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Leaders in governance

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Marian Kljakovic
Manager
Market Integrity Unit
Corporations and Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: insidertradingpaper@treasury.gov.au

Insider Trading: Position and Consultation Paper

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 and represent over 8,000 governance professionals working in public and private companies. Our members are all involved in governance, corporate administration and compliance with the *Corporations Act* (the Act) and we have drawn on their experience in the formulation of each submission on the matters contained in the Consultation Paper.

Summary of CSA recommendations

Recommendation 1

CSA strongly recommends that the Government *not* adopt the CAMAC recommendation to reduce the disclosure period in s 205G of the *Corporations Act* from 14 days to two days.

CSA recommends that the current five-day time limit, as set out in the Australian Securities Exchange (ASX) Listing Rules, supports the policy objective of maintaining an informed market and that any amendment to s 205G, which only applies to listed entities, should align with the ASX Listing Rule requirement.

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

Recommendation 10

CSA supports, in principle, the CAMAC minority view that the 'generally available information' definition in s 1042C be retained but **recommends** that the 'readily observable matter' test be better defined than as currently worded in the minority view.

CSA recommends that the words 'investors in Australia' would be a more practical definition and that the drafting reflect that information be available for a reasonable period of time having regard to the form of disclosure.

Recommendation 11

CSA recommends that any reform of the legislation clarify whether inside information is relevant at the time of entering the transaction or exercising the option.

CSA also recommends that Recommendation 11 be clarified so that it is clear that it covers exchange-traded options, but does not cover options issued under employee share plans.

Recommendation 38

CSA recommends that a carve-out be considered for sophisticated investors, who could have other avenues open to them, such as civil actions in contract law or under the *Trade Practices Act*, should disclosure not take place.

Background to CSA recommendations

Proposal to implement Recommendation 1 of CAMAC report: Strengthen the reporting requirements for directors

CSA understands that the government has decided to accept Recommendation 1 of the CAMAC report, which is to amend s 205G. CSA would like to point to serious concerns with the adoption of this recommendation. While we recognise that it does not form part of the Consultation Paper, CSA is concerned that the policy objective of a better governance framework will not be achieved by adopting the recommendation in full and takes this opportunity to comment.

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.

In adopting CAMAC’s recommendation to amend s 205G, the changes include:

- extending the obligation to all listed entities, not just listed public companies
- extending the obligation to senior executives as well as directors
- extending the obligation to the one-month period after resignation, and
- reducing the disclosure period from 14 days to two business days in most cases (this is shorter than the five business days currently allowed under the ASX Listing Rules).

Reducing the disclosure period

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.* In such circumstances, disclosure within two days is too late to achieve the policy objective of a transparent market and timely and equal access by investors and stakeholders to information that could affect, either favourably or unfavourably, the price or value of their holdings.

If a change in a director's interests is not price-sensitive, the current five-day time limit as set out in the ASX Listing Rules will continue to achieve the policy objective of maintaining an informed market to enhance confident and informed participation by investors.

The Listing Rules five-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, yet directors would be in breach of the law for not notifying the change in their holdings within two days.

CSA also notes that the five-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 two days will not accommodate T+3 settlement, which would potentially place directors in breach of the law despite acting in accordance with all due procedure.

CSA strongly recommends that the Government *not* adopt the CAMAC recommendation to reduce the disclosure period in s 205G of the *Corporations Act* from 14 days to two days.

CSA strongly recommends that the current five-day time limit as set out in the ASX Listing Rules supports the policy objective of maintaining an informed market and that any amendment to s 205G, which only applies to listed entities, should align with the ASX Listing Rule requirement.

Extending the obligation to senior executives
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 also notes that there will need to be a mechanism to address changes in key management personnel that might occur between remuneration reports.

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

Recommendation 2: Restrict the on-selling exemption for underwriters

CSA has no comment.

Recommendation 3: Repeal the exemption for external administrators

CSA has no comment.

Recommendation 10: Amend the test of generally available information

CSA does *not* support the CAMAC majority view recommended redrafting of s 1042C(1).

CSA supports, in principle, the CAMAC minority view that the 'generally available information' definition in s 1042C be retained. The minority view's recommended modification of the definition of 'readily observable matter' test should be noted.

However, confusion could be created by the three limbs proposed by the minority report when implementing the 'readily observable matter' test, in particular the term 'cross-section of Australian investors', which appears in two of the limbs, and the concept of 'reasonable time'.

CSA notes that information needs to be *able to be* observed by an appropriate and sufficiently large audience – it does not *have to be* observed.

CSA notes that a 'cross-section of Australian investors' may not include those investors the definition is seeking to include. For example, Australians living overseas will be captured in this definition, yet an advertisement taken out in Australian newspapers would not necessarily be available to Australian investors living overseas.

CSA recommends that the words 'investors in Australia' would be a more practical definition.

CSA also notes that a period of time for which information is available or needs to be available may vary according to the circumstances.

CSA therefore recommends that the drafting reflect that information be available for a reasonable period of time having regard to the form of disclosure.

Recommendation 11: Informed party exercising option rights

CSA notes that the Consultation Paper speaks of exchange-traded options, but that there are other sorts of options, such as options and performance rights issued in connection with employee incentive plans. These plans generally allow employees to acquire shares at a fixed price (or in the case of performance rights for token consideration) on satisfaction of various performance hurdles. An employee's decision as to whether or not to exercise the options or performance rights will almost always be exclusively determined by whether or not the options or performance rights are 'in-the-money'. An employee will generally not be influenced by any inside information that they might hold.

In the case of an employee incentive plan option satisfied by the issue of new shares by the company to the executive, CSA notes that the combination of ss 1043(2)(b) and 1042G would generally be sufficient to ensure that neither the company nor the executive are in breach of insider trading provisions as the company will be deemed to possess the same information as the executive.

However, an issue of shares on the exercise of an option or satisfaction of performance conditions for performance rights is only one way in which an executive incentive plan may operate. CSA notes that the defence above may not cover all circumstances, for example, where a trust holds the underlying shares which are transferred to the executive on the exercise of the options.

CSA recommends the introduction of an express exemption for the exercise of options or performance rights under an employee or executive incentive scheme, and issue or transfer of shares on exercise.,

Recommendation 14: Entity making an individual securities placement

CSA has no comment.

Recommendation 15: Share buy-backs (as it applies to issuers buying back securities)

CSA supports the majority position.

Recommendation 38: Focus the prohibition

CSA does *not* support the CAMAC majority view.

CSA supports, in principle, the CAMAC minority view involving the concept of insider trading laws applying equally to all financial markets and financial products, with the Australian Securities and Investments Commission (ASIC) enabled to approve exemptions tailored to specific OTC market conditions.

However, CSA reserves our position to comment again once we have reviewed any exposure draft of the legislation. CSA notes that when drafting the minority proposal, difficulties will be experienced clarifying how the position will work in practice.

CSA notes that there could be difficulties with specialist markets, and any that may come into being, for example, water rights, carbon credits etc. There is a question of whether such markets will be classified as OTC markets for the purpose of ASIC's exemption powers.

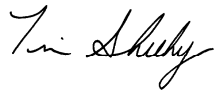
CSA recommends that a carve-out be considered for ‘sophisticated investors’, who could have other avenues open to them, such as civil actions in contract law or under the *Trade Practices Act*, should disclosure not take place.

Conclusion

CSA has given careful consideration to the issues raised by the consultation paper on proposed reforms to the insider trading provisions in the *Corporations Act*. CSA has also submitted that the recommendation from CAMAC to reform s 205G will not achieve the policy objective of a transparent market and timely and equal access by investors and stakeholders to information that could affect, either favourably or unfavourably, the price or value of their holdings.

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

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE

cc The Hon. Chris Pearce MP, Parliamentary Secretary to the Treasurer