CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

19 May 2006

The Hon Chris Pearce MP
Parliamentary Secretary to the Treasurer
Corporate and Financial Services Regulation Review
Corporations and Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Sent by email to: CFScomments@treasury.gov.au

Dear Chris

Corporate and Financial Services Regulation Review

Chartered Secretaries Australia (CSA) welcomes the opportunity to comment on the consultation paper on a variety of corporate and financial services regulatory issues. CSA agrees that, while the underlying principles of corporate and financial services regulation and how it operates in practice is generally satisfactory, it is clear that some aspects need fine-tuning.

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. We are an independent, widely respected influencer of governance thinking and behaviour in Australia. We represent over 8,000 governance professionals working in public and private bodies, all of whom are involved in governance, corporate administration and compliance. We have drawn on their experience in the formulation of this submission.

In preparing this submission, CSA has drawn on the expertise of the members of our two national policy committees.

1. Financial Services Regulation

CSA has no comment on Sections 1.1 – 1.27.

2. Company Reporting Obligations

2.1 Concise reporting requirements

CSA agrees that, in their current statutory form, concise reports are not concise. CSA supports the initiative to reduce their length. CSA also supports the continued existence of the concise report, as it is important for members to find in one place summary information on the company in which they invest.

Additional regulation in recent years has greatly increased the length of concise reports. The statutory remuneration report and reporting on compliance with the Australian Stock Exchange (ASX) Corporate Governance Council guidelines, for example, has added to the length. In the largest companies, these two disclosures alone account for well over 20 pages. As a result, in 2005, only 35 per cent of shareholders in the largest companies elected to receive the concise annual report, down from 50 per cent in 2003 and 60 per cent in 2001.

The increased length of such reports and the recognition by companies that the majority of shareholders want only specific and very concise information has led some companies to seek additional means of communication with their shareholders, such as introducing short-form non-statutory financial reports. The significant success of such initiatives highlights that reform in this area is needed.

CSA notes that on 7 April 2006 the Prime Minister, The Hon John Howard MP, and the Treasurer, the Hon Peter Costello MP, announced initiatives to reduce the regulatory burden on business that included allowing companies to make their annual reports available on the Internet with hard copies available only on request. This initiative, in effect, would shift the distribution emphasis for annual reports from an opt-out mechanism, as currently exists in the *Corporations Act*, to an opt-in mechanism. CSA strongly supports this initiative.

The consultation paper asks if separating the remuneration report from the directors' report and requiring it to be a stand-alone report will assist in reducing the length of concise reports.

While CSA believes that it is useful to separate the remuneration report by cross-referencing it to be part of but not included in the directors' report, we recommend that until an opt-in mechanism for the distribution of annual reports is introduced the legislation be left as it stands. CSA further believes that any proposal to separate the remuneration report from the directors' report must not lead to it being removed from the annual report.

CSA is of the view that while a reduction in the regulation of concise reports is a good thing, introducing statutory requirements in relation to summaries of the remuneration report and/or the directors' report in the concise report will simply add both to the burgeoning regulatory burden experienced by companies and the avalanche of unsought information swamping members.

Subject to reform to section 314 of the *Corporations Act* to allow companies to make their annual reports available on the Internet with hard copies available only on request, CSA recommends that the concise report become a non-statutory report, with no prescribed content required by law. If these reforms were effected, members could:

- review the full annual report or sections of the annual report, both statutory and non-statutory, on the company's website, as suited their interests, given that different sections could be posted as separate files or linked HTML pages
- request a hard copy of the annual report from the company
- request a hard copy of the company's non-statutory concise report, which would contain information that best suited member needs as decided by communication between the company and its members.

Any such reform should also leave the choice to the member to elect to receive either a full or concise annual report in hard copy.

Recommendation

While CSA believes that it is useful to separate the remuneration report by cross-referencing it to be part of but not included in the directors' report, we recommend that until an opt-in mechanism for the distribution of annual reports is introduced the legislation be left as it stands.

Subject to reform to section 314 of the *Corporations Act* to allow companies to make their annual reports available on the Internet with hard copies available only on request, CSA recommends that the concise report become a non-statutory report, with no prescribed content required by law.

2.2 Executive remuneration — disclosure requirements

CSA members are acutely aware of the difficulties caused by the conflict between the Australian Accounting Standards Board (AASB) standard 1046 (and its replacement standard 124) on remuneration reporting and the relevant provision in the *Corporations Act*, in section 300A. As a result, CSA strongly supports the provision of one governing standard on remuneration reporting, rather than parallel, and sometimes conflicting ones.

CSA is also aware that the AASB standards must align with international standards.

Subject to this requirement, CSA recommends that, as a matter of principle, the *Corporations Act* should focus on disclosure requirements relating to remuneration policy and the nature and amount of remuneration paid to directors and key executives through the directors' report, whereas the accounting standards should focus on disclosure of remuneration detail. If two standards are maintained, there needs to be consistency and harmonisation between them.

In the meantime, CSA notes that there is concern that unless ASIC renews its class order (CO06/50, which ceased to apply on 31 March 2006) to reinstate the regulations introduced in 2005 under the *Corporations Act,* companies with a balance date after 31 March 2006 may be required to duplicate remuneration reporting.

Recommendation

CSA recommends that, as a matter of principle, the Corporations Act should focus on disclosure requirements relating to remuneration policy and the nature and amount of remuneration paid to directors and key executives through the directors' report, whereas the accounting standards should focus on disclosure of remuneration detail.

2.3 CEO/CFO sign-off

CSA supports the ASX Corporate Governance Council's proposal to remove the obligation concerning CEO/CFO sign-off in Principle 4.1 from the *Principles of Good Corporate Governance and Best Practice Recommendations* and its replacement with a notation cross-referencing the requirement in the *Corporations Act*.

2.4 Thresholds for financial reporting of large proprietary companies

CSA supports an increase in the revenue and asset thresholds for financial reporting of large proprietary companies and believes this should be indexed.

CSA recommends that a policy be implemented ensuring a five-year review of such thresholds.

2.5.1 Removal of duplication in notifications

CSA believes it is important to enable office holders to notify the Australian Securities and Investment Commission (ASIC) of their resignation as office holder if they wish. The consultation paper suggests that office holders are "obliged" to notify ASIC of their resignation, but the provision is an enabling one only. CSA supports this provision remaining an enabling one, and does not suggest that it become an obligation. CSA notes that companies are currently obliged to notify ASIC of the resignation of an office holder.

However, CSA strongly recommends that any office holder should have an obligation to notify the company of their resignation. The office holder may then choose if they wish to notify ASIC of their resignation, using the correct form.

CSA members note that, in practical terms, the company can only be certain that a notification has been lodged by an office holder if it searches the ASIC database or is advised personally by the officeholder. In the experience of CSA members, it is usually the company secretariat that advises ASIC of any change in their status as office holder and this requirement needs to remain to ensure that the company can effectively administer the appointments and resignations of its officeholders. Therefore, any removal of the apparent duplication in notifications would not reduce the workload of the company and may be unfairly prejudicial to an office holder who has resigned but where the company secretariat has not yet notified ASIC of the resignation.

Recommendation

CSA strongly recommends that any office holder should have an obligation to notify the company of their resignation. The office holder may then choose if they wish to notify ASIC of their resignation, using the correct form.

2.5.2 Maintenance of registered office address

CSA supports a single process for notification of an update of a company's service address and registered office. However, CSA notes that it is important that ASIC does not link the two addresses, so that if the agent's address changes the registered office address does not necessarily also change.

While one form can be used to register the registered office and/or the agent's address, it is important that it not be seen as one process by ASIC.

2.6 Share and member reporting requirements

CSA strongly agrees that the obligation to notify ASIC of the top 20 members in each class of shares as part of the annual review process be removed for listed public companies. CSA notes that, for such companies, the information is available in the annual report and in the substantial holding notices on the website of the Australian Stock Exchange. Moreover, the information also changes daily for listed companies. Therefore, the notification to ASIC constitutes meaningless information and provides no real benefit.

However, CSA recommends that the obligation to notify ASIC of the top 20 members in each class of shares as part of the annual review process be retained for unlisted public companies, as this information is only available through ASIC. This information is commonly used for understanding the levels of control of any particular company.

CSA notes that there have been difficulties with ASIC attempting to reconcile the top 20 members in each class of shares with those previously received from a company. Given that the information is subject to change on an annual basis, such attempts at reconciliation have led to ASIC rejecting the form submitted by the company. Therefore, CSA's recommendation that the obligation remain for unlisted public companies is subject to ASIC accepting the information as supplied by the company with the annual return.

Recommendation

CSA agrees that the obligation to notify ASIC of the top 20 members in each class of shares as part of the annual review process be removed for listed public companies. The notification to ASIC constitutes meaningless information and provides no real benefit.

However, CSA recommends that the obligation to notify ASIC of the top 20 members in each class of shares as part of the annual review process be retained for unlisted public companies, as this information is only available through ASIC. This information is commonly used for understanding the levels of control of any particular company.

2.7 Removal of annual review fees for companies approved for voluntary deregistration

CSA supports the removal of the obligation to pay an annual review fee when a company has been approved for voluntary deregistration.

2.8 Parent entity financial statements

CSA notes that the idea of duplication is not attractive and supports the provision of summary financial information in relation to the parent entity.

2.9 Payment of ASIC lodgement fees by credit or debit card

CSA would like to take the opportunity to strongly support a move to allow for payment of ASIC lodgement fees by credit or debit card. CSA notes that many of its members have experienced difficulty in arranging for payment of multiple lodgements by cheque and electronic means. For example, if a payment is made in respect of annual statements for multiple companies, the payment is often allocated to one company, triggering non-payment correspondence in respect of the balance of companies. Arranging individual payments by cheque or electronic means is both costly and time-consuming. CSA believes that the introduction of payment by credit or debit card and/or rectification of the payment process covering multiple lodgements by cheque and electronic transfer would assist both lodging companies and ASIC.

3. Auditor Independence

3.1 Anomalies arising from CLERP 9

CSA supports the changes to CLERP 9 to address the nominated anomalies.

However, CSA recommends that the changes be incorporated in the Regulations to the Act rather than being incorporated into the *Corporations Act*.

4. Corporate Governance

4.1.1 Amounts that can be paid to related parties without member approval

CSA supports the introduction of a level of materiality in relation to transactions of related parties, requiring any benefit to be paid in excess of a particular amount during the course of a financial year to be approved by members. CSA believes that benefits should be assessed in the context of each financial year.

CSA also recommends that ASIC conduct a survey of relevant parties to ascertain the appropriate materiality level. If this cannot be effected quickly, CSA recommends a minimum level of materiality of $5,000.

4.1.2 Amounts given to director or spouse without member approval

CSA supports indexing the threshold level.

CSA again recommends that ASIC conduct a survey of relevant parties to ascertain the appropriate amount for such a threshold level.

CSA also suggests that the amounts under discussion in Points 4.1.1 and 4.1.2 could be set at the same level.

4.2 Remove directors' duties for single-director companies

CSA has concerns with any recommendation to alter directors' duties according to the size of the company and opposes the voluntary removal of directors' duties by resolution for single-director companies.

CSA notes that:

- the fiduciary duties should be the same for all directors
- the proposal would set a precedent that could lead to calls for different directors' duties for different sectors, eg, the not-for-profit sector or the public sector
- with the ever-increasing focus on corporate governance it is not desirable to be reducing the duties of directors
- it is good for directors of small companies, including single-director companies, to focus on their fiduciary duties and the need for a governance framework
- the proposal would create two classes of directors, which is a potentially dangerous move.

Recommendation

CSA opposes the voluntary removal of directors' duties by resolution for single-director companies, as it will create two classes of directors and the fiduciary duties should be the same for all directors.

4.3 Extend the business judgment rule

CSA supports a general protection for directors and other officers and notes that if a general protection is introduced it must apply to officers as well as directors.

CSA supports the four points noted in the consultation paper as a template for a general protection but notes that these points need to be expanded to include that directors must act:

- not for any material personal interest, and
- for a proper purpose.

Without the inclusion of these additional points, directors' duties may be diluted.

CSA also notes that the Corporations and Markets Advisory Committee (CAMAC) is currently exploring whether corporate duties should be extended below board level. CSA would like to remind the Treasury, as the initiator of this review, that any extension of the business judgment rule should also cover any extension of the liabilities of directors to other categories of persons which might arise from the 2005 CAMAC review on *Extending Corporate Duties Below Board Level*. Indeed, the business judgement rule should be extended to any person making decisions for the company if they can be held liable and accountable.

Recommendation

CSA supports a general protection for directors and other officers and notes that if a general protection is introduced it must apply to officers as well as directors.

4.4 Greater flexibility for company meetings

While CSA supports the concept of companies having greater flexibility in conducting meetings, CSA would like to know details of the meeting requirements that are proposed to be turned into replaceable rules before commenting on the proposal. CSA would also like to know more detail of the rationale behind this proposal before providing further comment.

CSA would, however, oppose a proposal allowing companies to set the rules for notices of meetings and proxy appointments. This would have the potential to confuse and possibly disenfranchise members, as each company of which they are a member could potentially adopt different rules and inconsistent meeting practices.

Given the current problems with proxy appointments, as outlined in CSA's discussion paper published in March 2006 entitled *Expressing the voice of shareholders: a move to direct voting*, and the recently released Corporations Amendment Bill (No 2) 2006, which seeks to address some of these problems, CSA believes it would be a regressive step to allow companies to individually set rules for meetings and proxy appointments.

Recommendation

CSA opposes a proposal allowing companies to set the rules for notices of meetings and proxy appointments. This would have the potential to confuse and possibly disenfranchise members, as each company of which they are a member could potentially adopt different rules and inconsistent meeting practices.

5. Fundraising

5.1 Obligation to produce a prospectus of rights issues of quoted securities

CSA agrees that the protection of investors must be balanced against the capacity of the market to raise capital efficiently. Achieving a fair balance is not a straightforward exercise.

When a company has made a conscious decision to raise capital, which will have an impact on earnings depending on how the money is used and the risks involved, it can be argued that a greater level of protection is required to be provided to the investor who is being invited to subscribe than when the investor chooses to buy existing shares from another shareholder. Thus the bid to raise capital normally deserves a prospectus as this provides more focus for company management to ensure that what is said in support of the capital raising is not misleading in what it states or omits to say.

CSA's preference is to at least remove the obligation to produce a prospectus for particular categories of rights issues of securities, as the need for a prospectus is difficult to justify, in each of the following circumstances:

- when the rights issue is fully underwritten, or
- when the company has a history of profit and the capital raising is proportionate to the profit.

In either of these circumstances, the requirement should be for a one-two page document setting out the terms of the rights issue, with detail provided as to whether it is a renounceable or non-renounceable rights issue.

However, where the company has no history of profit and therefore the capital sought to be raised is more at risk, the rationale for retaining the prospectus is stronger.

Currently the prospectus that is required for raising new capital provides a higher degree of protection to the investor than is achieved when the shareholder buys existing shares from another shareholder. This elevated level of protection should be retained in such circumstances where the risk to the investor is also elevated. It can also be argued that as the prospectus is a selling document, a higher level of disclosure is required.

CSA notes that section 713(4) provides investors with the right to obtain information consisting of the most recent annual financial report, any half-year financial report and any continuous disclosure notices issued by the company or to ask for a copy of such information. In practice, prospectuses not only list the existence of this information but also replicate a lot of the underlying information in full, in narrative form. This is because:

- while investors can seek the information listed in section 713(4) themselves in different places, such as the company's or ASX's website, the company takes the view that it is easier for the investor to find all such information in one place, namely, the prospectus.
- in bringing together the information in one place in narrative form the company is providing the corporate story of what has been achieved so far, and what is intended to be done in the future, thus providing a context for the capital raising. This would also give effect to section 715A (1) which provides that the information in a disclosure document must be worded and presented in a clear, concise and effective manner.

CSA notes that if it was clarified that the obligation to produce a prospectus for rights issues did not apply to circumstances where the rights issue is fully underwritten or where the company has a history of profit and the capital raising is proportionate to the profit, then section 713(4) is more likely to be utilised, thus providing cost and time savings to both companies and their shareholders.

CSA also notes that it is commonly the case that in small industrial companies without a strong profit record or in mining exploration companies the cost of a rights issue is seen to be too high in relation to the amount of capital sought to be raised. Such a company commonly decides to raise the capital by making a placement through a broker that has a good understanding of and faith in the company. The result is that shareholders are not offered the opportunity to participate in a rights issue. Existing shareholders, instead, discover that their shareholding has, to a degree, been diluted by the placement used for the capital raising. This negative impact on the shareholders has been caused by the cost of compliance, namely the disproportionate cost of preparing a prospectus.

Larger listed companies sometimes avoid the cost of prospectus compliance by doing a "jumbo placement". First they raise the bulk of the needed capital by a placement, for which no prospectus is required. This is then followed by an offer to each shareholder to subscribe for $5,000 under a share purchase plan. This also is exempt from a prospectus. Even then the shareholders are disadvantaged as the amount each may subscribe is the same, regardless of the size of the existing shareholder. The larger shareholders are materially disadvantaged.

CSA is concerned that prospectus compliance costs are unreasonable where the risk protected against is relatively small. Examples of this are:

(a) If a rights issue is underwritten, an investor has the comfort that a holder of an Australian financial services licence has been prepared to take on potential liability for the whole issue, albeit on terms that have "out clauses".

(b) If a company with a history of profit seeks capital proportionate to that profit, the clear implication is that the degree of risk for an investor is moderate.

Recommendation

CSA supports removing the obligation to produce a prospectus for particular categories of rights issues of securities, as the need for a prospectus is difficult to justify, in each of the following circumstances:

- when the rights issue is fully underwritten, or
- when the company has a history of profit and the capital raising is proportionate to the profit.

However, where the company has no history of profit and therefore the capital sought to be raised is more at risk, CSA suggests that the rationale for retaining the prospectus is stronger.

5.2 Review of the fundraising provisions to facilitate certain types of fundraisings

Section 708(1): Small scale offerings (20 issues or sales in 12 months)

This is a useful provision which favours, as a matter of policy, the efficiency of raising capital over the usual high level of protection afforded by a prospectus.

A material revision of either the amount or the number of investors permitted under the section would necessitate a revision of the policy behind it.

Section 708 (8): Sophisticated investors

The assumption behind section 708(8) is that a sophisticated investor can be defined as a person who can invest a minimum of $500,000, and that such a person can either afford to engage an accountant or lawyer to assess the risk of an investment or has the necessary expertise themselves.

However, CSA notes that some corporate failures reveal that there are many unsophisticated investors, with neither the financial resources to engage experts nor the necessary expertise, who can invest lump sums of $500,000, perhaps gained as the result of a lump sum retirement benefit or a personal injury settlement.

Section 708(8) provides an alternative measure of the sophisticated investor by providing for exemption if a certificate is supplied from a qualified accountant stating that the person to whom the offer is made has net assets of at least $2.5 million or gross income for each of the past two financial years of more than $250,000.

CSA notes that there are many investors who have the necessary expertise to make sophisticated investment decisions and considerable wealth who nonetheless do not pass either the asset test or the income test. Their assets are held by one or more companies or trusts rather than by the individual and their income is split between entities. Given that the policy objective of this provision is to allow sophisticated investors to accept an offer of securities without a prospectus, CSA believes that it is sufficient protection for the persons themselves to apply for exemption by certifying that they have under their control, either directly or indirectly, the necessary minimum level of assets or income. Therefore, CSA recommends that this section be simplified to allow it to work more effectively in practical terms.

5.3 Review secondary sale disclosure rules

CSA has no comment on this section.

5.4 Employee share ownership plans

CSA notes that employees of unlisted companies are not in a position to sell their shares on the open market. This raises the issue of whether they require protection in relation to disclosure of information setting out the risks attached to their share ownership. CSA also notes that, at present, no problems have been identified in relation to employees owning shares in unlisted companies.

CSA agrees that whatever changes need to be instituted should ensure that an unlisted company does not need to hold an Australian financial services licence in this situation.

5.5 Prospectus advertising and publicity

CSA agrees that a simplification of the disclosure requirements is useful *after* the prospectus has been lodged with ASIC, but opposes any change being made *prior* to the prospectus being lodged. It is inappropriate that offerers can flood the market with information so that potential investors do not read the prospectus, when the advertising pre-lodgement may contain substantially different information from the prospectus.

6. Takeovers

6.1 Telephone monitoring during takeover bids

CSA notes that the current rules applying to telephone monitoring during takeover bids are unduly onerous. For example, if the company secretary or the investor relations manager returns a call to a shareholder, then that person has to arrange for the call to be taped before they can speak to the shareholder. The rules therefore place a considerable cost and logistical burden on companies, and CSA members are yet to be persuaded that the benefits of telephone monitoring during takeover bids justify these costs.

CSA further notes that the company secretary and investor relations manager are in most cases fully aware of their duties under the continuous disclosure regime. Thus, CSA strongly supports removing the requirements in the *Corporations Act* that relate to telephone monitoring during takeover bids.

Recommendation

CSA supports removing the requirements in the *Corporations Act* that relate to telephone monitoring during takeover bids.

7. Collective Investments

CSA has no comments on Sections 7.1 – 7.2.

8. Dealing with regulators

8.1 Implement upfront payment option for ASIC annual fees

It is CSA's view that not many companies would avail themselves of such an option, due to uncertainty concerning the future. For example, a company could be taken over within a ten-year period or disposed of or deregistered due to the sale of its key asset. CSA sees no problem with the option, but does not see it being taken up by many companies.

8.2 ASIC/APRA information exchange

CSA notes that duplicated information that is currently required by both regulators includes:

- ASIC Form 484 and APRA Form 208
- ASIC Form 388 and APRA Form 70
- applying for licences
- information relating to directors.

CSA recommends consolidation of the information lodged on these forms and notes that there is a precedent for the operation of a system whereby if information is lodged with one regulatory body it is taken to have been lodged with the other regulatory body. When a listed company lodges its accounts and annual report with ASX, it is taken to have been lodged with ASIC.

CSA notes that ASIC and APRA have slightly different requirements concerning the information relating to directors (see above). CSA recommends that, where such slight differences exist in information requirements but the majority of the information is identical, the higher standard of reporting be taken as the standard required for both regulatory bodies. That is, the regulatory body with the lower standard should change its standard to meet that of the higher standard, so that two standards are not in operation.

8.3 Enhancing communication with ASIC

CSA supports communication between business and ASIC and notes that it already has member representatives on a number of ASIC liaison committees, both those formally constituted by ASIC and more informal committee meetings organised by CSA.

CSA hopes to continue to be involved in any such consultation groups and encourages ASIC to ensure such consultation groups meet on a regular basis, as while liaison at a national level is proving to be effective in facilitating communications between ASIC and industry, communication with stakeholders at a state level has not proven thus far to be as satisfactory.

8.4 Breach reporting requirements

CSA fully supports any move to overcome inconsistencies between breach reporting requirements and notes that the savings from removing additional compliance costs will be a benefit to business.

CSA would like to comment on the issue of breach reporting requirements in relation to the regulatory bodies ASX and ASIC, rather than in relation to specific legislation referring to breach reporting requirements to ASIC and APRA. For example, in relation to continuous disclosure, CSA notes that ASX has a higher standard than ASIC and that this should be utilised. CSA's preference is for a common standard, but CSA also suggests that one way forward is for each body to acknowledge that compliance with one body with the highest standard is immediate satisfaction of the other's standards.

CSA also notes that any reporting should be of a significant breach only.

8.5 Product Disclosure Statement in-use Notices

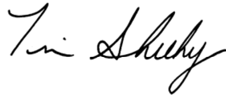
CSA would not like to see a renewal process. The Product Disclosure Statement remains in use until withdrawn (which currently does not have to be notified and which companies would not wish to be obliged to notify,) but a replacement is indicated on the new lodgement notice. CSA believes that one issue is that, at present, a one-size-fits-all document is in use, with many items relevant only to superannuation. Another issues is that the lodgements have to be on paper and the reference number of the product issuer is not recorded anywhere by ASIC.

CSA suggests that electronic lodgement would overcome the administrative issues, including having a cross-reference number from ASIC that would help identify in-use notice lodgements for accounting reconciliation and other administrative processes. Overall, CSA suggests that the purpose could be reviewed and then a process established to meet that purpose.

Conclusion

On a final issue, CSA notes that the recent Taskforce on Reducing the Regulatory Burden on Business received multiple submissions calling for extended consultation periods when legislative and regulatory reform is proposed. CSA appreciates that this consultation paper has been released with the intention of easing the regulatory burden on business, but notes that the one-month consultation period and the concomitant need to respond quickly to a number of proposals was experienced as onerous by our members.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE