

HR Business Briefing

Reward in Irish Companies 2011

Introduction

Mark Carter
PwC HR Services

Featuring

Frank O'Dwyer

CEO

Irish Association of
Investment Managers

Pat Mahon

PwC Director

Velma Roberts

PwC Senior Manager

*Governance
aspects of
Reward Design*

*Share Schemes-
The most
effective
reward
mechanism?*

*PwC Reward
trends
snapshot
survey 2011*

PwC
June 16, 2011

GOVERNANCE ASPECTS OF REWARD DESIGN

Frank O'Dwyer
CEO
Irish Association of Investment Managers

IAIM ROLE

- **VALIDATION OF SHARE BASED SCHEMES**
- **PRO-ACTIVE ENGAGEMENT WITH PROXY VOTING AGENCIES**
- **MONITORING OF GOVERNANCE**
 - **SAY ON PAY**
 - **DISCLOSURE / TRANSPARENCY**
 - **REMCOM COMPOSITION / PERFORMANCE**

OUR APPROACH

- **SMALL POPULATION OF LISTED COMPANIES**
- **INDIVIDUAL ENGAGEMENT**
 - **EARLY (REMCOM & ADVISORS)**
 - **ANNUAL (BEST OF BREED)**
- **TAILOR MADE SOLUTIONS TO CURRENT DESIGN CHALLENGES**
- **TRADITIONAL FOCUS ON SHARE BASED ELEMENT**
 - **FIXED & VARIABLE PAY NOW OF SIGNIFICANT INTEREST**
- **ASSESSMENT OF GOVERNANCE CULTURE FUNDAMENTAL**

GOVERNANCE CULTURE

- **OBSERVANCE**
 - REMCOM MEMBERSHIP
 - SAY ON PAY
 - PAST ROBUSTNESS
 - TRANSPARENCY / DISCLOSURE

- **BREACH**
 - (IR) RELEVANCE OF METRICS
 - INAPPROPRIATE PEER GROUP
 - CONSULTANTS 'WORKING' FOR EXECUTIVES
 - OVERLY FAST TURNAROUND TIMES
 - FAILURE TO ALIGN WITH RISK
 - UNDEMANDING VESTING TARGETS
 - SKILLSET ON REMCOM
 - REGULAR VISITS TO THE WELL
 - POOR DISCLOSURE

BASIC / BONUS

- **REALISTIC ASSESSMENT. NOT JUST PEERS. COMPANY PERFORMANCE RELEVANT.**
- **RELEVANCE AND FOCUS OF BONUS METRICS. DISCLOSURE.**
- **CASH COMPONENT OF BONUSES**
- **CLAWBACK**
 - **COMPLEX**
 - **POSSIBLE TAILORING**
- **ROOM FOR PERSONALISED TARGETS**
- **SEVERANCE ARRANGEMENTS**
 - **LEVEL**
 - **DISCLOSURE**
- **CURRENT ISSUE: SHORT TERM FOCUS**

SHARE BASED PAYMENTS

- **IT IS THE SHAREHOLDERS' EQUITY!**
- **EPS NO LONGER A PROXY FOR VALUE**
- **TSR SHOULD BE MAJORITY COMPONENT**
- **UNDERPINS**
 - **COMPANY SPECIFIC**
 - **RANGE FROM 'REASONABLENESS' TO HURDLES**
- **WHY RESTRICT TO 2 COMPONENTS (TSR and EPS) ?**
- **LONGER VESTING PERIODS MAY BE APPROPRIATE**
- **EVIDENCE OF EXECUTIVE SHAREHOLDING COMMITMENT**

SHARE BASED PAYMENTS (Contd)

- **ALL VEHICLES CONSIDERED. NEED COMMON VALUATION BASE.**
 - **VALUING OPTIONS NO LONGER CLEAR-CUT**
- **MAXIMUM VALUE OF ANNUAL AWARDS**
 - **SIZE, NATURE OF BUSINESS**
 - **NATURE OF METRICS**
 - **SETTING A NORMAL MAXIMUM AND ABILITY TO EXCEED**
- **VESTING AT MEDIAN SHOULD NOT BE EXCESSIVE**
 - **RELATIVE TO BASIC**
- **IMPLICATIONS OF GEOGRAPHIC SPREAD**

CRD 111

- **EFFECTIVE SINCE 1 JANUARY**
- **C.B. SEEKING REMUNERATION POLICY STATEMENTS**
- **U.K. EXTENSIVE PRE-CONSULTATION**
 - **FSA TEMPLATES APRIL 2011**
- **REMCOM / REMCOM PROXY NEEDED**
- **SIGNIFICANT ASPECTS**
 - **REMCOM / REMCOM PROXY NEEDED**
 - **PROPORTIONATE APPLICATION**
 - **CONTROL FUNCTION REMUNERATION**

CRD III (Contd)

- **REMCOM**
 - **SUBSIDIARIES IN IRELAND**
 - **REMUNERATION OF CONTROL FUNCTION PERSONNEL**
- **PROPORTIONALITY**
 - **BALANCE SHEET RISK**
 - **FSA: 4 TIERS : NEUTRALISATION**
- **WHO IS COVERED**
- **DESIGN ASPECTS**
 - **RETAINED SHARES / OTHER INSTRUMENTS. CASH ELEMENT**
 - **DEFERRAL**
 - **PERFORMANCE ADJUSTMENT**
 - **PROFIT MEASUREMENT AND RISK ADJUSTMENT**
 - **GUARANTEED BONUSES / RETENTION AWARDS**
 - **FIXED / VARIABLE RATIO**
- **LIKELY C.B. APPROACH**

Share Schemes

The most effective reward mechanism?

Pat Mahon, PwC Director

Share Schemes

The most effective reward tool?

- **Opportunities for HR**
 - Key data from PwC CEO surveys
 - The basics from recent tax/PRSI changes
 - Delivering savings through shares schemes

1. PwC CEO Survey findings Strategies for Managing Talent

Global CEO Survey 2011

83%

Top agenda item for 2011

[1,201 Global CEO's]

(2. Risk 77%)

(3. Investments 76%)

(4. Org. structure 74%)

Irish CEO Pulse Survey 2011

31%

3rd most critical item for 2011

[182 Irish CEO's]

(1. Reducing costs 59%)

1. PwC Global CEO Survey

PwC's view on Talent Management Reality

Many companies have not identified key talent

Designed to keep key talent?
Non-talent over-incentivised?

CEOs are asking:

- Are HR teams delivering **strategic thinking** needed to drive growth?

1

Who?

2

Incentive/reward models

3

HR Function effectiveness

1. PwC Global CEO Survey

***Global CEO
response to
challenge of
motivating &
retaining staff***

- “Instilling a deeper sense of ownership by **spreading employee stock ownership more widely** is another important retention tool.”

1. PwC CEO Survey findings

Irish CEO Pulse Survey

68%

of companies reviewing **bonus plans** in 2011

39%

reviewing **pension** arrangements

18%

reviewing **share** schemes

2. Tax/PRSI changes made simple

National Recovery Plan

Nov 2010

Budget 2011

Dec 2010

Social Welfare Act 2010

Dec 2010

Finance Act 2011

Feb 2011

Minister for Finance statement

Mar 2011

Revenue statement

Mar 2011

Revenue statement

Apr 2011

Jobs Initiative

May 2011

Social Welfare Bill 2011

?

2. Tax/PRSI changes made simple

The main message

Position pre-1 January 2011

- Self assessment
- No PRSI

Changes for 2011

- PAYE
- New Employee PRSI charge - 4%

NB: These changes do not significantly reduce share plan effectiveness

2. Tax/PRSI changes made simple

PRSI

Employer PRSI

- Will not apply. **NB**

Employee PRSI @ 4%

- No PRSI if on awarded evidenced in writing pre 1 Jan 11:
 - Options granted 2010 or earlier
 - Share awards promised in 2010 or earlier
- PRSI refunds?
- New awards from 1 Jan 2011 are liable

2. Tax/PRSI changes made simple

Share Options

No change to:

- Self assessment obligations
 - Income tax due 30 days
 - Tax return due 31 Oct

What has changed?

2011 changes:

- USC due within 30 days via self assessment
- *Employee PRSI for new grants

**Generally, no PAYE likely on 2011 option exercises*

2. Tax/PRSI changes made simple

Share Awards

Major change for companies

- **PAYE withholdings are required NB**

PAYE system must collect:

1. Income tax (41%)
2. Universal Social Charge or USC (7%)
3. Employee PRSI (4% on new awards only)

Treat as 'notional pay'

2. Tax/PRSI changes made simple

Share Awards: 2010 v 2011 value comparison

2010

| | |
|-------------------|---------------|
| Share award (RSU) | €3,500 |
| Income tax (41%) | (€1,435) |
| PRSI | - |
| Income levy (4%) | (€140) |
| Net value | €1,925 |

...and a cashflow benefit

2011

| | |
|-------------------|---------------|
| Share award (RSU) | €3,500 |
| Income tax (41%) | (€1,435) |
| PRSI* (4%) | (€140) |
| USC (7%) | (€245) |
| Net value | €1,680 |

...and immediate PAYE

2. Tax/PRSI changes made simple

Revenue Approved Profit Sharing Schemes (APSS)

The benefits

- Full income tax relief at 41% remains. **NB**
- Salary foregone facility remains
- €12,700 limit retained

What has changed

- Employee PRSI & USC on appropriation
 1. Pay from other net salary; or
 2. Receive APSS shares net of PRSI/USC

2. Tax/PRSI changes made simple

Revenue Approved Profit Sharing Schemes (APSS)

Means of funding USC/PRSI

| | SCENARIO 1 | | | SCENARIO 2 | | |
|--------------------------|------------|----------------|----------------|----------------|--------|----------------|
| QUALIFYING BONUS | | | €12,700 | | | €12,700 |
| (A) APSS Shares | | €12,700 | | €10,332 | | |
| (B) USC/PRSI on Shares @ | 11% | €1,397 | | €1,137 | | |
| Tax on (B) @ | 52% | €0 | | 52% | €1,231 | |
| Net Cash | | (€1,397) | | €0 | | |
| | | €12,700 | | €12,700 | | |
| EMPLOYEE POSITION | | | | | | |
| Shares to a value | | 12,700 | | 10,332 | | |
| Payroll hit | | (1,397) | | 0 | | |
| Net value received | | 11,303 | 89% | 10,332 | 81% | |

2. Tax/PRSI changes made simple

Period of Grace

30 June 2011 extension

- To regularise 2011 PAYE share awards
- P30 filing date of 14 July 2011 (or 23rd if ROS) will suffice
- Interest/penalties thereafter

2. Tax/PRSI changes made simple

PwC Summary of 2011 Employer Obligations

| | Share Awards (Including RSUs) | Share Options | Revenue Approved Schemes (APSS, SAYE, ESOTs) |
|--------------------------------------|---|--|---|
| Income tax | With effect from 1 January 2011 all share awards to be treated as notional pay and employer withholdings for PAYE required on vesting. | No employer PAYE withholding required. Employee must pay tax on option gain within 30 days of exercise via RTSO1 procedure. | No income tax due via withholdings (if conditions for approved scheme are met). |
| Universal Social Charge (USC) | With effect from 1 January 2011 all share awards to be treated as notional pay and employer withholdings for USC required on vesting. | No employer USC withholding required. Employee must pay USC on option gain within 30 days of exercise via RTSO1 procedure. | Employer to account for USC due via payroll withholding when shares are appropriated (APSS/ESOT), or when SAYE options exercised. |
| PRSI | If grant of award was subject to a written agreement before 2011 no PRSI should be due. If grant of award was subject to a written agreement on or after 1 January 2011 PRSI to be withheld via payroll on vesting. | If option grant was subject to a written agreement before 2011 no PRSI should be due. If option grant was subject to a written agreement on or after 1 January 2011 PRSI to be withheld via payroll on exercise. | If award was subject to a written agreement before 2011 no PRSI should be due. If award was subject to a written agreement on or after 1 January 2011 PRSI to be withheld via payroll on appropriation via APSS, or on exercise for SAYE options. |
| Reporting | Notional pay must be reported on relevant P60 and annual P35 employer returns. Share awards must also be reported on Form RSS1 for the relevant year (deadline 31 March following year-end). | Where PRSI is due, P30/P35 employer reporting requirements apply. Share options must also be reported on Form RSS1 for the relevant year (deadline 31 March). Employees should report option gains on Form RTSO1 within 30 days of exercise and on annual personal tax return by 31 October. | P30/P35 employer reporting requirements apply. Share awards must also be reported on the annual return for the specific scheme for the relevant year (deadline 31 March following year-end). |

3. Delivering savings through share schemes Restricted Shares / “Clog” Schemes

- Reduced taxable value if restriction on sale
- Other conditions apply (e.g. a trust)
- Taxable value is reduced by fixed percentage:

| Years of restriction | Abatement |
|----------------------|-----------|
| 1 | 10% |
| 2 | 20% |
| 3 | 30% |
| 4 | 40% |
| 5 | 50% |
| greater than 5 | 60% |

- Tax clawback if conditions breached.

3. Delivering savings through share schemes

Restricted Shares / “Clog” Schemes

- **Governance** rules easily satisfied
 - easy to link to performance strategy
 - forfeiture can be facilitated
 - retaining shareholding
- **Tax** efficiency
 - a tax relief that was not curtailed in past 18 months!
 - popular for Long Term Incentive Plans (LTIP)
 - an alternative where pension cap exceeded?

3. Delivering savings through share schemes

Approved Profit Sharing Schemes (APSS)

- **Opportunity for HR**

- lead a cost saving initiative
- employer PRSI saving (versus cash)
- New tax rules don't impede
- US parents can do it
 - Pharma sector most successful in persuading parent

- **68% of Irish CEOs looking at bonus plans (& performance!)**

- APSS's work best off bonuses
- Companies are implementing 'performance based' APSS
- PwC precedents agreed with Revenue

3. Delivering savings through share schemes

APSS Savings Example

Bonus pool €2.0m

1,000 employees

Bonus through APSS €1.0m

Average salary €40k

Salary foregone €0.5m

5% bonus

€1.5m

Employee tax savings €0.6m

50% take shares

Employer PRSI savings €160k

1/2 forego salary

4. Opportunities for HR

Who owns PAYE & reporting responsibility on share plans

1

Can HR partner with Finance?

Communications with staff

2

Updates required?

Generating cost savings

3

APSS or Clog Scheme

CEO Agenda

4

Ensure HR has the same priorities

Upcoming Webinar

2011 PwC Global Equity Incentive Survey

**PwC US hosting a
Webinar**

29 June @ 5pm GMT

**70 participants have
Irish operations
Likely to focus on
compliance challenge**

**Registration details
on our website**

www.pwc.com/ie/hrs

PwC Reward trends snapshot survey 2011

Velma Roberts, PwC Senior Manager

Introduction

Survey overview

- What are companies doing in relation to reward?
- 155 companies in Ireland
- Salary movements / pockets of pressure
- Prevalence of incentives and benefits
- Changes planned in 2011 and 2012

Detailed trends for all industry sectors

- Banking
- Insurance
- Construction & engineering
- Food & drink
- Retail
- Pharmaceutical
- Medical devices
- Telecoms/ ICT
- Other

48%

***reviewing reward
programmes***

Economic backdrop

- Difficult climate
- Signs of recovery?
- Challenging fiscal environment

| | 2010 | 2011 (f) | 2012 (f) |
|---------------------------------------|------|----------|----------|
| CPI | -1.0 | 2.5 | 2.5 |
| GDP | -1.0 | 2.0 | 3.0 |
| GNP | -2.1 | 0.5 | 2.0 |
| Unemployment rate (% of labour force) | 13.6 | 14.3 | 14.0 |

Source: ESRI Quarterly Economic Commentary Spring 2011

Salary movements



2%

Salary increases

Median salary increase 2010, 2011 & 2012

2%

- For companies who gave / are giving an increase*
- Median is similar at all employee levels
- Variations by industry
 - 2010 Insurance, Pharmaceuticals, Banking
 - 2011 Little variation
 - 2012 Construction, Banking, ICT
- Higher increases evident
 - Risk & compliance
 - Senior IT, finance & sales roles
 - Experienced technical experts

*The percentage of companies providing an increase in 2010, 2011 and 2012 varies by employee level

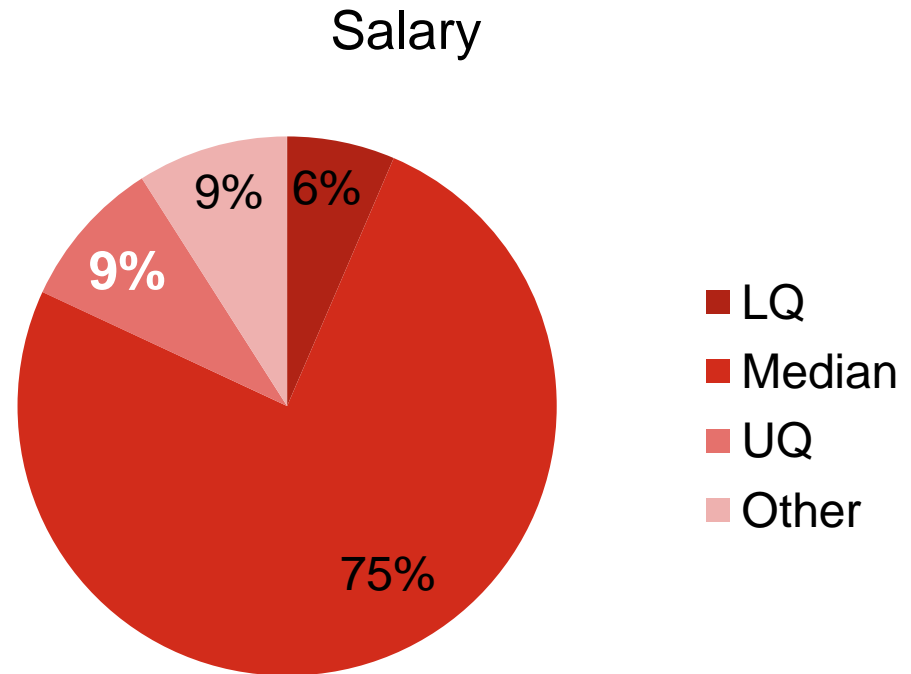
Drivers of salary increases in 2011?

| | |
|---------------------------|-----|
| Company performance | 69% |
| Individual performance | 64% |
| External benchmarking | 51% |
| Business unit performance | 30% |
| Consumer price index | 27% |

Salary increases

Remuneration philosophy

- 9% position **salary** at upper quartile versus market
- 24% position **total remuneration** at upper quartile versus market



Impact on market rates vs. wage restraint

Other remuneration provided



Other remuneration provided

| | |
|---------------------------|-----|
| Annual bonus | 79% |
| Long-term incentive plans | 45% |
| Pensions | 98% |

Other elements of reward...

| | |
|-------------------------------|-----|
| Performance management | 61% |
| Flexible working arrangements | 70% |

Reviewing annual bonus plans?

33% **HR**

PwC Reward trends snapshot survey 2011

68% **CEOs**

PwC CEO Irish Pulse Survey 2011

6%

***Addressing
pension cap***

Other findings

- **34%** providing share plans
- **75%** provide private medical insurance, life assurance, long term disability and short term sick pay
- **77%** provide car benefit
 - Car allowance more prevalent than company car
- **50%** companies have unpaid leave programmes e.g. sabbaticals
- Cost management

***Appropriate
communication
/employee
surveys***

What are companies saying?

“reviewing performance to improve productivity and reduce waste”

“increasing the annual bonus performance link for more junior colleagues”

“reviewing all benefits and will make changes where **COSTS** are not sustainable”

“Salary rate is not the most pressing issue for employees. **Job security** is a higher consideration.”

“As we expand, we are aligning our reward strategy to support our corporate growth goals to get the best return on our investment.”

Summary findings

***HR has a key role
to play in driving
business strategy***

- **60%** salary increases in 2012
- **2%** typical increase for all employee levels
- **48%** of companies reviewing reward programmes
- Link to performance and cost savings

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