Allens
101 Collins Street
Melbourne VIC 3000 Australia

GPO Box 1776
Melbourne VIC 3001 Australia

T +61 3 9614 1011
F +61 3 9614 4661
www.allens.com.au

ABN 47 702 595 758

Allens › ‹ Linklaters

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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 Consultation) Bill 2022: Employee Share Schemes (***Draft Regulatory Amendments***).

The Draft Regulatory Amendments build on the previous consultation in respect of the draft Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Employee Share Schemes. We refer to our submission dated 25 August 2021 in response to that previous consultation.

As noted in our prior submission, Allens endorses the reduction to regulatory barriers in implementing employee share schemes (***ESS***) and is supportive of the further amendments proposed to the regulatory regime under the Draft Regulatory Amendments.

Cap on share issues where a trust is used and no consideration required for unlisted body corporate ESS interests

In our prior submission, we noted that the draft legislation in most circumstances did not propose to cap on the number of ESS interests which can be issued under an ESS where payment is not required to participate. An exception to this was if an ESS involves ESS interests being issued through a trust, in which case it was proposed that a separate cap was to apply.

We questioned the reason for the proposed secondary cap in respect of ESS interests being issued through a trust and suggested certain amendments. We note that the this secondary cap remains in the Draft Regulatory Amendments. As we consider the point to be of some importance, we make the following further comments and suggestions by reference to the updated drafting. References to legislative provisions are to provisions of the *Corporations Act 2001* (Cth) unless otherwise indicated.

Under draft subsection 1100Q(1)(c), the number of shares that may be issued under an ESS are capped where any ESS interests are offered for consideration. The cap is not intended to apply to interests issued under an ESS where consideration is not required to participate (paragraph 1.12 and 1.72 of the Exposure Draft Explanatory Materials to the Draft Regulatory Amendments (***EM***)). As noted, however, if an ESS requires no consideration to participate but involves ESS interests being issued through a trust, a separate cap would apply under draft subsection 1100P(3)(e)(ii).

The EM notes generally that the reason for the cap is 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 1.41). We submit that the separate cap under draft paragraph 1100P(3)(e) does not seem necessary in the context of these concerns, especially given the requirement in subsection 1100P(3)(d) that, 'if the trustee is an associated body corporate of the body corporate or the responsible entity of the registered scheme referred to in subsection (1) – …..the trustee may only exercise voting rights associated with the ESS interests in accordance with the instructions of the holder of the interests or consistent with the trustee's fiduciary duties'.

The EM does not otherwise explain the reason 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 141 of ASIC Regulatory Guide 49 as follows:

> The imposition of a 20% 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. While this limit applies to all unlisted bodies, it is likely only to operate as a limit for unlisted bodies that have more than 50 members – which is the intention, given that they will be subject to the obligations of Ch 6.

If this is an additional reason, we suggest that it may be addressed in a more targeted way, by providing 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 would need to be quarantined from voting to avoid the distortionary effect - shares held on an *allocated* basis would be voted according to the instruction of the relevant beneficiary (or not voted if no instruction had been received).

To the extent that the cap is, despite our submission, to be applied, the inclusion in the Explanatory Memorandum of an explanation of the regulatory rationale for the cap, including the reasons for which it is distinguished from the general position set out in paragraphs 1.12 and 1.72 of the EM, would be welcome.

Yours sincerely

Marc Kemp
Partner
Allens
Marc.Kemp@allens.com.au
T +61 2 9230 4991