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Ms Nathania Nero
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30 April 2019

Employee Share Schemes consultation

Dear Ms Nero

We welcome the opportunity to provide our submission to the consultation process regarding the regulatory framework for employee share scheme (**ESS**) offers.

We believe consolidating and simplifying the current statutory exemptions and ASIC class order relief for ESS offers would significantly assist companies – in particular, unlisted companies – with reducing the regulatory barriers to offering company shares to their employees.

In our experience, the current regulatory framework has prevented many small businesses from implementing an employee share scheme, or has resulted in companies offering equity to only a small group of senior executives. With the changes introduced to the ESS tax provisions with effect from July 2015 (in particular, the tax concessions for equity plans operated by eligible “start up” companies), the Australian regulatory framework for offering ESS remains the main barrier to significantly broader take-up of employee share plans.

Please find attached our brief comments on the questions raised in the April 2019 *Employee Share Schemes Consultation Paper* (**Consultation Paper**).

We would welcome the opportunity to discuss our comments and look forward to continuing to be involved in the consultation process as the proposals are developed.

Yours sincerely

Chris Galway
Partner – People Advisory Services

Attachment: Appendix: responses to questions raised in Consultation Paper

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Appendix: responses to questions raised in Consultation Paper

1.1 Do you support consolidating and simplifying the statutory exemptions and ASIC Class Order [CO 14/1001] in the Corporations Act?

EY supports consolidating and simplifying the statutory exemptions, and consolidating CO 14/1000 and CO 14/1001 into the Corporations Act (**Act**). EY would also support incorporating in the Act a general exemption for employee share scheme offers that significantly simplifies the regulatory requirements for both listed and unlisted companies of making offers under ESS.

1.2 Does the complexity of the current regulatory framework for ESSs create significant difficulties for businesses looking to offer an ESS?

The current regulatory framework is complex and causes issues for companies where:

- The ESS involves an offer of rights (a right to receive a share in the future) to employees, and the offer does not meet the conditions of CO14/1000 and CO 14/1001. This most often occurs with contribution plans designed to meet the tax deferral conditions under Division 83A of the Income Tax Assessment Act 1997 (**Tax Act**). Neither Class Order extends relief to a contribution plan where contributions are used to acquire rights (as opposed to shares).

  The Act also limits the use of offers using rights to shares because ASIC views rights as "derivatives"[1] and there is no employee share plan exemption in Chapter 7 of the Act (or any relevant exemption that can be used for such offers).

  There are however some limited exemptions available where an option is used.

  EY does not consider there to be any significant difference between a right (a right to receive a share on a certain date in the future) and an option (a right to receive a share in the future by exercising that option and paying an exercise price), even where the right or option may be settled in cash or at the company's election.

  Therefore, the current regulatory framework could be simplified and broadened to provide flexibility on the use of different ESS vehicles / structures.

- An unlisted "start-up" company offers actual shares to its employees under an employee share scheme. In order to meet the "start-up" tax concessions in the Tax Act, the shares cannot be offered at a discount to market value that exceeds 15%[2]. However, under CO 14/1001 the offer cannot be for more than nominal consideration. As a result, it is not possible for an offer of shares by an unlisted company to satisfy both requirements.

- An unlisted company wishes to make ESS offers and rely on CO 14/1001 (so that a disclosure document – which would otherwise be prohibitively costly – is not required). However, the Class Order limits the value of any offer under an employee share scheme to $5,000. In EY's experience, in almost all situations unlisted companies wish to make offers to employees above this very limited amount, particularly in the start-up area where the offer of securities is often used as a form of remuneration by "start-up" companies to

[1] ASIC Regulatory Guide 49, *Employee incentive schemes*, paragraph 49.68
[2] Tax Act, s 83A-33(5)(a)

compete against larger / more mature companies that can pay higher salaries and cash incentives to employees.

1.3 Would there be significant benefits or risks for business in consolidating and simplifying the current regulatory regime?

EY considers simplification of the current regime would provide significant benefits to companies wishing to offer ESS; in particular, unlisted companies that are not able to rely on the very narrow unlisted company Class Order. The main benefit would be to reduce the regulatory / legal barriers to implementing an ESS, and offering equity to a broad group of employees (not just senior executives). EY does not see any significant risks with consolidating and simplifying the current regime provided appropriate limits / safeguards are incorporated for ESS offers where employees pay a contribution to acquire the interests.

1.4 Would compliance be significantly easier if the obligations applying to ESSs were all contained in the Corporations Act?

Consolidating requirements into the Corporations Act, particularly where an appropriately simplified, and broad, general ESS exemption was introduced into the Act, would assist significantly with compliance. However, if the existing requirements are only consolidated into the Act, and **not** simplified, there would be very limited benefits to companies in terms of reducing / simplifying compliance.

In addition, consideration should be given to ESS exemptions in both Chapter 6 and Chapter 7.

1.5 Are there significant advantages or disadvantages in using ASIC class orders as opposed to primary legislation to regulate ESSs?

There is no advantage for companies to rely on ASIC Class Orders instead of the primary legislation. While Class Orders could be easily updated if they were separate to legislation, it has not been necessary to date to make regular changes.

1.6 Are there any requirements or conditions of the ASIC class order that should be removed or amended as part of the consolidation?

Yes. The most straightforward approach would be to:

- Provide a general exemption for any ESS which is subject to Division 83A of the Tax Act
- Clarify that a right to receive a share is a security, and not a derivative, which should be treated in the same way as an Option, given that they are effectively the same instrument, except that an Option requires the payment of an exercise price
- Modify the following terms in the Class Orders:
    - CO 14/1000 and CO 14/1001 – extend relief for contribution plans to also cover the acquisition of rights and options (not just shares)
    - CO 14/1001 – remove the requirement that an offer be for no more than nominal consideration
    - CO 14/1001 – remove the requirement that the offer value for each employee be limited to $5,000. This could be changed to “monetary consideration” of $5,000, to provide a level of protection to employees where a contribution is

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paid by employees to acquire the ESS interest. Where no monetary consideration is payable by employees, in our view no limit should be necessary (in the same way as no corresponding limit is incorporated in the listed company Class Order 14/1000)

1.7 Should ASIC be given an additional power to determine that a company should not be permitted to rely on a statutory exemption for an ESS?

Yes, in circumstances where ASIC considers that either the company using the exemption or the ESS structure used operates to circumvent the intent of the Act (and is detrimental to protection of participants or shareholders). However, any such power should not operate to increase the burden or complexity of compliance.

2.1 Do you support increasing the offer cap per employee?

Yes, the current cap of $5,000 is unnecessarily restrictive and has resulted in the unlisted company Class Order having very limited practical application. It is not clear why an individual per-employee cap is required – particularly in the context of plans which do not require a contribution from employees. There is an overall "dilution" cap in both the listed and unlisted company Class Orders, but only the unlisted company Class Order has a limit per employee. We would suggest removing the offer cap entirely, except for offers where employees pay monetary consideration to acquire the ESS interest.

2.2 What are the benefits or risks of increasing the employee offer cap?

The benefit of increasing (or removing) the cap is that unlisted companies are able to use CO14/1001 to facilitate employee share plans.

EY considers there are two main risks:

- Employee protection – the limit provides protection for employees who may be enticed to acquire shares from unscrupulous employers. EY considers that this risk can be mitigated by changing the offer cap to a cap on "monetary consideration". Therefore, employees cannot be out of pocket by participating in Plans. Additionally, employees in start-up entities receiving part of their remuneration in shares are still protected by employment laws.
- Fundraising – there is a risk that the provisions become used for a fundraising purpose. EY considers this unlikely given that other exceptions under the Act are easier to comply with.

Based on the above risks, EY further submits that an employee offer cap only needs to be imposed, and is only appropriate, for contribution plan (where the employee's remuneration is being used to acquire equity). There is no need to impose a cap where nil or only nominal consideration is being provided for equity grants.

2.3 Is a $10,000 limit per employee per year appropriate or is a greater increase appropriate?

$10,000 will have little impact on the usability of the unlisted company Class Order. As noted above, we would suggest removing the cap for non-contribution plans. However, changing the limit to cap monetary consideration payable by employees (under contribution plans) to $10,000 would be effective.

2.4 Should senior managers (within the meaning of s9 of the Corporations Act) be excluded from this cap?

Although we note there are separate exemptions for senior managers, they should not be excluded. This is because companies can currently apply the Class Order to all offerees and provide them with compliant documentation. Exempting Senior Managers would necessitate two offer classes and would increase the compliance burden on companies.

2.5 Is the level of disclosure currently required by the ASIC class order for unlisted companies sufficient to address any risk associated with an increased employee cap? Is any additional disclosure or protection necessary or desirable?

EY considers that changing the cap to “$10,000 monetary consideration” would be desirable and should provide adequate protection for employees.

2.6 Are there any significant advantages or cost savings for business as a result of an increased cap per employee? Please provide details.

Companies that do not comply with CO 14/1001 (and the very limited $5,000 cap) and cannot meet another securities law exemptions must produce an Offer Information Statement. This is a costly and expensive exercise and often results in such companies not offering ESS.

3.1 Do you support contribution plans being able to be used to fund the acquisition of financial products for an ESS of unlisted companies?

Yes, companies should have flexibility to use contribution plans – although as noted above, it may be appropriate to introduce a limit on the consideration payable by employees where the company seeks to rely on a simplified ESS exemption.

3.2 What are the benefits or risks of allowing unlisted companies to offer contribution plans as part of their ESS?

There are no significant risks providing that participation is optional in the hands of the employee, adequate disclosure regarding the terms of the offer is provided, and a suitable offer cap is in place.

Also see our submission above on extending relief to contribution plans under which rights and options may be acquired by participants.

3.3 Are any additional protections necessary for employees participating in contribution plans? For example, capping monetary contributions at $10,000 per employee per year or requiring an independent valuation where a contribution plan is offered or the $10,000 cap is exceeded. Please provide details.

EY supports having a monetary consideration cap for contribution plans.

Unlisted companies will be required to value shares/options/rights for tax purposes. However, this is often not until after the offer date. Directors could be required to give an indication as to valuation, with the tax valuation following after the offer.

3.4 Are there any significant advantages or cost savings for business as a result of allowing contribution plans?

Yes, companies often obtain greater “alignment” between shareholders and employees, and the goals of the business, where employees have real “skin in the game” through equity they have acquired with their own funds.

4.1 Do you support expanding the types of ESS eligible for the exemption from public access to disclosure documents?

Yes.

4.2 What are the benefits or risks of expanding the types of ESS eligible for this exemption?

The benefit is that unlisted entities will be more willing to offer employee share schemes.