Points about treasury shares to raise with the Investment Association (IA) (and possibly the FCA) regarding the Listing Rules

Key question: - Would the IA be likely to reconsider their position on the restricted use of treasury shares given the difficulties public companies can face using trusts to recycle shares?

Justification

At the Share Scheme Experts Group on 4th December 2014 we discussed some of the consequences of HMRC's decision not to progress the Office of Tax Simplification's proposal to establish the concept of an employee shareholding vehicle to facilitate the holding and transfer of shares used for traditional tax advantaged and non-tax advantaged employee share schemes.

The idea had been to provide a 'safe harbour' trust or other vehicle so that the inconveniences and tax pitfalls of operating a trust, particularly an offshore trust, might be alleviated.

With the shelving of this proposal, many companies will still wish to consider simpler alternatives for buying back shares and holding on to them until they are required for the purposes of the relevant share plan.

There are a number of reasons why an employee trust may be used but, at least for quoted companies, generally it will be to minimise dilution to existing shareholders by purchasing existing shares on the stock market instead of issuing new shares.

Many companies would prefer to take the easier approach of buying the shares themselves and holding them as treasury shares before delivering the shares to employees through their share schemes.

Unfortunately, here are obstacles which can make it more difficult for quoted companies to use treasury shares for their share schemes.

1. The IMA Principles of Remuneration discourage the use of treasury shares by treating them for the purpose of dilution limits in the same way as the issue of new shares. The current principles provide as follows:

    2. Long-Term Incentives
    ix. Dilution
    The rules of a scheme must provide that commitments to issue new shares ***or re-issue treasury shares****, when aggregated with awards under all of the company's other schemes, must not exceed 10% of the issued ordinary share capital (adjusted for share issuance and cancellation) in any rolling 10 year period. Remuneration Committees should ensure that appropriate policies regarding flow-rates exist in order to spread the potential issue of new shares over the life of relevant schemes in order to ensure the limit is not breached. Commitments to issue new shares* ***or re-issue treasury shares*** *under executive (discretionary) schemes should not exceed 5% of the issued ordinary share capital of the company (adjusted for share issuance and cancellation) in any rolling 10 year period. This may be exceeded where vesting is dependent on the achievement of significantly more stretching performance criteria. The implicit dilution commitment should always be provided for at point of grant*

even where, as in the case of share-settled share appreciation rights, it is recognised that only a proportion of shares may in practice be used.

This approach has been a long held tenet of the Investment Association (and formerly the ABI) but we believe it should be reviewed and revisited to help companies take advantage of the Companies Act entitlements to acquire treasury shares. Treasury shares are not dilutive in terms of the shareholding and the costs of funding are no more than the alternative of funding purchases by employee trusts. Removing the reissue of treasury shares from the definition of dilution will help companies to reduce operating costs for legitimate employee share plans. Shareholder protection is an understandable concern for the IMA but equally of value is the encouragement for employees and directors to hold shares so their interests are aligned with shareholders.

2. The Listing Rules also contain a limitation for share schemes aligning the treatment of treasury shares with a new issue of shares. LR 9.4.1 makes it a requirement for employees' share schemes and long-term incentive plans to have shareholder approval if they involve the issue or new shares or treasury stock.

LR 9.4.1 Documents requiring prior approval
(1) This rule applies to the following schemes of a listed company incorporated in the United Kingdom and of any of its major subsidiary undertaking (even if that major subsidiary undertaking is incorporated or operates overseas):
(a) an employees' share scheme if the scheme involves or may involve the issue of new shares or the transfer of ***treasury shares****; and*
(b) a long-term incentive scheme in which one or more directors of the listed company is eligible to participate.

However, the requirement for shareholder approval of share plans as a general principle is less of a hurdle for the use of treasury shares on the basis that it is a 'one-off' requirement.

The Listing Rules do, however, create an inconvenience affecting share schemes such that there is a requirement to notify a RIS at times when the issue of shares or the transfer of shares would not require such a notification, e.g. to a person that is not a PDMR. This is a minor inconvenience but given the exemptions that apply throughout the Listing Rules relating to share schemes then an exemption here would support companies to encourage shareholding by directors and employees.

LR 12.6 Treasury Shares
If by virtue of its holding treasury shares, a listed company is allotted shares as part of a capitalisation issue, the company must notify a RIS as soon as possible and in any event by no later than 7:30 a.m. on the business day following the calendar day on which allotment occurred of the following information:
(1) the date of the allotment;
(2) the number of shares allotted;
(3) a statement as to what number of shares allotted have been cancelled and what number is being held as treasury shares; and
(4) where shares allotted are being held as treasury shares, a statement of:
(a) the total number of treasury shares of each class held by the company following the allotment; and
(b) the number of shares of each class that the company has in issue less the total number of treasury shares of each class held by the company following the allotment.