



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 162

Indirect self-acquisition by investment funds: Further consultation—Employee share schemes

June 2011

About this paper

This consultation paper seeks feedback on specific aspects of our proposed relief under s259C of the *Corporations Act 2001* (Corporations Act) for indirect self-acquisition by investment funds.

It follows Consultation Paper 137 *Indirect self-acquisition by investment funds: Further consultation* (CP 137).

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 16 June 2011 and is based on the Corporations Act as at 16 June 2011.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on indirect self-acquisition relief. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section C, Regulatory and financial impact.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 14 July 2011 to:

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What will happen next?

Stage 1	16 June 2011	ASIC consultation paper released
Stage 2	14 July 2011	Comments due on the consultation paper Drafting of regulatory guide
Stage 3	End 2011	Regulatory guide released

A Background to the consultation

Key points

Self-acquisition occurs where shares (or units of shares) in a company are issued or transferred to an entity it controls.

The Corporations Act voids the issue or transfer of shares (or units of shares) of a company to an entity it controls unless certain exceptions apply: s259C.

In CP 137, ASIC recently consulted on discrete issues relating to conditional relief from s259C to allow certain controlled entities of financial institutions to acquire the holding company's shares for investors, subject to safeguards designed to minimise the risks associated with indirect self-acquisition.

Since the release of CP 137, a new issue has arisen relating to employee share schemes. We are now seeking feedback on proposals that deal with employee share schemes before finalising our policy on indirect self-acquisition. We are also seeking feedback on some proposed amendments to the policy proposed in CP 1 for some of the conditions of relief.

Restrictions on self-acquisition and ASIC relief

- 1 Under s259C(1) of the *Corporations Act 2001* (Corporations Act), the issue or transfer of shares (or units of shares) of a company to an entity it controls (self-acquisition) is void unless one of the exceptions in s259C(1)(a)–(d) applies.
- 2 ASIC has the power under s259C(2) to exempt a company from s259C(1). In October 1998, ASIC released Consultation Paper 1 *Indirect self-acquisition by investment funds* (CP 1) to consult on the circumstances in which we should give relief to investment funds from the self-acquisition provisions in s259C.
 Note: For details of the operation of s259C and its exceptions, see page 10 of CP 1.
- 3 Since then, ASIC has granted interim relief on a case-by-case basis from s259C(1) based on the policy proposed in CP 1.
- 4 In June 2010, we released Consultation Paper 137 *Indirect self-acquisition by investment funds: Further consultation* (CP 137) to seek feedback on some discrete issues that have arisen since CP 1 was released. For reference, we have included links to CP 1 and CP 137 on our website in the appendix to this consultation paper.
- 5 Since the release of CP 137, we have become aware of an issue around the interaction of employee share schemes operated by financial institutions and s259C relief granted to those institutions based on the policy in CP 1. On a related note, we have also identified issues relating to the formulation of some of the standard relief conditions outlined in CP 1. We are now seeking feedback on our proposals to deal with these issues.

- 6 We intend to finalise the policy in CP 1, CP 137 and this paper subject to the feedback received in this round of consultation.

Underlying policy in CP 1 and CP 137

- 7 The policy objective of CP 1 and CP 137 is to permit investment funds of financial institutions to acquire the company's shares for the benefit of investors, subject to conditions designed to minimise the risks associated with indirect self-acquisition.
- 8 CP 1 and CP 137 outline the regulatory risks that could arise through self-acquisition, which include:
- (a) improper attempts to secure or consolidate corporate control;
 - (b) increased possibility of corporate failure;
 - (c) possible discrimination between shareholders;
 - (d) insider trading;
 - (e) market manipulation; and
 - (f) price opacity.

Proposals for further consultation

- 9 In Section B of this paper, we seek your feedback on proposals relating to:
- (a) the formulation of a standard relief condition outlined in CP 1; and
 - (b) the treatment of interests acquired by the company or its controlled entities under employee share schemes.

Standard relief condition: 5% limit

- 10 We have identified issues around the formulation of the standard relief condition outlined in CP 1, being that the company's controlled entities do not acquire the power to control voting or disposal in more than 5% of the company's voting shares in aggregate (the '5% limit').
- 11 We are seeking feedback on our proposals to amend this condition.

Interests acquired under employee share schemes

- 12 We understand that, due to changes in remuneration practices, a financial institution may not be able to comply with the 5% limit because of interests in its own shares acquired by the company or its controlled entities for the purpose of employee share schemes or incentive plans.
- 13 We are seeking feedback on whether the 5% limit should be amended for interests acquired in connection with employee share schemes and, if so, on what terms.

Disclosure of economic exposures through derivatives

- 14 We are proposing to amend the requirement to publicly report economic exposures acquired through derivatives to provide greater clarity to the market.

Proposals apply to longer-term self-interests

- 15 The conditions outlined in proposal B2 in this paper for relief relating to employee share schemes are intended to apply in circumstances where the company or its controlled entities have the power to control voting or disposal of the employee share scheme shares for more than a temporary period of time (e.g. where there is a significant vesting or deferral period under the employee share scheme).
- 16 These proposals do not apply where the power is held for a short period of time (usually less than one month) before the shares are unconditionally transferred to employees. We will generally apply different conditions to relief in circumstances where the power held by the company or its controlled entities is temporary, as the regulatory risks are not the same.

B Proposals for further consultation

Key points

We are seeking further feedback on proposals to deal with certain issues that have arisen since the release of CP 1 and CP 137.

Specifically, we are considering whether, and on what terms, an amendment to the 5% limit outlined in CP 1 should be made:

- to include interests held by the company as well as its controlled entities; and
- for interests acquired under employee share schemes.

We are also considering whether to change the requirements for reporting of economic exposures acquired through derivatives.

Calculation of the 5% limit

- 17 Relief for indirect self-acquisition by investment funds under CP 1 is subject to the 5% limit. In calculating this percentage limitation, we proposed in CP 1 to count the company's shares over which a controlled entity has the power to control voting or disposal. This applies irrespective of whether s259C(1) applies to the acquisition of those shares.
- 18 The 5% limit is generally imposed on s259C relief given for investment activities: see CP 1 at paragraphs 16–18. As outlined in CP 1, the 5% limit is designed to minimise the risk of improper exercise of control by the company or its controlled entities. A large block of shares could be used inappropriately to control a company in the following ways:
- (a) Any restrictions on voting may distort the voting power of all other shareholders in the company. The greater the number of shares that cannot be voted, the greater the degree of distortion.
 - (b) The risk of inappropriate exercise of control arises when the controlled entities of the company have the power to vote or dispose of the company's shares. For example, there is a risk that the company and its controlled entities could frustrate a takeover bid if their interests over the company's shares are sufficiently large. This may occur even where an acquisition by a controlled entity does not contravene s259C(1).
- 19 CP 1 states that the 5% limit is determined by including those company shares over which its controlled entities have the power to control voting or disposal.
- 20 However, on review, we consider that shares over which the company itself has the power to control voting or disposal should also be included in the 5% limit.

Proposal

- B1** We propose that the 5% limit should include shares over which the following entities have the power to control voting or disposal:
- (a) the company; and
 - (b) the controlled entities of the company.

Your feedback

- B1Q1 Do you agree that shares over which the company has the power to control voting or disposal should be included in the 5% limit?
- B1Q2 Would this proposal substantially increase the percentage of shares included in the 5% limit?
- B1Q3 Are there any impediments to complying with the proposed calculation of the 5% limit?

Rationale

- 21 The 5% limit is designed to address the risk of inappropriate exercise of control and is based on the concept of relevant interest that is used in the takeover provisions of the Corporations Act. Section 608(9) makes it clear that a company can have a relevant interest in its own securities.
- 22 We consider that the risk of inappropriate control is present where the company has the power to control voting or disposal of its shares, and not just where the company's controlled entities have this power. Excluding shares over which the company itself controls voting or disposal may result in a distorted picture of the group's aggregated control over the company.

Treatment of interests acquired under employee share schemes

- 23 Recently, we have become aware that some companies may not be able to comply with the 5% limit because of self-interests acquired for the purpose of employee share schemes. We are seeking feedback on whether we should amend the 5% limit in light of self-interests acquired under certain employee share schemes.

Note: In this paper, 'self-interests' refer to the company's shares over which the company or its controlled entities have the power to control voting or disposal.

- 24 We have formulated proposal B2 below in line with proposal B1—that is, we have included any self-interests held by the company, as well as controlled entities, in the calculation of the relevant limits.

Proposal

B2 Where appropriate, we propose to vary the 5% aggregate limit outlined in CP 1 for interests acquired in connection with employee share schemes subject to the conditions in Table 1.

Table 1: Proposed conditions for relief from s259C(1) for interests acquired under employee share schemes

Conditions	Description		
1 5% or less self-interest for non-employee share scheme activities	The aggregate self-interests in the company's shares held by the company and its controlled entities arising from activities other than employee share schemes must be 5% or less.		
2 Two options for employee share scheme interests	<table border="0"> <tr> <td style="vertical-align: top;"> <p><i>Option 1: No shareholder approval</i></p> <p>Under this option:</p> <p>(a) the total aggregate interest in the company's shares held by the company and its controlled entities, including from employee share schemes, must be less than 10% of the company's voting shares; and</p> <p>(b) the terms of the employee share schemes must include provisions allowing employees to direct acceptance into a successful takeover bid and the securities to be transferred or cancelled as part of a merger by scheme of arrangement.</p> </td> <td style="vertical-align: top;"> <p><i>Option 2: Shareholder approval</i></p> <p>Under this option:</p> <p>(a) the company must obtain the approval of the self-interest by its shareholders for the maximum amount of shares to be allocated under the employee share schemes; and</p> <p>(b) prohibitions on voting would apply to the company, its controlled entities and employees who have an interest in the employee share schemes.</p> </td> </tr> </table>	<p><i>Option 1: No shareholder approval</i></p> <p>Under this option:</p> <p>(a) the total aggregate interest in the company's shares held by the company and its controlled entities, including from employee share schemes, must be less than 10% of the company's voting shares; and</p> <p>(b) the terms of the employee share schemes must include provisions allowing employees to direct acceptance into a successful takeover bid and the securities to be transferred or cancelled as part of a merger by scheme of arrangement.</p>	<p><i>Option 2: Shareholder approval</i></p> <p>Under this option:</p> <p>(a) the company must obtain the approval of the self-interest by its shareholders for the maximum amount of shares to be allocated under the employee share schemes; and</p> <p>(b) prohibitions on voting would apply to the company, its controlled entities and employees who have an interest in the employee share schemes.</p>
<p><i>Option 1: No shareholder approval</i></p> <p>Under this option:</p> <p>(a) the total aggregate interest in the company's shares held by the company and its controlled entities, including from employee share schemes, must be less than 10% of the company's voting shares; and</p> <p>(b) the terms of the employee share schemes must include provisions allowing employees to direct acceptance into a successful takeover bid and the securities to be transferred or cancelled as part of a merger by scheme of arrangement.</p>	<p><i>Option 2: Shareholder approval</i></p> <p>Under this option:</p> <p>(a) the company must obtain the approval of the self-interest by its shareholders for the maximum amount of shares to be allocated under the employee share schemes; and</p> <p>(b) prohibitions on voting would apply to the company, its controlled entities and employees who have an interest in the employee share schemes.</p>		
3 Voting of shares	Employees must be able to direct the voting of shares held under the employee share schemes.		
4 Reallocation or disposal of shares	Where an employee loses or forfeits their rights to shares held on their behalf under an employee share scheme, those shares must be either reallocated to another employee under the scheme or disposed of within a short period of time.		

Your feedback

B2Q1 If you operate an employee share scheme and rely on relief from s259C(1) under CP 1, please provide the following information:

- (a) Do you require relief from s259C for that scheme?
- (b) Does your company or its controlled entities have the power to control voting or disposal of shares allocated under the employee share scheme? If so, what power exists and how long can it last?
- (c) If your answer to question B2Q1(b) is 'yes', are there impediments to restructuring your scheme so that this power does not arise?

- (d) What percentage of the company's total voting shares are comprised of shares allocated under employee share schemes over which the company or its controlled entities have the power to control voting or disposal? Do you anticipate that this percentage will increase significantly?
- B2Q2 Do you agree that we should amend the 5% limit for self-interests acquired under employee share schemes? If so, why do you consider these interests should be treated differently to self-interests acquired in other circumstances?
- B2Q3 Should self-interests acquired under an employee share scheme be excluded altogether from the 5% limit without any associated restrictions or conditions? If so, why?
- B2Q4 For the proposed conditions in Option 1:
- (a) is the percentage limit of less than 10% appropriate?
 - (b) do employee share schemes usually have terms relating to takeovers similar to the proposed condition (b) under this option? If not, what practical impediments might prevent adoption of such terms?
 - (c) should self-interests acquired under an employee share scheme be excluded from the 5% limit altogether as long as the scheme contains a term equivalent to the proposed condition (b)?
 - (d) is there a need for proposed condition (b) given the level of self-interest is restricted to less than 10% under Option 1?
- B2Q5 For the proposed conditions in Option 2:
- (a) who should be excluded from voting on the resolution for shareholder approval?
 - (b) is there a need for the additional proposed general condition (3) that employees must be able to direct the voting of shares held under the employee share scheme?
- B2Q6 Do you consider that potential takeover defence risks are adequately addressed by our proposed conditions?
- B2Q7 Are there any other regulatory risks we need to consider?
- B2Q8 Are there any commercial impediments to a company complying with proposed conditions 3 and 4?

Employee share schemes and the 5% limit

25 We understand that some employee share schemes can give the company or its controlled entities the right to control disposal of shares held by the trustee or company under the scheme. This power to control disposal can arise from, for example, rights exercisable by the company or a controlled entity upon a change of employment status of the employee or in relation to certain taxation events. This power to control disposal means that shares

held for the purpose of the employee share scheme are counted towards the 5% limit in CP 1.

26 To mitigate risks that may have arisen from remuneration arrangements in the past, we understand that certain practices in the financial services sector have resulted in more sizable components of deferred remuneration being paid as equity under employee share schemes. We also understand that there has been a move towards this type of remuneration being deferred for longer periods. These two elements mean that a greater proportion of a company's shares may be used for employee share schemes. This can present issues for compliance with the 5% limit in CP 1.

Our proposed relief

27 We recognise that appropriately-designed employee share schemes can be an important element of remuneration practices in financial institutions. However, this needs to be balanced against the risks of self-acquisition: see paragraph 8.

28 We are considering amending the 5% limit where a company cannot comply with it due to the number of shares held for the purpose of employee share schemes.

29 In many cases, the type of power to control disposal of shares held by the company or its controlled entities under employee share schemes is quite limited in nature: see paragraph 25. We would not consider amending the 5% limit where the power to control either voting or disposal is substantial.

30 Where necessary, we propose that the relief outlined in CP 1 and CP 137 could be amended, as set out in proposal B2, where a company seeks to exceed the 5% limit as a result of self-interests arising from employee share schemes.

5% or less self-interest for non-employee share scheme activities

31 We propose that the aggregate self-interests in the company's shares held by the company and its controlled entities arising from activities other than those related to complying employee share schemes should be 5% or less. A complying employee share scheme is one that complies with the proposed conditions in Table 1.

32 The self-interests held by the company and its controlled entities would be calculated as described in CP 1 (i.e. shares over which the company or its controlled entities have the power to control voting or disposal).

33 We consider that retaining the 5% limit for interests acquired other than under a complying employee share scheme is appropriate in light of the principles discussed in CP 1. Any self-interests acquired through employee share schemes that do not comply with the proposed conditions would be included in the calculation of this 5% limit.

Two options for employee share scheme interests

34 To address the risk of significant self-interests becoming a takeover defence, we propose that amending the 5% limit should be subject to companies satisfying either one of the following two conditions:

- (a) *Option 1: No shareholder approval*, where:
 - (i) the total aggregate self-interest in the company's shares held by the company and its controlled entities is less than 10% of the company's voting shares; and
 - (ii) the terms of the employee share scheme include provisions allowing employees to direct acceptance into a successful takeover bid and the securities to be transferred or cancelled as part of a merger by scheme of arrangement; or
- (b) *Option 2: Shareholder approval*, where:
 - (i) the company obtains the approval of the self-interest by its shareholders for the maximum amount of shares to be allocated under the employee share schemes; and
 - (ii) prohibitions on voting apply to the company, its controlled entities and employees who have an interest in the employee share schemes.

Option 1: No shareholder approval

Less than 10% self-interest

35 In light of the compulsory acquisition threshold in Pt 6A.1 of the Corporations Act, if shareholder approval is not obtained, we consider that limiting the total aggregate self-interest to less than 10% helps to reduce the risk that the shares in which the company and its controlled entities have a self-interest could be used as a takeover defence.

36 The self-interests held by the company and its controlled entities would be calculated as described in CP 1 (i.e. shares over which the company or its controlled entities have the power to control voting or disposal).

37 An alternative argument may be that, where the terms of an employee share scheme include provisions that allow employees to direct acceptance into a successful takeover bid and allow the securities to be transferred or cancelled as part of a merger by scheme of arrangement (see paragraphs 38–41), the risk of self-interests under that employee share scheme acting as a takeover defence will be adequately addressed. If this argument is accepted, self-interests under the employee share scheme could be excluded from the calculation of the percentage limit altogether.

Terms relating to control transactions

- 38 Where no shareholder approval is obtained, we propose that the terms of the employee share scheme must include provisions that allow the employee to direct acceptance into a successful takeover bid and allow the securities to be transferred or cancelled as part of a merger by scheme of arrangement.
- 39 A successful bid is a bid where holders of at least half of the bid class securities that are not held for the purposes of an employee share scheme to which the offer under the bid relates have accepted.
- 40 This condition is designed to address the takeover defence risk and is similar to ASX Listing Rules 9.17–9.18 and our policy on s606 relief for voluntary escrows: see Regulatory Guide 159 *Takeovers, compulsory acquisitions and substantial holdings* (RG 159) at Section Q.
- 41 We consider that this condition is necessary because, as a result of possible inaction by other shareholders, it might be practically difficult for a bidder to reach the compulsory acquisition threshold if controlled entities have the power to control disposal of between 5% and 10% of the company's shares.

Option 2: Shareholder approval

- 42 We are considering whether to permit the company to acquire 10% or more self-interest if it obtains the approval of its shareholders for the maximum amount of shares to be allocated under the employee share schemes.
- 43 This condition would effectively enable the company's shareholders to give their informed consent to the risks inherent in the company or its controlled entities acquiring a significant self-interest in the company's shares (e.g. the takeover defence risk). This type of informed consent is consistent with the principles underlying item 7 of s611.
- 44 The relevant notice of meeting should include specific information about the effects of the company's indirect self-acquisition, including that it may deter the making of a takeover bid for the company. Disclosure should also be made of all relevant terms of the employee share schemes that may have an effect on the control of the company, such as how the scheme operates in the event of a proposed control transaction.
- 45 Prohibitions on voting in favour of the transaction would apply to the company, its controlled entities and employees who have an interest in the employee share schemes.
- 46 We note that improper exercise of control in any of the above contexts risks an application to the Takeovers Panel for a declaration of unacceptable circumstances.

Voting of shares

- 47 We propose that employees must be able to direct the voting of shares held for employee share scheme purposes. Any restrictions on voting may distort the voting power of all other shareholders in the company. This degree of distortion is greater, the more shares cannot be voted.
- 48 An alternative argument may be that, where a company has obtained informed shareholder approval as proposed under Option 2, there is no need to impose this condition because shareholders have consented to the control implications of the employee share scheme including those relating to voting.

Reallocation or disposal of shares

- 49 Where an employee loses or forfeits their rights to shares held on their behalf under an employee share scheme, we propose that those shares either be reallocated to another employee under the scheme or disposed of within a short period of time. This is to prevent excess shares being accumulated.
- 50 As each employee share scheme may differ in its operation, we will assess what period of time is appropriate on a case-by-case basis. However, we are unlikely to allow excess shares to be held after the next allocation under the employee share scheme has occurred (i.e. the shares must be reallocated at the earliest opportunity or disposed of at that time).

Condition for managed investment schemes and trusts with a controlled responsible entity or trustee

Issue

- B3** In addition to proposal B2, if a company or its controlled entities accumulate more than 5% self-interest in the company's shares, we are seeking feedback on whether there is any need to impose a condition that limits the amount of the company's shares held by a controlled trustee or responsible entity to a certain percentage of the trust or scheme's assets.

Your feedback

- B3Q1 If a company accumulates more than 5% self-interest, do you consider it is necessary to impose a condition on investment funds that are not subject to any separate prudential requirements to address the risk of a conflict of interest between the interests of the controlled group and the interests of investors in the funds?
- B3Q2 If so, should the amount of the company's shares held by the controlled trustee or responsible entity be limited to a certain percentage of the trust or scheme's assets? What percentage of assets do you think is appropriate?

- B3Q3 What practical difficulties may arise from the imposition of this condition?
- B3Q4 Are there any reasons why a condition of s259C relief is not the most appropriate mechanism to deal with the risks associated with the identified conflict of interest (e.g. inconsistent treatment of different funds)?

Rationale

- 51 In CP 1, we stated that we did not intend relief to be subject to a condition limiting the amount of a company's shares held by a controlled entity to a particular percentage of a controlled entity's fund. We noted in CP 1 that many of the controlled entities that are likely to require relief under s259C(2) are already subject to separate prudential requirements: see paragraph 19 of CP 1.
- 52 We also stated in paragraph 20 of CP 1 that:
- We recognise that where a fund is not already subject to any specific prudential requirements relating to indirect self-acquisition, such as registered managed investment schemes, there is a risk of a conflict of interest which may arise in investing in the company's shares. Acquisitions of the company's shares by these funds, however, will not always be caught by s259C(2). In addition, these funds will have compliance plans and their responsible entities owe fiduciary duties to the investors. The risk of a conflict of interest in those cases is sufficiently small so as not to justify any prudential conditions.
- 53 Our view in CP 1 was predicated on the company and its controlled entities having a maximum 5% self-interest in the company's shares. We are now considering whether there is any need to change this position in light of our proposal to permit companies to exceed the 5% limit in certain circumstances.
- 54 Specifically, in relation to funds that do not have any separate prudential requirements, we are considering whether there is any need for relief to cease to apply where:
- (a) the company or its controlled entities have the power to control voting or disposal of 5% or more of the company's shares; and
 - (b) the value of the company's shares held by a controlled responsible entity or trustee for the scheme or trust is more than 10% of the value of the fund's assets.
- 55 If there is a need for relief to cease to apply in these circumstances, we have suggested a 10% limit (i.e. 10% of the value of the fund's assets) after taking into consideration the participation of various large financial institutions on the Standard & Poor's (S&P) index and ASX index.

Disclosure of economic exposures through derivatives

Proposal

- B4** We are considering whether the disclosure conditions in our standard s259C relief should be revised. We propose that a company should report two percentage figures to more fully disclose to the market the interests that the company has in its own shares.

Your feedback

- B4Q1** Should our standard relief from s259C require a company to disclose either:
- (a) the percentage level of voting shares in which group entities have the power to control voting or disposal, and the percentage level of the total net physical and economic exposure of all group entities; or
 - (b) the aggregate of physical shares and long derivative exposures, ignoring short positions?
- B4Q2** Alternatively, should the current requirement of our relief apply (i.e. for a company to disclose the percentage level of its relevant self-interests), also taking into account the company's net economic exposure through derivatives over its own shares?
- B4Q3** What do you consider are the benefits and risks in each method of reporting?
- B4Q4** What burdens may these reporting conditions create on a company's existing compliance systems?
- B4Q5** Do you think reporting of positions in one of these ways would help achieve the policy objectives of indirect self-acquisition relief?

Rationale

- 56 In granting standard relief from s259C, we impose a condition requiring the company to announce to the market the aggregated percentage total of the physical voting shares held by its controlled entities, and the shares to which the company and its controlled entities have 'an economic exposure arising from derivatives'.
- 57 We consider the use of the term 'economic exposure', as required by the current condition, captures the net economic exposure through derivatives of the entity to its own shares. That is, the aggregated percentage total that a company should report is the sum of its physical holdings and its net exposure to shares through derivatives. In some cases, the net exposure through derivatives may be short (or negative), in which case the reported percentage may be lower than the total number of physical shares held by the controlled entities.

58 The rationale for requiring reporting of positions in this way was that we believe net physical and economic positions are relevant to issues of market manipulation and insider trading. That is, significant changes in economic as well as physical exposures may indicate possible manipulation or insider trading: see paragraph 29(b) of CP 1.

Proposed change of requirement

59 However, reporting a single percentage may not provide sufficient clarity about control over voting or disposal of physical shares regulated by s259C. We are also considering whether market participants are sufficiently informed by a single percentage given the risks of insider trading and market manipulation.

60 We are proposing that a company should disclose both the percentage level of voting shares in which group entities have the power to control voting or disposal, and the percentage level of the total net physical and economic exposure. Our understanding is that this separate reporting method may better reflect the existing systems of companies that are currently subject to the condition—that is, the companies must already calculate and report substantial holdings of shares, and they calculate a net physical and economic position for risk purposes.

61 An alternative approach to the proposed condition is to require the disclosure of the aggregate of physical shares and long derivative exposures, ignoring short positions. This would be consistent with the type of disclosure required by the Takeovers Panel in their guidance on equity derivatives: see Takeovers Panel Guidance Note 20 *Equity derivatives*. However, we note that this disclosure is in relation to a takeover bid.

C Regulatory and financial impact

62 In developing the proposals in this paper we have carefully considered their regulatory and financial impact. We think the proposals for conditional relief in CP 1, CP 137 and this paper will strike an appropriate balance between permitting controlled entities to purchase the company's shares to hold for investors or employees and the regulatory risks that can arise from indirect self-acquisition.

63 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

- (a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;
- (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and
- (c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

64 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

65 To ensure that we are in a position to properly complete any required RIS, we ask you to provide us with as much information as you can about our proposals or any alternative approaches, including:

- (a) the likely compliance costs;
- (b) the likely effect on competition; and
- (c) other impacts, costs and benefits.

See 'The consultation process' at the front of this paper.

Key terms

Term	Meaning in this document
5% limit	The condition of relief outlined in the proposals in this paper that the company and its controlled entities do not acquire interests in more than 5% of the company's voting shares in aggregate
ASIC	Australian Securities and Investments Commission
ASX	ASX Limited (ACN 008 624 691) or the exchange market operated by ASX Limited
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
CP 1	Consultation Paper 1 <i>Indirect self-acquisition by investment funds</i> , released in October 1998
CP 137	Consultation Paper 137 <i>Indirect self-acquisition by investment funds: Further consultation</i> , released in June 2010
RG 159 (for example)	An ASIC regulatory guide (in this example numbered 159)
s259C (for example)	A section of the Corporations Act unless otherwise specified (in this example numbered 259C)
self-acquisition	Where shares (or units of shares) in a company are issued or transferred to an entity it controls
self-interest	For the proposals in this paper, this refers to the company's shares over which the company or its controlled entities have the power to control voting or disposal

List of proposals or issues and questions

Proposal or issue	Your feedback
<p>B1 We propose that the 5% limit should include shares over which the following entities have the power to control voting or disposal:</p> <ul style="list-style-type: none"> (a) the company; and (b) the controlled entities of the company. 	<p>B1Q1 Do you agree that shares over which the company has the power to control voting or disposal should be included in the 5% limit?</p> <p>B1Q2 Would this proposal substantially increase the percentage of shares included in the 5% limit?</p> <p>B1Q3 Are there any impediments to complying with the proposed calculation of the 5% limit?</p>
<p>B2 Where appropriate, we propose to vary the 5% aggregate limit outlined in CP 1 for interests acquired in connection with employee share schemes subject to the conditions in Table 1.</p>	<p>B2Q1 If you operate an employee share scheme and rely on relief from s259C(1) under CP 1, please provide the following information:</p> <ul style="list-style-type: none"> (a) Do you require relief from s259C for that scheme? (b) Does your company or its controlled entities have the power to control voting or disposal of shares allocated under the employee share scheme? If so, what power exists, and how long can it last? (c) If your answer to question B2Q1(b) is 'yes', are there impediments to restructuring your schemes so that this power does not arise? (d) What percentage of the company's total voting shares are comprised of shares allocated under employee share schemes over which the company or its controlled entities have the power to control voting or disposal? Do you anticipate that this percentage will increase significantly? <p>B2Q2 Do you agree that we should amend the 5% limit for self-interests acquired under employee share schemes? If so, why do you consider these interests should be treated differently to self-interests acquired in other circumstances?</p> <p>B2Q3 Should self-interests acquired under an employee share scheme be excluded altogether from the 5% limit without any associated restrictions or conditions? If so, why?</p> <p>B2Q4 For the proposed conditions in Option 1:</p> <ul style="list-style-type: none"> (a) is the percentage limit of less than 10% appropriate? (b) do employee share schemes usually have terms relating to takeovers similar to the proposed condition (b) under this option? If not, what practical impediments might prevent adoption of such terms? (c) should self-interests acquired under an employee share scheme be excluded from the 5% limit altogether as long as the scheme contains a term equivalent to the proposed condition (b)? (d) is there a need for proposed condition (b) given the level of self-interest is restricted to less than 10% under Option 1?

Proposal or issue	Your feedback
	<p>B2Q5 For the proposed conditions in Option 2:</p> <p>(a) who should be excluded from voting on the resolution for shareholder approval?</p> <p>(b) is there a need for the additional proposed general condition (3) that employees must be able to direct the voting of shares held under the employee share scheme?</p> <p>B2Q6 Do you consider that potential takeover defence risks are adequately addressed by our proposed conditions?</p> <p>B2Q7 Are there any other regulatory risks we need to consider?</p> <p>B2Q8 Are there any commercial impediments to a company complying with proposed conditions 3 and 4?</p>
<p>B3 In addition to proposal B2, if a company or its controlled entities accumulate more than 5% self-interest in the company's shares, we are seeking feedback on whether there is any need to impose a condition that limits the amount of the company's shares held by a controlled trustee or responsible entity to a certain percentage of the trust or scheme's assets.</p>	<p>B3Q1 If a company accumulates more than 5% self-interest, do you consider it is necessary to impose a condition on investment funds that are not subject to any separate prudential requirements to address the risk of a conflict of interest between the interests of the controlled group and the interests of investors in the funds?</p> <p>B3Q2 If so, should the amount of the company's shares held by the controlled trustee or responsible entity be limited to a certain percentage of the trust or scheme's assets? What percentage of assets do you think is appropriate?</p> <p>B3Q3 What practical difficulties may arise from the imposition of this condition?</p> <p>B3Q4 Are there any reasons why a condition of s259C relief is not the most appropriate mechanism to deal with the risks associated with the identified conflict of interest (e.g. inconsistent treatment of different funds)?</p>
<p>B4 We are considering whether the disclosure conditions in our standard s259C relief should be revised. We propose that a company should report two percentage figures to more fully disclose to the market the interests that the company has in its own shares.</p>	<p>B4Q1 Should our standard relief from s259C require a company to disclose either:</p> <p>(a) the percentage level of voting shares in which group entities have the power to control voting or disposal, and the percentage level of the total net physical and economic exposure of all group entities; or</p> <p>(b) the aggregate of physical shares and long derivative exposures, ignoring short positions?</p> <p>B4Q2 Alternatively, should the current requirement of our relief apply (i.e. for a company to disclose the percentage level of its relevant self-interests), also taking into account the company's net economic exposure through derivatives over its own shares?</p> <p>B4Q3 What do you consider are the benefits and risks in each method of reporting?</p> <p>B4Q4 What burdens may these reporting conditions create on a company's existing compliance systems?</p> <p>B4Q5 Do you think reporting of positions in one of these ways would help achieve the policy objectives of indirect self-acquisition relief?</p>

Appendix: Links to related papers (CP 1 and CP 137)

For reference, we have included links to CP 1 and CP 137 on our website. The papers and related media release are available for download at www.asic.gov.au/cp.

Consultation Paper 1 *Indirect self-acquisition by investment funds* ([CP 1](#)), released 19 October 1998, comments closed 18 December 1998.

Consultation Paper 137 *Indirect self-acquisition by investment funds: Further consultation* ([CP 137](#)), released 18 June 2010, comments closed 30 July 2010.