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AUSTRALIA

Leaders in governance

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Dear Malcolm

Listing Rule amendments — Company policies on 'trading windows' and 'blackout periods'

Chartered Secretaries Australia (CSA) is the independent leader in governance and risk management. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency.

Company secretaries have primary responsibility in listed companies to deal with the Australian Securities Exchange (ASX) and interpret and implement the Listing Rules. Our members deal on a day-to-day basis with ASX and have a thorough working knowledge of the operations of the markets, the needs of investors and the Listing Rules, as well as compliance with the Corporations Act (the Act). Our members have a significant role in administering company trading policies and in granting approval to executives below board level seeking to trade or otherwise deal with their shares.

CSA welcomes the opportunity to comment on the Listing Rule amendments — *Company policies on 'trading windows' and 'blackout periods* (Exposure Draft). CSA members support the introduction of a Listing Rule designed to maintain investor protection and confidence, and to reduce any perception of scope for market manipulation that trading by directors and key management personnel in company securities may provide.

CSA has made recommendations over a number of years not only that companies develop and publish trading policies but also on how best to develop such policies in order to address issues of concern. Our members have spoken on such matters extensively at both the CSA National Conference and Corporate Updates around Australia, and CSA has also published its own Good Governance Guide on developing trading policies, which is regularly reviewed and updated and is available on the CSA website at www.CSAust.com.

We have drawn on our members' experience in our submission on the Exposure Draft.

Executive summary

CSA supports the introduction of Listing Rule amendments covering company policies on trading in company securities. While largely supportive of the measures proposed to be introduced in the Listing Rule amendments covering company policies on trading in company securities, we do have concerns with two aspects of the Exposure Draft:

- disclosure to ASX of amended trading policy within five days of amendments taking effect, regardless of the materiality of the amendment
- amendment to Appendix 3Y covering disclosure of trading in a prohibited period beyond the specified blackout period or those periods outside published trading windows.

CSA recommends that each of the two aspects set out above should be modified.

General comments

CSA supports the introduction of Listing Rule amendments covering company policies on key management personnel trading in company securities.

Currently, under the ASX Corporate Governance Council *Corporate Governance Principles and Recommendations*, Recommendation 3.2 provides that a listed company should establish a policy on trading in company securities. Under the 'if not, why not' regime, a company is free not to establish such a policy, but must provide an explanation to investors for that decision. The research undertaken by ASX over some quarters has revealed that not all listed companies have such a trading policy. CSA supports the introduction of a Listing Rule mandating that all listed companies should develop a policy on trading in company securities.

The notification to the market of directors' interests in the securities of listed entities is an issue of market integrity. The absence of a policy on the trading by directors of the securities of the entities that they govern has the potential to damage the integrity of the market and investor confidence, as it creates the potential for speculation that directors could be trading in company securities when in possession of inside information. As noted in the Exposure Draft:

> Regardless of whether there is substance to such suspicions that breaches of the law are occurring, it is this perception that directors may be engaging in insider trading that negatively impacts the reputation of the listed entities and has the potential to undermine the market.

CSA therefore supports the introduction of a Listing Rule mandating a trading policy, as it will ensure that all listed entities turn their attention to how they wish to manage the matter of directors and key management personnel trading in the securities of the entities that they govern or manage. It will also provide the market supervisor with an enforcement capacity. CSA believes that this is a good governance outcome.

CSA also commends ASX for providing flexibility to each company to develop a trading policy that is tailored to its requirements. CSA members particularly commend ASX for clarifying that it is the company's decision to identify the periods of the year where trading in its securities by key management personnel will be allowed or prohibited, and also to put in place procedures providing a mechanism for key management personnel to obtain prior written clearance to trade in the entity's securities in exceptional circumstances during a period where trading is otherwise prohibited under the trading policy. What is suitable for a small start-up company may be quite different from what is suitable for a large corporate group. CSA is of the view that there is no 'one-size-fits-all' policy. It is important that the board and the key management personnel of each company address the issues central to any trading policy in order to develop a culture where trading in company securities and any constraints on such trading is understood and adhered to.

CSA notes that, irrespective of the terms of the trading policy, directors and key management personnel are subject at all times to the law on insider trading.

Furthermore, CSA notes that those companies that are dual-listed in the United Kingdom may also be subject to a similar Listing Rule. For example, the United Kingdom Model Code, applicable to all UK-listed entities, mandates a minimum policy on trading in company securities. CSA notes that the Exposure Draft is less specific than the UK Listing Rule, as it allows each listed company to decide the restrictions on trading and clearance procedures most appropriate for the circumstances of the company. Under the Model Code in the United Kingdom, these matters are mandated. CSA members appreciate ASX's willingness to allow companies to define prohibited periods, given that any mandated definition could prove problematic for dual-listed companies if the ASX definition were to vary from that set in another jurisdiction.

While CSA understands that the proposed new Listing Rule will not create any significant new compliance burden for large listed companies, which have had such trading policies in place for some years, it is to be expected that some smaller listed companies may face an increased compliance burden.

However, CSA is of the view, subject to our specific comments below, that the proposed Listing Rule does not introduce an unduly onerous compliance burden for any listed company. Developing a policy ensures that the board has turned its attention to how the company restricts trading in company securities that may be, or may be perceived to be, in breach of legal and regulatory requirements, as well as any framework set down by the company. The board, senior executives and other internal or external persons who have access to inside information relating directly or indirectly to the entity need to be clear as to the risks that the entity's policy is meant to address and clarity as to the periods in which they should not be trading in the entity's securities.

CSA recommendations

While CSA is largely supportive of the measures proposed to be introduced in the Listing Rule amendments covering company policies on trading in company securities, we do have concerns with two aspects of the Exposure Draft.

Our recommendations in relation to these two matters are set out below.

1 Disclosure to ASX of amended trading policy within five days of amendments taking effect

CSA is concerned that, if the proposal that disclosure to the company announcements office of the amended trading policy within five days of amendments taking effect is introduced, regardless of the materiality of the amendment, it ushers in an onerous compliance burden that brings no commensurate improvement of the governance framework or net benefit to individual listed entities or investors in such entities.

Currently, listed companies establish a large range of policies and charters, many of which are disclosed on company websites, providing ease of access by investors, customers, regulators and other interested parties. These may include constitutions, board and board committee charters, codes of conduct, trading policies, continuous disclosure policies, shareholder communication policies, risk management policies, corporate social responsibility policies, privacy policies, fraud prevention policies, and policies prohibiting the entering into transactions in associated products that limit the economic risk of participation in unvested entitlements under any equity-based remuneration scheme.

Policies on such issues can run to many pages in length. A large amount of information contained within these policies would not be of use to shareholders as it is directed towards management and other employees to assist them in complying with the policy. Such policies

may also include contact details, including phone numbers, of the various people to be contacted in particular situations. On this basis the ASX Corporate Governance Council's guidelines provide that companies may post a summary of any such lengthy policies to their websites.

CSA members note that such policies and charters are not, and nor should they be, static documents. As part of developing a culture of good governance, companies regularly review and amend the policies and charters listed above. They may also be amended as laws and corporate governance practices in Australia and elsewhere develop. CSA members strongly support and encourage a process of continuous improvement in the formulation and clarification of such policies and charters, and believe that the proposal to require announcement to the market of any amendments to a company's trading policy, regardless of whether the amendment is material, may stifle such ongoing review and improvement.

A central concern is that the elevation of the trading policy to almost a continuous disclosure issue, whether material amendments to the policy have taken effect or not, changes the policy from a document guiding behaviour to a binding agreement with the market supervisor. This in turn is likely to see policies remain static rather than be subject to ongoing review. It not only changes the document from a statement governing prudent conduct to a contract of assurance, but also distances the trading policies from all other policies.

CSA believes that, if the proposal that 'An entity must give any amended trading policy to the company announcements office for release to the market within 5 business days of the amendments taking effect' is implemented in its current form, it will not only introduce an onerous, unacceptably prescriptive approach to the formulation of trading policies, but also has strong potential to lead to 'boilerplate' policies drafted by lawyers being released, rather than policies developed by the company following consideration of the issues. Further, such policies are likely not to be subsequently reviewed and updated on a regular basis. This defeats ASX's policy objective of asking companies to disclose that they have put in place and regularly review how to manage the risks of directors, senior executives and other internal or external persons, who have access to inside information relating directly or indirectly to the entity, trading in company securities. CSA believes that the objective of the Listing Rule should be to require companies to turn their attention to ensuring that directors and other relevant parties are familiar with the content of the trading policy and their compliance obligations in relation to that policy.

Furthermore, dual-listed companies are subject to regulation in other jurisdictions and may need to amend their trading policies to comply with the rules in those jurisdictions. As in Australia, the regulatory framework can change frequently, necessitating amendment to the trading policy. CSA cannot see any enhancement to the governance framework of disclosing the amendments generated by changes to the regulatory framework in another jurisdiction that have no bearing on the Australian market.

CSA notes that, as set out in the ASX Corporate Governance Council's guidelines, the trading policy or a summary should be disclosed on the company website at all times.

CSA believes that the issue that needs to be addressed is materiality. Any amendment to the specified periods in which directors and key management personnel are prohibited from trading, whether they are framed as blackout periods or periods outside trading windows, should be announced to the market through ASX. However, an amendment to the policy or summary due to a change in house style, or a change in internal procedure, or to align with a change in regulation in another jurisdiction, should not also necessitate an announcement to ASX.

CSA recommends that the proposal that 'An entity must give any amended trading policy to the company announcements office for release to the market within 5 business days of the amendments taking effect' should be amended to 'An entity must give any amendment of the policy or summary of the policy in relation to the specified periods in which directors and key management personnel are prohibited from trading or allowed to trade, or approval procedures

that they must follow, to the company announcements office for release to the market within 5 business days of the amendments taking effect'.

2 Amendment to Appendix 3Y covering disclosure of trading in a prohibited period

CSA supports the proposal that companies should disclose in Appendix 3Y whether or not a change in a director's shareholding took place during a published restricted trading period. CSA also supports the proposal that companies should provide a brief explanation in Appendix 3Y for changes that take place during a published restricted trading period.

There are of course a range of legitimate reasons why a director's shareholding might change during a restricted period including:

- unexpected and immediate financial hardship
- court orders
- passive acquisitions arising out of, for example, dividend reinvestment plans, and
- transfers where there is no change in the director's relevant interest such as a transfer of shares to a self-managed superannuation fund
- acquisitions made by a trustee on behalf of a director pursuant to certain share schemes where purchases are made at fixed intervals based on instructions that cannot be altered by the director other than during a trading window.

However, it is important that the Appendix 3Y requirement does not lead to inadvertent disclosure that the company is in possession of significant but not yet announced information. Many companies impose restrictions on directors trading in shares when the company is in possession of non-public share price-sensitive information, regardless of whether the company is otherwise in a published restricted trading period. For example, a company involved in a significant but not yet announced acquisition might restrict its directors from trading in shares until the acquisition is announced.

Given that there is a continuous disclosure regime in place, whereby companies must, in a timely and equal fashion, disclose to the market any materially price-sensitive information, the disclosure of a prohibited period at any time other than the release of results potentially signals to the market that corporate action is under consideration or underway. This increases speculation, which is not optimal for market integrity.

Accordingly CSA submits that the disclosure requirements in the Appendix 3Y should only extend to a company's formally published and announced trading periods and not to any additional restrictions imposed by companies as a result of particular unannounced corporate actions.

CSA notes that the United Kingdom differentiaties between close periods and prohibited periods in its Model Code and disclosure of exceptional circumstances is only required where trades have taken place during a close period.

CSA agrees that permission must be sought in any prohibited periods prior to trading, and that the company should keep written records of any permissions granted. CSA envisages that, in limited circumstances, a standing permission may be considered appropriate, for instance where acquisitions made by a trustee on behalf of a director pursuant to certain share schemes where purchases are made at fixed intervals based on instructions that cannot be altered by the director other than during a trading window.CSA is also of the view that ASX should be able to review the record of written permissions that have been granted at any time and seek further information on any reasons supplied by a director for seeking an exemption from the trading policy.

CSA recommends that the proposed amendments to Appendix 3Y requiring disclosure of whether trades have occurred in a prohibited period and whether permission was granted prior

to the trade should specify that such disclosure is required in relation to the published specified periods designated as a blackout period or the periods outside trading windows, but should not extend to any other prohibited period set by the company relating to corporate actions.

CSA would also like to point to the practical difficulties attached to share purchase plans and the maturing of options. When directors and key management personnel participate in employee share plans, options may mature after a period of time (for example, after five years). The exercise of the options may occur during a blackout period or a period outside a trading window. CSA considers it important that ASX and ASIC provide appropriate and practical guidance to directors and companies on the application of share trading policies and insider trading laws in these circumstances.

Guidance note

The Exposure Draft notes that:

> The exceptional circumstances under which the person(s) specified in the trading policy may grant prior clearance for key management personnel to trade during a prohibited period under the entities' [sic] trading policy shall be determined by the company. However, it is expected that the exceptional circumstances would be limited to various passive trades and severe financial hardship. Interpretation could be provided on this in a Guidance Note in the Listing Rules.

CSA strongly recommends, if the proposed Listing Rule is implemented, that a Guidance Note clarifying exceptional circumstances should be included.

CSA notes again that our members believe that exceptional circumstances should be narrowly defined and should not extend beyond genuine financial hardship; a court order or similar requirement; or those instances where directors retain relevant interests in shares, for example, where shares are transferred into a self-managed superannuation fund or to other family members.

CSA members do not believe that a tax liability relating to shares received in connection with an employee or director share plan is a severe financial hardship. CSA notes that there are mixed views within the community and amongst CSA members as to whether a disposal of shares as a result of a margin call should be considered an exceptional circumstance. CSA members consider that it would be very useful for ASX to provide guidance in this regard.

Content of policy

CSA recommends that the Listing Rule should include a requirement that the company determine whether it allows or prevents key management personnel from dealing in unvested entitlements.

CSA Good Governance Guide: Issues to consider in developing or reviewing the policy on trading in company securities

CSA has developed and published a Good Governance Guide setting out the issues that companies need to consider in developing or reviewing the policy on trading in company securities. The Guide is available on the public domain section of the CSA website at www.CSAust.com. A copy of the Good Governance Guide is attached at Appendix A.

Conclusion

CSA supports the introduction of Listing Rule amendments covering company policies on trading in company securities. While largely supportive of the measures proposed to be introduced in the Listing Rule amendments covering company policies on trading in company securities, we do have concerns with two aspects of the Exposure Draft:

- disclosure to ASX of amended trading policy within five days of amendments taking effect, regardless of the materiality of the amendment
- amendment to Appendix 3Y covering disclosure of trading in a prohibited period beyond the published blackout period or those periods outside trading windows.

CSA recommends that each of the two aspects set out above should be modified.

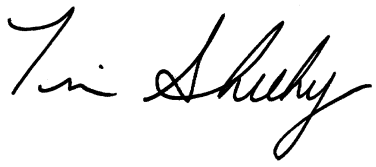
CSA also recommends, if the Listing Rule is implemented, that a Guidance Note clarifying exceptional circumstances should be included.

Unvested entitlements

CSA also recommend that the Listing Rule should provide that the content of the trading policy should include a requirement that the company should determine whether it allows or prevents key management personnel from dealing in unvested entitlements.

We would be happy to meet with you to discuss these issues and would welcome the opportunity to be involved in further deliberations.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE

Good Governance Guide: No 3.2

Category: **Ethics and responsible decision making**
Subject: **Issues to consider in developing or reviewing the policy on trading in company securities**
Source: **Chartered Secretaries Australia**

It is considered **good governance** for the board of listed entities to review regularly the company's policy on trading in company securities. This Guide is intended to outline issues to consider when developing or reviewing a policy on trading in company securities. Irrespective of the terms of the policy, the policy should be subject at all times to the law on insider trading.

The policy should also always be tailored to the requirements of the company concerned. What is suitable for a small start-up company may be quite different from what is suitable for a large corporate group. It is important not to copy another company's policy but to address each of the matters noted below in order to develop a culture where trading in company securities and any constraints on such trading is understood and adhered to.

Legal and regulatory context

The Corporations Act prohibits 'insider trading' generally and the ASX Listing Rules require notification of directors' dealings. The policy should also make reference to the ASX Corporate Governance Council 'Recommendation 3.2: Companies should establish a policy concerning trading in company securities by directors, senior executives and employees, and disclose the policy or a summary of that policy' and the contents of 'Box 3.2: Suggestions for the contents of a trading policy'. Companies also need to consider the legal and regulatory regime in more than one jurisdiction if the company is dual-listed.

Purpose of a policy

The policy needs to explain how the company restricts trading in company securities that is in breach of:

- legal and regulatory requirements
- the company's policy.

The board, senior executives and other internal or external persons who have access to inside information relating directly or indirectly to the entity need to be clear as to the risks that the entity's policy is meant to address.

Issues to address in the policy

It is **good governance** for the trading policy to address:

The prohibition on insider trading

The policy should provide an explanation of the prohibition on insider trading, including:

- an accessible and non-legalistic explanation of what inside information is. There is a definition of 'material information' in the context of continuous disclosure in ASX Listing Rule 3.1 that can be helpful in providing examples of what might constitute 'inside information'
- examples of inside information
- a list of what would have a material impact on the price of the securities, including examples specific to the company.
- clarification that the prohibition is mandatory and not a matter of guidance
- an accessible and non-legalistic explanation of what sanctions apply to insider trading and what consequences attach to directors, executives and employees from the company's perspective if the policy is breached
- an explanation that the prohibition extends to trading in the securities of subsidiaries (particularly partly-owned and related companies)
- an explanation that the prohibition may also extend to trading in the securities of other companies, including suppliers and customers.

Directors' interests notification

The policy should provide an accessible explanation of the legal requirements on directors to:

- notify the market of any trading, whether in company securities or otherwise
- notify the market of a substantial shareholding (more than five per cent) or any change(s) in that shareholding
- update the company's register of directors' interests, which may be minuted at the next board meeting.

Clearance to deal procedures

The policy should include:

- clearance procedures for allowing trading in company securities, including information on who must be contacted within the company to provide such clearance, in what circumstances clearance will be supplied or denied; and forms of notification before trading takes place
- how many days are available for trading once clearance has been provided
- a list of who is caught by the company rules on trading in company securities, with clarity on how the policy applies beyond the employment contract to spouses, dependents and external consultants and advisers.

Awareness of and compliance with policy

The policy should include:

- information on how the company approaches the development of a culture of awareness of the policy, and the matters it covers, for example, induction when commencing with the company; and ongoing training
- who is responsible for providing training on issues relating to trading in company securities
- how the company ensures the policy is communicated to all persons subject to it (including those external to the company)
- confirmation that ASX, ASIC and governance advisers take an interest in whether or not companies are complying with their share trading policies

Style

Attention to the following matters will assist in clarifying the terms of the policy to those to whom it applies:

- a summary of the main issues dealt with in the policy
- a glossary, including a clear definition of dealing (note that a poor definition of dealing will render the policy ineffective) and securities
- a set of questions and answers (Q & As) in relation to company rules for trading in company securities
- a process chart setting out clearance procedures and opportunities for trading
- a link to the Board Charter and Code of Ethics
- the title of the person who needs to be contacted if there are any queries.

Consideration needs to be given to:

- whether stock lending is included in the definition of dealing
- whether directors and executives are able to undertake any form of short-term trading
- margin lending and disclosures to the company of such
- whether exemptions of any kind will apply and in what circumstances. Such circumstances should not extend beyond:
  - genuine hardship (a potential tax liability does not constitute genuine hardship)
  - a court order or similar requirement

  and will need to be approved by the board or the chairman; however, if an exemption for genuine hardship or a court order or similar does not apply, the policy must not be silent on the issue but must state that any exemption is at the chairman's discretion.

Restrictions on trading

Restrictions on trading in trading policies can be expressed as either black-out periods, or trading windows (see Good Governance Guide 3.1: Trading in company securities: summary of issues). Regardless of which approach is decided by the company, it is **good governance** to ensure that the company clarifies which restrictions on trading are in place. A policy that does not include either a trading windows or a black-out approach to restrictions will give rise to reputational risk, as the perception could arise that trading is permitted at certain times despite legal prohibitions on insider trading.

Trading windows

A policy based on trading windows can:

- provide an opportunity that would not otherwise become available for directors and executives to deal in company securities. As it is now not uncommon for corporate activity to occupy most of the year, it can become difficult to locate a period in which directors and executives can trade without the perception arising that insider trading is occurring. However, the policy must be clear on the length of time for which the trading window operates, what triggers are appropriate to allow the trading window to operate, and be mindful of the continuous disclosure obligations to keep the market informed of price-sensitive information at all times
- give rise to a misunderstanding that trading is permitted during trading windows despite legal prohibitions relating to insider trading. It is important, therefore, that the policy clarifies that trading windows provide a conditional lifting of a blanket prohibition rather than permission and that any such lifting of the prohibition is subject to clearance procedures.

Black-out periods

A policy based on black-out periods can:

- clarify that restrictions and protocols are in place to counter any suspicion of insider trading
- provide reasonable (and easily defended) periods from balance date to results release for full and half-year results (and maybe quarterly blackouts for companies that report quarterly)
- give rise to a misunderstanding that trading is permitted in the period leading up to a black-out period despite legal prohibitions relating to insider trading. It is important, therefore, that the policy clarifies that black-out periods provide a conditional lifting of a blanket prohibition rather than permission and that any such lifting of the prohibition is subject to clearance procedures.

It is **good governance** to include the following black-out periods:

- if the company is involved in corporate transactions that might have a material impact on the share price
- the period following the close of books until at least one trading day after the release of results (to allow time for the market to digest the results).

There may be a black-out period imposed at any time without explanation to those affected.

It is **essential** that the policy clarify that, irrespective of whether trading occurs in a trading window or outside a black-out period, no trading can occur if it involves the use of inside information.

The restrictions on trading should also provide:

- a clear explanation of what constitutes an active trade and what constitutes a transaction that may be excluded from the policy, subject to the prohibition on insider trading (such a transaction is sometimes referred to as a passive trade, and includes bonus issues and participation in dividend reinvestment plans, director and executive share plans and employee share plans)
- a policy on hedging and an explanation of how the company prevents executives from dealing in unvested entitlements.

The company secretary

It is **good governance** for the company secretary to:

- ensure that any letter of appointment for directors includes a requirement that in addition to obtaining clearance the director immediately and where practical in advance notify the company secretary of any trading in company securities (see Listing Rule 3.19B). The letter should clarify that directors are obliged to notify the market of any trading in company securities under s205G of the Corporations Act (14 days) and Listing Rule 3.19A (5 days).
- set up a process for directors to advise the company of indirect interests, including their SRNs and HINs. Trustees may deal in securities in which a director has or is deemed to have an interest (for example, a family trust or outsourced superannuation fund), without the director making a decision to trade, but the director maintains the legal obligation to notify the market (whether the securities are company securities or otherwise). Alternatively, directors may hold shares through a broker, with the financial adviser controlling the holding, and the director again is not the person making the decision to trade
- set up an 'alert service' through the share registry, to notify the company of any changes in the number of company securities held by directors in any one or more of their holdings, whether directly or indirectly
- circulate all Appendix 3X (initial) or 3Y (change) announcements to all directors, so that the board as a whole is kept informed of all trading by directors
- implement a reminder system, for example via email or the company intranet to alert directors, executives and employees when trading windows and black-out periods open and close.