



Peng Lee
Senior Manager Corporations
Australian Securities and Investments
Commission
Level 24, 120 Collins Street
Melbourne VIC 3000
policy.submissions@asic.gov.au

31 January 2014
By email

Submission on Consultation Paper 218: Employee Incentive Schemes

We have pleasure in submitting Herbert Smith Freehills' Head Office Advisory Team's comments on ASIC's Consultation Paper 218: Employee Incentive Schemes.

The Head Office Advisory Team (HOAT) is supportive of ASIC's initiative to 'future-proof' ASIC Class Order 03/184. In particular, we are pleased to note that the revised Class Order (**Class Order 14/xx**) will:

- expressly apply to performance rights, including cash settled rights and dividend equivalent payments;
- clarify the availability of relief for offers involving stapled securities; and
- reduce the listing period required for companies to be eligible to obtain relief.

Our comments in response to some of the specific questions raised in the consultation material are set out in the attached annexure. We also have the following comments in relation to issues that were not specifically addressed in the consultation materials.

Drafting of the new Class Order

One of the existing difficulties with Class Order 03/184 is its technical nature, which makes it difficult for non-lawyers to understand and also results in some unnecessary (and probably unintended) technical issues and distinctions.

We suggest that any new Class Order should be drafted in plain English and, where possible, be 'principles-based' rather than prescriptive, so that it can be interpreted and applied by the human resource professionals who will be most impacted by the changes.

If timing permits, we request that the new Class Order be exposed for comment prior to it coming into effect.

Areas of continued uncertainty

Consideration could be given to clarifying the following items that are not specifically covered by the consultation materials:

- **form of offers** – ASIC could confirm that it is comfortable that compliant offers can be made by way of an electronic offer procedure and that offers may be structured as "opt out" offers, provided they are in a form that is not misleading or deceptive and are otherwise reasonable in all the circumstances; and
- **offer pricing** – where pricing is to be worked out in the future under a formula, offer documents currently must specify what the price would be if the formula was applied at the date of the offer. This is not possible in some cases, for example where offer booklets are printed by professional printers and printing occurs some days before the offer is made. The requirement could be changed

Doc 26168244.3



so that the formula need only be applied on a date “reasonably proximate to the offer”.

Further reforms

For completeness sake, we note that it would be welcome if ASIC were to consider class order relief for certain offers of derivatives in circumstances where Class Order 14/xx does not apply but the offer would have qualified under a Corporations Act exemption if it was an offer of shares. Global employee incentive schemes frequently involve offers of cash based ‘phantom’ share plans. Australia is currently in a very small minority of countries that do not facilitate such offers. Even limited relief for the making of such offers to ‘senior managers’ would be welcome.

Head Office Advisory Team

Herbert Smith Freehills



CP 218 reference	Statement/question	Response
Paragraph 12	<p>"We are also of the view that the exclusion from the definition of a 'derivative' of a contract for the future provision of services under s761D(3)(b) would also generally not apply to offers made under an employee incentive scheme to ensure that these do not involve the offer of a financial product."</p>	<p>If participation in the employee incentive scheme is contemplated by the employee's contract or included in the contract itself, we find it difficult to see why the exemption would not apply.</p> <p>However, we assume that ASIC is flagging that if the exclusion is used as a device with a view to structuring a derivative as an employee incentive scheme (when the primary purpose is not to remunerate an employee), then the exclusion would not apply.</p>
A2Q1	<p>Are there any other issues on which it would be useful to have ASIC guidance? If so, please give details.</p>	<ul style="list-style-type: none"> • ASIC could clarify the extent to which it considers offers made by Australian issuers to foreign employees to be regulated by Australian securities, financial services licensing and fundraising laws. • ASIC could consider providing guidance on when an employee will be considered by ASIC to fall within the expanded definition of 'senior manager' under Class Order 04/899. We would recommend that 'senior manager' should be construed purposively having regard to the class of persons unlikely to require special protection because their level of seniority is such that: (a) they are likely to already have a good understanding of the business; and (b) they are likely to be familiar with employee incentive plan offers and securities dealings.
A2Q3	<p>Are there any other issues that may be appropriate for us to address through an exemption or modification by class order? Please be specific.</p>	<p>ASIC could consider extending Class Order relief from all applicable provisions when an employee incentive offer is made without disclosure under the small scale offering exemptions (for example, relief from the financial services licencing, hawking and on-sale provisions).</p>
C3Q1	<p>Do you agree with our proposal to only provide limited conditional relief for non-executive directors? If not, why not?</p>	<p>We do not support the introduction of any special or additional conditions on offers to non-executive directors.</p>
C3Q2	<p>Do you agree with the proposed specific conditions in Table 3 for offers to non-executive directors? If not, why not?</p>	<p>The current Class Order does not impose any such conditions and we are not aware of any current practices that suggest the existing Class Order is deficient in this area or that the new conditions are necessary.</p>
C3Q3	<p>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?</p>	<p>To the extent that the purpose of the additional conditions is to address considerations extraneous to fundraising and protection of the investor, we</p>



		question whether this is appropriate?
C3Q4	To what extent is the small scale offerings disclosure exemption in s 708(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.	<p>Unlike the 'senior manager' exemption, the small scale offering exemptions do not provide 'flow through' relief for potentially applicable financial service licencing and hawking provisions.</p> <p>Accordingly, the small scale offering exemptions are currently less desirable exemptions to rely on in the context of an offer under an employee incentive scheme (see comments on A2Q3 above).</p>
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.	<p>The definition should not be limited to rights which "automatically vest" in the recipient.</p> <p>Some companies offer 'performance rights' that are exercisable (this can be beneficial from a tax perspective in some jurisdictions).</p> <p>Similarly, rights may be granted in relation to shares that may be purchased on market rather than issued, in which case they may not be considered by ASIC to be an option. It should be clear that rights of this nature fall within the definition of performance rights and will be covered by the Class Order.</p> <p>The definition of performance right should not be qualified by the right being subject to any kind of condition (whether length of service, performance or otherwise).</p>
D3Q6	Do you consider that paragraphs D3(c)(v)-D3(c)(vi) adequately capture the ability for some performance rights to be cash settled? If not, why not?	<p>We suggest that any reference to a cash amount should be phrased as a cash amount "referable to" or "based on" the value of the financial product, dividend or distribution, rather than a cash amount that is "equivalent to" their value.</p> <p>For example, where dividend equalisation payments are funded from dividends paid on unallocated shares held in a trust, it would be common for the payment to be net of tax paid by the trustee. Companies may also wish to offer performance rights that have potential for upside if the company outperforms (e.g. so that any cash payment is multiplied by a 'performance multiplier' which would make the payment more valuable than the underlying financial product). It also is not clear whether a payment "equivalent to" a dividend would be inclusive or exclusive of the value of franking credits.</p>
D4Q1	Do you agree with our proposal to provide guidance (and to potentially issue a separate class order declaration) that employment or employment-like remuneration arrangements,	<p>In our view further guidance or relief is unnecessary.</p> <p>The danger of providing additional guidance or relief is that it may unintentionally call into question previously unobjectionable cash</p>

	<p>under which commissions or bonuses may be payable, are not financial products for the purposes of Ch 7? If not, why not?</p>	<p>arrangements if they do not fit precisely within the terms of the guidance or relief.</p> <p>Any further guidance or relief should be broadly drafted to avoid such a consequence.</p> <p>For governance reasons, it is common for the terms of a grant to provide that employees will not receive dividends and voting rights attaching to unvested allocated shares. If the dividends are provided to the employee at all, it is not until the allocated shares vest. Accordingly, trust deeds often provide flexibility in terms of whether these dividend, voting rights and other shareholder entitlements 'flow through' to participants. It should not be a condition of Class Order relief that trust deeds require allocated trust property beneficiaries to have the same rights as the legal owner.</p> <p>Further, there is no need to impose new general conditions on the use of a trust. In particular:</p> <ul style="list-style-type: none"> • controlled trustees will usually be consolidated in the audited accounts of the ultimate parent company so there is no need to impose a separate audit requirement; • inspection rights are unlikely to be useful to or used by employees; and • controlled trustees may sometimes pay management fees or interest to a third party out of unallocated trust assets. This does not negatively impact allocated trust property beneficiaries, so it should not result in a loss of Class Order relief.
<p>E1Q3</p>	<p>Do you agree with the proposed conditions of relief in respect of allocated products? If not, why not?</p>	<p>It needs to be clear that the trust may hold unallocated products for more than one plan or offer, including plans or offers to employees that are not reliant on the Class Order.</p> <p>Further, there is no need to impose new general conditions on the use of a trust. In particular:</p> <ul style="list-style-type: none"> • controlled trustees will usually be consolidated in the audited accounts of the ultimate parent company so there is no need to impose a separate audit requirement; • inspection rights are unlikely to be useful to or used by employees; and • controlled trustees may sometimes pay management fees or interest to a
<p>E1Q4</p>	<p>Do you agree with the proposed conditions of relief in respect of unallocated products? If not, why not?</p>	



		<p>third party out of unallocated trust assets. This does not negatively impact allocated trust property beneficiaries, so it should not result in a loss of Class Order relief.</p>
E1Q6	<p>[CO 03/184] currently provides licensing relief for associates of issuers. Do you consider that other types of trustees (that may not be associates of issuers) also require licensing relief in the context of employee incentive schemes. If so, please provide examples and explain why relief is needed.</p>	<p>Relief should be extended to foreign trustees who comply with the regulations in their home jurisdiction.</p>
E3Q1	<p>Do you agree with the proposed new definition of 'contribution plan'? If not, why not?</p>	<p>Employee share purchase plans (however they are structured) are not offered by companies for the purpose of fundraising. Their sole purpose is to provide an incentive and additional benefit for participants.</p>
E3Q2	<p>In particular, do you consider that the proposed new definition of 'contribution plan' includes both deductions made from earned salary (described as an 'ineffective salary sacrifice' arrangement in Income Tax Ruling TR 2001/10 (TR 2001/10)) and agreements to take future salary in the form of eligible products (described as an 'effective salary sacrifice' arrangement in TR 2001/10)? If not, why not?</p>	<p>Unless shares are offered at a significant discount to market price (which in our experience is rare in Australia), if employee share purchase plans cannot be structured in a tax effective manner that provides employees with something more than they would have received if they had purchased the shares independently, there is no point making the offer.</p>
E3Q3	<p>Do you agree with the proposed conditions for how contributions are to be held? If not, why not?</p>	<p>Where a plan involves employee contributions, our experience is that companies are very careful to ensure that the offer document is very clear, particularly in terms of rights to cease participation and the consequences of doing so.</p>
E3Q4	<p>Do you agree with our proposal to change the timing for the opt-out requirement from 'any time' under [CO 03/184] to 'a notice period of no more than one month', with all money deposited for that participant at that time with an Australian ADI, including any accumulated interest, to be transferred to that participant as soon as practicable? If not, why not?</p>	<p>Accordingly we suggest that:</p> <ul style="list-style-type: none"> the only additional condition imposed on contribution plans (relative to other offers) is that employees may elect to cease to participate on one month's notice and contributions received prior to cessation of participation must be refunded to the employee in either cash or shares acquired at the next scheduled acquisition date (at the company's election);
E3Q5	<p>Are there any other conditions that should be imposed in respect of employee incentive schemes involving contribution plans?</p>	<ul style="list-style-type: none"> the Class Order recognise that companies may restrict a participant's ability to cease their participation at times when this is necessary to ensure compliance with law or the company's policy on dealing in securities; requirements to hold funds on trust in an ADI and to refund in kind are more than is needed for the protection of the employee; and



	<ul style="list-style-type: none"> relief be extended to include performance rights offered for nominal consideration in connection with a 'contribution plan' i.e. because these performance rights are provided as an additional 'bonus' rather than in consideration for the payment of the acquisition price. 	
E4Q1	<p>Do you agree with the proposed limited or no recourse limitation on loans offered for acquiring underlying eligible products (i.e. eligible products excluding options and performance rights) under an employee incentive scheme that qualifies for class order relief? If not, why not?</p>	<p>We are not aware of any current practices that suggest the existing Class Order is deficient in this area or that the new conditions are necessary. There is no reason why loans should not be able to be full recourse if, as required by the current Class Order, there is adequate price and other disclosure at the time an offer is made.</p> <p>In addition, some loan plans involve additional benefits (e.g. 'bonus' shares), which in some cases means that the potential value will exceed the full recourse amount. These offers should not be discouraged.</p> <p>We also note that some current loan plans are designed so that the loan is repaid during the life of the loan according to a repayment schedule.</p>
F4Q1	<p>Do you agree with the proposed new condition to impose a partial 12-month holding requirement? If not, why not?</p>	<p>We are not aware of any current practices that suggest the existing Class Order is deficient in this area or that the new condition is necessary.</p> <p>If ASIC's proposed change was implemented, there would need to be a significant shift in practice. Most offers contain cessation of employment and change of control terms that may provide for full vesting if employment ceases or a change of control occurs within 12 months of the offer.</p> <p>Full vesting within 12 months would often be appropriate in these cases, especially where the employee dies or becomes disabled, or is terminated without fault on their part due to downsizing or a change of control.</p> <p>For example, consider a deferred short term incentive arrangement, where the employee has a portion of their earned cash bonus for a year "deferred" into equity, which is then restricted from sale for 2 years. The employee has already earned this bonus and if they cease to be employed in the first few months of the deferral period (e.g. due to retirement), it would be an unusual outcome if a portion of the equity was required to remain restricted for a number of months.</p> <p>Other examples include \$1,000 tax exempt plans and salary sacrifice plans, which for tax reasons are typically structured so that restrictions cease on cessation of employment.</p>

		<p>If, notwithstanding the above, a partial 12 month holding requirement is imposed, it should not apply to any shares delivered on the vesting or exercise of options or performance rights or the delivery of bonus shares if the shares were only delivered after the satisfaction of a service condition.</p>
F5Q1	<p>Do you agree that the offer document should be clear, concise and effective, and include a brief summary of the key risks? If not, why not?</p>	<p>As a matter of practice, some offer documents already include a brief summary of the risks of share ownership.</p> <p>If a requirement to include a brief summary of risks is introduced, the requirement should:</p> <ul style="list-style-type: none"> relate to the risks of share ownership and any risks arising from the offer structure (e.g. any loan); not require a summary of business risks affecting the issuer.
F5Q2	<p>Do you agree with our proposal to replace the current requirement to provide offer documents to ASIC with a requirement to notify us of an offer using Form XX? If not, why not?</p>	<p>We do not support this change in its current form.</p> <p>The content of the proposed Form XX is onerous. It would be less burdensome to simply continue to lodge the documents.</p> <p>We suggest instead that it be a condition of relief that the entity must retain copies of the offer documentation provided to employees for a period of 7 years after the offer is made and that the documentation must be provided to ASIC on request, similar to the condition imposed in Schedule C of Class Order 01/1519.</p> <p>Alternatively, we suggest that the existing lodgement requirement be retained, but that the consequence of non-compliance be defined. The current consequence (i.e. non-availability of relief) is disproportionate given the theoretical consequences of breaching the disclosure and licensing provisions of the Corporations Act. More 'balanced' consequences of non-compliance could include, for example, a requirement to provide a written explanation to ASIC and an undertaking about the prompt lodgement of offer documentation for the next five years.</p>
F5Q3	<p>Do you agree with including the information at F5(b)(i)-F5(b)(xi) in Form XX? If not, why not?</p>	<p>We do not support the introduction of Form XX.</p> <p>However, if it is introduced, companies should be given the option of either filing in the Form or simply lodging pro forma documentation.</p> <p>We submit that the Form need only contain:</p>

		<ul style="list-style-type: none"> the name of the issuer; the date of the first offer under the plan; and a one paragraph summary of the plan. <p>Inclusion of additional information in the Form (e.g. the “types” of participants and the identity of any trustee) would be likely to result in entities inadvertently failing to update the Form when these aspects change.</p> <p>Similar to the point made in F3Q2 above, the consequences of failing to lodge or update the Form within the required period should be defined and should be less severe than loss of relief.</p>
F5Q5	Do you agree that some or all of this information should not be made public. If not, why not?	<p>We agree that the information should remain confidential.</p> <p>There are already mandatory remuneration reporting requirements and share based payment reporting requirements for the annual report that provide stakeholders with sufficient information.</p>
G2Q2	Do you agree with our proposal that offers by unlisted bodies of options and performance rights should relate only to ordinary shares? If not, why not?	<p>ASIC should consider whether relief extended to unlisted companies in relation to ordinary shares should also be available for unlisted stapled entities in relation to stapled securities. This comment applies generally to the proposals in section G of the consultation paper.</p>
H2Q4	Do you consider there are other forms of on-sale relief that are necessary in the context of employee incentive schemes? If so, please provide details.	<p>Yes. On-sale relief should automatically be available to any offers properly made without disclosure under an employee incentive scheme, including:</p> <ul style="list-style-type: none"> offers made in reliance on the ‘senior manager’ exemption; and offers made in reliance on the small scale offering exemptions.

