Employee Ownership
Australia & New Zealand
Making it your business

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30 January 2014

Peng Lee
Senior Manager Corporations
Australian Securities and Investments Commission
Level 24, 120 Collins Street
Melbourne VIC 3000

Dear Peng,

Re: CONSULTATION PAPER 218: Employee incentive schemes

The Employee Ownership Australia (EOA) expert's panel notes ASIC consultation paper dated November 2013. ASIC's expansion of relief and simplification of compliance requirements is generally positive. ASIC's proposed expansion of class order relief is generally to be welcomed as it eliminates significant compliance costs for employers. It brings disclosure, licensing, advertising and hawking relief to a larger number of the products being offered in the market.

In particular, employers covered by the expanded regime will no longer need to apply for ASIC relief on a case-by-case basis.

There are instances, however, where the proposed relief is hedged by unnecessary conditions and qualifications, which prevents the expanded regime from being truly comprehensive. We set out some of these instances below:

1. The unnecessarily narrow definition of "performance rights"

We consider that the term "performance right" is not a term of art which depends on:

- length of service of the recipient; or
- the performance of the recipient, the issuer, or the issuer's associate.

Rather, a performance right as an industry term merely refers to any zero exercise price option.

The ASIC's restrictive definition of performance rights unnecessarily narrows the class of interests that qualify for relief. It also means that ASIC is imposing potential conditions on employer's design principles and in general the EOA expert's panel would caution against this as no one size fits all companies, and market practice generally changes over time.

2. Employee share trusts problems not fully resolved

ASIC proposes to make it a condition for relief that trustees do not exercise voting rights:

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- attached to unallocated shares; or
- attached to allocated shares where the trustee has not received a voting direction from the beneficiary.

This is an unjustifiable restriction on relief. There is no risk in allowing trustees to vote in these circumstances, given that trustees are under fiduciary obligations to act in the best interests of the beneficiaries.

It is also not clear that ASIC fixes all of the problems associated with the requirement that beneficiaries should be given the same rights as if they were the owners of the shares. This is an issue particularly where the interests are subject to performance or other vesting conditions (and dividends may accrue later or only start to accrue at vesting and this has been driven by current shareholder concerns in this area).

3. Minimum 12 month holding period for significant portions is inflexible

ASIC has proposed that relief is to be granted only if the employee does not receive a significant portion (ie, 25%) of the interest within 12 months from the date of grant.

The requirement is inflexible, as it does not take into account involuntary events such as the termination of the employee's employment, or extreme events such as change in control of the issuer within the 12 month period.

Additionally, the 12 month requirement may make it difficult for employers to make payments to incoming employees in lieu of employee equity foregone with a previous employer.

Practically this provision will cause issues for large employee share plans that offer the $1,000 plan. This plan is taxed immediately but can be accessed by employee if they leave. If 25% were to be restricted, commonly, this would be a very small amount of shares and may be less than a marketable parcel size. This would cause an incredible administration burden on a company to manage for a relatively small benefit. In our experience it is also very difficult to manage former employees of plans as they don't necessarily update their information regularly and this can lead to unclaimed monies and lost shareholders, which creates a cost and administrative burden for a company.

Additionally, this requirement may be contrary to the current tax rules, i.e. the employee is only restricted for 3 years or cessation of employment if this is earlier. This is a specific condition of this type of plan.

4. Unlisted bodies should get further expanded relief

Although the proposed Class Order expands relief to wholly-owned subsidiaries of unlisted entities, there are substantial restrictions which significantly narrow the range of products able to be offered by unlisted bodies.

In our view, the ability of small businesses to offer relatively cheap employee incentive schemes would be highly desirable. A simpler model would facilitate employees to participate in equity in small business as part of succession planning to promote survival of small businesses.

Start-ups (currently the subject of a separate review by Treasury) may suffer from the requirement that there must be only one class of shares on issue. Typically, start-ups would also have convertible

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shares and other kinds of issued capital. The current proposed changes are, in effect, more limiting that the current provisions because of this requirement.

These issues are particularly important in the current national economic climate.

5. Inadequate definition of derivatives

The proposed reform dealing with derivatives and the expansion of the relief to derivatives is a welcome reform.

ASIC's views in relation to the scope and nature of derivatives, however, are problematic. In particular, ASIC's statement that a variable cash bonus or commission may fall within the technical definition of derivative in s 761D(3)(b) of the Corporations Act 2001 (Cth) ("contract for the future provision of services") is not within the accepted view of what constitutes a derivative. ASIC's approach is likely to create significant confusion and concern.

6. No cost exemption is unnecessarily restrictive

The narrowness of the manner in which the nominal monetary consideration, loan and financial assistance requirements are formulated is a major impediment to appropriate offering of employee equity.

This is an area where relief under the Corporations Act 2001 (Cth) is out of step with the provisions of the tax law, which take into account the consideration paid by the employee in calculating the cost base of ESS interests. In our view $1,000 plans should be classified as for no consideration because of the low risk associated with them.

A broader range of loans should be allowed, for example where the loans accrue interest which is repayable with cash dividends.

7. Synchronising terms with the Class Order and accepted taxation terms

There should be a recognised acceptance of terms and definitions across all regulations that are associated with the employee share schemes, for example the Class Order should adopt the same definition as the Tax Legislation for the sole purpose test for trusts and also the same definition of a contractor. This will minimise the number of different tests that companies need to comply with.

8. Contribution plans and options

ASIC proposes that performance rights and options are excluded from relief when they are bundled with a contribution plan. This unnecessarily prevents employers offering plans along the lines of e.g. British SAYE plans.

Kind regards

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