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Committee Secretary

Senate Economics References Committee

Dear Committee Members,

Treasury Laws Amendment (2021 Measures No 1) Bill 2021

Thank you for the opportunity to make a submission to this inquiry.

I have researched corporate law, financial markets and the civil justice system for close to 30 years. Given the scope of the inquiry, I propose to address particular issues as nominated below. My comments are confined the proposed amendments in Schedule 2 of the Bill regarding the continuous disclosure regime.

Overall, I urge the Committee to recommend that a proper process be undertaken to review Chapter 6CA Corporations Act that would engage the relevant expertise, stakeholders and deal with the fundamental issues that Chapter 6CA addresses, particularly information asymmetry in the financial markets. There are models for such a process in other jurisdictions that may be followed.

The process so far

The Bill is based on a series of inquiries that were directed to the questions about class actions and litigation funding in Australia. To reiterate, the ALRC's report *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* in 2019 recommended that the Government review the continuous disclosure regime in Chapter 6CA Corporations Act.[1] During 2020, Determinations No. 2 and No. 4 amended Chapter 6CA to bring its provisions into line with the Bill.[2] This was followed in December 2020 by the report of the Parliamentary Joint Committee on Corporations and Financial Services (PJC) on *Litigation Funding and the Regulation of the Class Action Industry* which recommended that the amendments to Chapter 6CA effected by Determinations No. 2 and

[1] Australian Law Reform Commission (ALRC), *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (ALRC Report 134) (24 January 2019), Recommendation 24, 12

[2] Corporations (Coronavirus Economic Response) Determination (No. 2) 2020 (Determination No. 2) - Corporations (Coronavirus Economic Response) Determination (No. 4) 2020 (Determination No. 4)

No. 4 be made permanent.[3] The Explanatory Memorandum to the Bill,[4] and the Second Reading Speech[5] both referred to the PJC recommendation. The majority report of the Senate Economics Legislation Committee also adopted the PJC recommendation.[6]

During this journey, the issues that were raised by the ALRC regarding the interaction between the operation of Chapter 6CA and enforcement by class actions were telescoped into recommendations of the PJC about class actions and litigation funding with little or no analysis of the broader operation of Chapter 6CA. There is no doubt that some of the questions about over deterrence under Chapter 6CA were ventilated in the PJC enquiry, but the PJC enquiry was directed at enforcement rather than the underlying policy regarding the efficacy or otherwise of a continuous disclosure regime.

I remind the Committee of the comments that were made about this issue by the ALRC in 2019:

> 9.21 Further, the emerging issues that were said to arise out of the inter-relationship between the class action regime and aspects of the corporate law appeared to the ALRC to require consideration of the underlying substantive law on which shareholder claims are typically based and, more importantly, required a thorough economic analysis of the assertions that had been put to it by particular stakeholders.
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> 9.22 The ALRC does not consider that it is appropriate to assess many of these matters solely through the lens of what is, in essence, a procedural law; nor are they likely to be resolved (if that were ultimately found to be warranted) by the procedural law.
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> 9.23 Any such review should undertake wide consultation; collect and draw from an evidence-base; and should be conducted by agencies with sophisticated understandings of the regulatory provisions, class action law and procedure, and the securities market.[7]

As noted by the ALRC, a proper inquiry into the operation of Chapter 6CA would encompass a much broader range of issues (e.g. questions about information asymmetry), stakeholders (e.g. regulators such as ASIC which have not made a submission to the current inquiry) and expertise (there is very little input into this process from the cognate disciplines of finance and economics).

In my view questions about the framework for disclosure in Australia's capital markets (which are discussed below) should be addressed independently of enforcement mechanisms.

With respect, the process that has led to the Bill is the tail wagging the dog.

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[3] Parliamentary Joint Committee on Corporations and Financial Services, *Litigation Funding and the Regulation of the Class Action Industry*, December 2020, Recommendation 29, xxxi
[4] Parliament of Australia, Treasury Laws Amendment (2021 Measures No. 1) Bill 2021, Explanatory Memorandum
[5] Second Reading Speech, Michael Sukkar MP, 17 February 2021
[6] Senate Economics Legislation Committee, *Treasury Laws Amendment (2021 Measures No.1) Bill 2021* Report
[7] ALRC, *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (ALRC Report 134) (24 January 2019) [9.21]-[9.23]

The history of the continuous disclosure provisions

Australia's continuous disclosure regime was first introduced by Michael Lavarch as Attorney General under the Labor Government in the Corporate Law Reform Bill 1993. This was subsequently passed as the Corporate Law Reform Act 1994. The introduction of the disclosure regime was part of the long-term reform of corporate law that had its genesis in the financial markets collapse in 1987. Importantly, when the Howard Government oversaw the further refinement of the corporations' legislation in the *Financial Services Reform Act 2001* (Cth) (FSRA) it retained the continuous disclosure regime. The first iteration of the regime had a comparable mental element to that proposed in the Bill but this was superseded by the changes in the FSRA that removed the fault element from the Corporations Act to the Criminal Code.[8]

The FSRA implemented reforms that began with the Wallis Report in 1997 which recommended sweeping changes to the regulation of financial markets and financial services. I note that Chapters 6CA and 7 of the Corporations Act still retain the blueprint that was provided by the Wallis Report. The ALRC currently has a reference[9] where it is working on the drafting of Chapter 7. This may lead to recommendations about the drafting of those provisions however it is not intended to implement policy changes therefore the Wallis blueprint retains its salience for the foreseeable future.

The point of this short history lesson is that the continuous disclosure provisions have been part of the regulation of financial markets for about 30 years and the impetus to introduce the regime was due to the inadequacies in disclosure that had been demonstrated by the 1987 crash. Australia's first class action regime was legislated in Part IVA of the Federal Court Act around the same time in 1991. It is curious that the two bodies of law would lead to considerable vexation in 2021 but it does not demonstrate the continuous disclosure regime is broke. It ain't necessarily so, particularly if one considers how the Australian markets have prospered under this regime.

The Australian market is distinctive

Peppered through the various reports and submissions is the comment that the Australian disclosure regime should somehow be brought into line with jurisdictions like the UK and US. In my view this is misconceived. The disclosure and class action regimes in each jurisdiction are radically different. For example, there are generally 3 types of disclosure that are mandated in each of the jurisdictions – continuous, periodic and special. There may be more onerous obligations upon companies to provide periodic disclosure and this may be taken into account to alleviate special disclosure e.g. during a takeover. Similarly if a company is subject to a continuous disclosure obligation it may have less onerous obligations to disclose information when engaging in fundraising.[10] The three types of disclosure are complementary.

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[8] See generally ALRC, *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (ALRC Report 134) (24 January 2019) at 9.17, citing Paul Miller, 'Shareholder class actions: Are they good for shareholders?' (2012) 86 Australian Law Journal 633, 648

[9] ALRC, 'Review of the Legislative Framework for Corporations and Financial Services Regulation' (21 September 2020)

[10] See for example, s713 Corporations Act – special prospectus content rules for continuously quoted securities.

The disclosure laws in the Corporations Act and obligations owed to the market provide a complementary framework to enable market operators and listed companies to make decisions about how the market should operate. For example, ASX Listing Rule 3.1 is the foundation for the disclosure obligations under section 674 in Chapter 6CA. Initially I was skeptical about the framework created by Chapter 6CA because it builds upon an unusual private law or market obligation in Listing Rule 3.1 and comparable rules in other markets.[11]

However, I have observed over time that market operators play an important role in buttressing the obligations of listed companies under the combination of Listing Rule 3.1 and section 674. This may be observed by the expanding guidance that is given by ASX under Guidance Note 8.[12] For example, Listing Rule 3.1 is strict because it requires that price sensitive information be disclosed 'immediately'. However, 'immediately' has been interpreted by ASX to mean 'promptly and without delay rather than 'instantaneously'.[13] ASX comments that a period of time will necessarily elapse between when an entity first becomes obliged to give information to ASX under Listing Rule 3.1 and when it is able to give that information to ASX in the form of a market announcement.[14] This is significant because disclosures to the market are formal acts by listed companies but there is a natural tendency to deliver good news quickly and bad news slowly.

The participation of retail investors in the Australian market

The Australian markets have distinctive features which are also strengths. This has consequences for regulation. For example, the Australian capital market is characterised by a deep liquidity due in part to the operation of institutional investors such as superannuation funds.[15] Perhaps most important to the present debate, the Australian market has a very high level of retail investor participation. The latest ASX *Australian Investor Survey* estimates that 6.6 million Australians hold shares or other on-exchange investments.

> Australian direct shares are by far the most widely held asset class, owned by 58% of investors. That compares to just 38% of investors who hold residential investment properties and 28% who hold term deposits.[16]

Notably, the demographics of retail investors has changed significantly over the last few years. I quote again from the ASX *Australian Investor Survey:*

> Among those who invest, more than half invest in direct shares, which have cemented their place as Australia's most accessible and widely used investment option, especially for younger investors. While the overall proportion of Australians with on-exchange investments has consolidated below the high point of the early 2000s, there has been an increase in new investors over the last few years, <u>many of them young and female.</u>[17]

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[11] Peta Spender, 'The Legal Relationship between the Australian Stock Exchange and Listed Companies' (1995) 13 *Company and Securities Law Journal* 240
[12] ASX, *Continuous Disclosure: Listing Rules 3.1–3.1B*, Guidance Note 8, 28 February 2020
[13] ASX, *Continuous Disclosure: Listing Rules 3.1–3.1B*, Guidance Note 8, 28 February 2020, 14
[14] ASX, *Continuous Disclosure: Listing Rules 3.1–3.1B*, Guidance Note 8, 28 February 2020, 15
[15] Centre for Commercial Law and Regulatory Studies (CLARS), *Should Australia Permit Dual Class Listings?* Webinar, Monash University, 18 May 2021
[16] ASX *Australian Investor Study* 2020, 18
[17] ASX, *Australian Investor Study* (2020), 13 (emphasis added). For a discussion of the operation of securities class actions at the high point of retail investor participation in the Australia market in the

To emphasise the point, direct share ownership constitutes the highest ownership by asset class in the group that ASX refers to as the "next generation" (aged 18-24). The direct ownership of shares is higher than ownership of residential property in this group.[18] It is now somewhat inaccurate and perhaps a little patronising to describe retail investors as 'mums and dads'. Given the difficulty that millennials are experiencing in securing homeownership, this is a pleasing trend because it demonstrates that they are accessing investment strategies that will be beneficial to themselves and to the economy more broadly. No doubt it is easier now to invest in shares because the transaction is streamlined and generally takes place over accessible devices such as mobile phones. The survey results indicate a responsible approach to investment[19] which can only be beneficial for everyone. However, there is some hesitancy about information.[20]

Perhaps an even more interesting and important trend in the demographics is the increasing participation by women in direct share ownership. The ASX study states:

> The growth in new investors entering the market has also seen a sharp rise in the proportion of women investing. Forty-five per cent of those who began investing in the last 12 months were female, up from 31% among those who started five to 10 years ago. It's a trend that looks set to accelerate, with women accounting for 51% of intending investors.[21]

This is against a history of lower participation by women in direct share ownership, accompanied by lower rates of financial literacy, particularly for older women.[22] The fact that women are now participating in greater numbers is a boon for the Australian economy and Australian democracy generally. However the study also indicates that women have some hesitation about active engagement with their portfolios and correspondingly about information.[23]

The changing demographics demonstrate the importance of having a disclosure regime that genuinely supports existing and emerging retail investors. Everyone benefits from a rigorous disclosure regime and the policy justification for a rigorous disclosure regime is information asymmetry. Regardless of whether or not one embraces the tenets of the efficient capital market hypothesis, there is no doubt that more good quality information in the market is beneficial for everyone. As discussed in several submissions, it also protects against insider dealing. The continuous disclosure provisions and the prohibitions against insider trading act as mirror provisions to one another so rigorous and immediate disclosure unlocks private information for the benefit of the market.[24]

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early 2000s see Peta Spender, 'Securities Class Actions: A View from the Land of the Great White Shareholder' (2002) 31 *Common Law World Review* 123.

[18] ASX, *Australian Investor Study* (2020), 27.

[19] ASX, *Australian Investor Study* (2020), 26

[20] ASX, *Australian Investor Study* (2020), 26

[21] ASX, *Australian Investor Study* (2020), 30

[22] The Social Research Centre, *ANZ Survey of Adult Financial Literacy in Australia* (May 2015) 21

[23] ASX, *Australian Investor Study* (2020), 21. The study also states, 'our research suggests that there is still more work to be done for female investors to participate in investment markets to the same degree as their male counterparts. Female investors tend to hold fewer assets, be less diversified, and more risk averse than their male counterparts' ASX, *Australian Investor Study* (2020), 30

[24] Note, for example, ASIC, *Review of Australian Equity Market Cleanliness* (Report 487, 2016) Appendix 3 Table 18, which found that the Australian market had one of the lowest indicators of

The submissions broadly recognise that institutional shareholders have many strategies available to them to find out information and continuous disclosure goes some way to levelling the playing field because it allows retail investors to at least access to the information that may be needed to make investment decisions. In my view, the current regime is more understandable and accessible to retail investors than the proposed regime. I will say more below about some of the difficulties of proof that are presented by the proposed amendments to Chapter 6CA.

The proposed standard in the Bill

Beginning with the premise that it is preferable for all investors that continuous disclosure be facilitated, there are difficulties with the new standard that is proposed to be implemented in the Bill.[25] Most lawyers understand that proving intentionality, recklessness or negligence makes proof more onerous. This is magnified when one is dealing with corporate entities. Proving the corporate will has presented the law with considerable challenges over the years. This is well documented in the ALRC report on Corporate Criminal Responsibility[26] and it is important to understand the potentially disproportionate effect that the proposed standard will impose. As far as I am aware, there has been little exploration of the opportunities provided to individuals under the so-called due diligence defences under s674(2B) Corporations Act, probably because directors and managers are rarely joined in enforcement proceedings in their personal capacity.

There is also the question about access to information about potential breaches. Assuming that there has been an intentional, reckless or negligent breach of Chapter 6CA, the evidence of the same may only be compellable at the discovery stage, which is a long way down the track of litigation and increasingly regarded as a discretionary aspect of court proceedings. In order to satisfy the Federal Court's pre-action protocols, it is likely that the information would need to be available early and this may result in an increase in satellite litigation without supplying the deterrent effect of substantive proceedings.

I also note that ASIC maintains its powers to issue an infringement notices for breaches of Chapter 6CA. I understand from media reports that ASIC did not consider that the changes in the Determinations should be made permanent.[27] ASIC has previously relied predominantly on infringement notices for certain breaches of market integrity standards.[28] However, ASIC was roundly criticised by the Hayne Royal Commission for its excessive use of remedies that promoted compliance rather than public denunciation of misconduct. The changes to the Corporations Act that are proposed by the Bill might create a further quandary for ASIC when choosing the appropriate enforcement strategy because most of

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information leakage ahead of mergers and acquisitions compared with other international jurisdictions.

[25] For the history of this standard see Australian Law Reform Commission, *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (ALRC Report 134) (No 134, ALRC, December 2018) [9.12]-[9.19]

[26] See generally, ALRC, *Corporate Criminal Responsibility* (Report No 136, April 2020) Chapter 6

[27] John Kehoe, 'ASIC Warns on Weaker Disclosure Laws', *Australian Financial Review* (online, 21 July 2020)

[28] See generally Ian Ramsay and Miranda Webster, 'ASIC Enforcement Outcomes: Trends and Analysis' (2017) 35 *C&SLJ* 289

their provable remedies are bifurcated between relatively low impact infringement notices and complex proceedings such as criminal proceedings under Chapter 6CA.

I note in passing the submissions of several business groups and the Explanatory Memorandum that the current regime has increased the cost of compliance and has discouraged directors from doing certain things such making forward looking statements for guidance and even taking up board positions. Given the increasing involvement of the new retail investors in the Australian market that I described above, it is important to encourage entrepreneurial risk-taking and innovation by managers. However, I note the following about the assertions in the submissions. First, there is no obligation under Chapter 6CA to make forward-looking statements, although I concede that managers now commonly give that guidance to investors. However, in my view these practices have evolved because of market demands. The law does not need to be amended to resolve this issue.

As regards board appointments, it has commonly been said over the 30 year period that I have been involved in Australian corporate law that changes will create disincentives for people to take up board positions. However, overall, the evidence refutes this. The demand for board positions remains strong and the levels of remuneration have not declined, other than initiatives that have been taken under COVID 19.

Changes to the disclosure regime should be based on a thorough review of the evidence about information asymmetry in Australia's capital markets and whether the current regime does in fact discourage innovation. This was recommended by the ALRC and in my view should be pursued before the proposed amendments in the Bill are made.

I would be happy to expand upon any of the issues raised above in order to assist the Committee.

Yours sincerely,

Professor Peta Spender