



ASIC
Australian Securities &
Investments Commission

Explanatory Statement

ASIC Corporations (Employee Share Schemes) Instrument 2022/1021

This is the Explanatory Statement for *ASIC Corporations (Employee Share Schemes) 2022/1021*.

The Explanatory Statement is approved by the Australian Securities and Investments Commission (**ASIC**).

Summary

1. *ASIC Corporations (Employee Share Schemes) Instrument 2022/1021* (**instrument**) provides relief in relation to provisions facilitating employee share schemes (**ESS**) in Division 1A of Part 7.12 of the *Corporations Act 2001* (**Act**).
2. The ESS provisions commenced on 1 October 2022. Companies and their advisors identified some difficulties with compliance as they applied the provisions to their own employee share schemes. These stakeholders informed ASIC that they would need to seek relief in order to take advantage of the ESS regime.
3. To reduce the cost and delay associated with individual relief applications, ASIC has provided minor technical relief in this legislative instrument in relation to:
 - a) the requirements for contribution plans in s1100T;
 - b) the way the issue cap operates in s1100V;
 - c) the financial information and valuations that unlisted companies may provide under s1100X;
 - d) the time frame for supplementary disclosure in s1100Z; and
 - e) the secondary sale exemption in s1100ZD.

Purpose of the instrument

4. The purpose of this instrument is to facilitate reliance on the ESS provisions in Division 1A of Part 7.12 of the Act and reduce the need for individual relief applications.

Consultation

5. On 29 September 2022, ASIC published Consultation Paper 364 *Modifications to the ESS regime* with a draft legislative instrument containing our relief proposals. There were 13 submissions in response to CP 364, mostly from law firms who advise clients on ESS.
6. The submissions provided technical feedback on the draft legislative instrument and were largely supportive of our relief proposals.
7. ASIC will publish a Report on Submissions outlining the submissions received and our response in 2023.

Operation of the instrument

8. The instrument makes several notional modifications to provisions in Division 1A of Part 7.12 of the Act because strict compliance may unintentionally reduce the ability of entities to operate employee share schemes in this jurisdiction. The instrument commences on the day after it is registered on the Federal Register of Legislative Instruments.

ESS contribution plan – section 1100T

9. Section 1100T sets out requirements for contribution plans that are intended to safeguard participants' interests. The provision does not clearly cater for salary sacrifice arrangements because it uses the term 'payments and deductions'. It also fails to exempt salary sacrifice arrangements and loans from the requirement to be held in an Australian ADI trust account or from the requirement to be repaid to the participant.
10. As a result of feedback received in response to CP 364, the instrument notionally modifies section 1100T so that it refers to 'contributions': see notional subsection 1100T(2). The instrument also exempts future gross wages or salary (i.e. salary sacrifice arrangements) and loans from the requirement to be held in an Australian ADI trust account and from the repayment requirement: see notional subsection 1100T(3).
11. To address concern that section 1100T may require a separate account with an Australian ADI for each ESS participant, the instrument adds a note to clarify that the contributions of more than one participant may be held in the same account.

Issue Cap – section 1100V

12. Submissions in response to CP 364 said that section 1100V(1)(b) should not extend to ESS interests that could not result in the issue of shares or interests in a registered scheme because either the offer had lapsed or the ESS interest itself had expired. The instrument notionally modifies paragraph 1100V(1)(b) so that it refers to ESS interests that "may be issued" under offers made in connection with an employee share scheme over the past 3 year period rather than ESS interests that "could have been issued". This is to clarify that the issuer does not

need to take into account ESS interests where the offer has lapsed. Nor does the issuer need to take into account ESS interests that have expired. Shares or interests in a registered scheme will not be ‘covered by’ an ESS interest where the ESS interest has expired.

13. The instrument also notionally modifies paragraph 1100V(1)(b) to clarify that it only extends to offers received in this jurisdiction. This means that offers made to participants in other jurisdictions will not need to be included when calculating the issue cap.

Financial information prepared under a foreign standard – subsection 1100X(2)

14. If ESS offers are made for monetary consideration, sub-section 1100X(2) requires an unlisted body corporate to provide financial information to ESS participants. Feedback from stakeholders suggested that compliance with subsection 1100X(2) would be difficult for foreign entities who are not registered under Part 5B.2 (and therefore do not lodge documents with ASIC under s601CK) and who do not ordinarily prepare financial information in accordance with international accounting standards.
15. The instrument notionally modifies section 1100X(2) so that entities who are not registered under Part 5B.2 of the Act may provide financial information that has been prepared in accordance with a foreign accounting standard that the entity uses in its place of origin or in its principal place of business: see notional subparagraph 1100X(2)(c)(ii).
16. Additional information specified by notional subsection 1100X(2B) may be required if a foreign entity wishes to rely on notional subparagraph 1100X(2)(c)(ii) to provide financial information that is not covered by subparagraphs 1100X(2)(a), (b) or (c)(i). Unless the entity reasonably believes the financial information is prepared in accordance with standards and generally accepted accounting principles applied in the United States of America (**US GAAP**), notional subsection 1100X(2B) requires:
 - (a) confirmation that there are no material differences between the foreign financial information and the information that would otherwise be required under subparagraph 1100X(2)(c)(i); or
 - (b) a reconciliation of material differences between the foreign financial information and the information that would otherwise be required under subparagraph 1100X(2)(c)(i).

Note: subparagraph 1100X(2)(c)(i) requires a balance sheet and P&L prepared in compliance with Australian accounting standards or IFRS.

17. A foreign entity only needs to provide the additional information specified in subsection 1100X(2B) if they are relying on notional subparagraph 1100X(2)(c)(ii) and the financial information is not prepared in accordance with US GAAP. For example, a foreign entity does not need to provide additional information when relying on subparagraph 1100X(2)(b) to provide a copy of the most recent documents lodged with ASIC under section 601CK

or when relying on subparagraph 1100X(2)(c)(i) to provide financial information prepared in accordance with IFRS.

Valuations by an unlisted body corporate – subsection 1100X(3)

18. Subsection 1100X(3) requires certain valuation information to be provided where an unlisted body corporate offers ESS interests for monetary consideration.
19. This includes a valuation that has been prepared consistently with an applicable method approved by the Commissioner of Taxation under section 960-412 of the *Income Tax Assessment Act 1997 (ITAA)*: paragraph 1100X(3)(a). At present, the only method specified under section 960-412 of the ITAA relates to ordinary shares: Income Tax Assessment (Methods for Valuing Unlisted Shares) Approval 2015 (**ESS 2015/1**). Under the ITAA, ESS 2015/1 may only be used by start-up entities. ASIC received feedback that paragraph 1100X(3)(a) required modification so that entities who are not start-ups may use the method. This is unnecessary because paragraph 1100X(3)(a) only requires that the valuation has been prepared consistently with the approved method and does not restrict the use of the method to start-ups.
20. ASIC also received feedback that another valuation method should be specified for ESS interests that are not ordinary shares. The instrument therefore notionally inserts paragraph 1100X(3)(aa) so that ESS interests that are not ordinary shares issued by a company may be valued by an expert.
21. The definition of ‘expert’ in section 9 of the Act for these purposes is a person whose profession or reputation gives authority to a statement made by him or her in relation to the relevant valuation. Valuations provided pursuant to notional paragraph 1100X(3)(aa) are subject to the requirement that they are not misleading or deceptive (see paragraph 1100Z(1)(a)).
22. Paragraph 1100X(3)(aa) only permits a valuation prepared by an expert if the ESS interest is not an ordinary share issued by a company. This is because paragraph 1100X(3)(a) provides an appropriate method for valuing ordinary shares. Foreign entities will be able to rely on 1100X(3)(aa) if they do not come within section 9’s definition of ‘company’. The definition of ‘company’ in section 9 of the Act means a body corporate registered as a company under the Act. This definition does not extend to foreign companies registered under Pt 5B.2 of the Act because they are not a company for the purposes of the Act. Registration under Part 5B.2 of the Act makes the relevant entity a “registered foreign company” and a “registered body” but not a “company”. Therefore foreign companies can rely on s1100X(3)(aa) to provide an expert valuation of ESS interests that are ordinary shares.

Requirement to update disclosure: paragraph 1100Z(1)(b)

23. The instrument notionally modifies paragraph 1100Z(1)(b) so that the offeror only needs to provide ESS participants with an updated ESS offer document during the application period for the offer. This is consistent with paragraph 1100Z(1)(d).

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24. ASIC received feedback that paragraph 1100Z(1)(c) should also be modified so that the offeror only needs to provide updated documents about options and incentive rights during the period which they can be exercised or vest. This modification is not required because 1100Z(1)(c) refers to paragraph 1100Y(4)(a), which requires documents to be given 14 days before exercise or vesting. It is therefore sufficiently clear that the obligation to provide updated information under paragraph 1100Z(1)(c) only applies during exercise or vesting period.

Secondary sales of ESS interests: section 1100ZD

25. The instrument notionally modifies section 1100ZD so that unquoted ESS interests may be sold to another ESS participant where the seller either acquired the ESS interest in connection with an employee share scheme or from another ESS participant: notional subsection 1100ZD(1).
26. The instrument provides a broader on-sale exemption for ESS interests that are issued in connection with an employee share scheme and quoted on a financial market: subsection 1100ZD(2). Subject to certain exceptions for ESS interests issued to a trustee, the body who issued the ESS interest must not have an on-sale purpose: paragraph 1100ZD(2)(d). This is consistent with ASIC's general approach to on-sale relief: for example, see *ASIC Corporations (Sale Offers That Do Not Need Disclosure) Instrument 2016/80* at paragraph 5, which removes the seller's on-sale purpose from section 707 (but not the 'issuer purpose test'). An 'issuer purpose test' is important for preventing any abuse of the ESS regime to avoid the Act's disclosure regime. There should not be any difficulty satisfying the 'issuer purpose test' for a genuine employee share scheme. For example:
- (a) the mere fact that an employer knows ESS participants have an on-sale purpose does not preclude reliance on subsection 1100ZD(2). See Regulatory Guide 173 *Disclosure for on-sale of securities and other financial products* at paragraph 70;
 - (b) there is no deeming provision similar to subsection 707(4) – which only applies for the purposes of subsection 707(3);
 - (c) the offer letter or other circumstances of the ESS offer will typically establish that the purpose of the offer is to promote mutual independence, give the ESS participant a stake in the business or similar.
27. Submissions also queried how a seller would know that the issuer did not have an on-sale purpose. This has not been problematic for on-sale relief provided in *ASIC Corporations (Sale Offers That Do Not Need Disclosure) Instrument 2016/80*. In the case of quoted financial products, the entity usually needs to confirm to the market operator that there will be no restrictions on trading.
28. ASIC received submissions that section 1100ZD would not cover financial products issued pursuant to another ESS interest (for example, shares issued on the exercise of an option). This is not the case - provided the financial product comes within the broad definition of an ESS interest. The drafting proposed in

consultation has been amended so that the ESS interest only has to be acquired ‘in connection’ with an employee share scheme rather than ‘under’ an employee share scheme.

29. ASIC also received submissions that section 1100ZD will not cover ESS interests where the original offer was received outside this jurisdiction. This is not the case. If the original offer for the issue of ESS interests (**original offer**) was received outside this jurisdiction, the original offer is not subject to all the requirements in Div 1A of Part 7.12 due to section 1100F. However, any subsequent sale offer will be covered by section 1100ZD if it meets the requirements of the section (regardless of where the original offer was received). This is similar to where shares are issued to a person outside this jurisdiction but the person needs to rely on subsection 708A(5) to sell their shares on a market in this jurisdiction.

Legislative instrument and primary legislation

30. The subject matter and policy implemented by this instrument is more appropriate for a legislative instrument rather than primary legislation because there is a need to move more quickly than Parliamentary process allow to address an urgent issue and facilitate employee share schemes, as intended by *Treasury Laws Amendment (Cost of Living Support and Other Measures) Act 2022*.
31. Shortly after the ESS provisions were enacted, employers and their advisors realised that there would be difficulty applying some of the provisions to standard employee share schemes. The technical relief provided by the instrument will address the issues identified for the majority of employee share schemes and will enable ASIC to terminate the ability to make new offers under [CO 14/1000] and [CO 14/1001].
32. It will be a matter for the Government and for Parliament as to whether the Act or Regulations may be amended in future to include the relief in the Instrument.

Duration of the instrument

33. The duration of the instrument is 5 years after commencement. This is because employee share schemes are usually long term arrangements and employers and their advisors need certainty as to the provisions that will be applicable. There will be additional costs to employers if they need to seek advice as to compliance with the Act for their employee share scheme within a shorter period.

Legislative authority

34. *ASIC Corporations (Employee Share Schemes) Instrument 2022/1021* is made pursuant to section 1100ZK of the Act. The instrument is a disallowable legislative instrument.

Statement of Compatibility with Human Rights

35. The Explanatory Statement for a disallowable legislative instrument must contain a Statement of Compatibility with Human Rights under subsection 9(1) of the *Human Rights (Parliamentary Scrutiny) Act 2011*. A Statement of Compatibility with Human Rights is in the Attachment.

Statement of Compatibility with Human Rights

This Statement of Compatibility with Human Rights is prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

ASIC Corporations (Employee Share Schemes) Instrument 2022/1021

Overview

1. *ASIC Corporations (Employee Share Schemes) Instrument 2022/1021* facilitates the employee share scheme provisions in Division 1A of Part 7.12 of the *Corporations Act 2001*.

Assessment of human rights implications

2. This instrument does not engage any of the applicable rights or freedoms

Conclusion

3. This instrument is 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*.