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Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

via email: economics.sen@aph.gov.au

Dear Committee Secretary

Treasury Laws Amendment (2021 Measures No.1) Bill 2021

Thank you for the opportunity to provide a submission to the Senate Economics Legislation Committee on the provisions of the Treasury Laws Amendment (2021 Measures No.1) Bill 2021 (**the Bill**).

The Australian Institute of Company Directors' (**AICD**) mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership reflects the diversity of Australia's director community, our membership of more than 45,000 is drawn from directors and leaders of not-for-profits, large and small businesses, and the government sector.

Our submission focuses on the proposed permanent amendments to continuous disclosure laws and the extension of temporary amendments to the rules relating to virtual meetings and electronic communication of documents.

1. Executive Summary

(a) Continuous disclosure

The AICD strongly supports permanent changes to Australia's continuous disclosure laws introduced by the Bill in line with *Corporations (Coronavirus Economic Response) Determination (No. 2) 2020* (Cth) (**Determination No.2**).

We support the permanent introduction of a fault element into continuous disclosure laws and the extension to misleading and deceptive conduct provisions. These changes will improve the effectiveness of the current securities class action regime whilst discouraging opportunistic claims. **They do not in any way change what needs to be disclosed, or by when.**

There are strong arguments to set a fault threshold on disclosure as proposed by the Bill. The current regime leads to adverse outcomes for Australian businesses and shareholders and is out of step with comparable jurisdictions.

The AICD supports robust market disclosure and believes that these amendments should support and encourage entities to provide timely and robust information to investors, including forward-looking statements.

(b) Virtual meetings and electronic communication of documents

The AICD also supports proposals in the Bill to extend the temporary relief measures for a further six months, allowing companies to hold virtual meetings, such as Annual General Meetings (**AGM**), as well as distribute meeting related materials and validly execute documents electronically.

We continue to believe that permanent reform is necessary. In our view, organisations should have the flexibility to adopt the best meeting format for their circumstances, shareholders/members and stakeholders.

However, we consider it is critically important that the legislation is not overly prescriptive and does not create an unnecessary compliance burden for smaller and not-for-profit organisations, given the risk of legislation becoming outdated as technology evolves.

2. Continuous disclosure

Last year, the AICD welcomed the introduction of Determination No.2, which was intended to enable companies and their officers to more confidently provide guidance to the market during the coronavirus pandemic. In particular, the AICD welcomed the provisions that temporarily modified the *Corporations Act 2001* (Cth) (**Corporations Act**) to ensure that a breach of the civil penalty provisions under continuous disclosure obligations occurs only where information is withheld from disclosure with knowledge that it would, or recklessness or negligence as to whether it would, have a material effect on the price or value of an entity's securities.

The AICD also backed calls by the Parliamentary Joint Committee on Corporations and Financial Services for substantial reform to Australia's securities class action settings, including the permanent introduction of a fault element in continuous disclosure laws and the extension to misleading and deceptive conduct provisions.[1]

(a) AICD welcomes permanent changes in line with international counterparts

The AICD strongly supports the introduction of the Bill which seeks to make the temporary amendments introduced in 2020 permanent and broaden their application to misleading and deceptive conduct provisions.

The proposed amendments do not in any way change the nature of the disclosure obligation, specifically what needs to be disclosed and by when. Rather they simply require that any proceeding brought against the entity or its officers, must establish some wrongdoing. It is incongruous that, until the recent temporary amendments to the Corporations Act which re-introduce a fault element to the continuous disclosure rules, directors and companies could be held liable without even negligence being established.

We agree with the Explanatory Memorandum that the changes bring Australia more into line with overseas' jurisdictions that already incorporate an element of fault or culpability into their disclosure rules. In particular:

- In England and Wales, not only is mere negligence insufficient to ground liability in the context of private enforcement, but the claimant must establish that the conduct of the directing mind of the issuer was reckless or dishonest; and

[1] The AICD's submission to the Inquiry into the regulation of the class actions regime is available here.

- Under US securities laws, in order to establish a contravention, a failure to disclose relevant information, or the disclosure of misleading or false information, must be willful.

The position in England & Wales, as well as the US, was discussed in some detail in the final report of the ALRC's class actions inquiry, highlighting the difference with Australia's regulatory approach. It is important to note that although the Government's proposals, if legislated, will bring Australia more in line with these jurisdictions, the threshold for liability in Australia will still remain lower than in the US and UK.

The AICD also strongly supports the related amendments to the misleading and deceptive conduct provisions (section 1014H of the Corporations Act).

The effect of those amendments is that if an alleged contravention is connected to an alleged failure to comply with a continuous disclosure obligation, the person will need to establish the contravention of the relevant new continuous disclosure civil penalty provision, including the fault element of knowledge, recklessness, or negligence, in order to prove the disclosing entity has contravened section 1041H(1). This is a sensible change which ensures that continuous disclosure cases cannot be re-cast as misleading and deceptive conduct cases in order to circumvent the requirement that fault be established.

(b) Permanent change is required to limit adverse legal and economic consequences

The AICD believes that the interaction between our substantive disclosure laws and class action regime has created a uniquely facilitative environment for securities class actions, with adverse legal and economic consequences. We are of the view that the changes proposed by the Bill will go some way to address the following challenges:

- **D&O insurance market crisis:** The D&O insurance market continues to deteriorate, with premiums increasing rapidly. Public companies have seen average D&O insurance cost increases of 229 per cent and deductibles climbing as high as $250m in 2020.[2] Of greater concern, insurers are increasingly unwilling to provide D&O cover, with six insurers effectively exiting from the Australian D&O insurance market.[3] Insurers and brokers consistently cite securities class actions as the most significant driver for the increased cost of D&O insurance in Australia and restricted availability. The negative impact of class actions on D&O cover extends well beyond the listed sector. Given the limited pool of insurance capital in this class of insurance, private and not-for-profit entities are also bearing cost increases. On average, Marsh's private and not-for-profit clients experienced premium increases of between 70 and 100 per cent throughout 2020.[4] Insurance is a critical risk mitigation tool with appropriate cover being crucial to attracting and retaining the most skilled and dedicated directors to Australian boards - a need all the more acute given the impact of the pandemic.

- **Driving risk-aversion:** Australia's regulatory environment creates a strong incentive for conservatism and risk-aversion in boardrooms. Notably, the AICD's latest director index sentiment for the second half of 2020 shows that 73 per cent of directors agree there is a risk-averse decision-making culture on Australian boards. The main reason given for this is the excessive focus on compliance over performance.[5] This constrains innovation and productivity, which is particularly problematic given the need to foster economic growth.

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[2] Marsh, Directors and Officers Liability (D&O) Insurance Market Recap 2020, pg 1. https://www.marsh.com/au/insights/research/directors-and-officers-insurance-market-recap-2020.html
[3] Ibid, pg 2.
[4] Ibid, pg 2.
[5] See the AICD Director Sentiment Index Second Half 2020 at https://aicd.companydirectors.com.au/advocacy/research/director-sentiment-bounces-back-despite-covid19-economic-uncertainty

- **Excessive time spent on disclosure:** Listed company directors regularly cite securities class action risks as a significant concern that consume board and company resources. The current regime has led to excessive focus on continuous disclosure issues at the expense of broader strategic considerations. This is especially critical in the context of Australia's recovery from the COVID-19 pandemic, where calculated risk-taking will be critical to accelerating growth and job creation.
- **Ineffective mechanism to compensate shareholders:** Continuing shareholders will ultimately be the most impacted when settlements are reached with companies. Itis their investments that will suffer as a result of expenses incurred and the increases in D&O insurance premiums, not those shareholders who are alleged to have sold their stock at the inflated prices. This issue has been referred to as the 'circularity problem' or a 'pocket-shifting exercise'.

If passed, the Bill should limit the time and cost expended by directors and management when speculative securities class action proceedings have been commenced against an entity. This will allow the board and management to focus on recovery from the COVID-19 pandemic and take calculated risks, which will be critical to accelerating growth and job creation.

It is also anticipated that the permanent changes will lead to cost savings for D&O insurance given that securities class actions have been a primary driver of cost increases for all entities (whether listed, private or not-for-profit). Notably, major D&O insurance broker Marsh welcomed the announcement and said it "represents an important and positive step forward for directors, corporations, and their insurers."[6]

(c) Temporary amendments have not resulted in adverse consequences

The AICD supports robust market disclosure and believes that these amendments should support entities to provide timely and robust information to investors, including forward-looking statements. Importantly, if legislated, entities and officers who are reckless, negligent, or knowingly fail to disclose will be subject to the full force of the law.

The temporary amendments have now been in force for close to eight months, which form somewhat of a 'natural experiment' about whether they will lead to a decline in the quality of disclosures or a chilling effect on market confidence, as their detractors claim. We are unaware of any evidence of this occurring. We continue to see entities provide timely and robust information to the market and there have been no suggestions by the ASX, investors or other market participants that disclosure quality has fallen since the temporary relief.

There has been no capital flight either; for example, the ASX states the number of new listings increased 23 per cent year-on-year to 113 from 2019 to 2020, three-quarters of which arrived in the second half of the 2020 calendar year when the relief was in force.[7] There have also been very strong secondary capital raisings, with December 2020 and June 2020 recording respectively the second and third largest monthly capital raisings for the last decade.[8]

It is also notable that ASIC continues to be able to prosecute an entity for criminal offences, issue administrative penalties and issue infringement notices for failure to comply with continuous disclosure obligations without proving fault. These public policy protections will also ensure accountability and

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6 Gangcuangco, T. Permanent changes to continuous disclosure laws – what do they mean for D&O insurance? https://www.insurancebusinessmag.com/au/news/professional-liability/permanent-changes-to-continuous-disclosure-laws--what-do-they-mean-for-dando-insurance-246896.aspx
7 ASX, Market statistics. https://www2.asx.com.au/blog/investor-update/2021/asx-ipo-review
8 ASX, Market statistics. https://www2.asx.com.au/about/market-statistics

robust market disclosure. According to ASIC enforcement reports, over the five year period to December 2019, with regards to continuous disclosure matters, ASIC has concluded:

- 5 civil matters;
- 2 criminal matters;
- 1 enforceable undertaking; and
- 16 administrative remedies (infringement notices).[9]

This appears to be a relatively limited number of cases when compared with the volume of securities class actions commenced over the same period.[10] In the AICD's view, ASIC should more vigorously enforce alleged breaches of the law given the centrality of disclosure laws to Australian public markets. This would allow public interest rather than commercial considerations to drive litigation.

Further, as has been lost in some of the public debate, there is additional regulatory protection from the ASX who oversees compliance with the Listing Rules and has a range of powers available to it (such as censure, ordering withdrawal of announcements, and suspension of trading). For example, during the recent period of COVID-19 uncertainty, we understand that the ASX has taken urgent action in a number of cases to prevent misleading or inaccurate releases from being made (or remaining in the market).

(d) Commercial interests of the Bill's opponents

We note that the Bill is opposed by some plaintiff class action law firms and litigation funders. Independent ALRC analysis has highlighted that during the period 2013 to October 2018, funders and legal advisers in Federal Court securities class action proceedings received a median return of 49 per cent of the proceeds of litigation (with the remaining 51 per cent going to class members).[11] More recent analysis from the Law Council of Australia found that across the period 2001 to 2020, the portion of the gross settlement of funded class actions going to lawyers and litigation funders was 41.4 per cent.[12] Accordingly, the high percentage of litigation proceeds flowing to funders and lawyers that are motivated by commercial rather than public interest, calls into question whether justice is truly being served.

3. Virtual meetings and electronic communication of documents

The AICD also welcomes the extension of temporary relief allowing companies to hold virtual meetings, such as AGMs, as well as distribute meeting related materials and validly execute documents electronically for a further six-month period.

This is welcome relief, sought by the AICD and others, and provides much needed certainty for those 31 December year end entities currently planning their AGMs.

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[9] ASIC enforcement outcomes January 2015 to December 2019: https://asic.gov.au/about-asic/asicinvestigations-and-enforcement/asic-enforcement-outcomes/

[10] For completeness, we note that there appears to have been no continuous disclosure matters concluded in the latest published ASIC data (covering enforcement outcomes for the period 1 January to 30 June 2020).

[11] ALRC Final Report. Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders, pg 85.

[12] Law Council of Australia Submission - Litigation funding and the regulation of the class action industry, 16 June 2020, pg 8. https://www.lawcouncil.asn.au/publicassets/e8a8ce0e-35b0-ea11-9434-005056be13b5/3832%20-%20Litigation%20funding%20and%20the%20regulation%20of%20the%20class%20action%20industry.pdf

(a) Benefits of allowing virtual meetings

We strongly support the proposals in the Bill that will enable organisations to continue to hold virtual meetings.

AGMs are one of the primary events in an organisation's governance calendar. They are a critical forum for shareholders/members: to hold companies, board and management accountable for their performance and reporting; to hear directly from the Chair and management; and to vote on the composition of the board and key governance resolutions.

However, there are clearly opportunities to reinvigorate the format. A 2015 Computershare survey found fewer than one per cent of shareholders attended AGMs (with a declining trend of attendance over a decade) and less than five per cent voted. The AICD's most recent Director Sentiment Index survey found that over a third (37 per cent) of directors consider the current AGM system to be dysfunctional.[13] Computershare data shows that overall attendance at AGMs has increased by 36 per cent when comparing attendance from 2019 to 2020, suggesting that the virtual and hybrid platforms have not inhibited shareholder and member attendance or engagement.[14]

With this in mind, the AICD supports proposals to allow companies to hold virtual meetings on a permanent basis. We are of the view that this could contribute to reinvigorating company meetings, providing companies with flexibility to use the best format for their circumstances and stakeholders, without diminishing accountability. There could be a range of drivers for companies to adopt hybrid or virtual meeting formats, including removing geographic and physical barriers to attendance by retail shareholders and members; and increasing questioning and engagement.

Permanent change would also bring us into line with other countries such as the US, Canada, Spain, South Africa, Denmark, Ireland and New Zealand, regarding the use of hybrid or virtual meetings.

(b) Ensuring accountability and engagement in virtual meetings

We recognise the concerns of some stakeholders regarding the transparency and quality of shareholder/member engagement in a virtual AGM format. The participation of shareholders, as the collective owners of a company, in general meetings is a crucial component of good governance.

In the AICD's view, virtual AGMs must not be used by organisations to reduce corporate accountability or disenfranchise shareholders/members. Whatever the format, whether that be physical, hybrid or virtual, there is a clear expectation and protection under the law that shareholders and members are given a reasonable opportunity as a whole to ask questions or make comments on the management of the company. This is a strict liability offence under section 250S of the Corporations Act.

Clearly, some of the meeting practices reported by investor groups do not meet these objectives. At the same time, during 2020 many listed companies *have* shown that it is possible to hold virtual meetings in a way that increases, rather than decreases, shareholder participation.

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[13] See slide 7, Director Sentiment Index: Research Findings Second Half 2020, available at: https://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/research/director-sentiment/2020/pdf/ds2020-second-half-oct2020-fullresults

[14] Computershare, Virtual AGM Report: Insights from online meetings in April & May 2020, available at: http://images.info.computershare.com/Web/CMPTSHR1/%7B6d3e4edc-c243-4d5b-8ae0-b7898bf1d9ac%7D_VIRTUAL_AGM_SEASON_INSIGHTS_FINAL.pdf

However, as with any new technology or alterations to established governance practices, there will inevitability be a period of evolution as stakeholders work through the practical changes to processes and practice. It is important that all stakeholders work together to improve the experience for all participants and ensure that virtual AGMs are not used as a means to reduce board accountability to shareholders/members.

To this end, we have concerns with the Bill's proposal to include a new requirement in section 253Q that, for those entitled to attend a meeting, a 'reasonable opportunity to participate' includes a 'right to speak' orally rather in writing.

Our member feedback suggests that facilitating telephone dial-in options that enable participants to speak during a meeting, in addition to webcasting, is less commonly used by organisations and their virtual meeting platform providers.

We understand that it is difficult for organisations and platform providers to securely verify the identity of those dialling-in as shareholders seeking to put questions orally to the meeting. By contrast, the ability to submit questions online to the webcast meeting is more securely monitored by the platform provider requiring shareholders to provide a passcode to verify identity. This still allows general access for interested stakeholders (for example, media, employees and other stakeholders) to view the webcast.

Given the legislation will cover a broad range of organisations, from not-for-profit organisations and small companies limited by guarantee, to large listed organisations, we consider it appropriate for the legislation to set the principles and framework that are appropriate for all organisations to comply with. Given the risk of legislation becoming outdated as technology evolves, it is important that the legislation does not impose minimum expectations that are overly prescriptive or unduly burdensome to comply with, particularly for smaller, not-for-profit entities.

Instead, we would encourage the Government and stakeholder community to take steps to address listed company investor concerns around meaningful shareholder engagement without embedding unnecessary prescription in legislation. This could be achieved via ASIC regulatory guidance supplemented by industry-agreed best practice principles.

While ASIC guidance is not legally binding it would create a clear expectation of practice and provide guidance on how the corporate regulator will enforce companies' pre-existing legal obligation to provide members as a whole with a 'reasonable opportunity to participate' at meetings. Where companies circumvent their obligations, ASIC should be encouraged to adopt a more proactive enforcement approach than its current practice.

In parallel, we would support the development of industry-led guidance to complement ASIC's work. For example, the Principles and Best Practices for Virtual Annual Shareowner Meetings is a commendable international example of stakeholders (e.g. retail and institutional investors, company representatives, proxy firms and lawyers) in the United States collaborating to develop a shared understanding of best practice.[15] We would be pleased to work with stakeholders in the Australian market to develop similar best practice principles reflecting the learnings from the 2020 AGM season, and have commenced discussions to that end.

[15] The Best Practices Committee for Shareowner Participation in Virtual Annual Meetings, Principles and Best Practices for Virtual Annual Shareowner Meetings, at https://www.broadridge.com/_assets/pdf/broadridge-vasm-guide.pdf

(c) Flexibility in format of meetings

In terms of permanent reform going forward, we reiterate our strong view that the Government should not hard-wire a particular format of an AGM into legislation. We are concerned, for example, that if a hybrid format for AGMs were mandated for virtual participation it could lead to some entities reverting to traditional physical meetings as the 'lowest denominator'. This would sacrifice the potential benefits of virtual meetings (including accessibility and broader participation) given the additional cost, duplication and complexity for companies.

It is important that organisations have the flexibility to adopt the best meeting format for their circumstances, shareholders/members, and stakeholders. Regulation should focus on the outcomes and purpose of meetings, while enabling flexibility in delivery and technological neutrality.

We look forward to Government providing further information about the 12-month opt-in pilot for companies to hold hybrid AGMs. We note however that not all organisations' constitutions will currently contemplate the conduct of a hybrid AGM and in some cases, will require organisations to amend their constitution to permit this format. For example, in the absence of provisions to displace the requirement for constitutional change (such as the Treasurer's temporary modifications to the Corporations Act under his emergency instrument-making power expiring on 21 March 2021), some organisations will first be required to seek shareholder approval either at their AGM or via an extraordinary general meeting (in a physical format) to amend their constitution to permit a hybrid AGM.

Accordingly, we encourage Government to consider how companies could be afforded the opportunity to participate in the 12-month opt-in hybrid AGM pilot, without the need for constitutional change where it is required.

(d) Notices of meeting

We strongly support the amendments that would allow organisations to send documents, including notices of meetings, via electronic means. In our view, allowing organisations to provide notices of meetings to shareholders/members electronically will produce significant cost savings and reduce postal delay for shareholders/members in rural and regional communities, as well as have a positive environmental impact. Again, we are of the view that these reforms should become permanent.

4. Next steps

We hope our submission will be of assistance.

Yours sincerely,

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