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By email

Mr Peng Lee
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Dear Mr Lee

ASIC Consultation Paper 218: Employee incentive schemes

Thank you for the opportunity to make comments in response to ASIC's Consultation Paper 218: Employee Incentive Schemes (CP). Gilbert + Tobin wishes to make a submission in relation to proposals A2, C1, C2, C3 and D3(c) in the CP.

1 Proposal A2

A2Q1: Are there any other issues on which it would be useful to have ASIC guidance? If so, please give details.

Definition of "eligible offer"

Employee incentive schemes are generally drafted such that the scheme documentation itself outlines the parameters within which the grant and issue of products under the scheme can be made by the body's board of directors. Accordingly, matters such as the number of products offered and the specific terms and conditions attaching to the specific offers are determined on a case-by-case basis as grants are made under the employee incentive scheme.

In paragraph 9 of the interpretation in the current ASIC Class Order 03/184, reference is made to "...an employee share scheme extended only to eligible employees of the issuer". As a consequence of this wording, employee incentive schemes have been drafted to specifically exclude non-executive directors as they are not 'eligible employees' for the purposes of the current ASIC Class Order 03/184. We submit that in drafting the new proposed class order relief, it be made clear that extending the employee incentive scheme beyond 'eligible employees' will not render all offers made under the employee incentive scheme ineligible for the class order relief, but rather only those offers that do not otherwise meet the requirements of the new class order relief. For administrative reasons, it may be desirable for bodies to make offers of products under the employee incentive scheme, even though those offers may not be eligible for the ASIC class order relief.

Permitting employee incentive scheme participants to appoint a nominee

In our experience, employee incentive schemes commonly permit a person to whom an offer is made to give notice that that they would like the offer to be made to another party (a 'nominated party').

Generally this request is related to the individual's tax circumstances. Whether a person is permitted to do this or not is generally at the sole and absolute discretion of the body's board of directors.

We understand that when reviewing employee incentive schemes in connection with granting relief similar to current ASIC Class Order 03/184, ASIC has recently paid close attention to the ability of a participant under an employee incentive scheme to nominate another party to take up the rights offered under the employee incentive scheme. In particular, to ensure that the ability to nominate does not impact on the ability of the offer to support the long-term interdependence between the body and its employees.

This is an area where it would be useful to have ASIC guidance as to the parameters of to whom such nominations may be made. In our experience, it has been appropriate to link the definition of 'nominated party' in the employee incentive scheme to the definition of 'Associates' as defined in the *Income Tax Assessment Act 1936* (Cth) (**ITAA**) so that the 'nominated party' does not fall outside the tax definition of 'associate' for the purposes of Division 83A of the ITAA.

2 Proposal C1

C3Q1: Do you agree with our proposal to extend our class order to offers of eligible products to contractors? If not, why not?

We agree with ASIC's proposal to extend the proposed new class order relief to offers of eligible products to contractors and casual employees as this recognises that the relationship between the body and the relevant person which forms the rationale for the relief as outlined in paragraphs 46 and 47 of the CP, can be created through different forms than a simple full time/part time employment relationship.

3 Proposal C2

C2Q1: Do you agree with our proposal to extend our class order relief to cover offers to prospective employees? If not, why not?

We agree with ASIC's proposal to extend the proposed new class order relief to cover offers to prospective employees. This can assist with attracting senior talent to bodies, as the employment offer can make an offer of participation in an employee incentive scheme, rather than stating that the person *may* be eligible to participate in the body's employee incentive scheme upon commencement with the body.

4 Proposal C3

C3Q1: Do you agree with our proposal to only provide limited conditional relief for non-executive directors? If not, why not?

We agree with ASIC's proposal to provide limited conditional relief to non-executive directors however, we do not agree with the proposed specific conditions (see further below).

C3Q2: Do you agree with the proposed specific conditions in Table 3 for offers to non-executive directors? If not, why not?

Paragraph 69 of the CP would appear to acknowledge that some start-up bodies prefer to remunerate directors by issuing financial products, particularly where cash reserves are low. However, proposed specific condition (c) in Table 3 for offers to non-executive directors requires directors to contribute their own funds to acquire the products. The CP states in paragraph 70 that the proposed condition (c) is designed to maintain the objectivity of the director.

In our experience, bodies in their early stages of development will often wish to remunerate directors by issuing financial products in lieu of paying cash remuneration. This is also true for other companies whose cash reserves are low (for example mining exploration entities), where it is common for those companies to issue financial products (particularly shares and options) in lieu of additional cash remuneration (subject to obtaining the necessary shareholder approvals). When financial products are offered to non-executive directors in these circumstances, they are not generally issued subject to a condition linked to the performance of the body.

The ability of companies to remunerate directors by issuing financial products in lieu of paying cash compensation is very important to companies whose cash reserves are low, as it enables them to attract and retain suitably qualified and experienced non-executive directors in circumstances where they otherwise may not be able to.

We submit that the proposed specific conditions for offers to non-executive directors in Table 3 be amended as follows:

- (a) the offer is only for quoted shares, depository interests, ~~or~~ stapled securities or options over any of these financial products;
- (b) the acquisition of these products, and where the product is an option, the exercise of the product, is not subject to a condition linked to the performance of the body;
- (c) directors must contribute their own funds to acquire these products or acquire the products in lieu of receiving cash compensation for services provided by the director to the body as a director of the body; and
- (d) the employee incentive scheme for non-executive directors must not involve a loan or other financial assistance to the directors.

We submit that extending the class order to cover offers of options to acquire the financial products referred to in condition (a) of Table 3 in circumstances where both the acquisition and exercise of the option is not linked to the performance of the body is consistent with the policy outlined in paragraphs 68 and 69 of the CP. We also submit that to permit non-executive directors to participate in employee incentive schemes in circumstances where conditions are not attached to the products will not undermine their independence: see paragraph 49.25 of the draft Regulatory Guide 49: Employee incentive schemes (**Draft RG**).

We also submit that requiring directors to contribute their own funds to acquire the products is not required to maintain the objectivity of the director. We submit that objectivity would be maintained in circumstances where the products are issued in lieu of receiving cash compensation for services provided by the director to the body as a director of the body.

C3Q3: Do you agree with our proposal to impose four of the general conditions of our new class order relief (set out in Table 3) on offers to non-executive directors? If not, why not?

We agree with ASIC's proposal to impose four of the general conditions of the new class order relief (set out in Table 3) on page 25 of the CP on offers to non-executive directors.

C4Q4: To what extent is the small-scale offerings disclosure exemption in s708(1) or 1012E relied on for offers to non-executive directors? Is this exemption useful for such offers? Please give reasons. Are any other exemptions relied on?

The ability of a listed entity to obtain conditional relief from the on-sale provisions in sections 707 and 1012C of the *Corporations Act 2001* (Cth) (**Corporations Act**) is important to reducing the compliance burden of making offers under an employee incentive scheme. The small-scale offerings disclosure exemption in section 708(1) or section 1012E of the *Corporations Act* is of limited assistance in reducing the compliance burden for listed entities to make offers to non-executive directors because if these exemptions are relied on, the on-sale provisions in sections 707 and 1012C of the *Corporations Act* will apply to the on-sale of the products. Where a convertible product is offered to non-executive directors, the listed entity is exposed to the risk that when the product is converted, at which point the entity may be obliged to publish a "cleansing statement", it will be required to publish any information that is being legitimately withheld from the market under an exception to ASX Listing Rule 3.1. This may have commercial consequences for the listed entity. The alternative is for the listed entity to require the recipient to agree that the security issued upon conversion is subject to on-sale restrictions for 12-months after its issue, which may not be commercially acceptable.

5 Proposal D3(c)

D3Q2: Do you consider the proposed definition of 'performance right' is broad enough to cover the conditional rights usually offered under an employee incentive scheme? If not, what other rights do you think should be included in the definition? Please provide a detailed explanation of the nature of these rights and why they should be included.

As an initial comment, we note from paragraph 102 of the CP that the proposed definition of "performance right" is designed to capture the most common types of rights that have been the subject of relief applications, as well as other similar types of rights. Given that the phrase 'performance right' is a phrase that is commonly used in the market to refer to a particular type of financial product (which product is significantly different for example, to a share appreciation right), we submit that ASIC should avoid the use of the phrase 'performance right' to try and capture all these rights, and instead introduce a new term such as 'share right' that does not carry with it a specific meaning in the market place.

We make the following submissions in relation to the definition of 'performance right' in the CP:

- (a) The rights are properly described as *conditional* rights to receive the products referred to in the definition of 'performance right'. They are conditional as:
 - (i) they do not vest unless specified conditions are met; and
 - (ii) the right to receive securities, or a cash amount, or a combination of securities and cash is generally at the discretion of the issuing body's board of directors.

- (b) A 'performance right' does not always automatically vest upon meeting the conditions attached to the right. We have drafted plans where our client has required that the performance right have an exercise mechanism upon vesting. However, due to other characteristics of the performance right, it has not met the definition of security in section 761A (for example, because the rights may be satisfied by a cash payment equivalent to an increase in the value of the shares). Accordingly, specific ASIC relief would be required. We see no policy reason for excluding these types of products from the proposed new class order relief solely because they have an exercise mechanism. Accordingly, we submit that the word "automatically" be deleted from the definition of 'performance right'.

Please don't hesitate to contact Marcello Cardaci or Mindy Bonomelli of this office if you would like to discuss our submission with us.

Yours sincerely

Gilbert + Tobin