Factsheet

A guide to Long Term Incentive Plans (LTIP's)

Background

The popularity of LTIPs among listed companies has increased steadily over in the late 1990's, partly as a result of the July 1995 publication of the Greenbury Report on Directors' Remuneration.

The Greenbury Report was perceived to be critical of option schemes for senior management and in favour of LTIPs on the basis that historically directors sold all the shares derived from the exercise of options almost immediately.

Greenbury felt that LTIPs could be more effectively linked to the company's performance and would encourage directors to build up a shareholding in their company thereby aligning the interests of the directors with those of shareholders. The Greenbury Report has now been consolidated along with Hampel and Cadbury into the combined code.

General Features

Under an LTIP participants are typically provided with free shares after a period of time (usually a minimum of three years) subject to certain conditions such as remaining in employment throughout the period and the company having met certain performance conditions.

The shares to be provided to participants will be held in trust and notionally allocated to participants. If the conditions attaching to the awards are met the trustees release or transfer the shares to the participants. An LTIP will typically comprise an employee benefit trust and a set of rules constituting the LTIP itself.

Very often the employee trust will be resident offshore (e.g. in the Channel Islands). This ensures that the disposal of shares by the trustees is not subject to UK Capital Gains Tax (CGT). If such disposals were subject to CGT there may well be a double charge to tax - once in the hands of the trustees and once in the hands of the participants.

In order for the trustees to purchase or subscribe for shares the company will lend or contribute funds to the trust. Corporation tax relief is available in respect of the value of shares released to a participant, but only when the trust releases the shares to a given participant.

Eligibility

All employees and full-time directors are usually potentially eligible. However, participation will be at the discretion of the directors or the remuneration committee and the scheme is often used to provide benefits to senior management.

Performance Targets

A popular performance measure is total shareholder return or "TSR". This measures a company's increase in share price and the dividends provided to shareholders over the relevant period and then compares that return to the TSR of a comparator group of companies, e.g. FTSE 100 or FTSE 250 or perhaps a sector encompassing the company's competitors.

The position of the company in the comparator group at the end of the performance period then determines the percentage of shares under the award which is transferred to the participant.

Limits

Shareholder approval is required for a listed company before they can set up the plan, if new shares are to be issued, or if directors may participate. As under option schemes, institutional investors are concerned to ensure that their interest is not diluted excessively by awards under an LTIP. Accordingly, the scheme limits (e.g. not more than 10% of share capital in 10 years being used for all schemes) will apply.

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Typically these limits will only count shares which are issued as new shares to participants (unlikely in the context of an LTIP) or are subscribed by the trustees. The limits do not count shares which are purchased on the market by trustees since the interests of existing shareholders are not diluted.

Cessation of Employment

As the intention of most LTIPs is to encourage the executive to stay with the company then it would normally be set in the rules of the scheme that if the employee left voluntarily then his entitlement to the shares may be forfeited. However, if an employee leaves due to special circumstances (for example leaving due to redundancy, injury or disability) then they may be eligible to take the shares vested to them. In the event of death of the employee, the personal representative(s) may also be eligible to take the shares vested.

Taxation

LTIPs are not drawn up to with the view to gaining tax relief's.
Income tax - and National Insurance - arises at the point the executive acquires the shares and therefore if needed they are able to sell sufficient shares to cover the tax due.

Dividends

Dividends would not normally be passed onto the employee until after vesting.

Benefits Associated in Operating an LTIP

Employer:

The whole essence of an LTIP is that it is flexible and should be designed to meet the needs of the company and its employees.
Under the Finance Act 2003, any financial benefit ultimately enjoyed by an employee will be deductible against corporation tax.

Employees:

As opposed to a CSOP or Unapproved Share Option the executive benefits from the full value of the shares, not merely the growth in value of the shares over the option period, so the problems of "underwater options" are avoided.

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