

## Old Europe vs New Europe

3.00 pm on 28 June 2007

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## Old Europe vs New Europe

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### The 'menu of content'

- Session will compare and contrast different forms of employee equity plans and tendencies/developments through different countries in old (Western) Europe and new (Eastern) Europe
- Old Europe means: UK, Germany, France, Austria
- New Europe means: Hungary, Turkey, Baltics

## Equity plans for employees in the UK



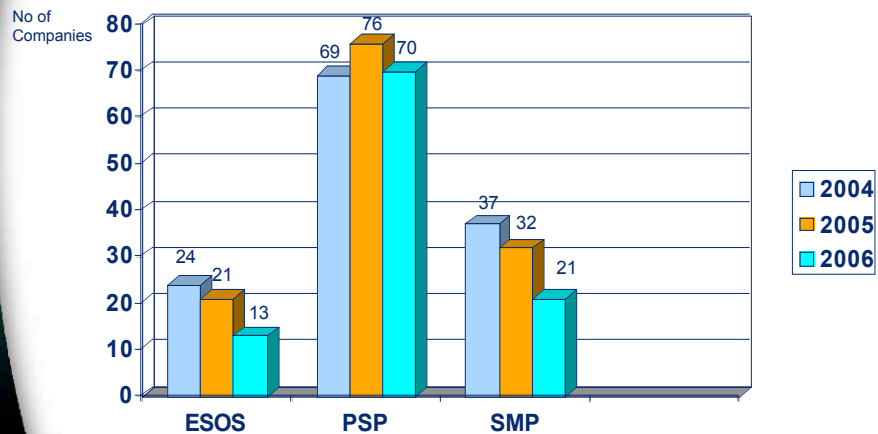
### The 'menu of choice'

- Share options
- Performance Share Plans (or L-TIPs)
- Share Matching Plans (or Co-investment Plans)
- Joint Ownership Plans (or ExSOPs)
- (In future?) Deferred Payment Plans
- For all employees:
  - Share Incentive Plans (Free and/or Partnership/Matching and Dividend Shares)
  - Savings-Related Share Options



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## What plans are companies introducing?



\*Source: ABI IVIS Service. 2006 Figures to end July. FTSE All-Share.



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## Equity plans for employees in the UK



### Share options

- Enterprise Management Incentives (EMIs)
  - for small independent cos (< £30m gross assets)
  - generous tax exemptions (effective rate of 10% after 2 years!)
  - individual limit of £100K
- HMRC-approved 'Company Share Options' (CSOPs)
  - individual limit of £30K
  - for independent cos
  - tax relief from income tax/NICs, but not CGT, if exercised after 3 yrs
- 'Unapproved' options
  - income tax/NICs on exercise
  - effective tax rate of 41%, or 48.68% if burden of employer's NICs transferred to employee



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## Equity plans for employees in the UK



### Performance Share Plans

- For most senior directors/executives only
- Benefit vests after, typically, 3 years, if corporate performance targets met
- Form of awards:
  - nil-cost options (exercisable by executive after vesting)
  - conditional share awards (gift on vesting)
  - forfeitable shares (gifted at outset but forfeited if targets missed)
- Charged to income tax/NICs on vesting/exercise



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## Equity plans for employees in the UK



### Co-investment plans

- Employee “commits” shares:-
  - acquired by way of bonus
  - already held (eg acquired on exercise of options)
  - which have vested under L-TIP
  - are held in a Share Incentive Plan
  - are held in a “Registered Pension Scheme”
- If committed shares held for, typically, 3 years and employee remains continuously employed and corporate performance targets are met
- then employee will be “gifted” additional shares
- Number of additional shares will, typically, be on a graduated basis according to performance level achieved



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## Equity plans for employees in the UK



### Influences on plan design

- Corporate governance guidance
  - ABI/NAPF guidelines
- Peer pressure
- Changes to Accounting Standards
- Desire to optimise tax treatment



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## Equity plans for employees in the UK



### All-employee share schemes

- Share Incentive Plans (SIPs)
  - free shares (£3,000 p.a.)
  - 'partnership shares' (acquired out of pre-tax earnings) (£1,500 p.a.)
  - 'matching shares' (up to 2 for 1 partnership shares) (max £3,000 p.a.)
  - dividends on plan shares may be reinvested tax-free
  - full benefit of tax relief if shares held in plan for at least 5 years
  - plan shares must be withdrawn on leaving
- Savings-related share options (SAYEs)
  - fixed 3, 5 or 7 year share options linked to savings contract
  - option gains generally free of income tax/NICs, but not CGT



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## Companies with tax advantaged employee share schemes



APRIL 2005

Company Status	All-Employee Schemes		Discretionary Schemes	
	SAYE	SIP	Company Discretionary Share Option Plans	EMI
FTSE 100	77	46	84	0
FTSE 250	149	60	182	*
Smaller listed	199	60	347	76
<b>Total listed</b>	<b>425</b>	<b>166</b>	<b>613</b>	<b>76</b>
Overseas	51	54	341	40
<b>Totals</b>	<b>476</b>	<b>220</b>	<b>954</b>	<b>116</b>

\*Figure cannot be revealed due to disclosure rules

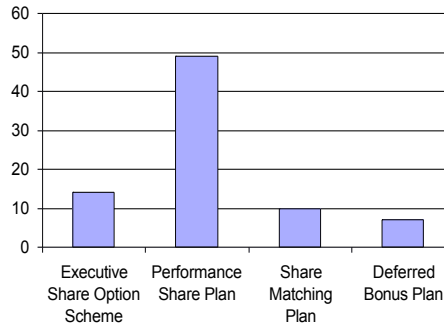
SOURCE: HM REVENUE & CUSTOMS PUBLISHED DATA



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## New discretionary schemes introduced by FTSE all share companies in 2007 (as at 25 May 2007)

Type of plan	Number	Percentage of Total
Executive Share Option Scheme	14	17.5%
Performance Share Plan	49	61.3%
Share Matching Plan	10	12.5%
Deferred Bonus Plan	7	8.8%
<b>Total</b>	<b>80</b>	

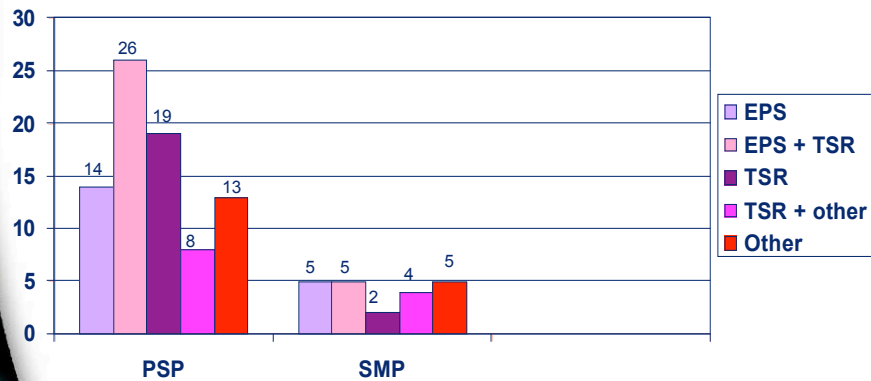


SOURCE: ABI – Institutional Voting Information Service (IVIS)

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## What performance conditions are being applied?

- ESOS – traditionally EPS (12 of 13 cases in 2006)
- PSP and SMP:



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## What have been investors' concerns?



- Upward spiral of base pay (and ratchet effect on other benefits)
- Rise in maximum annual bonus thresholds – performance target disclosures, year ended and current year (ABI December 2005 Guidelines)
- Pensions: addressing the new lifetime allowance from A-Day – no compensation for tax change; disclose policy intentions in Remuneration Report; consider alternatives that are performance linked (ABI); August letter to FTSE 350 Chairman (ABI)
- Share incentives:
  - annual review; continuing appropriateness of grant levels and performance conditions; use of discretions (ABI)
  - emphasis on detail of performance conditions (ABI)



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## Performance conditions



- EPS:
  - bespoke ranges in sliding scales
  - no case less than inflation (RPI or similar) plus 3% pa as minimum threshold
  - top thresholds range RPI plus 5/6% pa to RPI plus 15% pa (a few higher still)
  - reflection of company specific nature of EPS
- TSR:
  - predominantly a comparative measure (median for threshold/upper quartile or higher for full vesting)
  - comparison against “basket” or constituents of sector
- Other:
  - PBT; growth in net asset value; ROCE/ROE; revenue growth; cash flow based
  - “line of sight”



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## Maximum individual grant levels



- Traditionally 100% of salary annual individual grant limit in PSPs
- New PSPs in 2006, median maximum annual individual grant limit
  - FTSE 100 - 200% of salary
  - FTSE Mid 250 - 125% of salary
  - FTSE Small Cap - 100% of salary
- BUT - unusual to grant at maximum levels; actual grant levels still driven by company specific factors (eg dilution and accounting costs)



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**OLD EUROPE: Tendencies  
in Equity Plans for  
Employees in Germany**

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## Tendencies in equity plans for employees in Germany

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- Survey on SOP of the DAX 30 companies in 2006
- Trends in SOP with regard to the following main aspects:  
*(source: Union Investment 2006)*
  - performance objectives - minimum return targets
  - own investments of employees
  - adequate scope of the programme
  - duration of the programme
  - limitation/cap of the maximum value
  - transparency and trends.



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## Tendencies in equity plans for employees in Germany

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### Performance Objectives - Minimum Return

- SOPs of Lufthansa and Schering include a **relative** performance objective
  - Lufthansa: outperformance basket with 6 European airlines;
  - Schering: MSCI World Pharma & Biotech
- SOPs of Fresenius Medical Care, Infineon and Linde do not contain a **relative** performance objective
- **absolute** performance objectives: range p.a. between 9.1% (Telekom), 5.1% (VW) and 2.64% (Linde), 0.7% (Infineon), 0% (Altana).
- cumulative combination („and“) of objectives: Bayer – 15% minimum return over 3 years and better off than EuroStoxx 50; Daimler Chrysler, Commerzbank



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## Tendencies in equity plans for employees in Germany

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### Own Investments of Employees

- 45% of the SOPs do not provide for an own investment of the employees
- SOP of Commerzbank requires between 100 and 1,200 shares as employee investment
  - amount of the employee investment depends on the position of the employee
- SOPs of Bayer and Lufthansa provide request for investment for special tranches per SAR



## Tendencies in equity plans for employees in Germany

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### Adequate Scope

- Bayer and Lufthansa limited the scope of their SOPs → participants are only members of the board and some executive managers
- Münchner Rück insurance limited the volume to 0.7 % of the outstanding shares
- Daimler Chrysler: low volume
- Infineon: high charge
- Deutsche Post: high volume, high number of participants
- SAP: high number of participants.



## Tendencies in equity plans for Employees in Germany

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### Duration, Lock Up and Exercise Windows

- broad variety of duration
- between 3 to 5 years (Deutsche Telekom, VW, Commerzbank) and 7 to 8 years (Henkel, EON, Linde)
- lock up periods: between 2 to 4 years
- exercise windows:
  - 82% of the programmes define detailed and long exercise windows,
  - 18% contain vague and short exercise windows



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## Tendencies in equity plans for employees in Germany

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### Limitation/Cap and Basic Price Calculation

- SOPs of Lufthansa (30%), E.ON (100%) and Henkel (250%) include a limitation of the maximum appreciation value of the option
- no cap: Deutsche Post, Fresenius Medical Care, Infineon, Deutsche Börse
- reference period for basic price calculation:

Deutsche Börse:	60 days
Infineon and Linde:	5 days
Schering:	only 1 day
average:	20 days



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## Tendencies in equity plans for employees in Germany

### Transparency and Trends

- SOPs are becoming more complex (more requirements)
  - less transparency with regard to the charge of the company and for investors
- SOPs are displaced by stock incentive programmes/direct participation
  - more flexibility in design of programmes, but intransparent for the shareholders because there is no obligation to announce the direct participation in the statement of accounts, equity based compensation becomes less comparably



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### OLD EUROPE: Tendencies in Equity Plans for Employees in France

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## Tendencies in equity plans for employees in France

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### Share Option Plan

- Issued by any stock company, whether listed or not
- Beneficiaries freely determined by the board
- Exercise price/period: specified in the shareholders' resolution
- Tax and social security incentives subject to conditions
- Foreign share option plans may benefit from such incentives if they fulfill the same conditions



## Tendencies in equity plans for employees in France

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### Share Option Plan

- SOPs are mainly used by large companies:
  - 6.7% of companies with **250 to 499** employees
  - 11% of companies with **500 to 999** employees
  - 19.10% of companies with more than **1,000** employees
- Beneficiaries are limited in large groups
- Employees: 3% of Alcatel, BNP Paribas and Total employees own options
- Managing Directors: 3% of Alcatel, 13% of BNP Paribas and 7% of Total MDs own options
- The main concern in France is now the question of the value of granting of the shares and the dilution of existing shareholders. Listed companies also face the issue of the exercise of the option by the beneficiaries following an insider dealing.



## Tendencies in equity plans for employees in France

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### Restricted share plan

- Granting by the company of its shares for free
- Beneficiaries: the company's employees and legal representatives as freely determined by the board
- Vesting period: 2 years
- Resale of the shares: after a minimum period of 4 years following the granting
- Favourable tax and social security regime



## Tendencies in equity plans for employees in France

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### Restricted share plan

According to a 2006 survey among 28 French companies listed on CAC 40 and on SBF 120:

- 58% consider replacing their share option plan by a restricted share plan
- 23% consider granting free shares in addition to share options
- 80% say they will give free shares on a performance basis
- 50% say they will limit this measure to the top management



## Tendencies in equity plans for employees in France

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### Profit-sharing schemes (“participation”)

- Mandatory for profitable companies with 50 employees or more, optional for others
- Formula set forth by French law and based on the company’s taxable profit, shareholders’ equity, gross pay and added value
- Tax and social security benefits only if the sum is escrowed for 5 years
- Benefits may be used as a tool for beneficiaries to become shareholders through a dedicated fund (FCPE, SICAV...).
- 5.8 billion € were saved by employees using a profit-sharing scheme (50% of total savings)



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## Tendencies in equity plans for employees in France

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### Performance scheme (“intéressement”)

- Optional and without any specific framework
- The amount of the payment depends on the achievement of performance objectives
- Money received immediately available: taxed and subject to social charges
- Money received saved in a specific vehicle: tax and social charges free
- 2.8 billion € were saved by employees under a performance scheme (20% of total savings)



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## Tendencies in equity plans for employees in France

### Savings Plans

- 80% of savings benefits are escrowed each year to use the tax leverage
- 60% of French employees benefit from a savings plan
- The accrued rights are worth 82.4 billion €, 50% of which are used to become shareholders



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### OLD EUROPE: Tendencies in Equity Plans for Employees in Austria

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## Austrian Tendencies in Equity Plans for Employees

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### Development

- Dynamic development since 1994
- Implementation of tax incentives for SOP in 2001
- Growing demand for EEP since 2002
  
- 1993: appr. 20 companies providing EEP
- 1999: appr. 80 companies providing EEP
- 2006: appr: 130 companies providing EEP



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## Austrian Tendencies in Equity Plans for Employees

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### Direct or Intermediate model of EEP?

- 80%: direct models
- 20%: via an intermediate company (private trusts)



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## Austrian Tendencies in Equity Plans for Employees

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- 1% of companies: issuance of stock options
- 8% of companies: employee share ownership

### Still most important in Austria

- 25% of companies: no equity plans but profit sharing



## Austrian Tendencies in Equity Plans for Employees

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### Own Investments of Employees

- Most EEPs provide for an own investment of all employees
- Most SOPs do not provide for an own investment of the employees
- SOP: Investments depend on the position of the employee (mostly executive staff)
- SOP: Always on a voluntary basis
- Limitation (cap) of SOP: 57% of SOPs benefit under 5% of the nominal share capital



**NEW EUROPE: Tendencies  
in Equity Plans for  
Employees in Hungary**

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**Tendencies in equity plans for employees in Hungary**

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**Characteristics of Hungarian Management Culture**

- **Generally speaking:** no specific type of Management Culture could be developed in Hungary, the foreign influences are greatly determinant.
- Employee Stock Ownership Plan (**ESOP**): had been used as an instrument of privatization. In the absence of alternative buyers in 1992 Hungarian government shifted its former „market-based policy” into expansion of domestic demand by stimulating that demand with revenue generation, and involving employees on a self-financed basis. In 1993 ESOPs were used within the privatization of some 130 Hungarian company.

## Tendencies in equity plans for employees in Hungary

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### Characteristics of Hungarian Management Culture

- **Acknowledged Program of Stock Allotment to Employees**
  - effective January 2003 Hungarian laws related to personal income tax was amended
  - it was based on the government's intention to establish the legal bases of, and thereby support incentive plans in Hungary
  - owing to the relevant provisions of tax laws, the approved program is necessarily a benefit-focused, tax-driven and thereby a human capital focused incentive program.
- **Approved program** means an employee securities benefit program to which the Ministry of Finance has granted such status.
- Companies are free to design their own incentive plans within the frame of the applicable provisions of the relevant laws; procedure regarding the transfer of the shares shall comply with the Act on Personal Income Tax.



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## Tendencies in equity plans for employees in Hungary

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### Characteristics of Hungarian Management Culture

- Example of those companies adapted the Acknowledged Program of Stock Allotment to Employees: Borsodchem, Richter, Coca-Cola
- **International/Multinational Company Groups:**
  - bring along their own Management Culture and intend implementing those in Hungary as far as locally applicable in pursuance of Hungarian Laws
  - employees participating stock ownership plans of such company groups generally receive shares of the foreign parent company rather than the local Hungarian subsidiary.



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## Tendencies in equity plans for employees in Hungary

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### Characteristics of Hungarian Management Culture

- Hungarian feature in business life is the **One Strategic Owner** of companies. Typically, such strategic owners are foreign investors. The sole strategic owner has a hold over the effective decision-making procedure, and implements its own incentive culture in the Hungarian subsidiary, as well.
- Among others, the holding parent company being the strategic owner of the Hungarian companies implement:
  - ✓ Stock option;
  - ✓ Restricted stock unit;
  - ✓ Stock incentive;



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## Tendencies in equity plans for employees in Hungary

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### Involvement of Employee Trusts and Banks

As **administrative agents** of the employee stock ownership plans are involved:

- Securities Brokerage Firms
- Universal Banks

They carry out tasks related to the administration of the plan and/or serve as :

- ✓ paying agent;
- ✓ book-keeper;
- ✓ cash account keeper;
- ✓ securities/custody account keeper;

**Employee Trusts**, in spite of not having an adaptable Hungarian legal form thereof, may also apply, provided that the incentive plan is under foreign jurisdiction.



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## Tendencies in equity plans for employees in Hungary

### National attributes

- **Hungarian Securities Law** is applicable for incentive plans issued and distributed in the territory of the Republic of Hungary. Extra-territorial issuance and distribution shall result in the applicability of foreign laws.
- Due to the structure of the incentive plans effectuated in Hungary (issued abroad, subscription is effected abroad, etc.), all elements of such plans are external, only the recipients are Hungarian.
- Thus, those allotments which are aimed to be transferred to certain Hungarian employees are, **in most case not under Hungarian Laws**.

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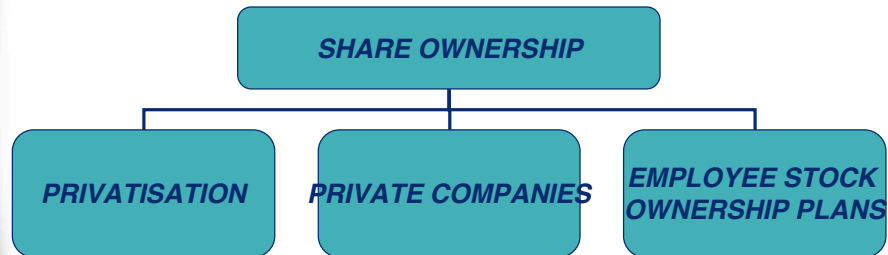
### NEW EUROPE.: Tendencies in Equity Plans for Employees in Turkey

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## Tendencies in equity plans for employees in Turkey

### A-SHARE OWNERSHIP



**B-PROFIT SHARING:** Within a research made among 50 publicly held companies, it has been observed that more than 80% of these companies' Articles of Association include profit-sharing to their employees.



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## Tendencies in equity plans for employees in Turkey

### General Attitude

- Share ownership schemes have been implemented mostly in the context of privatisation and in multinational companies while profit sharing is found amongst private companies.
- ESOP-like schemes based upon associations and foundations which collectively hold the shares of the employer firm for employees, who benefit from contributions of company profit in the acquisition of these shares.



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## Tendencies in equity plans for employees in Turkey

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### Legal and Fiscal Framework

- Under Turkish law there is no specific employee share ownership programme or any particular law or regulation governing specific issues of employee share ownership, as in other countries.
- The forms of employee financial participation covered by different laws are:
  - “**profit-sharing**”,
  - “**stock options**” and – to a limited extent –
  - regulations on the “**acquisition of shares by employees**”.
- Apart from tax deductibility for employers’ contributions to specially tax exempt associations and foundations, there are no direct incentives to set up equity plans for the employees.



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## Tendencies in equity plans for employees in Turkey

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### Taxation Issues

- There are **no** specific tax incentives for Employee Involvement Plans within the common tax legislation in Turkey.
- Apart from the employment incentive plans mentioned during my presentation, the new “**Individual Retirement System**” provides some tax incentives.



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## Tendencies in equity plans for employees in Turkey

GENERAL ATTITUDE	LEGISLATION AND FISCAL OR OTHER INCENTIVES	INCIDENCE OF SCHEMES
<p>Social Partners: Climate for Financial Participation friendly, Trade Unions are supportive, Employer Associations undecided, split; employees are interested</p>	<p><b>Employee Share Ownership:</b> Privatization Law (and decrees) favors transfer to employees and other selected groups, using discounts, credit and installments; Turkish Commercial legislation-issuing of preferential employee shares by Joint Stock Companies not possible.</p> <p><b>Employee Share Ownership Plan:</b> Turkish Commercial legislation and Civil Code "welfare funds" or "mutual assistance funds" operate with financial support of firms, subject to some restrictions.</p> <p><b>Profit Sharing:</b> TCC/Civil Code both Cash-based Profit-sharing and Share-based Profit-sharing possible subject to company meeting certain reserve.</p>	<p><b>Employee Share Ownership:</b> 12 main cases, mainly privatisations: 9- 37% Employee Share Ownership, some multinational companies.</p> <p><b>Employee Share Ownership Plan:</b> Few cases of ESOP type schemes (Adana Kagit Torba Sanayii, Teletas Telekomunikasyon).</p> <p><b>Profit Sharing:</b> In a sample of 50 public firms, more than 80% had PS in Articles of Association.</p>



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## Tendencies in equity plans for employees in Turkey

### What do employees think?

- According to some surveys made among employees, most of the employees are willing to purchase the shares of the company that they are working for.
- The employees consider that the main effect of employee share ownership is the creation of a direct connection between personal performance and rewards.



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## Tendencies in equity plans for employees in Turkey

### Foreign multinational companies

If a foreign multinational company wants to implement financial participation plans for employees working in a subsidiary or group company in Turkey in accordance with the rules of the home country, it has **to register** the plan with the **Capital Markets Board** which evaluates the application and approves or rejects it.

The main details of this application are as follows:

- The company should conduct the sale through an intermediary institution such as a bank, special finance institution or a brokerage house.
- The Company should apply to the CMB through an attorney in order to clarify whether the shares relating to the employment ownership plans are subject to the registration at the Capital Markets Board and whether the company needs to comply with any other legal requirements in accordance with the current legislation.



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### NEW EUROPE: Market Practice of Employee Incentive Plans in the Baltics

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## Market Practice of Employee Incentive Plans in the Baltics

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### Latvia

- Western owned companies operating in Latvia tend to import their home base employee participation plans into the local environment, so distinctions exist, depending upon the jurisdiction of origin of the company. Locally owned companies rarely utilize employee participation plans, but tend to favour **bonus incentive systems**.
- To the limited extent that employee participation plans exist, they are more likely than not to be restricted stock plans.
- It is not common to involve banks/trusts in employee participation plans.
- There is hardly any treatment of employee participation plans under the law.



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## Market Practice of Employee Incentive Plans in the Baltics

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### Lithuania

- Employee participation plans, in the relatively infrequent cases where they exist, tend to be in companies owned by foreign investors. **Insurance and pension plans** tend to be utilized more frequently than employee participation plans.
- Stock option plans and stock purchase plans are used to a very limited extent. Where used, stock option plans apply to the mother company's stock in a number of cases.
- It is uncommon for banks/trusts to be involved in the execution of employee participation plans.
- Local law is by and large silent on employee participation plans.



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## Market Practice of Employee Incentive Plans in the Baltics

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### Estonia

- Employee participation plans have been in the past utilized in some cases for companies traded on the open stock market.
- Currently some foreign international corporations operating in Estonia use SOP's to award their employees by practicing their corporate system of incentives.
- Estonian tax legislation does not treat favorable employee participation plans and levies taxes similarly to salaries.
- Majority of local employers do not tend to use SOP's to award their employees.
- If used, then SOP's are mostly used to award upper management of companies.



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## Questions?

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**Thank you for your participation**

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