Law Council
OF AUSTRALIA

Business Law Section

28 October 2022

Corporations Team
Australian Securities and Investments Commission
GPO Box 9827
Brisbane QLD 4001

By email: ess@asic.gov.au

Dear ASIC,

Employee Share Schemes—response to ASIC Consultation Paper 364 (ESS regime)

The Corporations Committee of the Business Law Section of the Law Council of Australia (the **Committee**) welcomes the opportunity to provide feedback on ASIC's proposed modifications to the ESS regime outlined in ASIC Consultation Paper 364 dated September 2022 (the **Instrument**).

Our submissions on the Instrument are set out in the final column of the table included within Schedule 1 (**Submission**) and, to assist with ASIC's review, provided in Annexure A, a marked-up copy of the Instrument (**Marked-up Instrument**) to be read with and give effect to the Submission.

The Committee note all references to the 'Corporations Act' in the Submission are references to the *Corporations Act 2001* (Cth) and references to specific sections are to sections of the Corporations Act.

The Committee would be pleased to discuss any aspect of this submission.

Please contact Robert Sultan, Chair of the Corporations Committee, at robert.sultan@nortonrosefulbright.com on (03) 8686 6571,
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Tony Sparks at Tony.Sparks@AllenOvery.com on (02) 9373 7879, if you require further information or clarification.

Yours faithfully,

Philip Argy
Chairman
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Schedule 1—Submission

ASIC proposal	ASIC feedback sought	Committee response
B1: We propose to notionally modify s 1100ZD to expand the secondary sale exemption for financial products that are quoted on a financial market covered by s 1100K and where the issuer had no on-sale purpose at the time of issue: notional s 1100ZD(2). We will also notionally modify s 1100ZD for unquoted products so that a person who acquired the product from the original recipient can on-sell it to ESS participants: notional s 1100ZD(1)(c). See paragraph 18 for our proposed requirements and paragraph 7 of the draft instrument	B1Q1: Do you agree with the proposed modification to s 1100ZD to expand the secondary sale exemption for quoted products?	Broadly the Committee agrees with the proposed modification. However, the Committee notes that any issues or grants made between 1 October 2022 (when the new ESS regime came into effect) and the date that the Instrument comes into effect will not receive the benefit of this modification. There is no policy reason why participants who received a grant made under the new regime prior to the Instrument coming into effect should not get the relief to the on-sale provision. To the contrary, it would further the objectives of the modification to extend it to those grants and it would ensure that issuers who have made grants during that time, with the expectation that there would be a cure to the on-sale provision, will not have acted to their (and their participants') detriment. As such, the Committee recommends that the Instrument be amended to state that the modifications and variations in the instrument apply to all grants made from 1 October 2022 (see proposed amendment in paragraph 2 of the Marked-up Instrument for further details). If ASIC is of the view that instrument cannot take effect from an earlier date, the Committee notes that another solution of this kind will need to be adopted. For example, the instrument could be amended to clearly express that the modifications and variations in the instrument apply to secondary sales of securities issued after the date of the instrument in relation to grants made before the date of the instrument, and no action would be taken in respect of securities issued between the Corporations Act coming into effect and the date of the instrument. The Committee would be open to discussing/consulting with ASIC on the required

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		amendments to the instrument if this was ASIC's proposed course of action to address this issue. The Committee also considered whether limiting this relief to listed entities will create any unforeseen problems. One situation where there is some potential for doubt relates to an unlisted entity that has on issue options or other financial products that are convertible into ordinary shares or similar products, and that conversion occurs in connection with an IPO of the issuer but at a point in time before the entity is admitted to quotation on ASX or another recognised exchange. On a strict reading of the new proposed s 1100ZD(2), the Committee considers that the on-sale provisions would not apply to the shares (or other ordinary securities) on and from the entity in this example being admitted to quotation. Provided that this is the intention, and ASIC does not take a differing view, the Committee has no further comments on the form of s 1100ZD. If this is not how ASIC considers this provision would work, the Committee recommends the Instrument be amended to ensure such relief is provided to financial products issued at or around the time that the entity is admitted to quotation on a recognised financial market.
	B1Q2: What costs are you likely to incur if ASIC does not expand the on-sale exemption in s 1100ZD in the way proposed? Are there additional costs associated with ASIC's proposal to grant relief? Please specify in both cases how such costs are likely to be incurred.	The Committee notes there would be significant costs should ASIC not expand the on-sale exemption in the notionally inserted s 1100ZD, though these costs are difficult to quantify. If the proposed amendments were not made to s 1100ZD, listed entities would either need to: (a) forgo reliance on the new regime and make the offer under a disclosure document (in which case the

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		Committee estimates that legal costs in the order of at least A$20,000 would be required to prepare an offer information statement or a section 713 transaction specific prospectus); or (b) rely on the new regime but engage in a cleansing process each and every time that new shares were issued to a participant under a plan. This could involve additional legal costs (for example, if an entity needed to prepare a section 713 transaction specific process as it was unable to meet the conditions necessary to issue a s 708A cleansing notice). There can be significant third-party adviser costs (i.e. lawyers, corporate advisers and accountants) in connection with preparing cleansing documents (whether this be conducted by way of cleansing notice or cleansing prospectus) and the associated due diligence that is required to ensure all "excluded information" is included within these documents. More difficult to quantify is the cost imposed on listed entities who may alter their behaviour to avoid putting themselves into positions where they hold materially price-sensitive information not disclosed to the market (e.g. relating to incomplete proposals and negotiations) at times that they expect to have to issue shares (to avoid risking confidentiality of such information when needing to continually cleanse the market of "excluded information"). The Committee queries what policy concerns ASIC may have for not expanding the on-sale exemption in the manner currently proposed as it was the Committee's understanding that the new ESS regime was enacted to streamline the ESS process and reduce regulatory red tape (which would not be the case should

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		entities have to routinely cleanse the market in connection with issues under an ESS). Ultimately, the Committee notes that, if a decision were made by ASIC to not expand the on-sale exemptions, this would have a negative effect on the prescribed purpose of the new ESS regime and dissuade listed entities from relying upon / utilising the relief afforded under the regime (which, anecdotally, is something that the members of the Committee who prepared this Submission have already seen firsthand).
	B1Q3: Are there any requirements in our proposed modification that will cause difficulties?	See response to B1Q1 above.
B2: We propose to notionally modify s 1100X(2) so that foreign companies not registered under the Corporations Act can provide a balance sheet and profit and loss statement prepared in accordance with accounting standards the company is required or permitted to use in the company's place of origin. This will be acceptable if the foreign company discloses either: a) confirmation that there is no material difference between the financial statements prepared under the foreign standard and the financial statements that would	B2Q1: Do you agree with the proposed relief?	The Committee believes that the proposed relief is helpful but would benefit from some changes to minimise the potential regulatory impact even further (without sacrificing investor protection). The Committee recommends that the Instrument be amended so that the proposed requirement for confirmation of no material difference / reconciliation will only apply where the foreign accounting standards are not either: (a) consistent with IFRS; or (b) accounting standards that are accepted by an ASIC-recognised foreign stock exchange (e.g. US GAAP, which is customarily accepted by "approved foreign markets" such as NYSE).

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otherwise be required under paragraph 2(c); or b) a reconciliation of the material differences. See paragraphs 6(a) and 6(b) of the draft instrument.		See proposed amendments in paragraph 6 of the Marked-up Instrument in Annexure A to this submission for a suggested way of taking this approach. ASIC states in RG72 that one of the criteria for ASIC designating a foreign exchange as approved is that it "has rules that meet ASX's listing and quotation, market information, regulatory, and trading and settlement principles". That is, the level of disclosure to the market of a recognised exchange must be acceptable to ASIC. Given all the circumstances, the Committee submits that the costs of acquiring the accounting advice required to meet the proposed requirement (see the response to question B2Q2 below) are not justified, given the marginal potential investor protection benefits that may come from requiring this additional confirmation/information where the foreign accounting standards are either IFRS-compliant, or are otherwise accepted by an ASIC recognised foreign stock exchange for disclosure purposes (as the extent to which the quality of the underlying financial information can be improved through such exercise is uncertain at best). The Committee also queries the cost/benefit analysis and underlying policy considerations should the decision be made not to permit foreign accounting standards, particularly given the fact that these costs may only be incurred as a result of a small number of employees being located within Australia. Where there is only a small number of Australian-based employees, compliance costs are a factor in determining whether or not those employees are made offers at all.

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	B2Q2: What are the financial or cost implications if ASIC does not modify s 1100X(2) by legislative instrument to permit information prepared under foreign accounting standards? For example, please specify the costs associated with a foreign company providing financial information that complies with s 1100X(2)(c) and the costs associated with a foreign company providing the information we have proposed (including the confirmation as to no material difference or a reconciliation of material differences).	The Committee notes that, should ASIC not modify s 1100X(2) (including the Committee's recommendations as included in the response in B2Q1 above), the costs could be significant, and—whilst difficult to quantify as they would depend on the circumstances of each issuer—likely to be in at least the tens of thousands of dollars (as an issuer would need to engage an accounting firm that has sufficient global operations/expertise to sign off on a comparison of two differing accounting standards).
	B2Q3: Should our relief require a reconciliation of net assets and profit after tax rather than the condition proposed (i.e. that the company either confirms there is no material difference between information prepared under the applicable foreign standard and Australian accounting standards or a reconciliation of the material differences)?	The Committee's position is that, regardless of how this requirement is expressed, the imposition of a confirmatory/reconciliation obligation would still require potentially significant additional costs to be incurred which can only really be justified where the foreign accounting standards are not either consistent with IFRS or otherwise used by an ASIC-recognised stock exchange.

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B3: Section 1100X(3)(a) provides that ESS interests may be valued in accordance with an applicable method approved by the Commissioner of Taxation under s 960-412 of the ITAA 1997. Currently the method specified under that provision only covers ordinary shares: Income Tax Assessment (Methods for Valuing Unlisted Shares) Approval 2015 (ESS 2015/1). For other types of ESS interests, we are proposing legislative relief that allows a company to provide a valuation of the ESS interests in an independent expert report. See paragraph 6(c) of the draft instrument, which notionally inserts s 1100X(3)(aa). See paragraph 6(c) of the draft instrument, which notionally inserts s 1100X(3)(aa).	B3Q1: Do you agree with our proposal to permit valuations prepared by an independent expert? B3Q2: If another valuation method was specified, what valuation method would you recommend and why do you consider it a reliable alternative?	The Committee has no objections to ASIC's proposal. If another valuation method were to be specified, the Committee would recommend the use of widely accepted valuation methodologies, such as the Black-Scholes model or Monte Carlo method. It further notes that, should ASIC have concerns about the assumptions used within these methodologies, the provision of parameters around acceptable assumption ranges, or a requirement to have these models/methods signed off by an independent expert, could be possible solutions to ensure they are used in an appropriate manner.
B4: We propose to make minor modifications to s 1100T, primarily so that salary sacrifice arrangements can comply with requirements for contribution plans. Consistent with [CO 14/1000], the proposed changes would exempt salary sacrifice payments from: a) the requirement to be held in an account with an Australian	B4Q1: Do you agree with the changes proposed above in relation to salary sacrifice arrangements—so that they can comply with the s 1100T requirements for contribution plans? If not, please explain why, including any difficulties and costs associated with salary sacrifice arrangements complying with s 1100T as modified.	The Committee has no objections to the proposed changes.

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authorised deposit-taking institution (ADI); and b) the repayment requirement applying to unused contributions if the ESS participant discontinues participation. See paragraph 5 of the draft instrument.	B4Q2: Section 1100T refers to 'payments' and 'deductions'. Do you agree that salary sacrifice arrangements are a 'payment'?	The Committee has no objections to the proposed changes.
	B4Q3: Do you agree that salary sacrifice payments should be exempt from the repayment requirement in s 1100T(d)?	The Committee has no objections to the proposed changes.
	B4Q4: Section 1100T(d)(i) refers to deductions ceasing and being repaid after an election to discontinue. Do you agree that s 1100T(d)(i) should also refer to payments ceasing and being repaid after an election to discontinue? If not, please explain why.	The Committee has no objections to the proposed changes.
B5: We are open to considering other technical relief if our stakeholders have identified unintended difficulties with the way the ESS provisions apply to standard employee share schemes (i.e. that are not covered in Section B or Section C of the paper).	B5Q1: Are you encountering any technical difficulties that are not covered in this paper as you apply Div 1A of Pt 7.12 to your employee share scheme? If so, please provide feedback.	The Committee notes the following technical difficulties: (**misleading and deceptive term**): the Committee recommends that s 1100Z be amended to make clear that the various conditions of relief set out in that section do not also require those requirements to be included as terms of the offer itself (which is the current effect of the drafting). For example, on one reading of this section, it is necessary to make it a term of an offer that the grant (and any accompanying offer documentation) is not "misleading and deceptive". Such terms are not required within the ESS terms themselves, rather this being a condition of the relief which, if breached, would result in loss of the relief (see proposed amendment in paragraph 8 of the Marked-up Instrument for further details);

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		(**issue cap**): the Committee considers it desirable to clarify that the number of shares included in calculating the issue cap pursuant to subsection 1100V(1)(b) is limited only to those shares that are offered (which were issued or could have been issued in the previous 3-year period) under an employee share scheme pursuant to offers made under the new ESS regime or ASIC Class Order 14/1000 (**Class Order 14/1000**). As currently drafted, subsection 1100V(1)(b) refers generally to offers made in connection with an employee share scheme, with no requirement that the offers be made under the new ESS regime or Class Order 14/1000. There are a number of instances where an entity may offer securities under an employee incentive scheme but choose not to make such offer under Class Order 14/1000 or the new ESS regime, such as where the proposed participant is a section 708 party. Therefore, the Committee submits that the issue cap should only include offers made under the new ESS regime or Class Order 14/1000. It has no concern with the issue cap including offers covered by section 1100P (offers for no monetary consideration) and section 1100R(1) (offers that do not need disclosure), subject to the above requested amendment being made (see proposed amendment within paragraph 8 of the Marked-up Instrument for further details). Were this change not to be made, it could have the effect of locking certain issuers out from using the new regime until 3 years have passed (which is not the legislative intention); and (**DDO**): as raised in our previous submission, section 994B(3)(c) of the Corporations Act, which disapplies the design and distribution regime from offers of securities that have been or will be issued under an ESS, has been repealed with effect from 1 October 2022. The Committee submits that the application of section 994B(3)(c) should also continue to apply with respect to

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		offers made under an ESS (whether utilising the ESS class orders or not) before *or after* 1 October 2022. It would be inappropriate for the benefit of that provision to be lost to any issuer who has relied on either ESS class order relief (between 1 October 2022 and 31 December 2022) or other provisions of the Corporations Act (e.g. s 708(1), or use of an offer information statement for an offer) to be lost purely because offers are made or remain open after 1 October 2022. The Committee understands that this recommendation will need to be dealt with under a new legislative instrument made by ASIC under section 994L of the Corporations Act however, for completeness it considers it important to flag this issue. (**Scope of "liquidity event"**): Paragraphs 44 and following of CP364 explain why ASIC is not presently minded to consider modifying the definition of "liquidity period" in section 1100ZB(7) to extend it to cover ESS interests that are issued by an entity which has sold or a substantial part of its business (an "asset sale exit"). Not making this change has the potential to undermine the objectives of the new provisions which were described by (then) Treasurer Josh Frydenberg as being to "… expand the availability of employee share schemes to more companies and employees, and allow employees to benefit from a larger share of the business[es]' growth".[1] The Explanatory Memorandum to the bill which introduced the new provisions said "the monetary cap does not apply when there is a liquidity event, such as *a business being purchased* or listed on a financial market". In reality, s 1100ZB(7) only provides for two out of the three common types of "liquidity event": an IPO, and a disposal via a share sale. It does not cover a sale of a business

[1] *"Huge incentives to be allowed under new changes to share schemes"*, Australian Financial Review 25 March 2022 (accessed on 17 October 2022 at https://www.afr.com/politics/federal/huge-incentives-to-be-allowed-under-new-changes-to-share-schemes-20220325-p5a7yj).

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		(also known as an "asset sale"), notwithstanding that this is a recognised means of disposing of an undertaking (and following which the proceeds, net of transaction costs and other liabilities, are distributed to shareholders and other equity owners). Further support for including a business or asset sale as one of the liquidity period events comes from the fact that the standard "start-up" option plan published on the ATO's website lists a "business sale" as one of the three exits which trigger exercise of start-up options (this is significant since virtually all start-up companies in Australia adopt these standard option plans given the concessional tax treatment afforded to participants under those plans).[2] The Committee urges ASIC to give further consideration to a modification of this kind having regard to the above considerations.

[2] See an "Employee Option Plan" at https://www.ato.gov.au/General/Employee-share-schemes/In-detail/ESS---Standard-documents-for-the-start-up-concession/ (see definitions of "Exit Event" and "Business Sale").

Annexure A – Marked-up Instrument

[Attached separately]