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TREASURY LAWS AMENDMENT (MEASURES FOR A LATER SITTING) BILL  
2020: EMPLOYEE SHARE SCHEMES

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EXPOSURE DRAFT EXPLANATORY MATERIALS



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# ***Glossary***

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<b><i>Abbreviation</i></b>	<b><i>Definition</i></b>
ASIC	Australian Securities and Investments Commission



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# **Chapter 1**

## **Regulatory Relief for Employee Share Schemes**

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### **Outline of chapter**

- 1.1 This Chapter provides an overview of the amendments in Schedule 1 to the Bill. These amendments make it easier for businesses to create employee share schemes.
- 1.2 References to the Act are to the *Corporations Act 2001*.

### **Context of amendments**

- 1.3 An employee share scheme is an arrangement put in place by a business to reward people who contribute to the business with shares or other interests in the business in exchange for their labour.
- 1.4 Employee share schemes are often used by start-ups and cash poor businesses to attract employees when the business would be unable to compete with the salary and wages offered by larger and more established businesses.
- 1.5 Participants are generally offered the ability to join an employee share scheme for a business when they start their employment with the business or reach a new level of seniority with the business. Participants can generally choose whether to participate in an employee share scheme.
- 1.6 Employee share schemes come in many different forms. Employee share schemes:
- can be offered in addition to salary and wages;
  - can be offered to all or only certain groups of people participating in the business (such as employees of a certain seniority, directors or independent contractors);
  - can be in shares or other interests in the business (such as options or units in a trust); and
  - can require the employee to make payments or take out loans to participate in the scheme.
- 1.7 Businesses can offer the interests to participants under an employee share schemes in different ways. Employee share schemes:

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- can be created by separate offer rounds where a business offers interests to participants, with a deadline for those participants to accept the offer; or
  - can be permanently open allow people who participate in the business to join the scheme at any time.

1.8 The Act contains a variety of rules for people who issue financial products and securities. These rules include a requirement to obtain an Australian financial services licence and restrictions on hawking and advertising and disclosure requirements.

1.9 Financial products and securities offered as a part of certain employee share schemes are excluded from some of these requirements under the Act.

1.10 Further exclusions are made in ASIC class orders CO 14/1000 and CO 14/1001. Class Order 14/1000 relates to listed body corporates and Class Order 14/1001 relates to unlisted body corporates.

1.11 As part of the Government's JobMaker Plan, the Government is committed to reducing red tape for business, supporting job creation and competitive remuneration, and incentivising employers and employees to work together to secure a strong and sustained post COVID economic recovery.

1.12 Going forward, employers offering employee share schemes, where employees do not have to pay or borrow to participate in an employee share scheme, and the employer is not otherwise engaged in regulatory avoidance, will not have to consider or comply with any requirements under the Act in respect of the employee share scheme.

1.13 These reforms build on the:

- Government's previous announcement on 13 November 2018 that it would streamline the exclusions under the Act and ASIC class orders to make it easier for businesses to offer employee share schemes; and
- Consultation paper released on 3 April 2019 outlining possible approaches.

## **Summary of new law**

1.14 If an employee share scheme is offered to directors and employees, and does not require payment to participate:

- the scheme can be operated without an Australian financial services licence;

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- general financial advice can be provided in relation to the scheme without an Australian financial services licence;
  - the restrictions on advertising and hawking securities and financial products in the Act do not apply to the scheme; and
  - no disclosure requirements apply to offers under the scheme.

1.15 The same relief is available to an employee share scheme which requires payment to participate or is offered to independent contractors if certain requirements are met.

1.16 In simple terms, an employee share scheme will meet these requirements if:

- the interests issued to participants under the scheme fall within certain eligible categories of interests (for example – shares or options);
- the participants in the scheme are directors, employees or independent contractors;
- if it requires payment to participate or is offered to independent contractors:
  - if the scheme has an associated contribution plan, loan or trust, the contribution plan, loan or trust meet certain requirements;
  - the total numbers of products issued under the scheme over the previous three years does not exceed the specified percentage of the body’s issued capital (5% for listed bodies or 20% for unlisted body corporates ); and
  - for an unlisted body corporate, no participant receives more than \$30,000 worth of interests under the scheme in a 12 month period.

1.17 Generally for an employee share scheme which requires payment to participate or is offered to independent contractors, the interests issued under the scheme to participants must be:

- for listed body corporates, the interest must be able to be traded on a financial market, and be one of the below types of interests:
  - a fully paid share;
  - a beneficial interest in a fully paid share;
  - a stapled security; or
  - a unit in, an incentive right in relation to, or an option to acquire one of the above interests;

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- for unlisted body corporates:
    - a fully paid ordinary share; or
    - a unit in, an incentive right in relation to, or an option to acquire a fully paid ordinary share;
  - for registered schemes:
    - an interest in the registered scheme that is tradable on a financial market; or
    - a unit in, an incentive right in relation to, or an option to acquire an interest in the registered scheme that is tradable on a financial market.

1.18 Employee share schemes which require payment to participate or are offered to independent contractors under the Bill will be required to provide the below disclosure for each offer under the scheme:

- for a listed body corporate or registered scheme – certain warnings;
- for an unlisted body corporate:
  - certain warnings;
  - certain financial information about the body corporate;
  - a valuation of the interests; and
  - a directors' solvency resolution.



## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
If an employee share scheme allows employees or directors to participate without requiring payment the scheme is generally not required to comply with the Act.	Employee share schemes that do not require payment to participate are required to comply with a variety of obligations under the Act.
If an employee share scheme requires payment to participate or is offered to independent contractors, the scheme must comply with a streamlined set of obligations under the Act. This relief is available even if the scheme has an associated loan or contribution plan which requires participants pay for the interest.	Employee share schemes that allow independent contractors to participate are required to comply with a variety of obligations under the Act.
<b><i>For unlisted schemes</i></b>	
An employee share scheme can only receive regulatory relief if each participant has received less than \$30,000 worth of interests from the scheme over the previous 12 months.	An employee share scheme can only receive relief if each participant has received less than \$5,000 worth of interests from the scheme over the previous 12 months.
<b><i>For listed schemes</i></b>	
An employee share scheme can receive regulatory relief regardless of how long the interests offered under the employee share scheme have been traded.	An employee share scheme can only receive regulatory relief if the interests offered under the scheme have been traded for 3 months before the offer is made.
An employee share scheme can receive regulatory relief regardless of whether the interests offered under the employee share scheme had been suspended from trading.	An employee share scheme can only receive relief if the interests offered have been not been suspended for more than 5 days from trading over the previous 12 months.
<b><i>For both listed and unlisted schemes</i></b>	
An employee share scheme can receive regulatory relief without disclosure, where those offers would otherwise not require disclosure under the Act (for example offers to senior managers).	An employee share scheme can only receive regulatory relief with disclosure, even if the scheme would otherwise not require disclosure under the Act (for example offers to senior managers).

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## Detailed explanation of new law

### *Regulatory relief for employee share schemes*

1.19 If an employee share scheme allows directors and employees to participate without requiring payment:

- the scheme can be operated without an Australian financial services licence; [*Schedule 1, item 36, section 1100K*]
- general financial advice can be provided in relation to the scheme without an Australian financial services licence; [*Schedule 1, item 36, section 1100K*]
- the restrictions on advertising and hawking securities and financial products in the Act do not apply to the scheme; and [*Schedule 1, item 36, section 1100K*]
- no disclosure requirements apply to offers under the scheme. [*Schedule 1, item 36, section 1100K and subdivision C*]

1.20 An employer that is a national system employer is still required to comply with the requirements of the *Fair Work Act 2009* in relation to their employees. This includes paying wages in line with any applicable modern award or enterprise agreement, or the National Minimum Wage Order for award and agreement free employees. Any ESS offer must be in addition to these wages, which must be paid in full and in money.

1.21 If an employee share scheme requires payment to participate, or is offered to independent contractors and the scheme meets the requirements in the Bill:

- the scheme can be operated without an Australian financial services licence; [*Schedule 1, item 36, section 1100K*]
- general financial advice can be provided in relation to the scheme without an Australian financial services licence; [*Schedule 1, item 36, section 1100K*]
- the restrictions on advertising and hawking securities and financial products in the Act do not apply to the scheme; and [*Schedule 1, item 36, section 1100K*]
- a streamlined set of disclosure requirements apply to the scheme. [*Schedule 1, item 36, section 1100K and subdivision C*]

1.22 This relief also applies in relation to any contribution plan or loan which is related to the employee share scheme. [*Schedule 1, items 8 and 36, section 9 definition of ‘managed investment scheme’ and section 1100K*]

1.23 The relief applies to any person associated with the employee share scheme such as the:

- the body which issues the interests under the scheme;

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- an associated body corporate to the above corporation; or
  - a trustee which is engaged to manage the employee share scheme.

*[Schedule 1, item 36, subsection 1100K]*

1.24 This will allow businesses to run their own employee share schemes, without having the same regulatory obligations of financial services providers. This is appropriate because these regulatory obligations are designed for arm's length transactions to consumers, unlike an employee share scheme, where there is a pre-existing employment relationship between the business and participant.

1.25 Employee share schemes which apply to independent contractors are subject to stricter requirements under the Bill because independent contractors do not receive the same workplace protections as employees under the *Fair Work Act 2009*.

### ***Requirements for an employee share scheme***

1.26 An employee share scheme which requires payment to participate or is offered to independent contractors will be entitled to relief if:

- the interests issued to participants under the scheme are ESS interests; *[Schedule 1, items 7 and 36, section 9, definition of 'ESS interest' and section 1100F]*
- the participants in the scheme are ESS participants; *[Schedule 1, items 7 and 36, section 9 definition of 'ESS participant' and section 1100E]*
- if the scheme has an associated contribution plan, loan or trust, the contribution plan, loan or trust meet certain requirements; *[Schedule 1, items 7 and 36, sections 9 definitions of 'ESS contribution plan' and 'ESS loan', 1100E(5) to (7) and 1100J(1)]*
- the total numbers of products issued under the scheme over the previous three years does not exceed the specified percentage of the body's issued capital (5% for listed bodies or 20% for unlisted body corporates ); and *[Schedule 1, item 36, section 1100J(2) to (3)]*
- for an unlisted body corporate no participant receives more than \$30,000 worth of interest under the scheme in a 12 month period. *[Schedule 1, item 36, section 1100J(4) to (6)]*

### ***ESS participants***

1.27 For an individual to participate in an employee share scheme they must be an ESS participant.

1.28 An ESS participant is:

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- an employee of:
    - the body corporate issuing the ESS interests; or
    - an associated body corporate to the body corporate issuing the ESS interests;
  - a director of:
    - the body corporate issuing the ESS interests; or
    - an associated body corporate to the body corporate issuing the ESS interests;
  - a independent contractor who is predominantly providing services to:
    - to the body issuing the ESS interests; or
    - an associated body corporate to the body corporate issuing the ESS interests;
  - in the case of an employee share scheme by a listed registered scheme, an employee of, director of, or independent contractor providing services predominantly to:
    - the responsible entity of the listed registered scheme; or
    - an associated body corporate to the responsible entity of the listed registered scheme.

*[Schedule 1, item 7, item 36, section 9, the definition of ‘ESS participant and section 1100E(2)]*

1.29 An employee includes a casual, part time or full time employee. The requirement that a casual employee being working for at least 40% of the hours of a full time employee to participate in the employee share scheme in the ASIC class orders has been removed by not replicating it from the class orders.

1.30 Directors includes executive and non-executive directors as well as salaried and non-salaried directors.

1.31 A person can also participate in the employee share scheme if they are about to become one of the above eligible categories (i.e. a person who has received an offer to become an employee of the body operating the employee share scheme and they intended to accept that offer). *[Schedule 1, item 36, section 1100E(2)(d)]*

1.32 A person can participate in an employee share scheme under the Bill, by having their ESS interest provided to:

- an immediate family member;
- a body corporate where all members of the body corporate are either the participant or immediate family members;

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- a body corporate that is the trustee of a self-managed super fund.

*[Schedule 1, item 36, section 1100E(3) and (4)]*

### ***ESS interests***

1.33 For an employee share scheme to receive relief under the Bill, the interests offered to participants must fall within certain eligible category of interests, referred to in the Bill as ***ESS interests***.

1.34 The ESS interests for a listed body corporate are:

- if the interest is tradable on a financial market operated by a market licensee or an approved foreign market:
  - a fully paid share;
  - a beneficial interest in a fully paid share;
  - an fully paid share which can be converted into a beneficial interest in a fully paid share (or visa versa) without charge or for a nominal fee;
  - a fully paid stapled security consisting of fully paid shares or beneficial interests in fully paid shares;
  - a unit in, an incentive right, or an option to acquire, any of the above interests;

*[Schedule 1, item 36, section 1100F(1)]*

- if the interest is not tradable on a financial market operated by a market licensee or an approved foreign market;
  - a unit in, an incentive right, or an option to acquire, any of the above interests which is not acquired or exercisable upon payment. *[Schedule 1, item 36, section 1100F(1)(e)(ii)]*

1.35 The ESS interests for an unlisted body corporate are:

- a fully paid ordinary share; or
- a unit in, an incentive right, or an option to acquire a fully paid share.

*[Schedule 1, item 36, section 1100F(2)]*

1.36 The ESS interests for a listed registered scheme are:

- an interest in a listed registered scheme which is tradable on a financial market operated by a market licensee or an approved foreign market; or
- a unit in, an incentive right, or an option to acquire an interest in a listed registered scheme which is either:

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- tradable on an a financial market operated by a market licensee or an approved foreign market; or
  - the unit, right or option is not acquired or exercisable upon the payment.

*[Schedule 1, item 36, section 1100F(3)]*

1.37 An incentive right is a right to be issued a security or financial product or a right to be paid a cash amount where the right is contingent on:

- the price or value of the security or financial product;
- the change in the price or value of the security or financial product;
- the amount of dividends or distributions paid in respect of an the security or financial product; or
- the change in the amount of dividends or distributions paid in respect of an the security or financial.

*[Schedule 1, item 7, section 9, the definition of ‘incentive right’]*

1.38 A wider variety of interests are permitted for listed body corporates, as the markets for these interests are more liquid, compared to interests in unlisted body corporates. However, interests in listed body corporates, which are not themselves able to be traded are more restricted, as these interests, like those in unlisted body corporates, lack liquid markets that participants can use to manage financial risks associated with these interests. Accordingly, such interests are only eligible if they are provided to the participants for free.

1.39 The requirement that a listed product have been traded for at least 3 months on the financial market operated by a market licensee or an approved foreign market before an employee share scheme by a listed body corporate can be eligible for relief has been removed by not replicating this requirement in the ASIC class order.

1.40 The requirement that a listed product not be suspended from trading for more than 5 days over the previous 12 months before an eligible employee share scheme can be eligible for relief has been removed by not replicating this requirement in the ASIC class order.

1.41 Removing these requirements will allow an employee share scheme to be eligible for relief immediately, making it easier for body corporates to give employees a stake in the success of a growing body corporate.

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### ***ESS loans***

1.42 An employee share scheme can be eligible for relief even if it has an associated loan. However the loan must meet certain requirements (referred to in the Bill as an ‘ESS loan’).

1.43 Participants will take out the ESS loan as a part of the employee share scheme and then make repayments on the ESS loan. This allows the participants to fully acquire the interests and to immediately exercise any rights in association with the interests (for example, voting rights) while making repayments.

1.44 Previously loans were only permitted in relation to employee share schemes created by listed body corporates. However ESS loans are now permitted in relation to employee share schemes created by unlisted body corporates, if the loan meets certain requirements.

1.45 The ESS loans can be given by the body offering the scheme or a third party.

1.46 For an employee share scheme with an associated ESS loan to be eligible for relief under this Bill, it must:

- have no interest or fees payable; and
- in the event of non-payment of the ESS loan, the rights of the scheme against the ESS participant or related person, are wholly limited to forfeiture of the ESS interests acquired using the loan.

*[Schedule 1, items 7 and 36, section 9 definition of ‘ESS loan’ and 1100J(1)]*

1.47 Body corporates will have to comply with normal regulatory obligations if they provide ESS loans which do not meet the requirements in the Bill (i.e. loans which allow recovery of property other than the ESS interest and loans with fees or interest). This is because the employee may contribute more than the value of the ESS interest they acquired under the ESS loan and therefore suffer significant financial loss.

### ***ESS contribution plans***

1.48 Employee share schemes can have contribution plans associated with the scheme to allow participants to contribute to the purchase of the interests over time and still receive regulatory relief under the Bill.

1.49 Contribution plans generally require the ESS participants to make repayments or allow for deductions to be made from their salary or wages.

1.50 An employee share scheme can be eligible for relief under this Bill even if it has an associated contribution plan. However the

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contribution plans must meet certain requirements (referred to in the Bill as an ‘ESS contribution plan’).

1.51 For an employee share scheme with an associated ESS contribution plan to be eligible for relief, the ESS contribution plan must:

- only relate to fully paid shares or units in, incentive rights granted in relation to or options to acquire fully paid shares;
- have contributions held on trust in an account with an Australian ADI which is solely kept for that purpose;
- allow the participant to discontinue from the deductions or payments at any time;
- if the participant decides to discontinue, within 45 days any deductions from salary or wages must cease and all deductions or payments, not yet exchanged for ESS interests, must be repaid to the participant; and
- before participating in the plan, the ESS participant must agree in writing to the terms of the plan.

*[Schedule 1, items 7 and 36, section 9 definition of ‘ESS contribution plan’ and 1100J(1)]*

### ***Trustees managing an employee share scheme***

1.52 A business can create an employee share scheme using a trustee to manage the ESS interests, and still obtain relief under the Bill, if the trust meets certain requirements.

1.53 The trust will meet the requirements of the Bill, if the trust deed sets out that:

- the activities of the trustee are limited to managing the employee share scheme;
- the trustee keeps written records on the administration of the trust;
- the trustee does not charge any fees or charges for administering the trust, other than reasonable disbursements;
- if the trustee is an associated body corporate of the body corporate issuing the ESS interests or the responsible entity of the listed registered scheme – that the trustee only exercise voting rights in accordance with the instructions of the ESS participants or consistently with their fiduciary duties; and
- the trustee will not hold more than:



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- for a listed body corporate or listed registered scheme—5% of the fully paid ordinary shares of the body corporate or interests in the listed registered scheme; or
  - for a body corporate that is not listed—20% of the fully paid ordinary shares of the body corporate.

*[Schedule 1, item 36, section 1100E(5) to (7)]*

1.54 The requirements are generally designed to minimise financial risk for the ESS participants, ensure the trustee acts in the best interests of the ESS participants and minimise the possibility of conflicts of interest.

1.55 If the employee share scheme is operated by a trustee, the ESS interest is taken to be offered by the body corporate to the ESS participant. *[Schedule 1, item 36, section 1100E(7)]*

### ***The issue cap***

1.56 An offer from an employee share scheme which requires payment to participate can only be eligible for relief if it complies with the issue cap. *[Schedule 1, item 36, section 1100J(1) to (2)]*

1.57 Employee share schemes are only intended to allow businesses to attract and keep employees. They are not intended to allow body corporates to raise funds. If a body corporate wishes to raise funds it must use other means (for example, issuing shares under a prospectus).

1.58 The issue cap limits the proportion of its share capital a body corporate can issue under an employee share scheme to ensure the offer is genuinely for attracting and retaining employees.

1.59 The issue cap also limits the proportion of shares that may be subsequently issued under ESS interests made as part of an offer under an employee share schemes (for example, an offer of options under an employee share schemes which can be exercised and result in shares being issued 12 months later).

1.60 An offer by an employee share scheme complies with the issue cap if the sum of the two below numbers do not exceed the specified percentage of interests actually issued by the body corporate:

- the number of shares that may be issued, directly or indirectly, as a result of the offer; and
- the number of shares that have been issued or could be issued as a result of previous offers under an employee share scheme made during the previous three years.

1.61 The specified percentage is 5% for listed body corporates and 20% for unlisted body corporates. *[Schedule 1, item 36, section 1100J(3)]*

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1.62 The issue cap does not apply to interests issued under an employee share scheme where payment is not required to participate. *[Schedule 1, item 36, section 1100J(1)(b)]*

***The offer value cap***

1.63 There is no cap on the value of interests that can be issued under an employee share scheme by a listed body corporate or a listed registered scheme for the ESS relief under the Bill to apply. This is because it is less likely that cash-flow considerations are driving a listed body corporate to substitute ESS interests for cash wages.

1.64 However the value of interests in an unlisted body corporate offered under an employee share scheme may be difficult for a participant to quantify. Therefore a participant who makes payments to acquire interests in an unlisted body corporate under an employee share scheme may be exposed to significant financial risk. Similarly, an independent contractor who is participating in an employee share scheme, even if not being required to make a payment to participate, may be exposed to significant financial risk, if their participation is a significant portion of the remuneration for their work.

1.65 Because of this risk, to be eligible for relief under the Bill, an employee share scheme of an unlisted body corporate, which requires payment to participate or which is made to independent contractors can only offer \$30,000 worth of interests to each participant over a 12 month period. *[Schedule 1, item 36, section 1100J(4)]*

1.66 The value has been increased from \$5,000 to create efficiencies of scale for businesses seeking to set up an employee share scheme, having regard to likely overall remuneration packages.

1.67 When calculating the value of interests offered to participants under an employee share scheme, offers which would not require disclosure under the Act are not included. These include offers to senior managers and small scale offerings under section 708 of the Act. *[Schedule 1, item 36, section 1100J(5)]*

1.68 Excluding offers which would not need disclosure under the Act from the value cap mean that unlisted businesses can offer ESS interests to their senior management without any cap on their value. This exemption is appropriate as senior management are generally more financially sophisticated than other employees taking part in an employee share scheme and are therefore in less need of the consumer protections under the Bill.

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### ***Disclosure for offers under employee share schemes***

1.69 Disclosure under an employee share scheme is required where payment is required to participate or the offer is made to independent contractors. *[Schedule 1, item 36, section 1100N(1)]*

1.70 An employee share scheme can rely on other existing exemptions in the Act when making an offer of ESS interests under an employee share scheme, for instance, in making offers only to senior managers (see section 708 of the Act). *[Schedule 1, item 36, section 1100N and 1100M]*

1.71 However, if no other existing disclosure exemptions apply, an employee share scheme is required to provide the below disclosure documents to each ESS participant when making an offer (referred to in the Bill as an ‘ESS offer’):

- for a listed body corporate or listed registered scheme – an ***ESS offer document***;
- for an unlisted body corporate:
  - an ESS offer document;
  - certain financial information about the body corporate;
  - a valuation of the interests;
  - a directors solvency resolution; and
- if the offer is made with a related ESS loan, ESS disclosure documents in relation to the loan;
- if the offer is made with a related ESS contribution plan, ESS disclosure documents in relation to the ESS contribution plan; and
- if the interests are to be held by a trustee for the participants, disclosure in relation to the trustee.

*[Schedule 1, items 7 and 36, section 9, definition of ‘ESS offer’ and sections 1100P to 1100T]*

1.72 Failure to provide the above disclosure documents (referred to in the Bill as ***ESS disclosure documents***) is an offence and a civil penalty provision. *[Schedule 1, items 7 and 36 to 38, sections 9, definition of ‘ESS disclosure document’, 1100P and 1317E and Schedule 3]*

1.73 The penalty for failing to provide an ESS offer document to each ESS participant in relation to an ESS offer is 15 years in prison. *[Schedule 1, item 36 and 38, section 1100P(1) and Schedule 3]*

1.74 The penalty for failure to provide any of the other ESS disclosure documents to each ESS participant in relation to an ESS offer is 5 years in prison. *[Schedule 1, item 36 and 38, section 1100P(2) and Schedule 3]*

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1.75 These penalties are consistent with other provisions in relation to failing to provide disclosure documents (see Part 6D.3 Division 1 of the Act).

*Disclosure for listed body corporates and listed registered schemes*

1.76 Each ESS participant receiving an ESS offer from a listed body corporate or a listed registered scheme must be provided with an ESS offer document.

1.77 For a listed body corporate, the ESS offer document must:

- include the terms of the offer, or a summary of the terms of the offer with a statement that, on request, a copy of the full terms of the offer will be provided to the ESS participant;
- provide general information about the risks of acquiring and holding the interests being offered;
- state that advice given in relation to the offer does not take into account the participants objectives, financial situation and needs;
- suggest that the ESS participant obtain personal advice in relation to the offer;
- explain how the participant may, from time to time, calculate the value of the interests; and
- state the application period during which ESS participants may accept the ESS offer.

*[Schedule 1, item 36, section 1100Q(1)]*

1.78 The disclosure requirements for a listed body corporate or listed registered scheme are less onerous than those for an unlisted body corporate as the value of an ESS interest which is listed is easy to ascertain when compared to an unlisted body corporate.

*Disclosure for unlisted body corporates*

1.79 Each ESS participant receiving an ESS offer from an unlisted body corporate must be provided with:

- an ESS offer document;
- certain financial information about the body corporate;
- a valuation of the interests; and
- a directors solvency resolution.

*[Schedule 1, item 36, sections 1100P and 1100R]*

1.80 For an unlisted body corporate, the ESS offer document must:

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- include the terms of the offer, or a summary of the terms of the offer with a statement that, on request, a copy of the full terms of the offer will be provided to the ESS participant;
  - provide general information about the risks of acquiring and holding the interests being offered;
  - state that advice given in relation to the offer does not take into account the participants objectives, financial situation and needs;
  - suggest that the ESS participant obtain personal advice in relation to the offer;
  - explain how the participant may, from time to time, calculate the value of the interests;
  - state the application period during which ESS participants may accept the ESS offer;
  - state whether the financial information accompanying the offer has been audited; and
  - state that the ESS interest may not have any value and that the value of the interest will depend on future events that may not occur.

*[Schedule 1, item 36, section 1100Q]*

1.81 The financial information about an unlisted body corporate, which must be provided with an ESS offer to each ESS participant is:

- if the body corporate must lodge a report for a financial year with ASIC under section 319 of the Act—a copy of the most recent report lodged with ASIC; or
- if the body corporate is a registered foreign body corporate—a copy of the most recent balance sheet lodged with ASIC under section 601CK; or
- a balance sheet and profit and loss statement prepared in compliance with the accounting standards.

*[Schedule 1, item 36, section 1100S]*

1.82 The valuation of the ESS interests which must be provided by an unlisted body corporate with an ESS offer to each ESS participant must:

- be less than 1 month old;
- explain the method used to conduct the valuation;
- be conducted on a reasonable basis;

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- if the body corporate has a turnover of greater than \$50 million – the valuation must be an independent expert valuation; and
  - if the body corporate had a turnover of less than \$50 million – the valuation must be an independent expert valuation or a directors’ valuation resolution.

*[Schedule 1, item 36, section 1100T]*

1.83 The ATO’s safe harbour methodology for valuing ESS interests under *Legislative Instrument – Income Tax Assessment (ESS 2015/1)* will likely be considered a reasonable basis for a director’s valuation of ESS interests under the Bill.

1.84 An ESS offer by an unlisted body corporate must also provide a copy of a positive solvency resolution for the body corporate, passed within 1 month prior to the offer being made. This resolution will act as a promise to the ESS participant from the management of the body corporate that the body corporate is solvent. *[Schedule 1, item 36, section 1100R(c)(iii)]*

1.85 The policy intent is for body corporates, where possible, to be able to use the same valuations that they make, to assist participants with determining their income tax liabilities.

*ESS offer disclosure for ESS loan or ESS contribution plan*

1.86 If an ESS offer is made with a related ESS loan or ESS contribution plan, each ESS participant receiving the ESS offer must be provided with:

- the terms of the loan or contribution plan; or
- a summary of the terms and a statement that the full terms will be made available upon request.

*[Schedule 1, item 36, section 1100R(a)]*

1.87 This requirement applies regardless of whether the ESS offer is made by a listed body corporate, listed registered scheme or unlisted body corporate.

*ESS offer disclosure for an trustee*

1.88 If an ESS offer is made with a related trust:

- the trust deed; or
- a summary of the trust deed and a statement that the deed will be made available upon request.

*[Schedule 1, item 36, section 1100R(b)]*

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1.89 This requirement applies regardless of if the ESS offer is made by a listed body corporate, listed registered scheme or unlisted body corporate.

1.90 If a person has provided an ESS participant in an employee share scheme a summary of the terms of the employee share scheme or an associated loan, contribution plan or trust and the participant then requests the full terms, the person must then provide the full terms within 10 days. *[Schedule 1, item 36, section 1100U]*

1.91 Failure to comply is a strict liability offence and a civil penalty. *[Schedule 1, items 36 to 38, section 1100U (4) and (5), section 1317E and Schedule 3]*

1.92 The offence has the penalty of 50 penalty units. *[Schedule 1, items 36 and 38, section 1100U and Schedule 3]*

### ***Vesting and exercise valuations***

1.93 If an unlisted body corporate has provided a unit, option or incentive right to a participant under an ESS offer and the unit, option or incentive right are to vest, the body corporate must provide the participant with a valuation. *[Schedule 1, item 36, section 1100V(1)]*

1.94 The valuation which is provided:

- must be made 1 month before the units or options will be exercised or the incentive rights will vest; and
- the valuation must be provided to the participant in the employee share scheme 14 days before the exercise or vesting day;
- the valuation must set out the method used to conduct the valuation;
- the valuation must be conducted on a reasonable basis;
- if the body corporate has a turnover of greater than \$50 million – the valuation must be an independent expert valuation; and
- if the body corporate had a turnover of less than \$50 million – the valuation must be an independent expert valuation or a directors' valuation resolution.

*[Schedule 1, item 36, section 1100V(2)]*

1.95 If the unlisted body does not provide a valuation which meets those requirements, the body corporate must repay all payments made by the participant to acquire the units, options or incentive rights. *[Schedule 1, item 36, section 1100V(3)]*

1.96 An ESS participant who suffers loss or damage because a body corporate does not provide a valuation which meets those requirements,

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can recover the amount of loss or damage from the body corporate.  
*[Schedule 1, item 36, section 1100V(4)]*

1.97 To recover loss or damage because of a failure to provide the valuation, an action must commence within 6 years. *[Schedule 1, item 36, section 1100V(5)]*

1.98 This obligation does not affect any liability of that person under other laws. *[Schedule 1, item 36, section 1100V(6)]*

1.99 The ATO's safe harbour methodology for valuing ESS interests under *Legislative Instrument – Income Tax Assessment (ESS 2015/1)* will be considered a reasonable basis for a director's valuation for valuing ESS interests under the Bill.

### ***ASIC stop orders***

1.100 ASIC may issue a stop order to stop an employee share scheme.

1.101 ASIC may issue a stop order if:

- information in an ESS disclosure document is not worded and presented in a clear, concise and effective manner;
- material in an ESS disclosure document is misleading or deceptive or has not been updated during the application period;
- an ESS offer document does not contain the required warnings;
- a disclosure document which is required to be provided with the ESS offer is not provided; or
- an offer of ESS interests is to be purportedly an ESS offer but is not be an ESS offer.

*[Schedule 1, item 36, section 1100W(1)]*

1.102 Before making the order ASIC must hold a hearing and give a reasonable opportunity to any interested people to make oral or written submissions about whether such an order should be made. *[Schedule 1, item 36, section 1100W(3)]*

1.103 However, if ASIC considers that a delay in making the order caused by holding a hearing would be prejudicial to public interest, ASIC may make an interim order without holding a hearing for 21 days.  
*[Schedule 1, item 36, section 1100W(4)]*

1.104 Such an order by ASIC must be made in writing and be served to the person who is ordered not to offer or issue under the disclosure document. *[Schedule 1, item 36, section 1100W(6)]*



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### ***Notice of intent to create an employee share scheme***

1.105 Before an offer is made under an employee share scheme which requires payment to participate or is offered to independent contractors, the employee share scheme must give written notice to ASIC. *[Schedule 1, item 36 and 38, section 1100G(1) to (2)]*

1.106 If the body corporate or responsible entity of a listed registered scheme fails to give such notice, they will commit an offence. *[Schedule 1, items 36 and 38, section 1100G(3) and Schedule 3]*

1.107 The offence has the penalty of 5 years in prison. *[Schedule 1, item 38, section 1100G(3) and Schedule 3]*

1.108 The penalty is consistent with other provisions in relation to failing to provide disclosure documents (see Part 6D.3 Division 1 of the Act).

1.109 Offers under employee share schemes that do not require payment do not require notification to ASIC. *[Schedule 1, item 36 and 38, section 1100G(1) to (2)]*

### ***Lodging documents with ASIC and public inspection***

1.110 The Bill does not require ESS disclosure documents be lodged with ASIC. However in certain circumstances, ESS disclosure documents may be required to be lodged with ASIC under other provisions of the Act.

1.111 The current law provides that, if an ESS disclosure document is lodged with ASIC, members of the public are entitled to inspect lodged ESS disclosure documents unless (see section 1274 of the Act):

- the employee share scheme relates only to employees;
- the ESS disclosure document relates to ordinary shares;
- the body corporates were incorporated 10 years ago;
- no equity interests in the body corporate or related body corporates are listed for quotation on a stock exchange; and
- the issuing body corporate has an aggregated turnover of less than \$50 million.

1.112 This makes businesses more reluctant to offer employee share schemes as they may result in them making internal financial information public.

1.113 The Bill removes the requirements contained in the first three dot points above so that members of the public are not entitled to inspect ESS disclosure documents if:

- 
- no equity interests in the body corporate or related body corporates are listed for quotation on a stock exchange; and
  - the issuing body corporate has an aggregated turnover of less than \$50 million.

*[Schedule 1, items 39 and 40, section 1274]*

1.114 This will encourage businesses to offer employee share schemes as any internal financial information contained in the ESS disclosure documents is less likely to be made public.

***Prohibitions, defences and penalties***

1.115 A variety of offences, civil penalty provisions and defences apply in relation to disclosure documents for employee share schemes.

1.116 The offences, civil penalty provisions and defences are consistent with other disclosure documents for issuing interests under the Act such as prospectuses (see Part 6D.3 Division 1 of the Act

***Offences***

1.117 A person commits an offence:

- if they make an ESS offer to employees and there is:
  - a misleading or deceptive statement in any of the disclosure documents;
  - a new circumstance arises during the period when the offer is open, which would have been required to be included in the ESS disclosure documents; and
- the misleading or deceptive statement, or the new circumstance, is materially adverse from the point of view of an ESS participant.

*[Schedule 1, item 36, section 1100X(2)]*

1.118 The offence is punishable by 15 years imprisonment. *[Schedule 1, items 36 and 38, section 1100X(2) and Schedule 3]*

1.119 Certain individuals must notify the person making the ESS offer in writing as soon as possible if, during the application period for the offer, they become aware of:

- a misleading or deceptive statement in any of the disclosure documents; or
- a new circumstance arises during the period when the offer is open, which would have been required to be included in the ESS disclosure documents.

*[Schedule 1, item 36, section 1100Z]*

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1.120 The certain individuals who must notify the person making the ESS offer are:

- the person making the offer;
- each director of the body making the offer if the offer is made by a body;
- a person named in any disclosure document with their consent as a proposed director of the body whose securities are being offered;
- a person named in any ESS disclosure document with their consent as having made a statement that is included in the document or upon which the document is based; or
- a person who places or is involved in placing misleading or deceptive statements in the disclosure documents or failing to update disclosure documents in relation to new circumstances.

*[Schedule 1, item 36, sections 1100Y and 1100Z]*

1.121 Failure to make the notification is an offence of strict liability and has a penalty of 120 penalty units. *[Schedule 1, items 36 and 38, section 1100Z and Schedule 3]*

1.122 Such a penalty is appropriate with regard to the Attorney General's Department's Guide to Framing Commonwealth offences. The Guide to Framing Commonwealth Offences notes that strict liability offences are also appropriate where they are likely to enhance the effectiveness of the enforcement regime, and where there are legitimate grounds for penalising persons lacking fault.

1.123 Here a strict liability offence is required to protect the participants in an employee share scheme. The body managing the employee share scheme is in a better position to gain access to information relevant to the value of the ESS interests and should be required to update relevant ESS disclosure documents if circumstances change.

*Civil penalty provisions*

1.124 The civil penalty provisions in the Bill are:

- failing to provide the required ESS disclosure documents to each ESS participant for an ESS offer:

*[Schedule 1, items 36 and 37, section 1100P(3) and 1317E]*

- failing to provide the full terms of an employee share scheme, associated loan, contribution plan or trust to an ESS participant upon request where;

- 
- the ESS participant has been provided a summary of the terms of the employee share scheme or an associated loan, contribution plan or trust deed;

*[Schedule 1, items 36 and 37, section 1100U(5) and 1317E]*

- making an ESS offer with:
  - a misleading or deceptive statement in any of the disclosure documents; or
  - failing to update the disclosure document for new circumstances which would otherwise have been required to be included in the disclosure document during the application period;

*[Schedule 1, items 36 and 37, section 1100X(3) and 1317E]*

1.125 The standard maximum financial penalty for a contravention of a civil penalty provision under the Act applies in relation to the civil penalty provisions (see section 1317G of the Act).

#### *Civil liability provisions*

1.126 A person who suffers loss or damage because of the below defects in an ESS disclosure document can recover the loss or damage from certain other listed persons:

- a misleading or deceptive statement in any of the disclosure documents; or
- a disclosure document is not update for new circumstances which would otherwise have been required to be included in the disclosure document during the application period.

*[Schedule 1, item 36, section 1100Y(1)]*

1.127 The certain other listed persons who damage can be recovered from are:

- the person making the offer;
- each director of the body making the offer if the offer is made by a body;
- a person named in any disclosure document with their consent as a proposed director of the body whose securities are being offered;
- a person named in any ESS disclosure document with their consent as having made a statement that is included in the document or upon which the document is based; or
- a person who places or is involved in placing misleading or deceptive statements in the disclosure documents or failing to

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update disclosure documents in relation to new circumstances.

*[Schedule 1, item 36, section 1100Y(1)]*

1.128 The damage that is recoverable from the certain listed person is limited to the role the listed person had producing the misleading statement or failing to update the ESS disclosure document for the new circumstances. *[Schedule 1, item 36, section 1100Y(1)]*

1.129 Any action for recovering the loss or damage must begin within 6 years of the day on which the loss or damage was caused. *[Schedule 1, item 36, section 1100Y(2)]*

1.130 The Bill does not affect any liability of that person under other laws. *[Schedule 1, item 36, section 1100Y(3)]*

#### *Defences*

1.131 Several defences apply in relation to misleading and deceptive statements and failing to update ESS disclosure documents.

1.132 These defences apply to the offences, civil penalty provisions and civil liability provisions in the Bill which relate to ESS disclosure documents.

1.133 A person does not commit an offence, breach a civil penalty provision and is not liable for damage caused in relation to a misleading or deceptive statement in an ESS disclosure document or failing to update an ESS disclosure document during the application period if:

- the person can prove they made all inquiries that were reasonable in the circumstance; and
- after doing so believe on reasonable grounds that the statement was not misleading or deceptive.

*[Schedule 1, item 36, section 1100ZA]*

1.134 A person does not commit an offence and is not liable for damage caused in relation to a misleading or deceptive statement in an ESS disclosure document or failing to update an ESS disclosure document during the application period if:

- the person proves they did not know the statement was misleading or deceptive.

*[Schedule 1, item 36, section 1100ZB]*

1.135 A person does not commit an offence and is not liable for damage caused in relation to a misleading or deceptive statement in an ESS disclosure document or failing to update an ESS disclosure document during the application period if:

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- the person proves that they placed reasonable reliance on information given to them by:
    - if the person is a body corporate – someone other than a director, employee or agent of the body corporate;
    - if the person is an individual – someone other than an employee or agent of the individual.

*[Schedule 1, item 36, section 1100ZC]*

### ***Subsequent sale provisions***

1.136 Sales of ESS interests by an ESS participant after they receive the interests under an employee share scheme, will generally not require disclosure. This is consistent with the requirements for sales of other interests after their issue under the Act (see section 707 and 1012C of the Act). *[Schedule 1, item 36, section 1100L(1)]*

1.137 However if a sale of an ESS interest by an ESS participant would require disclosure because it was an off-market sale by a person who controls the body issuing the interests under the employee share scheme, the sale will require disclosure (see sections 707 or 1012C of the Act). *[Schedule 1, item 36, section 1100L(2)]*

1.138 The disclosure that will be required for off-market sales by a person who controls the body issuing the ESS interests will be the standard disclosure requirements under the Bill, as if the person who controls the body issuing the interests under the ESS, was issuing the ESS interests to an ESS participant themselves. *[Schedule 1, item 36, section 1100L(3)]*

1.139 Other existing restrictions on the sale of interests after their issue under the Act do not apply to the sale of ESS interests after their issue (such as sales amounting to an indirect issue or sales amounting to indirect off-market sales by controllers under sections 707 or 1012C of the Act).

### ***Consequential Amendments***

1.140 The existing definitions of ‘employee share scheme’, ‘eligible employee share scheme’ and ‘employee share scheme buy-back’ are repealed and replaced by the new definitions inserted by the Bill. *[Schedule 1, items 3, 5 and 6, section 9, definitions of and ‘eligible employee share scheme’, ‘employee share scheme’ and ‘employee share scheme buy-back’]*

1.141 Consequential amendments are made to the definition and uses of ‘contribution plan’ throughout the Act and a new definition of ‘employee share buy-back’ is added. *[Schedule 1, items 1, 4, 9, 10, 11 and 14, section 9, definitions of ‘contribution plan’, ‘employee share buy-back’ and ‘selective buy-back’ and sections 257B and 709]*

1.142 A definition of ‘director’s valuation resolution’ is added to the Act. *[Schedule 1, item 2, section 9, definition of ‘directors valuation resolution’]*

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1.143 An ESS contribution plan is excluded from the definition of a managed investment scheme in section 9 of the Act. *[Schedule 1, item 8, section 9, definition of ‘managed investment scheme’]*

1.144 Amendments are made to sections 703B and 725A to indicate that Part 6D.3A of the Act does not apply to employee share schemes. *[Schedule 1, items 12, 13, 15 and 16, section 703B and 725A]*

1.145 The content relating to employee share schemes in relation to hawking securities and financial products in sections 736 and 992A of the Act is removed as it has been made redundant by the Bill. *[Schedule 1, items 17 to 19 and 23 to 30, section 736 and 992A]*

1.146 The content relating to employee share schemes in section 911A of the Act is removed as it has been made redundant by the Bill. *[Schedule 1, items 20 to 23, section 911A]*

1.147 Amendments are made to section 1010A and 1010BA of the Act to indicate that Divisions 5A, 5B, 5C and 6 do not apply to employee share schemes. *[Schedule 1, items 31, 32, 33 and 34 and section 911A]*

1.148 The general offences in relation to misleading and deceptive conduct in section 1041H of the Act will not apply to employee share schemes, as the Bill replaces them with more targeted obligations. *[Schedule 1, item 35, section 1041H]*

1.149 The Bill covers offers of ESS interests, invitations for applications for the issue of ESS interests and invitations to purchase ESS interests. *[Schedule 1, item 36, section 1100H]*