



AUSTRALIAN BANKERS' ASSOCIATION INC.

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Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
Level 16, 60 Margaret Street
SYDNEY NSW 2000
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Dear Mr Kluver,

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments to the Corporations and Markets Advisory Committee (CAMAC) discussion paper *Corporate duties below Board level*.

1. General observations

The discussion paper considers the extent to which officers (excluding directors), employees and other individuals are subject to personal duties and liabilities under the *Corporations Act 2001*. The discussion paper generally corresponds with the recommendations in the HIH Royal Commission report *The Failure of HIH Insurance* (April 2003) (HIH Report).

The ABA recognises that there are a number of matters that the HIH Report attempts to address as part of the recommendations, including:

- Clarifying the duties of managers without shifting responsibility from the Board;
- Taking account of structures of large companies where decisions may be collective and/or without reference to the Board;
- Clarifying the responsibilities of consultants who perform corporate functions; and
- Ensuring that corporate governance standards apply throughout the company.

However, the ABA is concerned that the proposals in the discussion paper may adversely impact on the sound, efficient and effective decision-making of companies. Furthermore, it is not clear as to whether the concerns held by some with the recent cases of corporate malfeasance have arisen due to inherent deficiencies with the law.

Firstly, the ABA is concerned by the proposal that statutory duties and obligations of directors and officers of a company under the *Corporations Act 2001* should be extended to others involved in the management of the corporation. A dilution of primary duties is likely to confuse management roles within the company particularly as directors, other officers and other employees would share responsibility for the same matters. This would be detrimental to the company, its shareholders, creditors, employees and other stakeholders.

The extension of liability beyond directors and officers to other managers or employees could have a substantial impact on the efficiency and effectiveness of business and compliance programs. If there is uncertainty regarding the liability of companies and individuals within the company, it is likely that companies would have difficulty in implementing adequate risk management procedures and insurance for potential liabilities. Directors' and officers' (D&O) and professional indemnity (PI) insurance would need to be extended to cover more complex and uncertain liabilities; thereby generating unnecessary compliance costs.

Secondly, the ABA is concerned by the proposal to introduce a statutory obligation to prohibit individuals from acting dishonestly in connection with the performance of their duties. Individuals should, and are required to act honestly according to a number of Federal, State and Territory statutes, including the Corporations Act (which provides that directors and officers commit an offence if they are intentionally dishonest). Therefore, the ABA believes that if a prohibition is introduced that it should be restricted to conduct in connection with the company's obligations under the Corporations Act.

2. Specific comments on proposals for law reform

2.1 Proposals 1, 2 and 3: Extend the duties of care and diligence, good faith, and proper purpose

Sections 180(1) and 181(1) of the Corporations Act currently apply only to directors and officers of a corporation. The definition of an 'officer' applies to those who make or participate in making decisions that affect the whole or a substantial part of the business of the corporation, or who have the capacity to significantly affect the company's financial standing¹.

¹ Section 9, Corporations Act

The discussion paper proposes to extend these duties to any other person who is concerned, or takes part in the management of the company. Therefore, the extended application of these duties would apply to middle management, employees, consultants, advisers and independent contractors. It could also cover directors and officers of related corporations in appropriate circumstances; however, arguably senior executives would already be captured by the definition.

The main issue raised by the HIH Report is ensuring that companies make sound decisions, and those individuals that make the decisions are accountable for them. However, the proposal in the discussion paper, in practice, may unduly impact on the ability of companies to make sound, efficient and effective decisions.

The ABA recognises that an individual who has a significant contribution to the decisions of the company, that have a real impact on the interests of the company, should have a duty to act in good faith, with care and diligence and for a proper purpose. However, the ABA has a number of concerns with the proposal to extend the statutory duties to a wider class of individuals within the company.

Firstly, the extension of these duties to a wider class of individuals may cause inefficient and overly cautious decision-making, or alternatively, a lack of decision-making, as managers and employees seek to shift responsibility, or debate who should accept responsibility for decisions and conduct. This cannot be good for the company, its shareholders, employees and other stakeholders. The ABA believes only decision-making which has a substantial impact on the company should be subject to good faith, care and diligence and proper purpose duties.

Secondly, contemplating extending the duty to act in good faith, with care and diligence and for a proper purpose to a wider class of individuals presents a challenge in how the proposal can be applied to those with genuine managerial responsibilities. The ABA considers that the current definition of an 'officer' as contained in the Corporations Act already ensures that managers that hold senior positions are responsible for their actions. Amending the definition to include individuals who "take part in" management, is too broad and would likely capture a wider class of individuals than is reasonably intended. The ABA does not support reintroducing the pre-CLERP definition of 'executive officer'.

The ABA also notes that since the HIH Report was released, there have been a number of shifts in the regulation of corporates, in particular Australian Prudential Regulation Authority (APRA) regulated entities. In June 2005, after a period of consultation, APRA released its draft *Fit and Proper* and *Corporate Governance Standards* and guidance notes for APRA-regulated entities, including authorised deposit-taking institutions (ADIs), general insurance and life insurance institutions.

The ABA recognises that the policy intention of the draft standards is to ensure that APRA-regulated entities exercise sound judgment and act prudently in their decision-making and apply corporate governance standards throughout the company. As this is consistent with the general policy intention contemplated in the proposal, the ABA believes that it would be useful for APRA to finalise its prudential standard prior to the Government giving further consideration as to whether it is necessary to extend any statutory duties as contained in the Corporations Act. The ABA has previously expressed concern with the potential for overlap, duplication or inconsistent obligations between the *Banking Act 1959* and the Corporations Act; and thereby the unnecessary legal, operational and administrative costs that would result.

If the statutory duties of directors, officers and other employees are varied in the Corporations Act, then there will be a need to consider amending the "business judgement rule" accordingly. Section 180(2) of the Corporations Act provides that a director or other officer of a corporation who makes a business judgement is taken to meet the requirements of care and diligence if they make the decision in good faith; do not have a personal interest; reasonably inform themselves about the subject matter; and believe the decision is in the best interests of the company. The business judgement rule operates in relation to the duties in section 180(1) and the equivalent duties in common law.

Furthermore, if the statutory duties of directors, officers and other employees are varied, then there will also be a need to consider access and availability to insurance policies, such as directors' and officers' (D&O), to ensure that any extension of legislative obligations is aligned with adequate insurance coverage. It is important for all employees to have certainty regarding their rights and responsibilities.

Finally, assignment of greater and wider responsibility within the company will impact directly on remuneration, as employees' accountabilities under the law are increased. Companies are already responding to increased workload and duties associated with the new corporate governance requirements and extended responsibilities by lifting fees for directors². Wages pressure will have an effect on shareholders, the employment market and the wider economy.

2.2 Proposals 4 and 5: Extend the prohibition on improper use of position or information

Sections 182(1), 183(1), 184(2) and 184(3) of the Corporations Act prohibit directors, company secretaries, other officers and employees of a corporation from using their position, or company information, to gain an advantage for themselves, or someone else, or to cause detriment to the corporation.

² Kitney, D, Buffini, F and Hooper, N (2005). *Shareholders urged to lift directors' fees*. Australian Financial Review. 7 November 2005.

The discussion paper proposes to extend these prohibitions to any other individuals who perform corporate functions, or otherwise act, for or on behalf of the corporation, such as consultants, advisers, contractors or other suppliers of services.

The main issue raised by the HIH Report is regarding individuals that may undertake activities that are similar to those of an employee of the company. However, the proposal in the discussion paper, in practice, would extend further than the problem identified by the HIH Report.

The ABA recognises that all employees should not use their position or company information in an improper manner. However, the ABA is concerned with the proposal to extend the prohibition to individuals that do not hold a "position" within the company. Such a provision is likely to be broad and therefore is likely to generate substantial unintended consequences. It seems illogical to create a criminal offence for external consultants and agents in respect of their dealings with corporations which would not apply to their non-corporate clients.

Furthermore, an extension of the duties to consultants, advisers, contractors and agents may result in directors and other officers being uncertain as to their responsibilities in terms of engaging specialised services. It is also unreasonable to assume that a consultant, adviser, contractor or agent would, in all circumstances, understand what is in the best interests of a company, if indeed this is how the extension of prohibitions is to apply.

A contract of engagement or employment is likely to contain provisions that relate to the improper use of position or information, such as confidential clauses. Notwithstanding, the ABA suggests that if a prohibition was to be introduced, that it would be more appropriate for this conduct to be prohibited under criminal or trade practices legislation.

2.3 Proposals 6 and 7: Extend offences concerning falsification of books and provision of false or misleading information

Under section 1307(1) of the Corporations Act, it is an offence for an officer or employee of a company to conceal, destroy, or falsify books relating to the affairs of the company. Under section 1309(1) of the Corporations Act, it is an offence for an officer or employee of the company to knowingly make available or give false or misleading information to the Board, auditors, shareholders or debenture holders.

The discussion paper proposes to extend these offences to any individual who performs functions, or otherwise acts, for or on behalf of the company. Information could include a company's accounts, capital raising documents (such as prospectuses and product disclosure statements), or any other information to be disclosed by the company according to its continuous disclosure obligations.

The ABA believes that maintaining accurate records of a company is essential for good corporate governance. Therefore, the ABA supports extending the application of the offences to individuals that have the capacity to falsify a company's books. However, to require any individual who performs functions for or on behalf of the company to take reasonable steps in relation to all information would be impractical.

2.4 Acting dishonestly

The discussion paper considers whether to introduce a statutory obligation to prohibit individuals from acting dishonestly in connection with the performance of their duties to the company.

The ABA believes that all individuals should act honestly when acting on behalf of a company. Indeed, clause 2.2 the Code of Banking Practice provides that: "We will act fairly and reasonably towards you in a consistent and ethical manner."

Under Chapter 2D of the Corporations Act, directors and officers must act in good faith, with care and diligence, for a proper purpose and in the best interest of the company. To act dishonestly must be considered not to be acting in good faith and it is difficult to conceive on public policy grounds that dishonesty could be legitimised as being in the best interests of the company.

In addition to the statutory provision relating to directors and officers of companies, under section 912A of the Corporations Act, financial services providers are obliged to act "efficiently, honestly and fairly".

The ABA considers that there are various Federal, State and Territory statutes that contain provisions regarding 'honesty', including the Corporations Act. Therefore, the ABA is concerned that introducing a general prohibition would be too broad and is likely to have substantial unintended consequences, such as duplication, overlap or inconsistencies with other legislative obligations. Firstly, liability for dishonesty in respect of other legislation is more appropriately dealt with in the specific legislation. Secondly, the inclusion of a general provision in the Corporations Act that applies to all legislation may lead to multiple offences and inconsistent defences.

The ABA notes that in the United States, section 404 of the Sarbanes-Oxley Act holds a company's officers accountable for 'misrepresentation'. In this instance, the obligation is limited to the Chief Executive Officer and Chief Financial Officer and in relation to financial information.

The ABA supports in principle a prohibition against dishonest conduct for all individuals acting on behalf of a company; however, the ABA is concerned with the proposal and therefore believes that a prohibition should be restricted to conduct in connection with the company's obligations under the Corporations Act. Statutory prohibitions against dishonesty in respect of other conduct is best dealt with in the specific legislation that regulates that conduct.

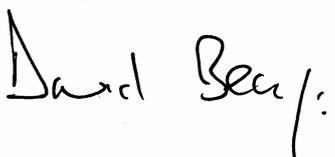
2.5 Corporate groups

The discussion paper contemplates whether legislative amendments are required to apply to corporate group executives either making one-off decisions regarding a particular corporate group or making general commercial decisions for the corporate group, but without considering which of the subsidiaries would be used to implement the decision.

The ABA does not believe that a person who makes or participates in making a decision that is implemented in whole or part by a related corporation, should hold specific duties not only to the first corporation, but also to the related corporation. Any such provision would necessarily be complex and confusing. Furthermore, the ABA considers that the definition of an 'officer' as contained in the Corporations Act would necessarily apply to a senior executive of a holding company who was involved in the management of a subsidiary.

The ABA would be happy to discuss any of the issues raised in this letter with you further. Please contact me or the ABA's Director, Corporate & Consumer Policy, Diane Tate on (02) 8298 0410: dtate@bankers.asn.au.

Yours sincerely

A handwritten signature in black ink that reads "David Bell". The signature is written in a cursive, slightly slanted style.

David Bell