# Senate Economics References Committee

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

# Submission by the Australian Securities and Investments Commission

June 2021

# Contents

# Executive summary

1 This submission focuses on how the amendments proposed will, in practical terms, impact on the way the Australian Securities and Investments Commission (ASIC) administers these laws. The key points are:

(a) to establish a contravention of the continuous disclosure provisions under the proposed reforms ASIC will need to rely on the common law rules of attribution to establish the corporation's knowledge, recklessness or negligence. Clear statutory attribution rules, similar to s769B(3) of the *Corporations Act 2001* (Corporations Act), would assist ASIC to prove the proposed fault element that will be required in pursuing civil penalty action under the proposed reforms;

(b) under the proposed reforms, ASIC will need to be ready to prove the requisite fault element when it issues an infringement notice (even though proof of the fault element is not required to issue an infringement notice) in the event that the infringement notice is not paid and ASIC then needs to enforce the law through civil penalty proceedings.

## Introduction and background

2 ASIC welcomes the opportunity to make this submission to assist the Senate Economics References Committee with its inquiry into the Treasury Laws Amendment (2021 Measures No. 1) Bill 2021 (the Inquiry).

3 ASIC is established under the *Australian Securities and Investments Commission Act 2001* (ASIC Act). ASIC is Australia's corporate, markets, financial services and consumer credit regulator.

4 Relevant to the Inquiry's terms of reference, the ASIC Act requires ASIC to strive to:

(a) maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and

(b) promote the confident and informed participation of investors and consumers in the financial system.

5 ASIC also has the function of monitoring and promoting market integrity and consumer protection in relation to the Australian financial system.

6 In this role, ASIC administers the Corporations Act and the provisions of the ASIC Act which are proposed to be amended by the Treasury Laws Amendment (2021 Measures No. 1) Bill 2021 (the Bill).

7 This submission focuses on how these amendments will impact on the way ASIC administers these laws and the potential impact on ASIC's functions. The submission sets out:

(a) how the proposed reforms may not align with the approach in overseas jurisdictions, in that ASIC will be required to establish a fault element before it can take civil penalty action;

(b) some practical implications of the proposed amendments in Schedule 2 of the Bill on ASIC's regulatory and enforcement action

(c) an overview of the existing regulatory framework, functions and responsibilities as they relate to the Inquiry's terms of reference and the proposed reforms to that regulatory framework; and

(d) the importance of the continuous disclosure obligations and misleading and deceptive conduct provisions in protecting investors and consumers and promoting market integrity in the Australian financial system;

## Schedule 1 of the Bill—Virtual meetings and electronic communication of documents

8 ASIC notes that Schedule 1 of the Bill extends the measures made under the Corporations (Coronavirus Economic Response) Determination (No. 3) 2020 which temporarily removed impediments to the use of virtual technology to hold meetings and permitted the dispatch of notices of meeting by electronic means. This Determination ceased to have effect on 21 March 2021.

9 In order to provide the market with a degree of certainty during this time, ASIC adopted a 'no-action' position in relation to the convening and holding of virtual meetings.[1] ASIC's 'no-action' position is temporary and applies to meetings held between 21 March and the earlier of 31 October and the date that any relevant measures are passed by Parliament. ASIC's position will be reviewed in September 2021.

[1] ASIC, Media Release (21-061MR) *ASIC adopts 'no-action' position and re-issues guidelines for virtual meetings* (29 March 2021).

# A Proposed reforms

**Key points**

Temporary modifications to the continuous disclosure provisions were enabled in May 2020 to facilitate the continuation of business in circumstances relating to the COVID-19 pandemic. These modifications expired in March 2021.

It is now proposed that these changes be made permanent and that additional changes be made to the misleading and deceptive conduct provisions in order to reduce the scope of opportunistic class actions and costs imposed on entities and company officers.

Noting that it is difficult to make direct comparisons across different jurisdictions, and that there is some debate, permanently introducing a fault-based framework for the enforcement of these laws by the regulator may place Australia out of step with other comparable jurisdictions such as the United States and the United Kingdom where it appears regulators can still take certain enforcement action for disclosure-related matters without establishing fault.

## Overview of the proposed reforms and their development

### ALRC Report

10 The Australian Law Reform Commission (ALRC) recommended in its 2018 report *Integrity, fairness and efficiency—An inquiry into class action proceedings and third-party litigation funders* that:

> The Australian Government should commission a review of the legal and economic impact of the operation, enforcement, and effects of continuous disclosure obligations and those relating to misleading and deceptive conduct contained in the Corporations Act and the ASIC Act.[2]

11 The ALRC received mixed views in response to this recommendation. In their submissions to the ALRC inquiry, industry bodies such as the Australian Institute of Company Directors (AICD) and the Law Council of Australia (LCA) supported the proposed review of the legal and economic impact of continuous disclosure obligations and provisions relating to misleading or deceptive conduct on listed entities (AICD in the context of its interaction with Australia's class actions market and LCA in order to 'optimally achieve' market integrity and the protection of investors). The Corporations Committee of the LCA proposed that any such review could also compare different approaches to regulation of this issue in other markets, such as the United States.

[2] ALRC, *Integrity, fairness and efficiency – An inquiry into class action proceedings and third-party litigation funders* (Report 134), December 2018.

### Temporary modification of the continuous disclosure provisions

12 The Corporations (Coronavirus Economic Response) Determination (No. 2) 2020 dated 25 May 2020 (Determination) temporarily modified s674(2), 674(2A), 675(2) and 675(2A) of the Corporations Act so that, in order to establish a breach of a civil penalty provision, ASIC and private litigants need to demonstrate that the listed entity knew or was reckless or negligent as to whether information alleged to be the subject of a disclosure obligation would have a material effect on price or value of the relevant securities.

13 The Determination was made for the express purpose of temporarily modifying the continuous disclosure regime to facilitate the continuation of business in circumstances relating to COVID-19. The Determination did not modify the application of s1041H and 12DA.

14 In the *Final report on litigation funding and the regulation of the class action industry* tabled on 21 December 2020 (PJC report), the Parliamentary Joint Committee on Corporations and Financial Services (PJC) recommended that the Australian Government permanently legislate the changes to continuous disclosure laws made in the Determination, primarily to reduce the scope for opportunistic class action litigation.

### Permanent changes in the Bill

15 The Bill proposes to make permanent the modification to continuous disclosure provisions in the Determination: see paragraph 20 for more detail on the proposed amendments.

16 The Bill also changes the mental element required under the misleading and deceptive conduct provisions (s1041H of the Corporations Act and s12DA of the ASIC Act).

## The fault element for regulatory action

### International comparisons

17 The proposed changes to the continuous disclosure regime will mean that private litigants will need to establish a fault element to establish liability for a breach of the continuous disclosure provisions and the misleading and deceptive conduct provisions.

18 Some submissions to the PJC inquiry (see paragraph 14) observed that the introduction of a fault-based framework for private actions would align Australia's rules with those that apply for private litigants in the United

States and the United Kingdom.[3] There is, however, a distinction to be drawn between private litigation, and enforcement action by regulators.

19 While it is difficult to make a direct comparison between different jurisdictions in light of different legislative frameworks and available remedies, introducing a fault-based framework for ASIC enforcement litigation may place Australia out of step with the United States and the United Kingdom where it appears regulators can take enforcement action without establishing fault.[4]

[3] See PJC report, paragraphs 17.52 and 17.53 and AICD, Submission 40, Appendix 1 (Herbert Smith Freehills, *Advice on comparative analysis of international corporate disclosure and liability regimes*, June 2018), p. 1
[4] See Pamela Hanrahan, 'Core issues in the regulation of misleading silence in corporate law' in Elise Banta and Jeannie Paterson (eds), *Misleading silence* (Bloomsbury Publishing, 2020). For an international comparison of civil action for continuous disclosure (including requirement to prove a fault element) see PJC report, Table 17.2.

# B Impact of the reforms on ASIC's regulatory action

**Key points**

The Bill amends the Corporations Act and the ASIC Act so that entities and their officers will only be liable in civil penalty proceedings in respect of continuous disclosure obligations and the misleading and deceptive conduct provisions if they have acted with knowledge, recklessness or negligence (referred to as the fault element).

There are practical issues for ASIC in having to rely on the rules of attribution to establish the fault element. Some of these practical difficulties could be addressed by inserting a deeming provision in relation to Ch 6CA of the Corporations Act.

Another practical impact is that under the Bill ASIC would be required to establish a fault element in order to bring civil penalty proceedings where an entity fails to comply with an infringement notice. In investigating the matter, it is likely that ASIC will need to obtain evidence to establish the fault element to ensure that it can take civil penalty action in that event.

## New fault element in the Bill

20 The Bill contains proposed changes to:

(a) Chapter 6CA of the Corporations Act (via the insertion of s674A and 675A) to provide that for all civil penalty proceedings commenced under the continuous disclosure provisions, the plaintiff (whether a private litigant or ASIC) must prove that an entity or officer acted with 'knowledge, recklessness or negligence' in respect of an alleged contravention: specifically, that the entity 'knew or was reckless or negligent' with respect to whether the information would have a material effect on the price or value of the entity's securities; and

(b) extend the mental element to misleading and deceptive conduct in s1014H of the Corporations Act and s12DA of the ASIC Act. Entities and officers will only be liable for misleading and deceptive conduct in the circumstances where the continuous disclosure provisions have been contravened if the requisite mental element in the disclosure obligation has been proved (i.e. knowledge, recklessness or negligence).

21 The Bill also provides that s1317QB of the Corporations Act (dealing with state of mind) does not apply to the contravening provisions. It will be necessary for ASIC to prove the person's knowledge, recklessness or negligence as appropriate.[5]

[5] We also note s1317EQE of the Corporations Act which provides that if an element of a civil penalty provision is done by an employee, agent or officer of a body corporate acting within the actual or apparent scope of the employee's, agent's or

## Establishing the fault element

22 To establish a contravention of s674A and 675A (and where applicable s1041H of the Corporations Act and s12DA of the ASIC Act), ASIC would need to rely on the rules of attribution under the common law to establish the corporation's knowledge, recklessness or negligence via:

(a) the guiding mind and will of the entity;

(b) an individual who is acting in the course of their employment with the entity; or

(c) special rules of attribution.

23 The above arises in the context of ascribing the liability of a natural person, for misconduct, to the corporation (ascribing corporate knowledge mainly to the board and management insofar as they are responsible for the transaction in question).

24 In many cases it is clear where a senior officer or the board receives a distinct piece of information, which, on its face, is material and the entity does not disclose it immediately or at all. However, experience shows us that this is not often the case. ASIC often investigates where an entity has disclosed information that, on its face, appears to be disclosed later than it should have been. A common example is a downgrade in a profit forecast very late in the forecast period. In these circumstances, given that most of the period on which the forecast was based has passed, it raises the question: why didn't the entity revise the forecast sooner?

25 Information will change and evolve over time and may increase in certainty and accuracy. Company information, particularly financial information, is constantly adjusted as it is updated with more information and as it is subjected to analysis and interpretation. In many instances, material information is created by collecting and collating separate pieces of data from both within and outside the entity (e.g. collecting the results of business units) and analysing or interpreting that data (e.g. creating a revised forecast). Establishing knowledge of materiality in such circumstances involves not only tracing the evolution of the information, and knowledge of the information, but also its significance at various points in the relevant period. Establishing all of this will take time.

26 One of the practical implications of administering the proposed provisions, without clear attribution rules will be difficulty in ascribing to an entity the knowledge of an individual as to, or an individual's recklessness or negligence with respect to, the materiality of information. This may be

officer's employment or authority or apparent authority, the element must also be attributed to the body corporate. However, s1317QE cannot be relied upon in relation to the attribution of fault, or state of mind, of an individual officer or employee to the entity, as what is done cannot be extended to what is known.

particularly difficult when an individual is aware of information which he or she has failed to escalate to the board (inadvertently or otherwise), or where the 'material information' consists of a number of facts taken collectively and in combination.

27 We note in this regard the inclusion in the definitions in the ASX Listing Rules at Listing Rule 19.12 that an entity becomes aware of information as soon as its officer has or 'ought reasonably have come into possession of the information in the course of the performance of their duties'. As highlighted in ASX Listing Rules: Guidance Note 8 (PDF 1.23 MB) at 4.4:

> The extension of an entity's awareness beyond the information its officers in fact know to information that its officers "ought reasonably have come into possession of" effectively deems an entity to be aware of information if it is known by anyone within the entity and it is of such significance that it ought reasonably to have been brought to the attention of an officer of the entity in the normal course of performing their duties as an officer. Without this extension, an entity would be able to avoid or delay its continuous disclosure obligations by simple expedient of not bringing market sensitive information to its officers in a timely manner.

28 The proposed inclusion of the fault elements as to the entity's knowledge of the materiality of the information appears to limit the practical operation of this definition in civil proceedings. For example, it is likely that it will be difficult for ASIC to prove that an entity is reckless or negligent with respect to the materiality of information of which it was not aware but should have been. Introducing clear attribution rules will provide an incentive for market-sensitive information to be elevated to a board or senior officer in a timely manner and for existing practices to be maintained.

29 Similar practical issues may arise in establishing the knowledge of the corporation where there are conflicting views as to the materiality of the information by different members of the board.

30 For the purposes of a provision under Ch 7 of the Corporations Act (such as s1041H), or a proceeding under Ch 7 of the Act, ASIC can rely on s769B(3) of the Corporations Act, in that if it is necessary to establish the state of mind of the body, it is sufficient to show that a director, employee or agent had that state of mind.

31 No equivalent provision appears to apply to Ch 6CA of the Corporations Act. The insertion of such a provision in the legislation would assist in addressing some of the practical issues with the attribution of knowledge necessary to establish the fault element as identified above and promote certainty for corporations.

## The use of infringement notices

32 ASIC acknowledges that the Bill retains the ability for ASIC to issue infringement notices without having to prove knowledge, recklessness or negligence: see paragraphs 60–61 for a discussion of the utility of infringement notices as a regulatory tool.

33 There is no obligation on an entity to comply with an infringement notice. It is ASIC's policy that we will generally bring civil penalty proceedings following the failure of an entity to pay an infringement notice penalty in order to ensure that infringement notices are not viewed as voluntary.

34 Under the Bill, unlike under the current legislation, if an entity fails to pay the penalty specified in the infringement notice ASIC cannot commence civil penalty proceedings under Pt 9.4B of the Corporations Act alleging the identical underlying facts (and relying on the same evidential material) that gave rise to the issue of the infringement notice. Rather, a civil penalty proceeding following the failure of an entity to pay an infringement notice penalty would require ASIC to meet an additional fault element.

35 The Bill is unlikely to otherwise impact the willingness of an entity to pay an infringement notice, but ASIC will not be able to determine this prior to issuing an infringement notice. ASIC will, therefore, need to be ready to bring civil penalty proceedings and establish the requisite fault element when it issues an infringement notice.

36 The requirement to meet a fault element for any civil penalty action is likely to necessitate ASIC conducting a more extensive investigation (and committing additional investigative resources and time) for less serious continuous disclosure breaches to ensure that, if an infringement notice is issued, it will be enforceable.

37 The failure of ASIC to pursue civil penalty action where an entity fails to pay the penalty specified may undermine the infringement notice regime. Given the recipient is not required to comply with the notice, it is vital that ASIC pursue civil penalty actions to seek a declaration that the entity breached the provision specified in the infringement notice and a pecuniary penalty order.

### Written determinations

38 Under the Bill, ASIC retains its powers under s708A(2), 713(6), 713A(23), 1012DA(2) or 1013FA(3) of the Corporations Act to make a written determination to prevent an entity from relying on the reduced disclosure rules if the entity breaches its continuous disclosure obligations using the strict liability test. It is proposed that these provisions, that currently only refer to s674 and 675 of the Corporations Act, will be amended to also refer to the relevant new civil penalty provisions in s674A and 675A.

39 ASIC will consider making these determinations irrespective of whether an entity has complied with an infringement notice: see RG 73 at RG 73.38.

# C ASIC's role and regulatory action

**Key points**

The continuous disclosure obligations and misleading and deceptive conduct provisions have been refined over a period of 20 years and are critical to protect investors, promote market integrity and maintain the good reputation of Australia's financial markets.

In the last 15 years, ASIC has commenced 149 investigations which included a suspected contravention of the continuous disclosure provisions leading to civil penalties, infringement notices and other regulatory outcomes. These sanctions have a significant deterrent effect.

## The existing regulatory framework

40 The obligation to disclose material information and keep the market informed is set out in the listing rules of the market operator. The obligations under the listing rules have the statutory backing of the Corporations Act. Listing Rule 3.1 of the ASX Listing Rules provides that:

> once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.

41 The obligation to disclose material information was first introduced under s1001A of the *Corporate Law Reform Act 1994* which provided that a listed entity could be found guilty of a criminal offence or held civilly liable if it intentionally, recklessly or negligently failed to notify the exchange of price-sensitive information.

42 The current continuous disclosure provisions in s674 and 675 of the Corporations Act were enacted on 11 March 2002 by the *Financial Services Reform Act 2001* (FSR Act). At that time the requirement to establish the fault element in a civil proceeding was removed. In addition to being a criminal offence, after 11 March 2002, breaches of the continuous disclosure provisions could also lead to the imposition of a civil penalty.

43 The FSR Act also enacted s1041H of the Corporations Act. This section provides a general prohibition on misleading or deceptive conduct in relation to financial products and services. Listed shares are one type of financial product that is covered by this provision.

44 Where a listed entity has made a market announcement or a statement that, while not necessarily false, overstates the true position, the conduct in these cases may also be characterised as misleading or deceptive in contravention of s1041H. A breach of s1041H results in civil liability only, as does a

breach of the relevant misleading and deceptive conduct provision under the ASIC Act, s12DA. Examples of civil relief include injunctions and declarations to deter other persons from contravening the relevant provisions and set appropriate market standards. Both provisions apply in relation to financial products or financial services more generally, not just listed shares.

45 In 2004, the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* introduced the ability for ASIC to issue infringement notices for breaches of the continuous disclosure provisions.

## ASIC's role

46 Working closely with ASX, ASIC conducts ongoing surveillance activities to detect potential breaches of disclosure obligations by listed entities, including monitoring abnormal trading patterns that could indicate a leak of market-sensitive information. Where a potential breach is identified, ASIC will conduct a formal investigation using its investigative powers to determine whether there has been a breach of the law.

47 The number of continuous disclosure referrals varies from year to year. Over the last 10 years, ASX has referred between 2 and 20 matters a year to ASIC, and ASIC has identified a further 1 to 12 matters a year that require formal investigation.

## ASIC's regulatory toolkit

48 In enforcing the continuous disclosure obligations, ASIC has a range of available regulatory tools.

49 ASIC considers the circumstances of each case and the evidence that is available to establish the case; for this reason, we undertake a careful assessment of the evidence before commencing enforcement action.

50 To pursue enforcement action, ASIC must have sufficient credible, reliable and admissible evidence to prove all elements of the alleged contravention to the requisite standard of proof. This means that ASIC must be able to prove the relevant facts of a matter beyond reasonable doubt (for criminal matters) and on the balance of probabilities (for civil matters).

51 There is a lower standard of proof needed to pursue administrative proceedings or enforceable undertakings because the rules of evidence do not apply. However, findings of fact in administrative proceedings, such as a determination that an entity may not rely on a short-form prospectus or a decision to issue an infringement notice, must be made based on material that is relevant, credible and probative.

### Criminal action

52 A contravention of s674(2) is an offence pursuant to s1311(1) of the Corporations Act. To establish that an entity has committed a criminal offence, ASIC must establish that the entity's failure to comply meets the standard of criminal responsibility and applies the fault elements as set out in the Schedule to the *Criminal Code Act 1995* (Criminal Code).

53 ASIC must prove one or more physical elements and a fault element—intention, knowledge, recklessness or negligence—with respect to one or more of the physical elements of the offence.

54 To establish a breach of s674 to the criminal standard, ASIC must prove that:

(a) a listed disclosing entity has information in relation to which the provisions of the listing rules require the entity to notify the market operator; and

  (i) Physical element: Circumstance

  (ii) Fault element: Recklessness

(b) the information is not generally available; and

  (i) Physical element: Circumstance

  (ii) Fault element: Recklessness

(c) the information is information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of ED securities of the entity; and

  (i) Physical element: Circumstance

  (ii) Fault element: Section 677—if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the enhanced disclosure securities

(d) the entity failed to notify the market operator.

  (i) Physical element: Conduct

  (ii) Fault element: Intention.

55 We will generally consider criminal action for serious conduct based on our assessment of the matters set out in paragraph 68. We may refer the matter to the Commonwealth Director of Public Prosecutions (CDPP) where we have gathered sufficient evidence to meet the higher standard required. The CDPP then determines whether the evidence is sufficient to commence criminal proceedings and whether the prosecution is in the public interest.

56 To date, there have been no criminal prosecutions against an entity for breaching their continuous disclosure obligations.[6]

### Civil penalty

57 Under the current regime, in order to bring a civil penalty action, ASIC does not need to establish a fault element.

58 The statutory obligation for the entity to disclose information arises as soon as an entity has information which the listing rules require the entity to disclose.

59 The court must be satisfied on the balance of probabilities, taking into account the nature of the cause of action, the nature of the subject matter of the proceeding and the gravity of the matters alleged.

### Infringement notices

60 Infringement notices were introduced to strengthen the enforcement mechanism in relation to contraventions of the continuous disclosure regime and enhance ASIC's capacity to penalise contraventions, thereby incentivising increased compliance with the regime. Empirical research suggests that infringement notices have a substantial deterrent effect.[7]

61 Infringement notices allow ASIC to:

(a) quickly deal with less serious contraventions of the continuous disclosure provisions of the Corporations Act that would not otherwise be pursued through the courts and provide a proportionate response to such contraventions; and

(b) signal its views regarding appropriate disclosure practices to listed entities more effectively than through court action alone.

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[6] Further, we note that a breach of s674(2A) relating to the liability of a person involved in a breach of s674 is not a criminal offence. There are, however, two cases in which ASIC has taken criminal actions against individuals relating to continuous disclosure offences – neither was under s674(2A).

- Mr Benjamin David Kirkpatrick was charged under the Criminal Code: see Media Release (MR 17-018) *Waratah Resources' former executive chairman convicted and sentenced for misleading the market* (30 January 2017). Mr Kirkpatrick pleaded guilty to a charge of aiding and abetting Waratah Resources Limited to breach its continuous disclosure obligations, contrary to s674(2) and 1311(1) of the Corporations Act and s11.2(1) of the Criminal Code in May 2016 and was sentenced in January 2017.
- Under the old legislative provisions and prior to the introduction of s674(2A), former Deputy Executive Chairman, Mr Steven Irvine Hart, and former Managing Director, Mr Richard Melvyn Hayter, were charged with one count of being knowingly concerned in Hart Australasia's failure to keep the market informed of the group's unexpected loss of $9.7 million in 2001. A District Court of Queensland jury was unable to reach a verdict on charges against Mr Hart. Mr Hayter was found not guilty. The prosecution was subsequently discontinued.

[7] For example, researchers examined the deterrent effects of different types of sanctions imposed by ASIC to enforce compliance with the continuous disclosure regime. By measuring the improvement in market liquidity, they found that administrative sanctions (e.g. infringement notices) imposed against a target firm had a substantial deterrent effect on industry peer firms: see X Chen, KW Choi, S Wright and H Wu, 'The effect of sanctions on continuous disclosure under the responsive enforcement strategy: Evidence from Australia' (28 July 2018). Available at SSRN: https://ssrn.com/abstract=3221640 or http://dx.doi.org/10.2139/ssrn.3221640.

62 In deciding whether to issue an infringement notice, an ASIC delegate takes all submissions and evidence into account. The relevant test is whether there are reasonable grounds to believe there has been a breach.

63 Our general approach and the process for issuing infringement notices for continuous disclosure breaches is set out in Regulatory Guide 73 *Continuous disclosure obligations: Infringement notices* (RG 73).

64 If an infringement notice is complied with (e.g. the penalty is paid), no further regulatory action can be taken against the recipient for that breach. If the infringement notice is not complied with, ASIC is entitled to bring a civil penalty action against the notice recipient seeking a declaration and a pecuniary penalty order.

65 Under the current legislation, to establish a breach of the civil penalty provision for continuous disclosure, ASIC would not need to establish a fault element.

### ASIC's exclusionary powers

66 ASIC can make determinations in writing excluding entities from relying on certain provisions of the Corporations Act which permit reduced disclosure, if ASIC is satisfied that, in the previous 12 months, the entity has contravened the continuous disclosure obligations.[8]

### Enforceable undertakings

67 Enforceable undertakings have also been used by ASIC in cases where there have been alleged breaches of continuous disclosure to obtain remedies for the alleged breach, including compensation for any investors that may have lost funds.[9] Enforceable undertakings can:

(a) require steps to be implemented to alter an organisation's or individual's behaviour and encourage a culture of compliance;[10] and

(b) offer faster, more flexible and effective regulatory outcomes than could otherwise be achieved through administrative or civil action.

## Deciding which regulatory action to take

68 When contemplating action for a potential continuous disclosure breach, ASIC considers factors that differ from those considered by private litigants (or their litigation funders). ASIC undertakes a careful assessment of what

[8] See, for example, s708A(2), 713(6), 713A(23), 1012DA(2) and 1013FA(3) of the Corporations Act.
[9] See, for example, the enforceable undertaking accepted from Multiplex Limited in December 2006 in which Multiplex undertook to pay an amount up to $32 million to settle claims by affected shareholders and appoint an independent expert to review their policies and procedures for dealing with continuous disclosure.
[10] As in the enforceable undertaking obtained from Multiplex: see footnote 9. Also see enforceable undertakings obtained from Nufarm Limited, Nusep Holdings, Leighton Holdings and Rhinomed Limited.

(if any) enforcement action should be taken, and what enforcement tools to use, after considering:

(a) the nature and seriousness of the suspected misconduct;

(b) the conduct of the person or entity after the alleged contravention;

(c) the strength of our case;

(d) the expected level of public benefit; and

(e) the likelihood that the business community is generally deterred from similar conduct through greater awareness of consequences.

## Regulatory action to date

69 In the last 15 years, ASIC has commenced 149 investigations which included a suspected contravention of s674 of the Corporations Act. ASIC has:

(a) commenced civil penalty proceedings against 10 listed entities alleging breaches of s674. In six of these matters, ASIC also alleged breaches of s1041H by the entity and in one matter ASIC alleged a breach of s12DA of the ASIC Act. Seven of these matters also involved proceedings against individuals for related director's duties offences;

(b) issued 37 infringement notices;

(c) issued at least five determinations under s713(6) of the Corporations Act against companies following findings of continuous disclosure breaches;[11] and

(d) accepted an enforceable undertaking from four entities and negotiated outcomes with three other entities to improve their continuous disclosure policies and procedures and corporate governance.

70 ASIC has conducted several reviews relating to the handling of confidential information[12] and the policies, processes and procedures that entities maintain to ensure they identify and respond to events that may trigger their continuous disclosure obligations.[13]

71 The enforcement of continuous disclosure obligations has an effect not only on the entity that has breached the law, but also on its industry peers. The

[11] Such determinations prevent an issuing entity from relying on the reduced-content prospectus disclosure rules in the Corporations Act for the period specified in the determination and the issuing entity must instead issue a full prospectus in order to raise funds from investors. These figures do not include the determinations made as a result of a surveillance or other regulatory action by ASIC in the absence of a formal investigation.
[12] See Report 393 *Handling of confidential information: Briefings and unannounced corporate transactions* (REP 450).
[13] For example, in November 2012, ASIC conducted a high-level review of emerging market issuers in Australia and reviewed the conduct and disclosure of a limited sample of ASX-listed emerging market issuers based on publicly available information. In reviewing disclosure against the ASX Principles and Recommendations, almost all the entities reviewed stated that they had a documented policy to ensure that they complied with ASX's recommendation on timely and balanced disclosure. Source: Report 368 *Emerging market issuers* (REP 368). From time to time, ASIC also conducts reviews of disclosure of listed entities.

sanctions imposed have a deterrent effect because they raise awareness of the offending behaviour and of the consequences of non-compliance.[14]

[14] 'The effect of sanctions on continuous disclosure under the responsive enforcement strategy: Evidence from Australia': see footnote 7.

# D Importance of the existing regulatory framework

**Key points**

Australia's listed markets are perceived by investors to operate with relatively few information asymmetries (referred to as market cleanliness). As a result, investors—whether retail, domestic institutions or foreign investors—are confident participants in Australia's markets.

The significant participation in Australian financial markets by retail investors and superannuation funds highlights the importance of the continuous disclosure obligations and misleading and deceptive conduct provisions in protecting investors.

## Protecting investors and promoting market integrity

72 Australia's continuous disclosure obligations and misleading and deceptive conduct provisions are critical to protect market integrity and maintain the good reputation of Australia's financial markets. Confidence in the integrity of Australia's equity markets:

(a) encourages investor participation;

(b) contributes to liquidity;

(c) stimulates more competitive pricing; and

(d) lowers the cost of capital.

73 Markets cannot operate with a high degree of integrity unless the information critical to investment decisions is available and accessible to investors on an equal and timely basis. That is why market cleanliness and continuous disclosure are essential to investor confidence. Price discovery in a clean market is efficient. Asset prices react immediately after new information is released through appropriate channels and thereby more closely reflect underlying economic value.[15]

74 Appendix 1 sets out data relating to the Australian financial market, its participants and capital raising practices, all of which rely on the efficient and effective functioning of Australia's continuous disclosure regime and market cleanliness.

[15] For a review of Australian equity market cleanliness, refer to Report 623 *Review of Australian equity market cleanliness* (REP 623).

75 The domestic equity market capitalisation at the end of March 2021 was $2.31 trillion.[16] This represents significant growth. At the end of March 2010, this figure was $1.408 trillion[17] and at the end of 2002, ASX domestic market capitalisation was $702 billion.[18]

76 In the first quarter of 2021, the average daily value traded on ASX was $7.8 billion. Australian investors including superannuation funds and retail investors comprise a substantial proportion of this trading. It is vital, therefore, that investors can trade in an informed market.

77 The continuous disclosure and misleading and deceptive conduct provisions also anchor many other elements of the regulatory regime for financial markets, including low-document capital raisings which is a distinctive feature of Australian capital markets: see Appendix 2.

[16] See ASX, Historical market statistics: End of month values.
[17] See ASX, Historical market statistics: End of month values.
[18] See ASX, *Australia's equity and derivative markets: An overview*, May 2008. This figure may relate to ASX only. In December 2006, the Australian Stock Exchange and the Sydney Futures Exchange merged to form the Australian Securities Exchange (ASX Limited).

# Appendix 1: Market data

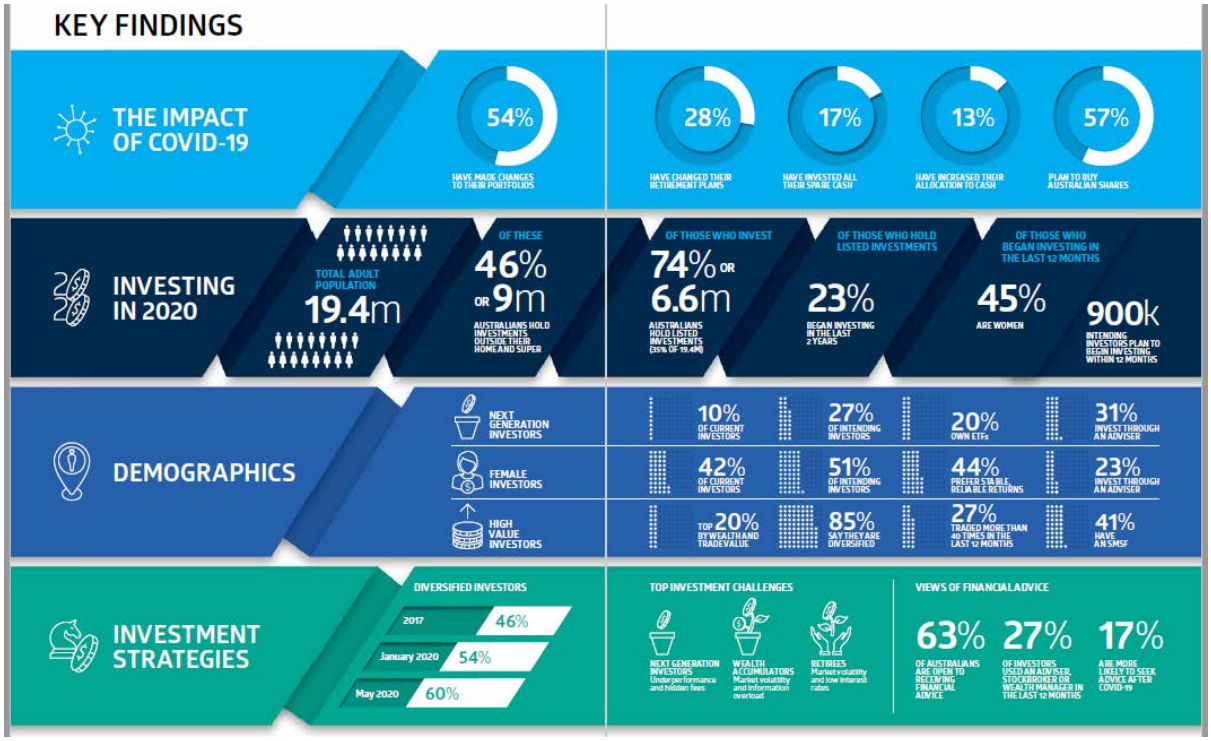
## Australian investors

The domestic equity market capitalisation at the end of March 2021 was $2.31 trillion.[19]

### Retail investors

For a summary of data on retail investors, see Figure 1:

**Figure 1: Retail investors**




Source: ASX Australian Investor Study 2020

### Institutional investors

Australian investors accounted for approximately 70% of issued capital in the ASX 200 in July 2019, with institutional and retail investors accounting for 42% and 28% respectively. North America represented the second largest source of ownership in the ASX 200 at 14.5%, a 21% increase from 2014 (12%). Almost all of these gains have come through US-based index funds, which now account for more than 60% of US investment in the ASX 200,

[19] ASX, Historical market statistics: End of month values.

and of which more than 90% is managed by three firms—Vanguard, BlackRock and State Street Global Advisors.

As at the end-of-December quarter 2019, 22% ($418 billion) of the $1.9 trillion superannuation funds under management were invested in Australian listed equities, 25.3% ($106 billion) in international listed equities and 4.1% ($17 billion) in unlisted equities.

Direct super fund investments in ASX 200 companies have more than doubled to $78.3 billion in the past five years, according to Orient Capital analysis. In 2008, that figure was $16 billion. If the growth rate continues, direct investment by superannuation funds in ASX 200 companies is estimated to reach $157 billion by 2023.

Exchange traded funds (ETFs) grew by over 30% to $79.3 billion in December 2020.[20] This trend continued into 2021 with Beta shares reporting the Australian ETF industry was $97.3 million by the end of February 2021.[21] According to Betashares, 83% of inflows in 2020 went to index products, 10% to active, and 7% to smart beta, indicating that investors wanted broad index exposure rather than paying for active ideas. By category, the industry saw the largest inflows into international equity products, followed by Australian equities, fixed income, commodities, and short products.[22]

## Trading volumes

For a summary of data on retail investors see Table 1:

**Table 1: Trading volumes**

| Quarter | Average daily volume (bn) | Average daily value ($bn) | Average daily # of trades (m) |
|---|---|---|---|
| April to June 2020 | 4.2 | 8.8 | 2.2 |
| July to September 2020 | 5.9 | 7.7 | 1.9 |
| October to December 2020 | 5.2 | 7.5 | 1.9 |
| January to March 2021 | 7.3 | 7.8 | 2.0 |

Source: IRESS and ASIC calculations. Averages calculated based on ASX trading days and figures only include one side of the trade to avoid double counting.

[20] Source: https://www.morningstar.com.au/etfs/article/2020-was-a-record-year-for-australian-etfs/209440.
[21] Source: https://www.betashares.com.au/insights/betashares-australian-etf-review-february-2021/.
[22] Source: https://www.betashares.com.au/insights/betashares-australian-etf-review-2020-in-review/.

# Appendix 2: Low-doc fundraising during COVID-19

On 31 March 2020, ASIC and ASX announced temporary measures to facilitate fund raising activity following the onset of the global pandemic. These measures allowed listed entities to place up to 25% of their issued capital provided it was followed by an entitlement offer or share purchase plan. The underwritten portion of any follow-on entitlement offer could be added when calculating the 25% placement capacity. The '1 for 1' limit on non-renounceable entitlement offers was also waived. These temporary measures were initially planned to end on 31 July 2020 but were extended to 30 November 2020.

In the period from March to October 2020, a total of over $41 billion was raised from equity raising transactions by around 240 companies (for transactions raising $10 million and above). This includes $26 billion from placements, $9.6 billion from entitlement offers, $4.7 billion from share and unit purchase plans and $0.8 billion from initial public offerings (IPOs). During this period, for transactions raising $10 million and above, 38 entities relied on the temporary ASX class waiver to undertake placements above 15% of their issued capital.

Key statistics for announced equity markets transactions ($10 million and above) from mid-March 2020 until 30 October 2020 are given in Table 2:

**Table 2: Summary of ASX equity raisings (March to October 2020)**

| Summary | Total raised<br>$ million | Average<br>% capital | Average discount<br>Last close | Average discount<br>TERP | Average premium<br>Close day 1 | Average premium<br>Close day 2 |
|---|---|---|---|---|---|---|
| Placements | 25,992 | 20.2% | 14.7% | NA | 20.6% | 11.4% |
| Entitlement offer | 9,636 | 69.4% | 23.3% | 16.4% | NA | NA |
| SPP/UPP | 4,721 | 4.3% | 11.4% | NA | NA | NA |
| IPO | 868 | 31.9% | NA | NA | 47.2% | 43.2% |
| **Total** | **41,217** | | | | | |

Note: TERP = theoretical ex-rights price; SPP = share purchase plan; UPP = unit purchase plan.

Source: ASX announcements and ASIC calculations.

As equity market conditions improved in the second half of 2020 we observed continued secondary market raising along with an increase in IPO activity in Q4 2020. This has continued into 2021.

# Key terms

| Term | Meaning in this document |
|---|---|
| ALRC | Australian Law Reform Commission |
| ASIC | Australian Securities and Investments Commission |
| ASIC Act | *Australian Securities and Investments Commission Act 2001* |
| Bill | Treasury Laws Amendment (2021 Measures No. 1) Bill 2021 |
| Corporations Act | *Corporations Act 2001*, including regulations made for the purposes of that Act |
| Criminal Code | Schedule to the *Criminal Code Act 1995* |
| Determination | Corporations (Coronavirus Economic Response) Determination (No. 2) 2020 |
| FSR Act | *Financial Services Reform Act 2001* |
| Inquiry | Senate Economics References Committee's inquiry into the Treasury Laws Amendment (2021 Measures No. 1) Bill 2021 |
| PJC | Parliamentary Joint Committee on Corporations and Financial Services |