

# ASIC CLASS ORDERS [CO 14/1000] and [CO 14/1001] (and related class orders)

## EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission

*Corporations Act 2001*

The Australian Securities and Investments Commission (*ASIC*) makes Class Orders [CO 14/1000] and [CO 14/1001] and related class orders under subsections 283GA(1), 601QA(1), 741(1), 926A(2), 992B(1) and 1020F(1) and paragraph 911A(2)(l) of the *Corporations Act 2001* (the *Act*).

Chapter 2L of the Act relates to debentures and requirements in relation to trusts, trustees and trust deeds. Paragraph 283GA(1)(a) provides that ASIC may exempt a person from a provision of Chapter 2L.

Chapter 5C of the Act relates to managed investment schemes and the requirements in relation to their registration and operation. Paragraph 601QA(1)(a) provides that ASIC may exempt a person from a provision of Chapter 5C.

Chapter 6D of the Act relates to fundraising and regulates disclosure to investors for offers for the issue or sale of securities. In order to issue securities, an issuer may be required to prepare a disclosure document which it must lodge with ASIC. Paragraphs 741(1)(a) and 1020F(1)(c) provides that ASIC may exempt a person from a provision of Chapter 6D and Part 7.9, respectively, of the Act; and paragraph 741(1)(b) provides that ASIC may declare that Chapter 6D of the Act, applies as if specified provisions were omitted, modified or varied as specified in the declaration.

Part 7.6 of the Act relates to the licensing of providers of financial services. Part 7.8 of the Act relates to other provisions relating to conduct connected with financial products and financial services, other than financial product disclosure. Part 7.9 of the Act relates to financial product disclosure and regulates disclosure to retail clients for offers for the issue or sale of financial products (other than securities). Paragraph 911A(2)(l) provides that a person is exempt from the requirement to hold an Australian financial services licence for a financial service they provide if the provision of the service is covered by an exemption specified by ASIC in writing and published in the *Gazette*. Paragraphs 926A(2)(a) and 992B(1)(a) provides that ASIC may exempt a person from a provision of Part 7.6 (other than Divisions 4 and 8 of Part 7.6) and Part 7.8, respectively, of the Act.

### **1. Background**

The Act regulates the offer to and investment by investors, including employees in their employer bodies. Unless a relevant exemption applies, or ASIC relief applies, the Act

requires bodies making offers of financial products to provide a prospectus, offer information statement or a Product Disclosure Statement to employees and, in some instances, to obtain an Australian financial services licence for financial services that may be provided in connection with the operation of the employee incentive scheme associated with the offers. The Act also prohibits or regulates certain other conduct associated with offers under the employee incentive scheme (e.g. hawking and advertising).

ASIC provided relief under Class Order [CO 03/184] *Employee share schemes*<sup>1</sup> to facilitate offers and associated activities without the need to meet various obligations under the Act where ASIC considers the benefits of the scheme outweigh the risks to employees.

The main policy objectives that must be satisfied to qualify for relief under Class Order [CO 03/184] are:

- (a) that the scheme is designed to support interdependence between the employer and its employees for their long-term mutual benefit by seeking to align their respective interests—for example, by giving employees an ownership interest in their employer and/or a financial benefit derived from the employer’s performance;
- (b) that there are adequate protections for participants in the scheme, including appropriate disclosure and pricing information for the products offered; and
- (c) that the objective of the offer is not fundraising.

ASIC has reviewed the relief underlying ASIC’s policy on employee share schemes.

In updating the policy, ASIC has changed the terminology from “employee share schemes” to “employee incentive schemes” because it considers this better reflects the wider scope of its relief in relation to the financial products covered by the updated policy. ASIC has however retained the word “employee” even though the updated policy covers offers to persons that are not employees but are nonetheless providing services to the body that are akin to those of employees.

ASIC considers that class order relief for employee incentive schemes is both necessary and appropriate. ASIC decided to widen the scope of its class order relief because it found that Class Order [CO 03/184] and certain limitations in ASIC's policy, were no longer able to accommodate developments, both in Australia and internationally, in relation to employee incentive schemes in circumstances where those developments did not offend the main policy objectives for granting the relief.

ASIC's review looked at expanding the scope of class order relief and publicly consulted on this expanded scope by considering the following—the classes of persons who could make

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<sup>1</sup> The relief in ASIC Class Order [CO 03/184], which is not registered on the Federal Register of Legislative Instruments (*FRLI*), is given by ASIC Class Order [CO 05/1270], which is registered on FRLI. For convenience, this Explanatory Statement will simply refer to the relief given by ASIC Class Order [CO 03/184] as that is the name by which the relief is commonly known.

offers in relation to employee incentive schemes; the classes of persons to whom employee incentive scheme offers could be made; the classes of financial products that could be offered; the structures that are used by employers to administer arrangements in relation to employee incentive schemes; and the terms and conditions that ASIC should apply to ensure that its main policy objectives relating to investor protection are appropriately maintained.

In light of this review, ASIC has decided to reissue the relief underlying Class Order [CO 03/184] in two separate class orders:

- (a) ASIC Class Order [CO 14/1000] *Employee incentive schemes: Listed bodies*; and
- (b) ASIC Class Order [CO 14/1001] *Employee incentive schemes: Unlisted bodies*.

Class order relief has been separated into two class orders because meeting ASIC's policy objective of ensuring there is adequate protections for employees who are retail investors are quite different. Where the financial products being offered are able to be traded on a well regulated financial market, ASIC considers that restrictions which ASIC needs to impose for relief are lower than is the case for financial products being offered in relation to an unlisted body—these differences relating particularly to the level of public information about the price and value of financial products being offered; and the level of regulation applying to the issuer of the financial product being offered.

## **2. Purpose of the class orders**

The purpose of ASIC Class Order [CO 14/1000] and [CO14/1001] is to reduce the regulatory burden on both listed and unlisted bodies that are operating employee incentive schemes by relieving the bodies from a range of statutory obligations in relation to product disclosure, financial services licensing, hawking and advertising that apply under the Act in relation to making offers of financial products under employee incentive schemes.

The purpose of ASIC Class Order [CO 14/977] is to make consequential changes to related existing class orders in relation to employee share schemes. These consequential changes are considered necessary and desirable in order to facilitate the transition from the previous suite of relief to the revised suite of relief.

The purpose of Class Order [CO 14/978] is to broaden the ability of a body to make small scale personal offers (20 investors and \$2 million limit) of securities without the need for a disclosure document under subsection 708(1) of the Act notwithstanding it has also made offers in reliance on Class Orders [CO 14/1000] and [CO 14/1001].

## **3. Operation of the class orders**

Class Orders [CO 14/1000] and [CO 14/1001] provide listed bodies (and their associated bodies corporate), unlisted bodies (and their wholly owned subsidiaries) and other persons engaged by these bodies, with conditional relief from the following requirements of the Act in respect of the offer of certain kinds of financial products under an employee incentive scheme:

- (a) the requirement to make disclosures through regulated disclosure documents such as prospectuses or Product Disclosure Statements;
- (b) the requirement to hold an Australian financial services licence for financial services provided directly in connection with the employee incentive scheme;
- (c) other requirements including in relation to hawking and advertising.

### **Eligible bodies**

Class Order [CO 14/1000] applies to bodies that are listed on specified financial markets (*eligible financial markets*), which include ASX and a range of well-regulated overseas financial markets. The class order also applies to associated bodies corporate of that listed body (i.e. bodies that are related bodies corporate of the listed body or bodies corporate that have voting power of not less than 20% of the listed body, or in which the listed body has not less than 20% voting power).

Class Order [CO 14/1001] applies to unlisted bodies and their wholly-owned subsidiaries.

### **Eligible participants**

Class Orders [CO 14/1000] and [CO 14/1001] apply to offers made under the employee incentive scheme to persons (*eligible participants*) who are full-time or part-time employees, directors (including non-executive directors), contractors and casual employees who work, or will reasonably be expected to work 40% of a comparable full-time position with the body. The class orders also apply in relation to prospective participants.

### **Eligible products**

Class Order [CO 14/1000] applies in relation to the following kinds of financial products (*eligible products*) of the listed body:

- (a) fully paid share of the body that is in a class of shares that is able to be traded on an eligible financial market;
- (b) a beneficial interest in a fully paid share of a body where either the beneficial interest, or the fully paid share, is able to be traded on an eligible financial market (e.g. CHESS Depository Interests, American Depository Receipts etc);
- (c) fully paid stapled security of the body that is in a class of stapled securities that is able to be traded on ASX;
- (d) an interest in a registered scheme that is in a class of interests that is able to be traded on ASX;
- (e) a unit in a financial product mentioned in paragraph (a)-(d);
- (f) an option to acquire, by way of issue or transfer, a financial product mentioned in paragraph (a)-(d);

- (g) a derivative that will result in the issue or transfer of a financial product mentioned in paragraph (a)-(d), or a cash amount which is calculated by reference to the price or value of a financial product mentioned in paragraph (a)-(d), or some combination of the financial products mentioned in paragraph (a)-(d) and cash.

Class Order [CO 14/1001] applies in relation to a limited class of financial products (*eligible products*)— namely fully paid voting ordinary shares, units in, and options and derivatives that relate to the fully paid voting ordinary shares of the unlisted body. This class order only applies in relation to these kinds of eligible products because fully paid voting ordinary shares are the most common and widely understood financial products.

### **Disclosure relief**

Class Orders [CO 14/1000] and [CO 14/1001] grant exemptions to eligible bodies from the requirement to provide a regulated disclosure document (e.g. a prospectus or a Product Disclosure Statement) when making offers of eligible products to eligible participants who have an employment or similar relationship with the body provided certain conditions are met.

As the Act prohibits the on-sale of eligible products within 12 months of issue where there is no regulated disclosure, the class orders also grant exemptions to permit on-sale without disclosure by the person making the sale offer, provided the eligible products were issued or otherwise granted to the eligible participant or trustee under the employee incentive scheme. These exemptions are principally intended to allow eligible participants to on-sell the eligible products which they acquire under the employee incentive scheme, provided the person selling has no reason to believe the scheme is not covered by the relevant class order.

In addition, under Part 7.9 of the Act, a financial services licensee, or an authorised representative of the licensee, who gives personal advice to an eligible participant that is a retail client and which includes a recommendation to acquire an eligible product under an employee incentive scheme, is required to give the eligible participant a Product Disclosure Statement. The class orders exempt the adviser from the requirement to give a Product Disclosure Statement provided the adviser has no reason to believe the scheme is not covered by the relevant class order.

### **Licensing relief - general advice, dealing and custodial or depository services**

ASIC accepts that a person making an offer of eligible products under an employee incentive scheme may make a recommendation or a statement of opinion that is intended to influence, or could reasonably be regarded as being intended to influence, an eligible participant in making a decision in relation to the eligible products. Accordingly, the class orders exempt such persons from the requirement to hold an Australian financial services licence in order to give general advice of this nature.

The body relying on the class orders can also issue an eligible product without requiring the body to hold a financial services licence where one is required, and can deal in the eligible product, provided any acquisition or disposal occurs through a financial services licensee or

where it occurs outside of this jurisdiction, through a person who is licensed or otherwise authorised to deal in financial products of that kind in that jurisdiction.

A body may operate an employee incentive scheme which is structured using a trust arrangement where a trustee may hold eligible products on behalf of eligible participants as a pool, or on behalf of a specified eligible participant. Class Order [CO 14/1000] exempts a listed body and its associated bodies corporate, and Class Order [CO 14/1001] exempts an unlisted body and its wholly owned subsidiaries, from having to hold a financial services licence for the purposes of providing a trustee service comprising of custodial or depository services, and being able to deal with the eligible products in the course of providing the custodial or depository service, in relation to the employee incentive scheme. These exemptions apply to the body on the condition that the body, as trustee, performs their duties in good faith and has sufficient resources to perform those duties.

### **Hawking and advertising relief**

Under Class Orders [CO 14/1000] and [CO 14/1001], ASIC has provided relief to enable the body to offer eligible products for issue or sale in connection with the employee incentive scheme as a result of an unsolicited meeting with an eligible participant. ASIC accepts that there may be times when offers may be made to eligible participants in the course of, or because of, unsolicited meetings or telephone calls given the nature of the existing, or potential, employment or employment-like arrangements between the body and eligible participants.

A body relying on the class orders for an exemption from disclosure for an offer of securities is not subject to the advertising restrictions under section 734 of the Act. However, for offers of eligible products regulated by Part 7.9 of the Act, section 1018A imposes restrictions in relation to advertising or publication of statements that are reasonably likely to induce an eligible participant to acquire an eligible product regardless of whether a Product Disclosure Statement is required or not. The class orders provide relief from the advertising restrictions in section 1018A given it may be necessary to advertise to existing directors, staff and contractors, as well as to attract future directors, staff and contractors.

### **Incidental managed investment scheme relief**

ASIC's policy on employee incentive schemes for listed bodies permits the use of contribution plans (see discussion below). ASIC's policy on employee incentive schemes for unlisted bodies does not permit the use of contribution plans.

Where an employee incentive scheme involves a contribution plan, it may involve the incidental operation of a managed investment scheme as a result of the pooling or use of the contributions in a common enterprise. In certain circumstances, such a scheme may be required to be registered under section 601ED of the Act. Class Order [CO 14/1000] provides relief from the registration requirements for listed bodies that operate a contribution plan associated with an employee incentive scheme.

## **Trust arrangements, contribution plans and loans**

### Trust arrangements

Class Orders [CO 14/1000] and [CO 14/1001] recognise that some employee incentive schemes may be structured through the use of a trust arrangement so that some of the financial products (the *underlying eligible products*) which are eligible for the class order relief may be held by a trustee on trust for an eligible participant pending transfer to the eligible participant. The class orders reflect that these underlying eligible products may be held in a pool on behalf of eligible participants, or on an allocated basis in favour of a specified eligible participant.

To ensure that trust property is protected for the benefit of eligible participants, the class orders provide that the trustee must only operate the trust for the benefit of an employee incentive scheme of the body, but is not limited to employee incentive schemes which rely on ASIC class order relief or ASIC case-by-case relief. Further, the trustee is obliged to maintain appropriate written records in relation to the trust, and is only entitled to use trust funds for reasonable disbursements which include brokerage and taxes incurred in connection with the operation of the trust.

In addition, where the trustee is the body or an associate of the body, the trustee is not permitted, at its own discretion, to exercise any voting rights attaching to any of the underlying eligible products that it holds on trust. However, if the trustee is not the body or an associate, it would need to be a trustee who is licensed or otherwise authorised to provide trustee services, and in those circumstances, the class orders do not prevent the trustee from exercising its own discretion in relation to the voting rights attaching to the underlying eligible products in accordance with its fiduciary duties.

There is also a holding limit imposed under both class orders. In the case of underlying eligible products of a listed body, the trustee is permitted to hold up to 5% of the voting shares of the listed body where such holdings relate to employee incentive schemes of the listed body, and in the case of underlying eligible products of an unlisted body, the limit is 20% of the voting shares of the unlisted body where such holdings relate to employee incentive schemes of the unlisted body. The reason for permitting a higher limit in relation to unlisted bodies due to the higher issue limit (see discussion below) and an acknowledgement that the spread of shareholders may be smaller.

### Contribution plans

Under Class Order [CO 14/1000], the employee incentive schemes may involve a contribution plan, enabling eligible participants to make financial contributions (whether from before-tax or after-tax contributions) towards the acquisition of eligible products.

The class order imposes conditions in relation to contribution plans. An eligible participant must agree in writing to participate in the contribution plan. A participant must have the ability to withdraw from participation by giving notice to the body and, on withdrawal, contributions that have not been used to acquire underlying eligible products must be

promptly returned to the participant. Contributions that are after-tax contributions must be held in a trust account until used to acquire eligible products. To the extent that underlying eligible products are acquired with the contributions of a participant, the participant must be entitled to direct the voting of any voting rights attached to the underlying eligible products, and must have an entitlement to receive any income in respect of the underlying eligible products that have been acquired, and held on trust, for the eligible participant.

Given the additional risks and complexity associated with employee incentive schemes relating to unlisted bodies, Class Order [CO 14/1001] does not permit offers to require the payment of more than nominal monetary consideration. Accordingly, Class Order [CO 14/1001] also does not permit contribution plans.

### Loans

Class Order [CO 14/1000] also provides relief for employee incentive schemes to extend to permitting a listed body or its associated bodies corporate to offer loans on a ‘non-recourse’ or ‘limited recourse’ basis. A limited recourse loan is a loan where the only recourse the body has in order to discharge of the loan is the eligible products acquired from the proceeds of the loan. These loans must also be free of interest or charges. The reason for these requirements is to ensure that the financial risk that an eligible participant faces under the employee incentive scheme is limited to the risk of forfeiting the eligible product itself.

For the same reasons applicable to the prohibition on contribution plans, as offers relating to unlisted bodies must be made for no more than nominal monetary consideration, loan arrangements are also not permitted.

### **Conditions on class order relief**

There are a number of standard conditions which apply to both Class Order [CO 14/1000] and Class Order [CO 14/1001]. The body:

- (a) must notify ASIC of reliance on the class order relief no later than 1 month after first reliance in relation to a particular employee incentive scheme;
- (b) must ensure that an offer document, containing certain key disclosures, is provided to eligible participants at the time of making an offer under the scheme;
- (c) must ensure the offer document includes general information about the risks of holding and acquiring an eligible product being offered under the scheme, and a prominent statement that an eligible participant should consider obtaining their own financial product advice in relation to acquiring an eligible product under the scheme; and
- (d) must provide a copy of the terms or a summary of the terms of the employee incentive scheme (and any other relevant documents, including in the case of listed bodies – contribution plans and loan agreements)).

A body must not issue more than 5% of the issued capital of the body in the case of a listed body, and 20% of the issued capital of the body in the case of an unlisted body, calculated on



the basis of the body's reasonable belief of what has and may be issued under the current employee incentive scheme, when aggregated with offers made under other employee incentive schemes of the body during the last 3 years. These limits apply in order to limit their use for the purposes of fundraising without a regulated disclosure document; and to mitigate against the potential effect on control and voting distortion that holding eligible products on trust may create.

There are a number of additional conditions applicable under Class Order [14/1001]. As discussed above, there is a higher level of transparency regarding the price and value of the financial products being offered by, and more public disclosure about the activities of, a listed body. Therefore the ability for ASIC to be satisfied that an eligible participant has adequate information to determine the price or value of the eligible products being offered is greater in the case of listed bodies than for unlisted bodies.

These additional conditions under Class Order [CO 14/1001] include the following:

- (a) an offer cannot be valued at more than \$5,000 per annum per eligible participant, with the basis of the valuation being approved by the directors of the body and disclosed in the offer document;
- (b) a prominent warning in the offer document about illiquidity and realisation value;
- (c) no more than nominal monetary consideration is to be provided by an eligible participant for the issue or transfer of fully paid shares;
- (d) only permitting the payment of monetary consideration in order for the exercise of options or the vesting of incentive rights and then only where certain liquidity events have been satisfied (e.g. a public listing or an arms' length trade sale); and
- (e) an audited financial report or a special purpose financial report must be provided to an eligible participant.

### **Transitional arrangements**

ASIC Class Order [CO 03/184] and the relevant part of Class Order [CO 04/671] that apply to employee share schemes, will be discontinued. ASIC recognises that the discontinuance of this existing class order relief may have adverse consequences for bodies operating existing employee share schemes who are currently relying on this relief in relation to employee shares schemes that are still in operation. ASIC is also aware that a number of bodies are also relying on individual instruments of relief that have incorporated parts of those class orders by reference.

ASIC wishes to migrate persons relying on our former employee share scheme policy to our revised employee incentive scheme policy in a cost-effective and orderly way. To facilitate this orderly migration, and to minimise the adverse consequences that might otherwise follow from the discontinuance of the existing suite of relief, Class Orders [CO 14/1000] and

[CO 14/1001] grants transitional relief to enable those persons who are relying on the existing relief to continue to operate their existing employee share schemes with equivalent relief.

#### **4. Consultation**

On 14 November 2013, ASIC released Consultation Paper 218 *Employee incentive schemes (CP 218)* seeking feedback on proposals to update ASIC's class order and regulatory guide relating to employee share schemes. The consultation period closed on 31 January 2014.

ASIC received 21 written submissions in response to CP 218. Details of the submissions received are contained in REP 417 *Response to submissions on CP 218 Employee incentive schemes* which is available on ASIC's website at [www.asic.gov.au](http://www.asic.gov.au).

## **Statement of Compatibility with Human Rights**

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

### **ASIC Class Orders [CO 14/977], [CO 14/978], [CO 14/1000] and [CO 14/1001]**

These class orders are compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### **Overview of the class orders**

ASIC Class Orders [CO 14/1000] and [14/1001] respectively apply to employee incentive schemes of listed bodies and unlisted bodies. The class orders give relief from requirements in the *Corporations Act 2001* in relation to product disclosure, financial services licensing, hawking, and advertising in connection with offers of financial products made under an employee incentive scheme.

These class orders update ASIC's policy to grant relief for employee incentive schemes in circumstances where the offers are designed to support interdependence between the body and its staff, in circumstances where there is adequate information about the body, and the body has not undertaken the offer for the purposes of fundraising. The update to ASIC's policy mainly reflects changes in market practices about the structure and types of financial products that bodies are now offering to their staff under employee incentive schemes.

The class order relief that applies to the employee incentive schemes of unlisted bodies under Class Order [CO 14/1001] is more restrictive than the relief that applies to the employee incentive schemes of listed bodies in Class Order [CO 14/1000] due to the lower level of price transparency and public information about unlisted bodies as against listed bodies.

ASIC Class Order [CO 14/977] makes consequential changes to related existing class orders in relation to employee share schemes. These consequential changes are considered necessary and desirable in order to facilitate the transition from the previous suite of relief to the updated suite of relief.

ASIC Class Order [CO 14/978] has the effect of broadening the ability of a body to make small scale personal offers (20 investors and \$2 million limit) of securities without the need for a disclosure document notwithstanding it has also made offers in reliance on the updated class order relief.

#### **Human rights implications**

Class Orders [CO 14/977], [CO 14/978], [CO 14/1000] and [14/1001] do not engage any of the applicable rights or freedoms.

## **Conclusion**

Class Orders [CO 14/977], [CO 14/978], [CO 14/1000] and [14/1001] are compatible with human rights as they do not raise any human rights issues.