ESOPs in the UAE: A New Beginning?

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What are ESOPs?

While employee share option schemes ("ESOPs") and other long term incentive plans ("LTIPs") come in a variety of shapes and sizes, they all share the same essential purpose of retaining, rewarding and incentivising employees. By linking part of an employee's remuneration to the company's financial performance under an ESOP, employees have a direct and tangible incentive to contribute to the company's success, as higher company performance will increase the value of their individual rewards and incentives. ESOPs are also a useful tool for employers to help retain and reward valuable staff members, as the incentives offered under an ESOP are typically staggered over time such that the longer an employee remains employed by the company, the greater their ESOP rewards will become.

While an ESOP (or other LTIP) can be a very valuable tool for companies to help retain high performing employees and incentivise them to drive the company's financial success, UAE companies have experienced various difficulties in the past when seeking to implement ESOPs for their UAE based employees.

What recent changes have affected ESOPs in the UAE?

Some of these difficulties have been overcome by the introduction of UAE Federal Law No. 2 of 2015 concerning Commercial Companies ("CCL") which came into force on 1 July 2015. For the first time, the CCL specifically provides that UAE companies may, by way of a special resolution approved by their general assembly, increase their share capital in order to implement an ESOP for UAE based employees. Participation in the ESOP is reserved for the company's employees only and the CCL does not allow for directors of the company to participate in the scheme.

Importantly, pursuant to the CCL the existing shareholders of a public joint stock company do not have pre-emption rights in respect of shares issued pursuant to an ESOP. This represents a major shift in the legal framework regarding ESOPs in the UAE as, prior to the introduction of the CCL, existing shareholders had priority to subscribe to any new shares (and would need to consent to any new shares being issued to an employee pursuant to an ESOP). In the context of options being granted under an ESOP, existing shareholders having pre-emption rights would not only make the administration of the ESOP significantly more cumbersome, but would also mean that any of the existing shareholders could essentially block the company from meeting its obligations towards an employee under an ESOP. Accordingly, the specific provision in the CCL for UAE companies to implement ESOPs, together with the fact that existing shareholders would not have pre-emption rights in respect of shares granted under an ESOP, has overcome one of the major obstacles for public and private joint stock companies seeking to implement an ESOP for UAE based employees.

The CCL provides that the Emirates Securities and Commodities Authority ("ESCA") will issue a Resolution on the "mechanism and conditions of implementation" of ESOPs. Whilst the Resolution has not yet been issued, we have had sight of it in draft form and anticipate that it will have legislative effect imminently.

The Resolution sets out the regulations for issuing and offering public joint stock company shares including as part of an ESOP. In terms of additional guidance of relevance, the draft Resolution provides that shares issued pursuant to an ESOP may not exceed 10% of the share capital increase and also that the company's board or remuneration committee shall develop the ESOP to include: (i) its size, (ii) the price of the shares and conditions and procedures relating to the ESOP, (iii) the determination of the ESOP participants, (iv) the implications of participants leaving their employment whether by dismissal or resignation (akin to 'good' and 'bad' leaver provisions), and (v) its duration.

What other options are available to our company?

Of course, the issue of pre-emption rights is only relevant where legal title to the shares is actually being transferred, and there are alternative ways to structure an LTIP which do not involve the employees receiving actual shares in the company. Where legal title to the shares is not transferred, an LTIP is essentially a contractual arrangement between the company and the employee whereby the 'incentive' for the employee is a cash payment (often calculated by reference to the share price of the company) rather than actual shares. For limited liability companies it is generally simpler to implement and administer an LTIP which does not involve the transfer of legal title to the shares, as the cumbersome share transfer process and maximum limit of 50 shareholders pose additional obstacles for limited liability companies to consider.

The most appropriate design of an LTIP must be assessed on a case-by-case basis and will depend on a variety of factors, including the type and size of legal entity, whether legal title to the shares will be transferred to employees, and whether it would be appropriate for the company to establish a separate legal structure to hold a pool of shares (and any legal and accounting implications which may then arise for the company).

How can our company design and implement its own ESOP?

It remains to be seen exactly how ESCA will develop the framework for UAE companies to structure and implement their ESOPs. In the meantime, pending issuance of the Resolution, specific direction and input from ESCA is required before the implementation of an ESOP (for public and private joint stock companies) is possible. Indeed it is highly likely, given the existing form of the draft Resolution, that specific direction and input will continue to be required from ESCA post issuance of the Resolution. However, it would appear from the draft Resolution that companies are likely to have a relatively wide degree of latitude in terms of the form of ESOP that they wish to adopt.

In the meantime, we are available to give guidance in terms of which structures may be most suitable for your business. This process will also involve the company auditors as they will need to assess how any proposed structures may impact the balance sheet. Part of the planning process will also involve the potential use of offshore vehicles and plan administrators to assist with the day to day administration of the plan.