

## Employee share purchase schemes – proposed exemption relief

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The Financial Markets Conduct Act 2013 (FMC Act) provides a statutory exclusion from the standard requirements of the regulated offers regime for employee share purchase schemes in clause 8 of schedule 1.

Market participants' feedback tells us there are three potential areas of concern in applying this exclusion. The issues relate to:

- offers made to trusts and relatives
- offers of savings scheme securities
- the application of the 10% limit in clause 8(1)(c)(ii).

After reviewing the issues, we propose to address all three by way of exemption relief. This paper provides details of our initial proposals.

We are seeking feedback on our proposals as well as any additional concerns issuers have when they use the employee share purchase exclusion.

**Submissions close on 15 October 2015. The form at the back provides more details.**

After the consultation, we will consider submissions with a view to having appropriate exemptions (if any) in place by the end of November 2015.

### About this consultation:

This consultation is for:  
companies, offerors, legal advisers

It aims to:  
seek feedback on possible exemptions for employee share  
purchase schemes

### Document history


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This version was issued in September 2015 and is based on legislation as at the date of issue.



## Employee share purchase schemes – existing relief

1. Employee share schemes have had long-standing relief from the disclosure requirements of New Zealand's securities law. Relief has been provided for these reasons:
  - employees are assumed to have some existing understanding of the company offering the securities due to their employment relationship
  - securities are often offered under employee share purchase schemes at limited or nil cost to the employee
  - employee share purchase schemes allow employers to link remuneration to the performance of the company, and can provide a partial substitute for cash remuneration, particularly for 'cash poor' companies
  - employee share purchase schemes can generate a sense of ownership amongst employees, as well as offering them a stake in the company's management and direction.
2. Under the Securities Act 1978 (Securities Act), there were a number of exemptions for employee share purchase schemes. These exemptions included:
  - the Securities Act (Overseas Employee Share Purchase Schemes) Exemption Notice 2002 (Overseas Exemption)
  - the Securities Act (Employee Share Purchase Schemes – Listed Companies) Exemption Notice 2011 (Listed Companies Exemption) and
  - the Securities Act (Employee Share Purchase Schemes – Unlisted Companies) Exemption Notice 2011 (Unlisted Companies Exemption).
3. These exemptions allowed companies to offer certain securities to employees without complying with the standard disclosure requirements of the Securities Act. Under the Overseas Exemption, companies were exempted from providing a prospectus and investment statement, while the Listed Companies Exemption and Unlisted Companies Exemption allowed issuers to prepare a reduced content evergreen prospectus. These exemptions were conditional on the provision of alternative disclosure.
4. Under the Financial Markets Conduct Act 2013 (FMC Act), relief for employee share purchase schemes is provided in clause 8 of schedule 1 (FMC Act Exclusion).
5. The FMC Act Exclusion is intended to focus on the employment relationship and its role in remuneration rather than the fundraising aspect of employee share offers. As such the FMC Act Exclusion is subject to certain restrictions:
  - the offer must be of equity securities
  - the offer must be made as part of the remuneration arrangements for an 'eligible person'. An 'eligible person' is defined as an employee, a director or a person who provides personal services principally to the offeror or its subsidiaries
  - the primary purpose of the offer from the issuer must not be to raise funds
  - there is a limit on the total number of financial products issued or transferred to eligible persons –
    - a) for voting products or options over voting products, 10% of the voting products of the issuer as at the start of the 12-month period
    - b) for non-voting products, 10% of the products of the issuer that are of the same class at the start of the 12-month period.

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6. While the FMC Act Exclusion means Part 3 disclosure is not required, an offeror relying on the exclusion must still provide alternative information to the offeree. This information includes a warning statement in a prescribed form, a document that contains a description of the employee share purchase scheme, an annual report (if available) and financial statements.<sup>1</sup>

### Background to this consultation

7. As the Securities Act was repealed on 1 December 2014, reliance on the existing Securities Act exemptions covering employee share schemes has depended on the transitional provisions of the FMC Act. Issuers relying on these notices are impacted by different transitional provisions:
- Issuers relying on the Overseas Exemption need not prepare a prospectus. They will be able to rely on those notices, in their offer, until 1 December 2016.<sup>2</sup>
  - Issuers relying on the Listed Companies Exemption and Unlisted Companies Exemption are required to prepare an evergreen prospectus. While these issuers will not be able to register a new prospectus after 1 December 2015, they will in practice be able to rely on their existing prospectus until 1 December 2016.<sup>3</sup>
8. On 13 March 2015, we released a paper consulting on whether ongoing exemption support was required across a range of different matters.<sup>4</sup> In the March paper, we considered the FMC Act Exclusion, and asked a number of questions of market participants.
9. Based on submissions received and internal review, our view is that several elements of the FMC Act Exclusion might create difficulties for market participants. These elements are:
- offers made to trusts and relatives
  - offers of savings scheme securities
  - the application of the 10% limit in clause 8(1)(c)(ii).
10. A review of each of these issues is set out below, along with our proposed approach.
11. This consultation paper also includes commentary on two additional items: the warning statement required by the FMC Act Exclusion and the treatment of ‘phantom shares’. They are found under the heading ‘Ancillary matters’ at the end of the paper.

### Offers to employee trusts and relatives

12. The FMC Act Exclusion definition of ‘eligible person’ is narrower than that provided in several of the Securities Act exemption notices. The Listed Companies Exemption and the Unlisted Exemption both provide a definition of ‘eligible person’ that includes relatives and trusts where an eligible person is a beneficiary of the trust.

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<sup>1</sup> See clauses 9-12, schedule 8, Financial Markets Conduct Regulations 2014.

<sup>2</sup> See clause 7, schedule 4, Financial Markets Conduct Act 2013.

<sup>3</sup> See clause 6, schedule 4, Financial Markets Conduct Act 2013. Equity securities are not ‘continuous issue securities’ for the purposes of clause 6.


<sup>4</sup> FMA consultation paper, Financial Markets Conduct Act exemptions, 13 March 2015.



13. The definition of 'eligible person' in the Listed Companies Exemption and Unlisted Companies Exemption also extends to companies within the control of an eligible person. This aligns with the FMC Act. Clause 9 of schedule 1 of the FMC Act allows offers to entities controlled by an 'eligible person' to benefit from the FMC Act Exclusion. Under clause 9, if an offer of financial products to a person (A) does not require disclosure under Part 3 of the FMC Act (for example an offer relying on the FMC Act Exclusion) an offer of those financial products to an entity controlled by A also does not require disclosure under Part 3 of this Act.
14. We understand that the narrower definition of eligible person may concern market participants because employees will not always participate directly in an employee share purchase scheme. In some cases, employees may wish to participate through, for example, their family trust.<sup>5</sup>
15. In light of this, in the March paper we considered whether, despite this narrower definition, the FMC Act Exclusion could extend to offers under a scheme where securities are issued to a trust or relative. We took the view that the FMC Act Exclusion did extend to these situations, noting that 'schemes where shares are offered to employees, but issued to another person...fall within the exclusion because the offer is still made to the employee (who is an 'eligible person') and this is the person who is making the decision to invest.' Our approach reflects the structure of the FMC Act Exclusion, which focuses on the person to whom an offer is made, not to whom the financial products are ultimately issued.
16. Based on feedback to the March paper, we are concerned that, while this view accords with the strict wording of the FMC Act, it is a technical interpretation that may create uncertainty for employers offering (or considering offering) under the FMC Act Exclusion.
17. To illustrate this, our view is it is clear the exclusion applies where the eligible person A to whom the offer is made applies for and accepts the offer, but then requests that the shares are issued to another person B. The situation becomes less clear whether the share plan more formally allows for participation by non-eligible persons under the following circumstances:
  - where the terms of the employee share purchase plan expressly permit A to nominate B to be issued shares; or
  - where B is making relevant payments for the equity securities as part of the share scheme.
18. In these circumstances it could be considered that the offer has been made (in substance) to B. As B is not an eligible person, an employer would not be able to rely on the FMC Act Exclusion for that offer.
19. Reliance on clause 9 of schedule 1 may provide partial relief in such circumstances, but raises its own complexities listed below.
  - The concept of 'control' (as defined in clause 48 of Schedule 1 of the FMC Act) is problematic when applied to trusts. Some trusts may be considered to be under the control of an eligible person. However, to rely on clause 9 of schedule 1 exemption, an employer may need to examine the structure of the trust that wishes to participate.
  - Offers to relatives (for example a spouse or child) will not be covered by clause 9 as this exclusion only applies to 'entities' under control.

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<sup>5</sup> We do not consider relief is required to address circumstances where the employee share scheme is itself structured as a trust. In these cases we do not consider there is in substance an offer between the employer and the trust. In many circumstances employee trusts may also potentially be subject to other schedule 1 exclusions (close business associates, persons under control).



20. Our initial view is that, given market practice, the inability for employees to participate in employee share schemes through other entities or persons may result in a policy outcome that is not optimal. Therefore, we consider there are grounds for considering potential relief for offers to trusts and relatives. The reasons are listed here.

- The broader definition of ‘eligible person’ under the Unlisted Companies Exemption and the Listed Companies Exemption was designed to accommodate the market practice whereby employees would not always participate directly in employee share schemes. These existing exemptions gave employees the flexibility to structure their affairs as they saw fit. The flexibility was not deemed to run counter to the policy intent of the exemptions as the employee was the recipient of the offer and was still in substance making the investment decision. We believe this policy rationale remains relevant under the FMC Act Exclusion. In particular, we consider an exemption may provide clarity for trusts where an eligible person may have influence over investment decisions but is not considered to be in control of the entity.
- The FMC Act Exclusion places a number of restrictions on issuers, as offers must be made as part of remuneration arrangements and cannot be used primarily for fundraising. Our view is these restrictions reduce the risk of any exemption applying more widely than necessary.
- A number of existing share purchase schemes were designed based on the Unlisted Companies Exemption and the Listed Companies Exemption. Participants under those schemes that are trusts not under the control of an eligible person or relatives will need to be removed and replaced with eligible persons when these schemes transition to the FMC Act. There is a risk this may have a disruptive effect on the market.

#### Proposed exemption for employee trusts and relatives

21. Our proposal is for an exemption enabling equity securities to be offered to ‘relatives’ on the same basis as the FMC Act Exclusion. The details of this proposed exemption are:

- an offer of equity securities to a ‘relative’ of an ‘eligible person’ would not require Part 3 disclosure and would not be a regulated offer
- ‘eligible person’ would be defined to mean an employee, a director or a person who provides personal services principally to the offeror or its subsidiaries
- ‘relative’ would be defined in line with clause 5(2) of Schedule 1 of the FMC Act. This definition includes both relatives of A and trusts of which A is a beneficiary
- the offer must be made as part of a remuneration arrangements for an eligible person
- raising funds for the issuer must not be a primary purpose of the offer.

22. The conditions for the exemption will require that the total number of voting products issued or transferred in a 12 month period to an eligible person or a relative of an eligible person would be limited to 10% of the voting products of the issuer (or non-voting products, as appropriate).

## Savings scheme securities

### ‘Savings scheme securities’ under the Securities Act






23. Under the Securities Act, 'savings scheme securities' were issued in some employee share schemes. We understand these securities are savings vehicles that allow funds to be accumulated over time for the eventual acquisition of shares.
24. As an example, as part of the employee share scheme, the employee's salary is deducted and saved in an account held on trust. At a certain point (for example annually), those savings are used to purchase shares in the employee's company or parent company. The employee may be given the right to ask for the funds to be repaid before they are used to buy the shares.
25. The primary issuers of these securities are large overseas companies and/or their local subsidiaries. Offers typically occur when these companies extend a global scheme (including a savings scheme element) to New Zealand employees on the same or similar terms.
26. Under the Securities Act 'savings scheme securities' were defined as debt or participatory securities. The Overseas exemption was available when the savings scheme securities were offered by a certain class of issuers, provided they were 'offered in connection with participation in an exempt issuer's employee share purchase scheme'.
27. Under the terms of the Overseas Exemption, three classes of issuers received relief for offers of savings scheme securities.
  1. New Zealand-registered banks and overseas banks.
  2. Issuers incorporated, listed, and quoted on an exchange in a jurisdiction that the FMA was comfortable had strong and appropriately comparable regulatory standards. Under the Overseas Exemption these jurisdictions were Australia, Austria, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, the Netherlands, Norway, Singapore, South Africa, Spain, Sweden, Switzerland, the UK and the US. Under the Overseas Exemption, offers could also be made by the wholly owned subsidiaries of these overseas issuers.
  3. Persons acting on behalf of a person in subparagraph 1 or 2. This covered, for example, trustees holding employment deductions on behalf of the issuer.

#### Transition to the FMC Act

28. In our March paper, we consulted on the issue of savings scheme securities. We asked market participants whether savings scheme securities were still being offered as part of employee share schemes, and if ongoing exemption support was required to allow these securities to be offered under the FMC Act. We noted our view that ongoing relief may not be required given that offers of savings scheme securities may fall within the schedule 1 exclusion for registered banks (this exclusion covers offers of category 2 products or debt securities).
29. Based on feedback on the March paper, we understand that savings scheme securities are still being offered. Submitters noted that, depending on the nature of the savings scheme security being offered, it is possible an overseas issuer, overseas bank or trustee may require exemption relief. These entities would not be able to take advantage of the schedule 1 exclusion available to registered banks.
30. Our view is that ongoing relief analogous to the Overseas Exemption may be appropriate. The reasons are listed here.
  - Under the FMC Act, our view is that savings scheme securities are an offer of a debt security and are unlikely to be a managed investment product. For savings scheme securities, the offer of debt is ancillary to the offer of an



equity security. As the savings arrangements are temporary and ultimately oriented toward an eventual offer of equity security, the value of Part 3 disclosure for investors is relatively limited.

- Savings scheme securities are being extended into New Zealand on the same basis as existing global employee share purchase schemes. We consider there is a real risk that these schemes would not be offered to New Zealand employees if there was a requirement to either restructure the scheme to remove the issue of savings scheme securities or comply with the Part 3 disclosure and governance requirements of the FMC Act.

### Proposed exemption for savings scheme securities

31. Based on industry feedback, we propose that a certain class of issuers be exempted from providing Part 3 disclosure when they make an offer of savings scheme securities. As part of this exemption these offers would not be considered a regulated offer.<sup>6</sup>

32. Realigning this exemption with the Overseas Exemption is desirable as certain overseas issuers have savings scheme securities that rely on the wording of this notice.

33. Under this proposed exemption:

- savings scheme securities will be defined to mean debt securities
- relief would be available where the savings scheme securities are to accumulate funds which are eventually used to buy equity securities as part of an employee share purchase scheme
- the exemption would provisionally extend to the current class of persons exempt under the Overseas Exemption notice (with this class noted broadly in paragraph 27), excluding NZ-registered banks
- relief would be subject to the following conditions:
  - the employee share purchase scheme or a parallel scheme associated with the savings scheme securities must also be offered (or have previously been offered) in the jurisdiction in which the overseas issuer is incorporated or listed
  - employee funds would need to be kept in a separate bank account
  - the funds would need to be held in that bank account until the equity securities were issued or the relevant monies were disposed of in accordance with the employee share purchase scheme
  - the details of the savings scheme security must be contained in the document provided to eligible persons that contains a description of the employee share scheme
  - if the issuer is relying on the FMC Act Exclusion for the offer of equity securities, the warning statement required by the FMC Regulations must include a statement explaining the nature of the savings scheme security arrangement.

34. As we have noted, our initial view is that providing an exemption from disclosure requirements in an offer of savings scheme securities will not be detrimental to investors. The savings scheme securities are a mechanism to invest in the shares of the parent company. There should be appropriate disclosures on the shares. For overseas issuers this will typically take place through compliance with the FMC Act Exclusion.

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<sup>6</sup> See section 561(2), Financial Markets Conduct Act 2013.





35. Our initial view is that the exemption would mean the offer of savings scheme securities is not a regulated offer. The consequence of this is that the offer will not receive some of the protections of the FMC Act (such as a trust deed and licensed supervisor). On balance our initial view is that this may be appropriate. The reasons are listed below.

- Savings scheme securities offered under the Overseas Exemption are currently exempt from the relevant governance and financial reporting requirements under the Securities Act regime.
- The offer of savings scheme securities is incidental to the eventual offer of equity securities.
- Debt securities held in bank accounts as savings scheme securities are in substance category 2 products. The exemption would provide relief from disclosure and governance requirements that is in line with the current exclusions available to New Zealand registered banks. To receive this relief, overseas banks and exempt issuers would need to be incorporated or listed in jurisdictions that the FMA was comfortable had strong and appropriately comparable regulatory standards.
- In the absence of relief, and in light of the fact that only a limited number of New Zealand persons will receive offers, it is possible that these employee share offers would not be made at all.

## The application of the 10% limit in clause 8(1)(c)(ii)<sup>7</sup>

36. There are potential issues associated with the 10% limit placed on issues in clause 8(1)(c)(ii) where a new class of non-voting product is (or has been) created specifically for an employee share purchase scheme. Examples of this scenario may include:

- where an employer creates (or offers options over) a new class of non-voting product for their employee share scheme
- where shares are issued into a trust and eligible persons are offered equitable interests in the shares, rather than the shares themselves.

37. Due to the definition of voting product in the FMC Act, the issue would not arise where shares are initially issued as non-voting products, but can convert to a voting product if vesting conditions (such as length of service requirements) are satisfied.<sup>8</sup> Shares issued to a nominee or trust to hold for a specified period would also be voting products.

38. However, when a new class of non-voting product is created, the shares to be issued would be 100% of that class (as no shares of that class have been previously issued). This would not fall within the 10% limit in clause 8(1)(c)(ii). In practice this prevents the creation of a new class of non-voting equity security for an employee share scheme. Even if a new class has already been created, an employer would be limited to offering 10% of this class, which may preclude a meaningful expansion of the employee share purchase scheme.

39. We consider this issue is largely technical in nature. As a result, our initial view is that it may be appropriate for limited exemption relief to be granted where a separate class of non-voting financial product has been established for an employee share purchase scheme, and the offer cannot satisfy (or finds it difficult in practice to satisfy) the quantitative threshold of the exemption because they are of a different class of security.

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<sup>7</sup>As noted in our update of 30 September 2015, there have been some minor amendments made to this section. A marked-up version of this document is available on request. To request a copy, please contact [consultation@fma.govt.nz](mailto:consultation@fma.govt.nz).

<sup>8</sup>See section 6 of the FMC Act.



## Proposed exemption

40. We propose to offer a limited exemption on basis listed here.

- Certain offers of non-voting equity securities relying on the FMC Act Exclusion would be exempt from complying with clause 8(1)(c)(ii). These securities are:
  - non-voting products created specifically for an employee share scheme, and any options over these non-voting products; and
  - equitable interests in the ordinary shares of the issuer
- This would be subject to a condition that limits the total number of financial products issued or transferred to eligible persons to 10% of the voting products of the issuer, at the start of the 12-month period.

41. Due to concerns around avoidance, we have not considered broader exemption relief appropriate (for example, one that exempts new classes of non-voting products from clause 8(1)(c)(ii) altogether).

## Ancillary matters

42. **Warning statements:** in the March paper, we received a number of comments regarding the appropriateness of the warning statement prescribed by clause 11 of schedule 8, of the FMC Regulations. Our view is regulation 9 of the FMC Regulations provides issuers with the ability to modify the warning statement to address their own circumstances (for example, if they are initially issuing options, rather than shares under their employee share scheme). We would welcome feedback from interested persons on this point.

43. **Phantom shares:** we are of the view that phantom shares are usually not derivatives, and therefore not a financial product. We have published an FAQ on this issue, available at <http://fma.govt.nz/compliance/offer-information/faqs/>.



## Questions

1. In your experience, is it common for employee share purchase schemes to make offers to trusts and relatives of eligible persons? Would the absence of relief create problems for existing employee share purchase schemes? If so, how?
2. Do you agree with our proposal to provide exemption relief for offers to relatives and trusts as part of an employee share purchase scheme? If not, why not?
3. We welcome further information on the structure of employee share schemes were savings scheme securities currently being offered. Do you consider these structures are appropriately dealt with as part of our proposed approach? Is the class of persons who would be entitled to relief under our proposed savings scheme securities exemption appropriate?
4. Based on our understanding of savings scheme securities, our view is they are likely to be debt securities under the FMC Act. Do you agree with that view, or do you believe savings scheme securities could also be considered an MIS product in light of their definition as 'debt or participatory securities' in the Overseas Exemption? If yes, should savings scheme securities that are MIS also receive relief?
5. Do you agree with the FMA's proposed approach regarding the 10% cap in clause 8(1)(c)(ii) of schedule 1? Are you aware of any other issues associated with the application of this limit?
6. Beyond the issues noted in this paper, are you aware of any other issues with the operation of the FMC Act Exclusion that the FMA should be aware of? Please provide details of these issues, as well as any proposed solutions.

## The next step

### How do I make a submission?

Please use the form on the next page – this gives the details of what you need to do. Forms must be submitted electronically in both PDF and word formats and emailed to [consultation@fma.govt.nz](mailto:consultation@fma.govt.nz) – please put 'Feedback: Employee share schemes – proposed exemption relief' in the subject line.

**Submissions close on Wednesday 15 October 2015.**

### Where can I get more information?

You'll find more information on our website [www.fma.govt.nz](http://www.fma.govt.nz).

If you have questions about the consultation process, please get in touch on 0800 434 567.

## Feedback: Employee share schemes – proposed exemption relief

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at [consultation@fma.govt.nz](mailto:consultation@fma.govt.nz) with 'Feedback: Employee share schemes – proposed exemption relief' in the subject line. Thank you. **Submissions close on Wednesday 15 October 2015.**

Date: \_\_\_\_\_ Number of pages: \_\_\_\_\_

Name of submitter:

Company or entity:

Organisation type:

Contact name (if different):

Contact email and Phone:

Paragraph or Question Number	Comment	Recommendation
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*You don't need to quote from the consultation document if you use part & paragraph numbers.*

*You may attach extra pages - please label each page with your name & organisation.*


**Feedback summary** – *if you wish to highlight anything in particular*

**Please note:** Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

**Thank you for your feedback – we appreciate your time and input.**

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