Macquarie Bank Limited
ACN 008 583 542

Level 22
20 Bond Street
Sydney NSW 2000
PO Box H68 Australia Square
New South Wales 1210

Telephone (61 2) 9237 3333
Facsimile 9237 3350
Telex 122246
Internet http://www.macquarie.com.au
DX 10287 SSE
SWIFT MACQAU2S

Money Market 9237 3600 Facsimile 9237 4227
Foreign Exchange 9237 3666 Facsimile 9237 3019
Bullion 9237 3444 Telex 72263
Futures 9231 1028 Telex 72263
Debt Markets 9237 3815 Facsimile 9237 4414

30 April 1999

The Committee Secretary
House of Representatives Standing Committee on
Employment, Education and Workplace Relations
Suite R1 116 PARLIAMENT HOUSE
CANBERRA ACT 2600

Dear Sir

Inquiry into Employee Share Ownership in Australian Enterprises ("Inquiry")

Thank you for your invitation to Macquarie Bank Limited ("Macquarie Bank") to provide a submission to the above Inquiry by the House of Representatives Standing Committee on Employment, Education and Workplace Relations. Following is Macquarie Bank's submission to the Inquiry.

Macquarie Bank

Macquarie Bank is the only major independent investment bank owned by Australians and headquartered in Australia. It is a full-service investment bank with more than 3,000 and has been listed on the Australian Stock Exchange since July 1996. In its last full financial year it made a net profit of $141 million and now has a market capitalisation of approximately $3 billion.

Macquarie Bank or its subsidiary companies operate in Australia, Britain, Germany, the United States, Canada and South Africa. We also have a strong presence in the South East Asian region through offices in New Zealand, China, Hong Kong, Korea, India, Malaysia and Singapore.

Macquarie's operations are divided among six major groups.

- Macquarie's Equities Group is one of the leading brokers on the Australian Stock Exchange in equities and equity derivatives. It provides a full range of stockbroking services to both institutional and private investors and through the new DirecTrade facility, gives investors the flexibility to trade securities over the Internet.
- Macquarie's Treasury and Commodities Group contains all the Bank's other financial markets activities including money market, foreign exchange, capital markets, bullion and commodities, dealing and treasury advice.

- The Corporate Finance Group is the leading Australasian corporate finance house. It oversees mergers and acquisitions and capital raising for clients in Australia and offshore.
- The Investment Services Group is Macquarie's funds management arm, offering both wholesale and retail services. Macquarie is the seventh-largest manager of retail funds in Australia. Overall, it manages a portfolio in excess of $20 billion in shares, cash and fixed interest on behalf of superannuation funds, corporations and individuals.
- Macquarie is a licensed bank and offers a range of business and private banking services through the Banking and Property Group. The Group includes the Property Investment Banking Division, which is one of Australia's largest property organisations. Its activities in mortgage securitisation through PUMA make Macquarie the largest private sector issuer of bonds in Australia and one of the top six home lenders.
- The Asset and Infrastructure Group acts as adviser or arranger for large scale financings including cross-border leasing - it is a world leader in this field. The Group also establishes and manages investment funds which invest in infrastructure and technology assets including the highly successful Infrastructure Trust of Australia.

Macquarie Bank's Employee Share Ownership Plans

Macquarie Bank has two active employee ownership schemes and is proposing to shortly introduce a third. These are briefly described below.

1. Employee Share Plan

Following shareholder approval at the 1997 Annual General Meeting, Macquarie Bank introduced the Macquarie Bank Employee Share Plan ("ESP") whereby each financial year, eligible employees are offered up to $1,000 worth of fully paid ordinary Macquarie Bank shares for no cash payment. Macquarie Bank's staff profit sharing pools are adjusted downwards by the aggregate market value of the shares issued under the ESP.

The ESP was introduced in the spirit of the Federal Governments' initiatives to encourage employee share ownership by providing concessional taxation treatment under Division 13A of the Income Tax Assessment Act 1936 or the Income Tax Assessment Act 1997 as amended (the "Tax Act").

Shares issued under the ESP cannot be sold until the earlier of three years after issue or the time when the participant is no longer employed by the Bank or a subsidiary of the Bank. In all other respects, shares issued rank equally with all other fully paid ordinary shares then on issue.

The number of shares each participant receives is the offer amount ($1,000) divided by the weighted average price at which the Bank's shares are traded on Australian Stock Exchange Limited on the seven days up to and including the date of allotment, rounded down to the nearest whole share.

The employees who are eligible for an offer are those permanent Australian-based employees who have been continuously employed by Macquarie Bank or a subsidiary of the Bank since 1 April of the relevant year and are still employed by Macquarie Bank or a subsidiary on the relevant allotment date.

Two offers have been made under the ESP and in each case, the acceptance rate was approximately two thirds of staff eligible to participate. At present there are about 1,574 employees with shares in the ESP.

2. Proposed New Staff Share Acquisition Plan

Macquarie Bank is currently well advanced with plans to offer a new employee equity plan, the Macquarie Bank Staff Share Acquisition Plan ("MBSSAP"), to all Australian-based staff. The MBSSAP is subject to shareholder approval being obtained at the next Annual General Meeting in July this year. The MBSSAP will also fall within the Federal Government's initiatives under Division 13A of the Tax Act but will not qualify for the $1,000 exemption (due to the inclusion of forfeiture provisions in the proposed plan). The main features of the proposed MBSSAP are:

1. Each financial year, the Bank would provide all Australian-based staff the opportunity to acquire a specific amount of shares in the Bank;
2. An independent Plan Company will then acquire on-market the specified amount of shares at prevailing market prices. Brokerage and stamp duty would be to the employees' accounts. The shares will be registered in the employees' names;
3. Forfeiture provisions will apply for the duration that the shares are within the Plan and will apply in the case of fraud, dishonesty or theft. This is in contrast to the $1,000 Employee Share Plan described above which does not have a forfeiture provision.
4. Given the risk of forfeiture while the shares remain in the Plan, the employee is not taxed up-front on the value of the shares. Rather the value of the MBSSAP shares are subject to income tax at their then market value only when they are withdrawn from the Plan which would be after at least six months, or on leaving the Bank or on their 10th anniversary in the Plan, if earlier. It is worth noting however that employees are given the choice in the Tax Act to elect to be taxed up-front if they so desire.
5. The shares may only be withdrawn/sold if approved by the Plan Company. In particular, applications for withdrawal in the first six months will generally not be acceded to except in special circumstances eg death, total and permanent disability, or demonstrated hardship.

The first offers under the new MBSSAP are expected to be made this year with the shares to be acquired in July/August 1999.

Unfortunately the Plan is offered only to Australian-based staff due to foreign regulatory and other restrictions.

The Committee should note that the Tax Act effectively prevents an employee from taking advantage of the taxation concessions applicable to both plans in the one year. This arises from the way the Tax Act provides the $1,000 exemption, which is for the employee to elect to be taxed up-front on the value of the share discount and then to exempt the first $1,000 of the discount. Such an election must apply to <u>all</u> employee shares acquired by the employee. Thus an employee must make a choice between:

- participating in a plan which provides a $1,000 exemption and which has no forfeiture provisions but has a 3 year restriction on sale of the shares; or
- participating in a plan which enables the employee to acquire a larger stake in the employer company but where the shares so acquired are subject to a forfeiture provision and where the employee is not taxed until the forfeiture provision is lifted by the release of shares from the plan.

Macquarie Bank's view is that it would be more consistent with the underlying policy of the Employee Share Scheme provisions in the Tax Act for an employee to obtain the $1,000 exemption even if they acquire shares in the same year through another plan of the employer containing a forfeiture provision.

3. Macquarie Bank Employee Share Option Plan

In December 1995, the Bank introduced an Employee Option Plan (the "Option Plan"). Staff eligible to participate are those of Associate Director level and above (approximately the most senior 20% of the Bank's employees). Currently, there are approximately 485 participants in the Plan.

Five year options over unissued ordinary shares in Macquarie Bank Limited are granted for no consideration with an exercise price based on the then current market price (ie with no discount on acquisition). The options have forfeiture conditions, such that if a recipient leaves the employ of the Macquarie Bank Group any un-vested options lapse unexercised. Vesting conditions for options being issued now are that one third of each tranche of options becomes exercisable after the second, third and fourth anniversaries of the date of grant respectively. Options granted to Executive Directors after the 1997 Annual General Meeting are subject to a performance hurdle based on Macquarie Bank's return on equity relative to other listed companies.

Impact on Workplace Relations and Productivity

The single most important factor in Macquarie Bank's success has been the recruitment and retention of the highest quality staff. A critical factor in achieving this has been Macquarie Bank's remuneration system including its employee share ownership plans.

Macquarie Bank's management and Board believe that employee share ownership is very positive for employees, employers and shareholders as it:

- provides a sense of belonging for an employee;
- encourages a commitment to the employer by employees;
- helps align the interests of staff and shareholders, by giving staff a shareholder perspective of the employer's returns and performance and hence provides both a better understanding and greater motivation to improve productivity.

In Macquarie Bank's case, the Option Plan and its predecessor plan involving partly paid shares, has been a major factor in encouraging long term commitment and incentive for senior employees.

As the Employee Share Plan has only been in place for about 18 months, it is difficult to comment on its impact on employees or Macquarie Bank. However, Macquarie Bank notes that it was introduced partly as a response to a major finding of a staff survey on workplace attitudes. That survey indicated a widespread desire for staff to have increased employee equity participation in Macquarie Bank. Macquarie Bank also notes the relatively high participation rate particularly amongst junior staff.

Taxation Incentives

Macquarie Bank notes that its Employee Share Plan and its proposed new MBSSAP obtain special tax treatment through provisions in the Tax Act specifically introduced by the Federal Government to encourage employee equity participation. Macquarie Bank commends these initiatives and believes that they have been, and will continue to be, successful in increasing employee participation, to the benefit of employees, employers as well as shareholders in those employer companies.

Macquarie Bank considers that the special tax treatment applying to shares acquired through employee share schemes provides very positive and meaningful incentives for employers to establish such schemes and for employees to participate in them.

However, Macquarie Bank notes that the legislation encompassing these concessions is complex and would encourage Parliament in any effort to simplify the legislation, both for the benefit of employers in implementing the schemes and for employees, in deciding whether to participate and in completing their annual tax returns.

More generally, Macquarie Bank would encourage the Federal Government to compare tax concessions offered in other jurisdictions to determine whether the employee share scheme incentives could be broadened to further encourage employee share ownership. From the perspective of developing Australia as a regional financial centre it would assist if the Australian tax system offered an employee share scheme incentive which would be attractive to offshore staff or which could apply even though staff may be temporarily relocated between Australia and offshore (or vice versa). This may involve introducing concessions which are aligned with concessions offered in offshore jurisdictions to reduce the likelihood of double taxation.

In relation to the existing $1,000 exemption, Macquarie Bank submits that the Federal Government should consider raising the exemption amount to a greater level. The benefits resulting from encouraging employee share ownership may well outweigh the revenue costs of increasing the exemption level.

At a more practical level it is worth noting that one of the eligibility requirements for the $1,000 exemption seems unduly restrictive. Currently, as noted above, an employee share plan will only obtain the $1,000 exemption if the plan has a condition restricting sale of the shares to the earlier of the time three years after acquisition of the shares by the employee or the time the employee ceases to be employed by the employer. The employee share scheme rules would be more practical if employers were also given the discretion to lift this restriction in appropriate cases, such as in cases of demonstrated hardship. At present, an employee suffering hardship must leave employment in order to sell the shares held in the plan.

Other Regulatory Issues

There are a number of regulatory requirements which employers must be aware of when implementing employee share plans, such as the prospectus requirements under the Corporations Law, Corporations Law issues relating to companies being prohibited from acquiring interests in their own shares, "entitlements", financial assistance and insider trading, stamp duty on the transfer of shares, Stock Exchange Listing Rules and, in the case of financial institutions, the acquisition of "stakes" under the Financial Sector (Shareholdings) Act ("FSSA"). These provisions are complex and difficult to navigate without (and even with) professional legal advice. In many cases, employee share plans fall foul of unintended consequences of technical provisions in these requirements and related regulatory provisions, such as the regulation of managed investment schemes.

One example, particularly relevant for employers such as Macquarie Bank which actively encourages high staff share ownership, is the regulation concerning the acquisition of "entitlements" under the Corporations Law and "stakes" in companies under the FSSA. Depending on the technical structure of one's plan, it is possible under the deeming provisions in these laws, that an employer (or a Plan Company or a trustee) could be deemed to have an entitlement and a stake in the shares held by employees in one of its share schemes. This could arise due to forfeiture or disposal restrictions in the scheme (which may be an essential feature of the scheme) or simply due to the plan structure (eg by the use of a trust structure). This is despite the fact that the employees are entitled to all dividends on the shares and have the right and ability to act completely independently in relation to matters such as exercising the voting rights attaching to the shares.

Obtaining an entitlement or a stake may then oblige an employer to track the aggregate holding and disclose it in a substantial shareholder notice (if over 5%), and *in extreme cases it may even prevent further acquisitions by any related party under the takeover provisions*.

A second issue is that of the need for a prospectus. 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.*

A third issue, which is really an issue for State Governments, is that Macquarie Bank has received advice regarding its new MBSSAP that with the use of a separate plan administrator, double stamp duty will be payable - the standard 0.15% on acquisition by the plan administrator on-market and then a further 0.30% on transfer of those shares by the plan administrator into the employees' names.

These corporations and securities law regulatory issues have 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 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.

Macquarie Bank also submits that in changing any relevant legislation (taxation or otherwise) that Parliament should undertake a widespread and early public discussion of the issues at the legislative design stage. Often such discussions raise awareness of unintended consequences or practical difficulties of intended changes. Further, Macquarie Bank notes that it is very important to avoid uncertainty in these areas as this can lead to employers becoming effectively paralysed as to the implementation or continuance of schemes, which in turn, leads to frustration for employees. Parliament should recognise the considerable lead time in implementing a new scheme or reconstructing an existing one.

Macquarie Bank hopes that the Inquiry will address some of the above issues so that the introduction of employee share schemes can be done without unnecessary complexity and without employers and/or employees incurring unnecessary legal and other costs.

Yours faithfully

Richard Sheppard
Deputy Managing Director