ProShare

Parliamentary briefing

For 40 years employees have been able to make savings through their workplace salaries without paying income tax from their monthly salary and at very low financial risk. Savings have paid for deposits for first time buyers, weddings, trips of a lifetime as well as creating a nest egg to draw upon in difficult times.

Whilst all employee share ownership plans have undoubtedly helped employees and employers considerably over the years of their operation, some of their design features are very much the product of their respective times. But times change, and so do workforces, workplaces and the nature of work itself, rendering some of these features irrelevant or actually counter-productive. Changes in how employee share schemes operate would open these advantages to more employees by making them simpler to manage and more attractive, particularly to younger workers. These changes would also benefit business. Employers who operate schemes experience increased productivity, better staff retention and stronger employee engagement.

Over 90 of the FTSE 100 offer these schemes to their employees and tens of millions of employees have benifited financially since they first became operational in 1980. The way we work has evolved and now these schemes need urgent reform to drive up participation, allowing more staff to participate and employers to more fully realise the business benefits.

1. What are employee share ownership plans?

There are two 'flagship' employee share ownership plans operating in the UK which between them are used by more than 1.7 million employees each year to save and invest:

- **Save As You Earn (SAYE):** Employers offer staff the opportunity to save up to £500 each month for a fixed term of either 3 or 5 years. This money is usually deducted from the employee's pay each month. At the end of the term, the employee can exercise an option to buy shares at a price that was fixed at the outset – usually at a 20% discount on their original value. If, at the end of the plan, the shares are worth less than this 'offer price', the employee can take back their money, with a cash bonus. There are currently over 700,000 UK employees participating in SAYE schemes. The average monthly savings amount per employee is £162.45.

- **Share Incentive Plans (SIPs):** There are a number of ways SIPs work but most commonly employees buy shares from their gross salary (the limit is either £1,800 or 10% of the employee's income for the tax year, whichever is lower) providing an automatic discount for taxpayers, or an employer offers free shares to the employee each tax year, up to the value of £3,600. If an employee keeps the shares in the plan for 5 years they don't pay Income Tax or National Insurance (NI) on their value. Employees don't pay Capital Gains Tax on shares sold if they are sold at the end of the plan. 1m employees participate in SIPs every year, with an average monthly contribution of £98.

2. Benefits of employee share ownership plans

- **Improving productivity**: *Oxera* estimates that the effect of tax-advantaged employee share schemes (or individual share ownership) on company performance is significant and productivity increases by 2.5% in the long term.
- **Increasing employee engagement and staff retention:** Evidence supports the notion that giving workers a stake in their employer enhances their commitment and motivation. For instance, the MacLeod Review of employee engagement named employee ownership as a 'profound and distinctive enabler of high engagement'.
- **Increasing employees' financial independence** and decreasing reliance on the state.
- **Increasing and promoting saving**, helping people to avoid debt & to put money aside for retirement.
- **A gateway into financial investment:** surveys have found that employee share ownership makes people more interested in other types of investment – suggesting that it can encourage individuals to engage more with savings and investment products.

3. About ProShare

We are a not-for-profit organisation that has been the voice of ESO since 1992 when we were established by the Government, a group of FTSE 100 companies and the London Stock Exchange to promote wider share ownership. Today, we are funded only by our members and focus solely on helping to promote employee share ownership (ESO) in the UK as the voice of employee share plan practitioners and professionals.

4. Key policy objectives

We would like to see the introduction of a number of measures designed to simplify plans and remove barriers to participation:

- **Reduce the SIP holding period from 5 years to 3 years:**
  - A SIP encourages employee share ownership as soon as an employee joins the plan. The shares, once awarded or purchased, are required to be held in a SIP Trust on behalf of participating employees for at least 3 years (Dividend shares) or 5 years (Free, Partnership, Matching shares) before they can be sold without attracting an income tax charge or NICs for the employee and usually the employer in the form of Employer's NICs.
  - ProShare's research study *'Attitudes To Employee Share Ownership'* found that, far from encouraging retention, the 5 year holding period for SIP shares actively discourages eligible employees from participating in the plans. 24% of non-participants say that they didn't join their employer's SIP because the 5 year holding period was too long.
  - The differing tax treatments for Free, Partnership and Matching shares up to 3 years, and between 3 and 5 years, are also confusing and hard for most eligible employees to understand. This makes the plan difficult for employers to communicate effectively to their workforce, and in turn lessens take-up rates and undermines the plan's primary intention to create and foster broad-based employee share ownership.
  - ProShare recommends the removal of the 5 year holding period, and the retention of a single, simpler to understand, communicate and administer, 3 year holding period for all SIP shares.
  - This change is supported by the CBI and the SMF.
  - A ProShare survey found that 93% of companies offering a SIP believe the 5 year period is too long. The same survey also revealed that 35% of companies that do not currently offer a SIP, but do offer another form of employee share plan would offer a SIP if the period was reduced to 3 years.

- **SIP 'bad levers' – the tax treatment for dividend shares exiting the SIP is anomalous and unfair:**

    - The current system penalises individuals who have, in good faith, saved and invested through their employer's SIP but choose to leave their employer before the end of their savings plan.
    - Participants who withdraw shares from their plan to take up a new job are classed as 'bad leavers' and incur tax on up to 3 years' worth of their dividend shares, the cumulative value of which may only be set against that single tax year's dividend tax allowance (which has reduced from £5,000 to £2,000). It must also be reported via self-assessment tax return which many of these people would not normally ever have to complete.
    - A fairer way of taxing dividend shares when a participant leaves their employer as a 'bad' leaver, would be to allow their cumulative value to be set against the value of the taxpayer's dividend tax allowance for the 3 preceding tax years.

- **Make resignation from an employer a 'good' leaver reason for SAYE:**

    - SAYE is essentially a savings scheme, facilitated through company payroll, with an option to use those savings to buy shares at a discounted option price at the end of the savings period.
    - However, in common with SIP, employees who resign from their job and exit their SAYE scheme are classed as 'bad leavers'. Unlike 'good' leavers (for example, people who retire or are on long term sick leave) who are able to exit their SAYE at the point of departure and exercise their option to buy company shares at a discount, bad leavers are forced to cash in their investment with all the monies saved returned to them.
    - Resignation should be re-categorised so that people changing jobs are classed as 'good leavers' and can exercise the options they have saved up to the point of their leaving date.
    - The current situation results in a particularly poor outcome for younger employees whose average employment tenure is 2.2 years. In fact, ProShare's research demonstrates that 18% do not participate in SAYE as they do not believe they will be at their employer long enough to benefit.

Conclusion

The employee share ownership sector backs these proposals, all of which we believe could be introduced with relative ease and we are keen to work with policy-makers to help secure these changes.

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