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CORPORATE UPDATE

ASIC PROPOSES A FRESH APPROACH TO THE REGULATION OF EMPLOYEE INCENTIVE SCHEMES

WHAT YOU NEED TO KNOW

ASIC is proposing to update and broaden its current employee share scheme class order relief and regulatory guidance in response to developments in market practice and the need for clarity.

ASIC is proposing to expand the classes of financial products that can be the subject of an offer under an employee incentive scheme to include performance rights and similar instruments and to simplify on-going lodgement requirements, which should be well received by issuers.

The proposals will be introduced via a new class order and updates to ASIC's Regulatory Guide 49 *Employee Share Schemes* (RG49), to be issued in the first half of 2014.

On 14 November 2013, ASIC released Consultation Paper 218 Employee Incentive Schemes which proposes changes to the way in which offers of securities under employee incentive schemes are regulated.

BACKGROUND

Class Order [CO 03/184] *Employee Share Schemes* provides relief from certain disclosure, licensing and hawking provisions of the Corporations Act for employee incentive schemes (EIS). RG 49 describes ASIC's underlying policy objectives and provides guidance on the circumstances in which ASIC will provide individual relief for offers made under an EIS.

Since issuing [CO 03/184] and RG 49 in 2003, ASIC has provided case-by-case relief in a number of situations not covered by the class order. There have also been changes to the Corporations Act relevant to the class order and developments in market practice for structuring an EIS. In light of these factors, on 14 November 2013 ASIC issued Consultation Paper 218, together with a draft updated version of RG 49, in which it outlines its proposed new approach to the regulation of employee incentive schemes.

CURRENT RELIEF UNDER [CO 03/184]

[CO 03/184] currently provides relief from the following provisions of the Corporations Act for certain entities offering an EIS:

- the requirement to provide a disclosure document for offers made under an EIS;
- the requirement to hold an AFSL for the provision of general advice when circulating and explaining the terms and conditions of an EIS;
- the prohibition on advertising or publicity before an offer or intended offer under an EIS; and
- the prohibition on the issue or sale of financial products arising out of unsolicited contact with employees.

WHAT CHANGES ARE PROPOSED BY ASIC?

Set out below is an overview of ASIC's proposed changes to the regulation of employee incentive schemes:

Issue	Proposed changes
Who can make offers?	***Listed entities*** Under [CO 03/184] disclosure relief is provided to listed companies and their associated bodies corporate for certain offers. There has been some confusion as to the application of the 'associated bodies corporate' concept particularly in the context of offers to employees of the group and in relation to joint ventures. The proposed changes will remove any doubt that offers made by listed entities under an EIS may be made to employees of its 'associated bodies corporate' and not just their related bodies corporate (a narrower concept), and a broader definition of 'associated bodies corporate' will also be introduced which will capture a whole range of EIS's. ***Unlisted entities*** Currently, unlisted entities may only make offers under an EIS to their own employees. ASIC proposes to extend the relief so that wholly owned subsidiaries of unlisted entities may also make offers to their employees.
Who can receive offers?	ASIC proposes to broaden the range of persons covered by the relief to include certain contractors and casual employees as well as prospective employees where the offer is made as part of an offer of employment. To be eligible, contractors and casual employees will need to have been engaged for at least 12 months. Contractors will need to have worked the pro-rata equivalent of 80% or more of a full time employee. Casual employees will need to have worked the pro-rata equivalent of 40% or more of a full time employee. ASIC also proposes to provide limited relief for offers of quoted securities to non-executive directors where the offer is not subject to a condition linked to the performance of the issuer. This condition has been included because ASIC considers that non-executive directors who participate in performance based schemes would lose their independence for the purposes of the ASX Corporate Governance Principles.
What financial products can be offered by a listed entity?	The proposed changes would expand the types of financial products that may be offered under an EIS. The financial products that may be offered will include: ▪ fully paid shares which are quoted on ASX or an approved foreign market ▪ certain depositary interests (ie CDIs, ADRs) which are quoted on ASX or an approved foreign market ▪ fully paid stapled securities ▪ options over, or units in, any of the above financial products ▪ performance rights (including cash settled performance rights) relating to the financial products listed above. ASIC has set out its interpretation of the legal characterisation of performance rights, which has

Issue	Proposed changes
	been the subject of much uncertainty in the market. Performance rights (including cash settled versions) are becoming more and more common and extending applicable regulatory relief is necessary to keep pace with market developments.
What structures can be used by a listed entity when making an offer?	The new proposals will: ▪ extend the relief to cover offers of certain financial products that are held on trust and are allocated to specific participants and also to include underlying eligible products held in a pool for participants ▪ impose a new condition (for financial products held on trust on an unallocated basis) that no more than 5% of the entity's financial products to which voting rights attach be held on trust for participants ▪ expand the definition of 'contribution plan' to include salary sacrifice arrangements of future earnings as well as deductions from taxed salary amounts ▪ impose a condition that loans must be limited or no recourse.
What general conditions apply to offers made by a listed entity?	The new proposals would result in a number of conditions of [CO 03/184] being amended, including: ▪ changing the period for quotation from a 12 month period without suspension for more than 2 trading days to a 3 month period without suspension for more than 5 trading days ▪ clarifying how the 5% share capital limit is to be calculated ▪ clarifying that offers of options and performance rights should be made for 'no more than nominal monetary consideration' rather than 'no more than nominal consideration' ▪ introducing a condition that participants must not receive a significant portion (ie 25% or more) of the underlying benefit of an offer under an EIS for a minimum period of 12 months ▪ introducing a requirement for the offer documentation for an offer to be worded and presented in a clear, concise and effective manner and to include appropriate risk disclosure ▪ replacing the requirement for an entity to lodge the offer documentation with ASIC with a requirement that the entity simply notify ASIC that an offer has been made ▪ allowing ASIC to exclude an entity from relying on the new class order relief
What financial products can be offered by an unlisted entity and using what structures?	[CO 03/184] currently provides relief to unlisted entities but this relief is limited to offers of options over fully paid shares. ASIC proposes to broaden this where the entity: ▪ only has one class of shares, being fully paid voting ordinary shares ▪ offers A$1,000 worth of ordinary shares for no more than nominal monetary consideration (such offers can be made annually) ▪ offers options over and/or performance rights over ordinary shares for no more than nominal monetary consideration ▪ includes the offer in an offer document which is presented in a clear, concise and effective manner and which includes appropriate risk disclosure ▪ includes certain conditions in its EIS relating to the exercise of options or vesting of performance rights

COMMENT

In proposing changes to the way in which employee incentive schemes are regulated, ASIC is seeking to reduce business costs by widening the relief available to better facilitate the offer of financial products under an employee incentive scheme and provide greater flexibility in the way employee incentive schemes can be structured.

Expanding the classes of financial products that may be offered under an EIS to include cash settled as well as equity settled instruments is also welcome recognition that approaches to incentivising employees have evolved over the last decade. The proposed relief also does a lot to address unnecessary administrative burden in this area by simplifying lodgement procedures, which is also a step in the right direction.

NEXT STEPS

ASIC is seeking comment on Consultation Paper 218 with submissions closing on 31 January 2014. ASIC is hopeful of issuing the revised guidance and the new class order during the first half of 2014.

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