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Corporations Team
Australian Securities and Investments Commission
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Dear Corporations Team,

Introduction

ASIC Consultation Paper 364 – Modifications to the ESS regime.

This Submission is made by Godfrey Remuneration Group Pty Ltd (**GRG**), a remuneration consulting firm which advises listed and unlisted entities in relation to the development of remuneration structures, including executive, director and general employee equity plans in Australia and internationally, from start-up to ASX 50 level. We have:

1. 316 current clients;
2. 168 of these are ASX listed;
3. 148 of these are unlisted;
4. GRG is disclosed as having provided independent "KMP" remuneration recommendations to Boards in the FY 22 reporting period for 31 ASX listed companies, which is the largest number of any consultancy firm in that period, based on disclosure of the top 1000 ASX listed entities.

Secondary Sale Exemption

B1Q1 – we agree in principle that section 1100ZD should be modified to expand the secondary sale exemption for quoted products. If section 707(3) of the Corporations Act 2001 (Cth) (**Act**) were to apply, participants in ESSs who exercise rights and are issued with quoted products could be prejudiced if the issuing company was unable to issue a Cleansing Notice under section 708A of the Act.

Such participants would be unable to dispose of their products for a period of not less than twelve months, thereby delaying their ability to benefit from participation in the Scheme, undermining the efficacy of long term alignment tools, and often resulting in financial loss if a dividend is declared or the price of the securities declines.

Further, participants may have a tax liability arising from the issuance of the products which they may not be able to fund without selling some of the products issued to them. Current plans and arrangements on-foot that may not be exercised until 2037 will not be able to align the taxing point with this disposal point. If the products were to decline

in value substantially after the taxing point, during the twelve-month period, the proceeds of sale at the end of the period could be insufficient to cover the tax liability, which represents a financial risk that may lead to participants rejecting the equity structures intended to align their interests with shareholders.

Listed entities may be unable to issue Cleansing Notices at the relevant time resulting in the prejudices, outlined above. Further, some listed entities, due to the nature of their businesses, are generally unable to issue Cleansing Notice and accordingly would be unable to establish ESSs under the New Law without the proposed relief. GRG has found that many ASX 300 companies, for example those that are often undertaking, or are the subject potential M&A activity, or because they often properly hold undisclosed price sensitive information (e.g. biotech companies and resources companies), find themselves unable to issue a cleansing notice through most of the year.

Given that it is necessary to offer participants a manual exercise opportunity for up to 15 years in order to manage insider trading and tax considerations, exercises of Rights resulting in new issues of shares arise at random times throughout the year. It should also be noted that due to the way the Tax Act operates, it is in the interests of the Company and shareholders to issue new shares upon exercise as late as possible within the 15 year tax deferral period, as this will generally minimize the net Balance Sheet, cash-flow and P&L impact of operating an equity plan. A switch to market-purchases would represent an onerous imposition for companies and their shareholders, and may consume much of the available cash in developing companies that rely heavily on equity to attract talent, due to having minimal cash reserves.

While we agree in principle with ASIC's proposed modifications, we submit that the proposed modifications should be varied as outlined in B1Q3 below.

B1Q2 – If ASIC does not expand the on-sale exemption, certain listed entities would be required to make disclosure in connection with the secondary issuance of products, thereby adding substantial additional costs to maintaining the ESS. Such costs would include legal and accounting fees, as well as substantial management time. Such costs would likely act as a deterrence to listed entities trying to establish ESSs.

B1Q3 in order to give proper effect to ASIC's intentions as outlined in ASIC's secondary sale exemption proposal, and having regard to the matters raised in our answers to B1Q1 and B1Q2 above, we submit that the proposed modifications be varied as follows:

a) Paragraph 18 of the Consultation Paper sets out four criteria for the secondary offering relief to apply. Criterion (d) (as set out in paragraph 18 and as reflected in section 7 of the draft Instrument) requires that the relevant entity "did not issue the financial product with the purpose of the recipient selling the product".

   Given the expectation that recipients will be required to sell at least a portion of the financial products to meet tax liabilities, and to reap the benefits of participation in the sceheme as well has hedging against downside movements in the security's price, this test may never be satisfied

   Further, the requirement seems incongruous, given that section 707(3) applies to sales amounting to an indirect issue the criteria for which includes (in the

alternative) for the purpose of the person to whom they were issued transferring them. It appears that if criterion (d)(i) is satisfied, section 707(3) would not necessarily apply in the first place.

Accordingly, we submit that criterion (d) should be as follows – "the body corporate … issued the financial product in connection with an employee share scheme".

b) The Consultation Paper does not propose relief for secondary offers made to overseas participants in ESSs. Section 1100F provides that the Division applies to offers received within the jurisdiction.

Many Australian listed entities have employees (either direct or through subsidiaries) who reside outside Australia and whom the entity would wish to have participate in an ESS, or otherwise risk not being able to compete in international markets to attract appropriate incumbents. While offers to such employees would need to be made in accordance with the laws of the jurisdiction in which they reside, the on-sale of securities would be subject to section 707(3), as the general relief proposed by ASIC would only apply to offers made under the Division. It should be noted that sales of the underlying equity held by international participants, generally newly issued shares, typically occurs in Australia via an Australian broker, and is thus caught by 707(3).

It is submitted that overseas participants should not be subjected to the prejudices outlined in B1Q1 above, nor should listed entities be subjected to the costs identified in B1Q2 above.

Accordingly, we submit that the proposed relief should be extended to include "offers made outside the jurisdiction in accordance with an employee share scheme which is reasonably believed to comply with the laws of the jurisdiction in which it is made, and which make reference to part 7.12 as part of the plan rules or terms of the invitation/offer".

c) The Consultation paper does not propose relief for secondary offers made under Class Order 14/1000. We understand that the Class Order expires in 2025 and is unlikely to be renewed.

Many ESSs that have issued rights pursuant to Class Order 14/1000 have rights expiring after 2025 which means that the secondary offering relief under paragraph 8 of the Class Order will no longer apply with the result that section 707(3) of the Act will apply.

Accordingly, we submit that the proposed relief be extended to include "offers which are reasonably believed to have been made under and in compliance with Class Order 14/1000."

Valuation of Financial Products

B3Q1 We do not agree with ASIC's proposal to permit valuations prepared by an independent expert in circumstances where shareholders are contractually bound to deal in ESS in an entity's securities at a price determined in accordance with a formula.

It is not uncommon for shareholders in unlisted entities to enter into shareholders' agreements which govern their relationship *inter se* as well as with the company. Such shareholders agreements typically include pre-emptive rights and similar provisions under which shareholders agree to deal in the company's securities at a price determined in accordance with a formula. The price of the securities may be objectively calculated without the need for a valuation by a qualified valuer, including by an independent valuation expert. Such arrangements are also often specified in plan rules, if a shareholder agreement is not in place.

As ESS interests convert into securities that may be valued in this manner, the value of such ESS interests may properly be valued in accordance with the same formula.

Such determinations are typically undertaken by management, or in some instances by the Company's auditor. In any event, such determinations may be made at little or no cost to the Company, as compared to independent expert valuations which tend to cost a minimum of $20,000 and may cost up to $50,000 each. If a number of these are required to be prepared in any one year, the cost to the company may become prohibitive, and as such, GRG takes the view that most unlisted companies would not consider implementing an ESS, based on GRG's experience. Further, it is noted that the Tax Act is not prescriptive regarding how unlisted equity must be valued for tax purposes.

B3Q2 We submit that valuations of ESS interests be permitted where they are undertaken based on and in accordance with a formula agreed by the company and its shareholders for all purposes under a contractually binding agreement, or under ESS plan rules.

In all other circumstances, a valuation by an independent expert would be appropriate.

Further, it may be logical for ASIC to simply refer to the Tax Act and determinations by the Tax Commissioner, for accepted approaches valuation for disclosure purposes. This would substantially simplify the regulatory burden, cost, and provide better alignment between the regulations.

Other Technical Relief

B5Q1 – we note that ASIC does not intend granting on-sale relief for unlisted entities. ASIC is concerned that any such relief could be subject to abuse as a means to circumvent the operation of section 707(3) where an entity is in fact raising capital.

However, we submit that absent limited relief, considerable expense would be necessarily incurred in circumstances where all or a majority of an unlisted entity's securities are being sold to a third party under an arm's length sales agreement.

Rights issued under an ESS are typically convertible in the event of a "liquidity event". On the occurrence of a liquidity event that involves the sale of all or a majority of the entity's shares, the ESS interests would convert into the underlying securities to enable the ESS participants to sell the underlying securities to the purchaser. In such case, the

issue of the underlying securities would be for the purpose of on-sale and therefore subject to section 707(3).

Absent a right to convert, ESS participants would be denied the opportunity of participating in the liquidity event which would be unfair and undermine an important benefit of ESSs in unlisted entities.

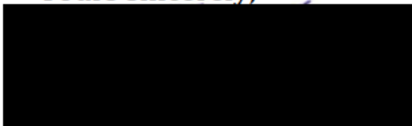
If such a right exists, the entity would be required to make disclosure to the purchaser. Such disclosure would be expensive and time consuming (see above) and in any event would be unnecessary. In most instances, purchasers will have undertaken due diligence and will have the benefit of warranties under the sale agreement. Further, GRG's unlisted clients have raised concerns that a 12-month-on-sale prohibition may effectively prevent or obstruct a sale of the company, and that an ESS would not be introduced if there is any risk at a purchaser may be prevented from buying shares issued within 12 months prior. For many companies this represents an unacceptable risk associated with the introduction of an ESS.

Accordingly, we submit that ASIC should grant on-sale relief to unlisted entities in circumstances where all or a majority of the entity's securities are sold on arm' length terms.

Conclusion

We would be pleased to provide further comment in relation to the matters raised in this Submission, if this would assist ASIC.

Yours sincerely,



Managing Director