CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

7 June 2011

Fiona Laidlaw
Senior Lawyer
Australian Securities and Investments Commission
Level 5, 100 Market Street
Sydney NSW 2000

By email: policy.submissions@asic.gov.au

Consultation paper 155: Prospectus disclosure: improving disclosure for retail investors

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. Members of CSA deal on a day-to-day basis with the Australian Securities and Investments Commission (ASIC) and have a thorough working knowledge of the operations of the financial markets, the needs of investors and the Corporations Act.

General comments

CSA welcomes Consultation paper 155: *Prospectus disclosure: improving disclosure for retail investors* (the consultation paper), which brings directional clarity to prospectus disclosure, particularly in relation to a definition of clear, concise and effective disclosure. CSA Members strongly support the approach to disclosure set out in the consultation paper and commend ASIC for releasing the guidance and seeking feedback on it.

Our comments on the following pages primarily seek further clarification of particular matters, to ensure that issuers can prepare prospectuses that satisfy the requirements of s 710 of the *Corporations Act 2001* (the Act) and retail investors can make informed decisions. In this submission, we do not provide detailed responses to each question set out in the consultation paper, but provide feedback on specific issues where we are of the view that further clarity would be useful in the guidance.

Clear, concise and effective disclosure

In discussions with ASIC concerning this consultation paper, it was suggested that clear, concise and effective disclosure equates to what you would expect to hear if you were seated next to a director at a dinner party and they informed you in a succinct and accessible manner of the company of which they were a director, its opportunities, prospects and the risks attached to investing in it. CSA Members fully support prospectus disclosure for retail investors that would meet these criteria.

CSA notes that broking firms prepare reports based on an analysis of prospectuses. These reports are generally clear and well-researched, providing pithy information on the company, balanced with information on the risks attached to the investment. Such reports allow

sophisticated investors to make informed decisions. CSA Members agree that retail investors should have access to similar clear and accessible information. The guidance provided by ASIC in the consultation paper should enable issuers to prepare high-level summaries that meet this need and also eliminate confusion brought about by repetition and replication.

CSA Members strongly support the proposals set out in Tables 3 and 4 of the Draft Regulatory Guide providing guidance on achieving clear, concise and effective disclosure by ensuring the prospectus:

- highlights key information
- uses plain language
- is as short as possible
- explains complex information, including any technical terms, and
- is logically organised and easy to navigate.

CSA Members agree with the proposed guidance that an investment overview is an effective way to help retail investors identify and understand the information that is the key to their investment decision. However, while CSA understands that ASIC is seeking to limit the emphasis on marketing in a prospectus, CSA is of the view that if photographs are factual and accurate, they need not only be placed after the investment overview.

CSA Members also strongly support the proposal that more detailed disclosure (for example, contracts, trust deeds, detailed corporate governance policies, secondary specialist expert reports and foreign offer documents) can be incorporated in the prospectus by reference to it. CSA notes that this concept is similar to the approach to shareholder communication undertaken by many large, listed companies who prepare short-form shareholder reviews to inform their investors of the company's performance and prospects, with the full annual report available on the website for those shareholders interested in examining the detail. CSA notes that this approach has found favour with retail shareholders and is of the view that the guidance proposed by ASIC in its consultation paper will similarly assist retail shareholders to make informed decisions.

However, **CSA recommends** that ASIC should provide further clarification of the application of s 712 of the Act and whether more detailed documents are required for sophisticated investors. CSA believes that there is a risk that without such clarification, legal advice will be that issuers should incorporate all detailed documents in the prospectus to ensure issuers meet the requirements of the law, which would in turn defeat the intent of being able to incorporate more detailed documents by reference.

CSA also recommends that the ASIC guidance clarify that a company must have an operational and effective website if such detailed disclosure is provided on it. Start-up companies do not always have operational websites or websites that are effective, and such websites should be mandatory if more detailed disclosure is incorporated in the prospectus by reference to it.

Investment overview

Due diligence committees and directors will have to turn their attention to considering if they have provided a clear picture of the main risks attached to the investment rather than confirming that they have covered all possible risks attached to the investment, which is the current approach.

CSA is of the view that there are differences in the form of disclosure of risks that should be required between, for example, a major bank raising money and a start-up company which has no track record of profit creation. In the case of the major bank, the company will be familiar with its risks, whereas a start-up company may be able to identify its risks but not yet be able to

articulate their impact. CSA believes that, if the investment is to fund business as usual, and disclosure is aimed at current investors, the investment overview should be less detailed than a prospectus covering a new opportunity aimed at new investors.

CSA recommends that ASIC provide further clarity that a scaled approach to risk disclosure can apply. CSA is of the view that ASIC intends that such a scaled approach to risk disclosure is intended to apply, but notes that further clarity would assist issuers.

Further to this, **CSA recommends** that any additional guidance from ASIC could note that additional detailed information on all risks attached to the investment, regardless of whether it is to fund business as usual or to develop a new opportunity, could be incorporated by reference. This would allay any concerns that directors may have in relation to their personal liability, as making disclosure of all risks available, including generic industry risks, will ensure that directors have fulfilled their statutory requirements. Investors could be asked if they want a copy of the additional risks, and directed either to the website or be sent a hard copy.

Disclosure of confidential information about the business model

CSA notes that the carve-outs in Listing Rule 3.1 cannot be relied on when issuing a prospectus. However, the proposed guidance is unclear as to the extent of disclosure of confidential information about the business model that is being contemplated.

In addition to creating commercial sensitivity, disclosure of business models and strategies for generating income and growth may also require disclosure of forward-looking statements and opinions. This may raise issues for issuers becoming comfortable with making such disclosure and the underlying assumptions to support such disclosure.

CSA recommends that ASIC provide further clarity as to its expectations concerning the disclosure of confidential information about the business model.

What to disclose if the company has an operating history

CSA notes that most start-up companies either do not have a three-year financial history to disclose or one that is minimal to the point of irrelevance. That is, a start-up company may have an operating history, but as the company was embryonic, its financial history carries little meaning. At the point of growth, when it is seeking investment, it is unlikely to have three years of audited financial information. Furthermore, when an existing business introduces a new business, it may also find that there is little meaningful financial history to disclose.

Financial information needs not only to be available but also useful to investors. For example, the registration of intellectual property to provide for the existence of a company is not useful information for investors, although it could constitute the financial history of the organisation. However, if the intellectual property registered is central to the commercial operations and activities of the company, that is relevant and useful information to investors and should be disclosed.

CSA recommends that ASIC's proposed guidance should state that three years of financial information should be provided 'where available and useful for potential investors rather than 'where applicable'. The company should include a guide to investors as to whether the funds raised are for a new venture, business or business as usual and therefore, the extent to which the previous financial history is any guide to the future.

Declaration that a person has been an officer of a company that entered into a form of external administration due to insolvency

CSA supports potential investors having confidence that any director or key manager of a company issuing a prospectus is fit and proper to govern. However, CSA also notes that companies enter into administration for legitimate reasons and external administration is a valid form of managing such circumstances. CSA is of the view that any guidance requiring directors and key managers to disclose if the person has been an officer of a company that entered into a form of external administration due to insolvency should be subject to materiality criteria. In CSA's view, ss 206D and 206F of the Corporations Act provide such materiality criteria. Under s 1274AA(1) of the Act, ASIC is required to maintain a public Register of Banned and Disqualified Persons. The Register is publicly available on ASIC's website and a name search can be conducted. Further, ASIC maintains a register of persons banned or disqualified from the financial services sector under s 922A of the Act. This material disclosure can be brought to the attention of investors without invoking the potential to impugn a person's credibility or reputation, which in itself could arguably erode the protection afforded to ASIC under s 246 *ASIC Act 2011* and expose ASIC to an action in defamation or negligence.

CSA is of the view that knowing that any director or key manager of a company issuing a prospectus is on the Register of Banned and Disqualified Persons is even more relevant to investors than that a person has been an officer of a company that entered into a form of external administration due to insolvency. For example, a director could have been an officer of a company that became insolvent 25 years ago, but CSA questions if such information is relevant to the information needs of investors a quarter of a century later. Many business people find that early entrepreneurial efforts fail, and CSA believes that the mere fact of insolvency should not of itself be read as proof of incapacity to govern a company. Alternatively, CSA believes that it is highly relevant information that should be disclosed should a director have been an officer of multiple companies that entered into a form of external administration due to insolvency.

While CSA is of the view that it is not reasonable to expect investors to independently search beyond the prospectus for disclosures as to the propriety of any director or key manager of the company, it is entirely reasonable for ASIC to require a covering letter be attached to any prospectus referring investors to the ASIC website and the Register of Banned and Disqualified Persons. The covering letter could provide the link to the appropriate page on the ASIC website.

CSA recommends that the proposed guidance requiring a declaration that a director or key manager has been an officer of a company that entered into a form of external administration due to insolvency should be subject to materiality criteria, which could be met by reference to ss 206D, 206F and 922A of the Corporations Act. **CSA also recommends** that ASIC require a covering letter be attached to any prospectus referring investors to the ASIC website and the Register of Banned and Disqualified Persons. The covering letter could provide the link to the appropriate page on the ASIC website.

Transition period

On a practical level, CSA notes that the proposed guidance, which sets out a very different approach to preparing prospectuses, may result in additional costs attached to legal and accounting scrutiny, as issuers come to grips with ensuring they meet the demands of the new approach. CSA is of the view that it would not be in the interests of the market for issuers to turn to other forms of capital raising due to any such rise in costs.

CSA Members note that, at present, investment banks use a template with which all parties are familiar and that ensures the issuers have complied with all relevant requirements of s 710. It

will be a drafting challenge for the first issuers preparing a prospectus to meet the definitions of clear, concise and effective disclosure as set out in the Draft Regulatory Guide and also meet the requirements of s 710.

CSA is of the view that ASIC has an educative as well as a compliance role to play in the transition period as issuers and advisers develop familiarity with the new approach to prospectus guidance set out in the consultation paper. That is, **CSA recommends** that ASIC ensure that consistency is applied in its review of prospectuses developed according to the guidance it provides, so that the market can develop skill and capacity to move to a new approach to prospectus disclosure. CSA is of the view that senior staff within ASIC could ensure such consistency is provided if they undertake the reviews of the first prospectuses that are released.

CSA also recommends that ASIC not reject prospectuses that have clearly attempted to meet the demands of clear, concise and effective disclosure, but that may, in small sections, have not quite met expectations, as this would not provide a helpful signal to issuers. CSA is of the view that it would not assist the market to move in the direction of embracing a new approach to disclosure if the first issuers to undertake the process were to find themselves arguing drafting with ASIC when the prospectus has evidently been prepared with every intention to meet the definition of clear, concise and effective disclosure. If the prospectus meets the requirements of the Act and it is evident that effort has been undertaken to provide clear, concise and effective disclosure, **CSA recommends** that ASIC could approve the prospectus, while providing feedback to the issuer on how it could improve its disclosure in the future. It would be disappointing if early adopters were to be penalised for minor infractions rather than assisted and then used as examples of good practice for the rest of the market.

CSA recommends that ASIC work closely with the investment banks and advisers developing any prospectuses early in the new regime as it will drive early and successful adoption if such parties are clear as to what the expectations are.

Application of guidance

CSA notes that the proposed guidance applies to Ch 6 but a number of other documents such as Product Disclosure Statements are dealt with under Part 7.9 of the Act. However, there is limited guidance on the distinction between initial offering or transaction specific-prospectuses and other offering documents. CSA is of the view that it would bring additional clarity to the market if, for example, disclosure related to stapled securities and listed trusts could be dealt with in the same fashion as that for listed companies.

CSA recommends that ASIC provide guidance on how the proposed guidance will apply beyond listed companies.

CSA also notes that international markets have different rules on disclosure and issuers may be seeking to meet the requirements of those other markets. For example, the United States requires very detailed disclosure.

CSA recommends that ASIC provide explanation as to its consultation with regulatory bodies in other jurisdictions and the impact of that consultation on Australian issuers.

Recommendations

CSA Members strongly support the approach to disclosure set out in the consultation paper.

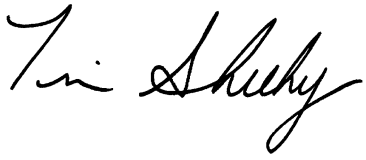
Our recommendations are that:

- ASIC should provide further clarification of the application of s 712 of the Act and whether more detailed documents are required for sophisticated investors

- the ASIC guidance clarify that a company must have an operational and effective website if more detailed disclosure is incorporated in the prospectus by reference to it
- ASIC provide further clarity that a scaled approach to risk disclosure can apply. CSA is of the view that ASIC intends that such a scaled approach to risk disclosure is intended to apply, but notes that further clarity would assist issuers
- any additional guidance from ASIC could note that additional detailed information on all risks attached to the investment, regardless of whether it is to fund business as usual or to develop a new opportunity, could be incorporated by reference
- ASIC provide further clarity as to its expectations concerning the disclosure of confidential information about the business model
- ASIC's proposed guidance should state that three years of financial information should be provided 'where available' rather than 'where applicable', and notes provided to give guidance to investors as to the likely impact of fund raising
- the proposed guidance requiring a declaration that a director or key manager has been an officer of a company that entered into a form of external administration due to insolvency should be subject to materiality criteria, which could be met by reference to ss 206D, 206F and 922A of the Corporations Act
- ASIC require a covering letter be attached to any prospectus referring investors to the ASIC website and the Register of Banned and Disqualified Persons. The covering letter could provide the link to the appropriate page on the ASIC website
- ASIC not reject prospectuses that have clearly attempted to meet the demands of clear, concise and effective disclosure, but that may have in small sections not quite met expectations. ASIC could approve such prospectuses, while providing feedback to the issuers on how they could improve disclosure in the future
- ASIC work closely with the investment banks and advisers developing any prospectuses early in the new regime as it will drive early and successful adoption if such parties are clear as to what the expectations are
- ASIC provide guidance on how the proposed guidance will apply beyond listed companies
- ASIC provide explanation as to its consultation with regulatory bodies in other jurisdictions and the impact of that consultation on Australian issuers.

CSA would be more than happy to arrange for ASIC to meet with our Members to discuss the issues canvassed in this submission.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE