POLICY FRAMEWORK FOR EMPLOYEE STOCK COMPENSATION PLANS

(“ESCP”)

TRINIDAD AND TOBAGO SECURITIES AND EXCHANGE COMMISSION

Guidelines for

Employee Stock Compensation Plans

May 14, 2009

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PART I – BACKGROUND AND PURPOSE

Introduction

The use of equity-linked compensation schemes to remunerate employees at varying levels in public companies has increased significantly in Trinidad and Tobago and the wider Caribbean over the past few years. Two forms of this type of compensation scheme exist – the *Employee Stock Ownership Plan* and *Employee Stock Option Plan.* These have become an important feature in the compensation packages of the management and employees of public companies. Collectively, for the purpose of this Paper, both types of compensation schemes would be referred to as Employee Stock Compensation Plans.

Equity-linked compensation Plans have been touted as a possible solution to the agency problem as it seeks to ensure the alignment of shareholder and management interests by providing incentives that are directed toward the maximization of shareholder wealth through focus on increasing the share price. However, this incentive mechanism has also posed new forms of the agency problem, whereby a management team is driven by self interest to take measures that artificially increase the share price in the short-term but to the detriment of the Company's long-term prospects. Additionally, these compensation measures may further entrench a management team by shifting effective control of a public Company from its shareholders to it management.

In 2007, the Commission had released for public comment, an earlier version of Guidelines for Employee Stock Compensation Plans ("the Guidelines"). The Guidelines have since been amended to take into account these comments. This Paper will take an introductory look at Employee Stock Compensation Plans, the current regulatory framework, and the attendant regulatory issues before reviewing the feedback that was received from the market in 2007. Finally, the draft guidelines that have been prepared are presented for further comments.

What are Employee Stock Compensation Plans?

Employee Stock Compensation Plans include both Employee Stock Option Plans and Employee Stock Ownership Plans.

Employee Stock Option Plans

Employee Stock Option Plans are contracts between a Company and its employees that give an individual employee the right, but not the obligation to buy a specific number of the Company's shares at a specified price **("the exercise price")** within a specified period of time **("vesting period")**. Employee Stock Option Plans tend to be issued to key employees or executives of publicly traded companies.

Structure of Employee Stock Option Plans

In a public company, an Employee Stock Option Plan is normally created either by Resolution of the Company's Directors or with the approval of the Company's Shareholders. Typically, the maximum number of options that can be granted to employees pursuant to the Plan is set when the Plan is created. The options are then placed in a hypothetical pool.

Depending on the rules of the Plan, options will be granted to employees as time progresses. The number of options granted to employees, the frequency of these disbursements, as well as the exercise price of the option and the exercise date are also governed by the Plan's rules.

Options usually have a ***vesting period***, meaning that the options must be held for a specific period of time before the right to purchase the Company's shares can be exercised.

In most Plans, the exercise price of the option is normally set at or above the current market price of the Company's share. This serves as an incentive for employees to whom the options are granted to ensure that the Company performs well so that at the exercise date, they can purchase the Company's share at a price that is lower than the current market price. Thus, employees may profit from the exercise of these options when the exercise price is lower than the actual price of the share at the time the option is exercised.

If at the exercise date the market price of the share is above the exercise price of the option, the rational employee who holds that option will exercise his right and purchase the Company's shares. Upon exercising his/her option to purchase the Company's shares, the employee is allowed to exercise the voting power attached to the shares.

Typically, at the employee's retirement, any shares purchased by the employee are re-sold to the Plan.

Employee Stock Ownership Plans

An Employee Stock Ownership Plan ("Plan") is a retirement Plan in which the Company contributes its stock to the Plan for the benefit of the Company's employees. The employees never take physical ownership of shares purchased pursuant to the Plan. Instead, the shares are held in the name of the Plan and may be voted by the management committee of the Plan in the interest of the Plan's participants. The Board of directors or decision makers of the Plan itself, in most circumstances comprise members of the Company's management. At retirement, employees become entitled to the shares in the Plan and can either take ownership of the shares or sell the shares back to the Plan. Unlike Employee Stock Option Plans, these Plans are normally targeted towards the rank and file employees of the Company.

Structure of Employee Stock Ownership Plans

Employee Stock Option Plans, (the Plans) are normally created either by Resolution of the Company's Directors or with the approval of the Company's Shareholders.

Once approval has been granted for the creation of the Plan, the Company places its shares under the control of the Plan's management. This can be done in one of two ways: the Company can issue new shares to the Plan or alternatively, it can purchase shares for distribution to employees of the market as and when the need arises.

Shares are then allocated to employees in accordance with the Plan's rules. As mentioned before, the shares remain under control of the Plan's management until the employee retires. It is worthwhile to note that the management of the Plan controls all voting rights attached to shares held in the Plan. At retirement, the employee can either take ownership of the shares or sell the shares back to the Plan.

The Need For Registration & Regulation

Are Options Granted Under Employee Stock Option Plans Securities?

Section 3(1) of the Securities Industry Act, 1995 ("the Act") defines a security as:

> *"…"security" means any document evidencing ownership or any interest in the capital or debt, property, profits, earnings or royalties of any enterprise or proposed enterprise and, without limiting the generality of the foregoing, includes any-*
>
> a. *bond, debenture, note or other evidence of indebtedness;*
> b. *share, stock, unit, unit certificate, participation certificate or certificate of share or interest;*
> c. *instrument commonly known as security;*
> d. *instrument or document constituting evidence of any interest or participation in-*
>   i. *a profit sharing agreement;*
>   ii. *a Trust;*
>   iii. *an oil, natural gas or mining lease, claim or royalty or other mineral right; or*
> e. ***right to acquire or dispose of anything specified in paragraphs (a) to (d),…"***

Given the above definition it is clear that options granted to employees as part of an Employee Stock Option Plan, are securities and as such should be registered with the Commission in accordance with Section 65(1) of the Act. The Issuer of the securities must also be registered as a Reporting Issuer in keeping with Section 64(2) of the Act, once the securities are being offered to the public i.e. in excess of thirty-five investors.

The Commission’s Current Regulatory Regime For Employee Stock Compensation Plans

The Commission currently applies one registration regime to both Employee Stock Option Plans and Employee Stock Ownership Plans. Under the current regime, the Commission registers only the ***shares*** that are issued by both the Stock Ownership Plans and the Stock Option Plans.

When a Reporting Issuer initially seeks to register shares under any of these Plans the Issuer is asked to provide the Commission with copies of the Plan’s constituent documents as well as any shareholder/director approvals that would have been necessary to create the Plan. These documents indicate the number of shares that have been approved for allocation to the particular Plan at hand.

The Commission currently requires that Issuers register shares only when they are about to be issued. Issuers are therefore, not granted the freedom of having a reservoir of shares that sit in a “fund” from which they can draw upon to satisfy the participants in the Plan as the need for shares arises.

When an Issuer wishes to issue shares to holders of options, it submits an application to the Commission for registration of the relevant number of shares on the required application form (Form No. 4) and the necessary registration fee. The registration form captures a limited amount of information including:

- The Directors in the Company and their residential address;
- The total number and value of shares in the Company in issue excluding the shares for which the application is made; and
- The number of shares the Company currently wishes to register pursuant to the employee stock compensation Plan.

Once the Commission grants its approval for the registration of the said shares there is no subsequent correspondence from the Issuer until it wishes to register a further set of shares for the Plan. This lack of correspondence after the Commission has granted its approval for the registration of shares pursuant to an Employee Stock Compensation Plan can cause various problems.

Problems Encountered

Reconciliation exercises undertaken by the Staff of the Commission have revealed that there should be some correspondence post-registration among the Commission, the Issuer and the Stock Exchange. Quite frequently, shares are registered pursuant to a particular stock compensation plan, but as a result of delays in the registration process on both the Issuers’ side as well as the Commission’s, the options for which the shares are registered are not exercised. This means that there are differences in the number of shares that are registered with the Commission and the number actually issued and outstanding.

Problems also arise at the Stock Exchange which lists shares registered in accordance with a particular Plan. From the Commission's standpoint, the Exchange lists these shares, provided that the Issuer provides documentary evidence of the shares being registered with the Commission. Once again, not all the shares that are registered are necessarily listed on the Exchange. This often leads to discrepancies between the Exchange's figure and the information filed with the Commission.

Notably, under the current disclosure regime, the Commission does not receive notice of:

1. The date on which the options are exercised. As mentioned above, holders of options may not always exercise their options right after registration of the said shares. This too can result in discrepancies between the Commission's records and the number of shares that are actually in issue and remain outstanding; and

2. The identities of the holders of options. In the case of Employee Stock Option Plans, the options to purchase shares in the Company are normally granted to executives or top management. It is important that the Commission maintain a record of the directors' holdings in a Company and is also equally important to track movements/dilutions/concentration of substantial shareholdings with respect to Reporting Issuers.

Overview of Comments Received from the Market

By way of circular letter dated August 14, 2007, the Staff of the Commission requested feedback from all registered Reporting Issuers on a prior version of the Guidelines. The following is a summary of the salient points from feedback received.

(i) Application of the Guidelines to Non-Publicly Traded companies – Registrants commented that the requirement to register shares or options that were issued pursuant to Employee Stock Compensation Plans should not extend to Reporting Issuers that were not publicly traded on a Stock Exchange. They argued that most Employee Stock Compensation Plans restrict the transfer of shares/options. Accordingly, the requirement to have shares/options that are issued pursuant to these Plans registered seemed impractical.

While the Staff has noted this concern, it must also be noted that the provisions of the Act require the registration of any security offered by a Reporting Issuer. Accordingly, the Guidelines ***must*** apply to all Reporting Issuers regardless of whether or not the Reporting Issuer's securities are publicly traded on an exchange.

(ii) Option valuation – Registrants expressed concern that the Guidelines' requirement for the valuation of an option was somewhat unclear and onerous. Registrants were of the view that the local securities markets currently lack the depth or sophistication that will facilitate the efficient and accurate valuation of options.

Although this concern has some merit, the Staff was aware of this prior to receiving feedback from the market and attempted to treat with this concern in the Guidelines by not prescribing any particular method for valuing options. Rather, registrants were given the opportunity to provide their own valuation using a methodology that is disclosed in clear precise terms and which is expected to be consistently applied throughout the operations of the ESCP. Further, International Financial Reporting Standards require the valuation of all options in a Company's financial statements. As such the valuation requirements in the Guidelines have remained as originally drafted.

(iii) Application of Market Access Fees to options as well as shares – Some concern was raised with respect to the registration of both options and shares and the concomitant application of market access fees to both registrations. While registrants appeared to agree that options were securities and as such required registration, they expressed concern about the application of market access fees to registration of the options ***and*** the shares.

Staff is of the view that this concern may be unfounded as it is quite likely that options will tend to be issued and therefore, will be registered when the exercise price is greater than the market price of the underlying share therefore implying that the option's value is close to zero. In such a case, the registration of the options will attract only the nominal registration statement filing fee of TT$100.

(iv) Shelf Registration System – registrants enquired into the possibility of shelf registration systems for both options and shares. Such a system would allow registrants the opportunity/convenience to register options or shares "in bulk" and issue from these pre-registered shares/options whenever the need arises. This would relieve registrants of the administrative burdens of filing applications for registrations whenever they intend to issue options or shares to employees.

The Need for Guidelines for Employee Stock Compensation Plans

The Guidelines for Employee Stock Compensation Plans ("the Guidelines") were developed with the intent that companies would be required to report detailed information with respect to the creation and operation of Employee Stock Compensation Plans on a regular basis. It is hoped that the increased flow of information that will be brought about by the Guidelines being implemented will allow shareholders to make a more accurate assessment of the companies' performance when determining whether to buy, hold or dispose of their investments.

Procedure to be followed for registration of options and shares in terms of the steps to be taken

The following outlines the procedure to be followed for the registration of shares/options issued pursuant to an Employee Stock Compensation Plan:

i. The Company must forward copies of Shareholders' Resolutions and/or Directors' Resolutions that approved the creation of the Plan unless this has already been lodged with the Commission;
ii. The Company must forward copies of the Plan's rules to the Commission unless the same has already been lodged with the Commission;
iii. A list of the beneficiaries of the Plan at the date of creation;
iv. Any other documentation material to the rights and obligations of Plan participants and the pricing of the securities issued under the Plan; and
v. The normal process for application for registration of securities applies hereafter vis-à-vis:
    a. Submission of a registration statement Form No. 4 pursuant to Section 65(1) of the Act;
    b. Submission of the registration fees; and
    c. Submission of any other supporting documents.

Applicable Fees

The following fees, as prescribed in the Securities Industry (Amendment) By-Laws, 2006, will be applied to the registration of shares and options issued pursuant to the Employee Stock Compensation Plans:

a. A registration statement filing fee of TT$100; and

b. Market Access Fee of 0.01% of the value of the securities to be registered.

    i. In the case of shares, the Market Access Fee will be calculated based on the exercise price or the price at which the shares will be purchased by the employee; and

    ii. In the case of options, the Market Access Fee will be calculated based on the value of the option as determined by taking the difference between the market price of the underlying share and the exercise price of the option. In the event that the market price of the underlying share is lower than the exercise price, the value of the option will be deemed to be nil.

These Guidelines suggest a regime that facilitates the use of Employee Stock Compensation Plans, but which is also sufficiently rigorous so as to ensure that shareholder's interests are adequately protected.

PART II – THE GUIDELINES

PRELIMINARY

1. These Guidelines may be cited as the Employee Stock Compensation Plan Guidelines, 2008.

a. In these Guidelines –

"business day" means any day on which the banks are open for the conduct of business in Trinidad and Tobago;

"issuer" means a person that has securities outstanding or issues, or proposes to issue, or distributes a security;

"Reporting Issuer" means an issuer that has filed a registration statement under section 64 of the Act and has not been the subject of an order of the Commission altering its status as a Reporting Issuer;

"security" means any document , instrument or writing evidencing ownership of or any interest in the capital or debt, property, profits, earnings or royalties of any person or enterprise and, without limiting the generality of the foregoing, includes any-

(a) bond, debenture, note or other evidence of indebtedness;

(b) share, stock, unit, unit certificate, participation certificate or certificate of share or interest;

(c) any document , instrument or writing commonly known as a security;

(d) any document, instrument or writing evidencing an option, subscription or other interest in or to a security;

(e) any investment contract;

(f) any asset backed security;

(g) any document, instrument or writing constituting evidence of any interest or participation in-
   i. a profit sharing agreement;
   ii. a trust; or
   iii. an oil, natural gas or mining lease, claim or royalty or other mineral right;

(h) an interest in the whole, or in part of, the net assets of a collective investment scheme; or

(i) any right to acquire or dispose of anything specified in paragraphs (a) to (h),

but does not include-

i. currency;

ii. a cheque, bill of exchange or bank letter of credit;

iii. a certificate or document constituting evidence of any interest in a deposit account with-

   i. a financial institution;
   ii. a credit union within the meaning of the Co- operative Societies Act;
   iii. an insurance company; and
   iv. a contract of insurance issued by an issuer;

"the Act" means the Securities Industry Act, 1995 and its related by-laws or any amendments, variations or replacements thereto.

RECOGNITION OF EMPLOYEE STOCK COMPENSATION PLANS

Registration of Employee Stock Compensation Plans

3.(1) A person who proposes to make an offer of securities pursuant to an Employee Stock Compensation Plan should register with the Commission as a Reporting Issuer and file a registration statement in accordance with these Guidelines.

.(2) An application for the registration of the securities that will be issued pursuant to an Employee Stock Compensation Plan should be accompanied, by the following:-

a. Completed Form No. 4 in respect of securities to be issued under the Plan;
b. A copy of the Shareholder's/Director's Resolution(s) creating the Plan, in keeping with clauses 5.(1) and 5.(2) below, if not already provided;
c. The legal documents constituting the Plan and a copy of the Plan's rules;
d. A list of the beneficiaries of the Plan at the date of its creation;
e. Copies of all documentation distributed to employees setting out the terms and conditions relating to the offer of securities ;
f. The relevant fees as required by the Act; and
g. Any other documentation material to the rights and

obligations of Plan participants including the pricing of the securities issued under the Plan.

Value of securities to be registered

4. The value of securities to be registered pursuant to an Employee Stock Compensation Plan shall be calculated based on the price at which the securities are to be issued to employees, i.e. the exercise price.

Submission of Plan's approvals

5.(1) A Reporting Issuer should provide the Commission with proof that its shareholders have approved the creation of the Plan and have approved of the terms under which the Plan would operate.

Synopsis of the Plan rules

.(2) Where, the Reporting Issuers' incorporating documents facilitate the creation of such Plans, without shareholder approval, the Reporting Issuer should provide the Commission with a certified copy of the Directors' Resolution approving the creation of the Plan.

.(3) A synopsis of the Plan rules should also be provided, which discloses:

a. The Name of the Plan;
b. The maximum number of shares or options to be granted pursuant to the Plan;
c. The employees or groups of employees who are eligible to participate in the Plan;
d. The conditions that must be met for shares or options to be granted to employees; and
e. Where applicable, the manner in which the exercise price of the options is to be calculated.

CONTINUOUS REPORTING

Continuous Reporting

6 (1) A Reporting Issuer shall inform the Commission in writing, immediately or not later than five business days of the exercise or expiration of an option issued pursuant to an Employee Stock Compensation Plan.

6 (2) A Reporting Issuer that has an Employee Stock Compensation Plan in place must provide the Commission with the following information on a quarterly basis,:

a. a summary statement of all Plans that the issuer operates which includes:

i. the number of securities authorized for issuance under each Plan;

ii. the number of securities issued, in addition to the number of securities to be issued upon the exercise of outstanding options granted, under each Plan during the last fiscal year;

iii. the number of securities to be issued upon the exercise of outstanding options granted, under each Plan other than in the last fiscal year; and

iv. the number of securities remaining available for future issuance under each Plan.

b. a summary of each Plan which includes:

i. a description of general terms of each Plan;

ii. the number of securities authorized for grants of options or other equity instruments;

iii. the number and weighted-average exercise price of:

(i) Options outstanding at the beginning of the year;
(ii) Options outstanding at the end of the year;
(iii) Options exercisable at the end of the year;
(iv) Options granted during the year;
(v) Options exercised during the year;
(vi) Options expired during the year;

iv. The range of exercise price for outstanding options;

v. The weighted average exercise price of outstanding options;

vi. The weighted average remaining contractual life of outstanding options;

vii. Number of securities remaining available for future issuance;

viii. The vesting schedule if applicable and the term or expiry of option; and

ix. A list of the beneficiaries in the Plan;

c. any other requirement specified as a condition to the registration of the securities.

For the purposes of this subsection (6(2) the information required to be provided to the Commission must be filed within two weeks of the end of the companies':

i. half year period; and
ii. financial year end.

Forms for Continuous Reporting

7.(1) The continuous reporting requirement in paragraph 6 (2) (a) and (b) will be satisfied if the Forms "ESCP No. 1" and "ESCP No. 2" in the Schedule hereto accompany each filing.

Appendices
SCHEDULE

Form ESCP-1

(Pursuant to paragraph7 (1)

Annual Disclosure Form for Reporting Issuers Employee Stock Compensation Plans (Summary Information for all Plans in Existence)

Company Name: ___________________________________

Report for Financial Period: January 1, 2009 – December 31, 2009

Name of Plan	# of Shares Authorized for Plan	# Of Options Authorized For Plan And Option To Share Ratio	# of Shares Issued in Period	# of Options Issued in Period	# of Shares exercisable in respect of options granted in Period	# of Shares exercisable in respect of options granted in previous Periods	# of Options remaining available for Distribution	# of Shares remaining available for distribution
ABC Company Limited Employee Stock Option Plan								
ABC Company Limited Management Stock Option Plan								
ABC Company Limited Directors Stock Option Plan								

Form ESCP-2

(Pursuant to paragraph7 (1)

Annual Disclosure Form for Reporting Issuers Employee Stock Compensation Plan – (Summary Information for each Plan)

Company Name: ______________________________

Plan Name: ______________________________

Plan Description ______________________________
____
____
____

Report for Financial Period: January 1, 2009 – December 31, 2009

	Number	Weighted Average Price
Shares approved for Plan		
Options approved for Plan		
Option to Share ratio		
Options outstanding at the start of the period		
Shares issued in period		
Options granted in period		
Options exercised in period		
Options outstanding at the end of the period		
Options exercisable at end of period		
Shares Remaining in Plan		
Options expired during the year		
Options remaining in Plan		

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2. USSEC Final Rule: Disclosure of Equity Compensation Plan Information, Release Nos. 33-8048, www.sec.gov/rules/final/33-8048.htm

3. A Study of Option Pricing Models, http://bradley.bradley.edu/~arr/bsm/model.html