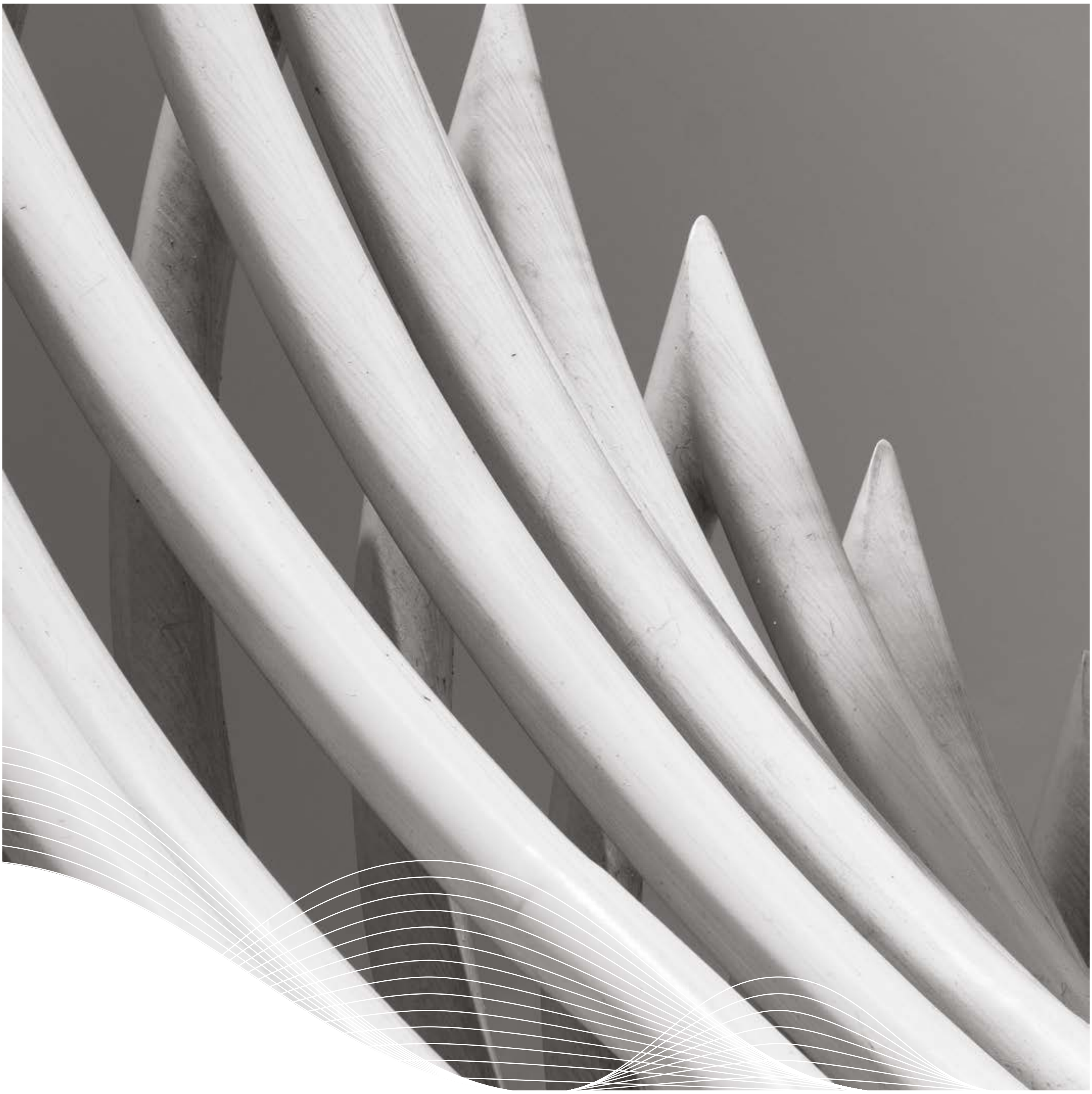

Employee Share Schemes

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Mohamed Toorani is a Partner and Head of the Bahrain office of DLA Piper. As a Bahraini national, his bilingual skills, innate understanding of the culture, and invaluable international and legal experience on corporate and finance matters, bring high value to the team.

Mohamed, ranked by various award winning legal directories including Chambers & Partners, is experienced in the Corporate and Finance practice and came to DLA Piper after working in situ at Mashreqbank psc, Dubai for a number of years. Mohamed has over 14 years of legal experience and advises on a broad range of corporate and finance matters, including general corporate, corporate governance, company formation, share and asset transfers, financial technology (FinTech), funds (ranging from mutual funds to hedge funds or PIUs), liquidations, drafting and reviewing of conventional banking facility documentation, securitization, joint ventures, special purpose vehicles, trademarks, licenses, intellectual property, employment, real estate, insurance, investments under Bahrain, UAE, and UK law.

Mohamed is admitted at the Bahrain Cassation Courts (Supreme Courts) and a Private Notary (English) appointed by His Excellency Sheikh Khalid bin Ali Al Khalifa, Minister of Justice, Islamic Affairs in Bahrain.

Mohamed is also the first and only Bahraini national to head an international firm in Bahrain.

Sohail Ali
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Sohail Ali is a litigation and arbitration lawyer, with over 15 years' experience advising a wide range of corporate clients on high value, premium banking and commercial disputes.

Sohail has particular expertise in advising on complex, cross-border disputes. He also leads the firm's global Islamic Finance disputes practice.

Sohail has done a number of client secondments including at Goldman Sachs, Barclays Capital, Mars and Lloyds Banking Group and he understands the importance of providing clear, commercial and strategic advice to his clients.

Ranked as a rising star in the Legal 500 for 2022, Sohail has been described by clients as "sharp as a tack", "peerless for his generation" and a "stand out individual in the litigation/arbitration team" with "exceptional client handling skills".

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Shabaz is a Senior Associate in the UK Corporate Crime, Investigations and Financial Services Regulatory group, with experience of acting in financial services regulatory (advisory, transactional, and contentious), corporate crime, and investigations matters for both corporates and individuals in both domestic and international matters.

Prior to qualifying as a solicitor, Shabaz spent over 2 years in the regulatory compliance team at a well-known UK stock broking firm. Further, Shabaz spent time on secondment in the Government Affairs and Regulatory Strategy team at the London Stock Exchange. These experiences allow Shabaz to combine his knowledge of regulatory law with an understanding of how things work in practice.

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Lulwa Alzain is a qualified lawyer with several years of experience at the Bahrain office of DLA Piper, with primary focus on general corporate, regulatory, investigation, fraud, employment and intellectual property matters.

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Jenan is a Shari'a qualified corporate lawyer who sits in the Bahrain office of DLA Piper.

Jenan specialises in supporting clients across all major financial services sub-sectors. Her core area of practice is regulatory driven strategic projects, corporate reorganisations, transactions and restructurings, as well as cross-border and FinTech related assignments.

1. Introduction

1.1 This document serves as a guide for Closed Joint Stock Companies that are considering the creation of an employee share scheme. Closed Joint Stock Companies are companies that have at least two subscribers for negotiable shares, which shares are not offered to the public for subscription.[1]

1.2 This document sets out:

a. An overview of employee share schemes;

b. The benefits of utilising such schemes;

c. The different types of common employee share scheme;

d. Variable factors in employee share schemes;

e. Considerations that companies need to take into account when designing employee share schemes;

f. The process of creating an employee share scheme; and

g. The legal and regulatory framework in the Kingdom of Bahrain in relation to employee share schemes.

2. Employee Share Schemes – Overview

2.1 An "*employee share scheme*" is a general term given to a number of schemes through which a company can allow its employees and directors to participate in the ownership of that company – usually at a discount, or at no cost to the employee.

2.2 Schemes can be tailored to fit the objectives of a company and could, for example (amongst other things):

a. Be mandatory or discretionary for employees;

b. Impose restrictions on which employees are allowed to participate;

c. Provide for immediate vesting or, alternatively, impose conditions on when interests in the company's shares vest.

2.3 There are a number of peculiarities that apply to employee share schemes of private companies versus publicly traded companies. Accordingly, there are unique considerations for private companies when setting up employee share schemes, which we discuss in this article. Some of the key differences which may impact the relevant considerations include:

a. The value of shares in private companies may only be known at certain valuation events, rather than on a daily basis. Private companies may therefore have to build these in at regular intervals;

b. Shares in private companies are usually not freely tradeable/transferrable, which may impact how a company designs its share scheme to allow employees to realise value;

c. The concentration of controlling shareholders may be higher in a private company versus a publicly traded company. This may impact how many and what type of shares are offered as part of an employee share scheme;

d. It may be easier in a private company to introduce different classes of share for employees, such as "*Growth Shares*" which only fully vest after certain conditions are met. Private companies may therefore have greater flexibility in how they design their employee share schemes.

2.4 We discuss the different types of employee share scheme and their characteristics in further detail below.

3. Benefits of Employee Share Schemes

3.1 There are a number of potential benefits to both companies and employees from the operation of employee share schemes. These include:

a. **Attracting and retaining employees, including senior executives** – overall remuneration package is a key factor in attracting and retaining key employees.

A remuneration package can consist of a number of elements, such as fixed cash elements (e.g. salary), variable cash elements (e.g. commissions), short-term cash incentives (e.g. bonuses), medium-term

1. Article 226 Company Law

cash incentives (e.g. deferred bonuses), security benefits (e.g. medical insurance), and other benefits (e.g. company cars, holiday days etc).

Another substantive part of a remuneration package can include medium-term non-cash incentives, such as the award of, or ability to acquire, shares in the company.

The provision of equity can be useful where a company may be relatively cash-short, and offers an alternative means to increase the overall compensation package.

Further, provision of equity as part of a remuneration package may be expected in certain types of industries – such as tech start-ups and private equity backed companies. Companies in these spaces often have high-growth as a goal, and providing equity to such employees can incentivise them and align them to those goals.

b. **Incentivising employees** – employees can be incentivised through cash bonuses, but the benefit of incentivising employees through the award of shares is that employees may see a compounding up-side to their hard-work.

c. **Aligning the interests of employees with those of the company and majority shareholders** – The award of shares will align interests because employees will directly benefit from the increased value of the company.

This can cause employees to be more productive, and be more willing to accept management's strategic direction for the company, and more willing to prioritise longer term goals that are beneficial for the overall growth of the company.

This may particularly be the case where there is a well-communicated vision for the company, and a set goal that will allow employees to realise their gains – for example, an IPO, or a sale, or a valuation and buy-back of shares.

d. **Improvement in job satisfaction and engendering a culture of inclusiveness** – employees with shares in the company they work for may find more job satisfaction, because their efforts are directly linked to their own reward. This may also engender a culture of inclusiveness, with employees perceiving less of a difference between management and themselves.

3.2 Taken together, these benefits of employee share schemes can help companies to achieve their growth aims. As mentioned above, employee share schemes can take multiple forms, and one of their benefits is the flexibility around them, and their ability to be tailored to suit a company's and its employees' needs.

4. Types of Employee Share Schemes

4.1 There are a number of common types of employee share schemes, but within each type of scheme there is a broad scope for variation.

4.2 Please note that the names given below for the types of schemes are a general descriptor only, and many jurisdictions have different names for different types of schemes – often aligned to categories of tax exemptions.

4.3 However, since the Kingdom of Bahrain does not generally impose tax on individuals, companies can be flexible with their schemes.

a. **Save as you earn** – companies may operate a scheme which allows employees to save, and purchase shares in the company, with their salary.

Such schemes are often operated over set periods – for example, of 3 years or 5 years. Over this period, employees will have a certain amounts deducted from their monthly salary (the "**savings**"). At the end of this period, those savings will be used to purchase shares in the company.

In private companies, a valuation of the company may take place at the beginning of such a period, and a price for the shares set by reference to this valuation.

Depending on the aims of the company, this price may be at a discount to the actual value of the shares.

b. **Bonus awards** – companies may award fully paid shares to employees as a bonus, or as some other element of a remuneration package such as a long-term incentive plan. Companies can attach conditions to these depending on their aims – for example, employees may not be able to sell them for a certain period. We discuss conditions that can be attached to shares in further detail below.

c. **Growth shares** – these are a particular type of share given to employees/senior management, but which only fully vest (i.e. employees only become fully entitled to them) if the company achieves certain targets or growth aims. These shares will often not carry any voting rights, and a majority shareholder (such as a private equity backer) can maintain full control of a company whilst incentivising employees with a significant economic interest in the company.

It will be important for companies to ensure that they consider their aims, and appropriately calibrate the rights/conditions attaching to these growth shares. For example, if the growth target is set too low, this might not incentivise employees to go over and above in their duties. Alternatively, if it is set too high, the goal may seem unachievable and have the same effect.

d. **Share options** – companies can award options to employees as part of an overall remuneration package.

Such options will allow an employee to purchase shares in the company, often at a discount, and may carry number of ***"exercise conditions"***.

For example, the options may only be exercisable after a certain period of time has expired. This is to ensure the options act as an incentive for employees to remain with the company. Further, they may only be exercisable once certain goals have been met in order to incentivise employees to prioritise company growth.

e. **Phantom options** – phantom options allow a company to offer the monetary benefit of a share option scheme, but without having to formally issue options and shares to employees.

Under a phantom option scheme, employees are awarded/granted option over a notional number of shares which are deemed to have a set price. Depending on the objectives of the company, this can be market price at the date of the phantom option, or at a discount. Employees can later "exercise" the option after any (phantom) vesting conditions are satisfied – such as time elapsed, or after certain goals have been met etc.

Upon exercise of the phantom option, the company will pay to the employee the difference between the deemed share price at issue of the phantom option, and the current market price.

4.4 In the next section, we set out considerations companies need to take into account when designing their share schemes.

5. Variable factors in employee share schemes

5.1 As noted above, there are different types of share schemes that a company can operate, and there is a broad scope for variation within each category.

5.2 Factors that companies might choose to vary in relation to their schemes include:

a. Which employees are entitled to participate in the relevant scheme;

b. How the award of shares or options will be calculated in relation to individual employees;

c. Whether shares are to be newly issued each time they are awarded, or whether they will be issued in bulk and sit within an employee benefit trust before being allocated to certain employees;

d. The length of time employees are required to notionally hold the shares before they fully vest;

e. The length of time before which options can be exercised;

f. Whether shares offered to employees will carry voting rights, or grant an economic interest only;

g. Any growth or target-oriented conditions applying to options before they can be exercised, or growth shares before they fully vest;

h. The valuation mechanism for the relevant shares, and whether employees can realise the value of shares before a formal company exit (such as an IPO or acquisition);

i. If options are to be exercised, the price at which the option can be exercised and whether this will differ to the share valuation price;

j. If shares are to be purchased, the price at which shares are to be purchased and whether this will differ to the share valuation price;

k. What happens to employees if they leave the company, and whether this is different for "*good leavers*" and "*bad leavers*".

6. Consideration when designing share schemes

6.1 In determining how to design its employee share scheme, a company will need to take into account various considerations. Examples of questions that a company should ask itself include (amongst others):

a. **What is the purpose for operating an employee share scheme?** – Is this to attract and retain employees? Incentivise them to achieve certain targets? To match competitors? To diversify the shareholding and those with voting rights? To provide economic value only? These questions, plus many more, will be relevant when it comes to designing an employee share scheme.

b. **What are the specific commercial goals of the company, and over what period does it intend to meet these goals?** – These will vary between companies, and will depend upon factors such as the size and age of the company, the sector it operates in, its existing level of staffing, what stage of a business cycle it is in etc.

This question is particularly relevant when determining any growth/target-oriented conditions which attach to options, growth shares, or in relation to any long-term incentive plan. It is also important when considering the time period before which options can be exercised, or shares fully vest.

c. **Does the company have an exit plan in mind? Should employees be able to realise value from their shares before a formal exit event (such as IPO or acquisition)?** – This will inform any valuation and buy-back mechanism (if any). It will also have an impact on what a company decided to do if employees leave before any formal exit event, and whether they are able to realise any value from any shares they have been awarded.

d. **What are the company's competitor's doing in this area, and does it want to operate at or above market level?** – This is particularly important if the intention is to attract employees away from competitors, and ensure that they are retained. If a company offers below-market remuneration (including any equity element), it may struggle to attract and retain employees.

e. **What percentage of the company will be available for employee ownership, and do these shares grant voting rights or will they provide an economic interest only? What is the monetary value of the portion of shares available to employees?** – These questions will be important when deciding how many options or shares to award, and the criteria for awarding those shares and options.

6.2 These questions are not intended to be exhaustive, and the circumstances impacting how a company's share scheme is designed can vary significantly.

6.3 There are a number of providers that specialise in helping companies to design and implement employee share schemes, and we would recommend consulting a provider where required.

7. Process for creating an employee share scheme

7.1 The process for creating an employee share scheme will differ depending on the type of scheme that a company decides to offer. However, there will likely be a number of distinct phases:

a. **Pre-design analysis** – as discussed above, a company will need to take into account various considerations before designing its employee share scheme. This process could also involve a consultation with employees, and engaging consultants to assist with the process;

b. **Design** – once the company has gathered data and considered the relevant factors, it will be able to design the share scheme it wants to offer, such as how many shares are to be allocated to the scheme, whether there needs to be a new class of shares, any conditions attaching to the shares/options etc. Informal discussion and approval with a company's shareholders will likely be required at this stage, before any documents are created and before formal approval. This is to avoid any issues further in the process;

c. **Documentation** – once an employee share scheme has been designed, documentation to implement this will need to be prepared/amended. Which documentation needs to be prepared or amended will vary depending on the design of the plan, but could include:

- **Articles of association** – the laws of the Kingdom of Bahrain require that the articles of association provide for such schemes and their details (see below). The articles of association will need to be amended to create new share classes if required, and deal with any conditions attaching to them;

- **Employee share option plan** – documenting the terms on which any options are issued and may be exercised;
- **Internal policy documents** – such as remuneration policies and procedures documenting how such shares will be awarded;
- **Internal communications** – providing information on the employee share scheme;
- **Template records in relation to the employee share scheme**.

d. **Implementation** – there will be a number of stages to implementing an employee share plan, including:

- **Shareholder approval** – shareholders will need to approve the design and documentation to the relevant share scheme.

  Further, if there is to be a new issue each time options are exercised or shares awarded, shareholders will need to approve the issue of these shares (likely up to a certain limit).

  Alternatively, if there is to be a bulk issuance of shares which sit within an employee benefit trust until awarded, the shareholders will need to give permission for the issuance of those shares.
- **Socialisation of the new policies and documents** – with remuneration decision makers (such as line managers or remuneration committees), as well as employees.
- **Awarding of options/shares**; and
- **Keeping records and updating the share register as required** – companies may do this in-house, or engage a service provider to assist with this;

e. **Periodic review** – companies go through different stages of growth, and the reasons for adopting a specific employee share scheme may vary over time. Accordingly, companies may want to periodically review their employee share scheme to ensure it is suitable and helps the company to meet its goals.

8. Laws of the Kingdom of Bahrain

8.1 Companies will need to consider the laws in the Kingdom of Bahrain when designing and implementing their employee share schemes.

It is also important to note that employee share schemes do not replace the statutory pension scheme with the Social Insurance Organisation.

8.2 The laws relating to employee share schemes in the Kingdom of Bahrain are predominantly contained in:

a. Articles 128 and 216bis of the Decree No. 28 of 2020 (amending the Commercial Companies Law promulgated by Legislative Decree No. 21 of 2001); and

b. Regulation No. 119 of 2021 issued by the Minister of Industry and Commerce.

Article 216bis of Decree No. 28 of 2020

8.3 This provides that "*A company may have one or more schemes to motivate its employees through their ownership of its shares. The company shall disclose to its employees the full details of such schemes including the conditions for their entitlement to its own such shares*".

8.4 It goes on to note that the Central Bank of Bahrain or the competent Minister for commerce affairs may issue such regulations as it deems appropriate to regulate such employee share schemes.

Regulation No. 119 of 2021

8.5 This makes a number of provisions in relation to employee share schemes of Closed Joint Stock Companies, including:

a. The articles of association shall provide for the relevant employee share scheme and include all their details, including conditions for employees' eligibility, and these articles of association must be approved by a company's extraordinary general assembly (i.e. they must approve the details of the employee share scheme);

b. The issuance of new shares allocated exclusively for the purpose of employee share schemes must be approved by a company's extraordinary general assembly;

c. A company is required to disclose to its employees the full details of any employee share scheme, including conditions for eligibility;

d. Employee share schemes may include a requirement that the employee's ownership of shares is contingent on their continued work for the company, or on the employee working for the company for a specific period of time. In such cases, the employee share scheme shall specify:

- The consequences if the employee leaves employment of the company;
- The extent of the company's eligibility to redeem shares owned by the employee;
- The amount payable by the company to the employee in return for redeeming those shares; and
- Any other rights accrued to the employee in this regard;

e. The company may own shares that are redeemed from an employee, or distribute them to the rest of the shareholders in proportion to the shares they hold, free of any restriction imposed on those shares.

Article 128 of Decree No. 28 of 2020

8.6 Shareholders do not have pre-emption rights in relation to shares issued for the purpose of an employee share scheme.

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