GRG Remuneration Insight 131

ASX Listing Rules Changes Etc.

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INTRODUCTION

In late 2019, several amendments were made to the ASX Listing Rules that are relevant to key management personnel (KMP) remuneration. They relate to resolutions concerning shareholder approval of KMP equity plans and grants of equity to directors, regarding notifying the market of rights issues (e.g. equity remuneration) and a change to the calculation of the 15% limit on new issues that can be made without shareholder approval. The importance of these amendments has only come to light in recent months as companies have been drafting resolutions and explanatory material for notice of meeting (NOM) resolutions. This GRG Remuneration Insight explains and comments on these amendments. Readers should also be aware that ASX Guidance Note 19 "Performance Securities" was released in August 2020 and has been expanded to cover performance rights and performance shares. **Contact us for a complimentary "Remuneration Committee Companion"** that includes a cheat-sheet of regulations, rules and guidelines that should be considered in respect of KMP remuneration governance, intended for directors and executives.

MAXIMUM NUMBER OF SECURITIES UNDER PLAN APPROVAL

ASX Listing Rule 7.2 states that Rules 7.1 (15% limit on new issues that may be made without shareholder approval) and 7.1A (additional issue capacity approved by shareholders via a special resolution) do not apply if an exemption applies. Exemption 13 applies to:

> *"An issue of securities under an employee incentive scheme* ***if within 3 years before the issue date****:*
>
> *(a) in the case of a scheme established before the entity was listed — a summary of the +terms of the scheme and the maximum number of equity securities proposed to be issued under the scheme were set out in the prospectus, PDS or +information memorandum lodged with ASX under rule 1.1 condition 3; or*
>
> *(b)* ***the holders of the entity's ordinary securities have approved the issue of equity securities under the scheme as an exception to this rule****.*
>
> *The notice of meeting must have included:*
>
> - *a summary of the terms of the scheme.*
> - ***the number of securities issued under the scheme since*** *the entity was listed or* ***the date of the last approval under this rule****;*
> - ***the maximum number of equity securities proposed to be issued under the scheme following the approval****; and*
> - *a voting exclusion statement.*
>
> ***Exception 13 is only available if and to the extent that the number of equity securities issued under the scheme does not exceed the maximum number set out in the entity's*** *prospectus, PDS or information memorandum (in the case of (a) above) or in the* ***notice of meeting*** *(in the case of (b) above).*
>
> *Exception 13 ceases to be available if there is a material change to the terms of the scheme from those set out in the entity's prospectus, PDS or information memorandum (in the case of (a) above) or in the notice of meeting (in the case of (b) above)."*

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The ASX has made it clear that the number of equity securities to be issued must be expressed as a number and not a formula for calculating the number.

The number of securities specified creates a limit on the number of securities that may be issued in reliance on the approval within the 3 year period following the approval. Although several high-profile resolutions have been published that refer to the Class Order 5% limit, recent feedback from the ASX indicates this is no longer sufficient to satisfy the maximum issue number requirement.

The purpose of requiring a number to be specified is unclear. If a company is not issuing shares to raise capital or as part of the consideration for acquisitions, then 15% of issued shares may be issued to employees each year (a total of 45%) over 3 years without shareholder approval. When this circumstance exists, the Exemption 13 approval by shareholders will generally have no practical relevance because issues to employees would usually be well below 15% of issued shares.

On the other hand, if shares are being issued to raise capital or as consideration for acquisitions then issues to employees may be constrained by the 15% annual limit unless and to the extent that shareholder approval is obtained under Exemption 13. If capital raising and acquisition issues are made in one of the 3 years, then the number covered by the Exemption 13 approval will most likely only have relevance in one year as the 15% limit will most likely cover employee issues in other years. However, if capital raising and acquisition issues are being made each year then the Exempt 13 number may be relevant in each year with the residual of the Exemption 13 number being available each year.

EQUITY GRANTS TO DIRECTORS APPROVAL REQUIREMENTS EXPANDED

Grants of options and rights to directors have for many years not required shareholder approval if the shares to be provided on exercise of the options or rights are required under the terms of the scheme to be sourced via on-market purchases (LR10.16(b)). Unless LR10.16(b) applies (on-market purchase settlement only) then shareholder approval of proposed grants of securities including options and rights to directors (and their associates) requires prior shareholder approval (L R 10.14). However, this exemption to the requirement for shareholder approval will no longer apply once approval is obtained for any participant in the plan under ASX LR 10.15 i.e. the old approach can only be used if no approvals are ever obtained for issues to directors under the plan, which is a practice that generally meets with criticism from shareholders.

ASX LR 10.15 specifies the requirements to be contained in the explanatory material seeking shareholder approval of grants of securities to directors. A new requirement is contained in LR10.15.11 and states:

> *"**A statement to the following effect:***
>
> - *Details of any securities issued under the scheme will be published in the annual report of the entity relating to the period in which they were issued, along with a statement that approval for the issue was obtained under listing rule 10.14.*
> - ***Any additional persons covered by listing rule 10.14 who become entitled to participate in an issue of securities under the scheme after the resolution is approved and who were not named in the notice of meeting will not participate until approval is obtained under that rule**."*

The second dot point overrides LR10.16(b) and therefore makes it compulsory for all grants to directors (and their associates) under the scheme to be subject to prior shareholder approval irrespective of whether or not on-market purchases will be used to settle options and rights once an approval has been obtained under LR10.15, as soon as shareholder approval is obtained for any single director in the plan. There is no time limit on this overriding provision, however it only applies to issues under the scheme so a new scheme should re-open the opportunity to rely on LR10.16(b) until an approval for a grant under the new scheme is obtained under LR10.15.

From a corporate governance point of view and to satisfy the preferences of proxy advisors, GRG recommends that all grants to directors be subject to shareholder approval. If this approach is adopted, then the foregoing change will be of little relevance. This mainly has implications for out-of-cycle grants to a managing director, such as in the case of a new appointment, or in the case of newly appointed non-executive directors. However, assuming the Board has a fixed policy for calculating grants based on a volume weighted average price at fixed points in the year and taking into account dividends, timing/delays of grants should not be of any concern to participants since the number to be granted will not be impacted by a delay until the next meeting of shareholders.

CROSSING BRIDGES BEFORE YOU GET TO THEM

ASX LR14.1A states:

> *"A notice of meeting which contains a resolution seeking an approval of security holders under the listing rules must summarise the relevant rule and what will happen if security holders give, or do not give, that approval."*

Thus, the explanatory material accompanying any resolution must now include a statement as to what will happen if the resolution is not approved. Many Boards would previously have given little attention to this aspect in the expectation that the resolution will be approved. Further, Boards would probably have preferred to delay making a decision on what action will be taken until they have considered any feedback from shareholders as to the reasons for voting against the resolution. Generally speaking, the alternative being presented in notices of meeting observed so far, is that the grant will be settled in cash instead. This provides shareholders with an incentive to approve the resolution, since cash settlement is generally less desirable for external stakeholders than equity settlement. Lessons should be taken from the Kogan case however, where proxy advisors have indicated they are voting against what they perceive to be an unreasonable grant to the managing director, noting the cash settlement consequence if not approved, and warning that they will vote against the re-election of any directors that fail to act to stop what they perceive as unreasonable remuneration. What action, if any, will be taken by ASIC if the resolution is not approved by shareholders and the Board implements its stated intention to deliver a cash alternative which could be viewed as a breach of s208 of the Corporations Act.

ASX/MARKET NOTIFICATIONS CLARIFICATIONS (APPENDIX 3B etc.)

For many years there has been confusion in the market regarding when to issue an Appendix 3B, with the ASX advising individual companies that only an "Announcement" is required when Rights are issued, while many companies issue an Appendix 3B when Rights are issued. Appendix 3B is intended to relate to a new issues of securities, however a Performance Right is very much a contingent interest in a security that may or may not result in a new issue of securities.

ASX Listing Rules 3.10.3 A and B and 3.10.5 have been amended to make this much clearer, and companies should now cease issuing an Appendix 3B upon the issue of a Performance Right or similar instrument.

GUIDANCE NOTE 19

Guidance note 19, now called "Performance Securities" as of August 2020, provides guidance on how to construct equity-linked performance remuneration in accordance with the ASX Listing Rules and the ASX's expectations regarding the interpretation and application of those rules. This amended Guidance Note has been expanded to capture rights, options, shares and a wider range of remuneration arrangements, including those that "are in effect performance rights". In addition to addressing the now best-practice discretionary-cash-settlement equity instruments common on the market, it also captures payments via equity interests related to mergers or takeovers.

The 10% limit on conversion upon a change of control has been removed, however it is clear under section 13 that a 10% limit on potential conversions when performance milestones are achieved will

require an independent expert to opine regarding whether that remuneration/issue is reasonable and fair to other security holders.

ASX CORPORATE GOVERNANCE COUNCIL'S UPDATED PRINCIPLES AND RECOMMENDATIONS

Although less recent, readers should be aware that the ASX Corporate Governance Council updated its Principles and Recommendations (4th edition) in 2019. The main amendments address the increasing importance of risk, including non-financial risk, in governing remuneration. It also addresses the link between culture and remuneration, in an extension of this theme.

One of the key updates is a clear expectation that companies have gates related to non-financial risk, to address the expectation that remuneration will not reward conduct that is contrary to the entity's values or risk appetite. This would also address APRA's requirement for regulated entities to have a high weighting on non-financial issues (if 100% of the award is subject to non-financial risk/culture gates).

The key change that impacts equity plan design is an expectation that boards retain discretion to modify short term and long term reward outcomes/awards/vesting. This is absent in many older or lawyer-drafted plan documents.

An expectation that companies disclose their policies and practices regarding minimum shareholding requirements for directors, reflects the increase in the expectation of many stakeholders that directors be aligned with shareholders through holding material equity stakes. As a result, pre-tax NED Fee Salary Sacrifice plans are rapidly growing, and confer the benefit of an effective nil/0% Capital Gains Tax rate for most directors (until they reach a 10% shareholding) while addressing the risk of prosecution by deferring the taxing point for up to 15 years (with dividends collected along the way on around double the amount of equity compared to post tax on-market purchase).

CONCLUSION

With so many moving parts, it is difficult to stay on top of all the rules, regulations and guidelines that need to be understood to effectively govern/oversee KMP remuneration. GRG's complimentary Remuneration Committee Companion is designed to help you stay ahead of these issues and avoid the pitfalls. Many are facing a particularly important period of change where the old way of doing things is no longer acceptable - the risk of being caught out by either the ASX or shareholders has never been so high, that is if you are not well informed of these issues.

GRG is able to assist with (but is not limited to) the drafting of:

- notice of meeting resolutions,
- modern equity plan rules for executives, and
- tax effective equity plans for directors, designed to meet current market requirements and best-practices.

Find out more by calling us on (02) 8923 5700, or access your complementary Remuneration Committee Companion via our website: www.grg.consulting/grg-services/coaching-and-development.