REPORT 759

Response to submissions on CP 364 Modifications to the ESS regime

March 2023

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 364 *Modifications to the ESS regime* (CP 364) and explains our response to those issues.

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Contents

Overview

Consultation on relief in relation to the ESS provisions

1 Provisions facilitating employee share schemes in Div 1A of Pt 7.12 of the Corporations Act (ESS provisions) commenced on 1 October 2022. On 29 September 2022 we published Consultation Paper 364 *Modifications to the ESS regime* (CP 364).

2 CP 364 sought submissions on a draft legislative instrument addressing technical issues that had been raised with us. We also sought feedback on whether the legislative instrument should cover other unintended consequences that stakeholders had identified about the way the ESS provisions operate (Proposal B5).

3 The consultation was open until 31 October 2022. We received 13 submissions. Four of these submissions were made on a confidential basis. We appreciate all the feedback provided.

4 Section A of this report highlights the key issues that arose out of the submissions received on CP 364 and our responses to those issues. Section B of the report covers other key issues raised in submissions on Proposal B5. The report is not a comprehensive summary of all the submissions we received.

5 For a list of the non-confidential submissions to CP 364, see the appendix to this report. Copies of the non-confidential submissions are currently on the CP 364 page on the ASIC website.

Overview of submissions

6 The submissions in response to CP 364 were supportive of our proposals although there were comments on the drafting of the legislative instrument and arguments in favour of broader relief. As explained in CP 364, we consider it is only appropriate to provide relief to address unintended consequences with the regime. We therefore did not provide relief where law reform would be more appropriate or where the implications of granting relief were difficult to assess.

7 Some respondents requested guidance on how the ESS provisions operate. This report provides observations on some of the issues raised and, in general, we support a commonsense approach to provisions that are intended to facilitate the offer of ESS interests to ESS participants without compromising consumer protection. See also CP 364 at paragraph 3.

Legislative instruments

Termination of ability to make new offers under EIS class orders

8 As noted in CP 364, the ESS provisions are intended to replace Class Order [CO 14/1000] *Employee incentive schemes: Listed bodies* and Class Order [CO 14/1001] *Employee incentive scheme: Unlisted bodies* (EIS class orders). We therefore terminated the ability to make new offers of financial products under the EIS class orders from 1 March 2023, although offers may remain open for acceptance until 1 April 2024: *ASIC Corporations (Amendment) Instrument 2022/1022*. See also the Explanatory Statement for ASIC Instrument 2022/1022.

9 Submissions in response to CP 364 observed that financial products issued under the EIS class orders will continue to require some exemptions after that date (now 1 March 2023). ASIC Instrument 2022/1022 therefore only terminates the ability to make new offers and the other relief provided by the EIS class orders remains. The EIS class orders will sunset on 1 April 2025 under s50 of the *Legislation Act 2003*. We anticipate that after the EIS class orders sunset, we may need to provide further exemptions (including on-sale relief) for financial products issued in reliance on the class orders. We will publicly consult on sunset arrangements in 2024.

Relief in relation to ESS provisions

10 On 16 December 2022, we made *ASIC Corporations (Employee Share Schemes) Instrument 2022/1021* granting relief in relation to:

(a) the requirements for contribution plans in s1100T;

(b) the issue cap in s1100V;

(c) the financial information required from unlisted companies under s1100X(2);

(d) valuation methods in s1100X(3);

(e) the period during which supplementary disclosure is required under s1100Z; and

(f) the secondary sales provision in s1100ZD.

Note: ASIC Instrument 2022/1021 commenced on 20 December 2022. See Media Release (22-370MR) *ASIC provides legislative relief to facilitate employee share schemes* (20 December 2022).

11 The Explanatory Statement for ASIC Instrument 2022/1021 provides guidance on how our modifications to the ESS provisions are intended to operate.

Determination of foreign financial markets

12 On 16 March 2023, we made a determination as to foreign financial markets for the purposes of s1100K: see *ASIC Corporations (Amendment) Instrument 2023/160*. These foreign financial markets are the same as approved foreign markets in *ASIC Corporations (Definition of Approved Foreign Markets) 2017/669*.

A Submissions on our proposals

Key points

This section outlines the key submissions on our proposals to grant relief in CP 364 and our response in relation to:

- secondary sales (see paragraphs 13–21);
- financial information provided by unlisted foreign companies (see paragraphs 22–25);
- valuations provided by unlisted companies (see paragraphs 26–31); and
- the requirements for contribution plans (see paragraphs 32–35).

Secondary sale exemption: Proposal B1 in CP 364

13 Section 1100ZD of the Corporations Act only permits an ESS participant to sell their ESS interests to another ESS participant if the seller reasonably believes they acquired the ESS interest under an employee share scheme and they are selling to another ESS participant.

14 CP 364 proposed to expand the secondary sale exemption for financial products that are quoted on a financial market covered by s1100K: s1100ZD(2). The proposed exemption contained an 'issuer purpose test': see paragraph 16. We also proposed to modify s1100ZD for unquoted products so that a person who acquired the product from the original recipient could on-sell it to other ESS participants: s1100ZD(1).

Note: The foreign financial markets covered by s1100K are set out in ASIC Instrument 2017/669.

Scope of on-sale exemption

15 Respondents argued that ASIC should grant broad secondary sales relief on similar terms to the EIS class orders for all ESS interests (whether quoted or not). Respondents also noted that ESS participants often need to sell their ESS interests to pay tax liabilities arising from the products and that restricting their ability to sell would make ESS offers less attractive.

ASIC's response

As explained in CP 364, we do not consider that it is appropriate to use our relief powers to provide a broad on-sale exemption when s1100ZD, as enacted by Parliament, provides a very narrow exemption due to concern that the ESS regime may be abused. The ESS provisions significantly expand the ability of

unlisted companies to offer ESS interests to ESS participants and therefore the exemption in the EIS class orders is not necessarily appropriate in the context of the ESS provisions. Although some submissions argued that the issue cap in s1100V would help prevent abuse of the ESS regime, we note the cap can be increased.

We therefore granted limited secondary sales relief on substantially similar terms to the relief we consulted on in CP 364.

We note that the Act's disclosure exemptions may also apply to ESS interests (even if s1100ZD is not available). For example, s708(8) may mean that a disclosure document is not required if an ESS participant wants to sell ESS interests issued by an unlisted company to a person who is not an ESS participant but who is a sophisticated investor.

Issuer purpose test for quoted products

16 Our proposed on-sale relief for quoted products required that the ESS interest was not issued with the purpose of being on-sold (issuer purpose test).

17 Some respondents queried the need for an issuer purpose test and raised concerns as to whether it was appropriate in the context of an employee share scheme where ESS participants often intend to sell their quoted interests.

18 Respondents 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*. Further, the issuer must generally confirm with the market operator that there will be no restriction on trading when applying for quotation.

ASIC's response

We decided to retain the issuer purpose test in s1100ZD(2). This is consistent with ASIC's general approach to on-sale relief—for example, see ASIC Instrument 2016/80 at paragraph 5, which removes the seller's on-sale purpose from s707 (but not the issuer purpose test). An issuer purpose test aims to prevent avoidance of the Corporations Act's disclosure regime.

We do not anticipate that a genuine employee share scheme will have difficulty in satisfying the issuer purpose test in s1100ZD(2). For example:

- the mere fact that an employer knows ESS participants have an on-sale purpose does not automatically mean the employer has an on-sale purpose and does not preclude reliance on s1100ZD(2): see Regulatory Guide 173 *Disclosure for on-sale of securities and other financial products* (RG 173) at RG 173.70;

- there is no deeming provision similar to s707(4)—which only applies for the purposes of s707(3);
- 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 company or similar.

In response to submissions on the drafting of the issuer purpose test, we amended the exemption so that the issuer purpose test may still be met even where the ESS interest is issued to a trustee with the intention that the trustee will transfer the interest to the ESS participant: s1100ZD(2)(d).

Offers received outside this jurisdiction

19 Some respondents argued that we should modify s1100ZD further so that our on-sale relief would apply if the ESS interests were originally offered for issue (original offer) outside this jurisdiction.

ASIC's response

We consider that our proposed on-sale relief would apply if the original offer was received outside this jurisdiction.

The ESS provisions do not apply to the original offer due to s1100F. However, any subsequent sale offer that occurs in this jurisdiction will be covered by s1100ZD if the requirements of the section are met (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 subsequently needs to rely on s708A(5) to sell their shares on a market in this jurisdiction.

Timing of the issue of ESS interests and our on-sale exemption for quoted products

20 A respondent suggested that proposed s1100ZD(2) should be amended so that it would apply to ESS interests issued:

(a) before the relief instrument comes into effect; or

(b) before the entity is included in the official list of a market covered by s1100K.

ASIC's response

We considered that proposed s1100ZD(2) did not require any amendment to cover the following situations:

- after the commencement of ASIC Instrument 2022/1021 on 20 December 2022, the exemption will apply provided the requirements of s1100ZD(2) are met at the time of the sale; and

- the original offer for issue of the ESS interests can be made before ASIC Instrument 2022/1021 commenced (provided the sale offer does not occur before this time) and the status of the entity at the time of issue of the ESS interests does not affect whether a subsequent sale is covered by s1100ZD(2).

Underlying financial products and our on-sale exemption

21 Respondents suggested that proposed s1100ZD(2) should be amended to cover financial products issued as a result of another ESS interest—for example, shares issued on the exercise of an option.

ASIC's response

We considered that s1100ZD(2) would cover these underlying financial products because the definition of ESS interest is broad. However, to make this clearer, we changed the wording of the exemption so that the ESS interest only needs to be issued 'in connection' with an employee share scheme rather than 'under' an employee share scheme.

Financial information: Proposal B2 in CP 364

22 Unlisted companies making an offer of ESS interests for monetary consideration under s1100Q are required to provide ESS participants with certain financial information: s1100Q(2)(a) and s1100X(2). If the company does not lodge financial statements with ASIC under s319 or s601CK, it is required to provide a balance sheet and a profit and loss statement that comply with Australian accounting standards or international accounting standards: s1100X(2)(c).

23 Stakeholders reported that some foreign employers would have difficulty complying with s1100X(2) because they operate using an Australian subsidiary and are not required to report under either s319 or s601CK. Where the foreign company prepares financial information that does not comply with either Australian accounting standards or international accounting standards, before our relief they were required to prepare special purpose accounts under s1100X(2)(c). This may have deterred reliance on the ESS regime and resulted in Australian employees missing out on offers made to their international counterparts.

24 CP 364 proposed that these foreign companies could provide financial information prepared under a standard permitted in their place of origin on the condition that they also provided ESS participants with the following additional information:

(a) a statement that there were no material differences between financial statements prepared under the foreign standard and the information that

would be required under Australian accounting standards or international accounting standards; or

(b) a reconciliation of net assets and profit after tax.

25 Respondents were supportive of our proposal but argued that the requirement to provide this additional information would be onerous, require expensive cross-border accounting advice and be of minimal benefit to ESS participants. Some respondents suggested that additional information should only be required if the financial information was not prepared in accordance with a standard that was accepted by ASX or an approved foreign market: see ASIC Instrument 2017/669.

ASIC's response

Most financial standards that are accepted by ASX or an approved foreign market comply with international accounting standards and companies who prepare information in accordance with these standards can rely on s1100X(2)(c)(i). The main standard that does not comply with international accounting standards is US GAAP.

We accepted that it would be onerous to require the proposed additional information where the financial information was prepared in accordance with US GAAP. We therefore amended our proposal so that the additional information is not required if the company reasonably believes that the financial information was prepared in accordance with US GAAP: s1100X(2A) and (2B).

Note: A foreign entity does not need to provide additional information under s1100X(2A) and (2B) if they are relying on s1100X(2)(b) to provide a copy of the most recent financial reports lodged under s601CK or if they are relying on s1100X(2)(c)(i) to provide financial information prepared in accordance with international accounting standards.

Valuations by unlisted companies: Proposal B3 in CP 364

26 Unlisted companies making an offer of ESS interests for monetary consideration relying on s1100Q are required to provide ESS participants with supporting information that indicates the value of the ESS interests: s1100Q(2)(a) and s1100X(3).

27 The main valuation method specified under s1100X is a method approved for tax purposes under s960-412 of the *Income Tax Assessment Act 1997* (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). CP 364 proposed relief to permit a valuation prepared by an independent expert where the ESS interests were not ordinary shares: s1100X(3)(aa).

Exclusion of ordinary shares from expert valuation proposal

28 Respondents supported an alternative valuation method but queried why our proposed relief in s1100X(3)(aa) excluded ordinary shares. In particular, it was submitted that:

(a) established companies may be unable to rely on s1100X(3)(a) because ESS 2015/1 only applies to those who meet the start-up concession requirement in that instrument; and

(b) our proposed exclusion of ordinary shares would be difficult for US companies who routinely obtain valuations of ordinary shares under US requirements that would not come within ESS 2015/1.

ASIC's response

We consider that it is appropriate to exclude ordinary shares issued by an Australian company from our expert valuation proposal. In our view, s1100X(3)(a) does not require the body corporate to have start-up status—it only requires a valuation to be prepared consistently with ESS 2015/1. Where a body corporate can use the valuation method specified under s960-412 of the ITAA 1997, they should do so because this is consistent with Parliament's aim to harmonise the ESS provisions and the tax regime.

However, we recognise that it may be onerous for a foreign company to use ESS 2015/1. For this reason, we amended s1100X(3)(aa) so that it can be used for any ESS interest that is not an ordinary share issued by a 'company'. The definition of 'company' in s9 means a body corporate registered as a company under the Corporations Act. This definition does not extend to foreign companies registered under Pt 5B.2 because they are not a company for the purposes of the Corporations Act. Registration under Pt 5B.2 makes the relevant entity a 'registered foreign company' and a 'registered body' but not a 'company'. Therefore, foreign companies can now rely on s1100X(3)(aa) to provide an expert valuation of ESS interests that are ordinary shares.

Independent expert requirement

29 Respondents argued that the body's auditor, accountant or chief financial officer should be able to prepare the valuation permitted by our proposed relief in s1100X(3)(aa). It was argued that the need for an independent expert would significantly increase the cost, deter reliance on the ESS provisions and provide minimal benefit to ESS participants.

ASIC's response

On balance, we agree that the independence requirement may be unduly onerous in the context of an employee share scheme. We also noted that a valuation prepared by a director may be acceptable for other transactions, provided the director has

sufficient expertise: see, for example, Regulatory Guide 74 *Acquisitions approved by members* (RG 74) at RG 74.32–RG 74.34.

We therefore amended our proposal so that the valuation may be prepared by an expert, which under s9 of the Corporations Act means a person whose profession or reputation gives authority to a statement made by him or her in relation to the valuation. We note that the valuation will be subject to the ESS provisions governing misleading or deceptive statements or omissions: see s1100Z(1)(a) and (f).

Alternative valuation proposals

30 There was a submission that we should provide relief so that a valuation of the ordinary shares could be used where the ESS interests are options or rights to acquire ordinary shares.

31 Some respondents requested that we give relief so that a disclosure document could be used for ESS valuation purposes, whether or not the disclosure document offer was being made at the same time as the ESS offer.

ASIC's response

We did not consider these alternative proposals were appropriate and therefore did not extend the relief in these ways.

- Although it may be easier to obtain a valuation of the ordinary shares, the ESS participant needs to understand the value of the actual ESS interest being offered to them.
- Section 1100X(3) intentionally limits reliance to contemporaneous disclosure documents and there are investor protection issues with using outdated disclosure for valuation purposes: s1100X(3)(b)–(c).

Contribution plans: Proposal B4 in CP 364

32 Section 1100T sets out the meaning of an ESS contribution plan. For relevant purposes, before our relief, s1100T required payments or deductions to be held on trust in an Australian authorised deposit-taking institution (ADI) that is kept solely for that purpose, allows payments or deductions to be discontinued at any time and sets out certain repayment requirements where participation is discontinued.

33 Before publication of CP 364, stakeholders informed us that participants' ability to discontinue deductions at any time and the requirements for repayment in s1100T may cause difficulties. CP 364 explained that we did not consider it would be appropriate to grant relief from the s1100T

requirement that participants have the option to terminate participation in a contribution plan at any time.

34 Stakeholders had also informed us that s1100T would not cater to salary sacrifice arrangements (where an employee elects to receive part of their future monetary entitlements in financial products before earning the entitlement). In contrast, [CO 14/1000] does cater to salary sacrifice arrangements. CP 364 therefore proposed exempting salary sacrifice contributions from the requirement to be held on trust in an Australian ADI and from the repayment requirements. This would be consistent with the requirements for salary sacrifice arrangements under [CO 14/1000].

35 Submissions were supportive of this proposal, but we received feedback that salary sacrifice arrangements are not technically a 'payment or deduction' (as referred to in s1100T before our notional modification).

ASIC's response

Due to feedback that salary sacrifice arrangements are not a 'payment or deduction', we modified s1100T so that it refers to 'contributions' and added a definition of contribution that is consistent with [CO 14/1000]. The class order's requirements for contribution plans are well established and, as far as we are aware, they have been appropriate for salary sacrifice arrangements.

B Other relief or guidance requested

Key points

CP 364 requested feedback on other unintended difficulties with the way the ESS provisions apply to standard employee share schemes: Proposal B5. Submissions in response to CP 364 requested relief or guidance in relation to:

- the operation of s1100R (see paragraphs 36–37);
- the issue cap in s1100V (see paragraphs 38–42);
- disclosure obligations under s1100Y and s1100Z (see paragraphs 43–48);
- the monetary cap in s1100ZA (see paragraphs 49–50);
- the concept of liquidity period in s1100ZB (see paragraphs 51–52); and
- the design and distribution obligations (see paragraphs 53–54).

Operation of s1100R(1)

36 Some participants queried the operation of s1100R(1) and advised that advisers had different interpretations of the provision. It was suggested that ASIC provide confirmation and a note to the section confirming that if an offer is made under s1100R(1), the offer does not need to comply with the ESS provisions.

ASIC's response

We considered that the operation of s1100R(1) is reasonably clear if the provision is considered together with s1100N, 1100ZC and 1100ZG:

- Section 1100N says that an offer of ESS interests to an ESS participant is eligible to be made under Div 1A of Pt 7.12 if it is covered by one of the specified sections, including s1100R and the offer is expressed to be made under the Division.
- Section 1100R(1) says that an offer of ESS interests to ESS participants is covered by the section if the offer would not require disclosure due to a disclosure exemption in Pt 6D.2 or Pt 7.9 (apart from exemptions relating to small-scale offers or offers for no monetary consideration).
- Section 1100ZC provides that various provisions relating to disclosure, licensing and hawking in the Corporations Act do not apply to an offer if it is eligible to be made under Div 1A of Pt 7.12.

- Section 1100ZB then revokes the regulatory relief provided by s1100ZC if an offer relied on a particular provision—for example, s1100Q—and failed to comply with certain other ESS provisions.

If an offer is covered by s1100R(1) it does not need to comply with most ESS provisions—for example, relating to trusts, contribution plans, loans, disclosure or terms. This is because the regulatory relief provided by s1100ZC is not revoked by s1100ZG for non-compliance with these provisions when the offer is covered by s1100R(1). This can be contrasted with offers that are covered by s1100R(2) (small-scale offers)—where regulatory relief is revoked by s1100ZG(3) if there is non-compliance with s1100S (re trusts), s1100T (re contribution plans) or s1100U (re loans.

Note: In order to be covered by s1100R, the offer needs to comply with s1100N.

37 The position regarding s1100R and the issue cap in s1100V is discussed at paragraph 42.

Issue cap

38 Where an entity makes any offers for monetary consideration under s1100Q, it must comply with the issue cap in s1100V. Subject to the entity's constitution, the issue cap is 5% for a listed entity or 20% for an unlisted entity.

ESS interests issued in other jurisdictions or that have expired

39 Some respondents argued that, due to the wording of s1100V(1)(b), the issue cap would include financial products issued (or that could be issued) in other jurisdictions and would therefore be too restrictive for international entities. It was observed that international entities would be unlikely to increase the issue cap via their constitution just for Australian employees.

40 We also received feedback that the wording of s1100V(1)(b) meant that the entity would need to include shares that could have been issued as a result of ESS interests where the offer expired or as a result of ESS interests that had lapsed.

ASIC's response

We do not consider that s1100V was intended to apply to ESS interests issued in other jurisdictions and modified s1100V(1)(b) so that the issue cap only applies to offers of ESS interests received in this jurisdiction.

We also do not consider that s1100V was intended to cover equity that will not be issued. We therefore modified s1100(1)(b) so that it refers to equity that 'may be issued' rather than 'could have been issued'.

Issue cap and earlier employee share schemes

41 Respondents said that it was unclear whether s1100V(1) required the entity to take into account the equity issued to employees under any arrangement that could qualify as an 'employee share scheme', equity issued to persons who happen to be ESS participants or just equity relating to an employee share scheme under Div 1A of Pt 7.12.

ASIC's response

We consider that s1100V(1) relates to any equity that was issued or may be issued under an employee share scheme within the broad definition in s1100L and not just employee share schemes covered by Div 1A of Pt 7.12.

This is because s1100L does not limit the definition to schemes that rely on Div 1A of Pt 7.12. Generally, employee incentive schemes that relied on [CO 14/1000] or [CO 14/1001] would be an employee share scheme within the meaning of s1100L. Therefore, equity that was or may be issued under those incentive schemes needs to be considered for the purposes of s1100V(1)(b).

Issue cap and s1100R

42 There were also queries as to whether s1100V applies to offers made under s1100R.

ASIC's response

If an entity only makes offers covered by s1100R, it does not need to comply with the issue cap in s1100V. However, if the entity also makes offers that are covered by s1100Q (offers for monetary consideration), then it will need to include ESS interests issued or that may be issued as a result of offers covered by s1100R when calculating compliance with the issue cap.

Disclosure obligations

Unlisted companies that become listed

43 The disclosure obligations for listed entities are significantly less onerous than for unlisted companies. For example, if a listed entity offers options for monetary consideration, then the ESS offer document must merely state the

acquisition price of the ESS interest or how it will be determined in the future and how to ascertain the market price of the underlying shares: s1100W(2)(f). In contrast, under s1100Y(4)(a), the terms of the offer require an unlisted company to provide more comprehensive information at least 14 days before the exercise of the option. This includes financial information and a valuation.

44 One submission said that a company which subsequently becomes listed after the grant of options should be able to provide the information required by s1100W(2) rather than the comprehensive information required by s1100Y(4).

ASIC's response

We did not consider it was appropriate to modify s1100W(2) to reduce the disclosure that a company may provide after it becomes listed.

One difficulty with this proposal is that s1100W(2) relates to information in the ESS offer document given to the ESS participant at the time of the original offer whereas s1100Y(4) relates to information required before the option is exercised.

We also consider there are risks with the terms of an offer under s1100Y(4) suggesting that a company may be listed in the future.

Further, many companies undergo a corporate restructure before listing and it is therefore unclear how often this issue will arise.

Term relating to misleading and deceptive statements

45 Concern was expressed that s1100Z(1)(a) requires it to be a term of the ESS offer that the ESS offer document, any supporting information and the terms themselves do not contain misleading or deceptive statements or omissions.

ASIC's response

We did not consider it would be appropriate to make any modifications to s1100Z(1)(a) because the rights of ESS participants under s1100Z(1)(f) to recover loss or damage are based on a contravention of this requirement.

Obligation to update information

46 Section 1100Z(1) contains obligations to update the ESS offer document or supporting information if the offeror becomes aware that the information is out of date or is otherwise not correct in a material respect. A submission was made that s1100Z(1)(b) requires the offeror to provide an updated ESS offer document for an indefinite period.

47 A similar submission was made regarding s1100Z(1)(c) because that provision does not specifically refer to any time period.

ASIC's response

We agreed that the obligation to update under s1100Z(1)(b) may apply for an indefinite time. We therefore modified s1100Z(1)(b) so that the obligation only applies during the application period for the offer (similar to s1100Z(1)(d)).

We did not consider that s1100Z(1)(c) required modification because that provision refers to s1100Y(4)(a). This means that the obligation to update information for options and incentive rights only exists during the period referred to in s1100Y(4)(a).

48 Concern was also expressed that an entity may be required to obtain a new valuation under s1100Z(1)(c) if the company becomes aware that some of the assumptions underpinning a valuation have changed.

ASIC's response

We consider that a company should monitor whether a change in the assumptions would render the valuation out of date or materially incorrect during the exercise period for options or the vesting period for incentive rights. We did not consider it was appropriate to reduce the offeror's obligation to provide an accurate valuation to ESS participants.

Monetary cap

49 If an unlisted company makes an offer of ESS interests for monetary consideration relying on 1100Q, the offer must comply with the monetary cap for ESS participants in s1100ZA. The basic cap amount is $30,000 per participant over 12 months under s1100ZA(6) but this may be increased through distributions received by the participant and cash remuneration conditional on the achievement of objectives: s1100ZA(5).

50 Under s1100ZA(3), the cap extends to offers under 'any employee share scheme operated by the body corporate or an associate of the body corporate'. A respondent queried whether this would include amounts payable on the exercise of options issued before the commencement of Div 1A of Pt 7.12.

ASIC's response

This is a similar issue to the one discussed at paragraph 41 and, in our view, such amounts do need to be included if the options were issued under the broad concept of employee share scheme and the payment could be made within the time frame specified in s1100ZA(3).

Liquidity period

51 Certain amounts are excluded from the monetary cap in s1100ZA if they are payable during a 'liquidity period' for the ESS interests: s1100ZB. A 'liquidity period' includes a period during which:

(a) the ESS interest is in a class of interests that is able to be traded on the official list of a financial market; or

(b) an executed sale agreement, constituting an offer to acquire ESS interests in the same class as the ESS interest, is open for acceptance: s1100ZB(7).

52 There were a few submissions recommending extension of the liquidity period concept. For example, it was recommended that liquidity period should cover:

(a) the sale of a business or major asset (not just an IPO);

(b) where there is an offer to acquire related ESS interests (rather than just agreements to acquire ESS interests in the same class);

(c) typical 'tag along and drag along' rights in a shareholders' agreement.

ASIC's response

The monetary cap under s1100ZA is already high and we did not consider there was a compelling reason to further increase it by expanding the definition of liquidity period in s1100ZB(7). We also considered that the changes recommended would require law reform because, for example, the sale of a business or major asset is very different from an IPO referred to in s1100ZB(7)(a).

Although the definition of liquidity period in s1100ZB(7)(b) will not cover all agreements relating to a sale of ESS interests, we note that the definition is only relevant to calculation of the monetary cap in s1100ZA and does not prevent an ESS participant from participating in an exit opportunity where they have the right to do so.

Design and distribution obligations

53 At the time the ESS provisions were enacted, the design and distribution obligations (DDO) exemption for employee share schemes in s994B(3)(c) was removed: item 25, Sch 4, *Treasury Laws Amendment (Cost of Living Support and Other Measures) Act 2022*. Paragraph 4.210 of the Explanatory Memorandum said that this exemption had been removed because it was redundant due to the disclosure relief provided by the ESS provisions. It is likely that s994B(3)(c) was considered redundant because DDO is generally triggered by an offer to retail clients under a disclosure document (see

s994B(1) and (2)) and the ESS provisions removed the requirement for a disclosure document for employee share schemes.

54 A respondent argued that s994B(3)(c) should continue to apply to offers made under an employee share scheme and that the DDO exemption should be reinstated.

ASIC's response

DDO would not apply to an offer under the ESS provisions (or EIS class orders) because those offers do not require a disclosure document or a Product Disclosure Statement (PDS). However, DDO may apply if financial products are offered to persons under a disclosure document or PDS, even if those persons could qualify as an ESS participant and the offer is made in relation to a plan that could have qualified as an employee share scheme and therefore could have been made under the ESS provisions.

We do not consider it would be appropriate to reinstate the exemption in s994B(3)(c) where an entity has decided to proceed with an offer under the disclosure regime in Ch 6D or Pt 7.9 rather than under the ESS provisions.

In regard to using a disclosure document for an offer of ESS interests, we note that the public inspection exemption for such disclosure documents formerly in s1274(2)(a)(iva) was repealed: item 34 of Sch 4 *Treasury Laws Amendment (Cost of Living Support and Other Measures) Act 2022*. This means that a disclosure document containing an offer of securities to employees must now be made available for public inspection.

Appendix: List of non-confidential respondents

- Arnold Bloch Leibler
- Ashurst
- Automic Group
- Corporations Committee of the Business Law Section of the Law Council of Australia
- Godfrey Remuneration Group Pty Limited
- Herbert Smith Freehills
- HWL Ebsworth Lawyers
- Johnson Winter Slattery
- Lander & Rogers