Company Management's Share-related Bonus Schemes in Publicly Unlisted State-owned Companies and Associated Companies, 19 December 2000

To the Cabinet Committee on Economic Policy

General Starting Points and Principles

The Memorandum of the Cabinet Committee on Economic Policy of 11 January 2000 states that the incentive emoluments bound to shareholding are applicable only to publicly listed companies. After this, needs have, however, risen for binding the company management with promotion of profitability and rise in value in state-owned companies and associated companies that are not publicly listed.

This memorandum outlines the principles and basic features that the share-bound engagement schemes and incentive schemes must observe in publicly unlisted state-owned companies and associated companies. The aim is that the outlines set out in this memorandum would complement the Memorandum of the Cabinet Committee on Economic Policy referred to above.

The starting point of these outlines is the Government Decision-in-Principle on the State's Corporate Ownership Policies of 16 September 1999. For instance, it states as follows:

"...Where possible, the engagement and incentive schemes used at listed companies should encourage the executive management to acquire shares in the company. Such systems shall motivate the management to adopt measures that support in the long term as efficiently as possibly the company's financial performance, ability to pay dividends, and increase the price of its shares in a way that is in the interest of the owner."

The engagement and incentive schemes intended for the top executives of publicly unlisted companies could be developed on the basis of the following general principles:

1. The engagement-/incentive scheme should encourage the top management to and engage it in long-term positive development of the company's financial performance and ability to pay dividends and of the share value.

2. The scheme shall be transparent: the calculation and other bases must be given in the company's annual report in so great a detail that an outside reader can get a notion of the contents and the effects.

3. The scheme must be reliable: the calculation and other bases must be such as to allow for an unequivocal assessment of the subscription price of the shares and the development of the value of the shares during each bonus period.

4. A maximum of 10% of the share capital may be included within the framework of the engagement and incentive schemes of the top management, unless there are company-specific justified special reasons for (e.g. the small size of the company) deviating from this upwards.

5. The scheme is to provide the so-called beneficiary with an exit possibility, i.e. the possibility of selling the shares obtained by him or have them bought.

6. At the same time as new bonus and engagement schemes are developed, incentives motivating and engaging the entire personnel should also be developed.

Based on the above general principles, it could be recommended that the top executives of the publicly unlisted state-owned companies and associated companies are encouraged and engaged either with a share-related bonus scheme or through their wallets. The share-related bonus scheme would provide the management with the possibility of obtaining a pre-set number of the company's shares, if the share values developed positively during the bonus period. 'Obliging through the wallet' means that the executives buy the company's shares with their own money or finance their acquisitions with borrowed money and commit themselves to keeping these shares in their possession for as long as it is considered necessary in view of assessing the development of the share value (at least 3 to 5 years).

Share-related Bonus Scheme

The share-related bonus scheme has the following characteristics:

An important factor is that the incentive calls for production of economic value added during the entire bonus period.

- If no economic value added is created, granting of an incentive is not justified, because in this case the assets of the current owner (i.e. the State) would be watered down. This condition shall apply to the entire bonus period, so that the value added would be significant to the owner.

- In determination of the value added, the requirement concerning the revenue on equity must describe the average return requirement on the stock market, so that the reference criterion for the calculations could be the profitability of the company's alternative investment objects, i.e. the other companies.

The bonus period must be at least 3 to 5 years.

- A sufficiently long time period also ensures that the added value has not been achieved at the expense of the operating conditions and profitability.

In the case of a director, the maximum number of shares is proportioned to his other salary (e.g. corresponding to his salary), and the shares subscribed with the bonus may be 10% of the share capital at a maximum, unless there exist justified company-specific special reasons for higher bonuses. When calculating the number of shares, an expert independent of the company shall determine the value of the shares in a reliable manner.

- Proportioning the bonus to other salary tends to reduce the significance of the tax implications in determining the salary and bonuses.

- When the maximum number of the shares is set at ten per cent, the main owner (i.e. the State) keeps almost full control of all issues of the company.

The right to subscribe for shares under the bonus scheme is not realised until after the end of the bonus period. The prerequisite for this realisation is that the value added accrued during the bonus period is cumulatively positive.
A director accepted within the bonus scheme may choose himself to what extent he will avail himself of his possibility of subscribing shares.

In the case that the company will not be listed nor its share will not otherwise be subjected to public trading during the financial period following the bonus period in compliance with the Securities Markets Act (495/1989), the director is provided with an opportunity to get back the shares subscribed for by him to the company or to sell them to the State and/or to the other owners at the subscription price.

- The aim is to guarantee the exit possibility to the director in a situation where it is not possible to list the company or where the plan concerning it will be delayed due to the market situation or for other reasons.

- On the other hand, if it is appropriate for the State as an owner, the State can buy the shares from the director at a current price referred to in sub-paragraph 14:19 of the Companies Act (734/1978) after the financial period following the end of the bonus period. The State owner commits itself to the practice according to which it will not use its statutory redemption right before this period of time. (It follows from the upper limit of the bonus scheme referred to in sub-paragraph 3 above that the State maintains the ownership and voting share of nine tenths required by this provision, which entitles it to the redemption. If the number of shares of the top management is higher than the ten per cent provided for in sub-paragraph 3, it is agreed in the shareholder's agreement between the director and the State that the procedure to be followed in the redemption is, however, the one laid down in the sub-paragraph mentioned above.)

The bonus scheme must be transparent.

- The calculation bases must be given in the annual report in so great a detail that outside readers get such a notion of the contents of the scheme that they can assess the impact of the economic development.

- The bonus scheme is controlled by an expert outside the company, e.g. an investment bank acting as an agent of the State owner.

Engagement through the Wallet

Engagement through the wallet may take place under the following conditions:

1. The top management may subscribe for the company's shares provided that it commits itself to holding these shares at least for 3 to 5 years. The shares to be subscribed for may amount to no more than 10% of the company's share capital, unless there are justified company-specific special reasons for raising this limit.

2. The subscription price of the share cannot be lower than the current price of the share. On the basis of company-specific considerations, the subscription price may be lowered, but the reduction cannot, however, exceed 10%.

   The bonus scheme is controlled by an expert outside the company, e.g. an investment bank acting as an agent of the State and possible other owners.

3. The subscriber for the shares finances his acquisition either with his own money or with borrowed money.

   The company and its owners cannot support the financing of the share acquisition.

4. In the case that the company will not be listed not its share is not otherwise subjected to public trading referred to in the Securities Markets Act (495/1989) during the financial period following the bonus/engagement period, the director will be provided with an opportunity to buy back the shares subscribed by him to the company or to sell them to the State and/or the other owners. However, the sale price of the share shall be no less than the subscription price referred to in sub-paragraph 2.

- If it is appropriate for the State as an owner, the State can buy the shares from the director at a current price referred to in sub-paragraph 14:19 of the Companies Act (734/1978) after the financial period following the end of the bonus period. The State owner commits itself to the practice according to which it will not use its statutory redemption right before this period of time.

- The redemption price shall be no less than the subscription price referred to in sub-paragraph 2. (It follows from the upper limit of the bonus scheme referred to in sub-paragraph 1 above that the State maintains the ownership and voting share of nine tenths required by this provision, which entitles it to the redemption. If the number of share of the top management is higher than the ten per cent provided for in sub-paragraph 1, it is agreed in the shareholder's agreement between the director and the State that the procedure to be followed in the redemption is, however, the one laid down in the sub-paragraph mentioned above.)