CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

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Dear Marian

Consultation on proposed reforms to section 205G of the Corporations Act

Chartered Secretaries Australia (CSA) is the independent leader in governance, risk and compliance. 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. Our Members are all involved in governance, corporate administration and compliance with the Corporations Act (the Act). Our Members work in both public listed and public unlisted companies, as well as in private companies. We have drawn on their experience in the formulation of this submission.

We welcome the opportunity to comment on the consultation.

Our recommendations are set out below and our reasons for these recommendations are set out on the following pages.

Summary of CSA recommendations

1. CSA supports the extension of s 205G to apply to all listed entities, not just listed companies.

2. CSA recommends that exempt foreign entities should be taken to have complied with the provision if they have complied with the disclosure requirements of their incorporating jurisdiction on the basis that a 'one-stop shop' notification be provided in Australia, such as notification to ASX, so that Australian investors can easily obtain the information (in English) on the trading of shares by directors and senior executives without having to go offshore to locate it.

3. CSA supports, in principle, the extension of the requirement to report securities holdings to senior executives, but notes that a clear definition of who is captured in this category is required. CSA suggests that the 'key management personnel' definition for the purposes of the remuneration report is a practical definition that could be readily adapted, without introducing further definitional issues or interfering further with the privacy of individuals. CSA notes that if this proposal is adopted it will be necessary for listed entities to monitor the identity of their key management personnel continuously and not just at the time of preparation of the annual remuneration report as is currently the case. The listed entity would need to inform the relevant individuals whether or not

they are key management personnel so that they can comply with their individual obligations under s 205G. It would also be appropriate for the listed entity to inform their market operator of any changes in its key management personnel.

4. CSA does not support the proposal to oblige a director or senior executive to remain under a disclosure obligation for one month after they resign. CSA is of the view that this proposal would not provide the market with significant useful information and would impose a compliance burden which would be difficult for the company to discharge on the director's or executive's behalf.

5. CSA recommends that the recommendation to reduce the disclosure period in s 205G of the Corporations Act from 14 days to five *business* days be adopted. CSA notes that, given the current ASX Listing Rule disclosure obligation is five business days, no additional compliance costs will result from this change.

Current compliance costs

CSA notes that it is difficult to quantify compliance costs attached to s 205G, as they vary from company to company.

Currently, while the disclosure obligation under s 205G is a personal one, companies usually discharge that obligation on behalf of directors, through the requirement under the ASX Listing Rules for companies to notify the market of any changes in directors' interests in the securities of listed companies. This involves allocating internal resources to put in place a system for keeping track of any transactions undertaken in securities held by directors and ensuring that notification to ASX occurs in a timely fashion, or outsourcing the function to an external party. Such resource allocation has costs attached to it, but this cannot be easily quantified, given that the costs vary from company to company. Furthermore, the disclosure obligation applies not only to active trades in securities, but also to passive acquisitions arising out of, for example, dividend reinvestment plans, as well as 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.

Many companies have in place monitoring systems to track all trades undertaken by directors, to ensure that the directors' disclosure obligations under s 205G and the Listing Rules are met. Share registries currently charge listed entities for monitoring any transactions undertaken by directors and their associated entities.

The costs attached to these monitoring systems vary from company to company. The pricing structure of contracts between share registries and companies varies greatly between companies. Most contracts in the industry are negotiated on two levels:

1. basic registry maintenance (includes annual processes including dividend disbursement), and
2. additional registry services (that is, corporate actions).

Only a small number of basic registry maintenance contracts in the industry are fixed price contracts (that is, an annual base fee). One of the key difficulties in comparing service offerings across the market is that almost every registry service contract is different given:

1. number of shareholders
2. length and terms of contract
3. types of services required/employed, and
4. service level requirements.[1]

[1] JP Morgan and Chartered Secretaries Australia, *Australian Registry Service Provider Survey 2010*, March 2010

Detailed feedback on proposals

Section 205G should apply in respect of all listed entities, not just listed companies. It should apply to the directors and senior executives of any entity that substantially manages the affairs of a listed entity

CSA supports the extension of s 205G to apply to all listed entities, not just listed companies. CSA can see no logical reason for not extending the application of s 205G. While it would mean that such entities will incur compliance costs that do not currently apply to them, CSA is of the view that the need for confidence in the market justifies these additional compliance costs. CSA does not consider there is any logical distinction between listed companies and other listed entities which would justify different disclosure obligations for directors and senior executives of listed entities which are not companies.

Directors of exempt foreign entities should be taken to have complied with the provision if they have complied with the disclosure requirements of their incorporating jurisdiction

CSA recommends that exempt foreign entities should be taken to have complied with the provision if they have complied with the disclosure requirements of their incorporating jurisdiction on the basis that a 'one-stop shop' notification be provided in Australia, such as notification to ASX, so that Australian investors can easily obtain the information (in English) on the trading of shares by directors and senior executives without having to go offshore to locate it. The legislation could provide that directors of foreign exempt entities are deemed to have notified ASIC if notification to the market has taken place.

Should directors of exempt foreign entities be taken to have complied with the provision if they have complied with the disclosure requirements of their incorporating jurisdiction as proposed, and that jurisdiction operates in a language other than English, Australian investors are potentially disadvantaged in terms of access to information and CSA is of the view that such an outcome does not justify any reduction in compliance costs.

The disclosure obligation should extend to all directors and senior executives, including the chief executive officer

CSA supports, in principle, the extension of the requirement to report securities holdings to senior executives, but notes that a clear definition of who is captured in this category is required. CSA suggests that the 'key management personnel' definition for the purposes of the remuneration report is a practical definition that could be readily adapted, without introducing further definitional issues or interfering further with the privacy of individuals.

CSA notes that, in many instances, the key management personnel will have much more immediate and frequent access to market-sensitive information than directors. Indeed, market-sensitive information provided to boards almost always comes from senior executives. CSA is therefore of the view that such personnel should be captured by s 205G.

However, CSA recommends that the definition of senior executives needs to refer to a relatively confined group, such as the key management personnel, to be consistent with other compliance obligations, and to better contain compliance costs. The shares held by the key management personnel are already disclosed in the accounts annually. Compliance costs could be extensive if the group of senior executives was more widely determined.

Furthermore, given that personal liability attaches to s 205G, individuals should not be in doubt as to whether they are part of the group of senior executives to whom the provision applies. Any individuals to whom the provision refers need absolute clarity as to whether the burden of disclosure applies to them or not. This will require that listed entities continuously monitor the identity of their key management personnel and inform the relevant individuals whether or not they are key management personnel.

CSA also notes that it may be necessary or appropriate to introduce a requirement on listed entities to notify the market of changes to the composition of its key management personnel that might occur between annual remuneration reports. While CSA accepts that this will increase compliance costs, particularly for the smaller listed companies who may not have the same level of resources as larger corporations, CSA is of the view that transparency of transactions involving securities in the company by those with access to market-sensitive information provides sufficient benefit to justify the additional costs. The creation of the additional compliance costs of notifying ASX of changes of key management personnel is outweighed by the market interest in receiving news of any such changes and the removal of scope for the perception of conflicts of interest that may arise if share trading takes place without such information being made available to the market at large.

CSA recommends that the 'key management personnel' definition for the purposes of the remuneration report be adopted as the senior executives to which the amended s 205G would apply.

Where a director or senior executive has resigned from that position, the disclosure obligation should cover any relevant transactions that occurred before that resignation and within one month thereafter

CSA does not support the proposal to oblige a director or senior executive to remain under a disclosure obligation for one month after they resign. CSA is of the view that this imposes an unreasonable compliance burden which would be difficult for the company to discharge on the director's or executive's behalf and would not provide significant useful information to the market. Instead, CSA recommends that directors and senior executives should be required to disclose their security holdings on the day they cease to be a director or key management personnel (as is currently the case for directors under the ASX Listing Rules). CSA is strongly of the view that this obligation is sufficient in terms of the company's obligation to notify the market.

CSA notes that, once the company's obligation to notify the market ceases with the cessation of appointment or employment, the obligation disclosure is purely a personal one. CSA is of the view that it is not practicable to extend the disclosure obligation, given that the individual will no longer be able to utilise the company to handle their disclosure obligations, and the ASX has no jurisdiction over individuals. ASX can only impose obligations on the company, through the contract to list on the exchange. CSA notes that, to the extent there is concern about a director or executive trading on inside information after they leave a listed entity, this is already covered by insider trading legislation and s 183 of the Corporations Act.

The information to be disclosed under s 205G should not include changes that have arisen from transactions that have applied equally to all shareholders, and without individual shareholder election, such as capital reconstruction or bonus issues

CSA does not support the proposal that the information disclosed under s 205G should exclude changes that have arisen from transactions that have applied equally to all shareholders, and without individual shareholder election, such as capital reconstruction or bonus issues.

CSA recommends that the information disclosed should be a complete record rather than a partial record, as this is more useful to those accessing the information. Companies currently have in place monitoring systems that capture all trades, so there would be no additional compliance costs attached to maintaining a complete record. Moreover, in some instances, some directors may subscribe to transactions that apply equally to all directors and others may not. Attempting to keep track of those who subscribe and those who do not for the purposes of a disclosure obligation would impose additional compliance costs.

Furthermore, CSA is of the view that an incomplete record would raise questions rather than enlighten or dispel concern. The notification to the market of directors' interests in the securities of listed entities is an issue of market integrity. A gap in the record of shareholdings, as reflected from one year to the next in the entity's annual reports/remuneration reports, creates the potential for speculation that directors could be trading in company securities when in possession of inside information. Regardless of whether there is substance to such suspicions that breaches of the law are occurring, it is this perception that directors or senior executives may be engaging in insider trading that negatively affects the reputation of the listed entities and has the potential to undermine the market.

The disclosure period should be reduced from 14 days to five days, except for changes arising under dividend (distribution) re-investment plans, where the period should remain at 14 days

Section 205G of the Corporations Act currently requires a director of a listed company to notify the market operator (for example, the ASX) of:

- any relevant interests of the director in securities of the company or a related body corporate, and
- contracts to which the director is a party or under which the director is entitled to benefit and which confer a right to call for or deliver shares in, debentures of, or interests in a managed investment scheme made available by the company or a related body corporate.

Notice must be given within 14 days of the director's appointment or any change in the director's interests. For listed companies and their directors, the ASX Listing Rules require notice of any change in the director's interests within five business days.

CSA supports the proposal to reduce the disclosure period in s 205G from 14 days to five *business* days.

Currently the proposal from Treasury is to reduce the disclosure period to five days, but this does not align with the current notice period required by the ASX Listing Rules, which is five *business* days.

CSA notes that, if any change in a director's interest is price-sensitive, it must be disclosed immediately under the continuous disclosure provisions (s 674) of the Corporations Act. If a change in a director's interests is not price-sensitive, a reduction of the current 14-day time limit to five business days will align with the requirement as set out in the ASX Listing Rules and will continue to achieve the policy objective of maintaining an informed market to enhance confident and informed participation by investors.

The Listing Rules five-business-day time limit currently accommodates any changes of interest arising from participation in an incentive plan, which would not necessarily be known to an individual director until two or three days after the change. An allocation may have been made to a director under an incentive plan, yet it is the trustee who buys shares, not the director. This is why the director may be unaware of the change until two or three days after the event. Such trades do not affect the price or value of investors' holdings. A reduction of the disclosure period

to five business days will provide sufficient time for the notification of such changes in directors' holdings.

CSA also notes that the five-business-day time limit was put in place to accommodate T+3 settlement and that the need to accommodate this remains applicable. Reducing the time limit to five business days not only aligns the Corporations Act with the ASX Listing Rules, but also accommodates T+3 settlement.

CSA recommends that the proposal to reduce the disclosure period in s 205G of the Corporations Act from 14 days to five *business* days be adopted. CSA notes that, given the current ASX Listing Rule obligation, no additional compliance costs will result from this change.

Removal of overlap with ASX Listing Rules

CSA would like to point to a matter that was not raised in the consultation paper issued by Treasury but that is relevant to the issues under discussion.

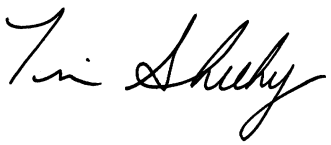
CSA is of the view that it would be useful for s 205G to be a complete statement of directors' and senior executives' security trading disclosure obligations so that Listing Rule 3.19A could be deleted. If necessary, s 205G could be amended to include an obligation on the listed entity to disclose relevant information to their market operator, in addition to retaining the personal obligation on directors and executives. With other exchanges entering the market, this would be a logical solution to requiring market notification. It should also reduce the costs of complying with similar but not quite identical requirements in the Corporations Act and Listing Rules. Of course, listed entities (and their directors and executives) should be able to meet their s 205G obligation by a single lodgment with their market operator.

Conclusion

CSA has given careful consideration to the issues raised by the consultation on possible reform to s 205G.

CSA would welcome further contact during the consultation process and the opportunity to be involved in further deliberations.

Yours sincerely



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