HERBERT SMITH FREEHILLS

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15 November 2013

Dear Ms Tan,

Submission on the Proposed Changes to ASX Listing Rules and Guidance Note 9 – Corporate Governance Disclosures

1 Summary

This submission is made by the Head Office Advisory Team at Herbert Smith Freehills in response to the consultation paper *Proposed Changes to ASX Listing Rules and Guidance Note 9 – Corporate Governance Disclosures* (**Consultation Paper**) released by the Australian Securities Exchange (**ASX**) on 16 August 2013. Although the Consultation Paper addresses a number of topics,[1] we have limited our submission to:

- the proposed insertion of Listing Rule 3.19B, which requires the disclosure of securities purchased on-market by or on behalf of directors, employees or their related parties, under the terms of a scheme for the purchase of securities (**on-market purchases**); and
- the proposed changes to the usage of the terms 'associate' and 'related party' in the Listing Rules.

1.1 Listing Rule 3.19B

In summary, our position is that Listing Rule 10.14 is currently operating as intended by ASX and that there is no gap in disclosure under Listing Rule 10.14 that needs to be addressed. Proposed Listing Rule 3.19B would only add an additional (and unnecessary) layer of complexity in relation to disclosure and, therefore, should not be introduced.

We also submit that the policy behind Listing Rule 10.14 (anti-dilution and arms' length transactions with related parties) does not provide a conceptually sound policy rationale for introducing a new market disclosure requirement and that adequate transparency is already provided for on-market purchases through current corporate governance mechanisms (such as the disclosure of directors' notifiable interests under Listing Rule 3.19A).

We are also concerned that the proposed disclosure requirements will impose administrative burdens on companies who engage share registries to purchase securities on their behalf and undermine the efficacy of these arrangements. In our view, this is an undesirable outcome that should be avoided.

1.2 Listing Rule 3.19B

In summary, our position is that the definition of 'associate' in Listing Rule 19.12 should not be amended to include related parties and in Listing Rule 10.14 the term 'associate' should not be replaced with the term 'related party'.

[1] We note that the Consultation Paper also proposes to insert a new Appendix 4G, make a number of changes to Listing Rules 1.1, 4.7, 4.10, and 12.7 to introduce a definition of "Corporate Governance Statement" in Listing Rule 19.12.

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2. Listing Rule 3.19B

2.1 No sound policy rationale for disclosure

The Consultation Paper states that the purpose behind introducing Listing Rule 3.19B is to address a perceived lack of transparency in Listing Rule 10.14 in relation to on-market purchases. Concerns have been raised in relation to the operation of the 'exception' to Listing Rule 10.14, given that entities can acquire shares on-market on behalf of directors or their related parties without the approval of shareholders and without disclosing the acquisitions to the market. It is our understanding that ASX proposes to introduce Listing Rule 3.19B to address this issue by requiring on-market purchases to be disclosed to the market.

(a) No gap in Listing Rule 10.14 to be addressed

We consider that there is no issue of disclosure in Listing Rule 10.14 that needs to be addressed. Listing Rule 10.14 requires a listed entity to obtain the approval of shareholders before directors or their related parties can acquire securities under an employee incentive scheme. This requirement applies unless the securities are acquired via an on-market purchase, in which case shareholder approval is not required.

We agree with ASX that Listing Rule 10.14 is currently operating well, in that it should not apply to on-market purchases on the basis that such purchases do not impact dilution of shareholder interests and are related to remuneration arrangements for employees and directors, which are already regulated by legislation and accounting standards rather than the Listing Rules. For the very same reasons, we believe there is no "gap" in disclosure that needs to be addressed.

In addition, if there was, hypothetically, a gap in disclosure that needs to be addressed, we question why the "remedy" provided in Listing Rule 3.19B requires an entity to disclose on-market purchases by or on behalf of directors, *employees* and related parties, when Listing Rule 10.14 only applies to directors and related parties. In our view, a remedy that goes beyond the underlying problem that it seeks to address is unjustified.

(b) Transparency should be addressed in relation to remuneration rather than dilution

Because disclosure of on-market purchases is more relevant to the remuneration of key management personnel and their related parties rather than dilution of shareholdings, it would be more appropriate for any issue of transparency to be dealt with in relation to remuneration arrangements rather than in response to the exception in Listing Rule 10.14, which is focused on preventing dilution of shareholdings and transactions with related parties on non arms' length terms.

This conclusion has been recognised by ASX, as the Consultation Paper notes that on-market purchases are related to the remuneration arrangements for employees and directors, which are matters regulated by legislation and accounting standards rather than the Listing Rules, given that on-market purchases do not dilute the economic interests of existing security holders.

2.2 Adequate disclosure through current corporate governance mechanisms

We consider that current corporate governance mechanisms such as the requirement for directors to notify ASX of notifiable interests (ASX Listing Rule 3.19A) and the disclosure of remuneration arrangements in a company's Annual Report (section 300A of the *Corporations Act* and AASB 124) provide adequate transparency in relation to on-market purchases and remuneration. As these avenues of disclosure already require entities to disclose information proposed to be disclosed under Listing Rule 3.19B, we submit that it is therefore unnecessary for Listing Rule 3.19B to be introduced and that its introduction would only lead to undue compliance burden.

(a) Disclosure of notifiable interests under Listing Rule 3.19A and Appendix 3Y and Appendix 3Z

Listing Rule 3.19A currently requires an entity to disclose all notifiable interests of its directors within 5 business days of directors being appointed, changing their interests, or ceasing to be directors (Listing Rules 3.19A.1 – 3.19A.3). The definition of "notifiable interests" is broadly framed under Listing Rule 19.12, and extends to interests arising as a result of on-market purchases. Appendix 3Y is required to be submitted when a director changes his or her interest, and requires the entity to disclose to ASX the name of the director, the nature of the interest, the number of securities purchased and the value or consideration provided for the securities, within 5 business days of the change occurring.

Listing Rule 3.19B mirrors these substantive requirements, and as noted by ASX, has timing consistent with the timing requirement for the disclosure of changes in a director's notifiable interests under Listing Rule 3.19A and Appendix 3Y and 3Z. We submit that there would therefore be limited utility in introducing Listing Rule 3.19B in relation to directors as it would only result in 'double disclosure' and additional complexity without meaningfully adding any level of transparency, which is the stated purpose for introducing Listing Rule 3.19B.

(b) Disclosure of remuneration arrangements through Annual Reports

As noted by ASX in the Consultation Paper, on-market purchases are related to remuneration arrangements of companies. Under current corporate governance mechanisms relating to remuneration, entities are already required to securities granted to key management personnel and there is already a high level of transparency in relation to the value of securities granted.

For example, section 300A(1) of the Corporations Act requires listed companies to disclose remuneration-related information in the company's Annual Reports, including the remuneration of each member of the key management personnel for the company and the policy for determining such remuneration. These disclosures include details of all securities allocated to key management personnel as part of their executive remuneration packages (including securities purchased on-market).

In addition, not only are such securities disclosed to members through the company's Remuneration Report, but listed companies must also put a resolution (that the Report be adopted) to a vote at its annual general meeting (section 250R of the Corporations Act). As such, there is currently sufficient transparency as, not only do companies have to disclose remuneration arrangements, but members also have the opportunity to comment and vote on the remuneration arrangements at the company's annual general meeting.

On this basis, we submit that there is adequate disclosure of remuneration practices and on-market purchases through companies' Annual Reports and Listing Rule 3.19A that the introduction of Listing Rule 3.19B would only result in 'double disclosure' and an unnecessary additional layer of administrative burden for companies.

2.3 Impact on current commercial arrangements for on-market purchases

One of the key unforeseen consequences of introducing disclosure requirements for on-market purchases is that such reform may adversely impact on current commercial arrangements that many companies have in place with share registries. We note that a number of companies currently engage share registries on arms' length terms to purchase securities on their behalf.

We are concerned that the disclosure requirements in Listing Rule 3.19B, which require entities to disclose on-market purchases within 5 business days of the purchase, will practically require companies to engage in continuous conversation with share registries in order to be fully informed of when on-market purchases are made so that all on-market

purchases are disclosed within the required time frames. This administrative burden to constantly engage in detailed discussion with share registries is likely to be particularly onerous in practice, given that:

- on-market purchases are often made in bulk meaning that it would not always be clear as to whether shares are being bought specifically by or on behalf of a particular director or their related parties, or simply to be able to 'warehoused' to satisfy future vesting obligations; and
- on-market purchases are often made in high volume over a given period, meaning that there is potential for companies to have to engage daily, or at least very frequently with share registries to ensure they meet the 5 business day disclosure time frame.

This administrative burden would only be heightened given that disclosures would need to be made with respect to directors, ***employees*** or their related parties, which is a much broader category of personnel than is currently contemplated by Listing Rule 10.14.

Requiring companies to engage with share registries on a constant and continual basis may also undermine the arms' length commercial basis on which the relationship is based between companies and their share registries, and may ultimately undermine the efficacy of such arrangements with respect to on-market purchases.

On this basis, we submit that Listing Rule 3.19B should not be introduced, as it may detrimentally impact current commercial arrangements in place with share registries in relation to on-market purchases, and does not increase transparency, despite this being the justification for introducing Listing Rule 3.19B.

3. 'Associates' and 'Related Parties'

3.1 Amendment to definition of 'associate'

We agree with the ASX's proposal to define the term 'associate' in the Listing Rules by reference to sections 12 and 16 of the Corporations Act (rather than sections 13 and 15 to 17 of the Corporations Act).

However, we do not support inclusion of the term 'related party' at the end of the definition of 'associate' in Listing Rule 19.12. Including the term 'related party' in this way will have blanket application and may have unforeseen consequences, especially in relation to the voting exclusions in Listing Rule 14.11. Listing Rule obligations and prohibitions should not be extended to individuals without a strong policy rationale for doing so in each case.

3.2 Replacing the term 'associate' with 'related party' in Listing Rule 10.14

We do not support the proposed substitution of the term 'related party' for the term 'associate' in Listing Rule 10.14. The term 'associate' incorporates a concept of parties acting in concert. However, the term 'related party' captures specific relationships, regardless of whether or not the parties are acting independently of one another. We do not believe that there is a policy need to extend the application of Listing Rule 10.14 to such people where they are not associates of a director.

By way of an example, if an employee of the company happens to be the independent adult child of a director, and that person is eligible to participate in a general employee share plan, what is the rationale for the Listing Rules requiring the company to seek shareholder approval? Whereas, if the child and the director were acting in concert, the term 'associate' would require the company to seek shareholder approval.

We note that the Corporations Act also provides protection against companies giving 'non-arms' length' benefits to related parties, requiring shareholder approval under Chapter 2E.

Yours sincerely

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