



Australian Government

National Innovation and Science Agenda – Employee Share Schemes

Consultation Paper
26 October 2016

NOTES TO PARTICIPANTS

Submissions are due by Wednesday 7 December 2016.

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CONSULTATION PROCESS

Request for feedback and comments

The Australian Government (the Government) welcomes feedback from all interested stakeholders on the issues outlined in this paper.

As part of its National Innovation and Science Agenda, the Government has recently released the exposure draft of a measure to amend the *Corporations Act 2001* (Corporations Act) so that employee share schemes (ESS) disclosure documents for certain start-up companies are not made publicly available when they are lodged with ASIC.

This paper contains a number of questions about further measures which could be taken in future to make ESS more user friendly. Stakeholders are invited to address any issues raised in this paper and should not feel obliged to address every question. The information obtained through this process will inform the Government's future approach to the treatment of ESS.

Closing date for submissions: **Wednesday 7 December 2016**

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NATIONAL INNOVATION AND SCIENCE AGENDA – EMPLOYEE SHARE SCHEMES

INTRODUCTION/BACKGROUND

1. The National Innovation and Science Agenda (NISA) drives prosperity by putting innovation and science at the centre of the Government's economic narrative. Innovation and entrepreneurship is central to economic growth, job creation and future prosperity.
2. As part of the NISA, the Government is taking steps to make it easier for employers to provide incentives to their employees through Employee Share Schemes (ESS).
3. An ESS provides a way for employers to offer incentives to their employees as part of their employment remuneration. ESSs align the company and employees' interests, motivate employees and enable employees to share in their employer's success. Importantly, they provide a mechanism for start-ups to attract employees at a time when they are often cash poor.
4. In 2015, the Government introduced tax concessions for ESS issued by eligible start-ups. However, current disclosure requirements in the *Corporations Act 2001* (Corporations Act) can discourage those startups from implementing an ESS because it may result in the release of commercially sensitive information.
5. Under the NISA, the Government has committed to:
 - 5.1. limit the requirement for disclosure documents given to employees under an eligible ESS and lodged with the Australian Securities and Investments Commission (ASIC) to be made available to the public; and
 - 5.2. consult on options to amend the disclosure requirements to make ESS more user-friendly.
6. The draft legislation which amends the Corporations Act to fulfil the first of these commitments has been published on the Treasury website at www.treasury.gov.au and will be open for comment until **2 November 2016**.

PURPOSE

7. This paper seeks public feedback about potential changes that could be made to the disclosure regime in the Corporations Act that would make ESS more user-friendly. In each instance, the public is invited to comment generally on the Government's proposals, and need not confine themselves to commenting in response to specific queries.

MAKING EMPLOYEE SHARE SCHEMES MORE USER-FRIENDLY

8. The Government is consulting on options to amend the disclosure requirements to make ESS more user-friendly by giving employers more choices as to how they offer incentives to their employees and reducing the red tape associated with offers of incentives to employees.
9. ESS usually involve the offer of shares, options or some other incentive by an employer to its employees. These offers may trigger a range of obligations under the Corporations Act, including those relating to disclosure, licencing, advertising, hawking, and the on-sale of financial products.
10. Unless an exemption applies, offers of securities or other products to employees are governed by Chapter 6D (for securities) or Chapter 7 (for other financial products such as derivatives related to shares) of the Corporations Act. These Chapters of the Act impose disclosure requirements which provide an important safeguard by ensuring that investors, including employees, have adequate information to make an informed investment decision.
11. The three most popular approaches to offering an ESS are:
 - 11.1. Companies may make an offer using a compliant disclosure document.
 - 11.2. Companies may utilise one of the legislative exemptions to the disclosure regime such as the small scale offer exemption (s708(1) in Chapter 6D for securities or 1012E in Chapter 7) or the senior manager exemption (s708(12) in Chapter 6D and 1012D(9B) for Chapter 7).
 - 11.3. Companies may seek the benefit of ASIC relief.
 - 11.3.1. For more information on ASIC's approach to granting relief from the disclosure, licensing, advertising, hawking, managed investment scheme, and on-sale provisions of the Corporations Act for ESS see *Regulatory Guide 49 Employee incentive schemes*; see also ASIC legislative instruments CO14/1000 (for listed bodies) and CO14/1001 (for unlisted bodies).

Making Offer Information Statements more user-friendly

12. Many ESS are considered to be an offer of securities for the purposes of the Corporations Act. Unless an exception applies, such offers are regulated under Chapter 6D, and when making an offer under an ESS to its employees companies must issue a disclosure document such as a prospectus or an Offer Information Statement.
13. Offer Information Statements (OIS) are designed to promote fundraising for small-to-medium size enterprises.
14. An OIS is a shorter form of disclosure document that may be used instead of a prospectus for offers to raise less than \$10m, taking into account all other amounts previously raised by the issuer and its controlled or related entities under previous OIS.
15. When calculating the \$10m threshold, issuers need not include amounts payable for securities, or payable on the exercise of options, if the securities or options are issued

under an eligible employee share scheme as defined in s9 of the Corporations Act: see s709(5).

The requirement for an audited financial statement

16. The content requirements for an OIS are set out in s715, and include that the OIS contain a copy of the audited financial report for the issuing body for the previous 12 months which has a balance date that occurs within the 6 months before the securities are offered: s715(2).
17. The requirement to provide audited financial statements may discourage some companies from offering an ESS under an OIS.
18. It has been suggested that the OIS timing requirements for the financial report may dissuade companies from using an OIS for an ESS in circumstances where it might require them to conduct a mid-year audit.

Question 1: Should the OIS financial report requirement be amended so that companies are not required to conduct a mid-year audit? What are the benefits and risks of this approach? What alternative disclosure would be appropriate to ensure that employees are still provided with adequate information to make an informed investment decision?

Question 2: Should the law be amended so that companies may issue an OIS in respect of an ESS without providing audited accounts? To which companies should this apply? What are the benefits and risks of such an amendment?

Extending the availability of an OIS to more ESS

19. Currently, when calculating the \$10 million threshold, s709(5) excludes securities or options issued under an 'eligible employee share scheme' as defined in s9.
20. An eligible employee share scheme is defined as an offer under a disclosure document where the offers are restricted to defined employees and are for fully paid ordinary shares, options for the issue or transfer of fully paid ordinary shares, or units in such shares: s9.
21. This definition of eligible employee share scheme restricts plans to those offered only to employees or salaried directors, and so excludes plans that allow non-salaried directors, contractors or consultants to participate.

Question 3: Should the Act be amended so that an OIS can be used when ESS plan rules allow non-salaried directors, contractors or consultants to participate in the scheme? What are the benefits and risks of such an approach?

OIS Generally

Question 4: Are there any other changes to the OIS regime which would make it more user-friendly for companies wanting to use an ESS?

Expanding the disclosure exemptions for all companies

22. Section 708 of the Corporations Act sets out a limited number of exceptions to the application of the fundraising provisions in Chapter 6D. Both public and proprietary companies can offer securities under these exemptions.

The small scale offering exemption

23. Many companies rely on the small scale offerings exemption in section 708(1), which permits a company to make a personal offer of securities that results in securities being issued or transferred to 20 or fewer investors (including employees) with no more than \$2 million being raised in any rolling 12 month period (the 20/12 rule).
24. It has been suggested that the ceilings in the small scale offerings exemption discourage companies from offering shares to their employees because it impacts on their ability to raise funds from outside the company.

Question 5: Should employees be excluded from being counted as investors for the purposes of the 20/12 rule?

25. In August 2015 the Government consulted on *Facilitating crowd-sourced equity funding and reducing compliance costs for small business*. That consultation paper asked for submissions on whether to amend the 20 investor limit and/or the \$2 million cap.

Question 6: Would it still be appropriate to consider changing the existing caps if employees were to be excluded from the calculation of the caps for the purposes of the small scale exemption? If so, what thresholds would be appropriate?

The senior manager exemption

26. Another avenue which allows proprietary and other companies to issue securities to their employees is the 'senior manager' exemption in s708(12). Under this exemption disclosure is not required to offer securities to a senior manager of the body as defined in s9, or a related body or their spouse, parent, child, brother or sister. It also extends to a body corporate controlled by one of those people.

Question 7: Should the law be amended to extend the scope of the senior manager exemption? If so, to whom else should the exemption apply?

The exemptions generally

Question 8: Could other exceptions to the requirement to issue a disclosure document be amended to facilitate offering an ESS? What would be the benefits and risks of such a change?

CONSEQUENTIAL CHANGES AND OTHER OPTIONS

27. The Corporations Act contains a number of other provisions which may apply to an ESS. Even if an offer can be made without disclosure under one of the exemptions to Chapter 6D or Chapter 7, the ESS may involve conduct that requires compliance with other provisions, such as the prohibition on advertising (s734, 1018A and 1018B), hawking (s736, 992A and 992AA), the on-sale of financial products (s707 and 1012C) or the provisions in Pt 5C requiring the registration of a managed investment scheme.

28. These restrictions may increase the compliance cost for companies who wish to offer an ESS.

Question 9: What changes to these and other provisions might the Government consider in order to make ESS more user-friendly?

29. The Corporations Act prohibits proprietary companies from engaging in any activity that would require disclosure to investors under Chapter 6D: s113(3). That subsection of the Act makes an exception for an offer of shares to an employee, but this does not extend to other offers such as offers of options over shares. Accordingly, proprietary companies may be restricted from making offers to their employees which involve other types of products such as incentive rights.
30. As indicated earlier, Chapter 6D regulates offers of securities such as shares and certain options. Chapter 7 of the Corporations Act deals with financial services and markets, and may apply to an ESS where an offer is made that includes products such as equity derivatives.

Question 10: Should the Corporations Act be amended to make it simpler for employers to offer such derivatives to their employees as part of an ESS? If so, what changes would be appropriate?

31. The Government is also seeking feedback from stakeholders on other ways to make it easier for employers to offer an ESS.

Question 11: What other changes to the Corporations Act should the Government consider to make ESS more user-friendly?