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Directors  
Market Conduct Division and  
Individual and Indirect Taxation Division  
The Treasury

**By email: ESSreforms@Treasury.gov.au**

Dear Directors

**Employee Share Schemes  
Submission on exposure draft legislation**

This is a submission prepared by Allens in response to the exposure draft Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Employee Share Schemes (***Draft Regulatory Amendments***).

Allens endorses the reduction to regulatory barriers in implementing employee share schemes (**ESS**) to be effected under the draft legislation, and provides the following comments and recommendations.

References to legislative provisions are to provisions of the *Corporations Act 2001* (Cth) unless otherwise indicated.

**Definition of 'ESS loan'**

The Exposure Draft Explanatory Materials for the Draft Regulatory Amendments (**EM**) states at paragraph 1.45 that 'The ESS loans can be given by the body offering the scheme or a third party'.

However, the Draft Regulatory Amendments appear to restrict ESS loans to those given by the body offering the scheme, with 'ESS loan' being defined as 'a loan offered by a body corporate ...for the purposes of acquiring ESS interests in the body corporate ...').

We note that commercial or tax considerations often favour a loan being provided by a subsidiary of a body offering an ESS, rather than the body itself (as apparently recognised in the EM), and suggest that the definition of ESS loan be amended to read:

**ESS loan** means a loan offered by a person ~~body corporate or a responsible entity of a listed managed investment scheme~~ to an ESS participant of the a body corporate or listed managed investment scheme, or a related person of the ESS participant referred to in subsection 1100E(3), for the purpose of acquiring ESS interests in the body corporate or scheme and which is offered on the following terms:

- (a) that the loan has no interest or fees payable;
- (b) that the rights of the lender ~~body corporate or responsible entity~~ as against the ESS participant or related person, in the event of default in payment of the loan, are wholly limited to forfeiture of the ESS interests acquired using the loan.

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### Meaning of ESS interest: stapled securities

The definition of 'ESS interest' in draft section 1100F is intended to include stapled securities. However, a stapled security is described in draft section 1100F(1)(e) as:

a fully paid stapled security, consisting of 2 or more interests in the body corporate mentioned in paragraphs (a) to (d), where the stapled security is able to be traded on a financial market operated by a market licensee or an approved foreign financial market

A stapled security ordinarily comprises a share in a body corporate and a unit in one or more separate managed investment schemes, rather than multiple securities in a single body corporate.

While a stapled security would likely be covered by the definition of 'ESS interest' in any event through the combined operation of draft sections 1100F(1)(e) and 1100F(3)(a), we suggest that the definition be amended to more accurately reflect the nature of such securities. For example, the relevant paragraph could be amended to read:

a fully paid stapled security, consisting of 2 or more ~~interests in the body corporate~~ financial products mentioned in paragraphs (a) to (d) or paragraph 1100F(3)(a), where the stapled security is able to be traded on a financial market operated by a market licensee or an approved foreign financial market

### Meaning of ESS interest: rights to acquire existing securities

Many ESS involve the grant of incentive rights that, if vested, can be satisfied by the delivery of securities either by way of issue or transfer of securities acquired on-market.

However, the Draft Regulatory Amendments do not appear to cater for the latter, with the proposed definition of incentive right being limited to 'a right to be issued a security or financial product ...' and not extending to a right to acquire an existing security or financial product.

While rights to acquire an existing security or financial product are arguably covered by the references to options in draft sections 1100F(1)(f) and 1100F(3)(b), we suggest that the position be clarified by amending the definition of 'incentive right' be amended to read:

***incentive right*** means a right to acquire ~~be issued~~ a security or financial product or a right to be paid a cash amount (or a combination of these rights) where the right to be paid the cash amount is contingent on any of the following: ...

### Meaning of ESS interest: interests via trusts

An ESS interest can include a unit in the various other approved categories of ESS interests. 'Unit' is widely defined in section 9 but, given that ESS interests can be issued 'through' trusts (subsections 1100E(5) and (6)), we suggest that reference also be made to beneficial interest, for example in subparagraph 1100F(1)(f):

'a unit or beneficial interest in, an incentive right granted in relation to.....'.

### Rights that are exercisable upon the payment of monetary consideration

Draft section 1100V provides that where an ESS participant is granted options or similar rights over shares in an unlisted body corporate, and the options are exercisable upon the payment of monetary consideration, the body corporate must provide the ESS participant with a valuation of the shares that complies with subsection 1100V(2).

Draft subsection 1100V(2) provides, among other things, that:

- the valuation must be conducted within the period of 1 month ending on the day (***the exercise or vesting day***) when the units or options will be exercised or when the incentive rights will vest; and
- the valuation must be provided to the ESS participant at least 14 days before the exercise or vesting day.

The drafting appears to assume that an ESS will involve only the grant of European style options, which are exercisable on a fixed date. It is, in fact, far more common for an ESS to involve the grant of American style options, which may be exercised at any time after vesting until their expiry date. It would be impractical to comply with the above requirements in the case of an American style option, given the potentially extended period over which the option may be exercised.

We suggest that draft paragraph 1100V(2)(a) be amended to read:

- (a) the valuation must be conducted within the period of 1 month ending on the day (***the exercise or vesting day***) when the units or options will first become exercisable ~~be exercised~~ or when the incentive rights will vest;

### Cap on share issues where a trust is used

Under draft subsections 1100J(1) and (2), the number of shares that may be issued under an ESS are capped where any ESS interests are offered for monetary consideration. The cap is not intended to apply to interests issued under an ESS where payment is not required to participate (paragraph 62 of the EM), except where ESS interests are being offered to independent contractors.

However, if an ESS involves ESS interests being issued through a trust, a separate cap applies under draft paragraph 1100E(6)(e).

The EM notes generally that the reason for the requirements under draft subsection 1100E(6) are to 'minimise financial risk for the ESS participants, ensure the trustee acts in the best interests of the ESS participants and minimise the possibility of conflicts of interest' (at paragraph 1.54). The separate cap under draft paragraph 1100E(6)(e) does not seem necessary in the context of these concerns, especially given the requirement in subsection 1100E(6)(d) that, 'if the trustee is an associated body corporate of the body corporate issuing the ESS interests or the responsible entity of the listed registered scheme – that the trustee only exercise voting rights in accordance with the instructions of the ESS participants or consistently with their fiduciary duties'.

The EM does not otherwise address the rationale for this secondary cap. It may be that it is the same as for the corresponding conditions in the current ASIC Class Orders, which is explained at paragraph 86 of ASIC Regulatory Guide 49 as follows:

The imposition of a 5% holding limit is to limit the distortion of voting power caused by the trustee holding a parcel of financial products that may effectively be quarantined from voting.

Assuming it is intended that the cap be applied on this basis, while we would not expect the cap to be exceeded in most instances, we suggest that the cap be drafted in such a way as to more closely reflect the underlying regulatory rationale enunciated by ASIC. In particular, we suggest that only shares that are held by the trustee on an unallocated basis be counted towards the cap, as it is only those shares that are quarantined from voting.

In addition, assuming it is intended that the cap be applied, the inclusion in the Explanatory Memorandum of an explanation of the regulatory rationale underpinning the cap would be welcome.

**Confirmation that ESS trusts do not need to be registered under Chapter 5C**

As noted above, the Draft Regulatory Amendments contemplate and allow ESS interests being issued 'through' a trust. We suggest that it be made clear that any such trust does not need to be registered under section 601ED(5) (in Chapter 5C). This is probably the case on the basis that any complying offer of ESS interests will be exempt from Part 7.9 under draft subsection 1100K(2) (and therefore there is no need to register the related scheme because of s601ED(2)). However, a clear statement that registration is not be required would be welcome.

**Exemption and modification power**

We suggest that the new Division 1A of Part 7.12 include provisions allowing ASIC to grant exemptions from, or modifications of, the relevant provisions, consistent with other comparable sections of the Corporations Act.

Yours sincerely



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