Corporate law and governance imperatives for the next Federal Government

In the lead-up to the next federal election, Governance Institute of Australia (Governance Institute) calls for the following key policy priorities for the next Federal Government and key regulators. Governance Institute is the only independent professional association with a sole focus on whole-of-organisation governance and the leading authority on best practice in governance and risk management.

Our members have primary responsibility to develop and implement governance frameworks in publicly listed, unlisted and private companies, and not-for-profit and public sector organisations.

Governance Institute believes the policies outlined below are critical to foster greater confidence in Australian capital markets, enhance the performance of Australian organisations and reduce substantially the burden of continually increasing legislative and regulatory compliance. Above all, we believe that the policies outlined below have the capacity to improve Australia's productivity.

In summary, Governance Institute calls for the next Federal Government to:

- foster greater confidence in capital markets and strengthen the economy by committing to a wholesale review of the corporations law — the Corporations Act needs updating to make it technology-neutral and shift it from its basis in a 'hard copy' 19th century world to a 21st century one. Also, contending liabilities and defences in corporate law and the legacy issues inherent in corporate structures developed in a pre-technological time need to be amended
- reduce compliance costs and facilitate shareholder engagement by undertaking a wholesale review of corporate reporting, including remuneration reporting
- facilitate shareholder engagement and reduce red tape through AGM reform
- enhance productivity for both the private and not-for-profit sectors by providing leadership on a permanent referral of powers from the states on corporations law and to provide for all incorporated associations to be regulated nationally to remove duplication of compliance obligations
- facilitate these reforms by establishing a Corporations Law and Governance Taskforce
- ensure that all new legislation is effective and achieves the desired policy objectives by introducing measures to enhance quality and efficiency.

We provide more detail on the following pages.

Yours sincerely

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Recommendation 1

Foster greater confidence in capital markets and strengthen the economy by committing to a wholesale review of the corporations law

Corporate law and taxation law are part of the infrastructure of a successful economy and need to be fit for purpose for the 21st century. Corporate law reform is linked to innovation and economic growth and should not be seen as separate from them. Currently, the *Corporations Act 2001* (C'th) is a 19th century regulatory model, showing the strain not only of its incapacity to facilitate a digital economy, but also of the compliance burden arising from inconsistent liabilities and defences and the accretion of piecemeal amendments over decades.

The Corporations Act was developed prior to the shift to a digital world. Currently, many aspects of the Corporations Act are mired in an assumption that the world operates in hard copy. While a few provisions have been updated over the years, other provisions still do not contemplate the use of technology.

If Australia's corporate markets are to be fit for purpose in the 21st century, the legislation governing corporations and the management of corporations needs to embrace technology.

However, importantly, given the speed of technological change, it is important that any amendments to the Corporations Act be technology-neutral. That is, they need to provide for the use of technology without specifying any particular technology. This allows for innovation in shareholder engagement and corporate reporting, as technology evolves.

Moreover, the capacity of companies to perform responsibly is hampered by contending liabilities and defences in corporate law and the legacy issues inherent in corporate structures developed in a pre-technological time.

Governance Institute recommends that the government commit to:

- a wholesale review of the Corporations Act to:
  - provide for technology-neutral legislation
  - consistency of liabilities and defences
  - the capacity to provide for corporate structures fit for purpose for the 21st century.

Recommendation 2

Reduce compliance costs and facilitate shareholder engagement by undertaking a wholesale review of corporate reporting, including remuneration reporting

a) Review of existing mandated corporate reporting

Many commentators, including Governance Institute, the Federal Government's former advisory body on corporations law — the Corporations and Markets Advisory Committee (CAMAC) — accounting bodies and the International Integrated Reporting Council have noted that corporate reporting needs improvement. This is not due to any lack of disclosure requirements in current legislation, or an unwillingness of companies to engage with their investors through enhanced reporting.

The aim of reporting should be to ensure that shareholders want to and can read the disclosures, and remain knowledgeable about and engaged with the entity in which they invest.

Disclosure needs to be more than simply comprehensive. It needs to be meaningful and comprehensible. The cumulative impact of increased disclosure requirements in relation to corporate reporting has seen much reporting become largely incomprehensible to investors, particularly retail investors, despite strenuous effort on the part of issuers to not only meet statutory requirements but also provide meaningful disclosure.

The most formidable barrier to effective engagement with shareholders is the sheer volume of statutory-driven information that they are required to digest. It is not unusual for the statutory annual reports of large listed entities to run to 300 pages or more of detailed financial and accounting disclosures. Remuneration reports have also become long and complex documents, as more and more disclosure requirements are added in piecemeal fashion to the legislation.

This has a particular impact on the retail shareholder. Mandating volumes of highly technical information makes it virtually impossible for unsophisticated shareholders to ever get 'up to speed' on making sense of what is put before them.

Governance Institute recommends that an assessment be undertaken of the total sum of mandated corporate reporting that is sent to shareholders so that it can check:

- if any of the information is repetitive
- if any of the information is so technical that anyone lacking technical expertise would not be able to make sense of it
- whether there is a clear policy objective behind the regulated information being sent out and, if so, whether that policy objective is being achieved
- whether there is ongoing justification for the information to be mandated
- whether current statutory provisions can be removed to allow for new forms of corporate reporting, such as integrated reporting.

Enhancing corporate reporting is only feasible following a holistic review of existing mandated corporate reporting.

The Financial Reporting Council could assist with this review.

Recommendation 3

Facilitate shareholder engagement through AGM reform

There are no legislative or regulatory barriers to the ability of institutional shareholders to engage and participate in the relevant corporate affairs of the companies in which they invest. But retail shareholders face challenges in engaging and participating in the corporate affairs of the companies in which they invest, given that the AGM is the prime forum for such engagement for this body of shareholders and it is not attracting significant numbers to it.

The AGM in its present iteration is not working as it should — it is a 19th century model that no longer works in the 21st century. Despite this, it is widely agreed that the AGM remains an essential element in the overall governance framework for company ownership and management. In any reform of the AGM, Governance Institute believes that the focus should be on:

- making the holding of a AGM a more productive and cost-effective exercise for companies (and therefore shareholders), and
- increasing the engagement of all shareholders, with a particular emphasis on encouraging the engagement of retail shareholders.

The holding of an AGM in the current regulatory climate has significant cost implications for companies — costs have been increasing, and range from $250,000—$1,000,000 for ASX200 companies. Despite this, shareholder attendance is decreasing year by year — it is down to 0.158 per cent of shareholders attending company meetings in 2015.[1]

Short-term reforms

There are a couple of very quick wins that could assist the existing AGM to work better. These can be effected quickly through non-controversial changes to the Corporations Act. These changes accommodate new and developing technologies to facilitate shareholder engagement, particularly the AGM.

The proposed changes are:

- **mandate voting via a poll** — mandate voting on all resolutions on a poll rather than a show of hands, so that the votes of all shareholders are counted rather than only those in the room on the day, which may not reflect shareholders' wishes overall — this is easily done now utilising mobile apps
- **provide for online voting as the default** — either online proxy lodgement or online direct voting, as the default option, but shareholders would be able to request hard copy voting forms
- **implement direct voting** — introduce a permissive clause in the Corporations Act to provide for direct voting so that shareholders do not need to appoint an agent to vote on their behalf if they cannot attend the meeting physically.

The Australian Government issued a discussion paper in May 2016 to facilitate the technology-neutral distribution of meeting materials, which is very welcome. But much more can be done to facilitate shareholder engagement.

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[1] Governance Institute has been tracking, in biennial surveys, the costs of AGMs and declining attendance of shareholders at the AGMs of the ASX200 over more than a decade. All data from *Benchmarking Listed Company Secretarial Practice in Australia 2014* and *Benchmarking Governance in Practice in Australia 2012, 2010, 2008, 2006 and 2004*, published by Governance Institute of Australia, and Computershare, *Intelligence Report, Insights from company meetings held in Australia*, 2013,2014 and 2015.

Longer-term reforms of AGM

Functions of the AGM

The AGM has historically carried out two functions:

- as ***the*** forum for two- way collective engagement with shareholders, and
- as a decision-making ***event*** for the passing of resolutions.

For the two long-term proposals submitted below, mandatory poll voting would be required at the bare minimum.

De-linking functions of the AGM

The AGM as an event in its current form does not function well as a decision-making forum. Institutional shareholders will always vote in advance; retail shareholders disengage and don't attend because:

- their attendance doesn't mean anything from a decision-making point of view
- the formality of the meeting means there are (often lengthy) recitals of the resolutions to be considered — even with a relatively small number of resolutions, it can take significant amounts of time just to recite the resolutions and proceed through the formalities, without any meaningful debate on the resolutions taking place, and this disengages shareholders at the meeting and discourages them from attending future meetings
- of the time taken to vote (by poll or on a show of hands), and
- the meeting is required to focus on historical financial statements.

Because votes by proxy must be lodged 48 hours before the AGM, the outcome of voting is known well in advance of the meeting. If voting is undertaken on a poll, **the votes on the floor have no impact on the decisions taken by the meeting** — the proxies have already decided that days beforehand. It is a fiction to say that decisions are taken at the AGM.

Governance Institute therefore recommends removing the decision-making function of the AGM.

AGM would still be held

A listed company would still have a statutory obligation to hold a meeting of shareholders at least once every calendar year.

No decision-making business would be carried out at that meeting. Shareholders and their duly appointed representatives would be required to be given a reasonable opportunity to comment on and/or ask questions regarding at least the following:

- the directors' stewardship of the company (collectively and individually)
- the financial position and performance of the company (although not required to be linked to the last annual report)
- the operations of the company
- the strategy of the company
- the culture and governance of the company
- remuneration practices and outcomes for key management personnel (although not required to be linked to the last remuneration report)
- the outcomes of any shareholder business conducted since the last shareholder meeting.

In this way, the meeting would encourage the engagement with both retail and institutional shareholders. As a discussion of company performance and prospects, it would certainly attract institutional shareholders and the media and could also attract analysts. It would engender more meaningful discussion and improve the quality of the debate from what is currently seen at AGMs.

Some retail shareholder bodies currently express a desire to be included in the questioning of directors and senior management by the media that takes place after many AGMs and by analysts and institutional shareholders outside of the AGM, due to the quality of the debate. For those large companies with large retail shareholder bases that are also customer bases, many of them already provide non-statutory investor briefings throughout the year where shareholders can ask customer-related questions (Telstra and AFIC being good practical examples).

Focusing the debate on shareholder issues at the meeting will assist retail shareholders to differentiate between customer and shareholder issues. Many retail shareholders are not professional investors, and providing them with access to a more meaningful discussion could assist in improving their financial literacy, which is a bipartisan policy goal.

Importantly, this provides retail shareholders with the same access at the meeting to the board and senior management to discuss company performance and prospects. It would not diminish the engagement that takes place with institutional shareholders that currently takes place prior to the AGM, as this engagement will continue to take place throughout the year and prior to voting.

The meeting need not be linked to the reporting season (although some companies will choose to do so) and it will ensure that the entire meeting is focused on what shareholders and their representatives wish to discuss and is not based on historical performance. An added advantage is that it takes the pressure off all AGMs being held over the period of a few months near the end of each calendar year.

Decision-making would still take place, but not tied to the meeting

The matters that currently require shareholders' votes (for example, re-election of directors, the remuneration report, constitutional change etc) will still be required to be transacted. However, they will be transacted via direct voting and on a poll, separately from the meeting (with a default of online voting). There would be a requirement for companies to keep the polls open for a set period of time (for example, 28 days) and the poll results would be announced as soon as practicable after the polls close (to allow for a proper review to ensure validity of voting). During the 28 days, companies would need to be mindful of their continuous disclosure obligations. Voting results are still open to public scrutiny. Voting entitlement dates could be adjusted to be earlier than polls closing to allow custodians and other nominees to properly vote on behalf of the underlying beneficial holders.

Engagement (on the resolutions) would be a matter for both the company and its shareholders, noting that with the requirement to publish the results and still hold a meeting about the company during the year, the company would remain open to public scrutiny for its actions. Those companies that engage will consider how best to provide for such engagement; this may include:

- providing telephone dial-in access to ask questions about the resolutions
- creating blogs to speak to the resolutions, and
- setting up social media discussion groups (such as via LinkedIn) where shareholders can ask questions about the resolutions.

If voting is contentious, or shareholders are dissatisfied with company performance since the last shareholder meeting, they are not constrained from expressing their views. The immediacy of social media means that any individual can express their views and find an audience. Shareholders can go to the press, write to the company, set up their own blog or discussion group online or ask the ASA to engage with the company on their behalf. Social media is not always a forum that companies can control — if companies choose not to engage actively with their shareholders, shareholders will find ways to make their views heard and it will be to the company's disadvantage.

Voting would be on the same regulatory timetable as operates currently. The only difference would be that the annual report would **not** be formally required to be laid before shareholders (as shareholders would have the right to ask comment on and ask questions on the company's financial position and performance at the de-linked meeting). Of course, the annual report would still be required to be prepared and made available to them within the normal regulatory timetable.

The current decision-making forum is archaic and bound by centuries of formulaic law. Technology will continue to evolve and companies will innovate as to how best to provide for shareholder engagement. As that process of innovation unfolds, there need be no concern that, as is currently the case, the meeting is not being validly held should the technology fail.

Industry bodies such as Governance Institute can provide guidance and education as engagement practice evolves. The law needs to provide a framework within which companies can continue to evolve engagement practices — it is vitally important that an archaic institution and framework is not replaced with another highly regulated framework that will quickly become out-of-date.

Recommendation 4

Enhance productivity for both the private and not-for-profit sectors by providing leadership on a permanent referral of powers from the states on corporations law and to provide for all incorporated associations to be regulated nationally to remove duplication of compliance obligations

Every five years, the Commonwealth is required to seek the agreement of the states on a referral of power to enable the Corporations Act to operate.

Furthermore, Australia continues to suffer from a duplication of compliance obligations on a number of fronts. We have seen attempts to harmonise workplace health and safety legislation founder, despite initial agreement from all state governments. There is a continuing dual regulatory regime operating in Australia for not-for-profit organisations, with state and territory-based associations' legislation co-existing with the national regulation of charities.

Lack of certainty that a referral of powers will be granted every five years, and any obligation to manage dual compliance obligations is not only at odds with the intent of the regulatory reform process to reduce red tape, but is also a refusal to accept that Australia is a national economy, with the internet providing for national operation regardless of where an organisation may be physically based.

For-profit sector
The states have not retained a role in regulating private companies since 2001 when the Corporations Act was introduced, and national regulation of the private sector has been of immense economic benefit and value to Australia. However, every five years the Ministerial Council for Corporations, comprising Ministers representing the Commonwealth, all states and the Northern Territory, needs to unanimously endorse another five year extension to the current references of corporations and related power from the states to the Commonwealth.

The purpose of addressing the extension of the referral of powers is to ensure a constitutional foundation for regulating Australia's 2.4 million companies.

While state involvement in the early years of the Corporations Act was justifiable to ensure that the new arrangements worked effectively and achieved policy outcomes, it can no longer be justified that the existence of 2.4 million corporations in Australia — and the workings of the Australian economy — are subject to a unanimous endorsement of the referral of powers by the states and Northern Territory. Australian corporations and markets should be able to remain confident that the legislative underpinnings of corporate activity will remain in place.

As with any change to an existing regime, leadership is needed to ensure its success.

Not-for-profit sector
While Governance Institute has been a staunch supporter of the NFP regulatory reform process and the establishment of the Australian Charities and Not-for-Profits Commission (ACNC), we remain concerned that there is ongoing duplication of compliance obligations for charities.

Associations are incorporated under state and territory associations incorporation legislation, which is not administered by ASIC, but by the various state and territory authorities.

For any regulatory reform of the NFP sector to succeed, it is essential that the sector is granted the same national context as the private sector. A fundamental aspect of the reform process should be for the states to agree to harmonisation or to refer powers to the Commonwealth, as occurred with the Corporations Act, to provide for all incorporated and associations to be regulated nationally.

Advances in technology have facilitated the establishment of a national regulator. Online interaction means that state-based offices are not required, as in the past, to facilitate registration of entities and lodgement of reports. The states should not retain any residual role in regulating incorporated associations in the long run (it is planned that the ACNC will regulate all NFP entities over the longer term), and certainly not in regulating charities that are also incorporated associations in the short term.

Maintaining such dual regulation is regressive, and condemns NFP organisations to continue being subject to a greater compliance burden than the private sector, which currently has recourse to a ‘one-stop-shop’ national regulator (ASIC). There is no private sector company in Australia, no matter how small or local in its activities, that is required to meet the compliance requirements of a state-based regulator as well as those imposed by ASIC — this has been the case since the commencement of the Corporations Act in 2001.

In the long run, the NFP sector will benefit most from either a harmonisation process or a referral of powers, as occurred with the Corporations Act. Governance Institute commends the Council of Australian Governments (COAG) for commissioning the *Regulatory Impact Assessment of potential duplication of governance and reporting standards for charities*, which pointed to these two outcomes as recommendations. While the ACNC is currently working with state governments on a harmonisation process, a commitment to achieve this should be government policy.

Governance Institute recommends that the Federal Government seek a permanent referral of powers from the states to the Commonwealth in regard to corporations law and commit to a policy of either harmonisation or referral of powers in relation to incorporated associations.

Recommendation 5

Facilitate each reform in this paper by establishing a Corporations Law and Governance Taskforce

Corporations Law and Governance Taskforce

In order to facilitate the review of the Corporations Act and corporate reporting, Governance Institute recommends that the Federal Government establish a Corporations Law and Governance Taskforce comprised of company representatives, investor bodies and senior partners of law firms to develop and submit proposals for reform of the Corporations Act to make it fit for purpose in the 21st century. The Taskforce would provide stakeholder input on proposals for legislative reform before such reforms are publicly issued in the form of a consultation, options or discussion paper or exposure draft.

Such a taskforce could be supported by the formation of a Corporate Law Drafting Advisory Group comprised of senior partners from relevant law firms who are able to review proposed drafting before it is issued publicly. The Advisory Group would provide feedback and assist in ensuring that the drafting captures the policy intent but does not introduce implementation issues — Governance Institute points to the success of this model in the Corporations Law Simplification Program.

This would address another issue that has arisen with the greatly increased amount of corporate law and governance legislation that has been introduced in recent years, which is the unintended consequences that arise from the practical implications attached to drafting. We believe that this is due, at least in part, to insufficient stakeholder consultation early in the process, and shortened timelines for responding to exposure drafts. Accordingly, we believe that consultation with relevant stakeholders much earlier in the development of legislative proposals would be beneficial, in particular to avoid the problem of subsequently having to 'fix' legislation time and time again.

Governance Institute stresses that the Taskforce and Advisory Group are not intended to introduce additional bureaucratic layers to the introduction of legislation, or lengthen timelines for the introduction of new legislation, but are intended to ensure that (a) any legislative approach captures stakeholder input as expressed in earlier consultations and (b) any exposure draft issued for public consultation reflects the will of the parliament at the time. This should simplify the introduction of legislation rather than hinder it.

To this end, **Governance Institute recommends** that the incoming Australian Government establish a Corporations Law and Governance Taskforce comprised of company representatives, investor bodies and legal advisers to develop and submit proposals for reform of the Corporations Act to make it fit for purpose in the 21st century. We recommend a proactive approach to utilising the expertise of the Taskforce, and not have it seen as an advisory body whose recommendations are not acted upon.

Recommendation 6

Ensure that all new legislation is effective and achieves the desired policy objectives by introducing measures to enhance quality and efficiency

Regulation is necessary to ensure that the interests of business, shareholders, the community and consumers are protected. For any regulation to be effective, it requires a high level of confidence among both business and the wider community that the need for any new regulation is real, and

- any new proposals will be effective in meeting the objectives and addressing the targeted shortcomings in the operation of the market
- without imposing costs that outweigh their expected benefits.

Nor is it desirable for any proposed new regulation to have a distorting or negative effect on the existing regulatory regime in place at the time.

There has been a sharp increase over some years in the amount of legislative and regulatory requirements to which business is subject. As an example, in the corporate law and governance arena, each piece of new regulation focused on disclosure is intended to provide greater transparency to shareholders. However, the legislation has been introduced in piecemeal fashion, to address particular issues, and there has been little or no consideration given to the impact on the quality of disclosure overall. As a result, in many areas, disclosure intended to provide greater transparency to shareholders can be now largely impenetrable to them.

The remuneration report (required by s 300A of the Corporations Act) is a very good example of this paradox. Since the requirement to put the remuneration report before shareholders was introduced almost a decade ago (s 250R), there has been a substantial number of new requirements added to the Corporations Act in relation to this disclosure requirement. Each new requirement supplements rather than replaces existing remuneration disclosure requirements. The stated policy objective is simplification; however ,adding layers of regulation rather than taking a holistic view results in complexity and confusion for shareholders and other stakeholders.

Put simply, adding another layer of legislation or regulation does not always produce the desired regulatory outcomes. The addition of each new individual element to the regulatory landscape needs to be evaluated for its impact on the regulatory 'whole' or 'sum of the parts'.

Another issue that has arisen with the greatly increased amount of corporate law and governance legislation that has been introduced in recent years is the unintended consequences that arise from the practical implications attached to drafting. We believe that this is due, at least in part, to insufficient stakeholder consultation early in the process, and shortened timelines for responding to exposure drafts. Accordingly, we believe that consultation with relevant stakeholders much earlier in the development of legislative proposals would be beneficial, in particular to avoid the problem of subsequently having to 'fix' legislation time and time again.

To this end, **Governance Institute recommends**:

- **stakeholder consultation in the form of roundtables and briefings** to take place prior to the release of discussion, options or consultation papers or exposure drafts by the Department Treasury — this consultation would ensure that all issues are robustly and rigorously discussed, with those subject to proposed regulation able to hear from and challenge each other and gain greater clarity as to the issues being addressed. Consultation should also canvass other approaches, such as whether a particular matter would be better dealt with through a principles-based approach, such as the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, or industry-led guidance and education, rather than turning to legislation in the first instance. Stakeholder consultation aims for a consensus approach to dealing with particular issues, and acknowledges that compliance outcomes are enhanced when those subject to regulation are consulted in the formation of public policy during its formulation

- **the introduction of sunset clauses and review dates every three years for key regulation** to ensure whether policy objectives are actually being achieved and to meet changing practice. Not all legislation can be made subject to a three-year review, but where appropriate it should be provided for

- **the introduction of staged reform** to ensure that any new regulation can be appropriately bedded down and reviewed for efficacy in achieving the desired policy objectives and required policy outcomes ,rather than the current approach of almost non-stop regulatory reform in the corporate law and governance arena, where layer upon layer of legislation or regulation is added to the existing framework

Governance Institute notes that the Department of Treasury itself, in its internal review of 2012, stated its need to better engage with industry and take advantage of the practical assistance that stakeholder groups can bring to the process of developing regulatory frameworks. Governance Institute is of the view that the recommendations set out above will assist in this process.