



TWO SEAS TRUST



October 2010

Briefing: Employee Incentive Plans

Preface

The world of executive remuneration and the forms of incentive provided is ever changing and increasingly competitive. Retaining and motivating employees and indeed winning new high profile executives over to your company requires a well structured and effectively administered remuneration package.

Employers need to be aware of the products that are available in the market place and have access to experienced advisors and trustees to effectively manage the risks and rewards associated with executive compensation plans.

This guide highlights the variety of plans in the market and illustrates the fact that schemes can be tailored to meet specific requirements as needed.

Carried Interest

The continuing growth in the funds industry worldwide has driven the need for competitive executive incentive plans and efficient methods for delivering carried interest arrangements. It is important to motivate and encourage senior executives such that their goals are congruent with those of their employer. Share ownership schemes often provide this synergy, but dealing with the carried interest on fund arrangements in a tax efficient manner or through retention arrangements is often an added incentive that will attract Western as well as Middle Eastern talent to an organisation.

These incentives are delivered through trust, company and partnership arrangements and can be tailored to meet each client's needs.

They can also be structured to include standard cash based employee benefit plans as a means of delivering discretionary bonuses to executives of companies and partners in a partnership.

Start-up Companies

One of the most difficult achievements for start-up company owners is the ability to attract and retain high quality employees that are as excited about the business as the founders are.

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A shortage of cash flow in the early years, means large cash bonuses and high salary increases often cannot be realised. Employees who are able to participate in share price growth will be motivated to meet the company's goals as well as act as a retention tool or effective lock-in period if the incentive is high enough.

The structure affords joint participation in the company's equity for the employee and the employee benefit trust. The employee participates in the growth in share value, whilst being bound by certain trigger events that are designed to retain, motivate and stretch the client's management team.

The structure meets the company's need to reach aggressive growth targets, whilst retaining key executives and provides a tax efficient incentive mechanism for delivering equity participation to ex-pats as part of a competitive remuneration package.

Cash Deferral Plans

Cash based incentive plans remain very popular with the financial sector, where traditionally high discretionary bonuses are paid.

Cash deferral trusts such as these provide very strong retention and incentive tools for employers and allows employees access to the trust assets through loans as well as the ability to recommend investment strategies to the trustees.

The use of the trust takes the assets off the employer's balance sheet and out of the hands of any potential creditors of the company; this provides security to key executives.

An additional benefit of using a trust is its ability to facilitate bonus deferral schemes with possible clawback of cash bonuses during the bonus deferral period. A trust allows for bonuses to be revoked without the employee having to repay any cash they may have received and perhaps already spent. This enhancement in delivering financial sector bonuses has been approved in the EU and United Kingdom and may be enforced in other jurisdictions in the years ahead.

Occupational Savings Schemes

Bahraini trusts can be used to establish Occupational Savings Schemes to segregate and safeguard employee funds in a scheme from those of the employer for the benefit of the

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employees. Please see our separate client briefing on Occupational Savings Schemes for more information.

Motivating Ex-Pats

Even though tax savings are not a concern for employees working in the Middle East, it may be necessary to consider the way in which incentive arrangements are delivered for ex-pats who may be moving back to their home countries. The use of trusts may assist in mitigating taxes at a later date for these employees and could enhance the company's ability to attract and retain key executives.

Market Maker

Private companies often have the problem of an illiquid market for trading shares. An employee incentive plan can assist in creating a market for a company's shares as part of a share incentive scheme.

The trust fulfils a dual role in addition to the share incentive arrangement. The trust can both create a market in the illiquid shares as well as hedge the company's exposure to its own share price prior to awards vesting, by holding or "warehousing" shares in the company. The delivery of value to participants is therefore capped at the value of the initial shares contributed to the trust and those shares can be "traded" between employees within the trust should an employee leave the company's employ and the articles forbid the holding of shares by ex-employees.

Advantages of a Trust Structure v Employer Operated Schemes

Insolvency

- ✓ Legal title to trust assets is vested in the Trustee under the Trust Instrument and will not be available to meet claims by creditors of the Manager / Employer or the Trustee in the event of their insolvency.

Responsibility

- ✓ The Trustee is responsible for the management of the trust assets and is the first point of call for employees.

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Employee Protection

- ✓ Bahrain based trustees are regulated by the CBB under the Financial Trusts Law. The Trust Instrument and Trust Law set out the duties that the Trustee has towards the employees as beneficiaries of the Trust.

Disputes

- ✓ The identity of the settlor and beneficiaries of a Bahraini trust are not in the public domain and therefore confidentiality is maintained.

Disputes

- ✓ Due to the fact the Trustee has a fiduciary duty towards the beneficiaries of the Trust, conflicts between employer and employee can be minimised. If there were to be a contentious matter between an employee and the Trustee, the employer's reputation remains intact.

Management Time

- ✓ The Trustee will administer the incentive plan and is able to provide full reporting services to the employees thus freeing up senior company management time to focus on the company's core services.

Flexibility

- ✓ The Trustee can adopt the existing plan rules
- ✓ The plan rules can set out in detail the investment policy
- ✓ The Trustee can delegate the investment management function
- ✓ An Advisory Committee can be appointed to offer suggestions to the Trustee on matters relating to investment management
- ✓ The assets under the existing plan can simply be transferred into the name of the Trustee as trustee of the Employee Benefit Trust



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Loans

- ✓ Employees can receive loans from the trust property or continue to receive loans in the same manner as they do under an existing scheme.

Trustees

- ✓ Individuals or Companies can be appointed as co-Trustees if required.

Plantrack – Integrated Web-based System

Plantrack is an integrated web based system used by Two Seas Trust to track, maintain and communicate the incentive awards within employee benefit plans.

The system is designed for various employee benefit schemes, including:

- Share based plans such as Share Option Plans,
- Restricted Share Plans and Long Term Incentive Plans
- Employee Benefit Trust / deferred compensation plans
- Executive fund selection schemes.

Online Access for Plan Participants

Plan participants are provided with secure online access to view and interact with their incentive awards at any time of day and from any location. Details of participants' current awards together with valuations and information about previous transactions are available. Plan documentation and associated literature such as plan rules and operational documentation may be downloaded and participants' personal details can be managed.

Online Access for Employer

Employer representatives can be permitted secure online access to view participants' awards at both an individual participant and consolidated levels. For example, access can be provided on a per country basis only allowing the local employer access to the awards of those participants in their country or at a head office level where all participant information can be accessed.

Reporting tools are also available to employers. These enable bespoke reporting of the entitlements of an individual participant or a broader population to be obtained.



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Dedicated Administration System

PlanTrack's administration capabilities allow the Employee Benefit Team to manage share based employee benefits plans and the associated participant awards accurately and professionally from a central platform.

PlanTrack has functionality which facilitates the administration of tax approved and unapproved arrangements. It can also operate with multicurrency and multi-instrument plans. Extensive reporting capabilities allow for bespoke reports and statements to be easily produced and distributed.

Should participants wish to take advantage of our Corporate Nominee facility post vesting and exercise of share awards, these details can also be viewed online through PlanTrack.

Secure Environment

The centralised system makes use of the latest technology and has been developed with high standards of security and audit controls. PlanTrack utilises the latest industry tested technology to provide a secure solution for both the internal administration system and the external participant/employer facing system. PlanTrack has automated back-up facilities and is fully integrated into Two Seas Trust's disaster recovery processes.

The external website server is housed securely in an offsite location with a specialist provider and regular replication of the administration database to the participant/employer facing website controls the information displayed to participants.

Occupational Savings Schemes (“OSS”)

Definition

An employee benefit trust may fall within the requirements of an OSS where it is established for the purpose of providing savings benefits to full time employees in the context of their occupational activity and on the basis of an agreement between the employer and employees, employers and employees of the same industry or on the basis of certain other arrangements including pooling.

Trustee

Where the employee incentive plan does fall within the definition of an OSS and is operated or managed or has its administration or trustee services provided from Bahrain, it will need to be registered with the Central Bank of Bahrain (“CBB”) as an OSS and be constituted as a trust under the Financial Trusts Law. The trustee, therefore, will be required to be licensed by the

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CBB and that trustee must take custody of the assets of the OSS. The trustee may also act as manager, provided that the CBB are satisfied that it has the necessary resources to fulfil its obligations as such.

Trust Instrument

The trustee should have power under the trust instrument to obtain professional advice and engage other service providers, should be obliged to take safe custody of the assets of the OSS and should be obliged to monitor the performance of the fund manager of the scheme.

Investment Policy

The OSS is required to adopt a written investment policy which is acceptable both to the trustee and to the beneficiaries of the trust and that policy must make provision for the scheme to invest in low risk financial instruments other than those issued by the employer or any of its associates or subsidiaries, with consideration being given to capital preservation and diversification of investment across sectors and markets. The policy should also provide that the investment manager will refrain from borrowing or lending in the management of the OSS's assets. The Trustee may lend to the participants in OSS provided that this is permitted by the trust instrument and is in the best interests of the participants as a whole.

Reporting

The trustee must appoint external auditors acceptable to the CBB. Audited accounts, together with a report addressing the solvency of the scheme and its adherence to its investment policy and the published rules relating to the operation of OSS, should be submitted to the CBB on an annual basis and to the employer within three months of the end of the financial year of the scheme. Reports must also be provided on an annual basis to the beneficiaries of the scheme on its operation, which must clearly disclose the charges and fees incurred by the scheme and the returns made by it.

Books of account must be maintained in Bahrain in respect of the scheme and record keeping should comply with the requirements of the CBB and International Financial Reporting Standards.

Size

In order to qualify for registration of an OSS, the scheme must have a minimum size of BHD250,000 (Bahraini Dinars two hundred and fifty thousand) or the equivalent.

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Regulation

The trustee of the scheme must act in an open and co-operative manner with the CBB and must conduct its activity in a professional and orderly manner and the scheme will be subject to inspection by the CBB as part of its supervisory role. The CBB may also impose further terms and conditions as it deems necessary when registering a scheme.

Conclusion

It is possible to tailor employee incentive arrangements to meet employer's specific financial and incentive remuneration needs.

A crucial element to effective remuneration planning is the use of experienced and professional advisors as well as professional, independent trustees and administrators that can deliver the service excellence that your scheme demands.

The Two Seas team provides proactive administrative services that will meet these needs. We are able to draw upon the experience of the Employee Benefit team at Ogier (see below) for support and details of the latest developments in employee benefit arrangements in Europe and also the legal team which has significant experience establishing offshore structures.

About Two Seas Trust

Two Seas Trust is a joint venture between Ogier Fiduciary Services (Jersey) Limited and Keypoint Consulting W.L.L. and is regulated by the CBB for the conduct of trustee, administration and related services. This includes employee benefit solutions and the administration of trusts and companies which own a diverse range of assets globally and in the GCC.

About Ogier

Ogier is one of the world's leading providers of offshore legal and fiduciary services employing over 850 professional and support staff. The group has a presence in nine jurisdictions around the world, namely Bahrain, the British Virgin Islands, the Cayman Islands, Guernsey, Hong Kong, Ireland, Jersey, London and Tokyo.

Ogier provides advice on all aspects of BVI, Cayman, Guernsey and Jersey law and associated fiduciary services through a global network of offices that cover all time zones and key financial markets including the rapidly growing Asian and Chinese markets.

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Ogier continues to be recognised as a leading law firm by the leading legal directories, including Legal 500 and Chambers. In Legal 500 Ogier have more tier 1 rankings for individual practice areas than any other Jersey firm.

About Keypoint

Keypoint is a leading provider of statutory advisory, accounting, fund administration and recruitment services in the Middle East. Based in Bahrain they currently provide corporate administration and fund administration services to a wide variety of clients including banks, individuals, real estate and private equity houses.

Prior to 2006, Keypoint formed a part of Ernst & Young Middle East.

Keypoint is licensed by the Ministry of Industry and Commerce in Bahrain and where relevant by the CBB for the conduct of all aspects of its business.

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