

IFSA Guidance Note No.13.00



Investment & Financial Services Association Ltd

Employee Share Ownership Plan Guidelines

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Table of Contents

Introduction & Background

- 1. Principles**
- 2. Designing Employee Share Ownership Plans**
- 3. Restrictions on Employee Share Ownership Plans**
- 4. Transparency and Accountability**

INTRODUCTION

The aim of employee share ownership plans is to encourage general employee participation in share ownership in their employer company and a collective effort towards improved company performance thereby increasing shareholder value. These guidelines provide guidance for boards and shareholders to use to develop employee ownership and incentive plans and provide guidance on the application of those principles. Boards are encouraged to develop 'good practices' when designing these plans and when seeking shareholder approval for them.

Appropriately designed employee share ownership plans are good corporate governance and as a practice should contribute to national savings by encouraging share ownership. Employee share ownership plans encourage and promote the achievement of common goals between employees, shareholders and the company. Participating in an appropriately designed share ownership plan provides an incentive for employees to increase productivity and share the rewards of the success of the company. These guidelines encourage companies to offer employee share ownership plans to a broad range of employees.

The second edition of these Guidelines was published in May 2000. The publication of this third edition is necessary so as to incorporate and reflect obligations under the current law; accounting standards; and generally accepted good practice regarding the composition and disclosure of employee equity plans.

Employee share ownership plans practices have evolved and will continue to develop in response to market conditions, relevant taxation concessions and international developments. These guidelines are not intended to restrict companies' flexibility in designing plans which reflect their particular circumstances in order to retain, reward and motivate their staff and drive improved company performance provided the plans are fully valued, expensed and disclosed in a manner which permits shareholders to assess whether they are appropriate.

1 PRINCIPLES

1.1 Share ownership plans are an effective means of encouraging share ownership for the purpose of improving employee and employer relations by:

- Aligning employees' focus on the corporate objectives and enhancing their commitment to the company's values and culture
- Creating commonality of purpose by aligning their interests
- Communicating with employees through channels normally reserved for shareholders
- Educating employees about the risks and rewards of share ownership
- Adding wealth and value for all shareholders.

1.2 The key principles that boards should consider in designing share plans for general employees and the process for shareholder approval of the plans are:

Structure of share plans

The share plan should be designed to meet the particular needs of the company. The plan should be designed, as far as is practicable, to align employee and shareholder interests and fit with strategic human resource initiatives that encourage improved company performance. Plan types will vary depending on the nature of the company and its particular circumstances. As a general guide, employee share ownership plans that offer shares rather than options or rights to shares are preferable for general employees, because they are less dilutive and provide a clearer alignment of value and benefit.

Amount of Shares

The amount of shares issued under employee share plans should be reasonable in relation to the existing capitalisation of the company. The number and value of shares that will be reasonable will vary depending on the nature of the business, the circumstances of the company, the market and the other components of the employees' remuneration.

Transparency and Accountability

Companies should provide shareholders with meaningful information to permit them to determine whether to approve employee share plans. All aspects of these plans should be disclosed to shareholders including their full cost.¹

¹ Note that all share benefits must be expensed under AASB 2 'Share Based Payment' and should be considered as part of an employee's remuneration.

Non-performance share based payments for employees

Where possible, companies should only offer these benefits by way of on-market purchase and not by way of new issue of shares.

2 DESIGNING PLANS

- 2.1 There are many different ways in which companies can design employee share ownership plans in order to align employee and shareholder interests and focus on improving company performance. A company should determine an appropriate employee share plan structure depending on the objectives of the plan and the company's individual circumstances. For these reasons these guidelines do not specify particular plan structures as preferred or appropriate. Rather, the emphasis is on ensuring that plans are well designed and fully expensed and disclosed to employees and shareholders.
- 2.2 The board should be responsible for the culture and philosophy underpinning employee share ownership within the company. The remuneration committee of the board, comprising a majority of independent directors, should be responsible for determining the parameters of, and processes required to ensure appropriateness of, the employee share ownership plan.² Senior management should have the delegated responsibility, with the board reviewing and overseeing, for the design and implementation of the employee share ownership plan within the philosophy and parameters set by the board.
- 2.3 The board should ensure appropriate corporate education processes are in place to explain the inherent risks and rewards of share ownership and the operational details of the company's specific employee share ownership plan. Where appropriate, employees should be encouraged to seek independent advice.
- 2.4 Companies may consider it appropriate to provide for a minimum period of service before an employee is eligible to participate in an employee share ownership plan.

3 RESTRICTIONS ON SHARE OWNERSHIP PLANS

- 3.1 A reasonableness test should be applied to the volume of shares issued under employee share ownership plans. The number of shares and the terms under which the equity is allocated that will be reasonable to issue under a plan will vary according to the individual circumstances of a company. Companies should consider the nature of their business, the existing capitalisation of the company and the maximum amount of shares and options issued under all employee and executive share and options plans when determining what is reasonable. For example, it is more likely that higher levels of executive and employee ownership in a start-up or venture capital company would be considered reasonable than for an established listed company with a large number of employees. It is important that the proposed volume of shares and options that may be issued is fully expensed and disclosed to shareholders to enable them to assess the dilutionary impact of the proposed plans.

² For further discussion of remuneration committees see 'Principles of Good Corporate Governance and Best Practice Recommendations', Australian Stock Exchange, March 2003 at page 51 and 'Remuneration Committees: Good Practice Guide', AICD, 2004.

- 3.2 Companies commonly provide share benefits to employees by way of remuneration sacrifice or other non-forfeitable benefit – that is, employees elect to receive an equivalent value in shares instead of cash. Where possible, companies should only offer these benefits by way of on-market purchase and not by way of new issues. This will ensure an appropriate alignment of the cost and benefit, prevent the occurrence of a non-deductible share based payment expense and will ensure that shareholders do not suffer the impact of dilution and lower distributable earnings.
- 3.3 Ordinary shares issued as a result of employee share ownership plans should rank equally with other shares owned by existing investors. These shares should be able to receive dividends and participate in all benefits of share ownership including voting on company resolutions, rights issues, bonus issues and any other preferential equity issues.
- 3.4 Companies must comply with all relevant laws including taxation and accounting standards, Corporations Act and the ASX Listing Rules when designing and administering employee share ownership plans.

4 TRANSPARENCY AND ACCOUNTABILITY

- 4.1 All employee share ownership plans must be fully expensed and disclosed and justified to shareholders in accordance with the Corporations Act and the Australian Equivalents to International Reporting Standards.
- 4.2 Companies should provide shareholders with meaningful information on the application of the board's remuneration policies in relation to employee share ownership plans. Shareholders should be presented with sufficient information to determine whether the plans are appropriate, reasonable and achieve their intended objectives. The structure and design of plans including levels of entitlement, performance hurdles, time periods before entitlement to shares and any restrictions on disposing of shares received as a result of plans must be disclosed to shareholders.
- 4.3 Shareholders need to assess the cost of plans and whether the expense and the possible equity dilution is commensurate with the overall benefits of improved company performance. The full cost of plans to the company and shareholders should be fully disclosed, including the methodology and assumptions used to calculate the cost of the plans, value of share based payments and the timing and method of purchase or issue of shares.
- 4.4 As a matter of good practice, all costs involved in employee share ownership plans should be disclosed. For example a loan funded plan should disclose the opportunity cost in respect of the terms of the loan and any possible downside risk protection provided to employees. For a remuneration funded plan, that is, where the shares are purchased from salary package dollars, the remuneration cost may represent either a salary sacrifice or a new incentive benefit.