



Law Council
OF AUSTRALIA

Business Law Section

15 December 2020

Senator Andrew Bragg
Chair
Senate Select Committee on Financial Technology and Regulatory Technology
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: fintech.sen@aph.gov.au

Dear Senator

**Senate Select Committee on Financial Technology and Regulatory Technology
Second Issues Paper – Employee Share Schemes**

This submission is made by the Corporations Committee and the Taxation Committee of the Business Law Section of the Law Council of Australia (the **Committee**) in response to the Second Issues Paper (**Paper**) of the Senate Select Committee on Financial Technology and Regulatory Technology (**Senate Committee**).

1. GENERAL OBSERVATION

- 1.1. The Committee shares the Senate Committee's view that the broad areas of tax, regulation, capital, culture and skills, and the impacts and opportunities that emerged in responding to COVID-19 are key to maintaining Australia's competitive position. However, at present tax and regulation are an impediment to investment and growth, and reform is needed to improve our competitive position.
- 1.2. Comments and recommendations in response to particular matters raised in the Paper follow.

2. TAX ISSUES – EMPLOYEE SHARE SCHEMES

- 2.1. The Senate Committee has expressed interest in (i) how to enhance Australia's ability to attract and retain highly skilled workers in FinTech and related fields; and (ii) in particular, how Australia could enact a tax regime which makes our country attractive to the world's brightest minds.
- 2.2. The Committee notes that Australia's current employee share scheme rules are less than optimal for attracting and retaining talent in the FinTech and RegTech space, especially for start-ups which may be cash-constrained for a period of years. While this has significant impact on FinTech and RegTech start-ups, it affects Australian companies more generally. US employee share scheme rules, in particular, appear to be much more effective to foster talent. More generally, tax and legal complexity to

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employee share schemes in Australia adds unnecessary cost and inefficiency to implementation of share schemes.

- 2.3. The Committee refers to its submissions of May 2020 in response to the Government's Standing Committee on Tax and Revenue's Inquiry into the Tax Treatment of Employee Share Schemes, which outlines the key issues for Australian share schemes.

Recommendation: The Committee recommends that the Senate Committee consider using tax settings to support share schemes that are simpler, more cost effective, and capable of attracting talent.

3. US RULE 10b5-1

- 3.1. The Senate Committee has requested feedback on the potential for a scheme similar to the Rule 10b5-1 trading plans (**Trading Plans** or **10b5-1 plans**) that are available in the United States.
- 3.2. The Committee has made enquiries and makes the following general observations regarding the operation of Trading Plans:

Insider Trading Safe Harbour

- (a) The Trading Plans serve as safe harbours allowing individuals to give instructions to their brokers regarding future securities trades at a time when those individuals are not in possession of material non-public information (**MNPI**) regarding the company in question or its securities.
- (b) The basis for this is the principle that a person should be able to schedule future trades, as long as those future trades are not based on MNPI at the time they are scheduled. This is helpful for issues like financial planning for future expenses, such as mortgage repayments, tuition fees, tax payments, or other future foreseen cash requirements.

Structure of Trading Instructions

- (c) The person can instruct the broker to sell enough securities to fund those future needs, even if the holder himself or herself subsequently comes into possession of MNPI, which would otherwise prevent him or her from trading at that future time.
- (d) Once a 10b5-1 plan is in place, all of the investment decisions are put in the hands of the broker without further input from the holder (which is similar to a blind trust but subject to specific instructions). Consequently, it is important that the instructions to the broker are clear.
- (e) In addition to their use for future known specific cash needs, Trading Plans often contain instructions to buy or sell up to a certain volume of securities at certain price points.

Termination or Changes to Plans

- (f) If a 10b5-1 plan is terminated or changed, there is a risk that the prior trades made under the plan may not be subject to the safe harbour protection of the plan. This is because a plan that is often changed or amended or terminated might instead be viewed by the US Securities and Exchange Commission (**SEC**) to not be a plan at all, but instead some transient instructions that are changed when circumstances (and knowledge of the holder) change. Thus, in order to maintain the protection of a Trading Plan, it is best not to amend or terminate it during its tenure. For example, if a holder sets up a 10b5-1 plan to sell stock over a period of time, but then something happens that greatly decreases the value of that stock, such that the holder does not want to sell it so cheaply, they may step in and terminate or amend the plan. In that case,

the prior trades under the plan may be examined more closely by the SEC, if they were made outside of an open trading window, and may not have the 10b5-1 protection.

Recommendation: The Committee is supportive of the introduction of a regime similar to US Rule 10b5-1.

3.3. However, Trading Plans have some shortcomings and it would be helpful to adopt clearer standards in the areas outlined below if a similar structure to the Trading Plans is adopted in Australia:

- (a) *Cooling-off period:* Some holders will specify that trades under their 10b5-1 plan will not begin until a certain period after the plan is adopted (such as 30 days). The idea of a cooling-off period is to add an extra layer of protection that the plan is not being put in place to profit from short-term stock fluctuations (or access to information), but is in fact a longer term plan regarding the holder's dispositions of the securities. For example, if a plan is put in place right at the end of an open window period, and trading begins shortly thereafter (but after the insider trading window closes), it could be alleged that the plan was being abused to simply extend the open trading window period for the holder. Some holders do not adopt a cooling-off period at all. Such a cooling-off period is not required under the relevant rules.

Recommendation: If adopted in Australia, the Committee recommends that clear rules are put in place with respect to cooling-off periods.

- (b) *Disclosure:* Trading Plans are not generally required to be disclosed to the market (although the company may be aware of their use), except for *Section 16¹* reporting officers who are reporting on their trades in securities.² In any case, in the US the specific broker instructions are never disclosed (since they could indicate an insider's view of a target stock price). The existence of some 10b5-1 plans is disclosed voluntarily.

Recommendation: If adopted in Australia, the Committee recommends that the existence of a trading plan for directors must be disclosed to the market, and that the existence of a trading plan for an employee should be disclosed only to the company (while still keeping the specific broker instructions undisclosed in each case).

- (c) *Duration:* There is no fixed time period for a 10b5-1 plan. They can range in tenure from 3 months to 2 years, but are typically one year long.

Recommendation: If adopted in Australia, and in order to ensure that such plans are used for the purposes for which the rules were created, the Committee recommends that, for example, it is a requirement that there should be a minimum period for specific plans (e.g. at least six months in duration). However, it should also be clarified that certain early termination events are permissible (e.g. hardship, death or incapacity, material change in circumstances, or a specified minimum term after cessation of employment/office).

- (d) *Coordination with other laws:* In the US, Rule 10b-18 provides a fairly simple and straightforward anti-manipulation safe harbour that provides certain rules on timing, price and volume of trades in order to avoid being categorised as

¹ Section 16 of the US *Securities Exchange Act of 1934* articulates the regulatory filing responsibilities that directors, officers and principal stockholders are legally required to adhere to. Anyone who is directly or indirectly a beneficial owner of more than 10% of a company, or any director or officer of the issuer of such a security, is required to file the statements required by Section 16.

² In Australia, this would be similar to reporting requirements of directors.

manipulative trading. Most 10b5-1 plans in the US are implemented in conjunction with this 10b-18 anti-manipulation safe harbour.

Recommendation: If adopted in Australia, the Committee recommends that careful consideration should be given to other laws to ensure harmony and efficient operation between various provisions. There should be balanced exclusions from market manipulation provisions of the *Corporations Act 2001* (Cth) and, for the avoidance of doubt, cartel provisions of the Australian *Competition and Consumer Act 2010* (Cth).

4. DISCLOSURE AND LICENSING RELIEF

- 4.1. The operation of employee share schemes in the US is assisted by broad disclosure exemptions, and does not attract the operation of any licensing rules. In Australia, there are limited and restrictive disclosure and licensing exemptions available that reduce the utility of the employee share schemes generally. These introduce structural complexity and complicate the remuneration strategy of companies as the business grows and transitions (for instance, upon listing). There is no justification for these constraints being so narrow.

Recommendation: The Committee recommends that broader and simpler disclosure and licensing exemptions should apply to all employee share schemes.

Committee representatives would be happy to discuss any of the matters raised, or provide further detail. If you have any questions – please contact Chair of the Corporations Committee, Shannon Finch (shannonfinch@jonesday.com or 0428 894 002) or Committee member, Rodd Levy (rodd.levy@hsf.com or 0417 053 177).

Yours faithfully,



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