TAPESTRY

INTERNATIONAL SHARE PLANS

TRAINING MANUAL

Module 5 – Global Legal Considerations

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Global Legal Considerations

As we said in module 1 the key point to remember is that every country has its own legal system and in relation to any given issue a different country may have a different position than the one you are used to in your home country.

In this module we will look at:

- Why companies look to comply with local laws.
- What kind of laws need to be considered? (Can you list them?)

It is perfectly normal for a company to pay the most attention and spend the most money on compliance in relation to its home country.

Its home country may be where the company is incorporated, where the company is listed, where the company has the bulk of its assets and where most of the employees are located. Clearly a company based in the US with thousands of employees in the US is going to spend more time thinking about compliance in the US than in relation to let's say Botswana where it has three employees in a branch office. However that does not mean that you can ignore the law in jurisdictions other than your home country jurisdiction. The question is how do you adopt a suitable balance which recognises the importance of the home country, wherever that may be, but which also avoids major legal pitfalls and risks of non-compliance in other countries.

1 Why is compliance with overseas laws important?

The reasons why companies do not want to be non-compliant are:

1.1 Criminal Offences

Nobody wants to commit a criminal offence. Both companies and the people working in those companies can sometimes commit criminal offences while doing the company's business. It is never a good idea on either a personal or professional level to do something which is likely to make either you or one of the company's directors liable for a criminal offence or even the risk of a criminal offence. It should also be noted that if a company has committed a criminal offence, even if it is not charged, it may have to be reported to a regulator under various "money laundering"/anti-crime legislation.

1.2 Non-enforceability of contracts

In many cases, when awards are granted to employees, the company wants that arrangement to be legal and enforceable. If the process is not legally compliant then the arrangements can be void or voidable. What this means is that at some point in the future if the process was not compliant and if the share price drops the individual could try and get out of the arrangement i.e. the individual could try and get their money back.

1.3 Dispute and litigation

Again if the process was not compliant on a local basis this can give rise to dispute and litigation by employees. Disputes always take time and cost money to resolve. They deliver no value to the company. Having a dispute with your employees also destroys the HR benefit you were trying to deliver. Therefore you want to avoid disputes if you can. It is important therefore to comply with local law regarding employment rights, contracts and discrimination for example.

1.4 Reputational risk

The importance of this depends on the particular kind of company. For example a financial services company which can only flourish if it is regarded as beyond criticism cannot be seen to ignore local laws even if those laws don't seem very important. If a company is found to have breached some legal requirement which becomes public that can be very embarrassing for the company and can damage its reputation publicly and with its regulators.

There is increased importance put on reputational risk for all companies – for companies to be seen as "Corporate Good Citizens" and not flout local laws.

1.5 Unintended consequences

Companies need to know what liabilities they are incurring when they set up an employee share plan. If companies do not do adequate due diligence then they may unintentionally generate problems for themselves. For example, they may increase their liabilities in terms of pensions or payments on a termination if they do not properly ensure that the share awards are separate benefits. Or if they have implemented a clawback clause, they may find it is not enforceable as it was not checked at the outset to be compliant with local employment laws.

1.6 Increased tax liability

Tax liabilities tend to translate directly into additional cost for the company. The company is therefore likely to be very keen to ensure that it does not unintentionally give itself additional tax liabilities. Often the way that a company operates share plans can affect the relevant tax due.

What follows are certain key issues which need to be examined on a country by country basis to make sure the company's share plan is compliant in various countries.

2 Securities laws

As we have said before the reason why securities laws are relevant is that the offering of a share plan usually involves the offering of shares. In almost every jurisdiction the offering of shares is a regulated activity. The general rule is that whenever shares are offered the company has to produce a prospectus. In the context of share plans companies never want to produce a prospectus because it takes a lot of time and money to do so and it would deliver no benefit to the employees. Therefore in each jurisdiction it is necessary to find an exemption which means that no prospectus is necessary. If there is no available exemption then the company has to consider whether to amend the plan in some way to avoid the need for a prospectus or possibly not operate the plan in that country. In a number of countries, even though there are exemptions available, there is still a need to file or report to the local regulator.

Some examples of jurisdictions where securities laws pose a serious issue are the US, Japan and the EU.

2.1 The US

In the US the regime governing securities laws divides between those companies which are reporting issuers in the US and those which are not.

- **S-8**. If you are a reporting issuer in the US then generally there are no limits on what share incentives you can award but you will have to make a filing on a form called the S-8.
- **701**. If the company is not a reporting issuer in the US then the company will have to come within an exemption. The main relevant exemption is called rule 701. For offers the total value of which is less than $5 million in any given year this exemption is fairly easy to satisfy. If however the value of the offer exceeds $5 million then there is significant additional disclosure required. There are certain other possible exemptions the most common of which is regulation D which is useful for individual sophisticated investors who are being made large awards.

  It is important to note that the US is a federal country. What this means is that we have to consider not only the federal legal position but also the individual state position. This can become a significant undertaking if the company has for example employees in 30 or 40 US states. Most of the states do not in fact require significant additional compliance effort as long as the company comes within a federal law exemption. However certain states, in particular California, do require specific terms to be included in the plan and filings to be made.

2.2 Japan

Japan has modelled its securities law quite closely on the securities law in the United States. If a company makes offers in Japan which exceed certain limited trigger levels then the company will

have to make significant filings in relation not only to that specific offer but also in relation to the company generally on an ongoing basis.

If a company becomes a reporting issuer in Japan it will have to file an annual report (Form 8); a semi-annual report (Form 10); and a Form 6 or a Form 7 whenever it makes an offer in Japan. It may also have to make filings in Japan whenever it makes offerings outside of Japan (yes – that sounds strange but is the case!)

These filings take a lot of effort and cost a significant amount of money. For a company which wants in effect to have a secondary listing in Japan then that may make sense. However for most companies the key message is that you have to ensure that your incentive plan offerings do not trigger filings in Japan.

2.3 Australia

Australia has significant securities laws which they enforce. If a publicly listed company makes a fairly standard plan offering in Australia then it is likely to come within what is called a class order exemption and only a fairly simple filing will be required. However if for some reason the plan does not come within the class order – for example if the plan is being offered by a non-listed company or if the share plan is in some way regarded as a derivative (for example because it is a plan based on a stock appreciation right), then special relief will be required from the Australian Securities and Investments Commission (ASIC).

2.4 The EU

In the EU securities law is made at an EU level which then has to be implemented at a local level by each of the 27 member states. The prospectus directive sets out the framework of the law applicable to the offering of securities within the EU. The general rule is that if a company offers shares then the company has to prepare a prospectus. As in other places there are exemptions which may apply. Companies will not want to provide a prospectus if they can avoid it.

- **EU listed companies**

  If the company has a listing on an EU exchange, the main relevant exemption is the employee share scheme exemption. This provides an exemption from the prospectus requirement for offers made in the context of an employee share plan. If the offer comes within this exemption then the requirements are very few – for example there has to be certain limited disclosure about the nature of the offer: the reasons for the offer and the number and type of securities which are subject to the offer.

  The directive has been applied inconsistently in EU member states in respect of what each country will regard as an EU listing. Some countries accept debt listings, others will only accept securities listed of the same class that is being offered to employees.

  The employee share plan exemption will be extended to include companies which are listed on other major stock exchanges including Dow Jones, NASDAQ and the Six Swiss Exchange. However at the moment companies which do not have an equity listing in the EU need to approach the securities laws in the EU carefully.

  This means that US companies for example may have to rely on other exemptions. Certain other available exemptions are:

  - offers to less than 150 people in any given member state
  - offers with a total value within the EU of less than €5 million
  - offers made to sophisticated investors
  - offers of non-transferable securities

  The problem with all these exemptions is that each state within the EU has implemented legislation which does not necessarily interpret these things in the same way. For example, is a non-transferable option over a listed company share a transferable security? Some

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countries take the view that the option itself is non-transferable and therefore it is exempt. Other countries, such as Germany, take the view that the security in question is the underlying share which is transferable and therefore the exemption does not apply. What this means is that if as a non-EU issuer the company is trying to make awards in many countries within the EU it needs to look at the interpretation of those rules on a state-by-state basis.

3 Other legal issues

3.1 Exchange control regulations

The basic questions which are relevant in relation to exchange control are:

- are there any restrictions on money leaving the relevant jurisdiction?
- are there any restrictions on money being sent to the relevant jurisdiction?
- are there any restrictions on individuals holding foreign assets?
- is there any requirement to repatriate funds on the sale of shares or dividends?
- are any filings or notifications required?
- can shares be held in a foreign nominee account?

Few countries now operate foreign exchange controls. However in certain countries they still exist and in certain countries it is a major issue. For example:

In China any share plan which involves either a Chinese national or a foreign national who has been resident in China for at least a year and who is employed by a Chinese subsidiary must be registered with SAFE (the State Administration of Foreign Exchange). The application process is a significant piece of work in its own right and requires various documents to be translated and submitted to the Chinese authorities. This can take at least three months to achieve. Assuming that consent is given what this means is that any payments in relation to the share plan in relation to those individuals covered by the consent have to be made through a specific foreign exchange bank account. There are also ongoing reporting requirements. There are certain aspects of share plans for which it is very difficult to get consent from the Chinese authorities. The main one of these is chargebacks. The process of passing money through the approved foreign exchange account also makes certain aspects of the plan very difficult to operate - in particular dealing with expats and leavers. This is the main example globally of where foreign exchange is a significant compliance problem in a major jurisdiction.

There are many other countries where foreign exchange can create issues but these are generally less significant from a company's perspective. For example in Argentina at the moment there are strict restrictions on sending money out of the country. In India there is a requirement to repatriate funds on the sale of shares and in many African countries it is very difficult to export foreign exchange.

3.2 Banking restrictions (and salary deductions)

The main issues in relation to banking are:

- can employees make deductions from salary and use those deductions for an employee share plan?
- are there any deposit taking issues?

Many plans involve the making of deductions from salary and the sending of that money from the local subsidiary to the parent company or to the administrator where the plan is being centrally managed. In some countries there is a problem with this because the law tries to protect employees by limiting the circumstances in which an employer can deduct money from their salary. These laws were usually developed to prevent the employer making unfair deductions (for example deducting the cost of breakages or theft). However in some countries the way that these laws are

drafted means that it is not actually legal for an employee to agree that some of his salary should be used towards a share plan. Examples of these countries are Hong Kong and Belgium.

Another significant issue surrounding this type of savings plan is that money is sent on a regular basis to be used in the plan. The reason this is a problem is that the industry of collecting and holding people's money is regulated (it is basically the banking industry) because individuals need to be protected from the situation where they deposit their money on a regular basis and then for some reason that money disappears either because of some fraud or because of bankruptcy for example. Therefore in many countries there is an issue of whether the administrator or the company which is collecting the money needs a licence to do so. In some countries it is necessary that the money is held by an authorised deposit taking institution. An example of this type of country is Australia.

3.3 Employment Law

In most countries there will be a body of law designed to protect the employee. Typically, employees will have an employment contract (although this is not always true, for example, in the US). Against this statutory and contractual background employees may then be given contractual rights through a share plan. The way these three sources of legal obligation relate to each other can be very different in different countries. The main things that the company will want to check in each country are:

- will it be possible to keep the share plan awards separate from the employment contract?
- will the share plan as contemplated offend against any compulsory laws in that country – for example will the plan be seen as discriminatory in any way?
- is there any requirement to have employee consultation about the plan?
- if there is a dispute will that dispute be heard locally because of the employment relationship or will it be heard under the law stated in the incentive plan agreement and in the country where the plan is operated from?

Employment law is one area of law which varies greatly from country to country. For example in Germany there may well be a requirement to consult with the employee works council about the plan. You may think that as the plan is giving additional rights to employees the works council would not create any problems for its implementation. However share plans often give very different benefits to people in different positions within the organisation. The works council may object to the fact that managers are receiving much greater benefits than the rank-and-file employees. The main consideration with works council consultation is that it can take a very long time to achieve.

3.4 Data protection

Data protection is frequently a concern in the context of global companies. In order to manage a global company, information about the employees, including very sensitive data about their pay levels and their terms and conditions, is often freely available throughout the HR function within that company. In many cases there is a single HR database which holds all such information. The reality therefore is that employee data is already being transferred around the globe.

In the context of a share plan various bits of information about specific individuals will need to be sent cross-border both within the company and to various external providers such as the administrator and perhaps the banker, broker and nominee. For example it will be necessary to give the email addresses and salary bands of the individuals to the administrator if you want the administrator to email the individuals asking them about the level of salary deduction they want to make.

The law on data protection however basically requires individuals to give their consent to any holding or using of data in relation to them and this is especially so if that data is transferred across border to countries which may not have strict data protection requirements.

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It is not possible for a share plan manager in the context of implementing a share plan to bring their entire corporate group into compliance with data protection law if that group is not in compliance at the beginning. However it is possible for the share plan manager to ensure that as soon as the process begins in relation to the share plan the individuals are told what data will be used by whom and where that data will be transferred to and to obtain their consent to that activity. It may also be necessary to make data protection filings in certain jurisdictions.

The key thing is to ensure that any data which is collected is kept secure (i.e. it is not put onto a laptop which is then lost) and to ensure that the data is only used for a proper purpose (i.e. the data showing who are the wealthy employees in the UK is not passed on to a marketing agency and no organisation that has access to it uses it for marketing).

3.5 Company law issues

Perhaps among all the issues which impact share plans the one which is most consistent on a global basis is how companies work. We have seen how some general legal principles, such as the requirement for the company to produce a prospectus when allocating shares, are universal. Although there are certain issues which are of course not globally consistent, the basic structure is very global.

In the context of employee share plans the key issues which the company will want to check are:

- is there a financial assistance issue and if so is there an applicable exemption?
- is there any requirement for specific approval either of shareholders or directors before a plan can be operated?
- are there any particular disclosure requirements either for the individuals or for the company on a local basis?

For example, if you want to do a tax approved plan in France or if you want to operate a plan in California it is necessary to get shareholder approval for that plan even if under the law where the company is incorporated there is no requirement for such shareholder approval.

3.6 Financial service firms

If a company is in the financial services sector, it will need advice on whether it is subject to any additional regulations with regard to the use of equity and disclosure. For example:

- following the financial crisis, the Financial Stability Board issued principles on remuneration and required its member states to have those principles implemented by their regulators;
- the EU also passed the Capital Requirements Directive III restricting pay for financial services firms covered by the Directive (the regulations will soon be changed following adoption of CRD IV)[1];
- the EU is also in the process of passing directives which will affect other firms in the financial services sector, including Solvency II, which will affect insurance companies.

4 Action!

Does your company review the legal issues in all/some of its countries?

Are there any potential risks with the approach being taken?

[1] We cover financial services remuneration regulations on our database – click through to the legal reports.