5

Further initiatives to facilitate the growth of employee share plans

Introduction

4.1 Fostering employee share plans requires more than providing stand-alone, consolidated legislation, appropriate regulatory arrangements and revision of the relevant taxation provisions. The Committee received a considerable amount of evidence concerning the effect of the Corporations Law on the creation of employee share plans. In addition, in the course of the inquiry a number of other matters emerged that also affect the creation of employee share plans, participation in them and their standing within the broader sweep of public policy. Some of these issues include: equity considerations within the community and within organisations, and issues surrounding corporate governance and disclosure. These issues are examined in this chapter.

The Corporations law and employee share plans

4.2 As noted in Chapter 1, this inquiry has taken place in a transitional period in both taxation law and corporate law. Many of the submissions were made on the basis of the operation of the tax law and corporations law prior to the amendments introduced by the *Corporate Law Economic Reform Program Act (1999)* (CLERP) and the perceived effect of the pre-CLERP laws upon employee share plans.

4.3 Although the full effect of the CLERP laws is still to be felt, the Committee was concerned to canvass opinion as to the new law's capacity to foster employee share plans, and in that light, to determine the extent to which the new legislative arrangements would address the problems noted by witnesses. For this reason, the Committee wrote to some witnesses who could provide expert advice on the effect of the new arrangements. These witnesses included the Australian Taxation Office (ATO), the Australian Securities and Investment Commission (ASIC), the Australian Employee Ownership Association (AEOA), the Remuneration Planning Corporation (RPC) and Ernst & Young.

4.4 The first part of this section deals with the problems that witnesses claimed employee share plans faced as a result of the operation of the corporations law before the passage of the *Corporate Law Economic Reform Program Act 1999*. The major problem concerned the prospectus requirements relating to equity issues under employee share plans.[1] The second part deals with the anticipated effect upon employee share plans of the CLERP Act, and whether there are any remaining problems.

Pre-CLERP legislation and its effect on employee share plans

4.5 Australian corporate law (pre-CLERP) required informed decision-making by investors. Participants in employee share plans were considered investors. Generally, investors were informed by providing them with a prospectus. In two cases it was possible for an enterprise to be exempt from the requirement to offer a prospectus:

- If there was a specific exemption in the Corporations law; or
- If ASIC granted an exemption for the particular activity.

4.6 The Corporations Law did not require a prospectus if:

- The shares were provided at no cost to the employee (i.e. they were a gift); or
- The shares were provided to executive officers or senior managers of the corporation; or
- The offer was made to no more than twenty persons in a twelve month period.[2]

4.7 If a corporation could not qualify for the exemptions provided in the legislation, it could apply for an exemption from the Australian Securities and Investment Commission under Policy Statement 49.

1 For example, AEOA, submission nos. 5, 5.1, 5.3, 5.4, 5.5; RPC, submission no. 30.

2 ASIC, submission no. 16.2.

Relief would be provided under Policy Statement 49 provided a number of conditions were met. These included:

- Only fully-paid ordinary shares could be offered. In the case of directors of the corporation, relief may be provided to offers of partly paid shares under Policy Statement 49 on a case by case basis;[3]
- The issuing corporation must have been listed on the Australian Stock Exchange for at least twelve months or on an approved foreign stock exchange for at least thirty-six months; and
- The offer could not exceed more than five per cent of the shares issued in that class of share as at the date of the offer. This had the effect of limiting the amount of capital that could be raised as a direct result of employee contributions (in whatever form that may take, for example, salary sacrifice plans, contribution plans and other structures).[4]

4.8 Options were treated differently. Where the issuing corporation was listed on the Australian Stock Exchange or an approved foreign stock exchange, relief from the prospectus provisions could be granted in the case of an offer made under an employee share plan, of options over unissued or issued shares, when the options were provided free or for a nominal consideration.[5] In general, however, Policy Statement 49 stated that the ASIC will not provide any relief from the prospectus provisions for employee share plans where options are offered for consideration (other than nominal consideration).[6]

4.9 In addition, where the issuing corporation was not listed on the Australian Stock Exchange or an approved foreign stock exchange, the ASIC could provide relief from the prospectus provisions in relation to the offer, but not the exercise, of options over issued or unissued shares that were provided free or at a nominal consideration. When an employee sought to exercise such options, a current prospectus was required if the shares were not quoted on an approved exchange.[7]

4.10 The ASIC advised the Committee that many unlisted companies that sought to establish employee share plans would have fallen within the exemption conditions then contained within the corporations law, that no prospectus was required where no more than twenty personal offers were made in a twelve month period. Those unlisted companies that did

3 ASIC, submission no. 16.3.

4 ASIC, submission no. 16.3; Policy Statement 49, sec. 49.24.

5 Policy Statement 49, sec. 49.29.

6 Policy Statement 49, sec. 49.28.

7 Policy Statement 49, secs. 49.31; 49.32.

not meet these conditions would, according to ASIC, have to bear the cost of preparing a prospectus, while listed companies could seek relief under Policy Statement 49.[8]

4.11 This view of the legislation and its enforcement was not shared by witnesses. The AEOA advised the Committee that the prospectus requirements acted as a forceful disincentive to unlisted companies:

> … while shares issued to employees of listed companies are covered by prospectuses required for the listing of company 'stock', unlisted companies face major prospectus hurdles. In order to issue shares to their employees, they must first meet ASIC prospectus requirements. Putting together a prospectus can be a daunting and excessively expensive business. As a result, the need to issue a prospectus has become the single greatest obstacle in the way of expanding employee ownership in the unlisted company sector of the economy.[9]

4.12 Brambles Industries, advised the Committee that the Corporations Law in operation at the time of his submission disadvantaged Australian-based employees. Brambles said that the then legislation:

> …effectively limits the number of shares or options issued to Australian employees to no more than 5 per cent of the sponsoring company's issued capital. The prospectus requirements do not apply to shares or options issued to overseas employees.
>
> For companies such as Brambles with a large international workforce, this means that Australian employees will ultimately not be able to participate in the company's employee ownership program to the same extent as overseas employees.
>
> …
>
> The cost of complying with the rules is prohibitively expensive. That is, the compliance cost effectively limits Brambles' ability to extend its Australian employee participation beyond the prospectus threshold set out in Class Order 94/1289'.
>
> …

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8 Submission no. 16.2. ASIC advised the Committee that some 731 enterprises had been granted relief under Policy Statement 49. ASIC cautioned that this figure included separate applications lodged by related enterprises and cases where a single enterprise has lodged more than one application. See submission no. 16.1.

9 Submission no. 5, p. 6. This is a view shared by CSL. See *Transcript of Evidence*, p. 323.

> When the option plan was introduced in 1987, the minimum entitlement was 2500 options. This has now dropped to 1000 options, directly as a consequence of the prospectus legislation.[10]

4.13 Criticism of Policy Statement 49 exemptions were made by Ernst & Young:

> The ASIC policy statement 49 could be described as a general prohibition on the issue of shares or options to employees of an unlisted company without a prospectus. Whilst the prospectus requirement may not be onerous for companies associating an ESOP with an initial public offering (IPO) they are very significant and often unsurmountable for small / medium unlisted companies.[11]

4.14 The Macquarie Bank advised the Committee that listed companies that sought relief under Policy Statement 49 also faced a powerful disincentive:

> While the Australian Securities and Investments Commission ("ASIC") has issued Class Orders (94 / 1289 and 94 / 1291) and a Policy Statement (Policy Statement 49) concerning situations where it will exempt employers from the requirement to issue a prospectus for an offer of shares or options under an employee share plan, Macquarie Bank believes there is a case for further widening the exemptions. *In particular, Macquarie Bank believes that the requirement for prospectus relief that the total number of shares to be issued plus the total issued under all employee share schemes during the previous five years must not exceed 5% of the total number of issued shares, is unnecessarily restrictive and should be removed, particularly given that these schemes often require shareholder approval before implementation.*[12]

4.15 The Macquarie Bank stated that this approach to ensuring adequate disclosure has:

> … largely contributed to the complexity in structuring employee share plans. This complexity is frustrating when endeavouring to introduce a plan which is easily explainable to, and understood by, the employees who are intended to benefit from the plan. The focus of regulation of employee share plans

10 Submission no. 32, pp. 1-2.

11 Submission no. 20.1.

12 Submission no. 18. Italics in submission. Criticism of this 5 per cent limit was also made by BHP; see submission no. 31.

> should be more on employment and remuneration issues through the taxation system, and less on the securities law and fundraising issues, which are ancillary to the main purpose of the plans.[13]

CLERP legislation and its effect on employee share plans

4.16 The submissions quoted in the previous section were provided before the passage of the *Corporate Law Economic Reform Program Act 1999* (CLERP). This legislation does relax the prospectus requirements. Under the fundraising provisions of this legislation[14] new types of disclosure documents are allowed and statutory recognition is provided for specified classes of offers that do not require disclosure documents. In addition, ASIC would still be able to provide discretionary relief in accordance with Policy Statement 49. For the purposes of this inquiry, the most relevant provisions of the CLERP Act are:

- replacing the exemption in the pre-CLERP legislation with a new exemption allowing unlimited personal offers leading up to issues to 20 investors in a 12 month period ,with a ceiling of $2 million in funds raised;[15] and
- the introduction of the Offer Information Statement (as opposed to a prospectus) for capital raisings of up to $5 million once during the life of a body.[16]

4.17 The Explanatory Memorandum stated that the fundraising provisions were designed to:

> Minimise the costs of fundraising while improving investor protection. The purpose of the fundraising provisions is to promote the disclosure of information that investors reasonably require in order to make informed investment decisions. The reforms will promote the operation of informed markets and, by removing unnecessary impediments to fundraising, facilitate investment which is vital to Australia's economic performance. The reforms also seek to ensure that the fundraising rules provide an appropriate cost effective framework for capital raising by small, medium and large companies.[17]

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13 Submission no. 18.

14 *Corporate Law Economic Reform Program Act 1999*, Chapter 6D: Fundraising.

15 *Corporate Law Economic Reform Program Act 1999*, s. 708.

16 *Corporate Law Economic Reform Program Act 1999*, s. 709 (4).

17 Parliament of the Commonwealth, House of Representatives, Corporate Law Economic Reform Program Bill 1999, *Explanatory Memorandum*, paragraph 1.5.

4.18 The Australian Securities and Investment Commission advised the Committee that:

> … ASIC believes that the way in which the Corporations Law sets out a framework under which capital may be raised, combined with ASIC's wide discretionary modification and exemption powers,[18] is both adequate and appropriate. Since Parliament cannot always anticipate or respond quickly to new developments in the market, our discretionary powers give us flexibility to facilitate employee share schemes in the context of an ever changing commercial environment.
>
> ASIC currently has sufficient powers to relieve employers offering employee share schemes from the prospectus (fundraising) provisions where appropriate and in fact has done this to the extent outlined in ASIC Policy Statement 49.
>
> Since the CLERP Act changes are quite extensive in terms of the facilitation of small business fundraisings, ASIC believes that whether or not further changes to the Law are appropriate would be best determined after there has been some experience with the operation of the new law.[19]

4.19 Witnesses provided a mixed assessment of the extent to which the CLERP Act changes would facilitate the growth of employee share plans, especially in those enterprises where these plans are at present uncommon; for example in small, medium, unlisted and sunrise corporations.

4.20 The Australian Employee Ownership Association advised the Committee that, 'In practice, these measures have not helped. Further legislation will be required.'[20]

4.21 Ernst & Young advised the Committee that:

> The CLERP changes did not go far enough. There should be an exemption from the application of all the prospectus provisions of the Corporations Law for all offers, invitations and issues of shares and options (and shares issued on exercise of options) under an ESOP. However, such an exemption should carry an obligation to reasonably inform the potential applicants by providing, say :-

18 Footnote in submission no. 16.3: 'For example section 1084 under the current Law; and section 741(1) under the CLERP Act amendments effective 13 March 2000.'

19 Submission no. 16.3.

20 Submission no. 5.5.

- copies of the constituent documents of the company
- copies of the relevant plans
- an outline of the likely tax implications for participants
- copies of the most recent financial statements presented to the shareholders
- a broad / sensible commentary regarding post balance date events (ie to update the fin[ancial] statements).[21]

4.22 The Remuneration Planning Corporation, in contrast, advised the Committee that:

> Generally the new requirements are more flexible. … The impact on ESOPs is hard to assess. At present many ESOPs can rely on prospectus relief under PS49, which is quite comprehensive and relatively easy to comply with. One exception is for companies about to list, or [which] have not been listed for 12 months. Where this relief is not available the new provisions should be easier to satisfy and therefore conducive to ESOPs.
>
> However, the prospectus requirements really represent a constraint for private company ESOPs. The new provisions do not seem to provide any real relief in this regard and any ASIC modification of PS49 in the light of the new rules will determine whether private company ESOPs are facilitated under the new provisions.[22]

4.23 When asked about the flexibility of Policy Statement 49, the AEOA said:

> In these matters, Policy Statement 49 is already sufficiently detailed and exacting - at points, excessively so. For example, only companies which have been listed for 12 months are eligible for a PS 49 prospectus exemption. This discriminates against new, emerging businesses which are among the keenest to promote employee ownership. Such companies are obliged to issue supplementary prospectuses in order to make additional offers of shares to existing employees, or offers to new employees, within a year of listing.[23]

4.24 The statutory exemptions on disclosure and the introduction of an Offer Information Statement, will ease the burden on listed and unlisted small, medium enterprises and sunrise companies. Policy Statement 49

21 Submission no. 20.2, pp. 5-6.

22 Submission no. 30.3.

23 Submission no. 5.5.

continues to provide an avenue of relief for listed enterprises, subject to the conditions mentioned at paragraph 5.7.

4.25 Nevertheless, the Committee does recognise that the amended legislation and Policy Statement 49 together may not provide sufficient relief for certain types of enterprise. Consequently, the existing disclosure arrangements may still act as a disincentive to those enterprises when they consider establishing an employee share plan. In particular, the Committee notes:

- Policy Statement 49 relief only applies to enterprises listed on the Australian Stock Exchange for more than twelve months. This may affect the capacity of recently established or newly listed companies, such as rapidly growing 'sunrise' companies, to create employee share plans that can be used to attract staff.
- Policy Statement 49 is restricted to ordinary, fully paid shares, but it does allow an employer to offer a loan to acquire the shares. Where the owners of a small or medium sized enterprise wish to provide some sort of equity interest in their company to employees, but without diluting control, or where they are unwilling to provide a loan to provide the shares free, then Policy Statement 49 fails to provide any relief.
- Policy Statement 49 will provide relief, in respect of options, only if they are provided free or for a nominal amount. In some cases, where a group of investors in a small or medium corporation or a sunrise enterprise can reasonably be thought to be knowledgeable or expert investors, relief may be appropriate; yet if they intend to obtain options for more than a nominal amount, relief will not be forthcoming under Policy Statement 49. This may retard the development of certain sorts of small, medium and sunrise corporations.
- Policy Statement 49 places a 5 per cent ceiling on the number of equities that may be issued in any one class under an employee share plan. Again, where a small, medium or sunrise company wishes to attract a talented team, Policy Statement 49 may not provide relief.

4.26 In the case of certain sunrise enterprises, an employee share plan may involve more than twenty employees providing more than $2 million in capital in return for participation in an employee share plan. In some cases the $5 million may be easily exceeded. The CLERP Act (1999) would not provide any relief, and it is unlikely in such cases that Policy Statement 49 would either. For example, such plans may involve more than 5 percent of the enterprise, or the enterprise may not have been

listed for twelve months on the Australian Stock Exchange or an approved foreign exchange.

4.27 Although the Committee recognises these potential problems, the actual extent of the problems is unclear. It is important, if employee share plans are to be fostered that legislation and regulation remain both responsive and also consistent with their intended purpose. In this case that is to facilitate investment, while at the same time providing adequate and appropriate levels of protection for investors from unassessed risk.

Recommendation 40

4.28 **The Committee recommends that the Australian Securities and Investment Commission:**

- **monitor the operation of the provisions of *Corporate Law Economic Reform Program Act 1999* and Policy Statement 49 in respect of their effect on employee share plans and advise the Treasurer annually as to:**

⇒ **the number of applicants who seek to use the relevant provisions of the CLERP Act;**

⇒ **the number of applicants who seek relief under Policy Statement 49;**

⇒ **the number of applications in each class which were approved;**

⇒ **the number of applications which were not approved; and**

⇒ **if not approved, the reasons why they were not approved.**

- **advise the Government as to any amendments that may be required to facilitate the operation of the *Corporate Law Economic Reform Program Act 1999* in respect of employee share plans without unduly increasing investor risk;**

- **if necessary, amend Policy Statement 49 so as to facilitate the creation and operation of employee share plans, especially in regard to unlisted, small and medium companies, and those in sunrise industries, without unduly increasing investor risk; and**

- **advise the Treasurer on the feasibility of a specific disclosure document designed to be used by the operators of employee share plans that cannot otherwise use the disclosure exemption provisions or the Offer Information Statement provisions of the CLERP Act.**

Corporate governance, disclosure issues and the stability of the financial system

4.29 The use of employee share plans as elements of (typically executive) remuneration packages is increasing. Within employee share plans, options-based plans are increasingly popular and dominate the plans on offer to executives.[24] Not only is there a proliferation in the number of employee share plans offering options, but the numbers of options offered to executive employees is increasing each year.[25] Issuing options to general employees, on the other hand, is not common. Options-based employee share plans are confined, almost completely, to small, select groups of employees, typically, the executives and / or directors.[26]

4.30 While the number and value of options allocated to general employees is not known, reports in the business press, and supported by submissions to this inquiry, indicate that executive employees and directors are currently the predominant beneficiaries of employee share plans. They receive by far the most generous allocations of equities.[27] Issuing such large amounts of equity in an enterprise, and providing such levels of control over an enterprise, as well as the broader question of executive remuneration, have provoked public expressions of concern from amongst business analysts,[28] business leaders[29] and share holder associations.[30]

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24 RPC, submission no. 30, pp. 17 and 20. See D Kitney and B Clegg, 'CEO pay increases 22pc: Top earners hold 975m in shares and options', *The Australian Financial Review*, 1 November, 1999, pp. 1, 25-29. [See also the other articles on this topic by these writers and the article by T Sykes, 'Overpaid, male and not always a performer', all in this same issue of *The Australian Financial Review*.]

25 B Clegg, 'Drawing lines on bonuses and options', *The Australian Financial Review*, 1 November, 1999, p. 28; A Mitchell, 'Grand bouffe in the executive suite…' *The Australian Financial Review*, 15 December, 1999, p. 19.

26 RPC, submission no. 30, pp. 17, 20.

27 A survey conducted by *The Australian Financial Review* revealed that the value of executive share schemes had risen in the year to April 2000 by an average of 124 per cent, while non-executive employee share schemes had experienced gains in value of 29 per cent. See B Clegg and A Hepworth, 'High-tech employees rethink packages', *The Australian Financial Review*, 16 May, 2000, p. 26.

28 F Burke, N Hopkins, and M West, 'Telstra stake hits snag', *The Australian*, 22 March, 2000, p. 25; T. Sykes, 'Overpaid, male and not always a good performer', *The Australian Financial Review*, 1 November, 1999, p. 26

29 L Caruana, 'Put Blountly, it's salary payback time', *The Australian*, 16 December, 1999, p. 21; S Evans, 'Blount sounds alarm on mega-salaries', *The Australian Financial Review*, 16 December, 1999, p. 3; D Kitney and B Clegg, 'CEO pay increases 22 pc', *The Australian Financial Review*, 1 November, 1999, pp. 1, 25.

30 B Clegg, 'Drawing lines on bonuses and options', *The Australian Financial Review*, 1 November, 1999, p. 28.

4.31 The issues raised by employee share plans concern, at their broadest, corporate governance: the prudent management of an enterprise so as to further shareholder interests. The effect of employee share plans on corporate governance is examined in this section. In particular, the issues examined are:

- Whether current arrangements concerning employee share plans lead to adequate levels of disclosure of the size, nature and value of employee share plans so that investors can assess:

  The level of risk, and the nature and size of any liabilities posed by the employee share plan; and

  The potential and actual effect on the value of the enterprise, and the likely value of the enterprise and its profitability;

- Whether the employee share plans create an incentive for executives to manage enterprises in a manner that may be contrary to the best interests of non-executive shareholders; and

- Whether the aggregate effect of employee share plans poses any undue risk to the business or financial system.

Disclosure

4.32 So that actual and potential investors can assess the value of an enterprise and any risks that it faces, it is essential the investors have access to accurate information about the size, value and conditions attaching to employee share plans. This is the case no matter the type of equity that is allocated under an employee share plan. However, current disclosure and accounting requirements enable enterprises not to disclose fully the cost of employee share plans.

> Whilst companies are entitled to a tax deduction on the cost of shares issued under employee share ownership schemes, the cost of shares are not recorded as an expense in the Profit & Loss under the current accounting standards. This provides an incentive for companies to use employee share ownership schemes to remunerate staff. Changes to the current accounting treatment may affect company views on employee share ownership schemes.[31]

4.33 Deficiencies in the level and detail of employee share plan disclosure are of particular concern in relation to those plans that use share options. In many plans, executives are granted options over large numbers of

31 Qantas Airways Limited, submission no. 35, p. 5.

shares. Providing the shares that are the subject of the options, through an open-market purchase, would also involve a cost for the enterprise. In short, executive share option plans may affect the profitability of an enterprise. Alternatively, if linked to performance indicators, they may ultimately improve profitability, and increase dividends.

4.34 When asked about the current disclosure arrangements, the Australian Securities and Investment Commission advised the Committee that:

> Accounting standards do not currently require disclosure of the value of options in an employee share scheme. However, paragraph 14(d) of AASB 1028 does require the full-year financial statements and consolidated financial statements of reporting entities to disclose the number and types of shares or other equity interests still available to employees under the scheme at reporting date and the market value of those shares or other equity interests as at year end.[32]

4.35 Other submissions to the inquiry provided additional information. Under current arrangements operating in the Commonwealth, according to Dr Jacqueline Dwyer and Dr David Gruen:

> …there are no accounting standards requiring firms to record either the issue or repricing of share options as an expense. This situation arises because there are no international accounting standards on the treatment of share options to which we must adhere.
>
> In practice, the bulk of information about share options is given in disclosures in company reports. In the US case, disclosure must be accompanied by some estimated value of the worth of the share options. In the Australian case, it is sufficient to report the basic features of the share option scheme.[33]

4.36 The current state of disclosure requirements under Australian Accounting Standards was set out by the Australian Standards Accounting Board in its July 2000 publication, *Invitation to Comment: Accounting for Share-Based Payment: G4+1 Proposals*:

> In Australia there are no current or proposed requirements for the recognition and measurement of equity compensation benefits in financial statements.
>
> …

32 Submission no. 16.3, p. 10.

33 Submission no. 49, p. 2.

> Australian Accounting Standards AASB 1028 and AAS 30 do not apply to the recognition and measurement of employee entitlements in the form of equity-based remuneration plans. Certain disclosures are required to be made, including the number and types of shares or other equity interests that have been issued to employees during the financial year, the total market value of those shares or other equity interests at issue date and the total amount received and / or receivable from employees for those shares or interests.[34]

4.37 These comments and the practice of enterprises failing to fully disclose the value of employee share plans to investors have been commented on in the press. Mr Robert Millar, a director at Towers Perrin, was reported in *The Australian Financial Review* as having said that in terms of disclosure of executive share option plans, 'Australia lagged international best practice'.[35] This would appear to be supported by a report in *The Australian* which said that :

> Only a handful of 210 companies surveyed by the corporate watchdog [ASIC] gave a value for share options that can be worth many more times than salaries for top executives.
>
> The Australian Securities & Investment Commission was "disappointed" many companies did not follow accounting rules and disclose the terms and value of options.
>
> Many companies ascribed a nil value [to options] even when the exercise price of the options was less than half of the market price of the shares close to the exercise date.[36]

4.38 This report also claimed that some companies failed to reveal the remuneration provided to the five most highly paid executives and one company had disclosed the salaries of senior officers expressed in a foreign currency. This is, the ASIC observed, contrary to the intent of the law and in a manner that was potentially misleading.

4.39 Alan Mitchell's press article 'Grand bouffe in the executive suite…', in *The Australian Financial Review* of 15 December 1999, (p. 19) commented on these problems:

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34 AASB, Melbourne, 2000, pp. iv, 91. The G4+1 countries are: Australia, Canada, New Zealand, United Kingdom and the United States of America.

35 B Clegg, 'Staff share plans 'hurt' other investors', *The Australian Financial Review*, 16 May, 2000, p. 26.

36 T Boreham, 'Boards keep best cream top secret', *The Australian*, 22 December, 1999, p. 23; see also B Clegg, 'Drawing lines on bonuses and options', *The Australian Financial Review*, 1 November, 1999, p. 28.

> Australian CEOs have leapt into executive options and other share-purchasing arrangements as a form of remuneration. The option schemes, in particular, have been subject to severe criticism. Executive options were introduced to better align the interests of executives with those of share holders. But they have become popular for a less noble reason.
>
> The most common option schemes are not included as a charge against company profits – because they are "paid for" by the shareholders and not the company. Nor, under present accounting rules, does the value of options have to be clearly disclosed so that shareholders can readily see how much they are paying for their CEO.
>
> The effect of such an option scheme, therefore, can be to understate the true earnings of the CEO and overstate the profits of the business.
>
> Another frequent criticism is that executive option schemes are frequently not tied particularly closely to the company's performance.[37]

4.40 The Parliamentary Joint Committee on Corporations and Securities also noted in its October 1999 report, *Matters arising from the Company Law Review Act 1998*, that evidence from an ASIC survey indicated that some companies did not disclose in their reports the value of options granted to directors and officers. The Parliamentary Joint Committee stated that:

> Given the increasingly large amounts involved where options are granted to senior executives the [Committee] believes that the [Corporations] Law should require the disclosure of a value of options in the remuneration package… [including] options granted, exercised and lapsed unexercised during the year and their aggregation in the total remuneration.[38]

4.41 In July 2000 the Australian Standards Accounting Board released for comment proposals to recognise, and measure in financial statements, share-based payment. The main proposals are that:

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37 The Australian Shareholders Association, according to press reports, 'does not believe that options should be part of remuneration packages'. Mr Tony McLean, executive officer of the Australian Shareholders Association, is reported as saying, 'Package components need to be more transparent. Overall, remuneration packages are not disclosed as fully as they should be.' A Ferguson and K de Clercq, 'Boss Cocky', *Business Review Weekly*, 21 (1999), 5 November, 1999.

38 *Report on Matters Arising from the Company Law Review Act 1998*, Parliament of the Commonwealth, Canberra, October, 1999, pp. 155-156.

- where shares and options are used as a payment for goods and services, including payment for work, the equities should be recognised in financial statements, with a corresponding expense recognised in net profit and loss;
- such allocations should be measured at fair value at the vesting date; and
- where the provision of the services occurs between grant date and vesting date an estimate of the cost should be accrued over the performance period.[39]

4.42 Disclosure is important for two reasons. First, so that investors are in a position to assess the risks and liabilities that face an enterprise. Investors face increased risk as enterprises borrow funds to buy equities on the open market that will be allocated on favourable terms to executives.[40] As Dr Dwyer and Dr Gruen advised the Committee, 'investors require detailed financial information (including fair value estimates of the cost of share options) to make informed financial assessments about firms in which they may wish to invest'.[41]

4.43 These concerns have been raised in the United States, where the level of disclosure of options in annual reports and the manner in which options are counted in the financial reports of corporations have become pressing issues. Some analysts have suggested that the true profit situation of those corporations which make generous issues of options is considerably worse than the financial reports indicate.[42] It is difficult to tell, *The Economist* reported, 'whether profits have in fact risen all that much, for the cost of most executive share-option schemes is not fully reflected in company profit and loss accounts'.[43]

4.44 The Chairman of the US Federal Reserve Board, Dr Alan Greenspan, said in August 1999: 'This distortion, all else [being] equal has overstated growth of reported profits according to Fed staff calculations by one to two percentage points annually during the past five years.'[44]

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39 *Invitation to Comment: Accounting for Share-Based Payment: G4+1 Proposals*, AASB, Melbourne: 2000, p. v.

40 Anon., 'Share and share unlike', *The Economist*, 7 August, 1999, p. 18

41 Submission no. 49.

42 In a document accompanying submission no. 49, it was reported that, '…Microsoft, the world's most valuable company, declared a profit of $4.5 billion in 1998; when the cost of options awarded that year, plus the change in value of outstanding options, is deducted, the firm made a loss of $18 billion…', *The Economist*, 7 August, 1999, p. 20.

43 Anon., 'Share and share unlike', *The Economist*, 7 August, 1999, p. 19.

44 'New Challenges for Monetary Policy', speech at Jackson Hole, Wyoming, 27th August, 1999. URL: http://www.bog.frb.fed.us/boarddocs/speeches/1999/19990827.htm. The full quotation is: One is the apparent overestimate of earnings that occurs as a result of the distortion in the accounting for stock options. The combination of not charging their fair value against income, and the practice of periodically repricing those options that fall

Referring to an article in the *Financial Times* in April, 1998, Dr Dwyer and Dr Gruen reported that:

> Smithers & Co, a London research firm, recalculated the profits of the 100 largest US listed corporations and estimated that their profits should have been 30 per cent lower than reported in 1995 and 36 per cent lower in 1996. (*Financial Times*, 19 April, 1998).[45]

4.45 The Chairman of the US Securities Exchange Commission, Mr Arthur Levitt, said in September 1998:

> The significance of transparent, timely and reliable financial statements and its importance to investor protection has never been more apparent. The current financial situations in Asia and Russia are stark examples of this new reality. These markets are learning a painful lesson taught many times before: investors panic as a result of unexpected or unquantifiable bad news. If a company fails to provide meaningful disclosure to investors about where it has been, where it is and where it is going, a damaging pattern ensues. The bond between shareholders and the company is shaken; investors grow anxious; prices fluctuate for no discernible reasons; and the trust that is the bedrock of our capital markets is severely tested.[46]

4.46 Mr Levitt stated clearly the importance of transparency to the ongoing, efficient and stable operation of markets:

> The American experience proves that public disclosure is not a theoretical concept but a living principle. Everyday practices – whether in government, the media, academia or finance – when examined through the public lens, attain a measure of veracity and probity that would not exist if consummated under the veil of darkness.
>
> Transparency is both a means and an end. It plays a fundamental role in making our capital markets the most efficient, liquid and resilient in the world. And, at the same time, transparency is a goal. We know from our own past experience and from the current situation in Asia and Russia that there is a direct relationship between information and investor

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significantly out of the money, serves to understate ongoing labour compensation charges against corporate earnings.

45 Submission no. 49, p. 3.

46 'The Numbers Game', speech at NYU Center for Law and Business, 28th September, 1998. URL: http://www.sec.gov/news/speeches/spch220.txt

> confidence: Increase one and you increase the other; decrease one and you decrease the other. This is not rocket science. The choice is clear.[47]

4.47 Dr Dwyer and Dr Gruen indicated that the effect of inadequate disclosure is likely to be particularly significant in relation to new high-tech companies. The issuing of options to executives is particularly prevalent in such companies, and 'standard option-pricing formulae yield higher valuations of their share options than those for other companies'. This can lead to a substantial overstating of profits.[48]

4.48 The Committee sought the advice of the Australian Securities and Investment Commission concerning the adequacy of the current disclosure requirements. The Australian Securities and Investment Commission noted that:

> At present, the accounting standards do not require disclosure of a value attributed to rights under employee share schemes nor specify the method for determining that value. Nor do they specify a method of accounting for the rights issued under the schemes (eg whether they give rise to an expense, whether changes in value subsequent to their issue should be recorded, recording the effects of the exercise of those rights).[49]

4.49 However, ASIC advised the Committee that it, 'believes that the existing requirements for disclosure in relation to employee share schemes in annual financial reports as set out in the law and the accounting standards … are generally appropriate'.

4.50 In the light of all the information it has received, the Committee considers that in order to preserve a sound financial and business system, as free as possible from significant share market 'corrections', more complete information should be available to investors.

4.51 The principal argument against disclosure is that placing this information in the public domain invades the privacy of executives and directors. In the Committee's view, however, the community interest would appear to outweigh particular privacy considerations. The Committee agrees with the Joint Committee on Corporations and Securities that the public interest is best served by full disclosure:

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47 Mr Arthur Levitt, 'The Importance of Transparency in America's Debt Market', available at: http://www.sec.gov/news/speeches/spch218.htm.

48 Submission no. 49, p. 3.

49 Submission no. 16.3.

> The overriding principles in respect of directors' and executives' remuneration are those of accountability and openness. The PJSC attached the highest importance to the full disclosure of directors' and executives' remuneration as a means…of ensuring accountability to shareholders and public confidence in the capital markets. As witnesses told the PJSC, shareholders are entitled to know the remuneration of directors and executives in all its form and the board's policy in determining director's remuneration.[50]

4.52 Moreover, if the executive labour market is to operate most efficiently, enterprises must know what senior employees and directors are worth. Disclosure would promote the operation of the market in this respect.

4.53 The Joint Committee on Corporations and Securities recommended that the Corporations Law should be amended to specify more clearly the requirement to include in annual reports information concerning the value of options issued to executives and directors.[51] This Committee supports the view of the Joint Committee that the legal requirement should be explicit, and recommends accordingly.[52]

4.54 Full disclosure of all forms of remuneration, including participation in employee share plans, should be made in relation to general employees, as well as in relation to executives and directors.

Perverse incentives

4.55 The Committee is concerned about the potential for perverse incentives to develop as a result of the allocation and operation of equities under employee share plans. An article in *The Economist* makes the point this way:

> A recent study of share repurchases…found that much of the recent surge in buy-backs reflects an attempt to return cash to shareholders in a way that raises the value of executive stock options more directly than a simple increase in the dividend would do. Others see the buy-backs in a more sinister light. They say that companies often buy their own shares aggressively at times when the market looks about to tumble, thus helping to reverse the direction.

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50 *Report on Matters Arising from the Company Law Review Act 1998,* p. 153.

51 *Report on Matters Arising from the Company Law Review Act 1998,* pp. 156-157.

52 See paragraph 4.64.

> …managers with share options may be using their firm's resources to increase the short term value of their own holdings.[53]

4.56 The absence of complete disclosure requirements deprives investors of the capacity to assess the risk of share-price manipulation and the vulnerability of the enterprise to inadequate corporate governance. Dr Dwyer and Dr Gruen outlined the problem this way:

> …an inherent conflict exists between option holders and shareholders, threatening good corporate governance. Essentially, this conflict arises because the payment of dividends reduces the value of share options and therefore tends to be opposed by employees and / or managers who hold these options. Reflecting this, companies with share option plans tend to engage in buy-backs rather than pay dividends.[54]

4.57 Such problems are amplified in cases where an employee share plan contains performance hurdles. Mr Fred Hilmer, CEO of the Fairfax group, was reported in a November 1999 newspaper article as being opposed to performance hurdles for this reason. Mr Hilmer was reported as having said that performance hurdles encourage a CEO to take short-term measures that boost the share price and increase the value of options. 'All the hurdle does', Mr Hilmer said, 'is make people who don't understand the complexity of the matter feel good, but it can actually drive a wedge between the long-term shareholder interests'.[55]

4.58 The Committee does not consider that the possibility of creating incentives for directors or executives to act contrary to the interests of general shareholders is sufficiently strong to warrant banning their participation in employee share plans. It must be recognised that such plans can, in powerful ways, more strongly align the interests of executives and shareholders.

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53 Anon., 'Share and share unlike', *The Economist*, 7th August, 1999, p. 19.

54 In their submission, Dr Dwyer and Dr Gruen provide this explanation: 'In a buyback, the per-share value of the firm should not change, because the outflow of earnings is matched by a proportionate reduction in the number of outstanding shares. Dividends, on the other hand, do dilute the per-share value of the firm, because there is an outflow of earnings for an unchanged number of outstanding shares. Consequently, share options are worth more after a buyback than after the payment of dividends.'

55 B Clegg, 'Drawing lines on bonuses and options', *The Australian Financial Review*, 1 November, 1999, p. 28. In a paper written for the economics department of the OECD, Colin Mayer of the School of Management Studies, University of Oxford, noted that options may provide a perverse incentive: '…executives may be encouraged to pursue unduly risky strategies to activate their share options'. 'Corporate governance and performance', OECD, Paris 1996, Document id: OCDE / GD(96)99, p. 7.

Aggregated effect of employee share plans

4.59 The effect of a lack of full disclosure upon the stability of the equity markets and the economy cannot be ignored. As *The Economist* noted: 'If reported profits have been overstated, investors may have over estimated future profits when valuing shares, and paid too much for them'.[56] *The Economist* also reported that 'the total of shares and share options still 'live' in incentive plans at the end of 1998 amounted to 13.2 percent of corporate equity, or around $US1.1 trillion'.[57] In addition, enterprises are buying equities on the open market to allocate to executive employees, with increasing frequency. In 1998, according to *The Economist*, enterprises in the United States announced repurchases of $US220 billion, compared with only $US20 billion in 1991. *The Economist* claimed that 'Companies are buying back their shares in the market in order for employees to exercise their options'. The practice itself, *The Economist* reported, may in fact increase the prices of those equities.[58] Such increases would be related not to the better performance of the enterprise, but to a distortion of the market created by the operation of the executive employee share plan. In effect, the over estimation of profitability and the artificial inflation of the share price could create a financial bubble with the possibility of a subsequent sharp correction.

4.60 It is difficult to gauge the extent to which the Australian economy is exposed to these risks. The information upon which to form a reliable judgement is not collected. However, the sheer number of shares and options provided to senior employees, suggests there may be a problem. They may distort the true market picture of a company, and provide the potential to de-stabilise the market itself, if they are exercised in short order.

4.61 Wholesale liquidation of equities acquired through an employee share plan does occur. The Finance Sector Union of Australia, advised the Committee that senior executives in a major financial institution collected $29 million after exercising their options, allocated three years previously, and selling the shares on-market.[59] In another financial

56 *The Economist*, 7 August, 1999, p. 19.

57 *The Economist*, 7 August, 1999, p. 19.

58 *The Economist*, 7 August, 1999, p. 19.

59 Finance Sector Union, submission no. 29, p. 14.

institution, 26 million shares were sold in the course of a few weeks, a significant portion of which were from executive share plans.[60]

4.62 Some sectors of the economy, for example high technology companies, are particularly vulnerable in this regard. As Dr Dwyer and Dr Gruen advised the Committee, the share prices in these types of enterprise are particularly volatile and may be overstated.[61] As well, investors are likely to be prone to riskier decisions and be more optimistic about an enterprise than is warranted by the actual profitability of an enterprise.

4.63 The Committee believes that the best protection is complete disclosure, independent auditing and evaluation of the performance of enterprises. For this reason, the Committee supports comprehensive, legislatively based disclosure requirements.

Recommendation 41

4.64 **The Committee recommends that it be a requirement that the following information pertaining to employee share plans be provided in a readily understandable form in all annual reports:**

- **the total value and size of all employee share plans, including the value of options and other equities and number thereof;**
- **the value and number of equities allocated in the year in respect of all plans and types of equity;**
- **the method of valuing the equities and determining the size of allocation;**
- **the aggregate amount received in the year by all employees. The aggregate sum received by directors and executive employees and other employees receiving executive-level remuneration should be identified as a specific line item;**
- **the total value and number of equities of all sorts allocated to, or exercised by, directors, executives and any other employee receiving executive-level remuneration, and the value and number of options**

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60 Submission no. 29, p. 14. It was reported in *The Australian Financial Review* (H van Leeuwen, 'Macquarie staff cash up', 13 December, 1999, p. 27) that, 'Macquarie Bank Staff earned themselves as much as $3.3 million in November as they cashed in on the bank's soaring share price. [November] also saw 225,000 new options issues… However not all the new and exercised options necessarily related to the employee equity participation plans.'

61 Submission no. 49, p. 3.

which they allowed to lapse;

- **whether the equities allocated in the year in question or in previous years under an employee share plan gave rise to an expense for the enterprise and the size of that expense; and**
- **the effects, if any, of the exercise of those options on the enterprise's financial standing.**

Recommendation 42

4.65 **The Committee recommends that information about all of an enterprise's employee share plan or plans:**

- **be held by a designated officer of each company;**
- **be notified to the regulatory agency or, failing the establishment of such an agency, the Australian Securities and Investment Commission.**

The Committee further recommends that failure to disclose that information or providing misleading information should be considered an offence.

Recommendation 43

4.66 **The Committee recommends that when a significant proportion of the equities held by an executive or director of a company is to be disposed of within a two-week period, fourteen days notification should be provided to the Australian Stock Exchange and the Australian Securities and Investment Commission, for public release. The threshold which triggers the requirement for such notification should be determined by the Government in consultation with the Employee Share Plan Advisory Board.**

Equity issues

4.67 Employee share plans are not evenly distributed across the community or within organisations. As noted in Chapter 1 and also in Chapter 3, the Committee is in favour of increasing both the number of employees who

have access to such plans and the size of their individual holdings. As well, the Committee believes that those employees who do not have access to employee share plans should have some other means of receiving similar benefits. This section examines these issues.

Equity within and between organisations

4.68 According to a report in the business press in November, 1999, a survey of the top 100 Australian companies revealed that the executives of those companies hold $975m in shares and options. On average, each chief executive holds $2.9m in shares and $6.15m in options.[62] RPC reported that of the publicly listed companies with employee share plans, more than 80 per cent offer participation to executives only and less than 10 per cent have meaningful all employee share plans.[63] Executives are by far the greatest beneficiaries of employee share plans. The observation provided by the AEOA is apt: 'even among the Top 350 companies share plans tend to benefit the few rather than the many.'[64]

4.69 The evidence suggests that the disparity between executive remuneration and that of general employees is increasing markedly. For example, the Committee was advised by the Finance Sector Union, that in 1992 the chief executive of a major financial institution was paid forty-two times the wage of a first-year bank teller. In 1998, the chief-executive's position attracted a salary 103 times that of a first-year bank teller.[65] This disparity is also reflected in the size of allocations available to general employees under an employee share plan, when compared to the allocations provided to executives.

4.70 Executive salaries are increasingly being questioned by shareholders. Mr Frank Blount, the former Chief Executive of Telstra, has been reported in the business press as 'warning company directors of a looming backlash against the gap between workers and executives'

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62 D Kittney & Brett Clegg, 'CEO pay increases 22pc', *The Australian Financial Review*, 1 November, 1999, p. 1.

63 Submission no. 30, p. 4.

64 Submission no. 5. The AEOA provided a similar breakdown of figures on employee share scheme participation: While seventy-four percent of Australia's 350 top listed companies have share plans, the vast majority of plans are aimed at executive employees and only a small minority, perhaps as low as eight percent of plans, are aimed at rank and file employees; submission no. 5. The submission from the Australian Chamber of Commerce and Industry also noted that option schemes have been generally restricted to executive and management ranks, although there were now some indications that a wider proportion of employees were being given access to option schemes. Submission no. 4, p. 2.

65 Submission no. 29.

salaries'.[66] 'From what I see in the US', Mr Blount said, 'on boards I serve on, the disparity of what gets paid at the top and what gets paid on the coalface, I think there is going to be a day of reckoning'.[67]

4.71 The allocation of equities can be more than a simple disparity between the amounts allocated to different employees. As noted in Chapter 2, there is not always a consistent linkage between the performance of executives and directors, and the performance of an enterprise. Non-performing executives sometimes appear to reap rewards in spite of their performance, whereas general employees who miss a performance target only marginally may not. The business press have drawn attention to some specific instances of chief executives who received large retirement packages and / or regular increases in remuneration after leading companies with rapidly declining share values. The Committee does not wish to name individuals in this report. Readers may refer, if they wish, to the relevant articles.[68]

4.72 Equity concerns emerge also in relation to general employees who do not work full-time or who work on contracts, as well as the eligibility conditions for participation in a share plan. The Finance Sector Union advised the Committee that there is considerable variation in the way that part-time employees in the finance sector are treated by different employers in respect of employee share plans. A review of the evidence from other witnesses indicates that such variation occurs across a range of industries.

4.73 The inequities within organisations and between organisation in respect of access to employee share plans may increase as the number of part-time and casual employees increases. This will produce other effects. As the number of employees working part-time or casually increases, they may be excluded from participation in employee share plans. This may limit the potential number of people who could participate and in doing so effectively limit the growth of employee share plans.

4.74 The contrasts in treatment of different types of employees will diminish the capacity of employee share plans to align the interests of employees and employers. The Finance Sector Union commented:

> FSU submits that the arbitrary nature of determining which permanent employees have access to share plans is inequitable

66 T Boreham, 'Boards keep best cream top secret', *The Australian*, 22 December, 1999, p. 23.

67 L Caruana, 'Put Bountly, it's salary payback time', *The Australian*, 22 December, 1999, p. 21.

68 For example, Adele Ferguson and K de Clercq, 'Boss Cocky', *Business Review Weekly*, 21 (1999), 5 November..

> and at worst discriminatory and sends out inappropriate messages to a growing proportion of the Bank's workforce.
>
> Such arbitrary requirements ensure that a significant proportion of permanent employees do not have equal access to a stake in the organisation's corporate success.

4.75 Equity issues also emerge in respect of access to plans. There is wide variation across the private sector concerning the amount of service that must be completed before an employee is eligible to participate in an employee share plan. Apart from the variation between different employers, there is variation within an organisation, with executives often receiving immediate access while general employees may have to serve a waiting period. The Finance Sector Union advised the Committee that:

> Financial sector employers vary in their requirement for minimum service requirements before an employee is eligible to participate in a share plan. The range includes immediate eligibility, one year or two year service requirements. Given that incoming senior executives generally have the capacity to participate in share plans at the outset of their contract, FSU asserts that non-executive employees should also have immediate access to employee share plans. In light of current employment turnover rates in the finance sector that generally oscillate between 20% - 25%, immediate access to employee share plans would make such arrangements more meaningful to a substantial proportion of the finance sector workforce.[69]

4.76 This variation is reflected across the private sector. Moreover, two consequences are produced that are at odds with the stated purpose of employee share plans. The capacity of an employee share plan to foster an alignment of employee and employer interests is hindered when a large number of a particular employer's workforce are not in a plan. Second, employers are faced with the ongoing costs of employee turnover. Participation in a share plan may lead to a reduction in employee turnover and the associated costs faced by employers.

4.77 Such effects cannot be ignored by the business community, by either listed or privately held companies. Employees are increasingly mobile and skilled employees can be much in demand. An important consideration in a decision to accept employment with a particular employer and remain with that employer is the employment conditions.

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69 Submission no. 29.

This should serve to promote the creation and development of employee share plans. As Mr Andrew Purdon of KPMG advised the Committee:

> In most industries, once one company does it, there tends to be a trend to follow it for employee relations and to retain employees. Once they find out that two or three competitors have got a benefit like a share plan, then they say, 'Well, we'll follow suit.'[70]

4.78 The Government has a role to play in encouraging employee share plans, based upon an equitable approach. The correct course of action by the Government necessarily involves a range of initiatives. This includes not only amendments to the relevant taxation legislation, such as Division 13A, but also laws and regulations concerning disclosure, the operation of companies, and trusts.

4.79 It is important that Australia keep abreast of developments overseas that promote employee share plans. For example, other comparable jurisdictions have or are planning extensive legislative initiatives that foster employee share plans.[71] In addition, some countries, such as the United Kingdom, actively promote employee share plans by way of dedicated teams from the Inland Revenue who provide information on employee share plans and advice on design and compliance.[72] As noted in Chapter 3, these are initiatives that the ATO should consider in Australia.

4.80 In time it may be necessary to examine more active legislative initiatives. In France, for example, all companies, including unquoted companies, with at least 50 employees are legally obliged to establish a company savings plan. Employee participation remains voluntary. These legally mandated plans can take the form of employee savings plans, which receive larger tax incentives for investment in shares, or employee shareholding plans. These latter plans involve the purchase of shares in the employer and must be open to all employees.[73] Such a plan would address the equity issue, however, only if employee share plans

70 *Transcript of Evidence*, p. 266.

71 The Blair Administration in the United Kingdom has released details of planned legislative initiatives intended to promote employee share plans, including draft legislation. There are two plans: a new, general purpose share plan, the 'New All-Employee Share Plan' as well as a plan intended to assist small companies attract and retain high calibre staff. This is the 'Enterprise Management Incentive'. Details of both plans, including draft legislation is available at: www.inlandrevenue.gov.uk/shareschemes/index.htm.

72 See, http://www.inlandrevenue.gov.uk/shareschemes/team.htm.

73 The Rt Hon Gordon Brown MP, *Consultation on Employee Share Ownership*, UK Government.

were legally required and the number of shares allocated to general employees was guaranteed by reference to the number allocated to executive employees.

4.81 Another, and possibly additional, approach would be to provide various concessions to plans that are generally open to executive employees only on condition that the number of shares made available to non-executive employees exceeded a statutory minimum. This approach would involve amendment of the qualifying conditions in Division 13A.

4.82 It is difficult to formulate clear policy options when information necessary for an accurate assessment of the nature and performance of plans is not generally available. Such policy options need to be kept under review as better systems for gathering information about employee share plans are put in place.

Recommendation 44

4.83 **The Committee recommends that the Australian Taxation Office and Treasury evaluate the feasibility of requiring, through legislation, employee share plans to provide guaranteed levels of employee share ownership to different classes of employees, in listed private sector organisations that have more than twenty employees.**

4.84 The Committee also considered a number of matters that fell outside its terms of reference, but which nevertheless affect the level of participation in employee share plans.

4.85 Evidence provided to the Committee indicated that at best, only about twenty per cent of the community would be eligible to participate in employee share plans.[74] This raises the issue of equity across the community and whether there is any feasible policy initiative to increase employee equity participation.

4.86 At present, taxation concessions are aimed at qualifying equities provided to employees at a discount. Another issue is whether taxation concessions should aim exclusively at discounted equities or whether, in certain circumstances, full-cost equities provided under an employee share plan should be eligible for some form of taxation concession. The

74 Mr John Egan, submission no. 52, p. 5.

Committee was advised of successful employee share plans that provide full cost equities.[75] However, insufficient information is available to provide a foundation for clear conclusions and for recommendations concerning policy.

4.87 Another issue that the Committee examined was the feasibility of providing incentives for employers to establish plans for their employees that offer equities in enterprises other than the employer. Such plans could be used in enterprises where share plans are not practicable, such as publicly owned enterprises. At present, the Committee could not discover any pressing public advantage to be obtained from operating such plans. However, the matter should be kept under review, especially in the light of developments in the international economy.

4.88 The Committee also considered the place of employee share plans in industry assistance programs. In the light of information about the effectiveness of employee share plans, it may be useful to consider providing some industry assistance, especially in the sunrise industries, on the basis that the recipient of the support implement an employee share plan. Before a conclusion can be reached, more information is required.

4.89 The Committee did make some recommendations that would facilitate succession planning and employee buyouts and buy-ins. The relaxation of the cessation conditions, the limit on the number of equities any person is permitted to hold and recommendations for further relaxation of the Corporations Law will assist. Further initiatives may be necessary. Again, the Committee could not discover any pressing public advantage to be obtained from more ambitious proposals in this area. However, the matter should be kept under review, especially in the light of developments in the international economy and the additional information that will be generated by the share plan regulatory agency.

4.90 A final matter was whether taxation concessions should be allowed on some portion of a capital gain arising from the sale of equities into an employee share plan, on the proviso that the proceeds are invested in another start-up enterprise. This would be likely to encourage already successful entrepreneurs to establish other successful enterprises. Again, the lack of information made it impossible to evaluate the feasibility of such a suggestion, its likely benefits or possible costs.

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75 Woodside Petroleum Ltd, submission nos. 37 and 37.1.

4.91 All these matters are worthy of further investigation. However, this can only occur in the light of more detailed and reliable information. The Committee is prepared, on the evidence available, to make some relatively modest proposals. A key element of these proposals is that information of a systematic nature be collected. In the light of such information, it would then be possible to examine the issues referred to in this section, as well as any that arise over the next three to five years, and to develop appropriate policies.

Recommendation 45

4.92 **The Committee recommends that when more information is available about the operation of employee share plans, a further Parliamentary inquiry be conducted into the use and nature of employee equity arrangements, with particular emphasis on the feasibility of:**

- **providing equities at full cost;**
- **providing equities in enterprises other than in the employer of the person receiving the equity;**
- **further assisting share plans designed to facilitate succession and employee buyouts and buy-ins and as elements in industry assistance programs; and**
- **allowing taxation concessions on some portion of a capital gain arising from the sale of equities into an employee share plan, so long as the proceeds are invested in another enterprise.**

Brendan Nelson MP
Chair
7 September 2000