Title: Employee Ownership and Share Buy Backs **IA No:** **Lead department or agency:** BIS **Other departments or agencies:** None.	**Impact Assessment (IA)** **Date:** 20/08/2012 **Stage:** Consultation **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:**

Summary: Intervention and Options

RPC Opinion: N/A – de-regulatory

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
			Yes	OUT

What is the problem under consideration? Why is government intervention necessary?

The independent Nuttall Review of employee ownership set out the significant economic and social benefits of employee ownership, which the Government has endorsed. Employee owned companies sometimes need to buy back their shares to distribute them to new employees in the company. Buy backs are voluntary arrangements between companies and a shareholder. The Nuttall Review found that the regulation of the process of buying back shares was overly burdensome for companies. It recommended that Government reviews those regulations with a view to simplifying them.

What are the policy objectives and the intended effects?

The objective of the measures being consulted upon is to simplify and deregulate the process companies must comply with when buying back shares. The intended effect is to make it easier for employee owned companies to undertake share buy backs by removing administrative burdens they experience. The measures would also make employee ownership more attractive insofar as it is less burdensome to administer.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 1 (preferred option, as per Nuttall Review recommendations) – Consulting upon measures targeting the three key stages involved in share buybacks pursuant to employee share schemes, which would relax the conditions under which companies can (i) authorise buybacks, (ii) finance buybacks, and (iii) hold shares that are repurchased in treasury.
Option 2 – Do nothing.

Option 1 is preferred to the status quo given the Government's agenda to promote employee ownership, as per the agenda set out in the Nuttall Review, and the Government's broad agenda to reduce the regulatory burden on business.

Will the policy be reviewed? It will be reviewed 3 years after implementation.

Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**	**Non-traded:**	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: .... Date: ....

Summary: Analysis & Evidence — Policy Option 1

Description: Relax the conditions under which share buybacks that are pursuant to employee share schemes are carried out.

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

Costs have not been monetised at this stage of policy development. We are consulting to develop our evidence base and to be able to monetise where possible.

Other key non-monetised costs by 'main affected groups'

The policy proposes to remove certain restrictions from existing legislation and is therefore deregulatory and is not expected to impose any new costs on business. The consultation aims to test whether deregulating would result in unacceptable risks resulting from removing regulation. These risks could pertain to reducing the scope for shareholders to have discretion over share buy backs entered into by a company, and to the risk to creditors to a company of allowing the company more flexibility in arranging buy backs.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Benefits have not been monetised at this stage of policy development. We are consulting to develop our evidence base and to be able to monetise where possible.

Other key non-monetised benefits by 'main affected groups'

Firstly, the measures would reduce administrative burdens associated with existing regulation, and increase the flexibility for companies who wish to arrange share buy backs. Secondly, the measures may also encourage an internal market of shares within private companies which would make their shares more liquid. Thirdly, by making the process easier, the measures may also promote employee ownership more generally, which carries significant economic and social benefits for participating companies and individuals.

Key assumptions/sensitivities/risks **Discount rate (%)**

The benefits of the proposed simplifications and de-regulations are dependent on companies using the new flexibilities afforded them.

The consultation period will be used to obtain stakeholder views on unintended consequences.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs:	**Benefits:**	**Net:**	Yes	OUT

Evidence Base

Problem under consideration

1. Employee ownership is implemented through either (i) the use of an employee benefit trust in which shares in a company are held collectively on behalf of the company's employees ("indirect share ownership"), (ii) the use of a share plan which enables employees to become individual shareholders in the company ("direct share ownership"), or (iii) a combination of (i) and (ii).
2. There are benefits to both indirect and direct share ownership schemes and it is up to the company considering adopting an employee ownership structure to determine which option best suits their needs. The independent Nuttall Review of employee ownership found, for example, that some companies seek to embed employee ownership into their governance structures by using Employee Trusts to hold shares. Other companies prefer direct share ownership and allowing employees to benefit from, and to be incentivised by, shares they hold as individuals.
3. The Nuttall Review concluded that there are key Company Law challenges faced by companies seeking to utilise direct share ownership. These challenges pertain to both the regulatory burden and restrictions associated with buying back company shares and restrictions upon the ability of private companies to hold shares in treasury.
4. Thus, the Nuttall Review recommended that:

Recommendation V

The Department for Business, Innovation and Skills should consult upon improving the operation of internal share markets to support companies using direct share ownership, including holding private company shares in treasury and facilitating share buy backs.

5. There are three key provisions which regulate how buy backs may be administered. Broadly, these are designed to protect the interests of shareholders and creditors. However the Nuttall Review concluded that they were unduly burdensome for employee owned companies, and may be holding back more employee ownership in the economy, which is a stated Government objective. The relevant provisions are below and the consultation will aim to test whether they should be simplified whist at the same time minimising the risk of removing the regulatory protection and benefits the original provisions are designed to ensure.

(i). Authorisation of a share buyback.

6. *The status quo* – private companies may only buy back shares off-market (i.e. not on a regulated investment exchange) if they have a buy back contract authorised by a *special resolution* of the shareholders (i.e. with 75% agreement) (ss.693-695 CA 06). Such a resolution is needed each and every time a buyback is sought. An ordinary resolution is needed for market purchases.
7. The regulation provides shareholders with oversight over the running of the company and action the company may to arrange share buy backs.

(ii). Financing share buybacks.

8. *The status quo* – a company when buying back shares must (i) pay for them in full and (ii) finance the purchase using distributable profits, or the proceeds of a fresh issue of shares made for the purpose of financing the share buyback. In addition, a private company may also use its share capital, but to do so is subject to a number of further restrictions to protect the interests of shareholders and creditors to the company. The range of financing options to limited companies is therefore restricted.
9. Preventing payment by instalments protects the interests of creditors. If payment was allowed in instalments, the share capital available to creditors on the insolvency of a company would be diminished. This includes the interests of shareholders who if they sell their shares back to a

company, thus becoming creditors, may be vulnerable should a company subsequently become insolvent.

(iii). After share buyback.

10. *The status quo* – when shares have been bought back, they are either cancelled or held in treasury. Shares held in treasury may be disposed of (sold for cash or transferred for an employee share scheme) by the company, but while holding them the company cannot exercise any associated ownership rights. Only shares that are listed or traded on a regulated market may be held as treasury shares, meaning that private companies do not have this option and must cancel shares following a buyback. Private companies have to go through the process of issuing new shares should the company wish to enable new or different employees to own shares in the company, which is a relatively more expensive and time-consuming process.

11. Allowing private companies to hold shares in treasury was considered during a previous consultation process on Company Law, but no interest in allowing this flexibility was identified at that time.

Rationale for intervention

12. The Nuttall Review set out the benefits of employee ownership. In light of these benefits, the Government is pursuing an agenda to remove barriers to further uptake of employee ownership in the private sector. The Nuttall Review identified a number of such regulatory barriers, including those relating to share buy backs (Recommendation V, cited above). The topics in this consultation are those that the Nuttall Review raises.

Benefits of employee ownership

13. There is widespread evidence that employee ownership has a positive impact on both business and employees. The Nuttall Review provides an analysis of the benefits of employee ownership (in Chapter 2 of the final report). The Nuttall Review links employee ownership with the following outcomes:
    - improved business performance, in terms of profitability, productivity as well as employment growth;
    - increased economic resilience, with employee owned businesses outperforming traditional businesses during the recessionary period following 2008;
    - fostering employee commitment and engagement;
    - greater innovation, although the evidence in this regard is somewhat ambiguous and requires further investigation;
    - enhanced employee well-being by cultivating a sense of engagement with management;
    - reduced absenteeism.

14. It is important to note that although a wide body of literature generally tends to find that employee ownership is mutually beneficial to both the employees and the organisation, a strong theme which emerges is that share ownership should be combined with enhanced engagement practices in order to reap the full benefits of employee ownership.

15. In addition to the above research, stock market data indicates that employee owned businesses perform very well. Field Fisher Waterhouse compiles and maintains a stock index of employee owned businesses, which has outperformed the FTSE All Share by an average of 10% annually since the index's inception in 1992. There are also several success stories of employee owned businesses that have been compiled by the Employee Ownership Association.[1]

[1] See the information available at the website of the Employee Ownership Association http://www.employeeownership.co.uk/employee-ownership/about-employee-ownership/case-studies/.

Policy objective

16. The policy objectives of the proposals to be consulted upon are to : -

- Reduce the administrative burden faced by companies when administering share buy backs, and to increase the flexibility of those companies so they may administer buy backs in the manner most effective for them and their employees;
- Reduce the extent to which firms are disincentivised from adopting an employee owned structures because of an aversion to complicated processes; and
- Ultimately, make employee ownership more attractive and thus more widespread in the economy, given its economic and social benefits.

17. A further objective is to ensure any simplification minimises the likelihood of unintended consequences and does give rise to undue risks to either businesses or employees participating in employee share schemes.

Description of options considered (including do nothing)

Option 1 (preferred option) – Consultation upon a package of measures designed to reduce the regulatory burden on companies using direct share ownership. The consultation will aim to determine the benefits of simplifying these provisions whilst testing whether the regulatory protections and benefits derived from the provisions are already secured by other means.

In terms of scope, policy proposals (i) and (iii) below relating to the authorisation of buybacks and treasury shares will affect private companies only. Policy proposal (ii) regarding the financing of share buybacks will affect limited companies.

The proposals being consulted upon are: -

(i) Authorisation of a share buyback.

The status quo: private companies may only buy back shares off-market (i.e. not on a regulated investment exchange) if they have a buy back contract authorised by a *special resolution* of the shareholders (i.e. with 75% agreement) (ss.693-695 CA 06). Such a resolution is needed each and every time a buyback is sought. An ordinary resolution is needed for market purchases.

Consultation: we will consult on whether they should be made subject to an ordinary resolution.

(ii). Financing share buybacks.

The status quo – a company when buying back shares must (i) pay for them in full and (ii) finance the purchase using distributable profits, or the proceeds of a fresh issue of shares made for the purpose of financing the share buyback. In addition, a private company may also use its share capital, but to do so is subject to a number of further restrictions to protect the interests of shareholders and creditors to the company.

Consultation: we will consult upon whether and how provisions could be simplified to allow companies seeking to buy back shares more flexibility in paying for buybacks.

(iii). After share buyback.

The status quo – when shares have been bought back, they are either cancelled or held in treasury. Shares held in treasury may be disposed of (sold for cash or transferred for an employee share scheme) by the company, but while holding them the company cannot exercise any associated ownership rights. Only shares that are listed or traded on a regulated market may be held as treasury shares, meaning that private companies do not have this option and must cancel shares following a buyback. Private companies have to go through the process of issuing new shares should the company wish to enable new or different employees to own shares in the company, which is a relatively more expensive and time-consuming process.

Consultation: we will consult on allowing private companies to hold shares in treasury, after they have bought back shares.

Option 2 – Do nothing. Under this option there would be no change to the current regulatory structure surrounding share buybacks.

Monetised and non-monetised costs and benefits of each option

18. In the current consultation stage IA, an attempt has not been made to monetise any of the costs and benefits associated with the policy. The intention is to utilise the consultation period as an opportunity to obtain further information from stakeholders regarding the quantification of the likely impact of the policy proposals. Therefore, for the purposes of this IA, a qualitative analysis of the costs and benefits is provided.

19. Examples of the type of questions that will be put forward to stakeholders in the consultation document are provided below. This gives an indication of the type of quantitative information we intend to elicit about costs and benefits from consultation respondents as well as whether there are wider costs and benefits which are not immediately apparent.

Option 1

Benefits

20. The overarching benefits are to reduce regulatory burden and increase flexibility, and to increase the attractiveness of employee ownership – which carries significant social and economic benefits as set out in the Nuttall Review. The population affected will be companies who utilise employee ownership via the direct share ownership structure described above. It is difficult to estimate the exact population figure of this group. The Employee Ownership Association estimates that employee owned companies (using a definition of 'employee owned companies' which refers to companies more than 20% owned by employees) make up to 2% of the economy (by turnover). Companies below that 20% threshold also utilise employee share plans and thus are in scope of these simplifications, so that figure is likely to be low.

(i). Benefits of simplifying the process to authorise share buybacks.

21. Simplification – or removal – of the requirement to hold a special resolution in order to authorise the repurchase of company shares, is aimed at reducing the administrative burden to companies of arranging and administering a special resolution, with which there is likely to be a both cost and time demand associated with doing so. This benefit would apply to private companies seeking to arrange share buy backs.

(ii). Benefits of easing financing restrictions on share buybacks.

22. Removal of the requirement to pay for shares in full at the time of repurchase is designed to give companies more flexibility in financing buy backs. This should in turn lower the costs to businesses by allowing them more scope to manage their payments and opt for the most suitable arrangement that the particular instance requires.

23. Permitting a greater range of funding options is intended to increase the flexibility of businesses in how they can finance share buy backs, thereby allowing them to select the most suitable financing arrangement for their particular needs. These benefits would apply to limited companies.

(iii). Benefits of holding shares in treasury.

24. It is proposed that private companies should be able to hold repurchased shares in treasury in order to prevent the need for such companies to go through the burdensome procedure of cancelling and re-issuing fresh shares as the need to do so arises (for example, in order to provide shares to new starters in the company).

25. Furthermore, holding shares in treasury allows – to some extent – a market in the company's shares to be created, making them more liquid and increasing the ability of employee owners to realise capital gains they make on their share holding.

<u>Costs</u>

26. The policy proposals are deregulatory, removing requirements which exist in current legislation. There may be small familiarisation costs incurred by employee owned companies who are already aware of and use the existing provisions, and who would need to learn the new provisions and changes made to them. We do not expect familiarisation costs to apply to employee owned companies who have not used these provisions before – they would need to learn the provisions anew whether or not these changes were made. Apart from potential familiarisation costs, we can determine no other direct costs associated with the proposals at this stage, although there are some potential wider risks to the proposals described below.

(i). Simplification of the process to authorise share buybacks.

27. The proposal may reduce regulatory protections aimed at allowing shareholders to control or veto a company from pursuing employee share schemes. However there are a number of other regulatory protections which already provide for this: for example, (i) director's duties, (ii) the ability of shareholders to (via special resolution) alter a company's Articles of Association to prevent share buy backs, and (iii) the requirement for a company to gain approval by special resolution if the buy back payment is to be made out of capital.

(ii). Easing financing restrictions on share buybacks.

28. Allowing instalments may put creditors and share sellers at a disadvantage if the company becomes insolvent before all instalments of payment have been made.

<u>List of consultation questions</u>

General

1. Do you agree that Company Law regulations on share buy backs and treasury shares can act as an impediment to further uptake of employee ownership? If so, to what extent?

Authorisation of share buy backs

2. What estimate do you make of the time or cost of complying with this regulation in your company/ the companies you represent; or of operating alternative arrangements such as an employee trust?

3. Do you agree that allowing private companies to arrange share buy backs should be subject to an ordinary resolution rather than a special resolution? Would this change simplify the authorisation process, help remove unnecessary costs, and make employee ownership easier to administer?

4. Do you agree that this proposal provide shareholders with adequate oversight and discretion over the activities of companies in the respect of share buy backs?

5. Are there any potential issues or unintended consequences that could arise from implementing this proposal? Are there more effective alternatives?

Financing buy backs

6. What estimate do you make of the time or cost of complying with this regulation in your company/ the companies you represent, or of operating alternative arrangements such as an employee trust?

a) Payment by instalments

7. Do you agree that payments by instalments (a) a useful flexibility for companies, (b) an acceptable risk for general creditors, and (c) an acceptable risk for selling shareholders?

8. Do you agree that the maximum time period over which payments may be made should be solely a matter of negotiation between the buying company and the selling shareholder? Or should a maximum time period be specified in statute?

b) Sources of finance

9. Are the current financing restrictions an unreasonable limitation to companies seeking to buy back shares for the purposes of an employee share scheme?

10. Do you agree that the current restrictions be removed without issues or unintended consequences for the remaining shareholders?

After share buy back

11. Do you agree that private companies should be able to hold shares 'in treasury'?

12. If you agree that it would be helpful for private companies seeking to administer employee ownership to have an ability to hold shares 'in treasury', can you estimate the extent of this benefit?

13. Do you agree that shareholders will have sufficient oversight over private companies if they are able to hold shares in treasury?

Rationale and evidence that justify the level of analysis used in the IA (proportionality approach)

29. This IA draws on a significant body of research outlining the benefits of employee ownership for companies and individuals. The proposals are intended to enable employee ownership schemes to operate more effectively and are therefore designed to help unlock the general benefits of employee ownership established in the literature. The primary benefit of the policy proposal is therefore difficult to quantify; it is complex to accurately monetise the benefit of creating a more flexible environment in which employee share schemes are operated. Nevertheless, the policy does remove certain administrative cost burdens and it is the intention that the consultation period will help to shed light on the order of magnitude of these savings.

30. In recognition that the policy is deregulatory and the benefits of employee ownership are established by the independent Nuttall Review, it is felt that the level of analysis presented in this IA is sufficient for the purpose of characterising the policy's impact at this stage in the policy process. Although costs and benefits have not been explicitly monetised, this IA describes the areas in which the policy is likely to result in a cost reduction to firms as well as where wider risks could potentially arise, allowing respondents to the consultation to express independent assessments of the analysis.

31. We expect the final stage IA to draw on the evidence gathered in this consultation.

Risks and assumptions

32. The policy package is intended to *enable* a more flexible approach to the implementation of employee share schemes. The benefits from the policy would only be realised to the extent that companies decide to take up the new flexibilities available to them subsequent to any de-regulation.

33. The policy proposals contained in this IA represent only one part of a wider set of recommendations set forth in the Nuttall Review. The policy objective – to facilitate more employee ownership in the private sector – will thus be met not only be this policy proposal, but by several others set out in the Government's agenda to promote employee ownership and implement the Nuttall Review.

Direct costs and benefits to business calculations (following OIOO methodology)

34. At this stage of the policy development process, quantified costs and benefits have not yet been calculated and as a result a direct net cost to business under OIOO methodology has not been explicitly provided.

Nevertheless, the analysis provided in this IA indicates that the policy is a deregulatory "out" and is anticipated to result in a net reduction in the costs to business. Most of the costs that the consultation stage will seek information on are direct administrative burdens.

Wider impacts

35. We will be consulting with stakeholders on likely wider impacts and any possible unintended consequences of the policy proposals. We do not anticipate that the proposals are discriminatory on the basis of the categories set out in the Equalities Act 2010.

36. A waiver from the micros exemption will be sought so all company sizes can benefit from any deregulation.

Impact on Micros

37. Given that no major costs are anticipated from the deregulatory measures being proposed, and any familiarisation costs are likely to be small, we are consulting on the basis that the policy package would be applicable to micros.

Summary and preferred option with description of implementation plan

Summary

38. For the reasons set out above, the Government proposes to consult upon targeted reforms relating to the operation of internal share markets, specifically in order to remove administrative burdens incurred during the process of share buybacks by companies.

39. The policy measures being proposed follow recommendations made by the Nuttall Review of employee ownership. They target the key steps in the buyback procedure. The proposed changes would be deregulatory and remove restrictions on companies' ability to (i) obtain shareholder approval for share buybacks, (ii) finance buybacks and (iii) hold repurchased shares in treasury.

Implementation plan

40. Subject to consultation and on current plans, the Government would proceed with secondary legislation in the New Year.

Post implementation review

41. We will undertake a post implementation review 3 years after implementation.