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18 June 2014

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Dear Ashly,

ASIC's deregulatory initiatives – ASIC Report 391

The Australian Institute of Company Directors welcomes the opportunity to provide comments to the Australian Securities & Investments Commission (ASIC) on Report 391 deregulatory initiatives (the Report).

The Australian Institute of Company Directors (Company Directors) is one of the two largest member-based director associations worldwide, with individual members from a wide range of corporations; publicly-listed companies, private companies, not-for-profit organisations, charities and government and semi-government bodies. As the principal Australian professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

Company Directors is pleased that ASIC is considering ways in which to reduce red tape and to deliver compliance cost savings for regulated businesses. Company Directors has long advocated for a reduction in red tape given that creating a system of efficient regulation is a key element for boosting national productivity. We have stated on many occasions that a good deregulatory agenda is not just about having less regulation it is also about having better and more effective regulation.

For this reason we focus our comments on suggestions for corporate regulatory change that ASIC might discuss further with the Treasury and the Federal Government. In addition we also provide examples of areas where ASIC might be able to improve or streamline its processes to deliver cost savings for ASIC and regulated corporations in Australia.

1. Summary

In summary, the comments of the Australian Institute of Company Directors are as follows:

(a) we are pleased that ASIC is considering ways to reduce red tape and to deliver compliance cost savings for regulated businesses;

(b) the reduction in red tape and the creation of a system of efficient regulation is a key element for boosting national productivity;

(c) to ensure that regulation of corporations and directors remains efficient, effective and contributes to national productivity, ASIC should recommend to the Government that:

(i) a broad based defence for directors be inserted into the Corporations Act;

(ii) the Corporations and Markets Advisory Committee (CAMAC) be reinstated;

(iii) the thresholds for financial reporting be reconsidered;

(iv) greater flexibility for entities trying to change their financial year end be accommodated;

(v) the reversal of the evidentiary onus of proof in section 12BB of the ASIC Act relating to forward looking statements be amended;

(vi) an environment that encourages the proliferation of class actions against corporations be re-visited and a tailored licensing regime for litigation funders be inserted into the Corporations Act and enforceable by ASIC.

(d) In regard to ASIC's processes and forms we recommend that ASIC:

(i) carefully consider the scope of its regulatory guidance, particularly Regulatory Guide 247 - *Effective Disclosure in the Operating and Financial Review,* as guidance such as this has the potential to add to the compliance burden for companies and directors;

(ii) make improvements to the auditor resignation requirements; and

(iii) facilitate the electronic completion and lodgment of all ASIC forms.

2. Suggestions for regulatory change

The growth of regulation and red tape imposes direct and indirect costs on Australian business, plays a role in hindering good business decisions and can prevent the growth of investment and job creation. Approaches to regulation and levels of red tape must be continuously monitored. If not, governments and regulators will cease to operate as effectively as they could due to complexity and the overlap of the legislation and regulations they are required to administer.

We are therefore encouraged that ASIC is seeking specific proposals that provide a net regulatory benefit or a minimal regulatory detriment that is clearly outweighed by a demonstrated commercial benefit. We are of the view that the following areas provide scope for change and are suggestions that ASIC could further discuss with Treasury and the Government.

2.1 Insert a broad based director defence into the Corporations Act

We are firmly of the view that Australia needs to actively create an environment where directors that act with integrity and commitment are free to pursue and harness new opportunities, take calculated risks, drive performance and create jobs without being overly focussed on personal liability concerns.

Company Directors has long stated that the current business judgment rule does not provide directors with appropriate protection in the performance of their roles. The business judgment rule has very narrow operation. It only applies to one contravention of the Corporations Act, being the statutory duty of care and diligence

in section 180(1) of the Act and its equivalent duties at common law and in equity. The business judgment rule is not available as a defence to any other alleged contravention of the Corporations Act (including for example, alleged breaches of disclosure provisions, corporate reporting requirements or the insolvent trading provisions).

We are concerned that requiring directors who perform their roles honestly and diligently, to operate in a regulatory environment where there is a lack of an effective business judgment rule defence and a high risk of personal liability is detrimental to Australia's economy and prosperity. We are of the view that the current approach to the regulation of directors deters good directors from accepting board positions, stifles innovation and entrepreneurialism, slows decision-making and dampens productivity.

The impact of stringent regulation causing directors to be overly concerned about personal liability manifests itself on numerous fronts. One example, is Australia's insolvent trading regime. In Company Directors' view the insolvent trading regime, amongst other things:

- not only encourages, but effectively mandates directors to move to external administration as soon as a company encounters financial difficulties in order to avoid personal liability and consequent reputational damage;
- discourages directors from taking sensible risks when considering other kinds of informal corporate reconstructions or "work-outs" to deal with a company's financial problems; and
- can lead to losses by shareholders, creditors, employees and, in many cases, may have downstream impacts on the broader community through loss of the value of their investments, retirement savings and jobs.

Irrespective of any further insolvency reform approaches that may have merit, we consider that a critical element to addressing the problems created by the insolvent trading regime and numerous other corporate law issues is for directors to have access to a broad based defence in the Corporations Act.

We are of the view that the insertion of an overarching and broad-based defence into the Corporations Act is now required to protect directors that act honestly and with an appropriate level of commitment, but who now work in an increasingly complex and compliance focussed regulatory environment. Company Directors would be happy to discuss our views on this issue with ASIC in more detail.

2.2 Request that the Government reinstate CAMAC

The Australian Institute of Company Directors was very disappointed to learn that the Federal Government has decided to disband the Corporations and Markets Advisory Committee (CAMAC). CAMAC has played an important role in the development of the corporations law since it was created in 1989.

While in the short term the abolition of CAMAC and streamlining its functions into Treasury may appear to be an effective cost saving measure, we are of the view that such a decision is short sighted and has the potential to increase red tape in the future. This is because there will no longer be a cost effective, highly experienced and independent body considering improvements to the corporate law in Australia.

As we stated above, the hallmark of any solid deregulatory agenda is not just removing regulation but ensuring that the regulation which remains, is working as effectively as possible. One of the key elements in achieving effective regulation is to first determine whether a problem exists and if so, to appropriately define that problem. It is only then that analysis can be undertaken as to whether regulation or another option provides an appropriate solution. Regardless of one's views as to the recommendations proposed by CAMAC on particular issues, CAMAC has played a critical role in identifying, explaining and analysing corporate law and market related problems. CAMAC has also played an important educational role by preparing high quality and well researched reports which effectively set out technical issues in a clear and highly readable manner.

The level of consultation conducted by CAMAC with stakeholders is also noteworthy. CAMAC's expertise in the corporations and markets area ensures that there is a great understanding within CAMAC of the issues and laws being canvassed by stakeholders when consultation occurs. This has ensured high quality communication and debate on matters being considered by CAMAC.

It is not only the director community that has benefited from the informed debate generated by CAMAC, ASIC too has benefitted from CAMAC's work. We note that at page 14 of this Report ASIC cites CAMAC's work on *The Establishment and Operation of Managed Investment Schemes*. Given the valuable role CAMAC has played in the corporations and markets arena over the past 25 years, we are of the view that ASIC should join Company Directors in recommending to the Government that CAMAC be reinstated.

2.3 Thresholds in financial reporting

Section 45A of the Corporations Act sets out the thresholds that must be met in order for proprietary companies to be classified as either large or small. Companies that satisfy two or more the criteria in section 45A(2) will be small proprietary companies and companies that satisfy two or more of the criteria in section 45A(3) will be large proprietary companies. This classification determines the nature and extent of financial reporting for such companies. Company Directors recommends that ASIC advocate for the Government to increase elements of these thresholds and reduce the financial reporting burden on smaller entities. The Australian Institute of Company Directors recommends that the revenue threshold be increased to $100 million and the gross assets threshold be increased to $50 million in the relevant subsections.

Further, Company Directors requests that ASIC consider amending the requirements that entities inform ASIC annually whether they are a large or small proprietary company and allow these entities to notify ASIC only when their status changes.

2.4 Extending the period of a financial year of entities that are changing a subsequent financial year end

The Australian Institute of Company Directors encourages ASIC to consider recommending the amendment of section 323D(2A) of the Corporations Act in relation to financial years. This section limits entities when changing their subsequent financial year to a financial year that has a minimum duration of six months and a maximum duration of 12 months. Company Directors would encourage ASIC to advocate to the Government and Treasury that this be amended to allow entities to change their year end and to have a subsequent financial year up to a maximum duration of 18 months when they have met the requirements set out in

section 323D(2A). This amendment would increase the flexibility available to entities to change their year ends.

2.5 Amend the reversal of the evidentiary onus of proof in the ASIC Act relating to forward looking statements

The Corporations Act and the ASIC Act contain various provisions which are relevant to statements or representations about future matters. Aside from provisions which require the corporation to disclose information about a future matter, corporations and directors must ensure that statements or representations do not contravene the prohibitions against misleading or deceptive conduct in both Acts. These provisions generally require that statements as to future matters be made on reasonable grounds.

In summary, section 12BB of the ASIC Act provides that a representation as to a future matter must be made on reasonable grounds. However, unlike section 769C of the Corporations Act section 12BB of the ASIC Act reverses the evidentiary burden of proof and assumes that the director and/or the corporation did not have reasonable grounds for making the representation with respect to the future matter unless the company or director can adduce evidence to the contrary.

We see no sound policy reason why the evidentiary onus of proof in the ASIC Act should be reversed when the equivalent provision in the Corporations Act does not reverse the evidentiary burden in this manner. We recommend that ASIC recommend to the Government and Treasury that section 12BB of the ASIC Act be amended. The retention of this provision is just one of the reasons why there is hesitance on the part of directors to provide statements as to future matters. We are happy to discuss with you directors' broader concerns about the provision of forward looking statements in Australia if this would be of interest to ASIC.

2.6 Discourage the proliferation of shareholder class actions and support efforts to regulate litigation funders

Company Directors has consistently raised concerns about major litigation against corporations being instigated, promoted and funded by professional litigation funders. We continue to be concerned about the practice of litigation being commenced for the dominant purpose of profit-making by third parties that have no genuine interest in the issues being litigated.

Company Directors considers that the fundamental objective of the court system is to facilitate justice and to resolve real disputes between aggrieved persons. We are of the view that a regulatory regime which encourages the proliferation of class actions for third party profit is not in the best interests of the Australian economy or community.

Despite the deregulatory agenda of the Government and ASIC, we are of the view that litigation funding is one area that needs to be subject to increased regulation. We have also consistently stated that our preference is for litigation funders to be subject to a tailored licensing regime contained in the Corporations Act which is capable of being enforced by ASIC.[1] We note that recommendation 18.2 in the Productivity

[1] Submission to Federal Treasury dated 17 August 2011, Submission to Treasury dated 27 January 2012, Submission to Federal Treasury 7 November 2012, Submission to ASIC 13 March 2013, Submission to Productivity Commission dated 4 November 2013. All submissions are available at www.companydirectors.com.au.

Commission's recent draft report *Access to Justice Arrangements* is broadly consistent with our recommended approach.

We are of the view that the increase in funded shareholder class actions is creating an environment where litigation funders and some lawyers are acting primarily as entrepreneurs and promoters of litigation. This may occur, for example, where a lawyer scans the ASX announcements platform for a corporate profit downgrade announcement and a subsequent share price fall, prepares a claim and then actively seeks out a plaintiff and group members who may wish to be involved in a class action against the corporation.

Company Directors remains of the view that class actions brought against corporations are highly complex pieces of litigation that have the potential to impose significant burdens on the companies and directors involved. This type of litigation due to its size and scale can impose costs on the public in the form of higher consumer prices, the diminution of share value (reflected in superannuation account balances) and decreased tax revenue (as corporate profits decline). While the government and commentators have focused on the access to justice arguments which support litigation funding for major class actions, little attention has been paid to the actual returns received by investors in these actions or the impact of such actions on Australian markets, productivity and the economy as a whole.

We are of the view that ASIC has a role to play in actively discouraging this type of entrepreneurial litigation and the burden it creates for corporations, directors and Australia's shareholders and superannuants. We also request that ASIC support the effective regulation of litigation funders by way of a tailored licensing regime set out in the Corporations Act and enforceable by ASIC.

3. ASIC processes and forms

Company Directors is of the view that consideration by ASIC of our comments below may assist ASIC in making improvements that could have a deregulatory impact upon regulated corporations.

3.1 Carefully consider the role and scope of regulatory guidance

Company Directors has previously expressed concern that in some circumstances ASIC's expansive interpretation of legislative provisions in its Regulatory Guides may add to, rather than ease, the compliance burden experienced by companies and directors.

We have re-iterated on numerous occasions that ASIC Regulatory Guides are not a statement of the law, but rather ASIC's interpretation of the law. Difficulties and costs in compliance arise when directors and companies take a legally sound, yet different view of the law to ASIC. In these circumstances companies and directors often feel compelled to follow the guidance or risk facing increased ASIC scrutiny. The practical effect of a Regulatory Guide then becomes one of a de-facto legal requirement rather than guidance.

In our view, a recent example of this is ASIC Regulatory Guide 247 *Effective Disclosure in the Operating and Financial Review*. This guide sets out ASIC's interpretation of section 299A of the Corporations Act. Section 299A(1) provides that:

> "The directors' report for a financial year for a company, registered scheme or disclosing entity that is listed must also contain information that members of the listed entity would reasonably require to make an informed assessment of:
> (a) the operations of the entity reported on; and

(b) the financial position of the entity reported on; and
(c) the business strategies, and prospects for future financial years, of the entity reported on."

During consultation, we stated that we did not agree with ASIC's interpretation as to the content and level of disclosure suggested by ASIC for inclusion in the operating and financial review. We stated that directors were responsible for determining the level of disclosure in the operating and financial review and for making judgments as to the information about an entity's operations, financial position, business strategies and future prospects that was material and relevant to enable members to make an informed assessment. We made clear that the operating and financial review was not a "one size fits all" situation. Despite this, ASIC released guidance which in our view extended beyond the requirements set out in 299A of the Corporations Act.

We continue to be concerned that Regulatory Guide 247 will result in companies focussing on complying with the "requirements" of the Guide rather than on those issues that are significant and material to the company's particular circumstances. We are further concerned that the Regulatory Guide will result in longer and more unwieldy operating and financial reviews that do not sufficiently highlight those matters that are of significance to a member's understanding of the performance, financial position, business strategies and prospects of the entity.

With this example in mind we are of the view that ASIC should be cautious not to issue guidance which has the effect of extending legislative provisions beyond their scope or by creating a 'quasi-compliance checklist' on a particular issue. This approach adds to the compliance burden faced by corporations and directors.

We also continue to recommend that the front page of each ASIC Regulatory Guide should include a prominent statement which makes clear that ASIC Regulatory Guides are not a statement of the law but rather ASIC's interpretation of law. A similarly prominent statement should also be expressly included in the overview of each Regulatory Guide in the "Key Points" section. We are of the view that a statement of this type serves as a reminder to users and ASIC staff that Regulatory Guides are ASIC's view of how the law in a particular area should be applied. They are not conclusive statements of the law and ASIC's views may not be the same as a court's interpretation of the same legislative provisions in the Act. As we have stated companies and directors have a responsibility to comply with the law.

3.2 Improvements to the auditor resignation requirements

The Australian Institute of Company Directors is supportive of the deregulatory initiatives of ASIC in respect of pursuing changes to the process for the resignation of auditors which is set out in paragraph 74 of the Report. Company Directors would recommend that ASIC introduces a more streamlined process for the resignation of auditors of all entity types. The current process is time consuming and should one party not lodge the correct form with ASIC in a timely manner, significant delays can result in the finalisation of the change of auditor process.

3.3 Facilitate the electronic completion and lodgment of all ASIC forms

At present not all ASIC forms are able to be completed and lodged electronically. While the ability of corporations to lodge forms electronically has improved in recent years, we have received feedback that facilitating the electronic completion and

lodgment of all ASIC forms would reduce the workload and increase the efficiency of company secretarial teams within corporations. ASIC may also be assisted by considering other electronic lodgment platforms such as ASX online, in the event it decided to benchmark the user-friendliness of its online lodgment facilities. From a director's perspective, assisting the company secretarial function to undertake the administrative and compliance aspects of their role more easily, may have the benefit of allowing company secretaries to increase their focus on assisting boards and directors to achieve an even higher standard of corporate governance within their corporations.

We would also encourage ASIC to keep considering the range of circumstances where it may still be appropriate for documents to be delivered electronically to shareholders, or where lodgment with the ASX or posting documents on the corporation's website might constitute sufficient disclosure for ASIC's purposes. The use of electronic distribution and disclosure not only saves costs, it also allows documents to be easily amended or supplemented should this be required.

We hope that our comments will assist ASIC as it pursues deregulatory initiatives. If you would like to discuss any of our views please contact me or Senior Policy Advisor Leah Watterson on (02) 8248 6600.

Yours sincerely,

Rob Elliott

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