Level 23, 150 Lonsdale St, Melbourne VIC 3000 | **T** +61 3 8677 3890 | **E** info@acsi.org.au | **W** www.acsi.org.au

1 March 2021

Mr Mark Fitt
Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
Email: economics.sen@aph.gov.au

Dear Mr Fitt

TREASURY LAWS AMENDMENT (2021 MEASURES NO.1) BILL 2021

On behalf of the Australian Council of Superannuation Investors (ACSI), thank you for the opportunity to make a submission in relation to the Treasury Laws Amendment (2021 Measures No.1) Bill 2021 (the Bill).

About ACSI

Established in 2001, ACSI exists to provide a strong, collective voice on environmental, social and governance (ESG) investment issues on behalf of our members, who include 37 Australian and international asset owners and institutional investors. Collectively, our members own, on average, 10 per cent of every ASX200 company, on behalf of millions of beneficiaries. Our members invest over AUD $200billion in Australian equities and therefore take a strong interest in market integrity, including the operation of Annual General Meetings and the effective operation of the continuous disclosure regime.

ACSI's position on the Bill

Schedule 1: Annual General Meetings

The Annual General Meeting (AGM) is a key accountability and transparency mechanism, and shareholders' ability to genuinely participate in an AGM is centrally important. It is appropriate to extend the temporary provisions to allow meetings to continue virtually through the current COVID-19 pandemic. However, any permanent changes to make AGMs virtual-only would undermine shareholder rights and therefore we welcome the consideration of a hybrid model. We support the addition of a right for shareholders to address the meeting in real time, to ensure that AGMs provide the opportunity for effective participation of shareholders. Extending the temporary provisions will also allow time to support a transparent policy debate on appropriate permanent change. We therefore support Schedule 1 to the Bill.

In relation to permanent changes under consideration, we continue to support:

- a hybrid model for meetings as the minimum standard, as opposed to virtual-only meetings;
- proposals included in the Bill to reduce cost and improve efficiency through the adoption of electronic communication to distribute meeting materials.

Schedule 2: Continuous Disclosure

Australia's continuous disclosure obligations and misleading and deceptive conduct laws are a foundation to maintaining market integrity. This is acknowledged by the Australian Securities and Investments Commission, which described the continuous disclosure rules as '[a fundamental tenet of our markets]'.

We are concerned that the Bill's proposed changes would undermine the integrity of the market as they may significantly reduce accountability for poor corporate disclosures. The Bill seeks to address challenges associated with the structure and implementation of the class action framework, however these issues have been conflated with the operation of the continuous disclosure laws. Reducing accountability for poor disclosures is not the answer to addressing issues with class actions.

As we outline in our submission, there was no need for the temporary changes. They were not supported by the regulator at the time and there has been little, if any, genuine consultation on the matter. Accordingly, permanent change should not proceed.

Our more detailed comments are set out in this submission. I trust they are of assistance. Please contact me or Kate Griffiths, ACSI's Executive Manager – Public Policy and Advocacy, should you require any further information on ACSI's position.

Yours sincerely

Louise Davidson AM
Chief Executive Officer
Australian Council of Superannuation Investors

SCHEDULE 1: ANNUAL GENERAL MEETINGS

Extension of temporary provisions

We support the proposal to extend the temporary provisions to allow AGMs to take place virtually in the upcoming season. We recognise the significant challenges with large scale gatherings due to the Covid-19 pandemic. We also support the provisions that are aimed at ensuring that, insofar as is possible, the shareholder's experience is maintained: in particular, a right to speak in real time during the meeting.

Appropriate consultation on permanent provisions

A proper and effective consultation process should be undertaken before any permanent provisions are proposed. It is crucial that sufficient time is allowed to analyse the impacts of the temporary provisions, and for stakeholders to have the opportunity to express informed views on any proposed permanent changes. The hybrid model of virtual and in-person meetings is a significant shift in standard practice, so genuine consultation is necessary to ensure that the model achieves its objectives of efficiency and access, without compromising the rights of shareholders. A broader consultation would also allow for the consideration of long-standing issues which were identified in 2012 by research commissioned by ACSI and many of Australia's largest asset managers. That research found evidence of many operational weaknesses in the systems used to cast votes at company meetings.

Longer term: hybrid meetings

When considering appropriate permanent changes, hybrid meetings which allow for both online and in-person participation should be the minimum standard. Alternative provision could be made for extreme circumstances such as the COVID-19 pandemic, however where virtual-only meetings are required due to extreme circumstances, provision should be made to clarify that virtual-only meetings are not best practice.

Ensuring proper engagement and interaction during meetings

AGMs provide the only opportunity for many shareholders to meet and ask questions of their representatives, the company's directors. Any permanent changes that are made to the provisions should not negatively impact investors' ability to participate in the AGMs, or reduce transparency and accountability. Changes should establish flexibility to hold AGMs with some participants joining virtually, whilst simultaneously protecting the rights of shareholders to engage fully in the discussion.

We observe from the experience of the past months that virtual-only meetings have not generally provided the same opportunity for genuine interaction and engagement between shareholders and company representatives as in-person meetings. For example, this has been due to:

- company directors being unavailable for questions during meetings,
- audio-only format being used, which has not allowed shareholders to observe company representatives address the meeting and answer questions, or to see the reaction of the audience,
- meetings that focus solely on the chair of the board with minimal or no opportunity for shareholders to interact with other directors,
- companies requiring questions and comments to be submitted in writing ahead of the meeting rather than in real-time,
- discussion time being limited,
- companies cherry-picking questions and ignoring follow up comments.

'A reasonable opportunity to participate' requires that shareholders have a genuine opportunity to engage in meetings regardless of whether they participate in-person or virtually. We therefore support the amendment of the temporary provisions to require that shareholders be given an opportunity to address the meeting in real time, and recommend that, at a minimum, this requirement be maintained where provision is made for virtual shareholder attendance at meeting on a permanent basis as part of a hybrid solution.

SCHEDULE 2: CONTINUOUS DISCLOSURE OBLIGATIONS

Australia's continuous disclosure obligations and misleading and deceptive conduct laws are a foundation to maintaining market integrity. Indeed, the Australian Securities and Investments Commission described the continuous disclosure rules as 'a fundamental tenet of our markets'. It is therefore imperative that the regulatory framework around continuous disclosure and misleading and deceptive conduct remains effective, efficient and fair.

We are concerned that the Bill's proposed changes operate to limit investors' ability to hold companies to account, and therefore undermine the integrity of the market. Without appropriate accountability for the

quality of disclosures, it can be expected that the standard of information in the market will deteriorate. Indeed, the time allocated to ensuring information provided to the market is fit-for-purpose is argued as a rationale for the proposed changes. Given the importance of ensuring that information provided to investors is complete, accurate and timely, the time that companies invest in establishing the appropriate systems is time well spent. While many directors will seek to do the right thing, the reality is that some will also seek to take advantage. A stronger, objective test for disclosure obligations is preferable to support focus on high quality information being provided to the market.

Challenges associated with the structure and implementation of the class action framework are being conflated as issues related to the continuous disclosure laws. The proposed changes to the continuous disclosure obligations and misleading and deceptive conduct laws are an inappropriate answer to the challenges within the class action framework canvassed by the ALRC.

The changes proposed in Schedule 2 of the Bill should not progress, and the continuous disclosure obligations and misleading and deceptive conduct laws should remain in their pre-pandemic state.

Lack of proper consultation

The Explanatory Memorandum and other materials point to the recommendations in the ALRC's report titled 'Integrity, Fairness and Efficiency - An Inquiry into Class Action Proceedings and Third Party Litigation Funders and the recommendations of the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Litigation Funding and the Regulation of the Class Action Industry, as independent reports that recommend change. However, as suggested by its title, the ALRC report was focussed on the class action regime. The ALRC did not call for the changes that are proposed in the Bill. Instead, at recommendation 24, the ALRC states 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…*' (p.12).

While the Parliamentary Joint Committee on Corporations and Financial Services considered some of the issues, again its inquiry was into *Litigation Funding and the Regulation of the Class Action Industry*. The Terms of Reference did not mention the continuous disclosure laws. In addition, the Explanatory Memorandum and other materials related to the Bill do not acknowledge the dissenting opinion in the Parliamentary Joint Committee's report, which states that there are '*many economists, companies and institutional investors who would have welcomed an opportunity to make submissions on the operation of the continuous disclosure laws but did not do so because nothing in the terms of reference would have alerted them to the fact that the Committee was proposing to consider those laws in detail (let alone recommend permanent changes to those laws)*' (p363).

The review recommended by the ALRC has not occurred, neither has any genuine policy debate taken place in respect of the proposed changes. Therefore, the changes should not proceed until that debate has taken place and the genuine concerns raised by stakeholders are addressed. Without meaningful consultation and policy debate, this proposed change is a solution that is looking for a problem.

The impact of weaker continuous disclosure obligations

We are concerned by the Bill's proposal to weaken continuous disclosure obligations by requiring the state of mind of a disclosing entity, and relevant individuals, to be taken into account.

The Explanatory Memorandum states that, in the opinion of the Parliamentary Joint Committee, this change would address an imbalance between the benefits to the market of continuous disclosure obligations and the costs imposed on entities and officers.[1] However, realistically, an added requirement to prove that a disclosing entity was reckless or negligent with regard to its continuous disclosure obligations disrupts the finely tuned balance that has been established in Australia to ensure market integrity and efficiency.

It is crucial to remember the importance of continuous disclosure obligations in protecting investors' ability to hold companies accountable for their disclosures (or lack thereof). The ability to do so is an important mechanism in maintaining the integrity of Australian markets, bolstering ASIC's role. If shareholders are required to prove a subjective standard (the mental state of the disclosing entity) rather than the current objective standard of materiality, this will make it more difficult for shareholders to hold companies to account.

The proposed changes to the continuous disclosure rules could therefore adversely affect the balance between companies and investors, and work to undermine market integrity. The changes are not appropriate, nor are they required – rather, there is significant guidance already available to companies (and their directors and officers) on how to manage their responsibilities to investors.

[1]Noting that there was a dissenting opinion in the Parliamentary Joint Committee's report.

Conflation of the issues

The Explanatory Memorandum notes that class actions are frequently brought in relation to continuous disclosure obligations. We recognise that there are challenges with the structure and implementation of class actions in Australia.[2] There is however some doubt with regard to claims that there has been an 'explosion' in class action litigation. The ALRC's report notes that the increase in raw numbers is actually 'small' (p257). There is also an absence of cases in which company directors have been unfairly held accountable under current continuous disclosure obligations.

The challenges in the class action system are a result of the way the system has evolved, rather than of the operation of the continuous disclosure provisions or the misleading or deceptive conduct laws. It is crucial not to conflate the challenges with the class action system with the operation of the continuous disclosure obligations, because this undermines the distinct value and purpose of continuous disclosure obligations, which underpin market integrity.

Rather than watering down the continuous disclosure obligations by imposing a requirement to prove the mental state of the disclosing entity, we propose that a more appropriate solution would be to conduct a broader policy discussion informed by the recommendations of the ALRC, which have been given insufficient consideration thus far.

Underlying rationale for the changes

The Explanatory Memorandum takes the pandemic as its starting point, and notes that the Australian Government temporarily amended the continuous disclosure obligations in order to 'enable companies and their officers to more confidently provide guidance to the market during the coronavirus pandemic'(p23). Given that there is no obligation for companies to provide forward-looking guidance to market, these temporary changes were not necessary. This is consistent with the ASX's Compliance Update issued on 31 March 2020 which, early in the pandemic, reinforced the pre-existing regulatory position and should have sufficiently addressed any doubt that companies may have had about the appropriate actions.

Therefore, the pandemic did not create any need to modify the continuous disclosure obligations. This was evidenced by the large number of companies that withdrew their forward-looking guidance as the economic disruption posed by the COVID-19 pandemic emerged. Investors understood why companies took this action, and did not expect the guidance to be replaced in such circumstances, recognising the importance of accurate disclosure from companies.

It follows that there is also no need to change the continuous disclosure obligations or the misleading and deceptive conduct laws on a permanent basis.

Further, the rising cost of directors' and officers' (D&O) insurance is often argued as a rationale for the proposed changes, suggesting that Australia is unique in this respect. However, worldwide there has been a tightening of the market for D&O insurance, with reports of FTSE 350 companies experiencing average premium increases of 178 per cent, attributed to a 'combination of factors'. While these factors include uncertainty over Covid-19, analysis also points to repricing due to years of loss making, suggesting the issues are not confined to the Australian market. The ALRC Report also found that there was a lack of evidence to establish the cause of increased D&O premiums (p291 at 9.81)

[2] As previously outlined by investors in submissions to the Australian Law Reform Commission and ACSI's submission to the Parliamentary Joint Committee on 11 June 2020.