's toxic bets piled up, the government had to shell out £20bn to keep RBS afloat late last year. The rescue gave taxpayers a 58pc stake in the bank, slicing Goodwin's stake to just £1m. Like other ceos during the bull market, Goodwin ignored best investment practice and left almost all his money in RBS shares. The crash in commodity prices cost mining bosses dear. Mick Davis, the ceo of Xstrata, saw £4.5m wiped off his holding, leaving him with just £1.6m worth of Xstrata shares. Another big loser was Sir Martin Sorrell, the boss of advertising firm WPP. His 16m WPP shares were recently worth £67m, down from £120m. Since last June CEOs have lost a further £2,230,000 each on average. The research showed that 34 percent of such assets are held as shares in ceo's own names and the rest as share options or in Long Term Incentive Plans. During the past two years there has been a significant shift in value away from shares, which in 2006 accounted for 55 percent of the value of their reward assets, towards share options and LTIPs.

ON THE MOVE

Mike Kemsley, who was the Cyril Sweett's cfo for 15 years, has left the company to pursue other career

interests. Francis Ives, chairman of the group, said: "I would like to thank Mike as he made wide contributions to our development and played a major role in the flotation in 2007, our mergers and acquisitions and our employee shareholding ethos." Mike said: "When I first joined Cyril Sweett, it was a London partnership with a couple of regional satellites and a small Paris branch. I really enjoyed helping to transform it into an employee owned, international consultancy. I was the third largest employee shareholder and remain totally committed to employee financial participation. The preparations for flotation in 2007, followed by several mergers kept me interested and occupied, but I am now replaying old records and need a fresh challenge. I leave Cyril Sweett with a strong balance sheet and financial condition, well-placed to weather the very tough economic climate we all face." Contact him at Fieldwick Kemsley & Partners Ltd T: 020 8892 6140 M: 07824 556710

Paul Beirens has retired from Unilever and Joan Kalmans (joan.kalmans@unilever.com), director global share plan administration, based in New Jersey US, now has responsibility for Unilever's world-wide share plans. Paul writes: "I plan to keep in touch with the business and provide advice and support to companies (whether in Europe or Dubai!) on an ad-hoc basis. In Unilever I contributed to the development and running of share plans as a team member, together with finance, tax, legal, treasury and HR, and this is where I can add value by bringing in my experience as well as my accounting background. Belgium and the Netherlands are where I can operate with fewest expenses, but there is the internet and I am willing to travel." Contact: Paul Beirens: Tel +32-(0)3 283 57 74 beirens paul@hotmail.com

PricewaterhouseCoopers has acquired the executive remuneration business of Halliwell Consulting, as part of its plans for long-term growth. Ten people joined PwC's reward business, including Halliwell partner, Marcus Peaker and director Paul Wolstenholme. The new team joined PricewaterhouseCoopers in January and are based at the London Embankment Place office. Halliwell Consulting is a niche reward consultancy, which provides advice on executive remuneration and share schemes to mid-FTSE companies.

How many Treasury ministers can shove their oars into share scheme operations these days? Try: **Ian Pearson MP** Economic Secretary, MP who has held various ministerial posts; Financial Secretary **Stephen Timms MP**, who has strategic oversight over UK taxation and finally Financial Services Secretary **Paul Myners**, ex chairman of the Guardian Media Group who oversees the FSA and "better regulation."

MADOFF WITH THE MONEY

The European Union said it will review investor protection rules in all 27 member nations after France complained of lax standards when French investors lost billions in the US\$50bn Madoff fraud. Such checks should clarify how far European funds could be held responsible for placing client money with U.S. financier

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Bernard Madoff and whether they could be ordered to compensate investors. France's government pointed the finger at Luxembourg as the home of funds that invested French money with Madoff, but Luxembourg strongly denied that it did not apply EU rules properly. The UK Serious Fraud Office is investigating the activities of Madoff. "The focus of the investigation will be on UK victims and any criminal offences that might have been committed in the UK," it said, confirming that it was liaising closely with US counterparts. Fund managers and intermediaries worldwide rushed to distance themselves from the Madoff's vanished funds disaster. So what were the flashing red lights, which they saw? - *Madoff's auditor was a retired Florida accountant, employing one audit clerk in a broom-cupboard sized office *Madoff was his own custodian, so there was no third party independent custodian holding title deeds and checking these against valuations *He was his own broker so there was no third party evidence of deals he said he had made on behalf of clients *Madoff had no independent valuation administrator – he prepared client portfolio valuations himself. Among the warnings the Securities & Exchange Commission received about Madoff's operations was a 17-page expose in 1999 entitled 'The biggest hedge fund in the world is a fraud.' SEC Chairman Christopher Cox admitted there had been "multiple failures over at least a decade to thoroughly investigate Bernard L. Madoff Investment Securities. But although he registered his investment advisory business with the SEC in 2006, Madoff used an unregistered management company to 'invest' his clients' funds. The SEC had no clear jurisdiction over this huge pool of unregulated money. Madoff, a former chairman of Nasdaq, was himself a member of SEC advisory committees. Congress is preparing the biggest revision of laws governing US financial markets since the Great Depression. Young Florida trustafarians (whose funds he has emptied) toilet-papered his Palm Beach mansion in revenge.

EXSOP GETS THE HMRC GREEN LIGHT

HMRC has now publicly confirmed that it accepts Pinsent Mason's tax analysis of the ExSOP and that it will not seek to challenge the tax-efficacy of such arrangements, reports partner David Pett. HMRC had previously confirmed that an ExSOP is not a "discloseable tax avoidance scheme." As a result of this HMRC announcement, regarding a client who sought a post transaction tax ruling, it is likely that joint ownership plans will now become more popular amongst companies as a mainstream alternative to conventional share option, LTIP, "flowering share" and other growth-based share incentive plans' said Mr Pett. "Having first invested in the development of such plans, we have already established ExSOPs for a broad range of companies including fully-listed, AIM-listed, large multi-national

private, and smaller independent, as well as private-equity backed companies. In those companies which have since enjoyed substantial growth in value, participants in the plans have benefited from the growth accruing to them being taxed as capital gain, not as employment income. Whilst such new plans may not be suitable for every company seeking to establish tax-efficient share incentives, we would recommend that any independent or private equity backed company operating an L-TIP, deferred share purchase, or share option scheme, look carefully at the ExSOP and see if it might be a solution worth considering."

COMPANIES

The Aer Lingus Employee Share Ownership Trust (ESOT) said that its advisers had met representatives of Ryanair, the low-cost rival, which has launched a second hostile bid for the Irish national carrier. The ESOT owns 14 percent of Aer Lingus.

INTERNATIONAL

The German Federal Labour Court clarified the legal framework for stock option plans in Germany in two recent decisions, writes Bill Cohen, partner, global employer services at Deloitte & Touche. In the first decision, the Labour court held that under certain circumstances it may be obligatory for a German subsidiary to make stock options available to employees if the foreign parent company offers a stock option plan. This could be the case even if such a benefit is not included in the individual's employment contract. In the second decision, the court held that termination of employment can be a valid reason for forfeiting stock options as long as the vesting period does not exceed five years.

The South African Revenue Service has published a binding private ruling, which provides clear guidance regarding the timing of taxation for stock options granted on or after 26 October 2004 in a specific case. The general rule in South Africa has been that stock options are taxed at vesting, when the options become exercisable. However, this new ruling provides that the tax point can be exercise itself if certain conditions are met. Deloitte is seeking further clarification from South Africa in relation to the possible implications for restricted stock units (conditional share awards) e.g. the possibility for taxation at delivery of the shares rather than at the vesting point.

Reminder: Will members please update their company and personal contact details on the Centre website – www.hurlstons.com/esop. In a few cases company name changes have not been confirmed on the site and individual contact details may have changed.

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