



Review of directors' trading during the "blackout" period – Q3 2008

11 December 2008

EXECUTIVE SUMMARY

What this report is about

The rule framework created by listing rules 3.19A and 3.19B requires listed entities to disclose directors' interests in securities and transactions in securities. This framework complements the director notification requirements of Section 205G of the Corporations Act. The Listing Rules and Section 205G, together with the prohibitions on insider trading and market manipulation, help to maintain an informed and orderly market.¹

Directors' Interest Notices (Appendices 3X, 3Y and 3Z) reported to ASX by lodgement of the Directors' Interest Notices under listing rule 3.19A via the Companies Announcements Platform (CAP), are monitored by ASX Markets Supervision Pty Limited (ASXMS) as a matter of course. ASXMS also undertakes periodic reviews of entities' compliance with the requirements of this listing rule.²

ASX announced in June 2008 that it would carry out reviews of trading by directors during Q1 and Q3 of each year.³ Using the data from the reviews of directors' trading ASXMS also conducts reviews of trading by directors during the period between the close of books and the release of the entity's half-year and full-year results ("blackout period")

ASX considers that disclosure of directors' trading primarily is one of good corporate governance. Investor confidence in directors and the market can be undermined when there is active trading in the blackout period in contravention of the entity's publicly disclosed trading policy.

ASXMS reviewed all Directors' Interest Notices lodged by all listed entities via CAP between 1 January 2008 and 31 March 2008 (Q1 2008). Following that review, ASXMS conducted a review of directors' trading in Q1 to identify whether there were instances of directors engaged in active trading in securities during the blackout period.

ASXMS conducted a second review of all Directors' Interest Notices lodged between 1 July 2008 and 30 September 2008 (Q3 2008). The results of the Q3 review showed an improvement in the level of compliance with listing rule 3.19A in that approximately 6.4% of Appendices breached the rule compared to 13% in Q1 2008.

Using the data from the Q3 review ASXMS conducted a review of trading by directors during the blackout period in Q3 2008. The results of this review show that of the 1,418 active trades during Q3, 718 (50.6%) occurred during the blackout period. Of these, 95 trades (13.2%) potentially contravened the trading policies of the entities concerned, compared to 57 (7.2%) potential contraventions in Q1 2008. Of the 95 potential contraventions in Q3 2008 there were 15 (2.1%) confirmed contraventions compared to 6 (0.7%) confirmed contraventions in Q1 2008.

ASX notes that despite the improved level of compliance with listing rule 3.19A during Q3 2008, the number of confirmed contraventions of entities' trading policies increased during Q3 2008. ASX considers that where trading occurs outside the usual trading windows specified in the entity's trading policy, the entity should provide additional explanation in relation to the trade to the market.

ASX will be examining the data from the blackout trading review, in conjunction with the usual examination of all trading data, to determine if there are possible instances of insider trading by directors and/or breaches of continuous disclosure obligations by listed entities. If ASX has reason to suspect that there may be potential breaches then ASX will refer the matter to ASIC for further investigation.

ASX also notes that the Government referred the issue of directors' trading during the blackout period to the Corporations and Markets Advisory Committee (CAMAC) in November 2008.⁴ ASX considers it appropriate to pass the

¹ ASX released a Companies Update in October 2005 reminding entities of their obligations under listing rules 3.19A and 3.19B and outlining possible ASX action where entities do not comply with the Listing Rules. ASX also wrote to each entity to advise of the ASX enforcement program. ASX released a further Companies Update in June 2008 advising of ASX action in cases of non-compliance with the Listing Rules.

² ASXMS conducted a review of all Directors' Interest Notices lodged by all listed entities via CAP between 1 January 2008 and 31 March 2008. ASXMS conducted a second review of all Directors' Interest Notices lodged via CAP between 1 July 2008 and 30 September 2008. The results of these reviews are at www.asx.com.au.

³ See Companies Update 05/08 27 June 2008.

findings of this review to the Government to assist CAMAC's current enquiry into blackout trading and other market practices.

KEY FINDINGS

Blackout trading

- There were 3,380 Appendices 3Y Change of Director's Interest Notices lodged during Q3 2008 compared to 3,218 in Q1 2008. Of the Appendices 3Y lodged during Q3 2008, 1,418 involved active trades compared to 1,863 active trades during Q1 2008.
- Of the 1,418 active trades conducted during Q3 2008, 718 (50.6%) trades occurred during the blackout period. These 718 trades were conducted by 454 individual directors in the securities of 331 different entities. This compares with 795 (42.7%) trades conducted during the blackout period in Q1 2008 by 556 individual directors in the securities of 381 different entities.
- Of the 1,418 active trades during Q3 2008, 95 (13.2%) trades potentially contravened the trading policies of the entities concerned compared to 57 (7.2%) potential contraventions during Q1 2008.
- Following the review of director trading in Q3 2008, ASX sent letters to 46 entities to ascertain whether a contravention of the trading policy may have occurred. The majority of responses to these letters indicated that the transactions did not breach the relevant trading policy because the Chairman of the board had given the appropriate approval for the trade.
- Of the 95 potential contraventions of the trading policies of the entities concerned, there were 15 (2.1%) confirmed contraventions in Q3 2008 compared to six (0.7%) confirmed contraventions in Q1 2008.
- Of the 15 confirmed contraventions of trading policies in Q3 2008, two trades related to entities in the All Ordinaries Index (AOI), including one that was also in the S&P/ASX 200 Index. The remainder related to entities outside the AOI. This compares to four trades in the AOI, including two trades relating to entities in the S&P/ASX 200 Index, during Q1 2008.
- In Q3 2008 the 15 confirmed contraventions of the trading policies of the entities concerned were made by 12 individual directors in the securities of nine different entities. This compares to six confirmed contraventions by five individual directors in five different entities in Q1 2008.

Results of Q1 and Q3 reviews of blackout trading

Blackout trading							Total	
2008 Month	Jan	Jul	Feb	Aug	Mar	Sep	Q1	Q3
Number of Appendix 3Y forms lodged	890	1,103	980	903	1,348	1,374	3,218	3,380
Total number of active trades	432	408	569	391	862	619	1,863	1,418
Total number of active trades during blackout period as % of active trades	353 (81.7%)	308 (75.5%)	339 (59.6%)	287 (73.4)	103 (11.9%)	123 (19.9%)	795 (42.7%)	718 (50.6%)
Number of potential contraventions of trading policy as % of active trades during blackout period	15 (4.2%)	46 (14.9%)	39 (11.5%)	39 (13.6%)	3 (2.9%)	10 (8.1%)	57 (7.2%)	95 (13.2%)
Confirmed contraventions of trading policy as % of active trades during blackout period	4* (1.1%)	7^ (2.3%)	2** (0.6%)	7^^ (2.4%)	-	1^^^ (0.8%)	6 (0.7%)	15 (2.1%)

* Trades occurred in two entities in the AOI of which one was also in the S&P/ASX 200 Index. A third entity was outside the AOI.

^ Trades occurred in four different entities, of which one was in the AOI and also in the S&P/ASX 200 Index.

** Trades occurred in two entities in the AOI of which one was also in the S&P/ASX 200 Index.

^^ Trades occurred in six different entities, of which one was in the AOI.

^^^ Entity outside the AOI.

⁴ See the reference from the Minister for Superannuation and Corporate Law to CAMAC at [http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFReference/\\$file/Ref_Market_Volatility.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFReference/$file/Ref_Market_Volatility.pdf)

BACKGROUND

Listing rule 3.19A and the Corporations Act

The framework created by listing rules 3.19A and 3.19B was introduced by ASX in 2001 and requires listed entities to disclose directors' interests in securities and transactions in securities. This framework complements the director notification requirements of Section 205G of the Corporations Act. Since the introduction of listing rules 3.19A and 3.19B in 2001, ASX has conducted ongoing analysis of compliance to help identify strategies to improve compliance. This includes education initiatives through Companies Updates, Guidance Notes or possible rule changes to establish guidelines for appropriate enforcement activity.⁵

The Listing Rules and Section 205G, together with the prohibitions on insider trading and market manipulation, help to maintain an informed and orderly market. ASX considers that investors in a listed entity and the market in general, have a legitimate interest in trading by directors. To be useful this information about holdings must be up-to-date and, where changes have occurred, must enable investors to understand the nature of the changes.

ASX recognises that a director may choose to trade an entity's securities for a broad range of reasons and that trading by directors is not necessarily an indicator of an entity's prospects. ASX considers that disclosure of directors' transactions is primarily a matter of good corporate governance.

Blackout trading

Limiting trading by directors and others during the blackout period is also a matter of good corporate governance. Public confidence in an entity can be eroded if there is insufficient understanding about the entity's policy on trading by "potential insiders", such as directors, officers and employees. Investor confidence in directors and the market can be undermined when there is trading in blackout periods in contravention of entities' securities trading policies.

A trading policy which includes a provision for a blackout on trading by directors and others in the period between the close of books and the announcement of full or half-year results acts as a mechanism for minimising the potential for any perception that directors or others are dealing in the entity's securities while in possession of inside information. Trading policies frequently permit trading in "windows" following the full and half-year results' announcements.

Blackout trading does not breach the Corporations Act or the ASX Listing Rules. However, directors and others who trade with information that is not generally available are subject to the insider trading provisions of the Corporations Act and directors are also subject to the notification provisions of listing rule 3.19A and Section 205G of the Corporations Act.

ASX notes that the Government has referred the issue of blackout trading to CAMAC requesting it to report on how overseas jurisdictions regulate blackout trading and to advise whether changes are required to the Australian regulatory framework to provide for greater confidence in the integrity of the Australian market particularly, in relation to director trading.

ASX Corporate Governance Council's Principles and Recommendations

Both the ASX Corporate Governance Council's (Council) *Principles of Good Corporate Governance and Best Practice Recommendations*, 2003 (2003 Principles) and the *Corporate Governance Principles and Recommendations*, 2007 (Revised Principles) recommend that entities establish a trading policy concerning trading in the entity's securities.⁶ Both the 2003 Principles and the Revised Principles suggest in Principle 3 that a trading policy identify whether trading windows or blackouts are used and if so, details of how they apply.⁷ It is also recommended that entities disclose their trading policies or summaries of those policies.

While listed entities are not required to follow the Council's Recommendations, they are required under listing rule 4.10.3 to disclose the extent to which they have followed the Council's Recommendations in the corporate governance

⁵ ASX released Guidance Note 22 in 2002 which provides information to assist listed entities in complying with their obligations under listing rules 3.19A and 3.19B, and also provides an overview of ASX policy in relation to disclosure of directors' interests and transactions in securities.

⁶ See the 2003 Principles Recommendation 3.2 at page 26 and the Revised Principles Recommendation 3.2 at page 23.

⁷ See Principle 3, 2003 Principles at page 27 and the Revised Principles at page 23.

statement in their annual report. Where entities have not followed the Recommendations they must identify the Recommendations they have not followed and give reasons for not following them - the "if not, why not" approach. Central to the "if not, why not" approach is the need for an entity to explain how its practices accord with the "spirit" of the relevant Principle.⁸

While an entity is not required to have a trading policy or to have a trading policy that provides for blackout periods, it should nonetheless explain how its practices meet the spirit of Principle 3.

ASX monitoring of Appendices and blackout trading

All announcements made by listed entities lodged via CAP are monitored by ASXMS Issuers Advisers. This includes every Appendix 3Y lodged on CAP.

ASX announced in June 2008 that it would carry out reviews of trading by directors during Q1 and Q3 of each year. Using the data from the reviews of directors' trading, ASXMS also conducts reviews of trading by directors during the blackout period.

RESULTS OF REVIEWS CARRIED OUT AND ASXMS RESPONSE

Blackout trading review

The review of blackout trading involved examining all 3,380 Appendix 3Y Notices lodged in Q3 2008. ASXMS found that 1,418 (41.9%) involved active or on market trades. Of these active trades, 718 (50.6%) occurred during the blackout period.

The 718 trades involved the securities of 331 entities conducted by 454 individual directors. A review of the publicly available information on share trading policies showed that prima facie, 95 of the active trades conducted during the blackout period may also have contravened the entities' own trading policies.

ASXMS response to contraventions of trading policies

ASXMS wrote to 46 entities where prima facie it appeared that an active trade during the blackout period may have contravened the entity's own trading policy. In these letters ASXMS asked entities:

- Whether the trades occurred outside a designated trading window.
- If the trades occurred outside a designated trading window, the reason for the departure from the entity's trading policy.
- In the event that the trades deviated from the usual trading window specified in the entity's trading policy with the approval of the Managing Director or Chairman, when the approval was obtained and why it was granted.
- What arrangements the entity has in place with its directors to ensure compliance with the trading policy.
- If the current arrangements are inadequate or are not being enforced, what additional steps the entity intends to take to ensure compliance with its trading policy.

The majority of responses to these letters indicated that the transactions did not contravene the relevant trading policy because the Chairman of the board had given the appropriate approval for the trade.

ASX considers that where trading occurs outside the usual trading windows specified in the entity's trading policy, the entity should provide additional explanation in relation to the trade. If the departure from the usual trading window has been approved by the board, this together with the reasons for the departure and any other relevant information should be communicated to the market. This additional explanation could be provided either in the Appendix 3Y form or at the time the Appendix 3Y is lodged. It is for boards and shareholders to address these issues.

⁸ See the Revised Principles at page 6.

The data from the Q3 blackout trading review will also be further analysed to determine whether there are possible instances of insider trading by directors and/or breaches of the continuous disclosure requirements by listed entities, in which case, they will be referred to ASIC for further investigation.

METHODOLOGY

Blackout trading

ASXMS analysed all 3,380 Appendix 3Y Change of Director's Interest Notices lodged from 1 July 2008 to 30 September 2008 inclusive. The changes of relevant interest were initially classified as "active" or "passive". Changes of relevant interest were deemed to be passive if they involved the acquisition of securities through an employee incentive scheme, if the issue had been approved by security holders or otherwise presented no market concerns; for example, issues under dividend reinvestment plans, share purchase plans and rights issues – in each case directors participate on identical terms to all other security holders.

The active changes of relevant interest were then assessed to determine whether the trade occurred during the blackout period, that is, the period between the close of the financial period and the release of half-year or full-year results. The publicly available information on share trading policies was reviewed to determine whether or not any of the active trades conducted during the blackout period had also contravened the entity's own trading policy.

All active changes of interest in contravention of the entity's trading policy are currently being further analysed for possible instances of insider trading by directors and breaches of the continuous disclosure requirements by listed entities.