

REGULATORY IMPACT STATEMENT

AMENDMENTS TO COMPANIES ACT AND FRIENDLY SOCIETIES AND CREDIT UNIONS ACT TO REDUCE COMPLIANCE COSTS

AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by the Ministry of Economic Development.

It provides an analysis of options to clarify the application of technological advancements to New Zealand's companies legislation, namely the manner in which shareholders of companies may be permitted to exercise their right to vote by electronic means and companies may send documents to shareholders electronically.

In terms of the current provisions of the Companies Act, there is doubt that the current law allows electronic postal voting, or electronic appointment of proxies. Officials' view is that direct electronic voting during a meeting held via a webcast, where shareholders vote by indicating a preference on a website, is not permitted by the current provisions of the Companies Act.

Electronic voting is widely used in overseas jurisdictions and would enable increased shareholder participation in corporate decision making and reduce costs incurred by companies in dealing with postal votes and proxy forms.

The Regulatory Impact Statement also considers the proposal to update by Order in Council the threshold above which a friendly society is required to appoint an auditor.

The policy options proposed will reduce compliance costs for business. The proposed amendments to the Companies Act and Friendly Societies and Credit Unions Act are not likely to cause any of the effects that the government has identified as requiring a strong case before regulation is considered.

pp 

Bronwyn Turley, Manager Corporate Law and Governance, CTI, MED

STATUS QUO AND PROBLEM DEFINITION

Companies Act 1993

The purpose of the Electronic Transactions Act 2002 (ETA) was to confirm the legality of electronic transactions and facilitate the use of electronic technology for meeting statutory requirements, however the Companies Act 1993 (the Act) provisions regarding meetings of shareholders appear to preclude the use of such technology.

The narrow scope of clause 3 of Schedule 1 of the Act restricts shareholders participating in meetings using some available electronic technologies. Clause 3 of Schedule 1 provides that a meeting may be held:

- By a number of shareholders, who constitute a quorum, being assembled together at the place, date, and time appointed for the meeting; or
- Subject to the constitution of the company, by means of audio, or audio and visual, communication by which all shareholders participating and constituting a quorum, can simultaneously hear each other throughout the meeting.

Where shareholders join a webcast of a meeting and participate in voting over the internet, it would not be possible to ensure that all shareholders can simultaneously hear each other throughout the meeting.

In addition, the Act was drafted on the basis of using paper-based systems where a shareholder wishes to vote but will not be present at a meeting. Schedule 1 of the Act includes provision for postal voting and appointment of proxies. There has been some doubt about whether Schedule 1 permits, or facilitates, electronic technology being used for postal voting and appointment of proxies. It has become broadly (but not universally) accepted that this position is altered by provisions of the ETA. However it is undesirable for there to be uncertainty on an issue that touches directly upon corporate governance and decision making, and the inclusion of clear express provisions in the Act will enhance accessibility of the law.

The lack of clarity around these measures (together, "electronic shareholder participation") has stifled the growth of these alternative tools for shareholder participation in corporate decision making. The use of email and the internet has become the norm for most commercial transactions and communications, including securities trading and operation of share registers. In this context, the continued use of paper-based shareholder participation is anomalous.

The status quo is out of step with recent changes to other provisions of the Act to facilitate more effective shareholder communication in relation to annual reports (particularly section 209), and with equivalent international regimes.

Friendly Societies and Credit Unions Act 1982

The Friendly Societies and Credit Unions Act 1982 (FSCU Act) came into force in 1983. A friendly society is an unincorporated association established to provide, by voluntary subscriptions or donations, services for any purpose permitted by the FSCU Act. The purposes specified in the FSCU Act include benevolent or charitable purposes, assisting families of members with funeral expenses or providing an amount on the birth of a child or assistance with medical expenses, etc. Section 62 of the FSCU Act sets out a requirement for friendly societies to appoint an auditor, with an exemption for small friendly societies, i.e. those with annual receipts and payments, and assets at the end of the financial year, not exceeding \$20,000. Section 62 provides for the threshold for an exemption to be changed by Order in Council. The threshold has not been changed since the FSCU Act came into force, and the Council of Friendly Societies has submitted that an increase is justified. The Council of Friendly Societies has indicated that small friendly societies have difficulty in finding auditors willing to take on small audits.

OBJECTIVES

The Companies and FSCU Acts are both part of New Zealand's business regulatory framework. The proposed changes to these Acts are part of the regulatory reform agenda to reduce compliance costs and the regulatory burden on business.

Companies Act

Facilitating electronic shareholder participation is intended to enable increased shareholder participation in corporate decision making and to enable companies to reduce printing and postal costs arising from postal voting and appointment of proxies. This is consistent with the purpose of the Companies Act to provide basic and adaptable requirements for the incorporation, organisation, and operation of companies.

FSCU Act

Raising the threshold above which a friendly society is required to appoint an auditor is aimed at providing relief from this requirement for very small friendly societies.

REGULATORY IMPACT ANALYSIS

Companies Act

Two options have been considered to clarify the availability of electronic shareholder participation:

- declaratory judgment in the High Court; and
- amending the Act.

Declaratory judgment in the High Court

Under section 3 of the Declaratory Judgments Act 1908, it is permissible to make an original application to the High Court for a binding declaratory judgment where laws lack clarity.

Typically, the Court will consider that it has no jurisdiction to make a declaratory judgment in circumstances which do not involve an adversarial context with contested legal rights between parties and non-hypothetical legal disputes. Declaratory judgment is unavailable where the applicant seeks to have the High Court declare the law or give general advisory opinions. For these reasons, it is unlikely that the electronic shareholder participation issue is amenable to declaratory judgment, as the High Court's jurisdiction to consider the matter is doubtful.

Even if jurisdiction could be found, there are a number of other factors against using the declaratory judgment process:

- the private nature of Court processes (compared to legislative processes) mean that fewer opportunities for public contributions are available;
- there are few incentives for any specific applicant to incur the expense of bringing an application for declaratory judgment for the benefit of all companies in New Zealand; and
- there is a lack of certainty of the outcome from using the court system.

Importantly, a declaratory judgment would not facilitate direct, real time, electronic voting because the restriction in clause 3 of the Schedule 1 (which currently requires all shareholders participating to simultaneously hear each other throughout the meeting), precludes the use of some available electronic technologies such as webcasting in conjunction with online voting.

Overall, while it would partly achieve the objectives, declaratory judgment is not considered to be a viable response to the issue.

Amending the Act

The second option is to amend current legislative provisions in the Companies Act to explicitly provide for electronic shareholder participation. The amendments will give companies the flexibility to introduce electronic shareholder participation, at the discretion of the board.

The amended provisions in Schedule 1 to the Act will provide that the board of a company may (either generally or on a meeting by meeting basis), permit:

- the appointment of proxies (or corporate representatives) to be made by electronic means; and
- votes to be cast on resolutions put (or to be put) to a shareholders' meeting by electronic means.

Provisions (in sections 388, 390 and 391 of the Act) governing the means of sending notices and other documents to shareholders will also be amended to make it clear that shareholders may opt to receive notices electronically.

This would result in the following benefits (discussed in further detail below):

- increased shareholder participation in company decisions; and
- reduced compliance costs for companies.

Enabling shareholder participation

Facilitating electronic shareholder participation is likely to result in an overall increase in shareholder participation in corporate decision making, which is in itself a key element in companies' governance framework. For a shareholder, casting a vote electronically is quicker and simpler than personally attending a meeting, or appointing a proxy or casting a vote by post, and makes receiving notices and other company documents electronically more convenient.

As with physical meetings, it is proposed that shareholders have the opportunity to hear or view information being presented, and put questions, via the chairperson, to the board and management. Any reduction in discussion opportunities for those participating electronically would be balanced by the increase in the number of shareholders who could actually participate in a meeting (as opposed to non-participation or participation by proxy). At present shareholders who vote by post or by proxy do not have the opportunity to participate in discussion. There will continue to be options for shareholders to choose how they wish to participate in corporate decision making.

Reduced compliance costs

While a shift to electronic participation would involve an initial outlay for companies, their costs would be reduced overall through the use of internet-based technologies. In terms of monetary savings, the proposed reform will reduce costs for both the companies involved (printing and postal costs, travel costs for out-of-town staff, reduced labour costs of collecting and processing postal votes) and shareholders (travel costs). Providing for boards to have the discretion to introduce electronic participation will enable an individual company to decide if there is a net benefit from doing so.

On current figures, the approximate cost of an issuer distributing hard copy annual reports and voting materials by post and processing hard copy proxies is estimated at \$6.95 per shareholder per vote. If annual reports and voting materials are distributed by email and voting is conducted online the cost should be able to be reduced to approximately \$2.10 per shareholder per vote.

The Listed Companies Association (LCA) advises that there are approximately 1,085,000 holders of equity securities listed on the NZX.

On the basis of:

- b a 30% uptake of the use of electronic voting facilities;
- c electronic facilities being used for one voting process per equity security holder each year; and
- d electronic communications being made available to electing shareholders for distributing hard copy annual reports and voting materials, and for receipt of proxies and votes,

the LCA estimates that an aggregate cost saving of approximately NZ\$1.5 million per annum could be made by those listed companies. In addition, the small number of widely held unlisted companies will also be able to benefit from these amendments. Officials consider that the assumption of 30% adoption of electronic voting is reasonable and note that even a lower rate of uptake would still result in substantial cost savings.

There may be one-off legal costs associated with development of protocols and rules for facilitation of electronic shareholder participation. Companies would need to consider issues in relation to the reliability of connectivity and telecommunications security. However, experience in Australia (where electronic technology is widely used to count votes cast by proxy) suggests that this risk can easily be overstated.

FSCU Act

A possible way of providing relief to very small friendly societies from the requirement to appoint an auditor would be to increase the threshold for this requirement. The FSCU Act provides for the threshold to be amended from time to time by Order in Council hence this is the only option being considered. Increasing the threshold will reduce costs for very small societies which will not be required to have their accounts audited by a qualified auditor, and will benefit the members of those societies by maximising the amount of funds available for the benevolent or welfare purposes for which the society was established.

The Review of the Statutory Framework for Financial Reporting which is currently being undertaken is considering the financial reporting system for all categories of entities in New Zealand, including friendly societies. The review will weigh the benefits of financial reporting against the associated compliance costs, including the costs of carrying out audits that would not otherwise be carried out. The legislative changes to implement that review are intended to come into effect in 2012. Increasing the threshold would give relief to very small friendly societies in the interim and is not inconsistent with the objectives of the broader review.

CONSULTATION

Companies Act

Consultation regarding electronic shareholder participation has been undertaken by MED with the LCA, the New Zealand Shareholders Association Inc, NZX Limited, and the Securities Commission. A summary of the proposed amendments was provided and stakeholders were asked for their comments.

The stakeholders were strongly in favour of the amendments to the Companies Act. A number of listed companies that are members of the LCA have also made submissions in support of the proposals. No concerns were raised. Stakeholders emphasised that electronic voting and proxy appointment is permitted in many other jurisdictions, and is consistent with the use of electronic communication in the commercial environment.

FSCU Act

The proposal to change the threshold figure in section 62 of the FSCU Act was the subject of a submission from the New Zealand Council of Friendly Societies. The proposed increase in the threshold was discussed with the staff of the Registrar of Friendly Societies, who carries out registry and oversight functions under the FSCU Act, and with the Reserve Bank, which will have responsibility for prudential regulation of the insurance sector on the enactment of the Insurance (Prudential Supervision) Bill which is currently before the House. Both regulatory agencies are supportive of the increase in the threshold to take account of the rate of inflation over the period since the Act was passed (noting the percentage change of 199% in the CPI from Q4 of 1982 to Q1 2010).

CONCLUSIONS AND RECOMMENDATIONS

Companies Act

It is recommended that the legislation be updated to ensure clarity and that the obstacle to using some available electronic technologies be removed. This would be achieved by amending Schedule 1 and sections 388, 390, and 391, of the Companies Act to provide that the board of a company may enable:

- the appointment of proxies (or corporate representatives) to be made by electronic means; and
- votes to be cast on resolutions put (or to be put) to a shareholders meeting by electronic means,

and for shareholders to be able to elect to receive company notices electronically.

This will allow companies to "opt in" to using electronic shareholder participation for company decisions, and for shareholders to "opt in" to receiving communications electronically. This flexibility will allow companies to balance the benefits of electronic shareholder participation against the costs in their particular context, and if they decide to introduce electronic voting, to do so in the manner that is most efficient for them. This amendment will bring New Zealand legislation into greater harmony with other comparable international jurisdictions including Australia, and will create more legal certainty for businesses wishing to utilise new electronic participation technologies for their shareholders.

Preferred option

An amendment to Schedule 1, and sections 388, 390, and 391, of the Act is the preferred means by which to achieve the objectives of reducing company compliance costs under the Act while increasing shareholder participation in company decision making. It will also increase trans-Tasman regulatory harmonisation and consistency of methodology of commercial behaviours.

FSCU Act

It is recommended that the sum of \$20,000 in section 62(2) of the FSCU Act be increased to \$50,000 by Order in Council.

IMPLEMENTATION

The amendments to the Companies Act 1993 are proposed to be included in the Regulatory Reform Bill 2010. The Bill is expected to be passed by December 2010. Officials will support and monitor the progress of the bill to ensure the amendments are implemented.

As the amendments will allow companies to choose whether or not to utilise electronic shareholder participation, they do not require any form of transitional arrangements. It is expected that the amendments will be able to be brought into force once enacted.

The amendments will enable a reduction in compliance costs, particularly for listed companies.

The amendment to the FSCU Act will be made by Order in Council, with the drafting of the Order being done following the Cabinet decision agreeing to the amendment.

MONITORING, EVALUATION AND REVIEW

Officials will seek feedback from the Listed Companies Association to ensure that the amendments are delivering the anticipated benefits.