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Bulletin No. 257

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1. Recent Corporate Law and Corporate Governance Developments

1.1 IOSCO statement on disclosure of ESG matters by issuers

18 January 2019 - The International Organization of Securities Commissions (IOSCO) has published a statement setting out the importance for issuers of considering the inclusion of environmental, social and governance (ESG) matters when disclosing information material to investors' decisions. IOSCO emphasises that ESG matters, though sometimes characterized as non-financial, may have a material short-term and long-term impact on the business operations of the issuers as well as on risks and returns for investors and their investment and voting decisions.

In the statement, IOSCO encourages issuers to consider the materiality of ESG matters to their business and to assess risks and opportunities in light of their business strategy and risk assessment methodology. When ESG matters are considered to be material, issuers should disclose the impact or potential impact on their financial performance and value creation. In doing so, issuers also are encouraged to give insight into the governance and oversight of ESG-related material risks. Issuers can provide such insight, for example, by disclosing the methodologies they follow in their risk assessment, as well as the steps taken, and/or action plans developed, to address the risks that they have identified. The information provided by issuers should be balanced and should consider and reflect both risks and opportunities presented by material ESG matters.

1.2 IOSCO issues good practices to assist audit committees in supporting audit quality

17 January 2019 - IOSCO has published the IOSCO Report on Good Practices for Audit Committees in Supporting Audit Quality, which seeks to assist audit committees in promoting and supporting audit quality.

The quality of a company's financial report, supported by an independent external audit, is key to market confidence and informed investors, and to the effective functioning of capital markets. While the auditor has primary responsibility for audit quality, the audit committee should promote and support audit quality and thereby contribute to greater confidence in the quality of information in the listed company's financial reports. The report can assist audit committees in considering ways in which they may be able to promote and support audit quality.

The report provides good practices that audit committees may consider when:

- recommending the appointment of an auditor;
- assessing potential and continuing auditors;
- setting audit fees;
- facilitating the audit process;
- assessing auditor independence;
- communicating with the auditor; and
- assessing audit quality.

The report sets out good practices regarding the features that an audit committee should have to be more effective in its role, including matters such as the qualifications and experience of audit committee members.

1.3 Consultation on the implementation of the Corporate Collective Investment Vehicle

17 January 2019 - The Australian Government has released for public consultation two Bills that implement the tax and regulatory components of the Corporate Collective Investment Vehicle (CCIV) regime and their related explanatory materials. This consultation allows stakeholders the ability to assess the complete package of reforms to implement the CCIV.

A CCIV is an investment vehicle intended to increase the competitiveness of Australian export funds management industry and attract foreign investment. Investor protections for retail CCIVs include the requirement to have an independent depositary. The depositary is responsible for the oversight of key administrative functions of the CCIV and the safekeeping of the CCIV's assets.

The proposed new law contains:

- the new Chapter 8B in the Corporations Act 2001 No. 50 (Cth) containing the core provisions outlining the establishment of CCIVs and their operational and regulatory requirements;
- amendments to other legislation to support the implementation of CCIVs (such as amendments to the Australian Securities and Investments Commission Act 2001 No. 51 (Cth) and the Personal Property Securities Act 2009 No. 130 (Cth); and
- the tax legislation, which ensures the tax treatment of CCIVs broadly aligns with the existing treatment of attribution managed investment trusts, providing investors with the benefits of flow-through taxation.

1.4 Consultation on disclosure in general insurance

16 January 2019 - The Australian Government has released a discussion paper on improving disclosure in the general insurance sector.

This discussion paper follows from recommendations made in the Senate Economics References Committee's report into the general insurance industry, and seeks views on the issues and objectives behind component pricing, disclosure of year-on-year premiums, standard cover and definitions in insurance contracts, and the *Key Facts Sheet.*

Improving disclosure practices of the insurance industry will enable consumers to be informed and ensure the market remains fair and competitive. Lack of transparency or poor disclosure practices limits choice and makes it harder for consumers to make informed and appropriate decisions on insurance coverage.

In developing a model for improved disclosure, in addition to considering submissions from stakeholders, the Australian Government will also have regard to any recommendations relating to disclosure from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and the recommendations in the First Interim Report of the Australian Competition and Consumer Commission's *Northern Australia Insurance Inquiry*.

1.5 Global M&A update - 2018 annual review

10 January 2019 - The International Institute for the Study of Cross-Border Investment and M&A (XBMA) has published its 2018 Annual Review.

Key findings include:

- Global M&A volume in 2018 reached US$4.0 trillion, a level achieved only once before in the last decade (2015);
- 2018 was a notably strong year for cross-border M&A, despite escalating trade tensions. US$1.6 trillion (39%) of deals in 2018 were cross-border transactions, approximating recent highs in terms of both dollar value and percentage of global deal volume;
- Takeda Pharmaceutical's US$77 billion cross-border acquisition of Shire was the largest deal of the year in global M&A. 2018's other cross-border mega-deals included T-Mobile and Deutsche Telekom's US$60 billion deal with Sprint and Comcast's US$48 billion acquisition of Sky; and
- M&A was propelled by strong economic growth and an abundance of corporate cash (including from tax reform in the US), the continued availability of inexpensive debt through the third quarter of 2018, and strategic imperatives to address or anticipate technological disruption. In the second half of 2018, however, global trade tensions, rising interest rates in the US, and equity market volatility combined to slow global M&A activity from its record-setting pace.

1.6 Productivity Commission report on superannuation

10 January 2019 - The Productivity Commission has released a report that assesses the efficiency and competitiveness of Australia's superannuation system and whether better ways to allocate defaults are needed.

Key points of the report include:

- Australia's super system needs to adapt to better meet the needs of a modern workforce and a growing pool of retirees. Structural flaws - unintended multiple accounts and entrenched underperformers - are harming millions of members, and regressively so;
  - fixing these twin problems could benefit members by $3.8 billion each year. Even a 55 year old today could gain $79,000 by retirement. A new job entrant today would have $533,000 more when they retire in 2064;
- the Productivity Commission's assessment of the super system reveals mixed performance;
  - while some funds consistently achieve high net returns, a significant number of products underperform, even after adjusting for differences in investment strategy. Underperformers span both default and choice, and most (but not all) affected members are in retail funds;
  - evidence abounds of excessive and unwarranted fees in the super system. Reported fees have trended down but a tail of high-fee products remains entrenched, mostly in retail funds;
  - compelling cost savings from realised scale have not been systematically passed on to members as lower fees or higher returns. Much scale remains elusive with too few mergers;
  - a third of accounts (about 10 million) are unintended multiple accounts. These erode members' balances by $2.6 billion a year in unnecessary fees and insurance;

- the system offers products that meet most members' needs, but members lack simple and salient information and impartial advice to help them find the best products; and
- not all members get value out of insurance in super. Many see their retirement balances eroded - often by over $50,000 - by duplicate or unsuitable (even "zombie") policies;

- inadequate competition, governance and regulation have led to these outcomes;
    - rivalry between funds in the default segment is superficial, and there are signs of unhealthy competition in the choice segment (including product proliferation). Many funds lack scale, with 93 Australian Prudential Regulation Authority (APRA)-regulated funds - half the total - having assets under $1 billion;
    - the default segment outperforms the system on average, but the way members are allocated to default products has meant many (at least 1.6 million member accounts) have ended up in an underperforming product, eroding nearly half their balance by retirement; and
    - regulations (and regulators) focus too much on the interests of funds and not members. Subpar data and disclosure inhibit accountability to members and government;
- policy initiatives have chipped away at some problems, but architectural change is needed;
    - default should be the system exemplar. Members should only be defaulted once, and move to a new fund only when they choose. Members should also be empowered to choose their own super product from a "best in show" shortlist, set by a competitive and independent process. This will bring benefits above and beyond simply removing underperformers;
    - all MySuper and choice products should have to earn the "right to remain" in the system under elevated outcomes tests. Weeding out persistent underperformers will make choosing a product safer for members;
    - all trustee boards need to steadfastly appoint skilled board members, better manage unavoidable conflicts of interest, and promote member outcomes without fear or favour; and
    - regulators need clearer roles, accountability and powers to confidently monitor trustee conduct and enforce the law when it is transgressed. A strong member voice is also needed.

1.7 EU report on regulatory sandboxes and innovation hubs

7 January 2019 - The European Supervisory Authorities (ESAs) have published a joint report on innovation facilitators (regulatory sandboxes and innovation hubs). The report sets out a comparative analysis of the innovation facilitators established to date within the EU. The report also sets out best practices for the design and operation of innovation facilitators.

The number of innovation facilitators in the EU has grown rapidly in recent years. As at the date of the report, 21 EU Member States and three EEA States have established innovation hubs and five EU Member States have regulatory sandboxes in operation. A comparative analysis of these national innovation facilitators is set out in the report and, based on this analysis, a set of best practices has been prepared.

The best practices are intended to:

- promote consistency across the single market in the design and operation of innovation facilitators;
- promote transparency of regulatory and supervisory policy outcomes; and
- facilitate cooperation between national authorities, including consumer and data protection authorities.

The report also sets out options, to be considered in the context of future EU-level work on innovation facilitators, to promote coordination and cooperation between innovation facilitators which would support the scaling-up of FinTech across the single market.

1.8 UK report on remuneration reform

3 January 2019 - The UK High Pay Centre and the Chartered Institute of Personnel and Development have published a new report, RemCo Reform: Governing successful organisations that benefit everyone, based on interviews with remuneration committee members, investors and other stakeholders in the pay setting process, calling for corporate governance reform, with more emphasis on people management and employment culture.

The report argues that there is an "opportunity cost" to the considerable resources companies expend on determining the pay of a small number of executives. Remuneration committees' conceptions of company performance are also too narrow.

The report makes the following recommendations. They are aimed primarily at the boards and shareholders of the major UK-listed companies. However, it is stated in the report that they should also be considered by policy-makers and regulators charged with guidance and oversight of corporate governance in the UK. Similarly, corporate culture, people management and fair pay practices are as important to privately owned companies as to those listed on public markets. Therefore, boards and owners of private companies should also consider implementing these recommendations.

- (1) companies should consider establishing a formal "people and culture" committee in place of their remuneration committee. Those that choose not to do so should still demonstrate clearly, in their annual reports, how company pay practices relate to their strategy for people management and corporate culture. The report provides a draft Terms of Reference to act as a template for those wishing to formally expand their remuneration committee's remit to "people and culture";
- (2) companies should formally assess their non-financial performance - for example, by looking at their impact on different stakeholder constituencies, and reviewing their social and environmental performance. They should explain their methodology for this assessment - and the results - in their annual report. Performance in this respect should be a key consideration when making annual pay awards;
- (3) succession planning and development of long-term executive capability within the organisation should be explicitly included in the committee's remit, as should organisational fairness in relation to pay;
- (4) to this end, professionals with people management experience should be appointed to remuneration committees - or people and culture committees - as well as representative of the company's stakeholder communities, including its workforce; and
- (5) long-term incentive plans should be replaced as the default model for executive remuneration with a less complex system based on basic salary, with an incentive to

deliver sustainable long-term performance provided by a much smaller restricted share award.

1.9 SEC solicits public comment on earnings releases and quarterly reports

18 December 2018 - The US Securities and Exchange Commission (USSEC) has published a request for comment soliciting input on the nature, content, and timing of earnings releases and quarterly reports made by reporting companies.

The request for comment solicits public input on how USSEC can reduce burdens on reporting companies associated with quarterly reporting while maintaining, and in some cases enhancing, disclosure effectiveness and investor protections. In addition, USSEC is seeking comment on how the existing periodic reporting system, earnings releases, and earnings guidance, alone or in combination with other factors, may foster an overly short-term focus by managers and other market participants.

The request for comment addresses:

- the nature and timing of disclosures that reporting companies must provide in their quarterly Form 10-Q reports, including when the Form 10-Q disclosure requirements overlap with the disclosures such companies voluntarily provide to the public in earnings releases furnished on Form 8-K;
- how USSEC can promote efficiency in periodic reporting by reducing unnecessary duplication in the information that reporting companies disclose and how any such changes could affect capital formation, while enhancing, or at a minimum maintaining, appropriate investor protection;
- whether USSEC rules should allow reporting companies, or certain classes of reporting companies, flexibility as to the frequency of their periodic reporting; and
- how the existing periodic reporting system, earnings releases, and earnings guidance (either standing alone or in combination with other factors) may affect corporate decision making and strategic thinking, including whether these factors foster an inefficient outlook among reporting companies and market participants by focusing on short-term results.

1.10 UK audit services market report

18 December 2018 - The UK Competition and Markets Authority (CMA) has published its statutory audit services market report.

The key points in the report include:

- recent events have brought back to the surface longstanding concerns that audits all too often fall short;
- the fact that companies select and pay their own auditors is an impediment to high-quality audits;
- choice of auditor is extremely limited for the biggest companies: sometimes to as few as one or two firms; and

- in order to create the strongest possible incentives for highly competent, professionally sceptical audits, competition must be focused on quality, and there must be sufficient choice of viable competitors over the long term.

The CMA proposes the following remedies to create incentives for better audit quality:

- auditor appointments need to be made with a focus on ensuring that companies' numbers are tested as effectively as possible. This could be fully achieved if appointments were taken away from audited companies, particularly in the absence of widespread investor focus on audit. But it is not possible to do this on a generic basis for all large companies, at least not now, as the European legal framework appears to preclude it. The practical complexities of appointing auditors for the biggest companies also present challenges. As an alternative, the CMA proposes close scrutiny of audit appointment and management by the regulator, to secure audit committees' accountability and independence from companies. This must ensure a clear priority on quality and challenge from auditors, as well as minimising any bias against firms from outside the Big Four;
- the market structure needs to change to ensure that there are enough realistic alternative audit providers. The CMA proposes that FTSE350 audits should be carried out jointly by two firms, at least one of which should be from outside the Big Four. This will give challenger firms access to the largest clients, while allowing for a cross-check on quality, as each auditor reviews the other's work. A possible alternative if concerns arise over joint audit's effectiveness is a market share cap - ensuring that a subset of major audit contracts are only available to non-Big Four firms - which would also support long-term choice;
- to produce the best quality, auditors' exclusive focus should be on providing audits; and their wider business interests should not in any way compromise this. This could imply a full structural split of advisory and other non-audit services away from audit, which would also ensure maximum choice among the Big Four. However, the international networks these firms belong to, and the extent to which audits draw on advisory expertise, present some difficulties. A more immediately feasible alternative would be for firms' audit and non-audit businesses to be split into clearly defined separate operating entities, with separate management, accounts and remuneration, but to remain under the same organisational umbrella. That way auditors would only be rewarded for providing good audits, but would still be able to draw on expertise from their sister firms; and
- peer review of audits, commissioned by and reporting to the regulator, could offer an additional way of enforcing standards.

1.11 Reforms to address illegal phoenix activity

11 December 2018 - The Australian Government has introduced new rules to protect the interests of honest creditors from illegal phoenix activity, including trade creditors and employees: *Insolvency Practice Rules (Corporations) Amendment (Restricting Related Creditor Voting Rights) Rules 2018 (Cth)*.

The new Insolvency Practice Rules restrict the voting rights of certain creditors related to the phoenix company to ensure the interests of honest creditors are not affected by those complicit in illegal phoenix activity.

The federal government will also provide an additional $8.7 million over four years from 2018-19 to increase funding for the Assetless Administration Fund (the Fund). The Fund is administered by the Australian Securities Investment Commission (ASIC) to finance preliminary investigations and reports by liquidators into the failure of companies with few or no assets,

where this may lead to ASIC enforcement action, with a particular focus on curbing fraudulent phoenix activity.

This additional funding will increase ASIC's ability to fund liquidators, who play an important role in investigating and reporting illegal phoenix activity, including supporting the new liquidator avenues to recover assets lost through illegal asset stripping activity.

The Insolvency Practice Rules can be found on the Federal Register of Legislation.

1.12 Principles to improve corporate governance standards among private companies

10 December 2018 - New Principles for the corporate governance of large private companies (the Principles) has been launched in the UK. The Principles have been developed by a coalition established by the Financial Reporting Council and chaired by James Wates CBE. By explaining the application of these Principles large private companies will be able to meet their obligations under The Companies (Miscellaneous Reporting) Regulations 2018 (UK).

The six principles are:

- Purpose and Leadership - An effective board develops and promotes the purpose of a company and ensures that its values, strategy and culture align with that purpose;
- Board Composition - Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company;
- Board Responsibilities - The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge;
- Opportunity and Risk - A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value and establishing oversight for the identification and mitigation of risks.
- Remuneration - A board should promote executive remuneration structures aligned to the long-term sustainable success of a company, taking into account pay and conditions elsewhere in the company; and
- Stakeholder Relationships and Engagement - Directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

View the consultation feedback statement here.

1.13 Report on the 2018 US proxy season

December 2018 - Georgeson and Proxy Insight have published the 2018 Annual Corporate Governance Review. The report offers 2018 US proxy season data, including voting data for companies that held an annual and/or special meeting during the time period 1 July 2017 to 30 June 2018.

Topics include:

- shareholder proposals on governance issues;
- environmental and social shareholder proposals;
- director elections;
- Say-on-pay proposals; and
- CEO pay ratio disclosure (this includes data on the new requirement for US public companies to disclose their CEO pay ratio in their proxy statements).

2. Recent ASIC Developments

2.1 Consultation paper on reform of fees and costs disclosure for superannuation and managed investment schemes

8 January 2019 - ASIC has released a consultation paper seeking feedback on proposed changes to the fees and costs disclosure regime for managed investment schemes and superannuation.

To assist industry in understanding the proposals, the consultation paper includes a proposed updated *Regulatory Guide 97 - Disclosing fees and costs in PDSs and periodic statements* (RG 97), as well as draft amendments to Schedule 10 of the Corporations Regulations 2001 No. 193 (Cth).

Concurrently with the industry consultation, ASIC will undertake consumer testing of some aspects of the proposals.

Consultation Paper 308 - Review of RG 97: Disclosing fees and costs in PDSs and periodic statements (CP 308) reflects ASIC's commitment to ensuring that consumers seeking information on fees and costs receive transparent and useable information that helps them understand fees and costs, compare products, and make confident and informed choices.

ASIC also seeks to ensure that the proposed fees and costs disclosure regime is practicable for industry.

CP 308 sets out ASIC's response to recommendations from a review of the regime by external expert, Mr Darren McShane. Report 581 - Review of ASIC Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements (REP 581) was released in July 2018 following industry consultation.

ASIC proposes to take forward key recommendations from REP 581 that relate to:

- simplifying how fees and costs information is presented to consumers;
- reducing data inputs, including eliminating the requirement for fees and costs disclosure to incorporate some costs categories, particularly property operating costs, borrowing costs and implicit costs, and
- making disclosure for managed investment schemes more consistent with superannuation.

2.2 Review of allocations practices in equity raising transactions

20 December 2018 - ASIC's review of allocations in equity raising transactions in Report 605 - Allocations in equity raising transactions underscores the potential impact of conflicts of interests in allocation decisions. In the report, ASIC highlights areas of improvement for both financial services licensees (licensees) and issuers when raising equity on the listed markets.

ASIC's review of a range of large and mid-sized Australian-based licensees found a range of discretionary factors are taken into account in an allocation recommendation, including the objectives of the transaction, investor types and the investor bidding into the bookbuild. The issuer's objectives should be the primary driver of allocation recommendations.

ASIC makes recommendations on improvements to licensee practices in the conduct of allocations. These include:

- improving the documentation, accuracy, timing and delivery of messages (including updates) to investors during equity raising transactions to ensure they are not misleading and deceptive. This includes reviewing whether information previously provided, particularly about the level of demand for a capital raising, is correct;
- engaging with issuers at various stages during a transaction (issuers are also encouraged to take an active interest in the allocation process);
- reviewing the adequacy of their allocation policies and procedures, compliance arrangements and record keeping for allocations;
- avoiding allocations to connected persons as they can present a significant conflict of interest; and
- identifying and managing potential conflicts of interest when making allocation recommendations, for example, disclosing the conflict to the issuer with an explanation of how it is being managed.

View:

- Report 605 - Allocations in equity raising transactions
- Report 606 - Allocations in equity raising transactions (summary version)

2.3 Temporary extension of disclosure related relief for superannuation funds

19 December 2018 - ASIC has extended an ASIC relief instrument to allow additional time to consider the policy position in relation to a disclosure-related obligation of superannuation trustees.

The relevant instrument is *ASIC Class Order [CO 14/541]* (CO 14/541). The relief instrument was due to expire on 1 January 2019. This extension will maintain the status quo.

ASIC will adjust or revoke the relief once policy positions in relation to the aspects of disclosures by superannuation funds are settled.

The new expiry date specified in the instrument aligns with the usual ten-year sunsetting period for legislative instruments under the Legislation Act 2003 No. 139 (Cth). It should not be assumed that the relief instrument will continue in force for that length of time.

CO 14/541 provides relief from s. 29QC of the Superannuation Industry (Supervision) Act 1993 No. 78 (Cth).

Section 29QC provides that if a superannuation fund trustee gives information to APRA under an APRA reporting standard, and the trustee gives the same or equivalent information to another person, or on a website, the fund trustee must ensure that the information is calculated in the same way as the information given to APRA.

The ASIC relief is to help facilitate the ongoing consideration and finalisation of aspects of policy relating to disclosures by superannuation funds, and which may impact APRA reporting standards. This includes the consideration of government policy in relation to the requirements for superannuation funds to publish product dashboards, and the consideration of fees and costs disclosures.

View:

- ASIC Class Order [CO 14/541]
- ASIC Superannuation (Amendment) Instrument 2018/1080
- Explanatory Statement - ASIC Superannuation (Amendment) Instrument 2018/1080

2.4 Lenders commit to improve credit card practices following ASIC review

18 December 2018 - ASIC has released Report 604 - Credit card lending in Australia - An update (REP 604), which sets out the changes being made by lenders to help consumers with credit card debt.

In July 2018, ASIC released Report 580 - Credit card lending in Australia (REP 580), which found more than one in six consumers is struggling with credit card debt.

The report made it clear that ASIC expects credit providers to:

- take proactive steps to address problematic credit card debt and products that do not suit consumers;
- minimise the extra credit provided to consumers who regularly exceed their credit limit; and
- allocate repayments for all credit cards in the more favourable way required for cards entered into after July 2012.

ASIC engaged with the 10 largest credit providers that were part of ASIC's review (American Express, ANZ, Bendigo and Adelaide Bank, Citigroup, CBA, HSBC, Latitude, Macquarie, NAB and Westpac) and sought their commitment to change. Their commitments are described in the report.

Although these commitments are not required by the law, they are important in ensuring that the credit card market works for consumers, including vulnerable consumers.

Across the board, lenders have committed to changes to address the concerns by ASIC:

- nine large credit providers committed to taking proactive steps to help consumers with problematic credit card debt;
- four committed to fairer approaches for balance transfers; and

- nine credit providers committed to lower the amount by which consumers can exceed their credit limit.

Many credit providers are trialling measures - such as tailored communications and/or structured payment arrangements - to help consumers with potentially problematic credit card debt or who are failing to repay balance transfers.

Others are taking a fairer approach to balance transfers, such as by allowing interest free periods on new purchases and enhancing disclosure about cancelling old credit cards.

2.5 Consultation on sunsetting class order for warrants and out-of-use notices

13 December 2018 - ASIC has released a consultation paper proposing to remake its class order regarding warrants and out-of-use notices. The class order is due to expire (sunset) on 1 April 2019.

ASIC proposes to remake the class order, as in ASIC's view, it is operating effectively and efficiently, and it continues to form a necessary and useful part of the legislative framework. The fundamental policy principles that underpin the class order have not changed.

The new instrument would continue the relief, without significant changes, currently given by Class Order [CO 08/781] Warrants: Out-of-use notices, so that the ongoing effect will be preserved without any disruption to the entities that rely on it.

Consultation Paper 307 - Remaking ASIC class order on warrants: out-of-use notices (CP 307) outlines ASIC's rationale for proposing to remake the instrument. CP 307 invites submissions from relevant stakeholders as to whether the class order is currently operating effectively and efficiently.

2.6 Consultation on measures to restrict offers to retail investors of stub-equity in proprietary companies

13 December 2018 - ASIC has stated that it is concerned about recent control transactions where part or all of the consideration includes stub-equity in Australian proprietary companies. These offers of stub-equity have been made to a large and diverse group of target shareholders, including retail investors.

Proprietary companies are required to be closely held and are prohibited from making broad public offers of their shares. By structuring control transactions to avoid these restrictions, retail investors who accept scrip consideration miss out on the disclosure and governance protections that apply to public companies, but from which proprietary companies are exempt.

ASIC intends to issue a consultation paper in early 2019 seeking views on a proposed legislative instrument to prevent these kinds of offers in control transactions.

ASIC may also consider making individual instruments to prevent these offers where the control transaction is announced after the date of this media release but prior to the conclusion of ASIC's consultation.

Background

An offer of "stub-equity" occurs where scrip consideration is offered to target shareholders under a proposed control transaction (a scheme of arrangement or takeover bid). These offers provide an opportunity for target shareholders to retain an economic exposure to the underlying business of the target company through holding scrip in the bidding, or holding, vehicle (HoldCo). Generally, HoldCo is a newly incorporated special purpose vehicle set up by a private equity bidder.

Recent control transactions involving a proprietary HoldCo have been structured to avoid the two main restrictions placed on proprietary companies under the Corporations Act 2001 No. 50 (Cth) (the Corporations Act):

- proprietary companies must have no more than 50 non-employee shareholders (s. 113(1)); and
- proprietary companies are prohibited from fundraising activities which would require disclosure to investors (s. 113(3)).

The terms of these transactions have required certain shareholders to direct their scrip consideration be issued to a nominee or custodian to be held on the shareholder's behalf, to ensure that HoldCo has fewer than 50 members and can therefore remain a proprietary company.

Proprietary companies are also not generally able to make broad public offers of their shares because such offers (fundraising activities) would require disclosure to investors. However, where an offer is made under a scheme of arrangement or takeover bid, s. 708 of the Corporations Act provides an exception to this disclosure requirement.

Despite the general disclosure exception in s. 708, ASIC considers that it is contrary to public policy, and the specific prohibitions and legislative intent of s. 113, for a proprietary HoldCo to make a broad offer of scrip to more than 50 target shareholders, and to combine the offer with the contemplated use of a custodian arrangement to ensure HoldCo can remain a proprietary company.

ASIC considers it important that investors in widely held companies are afforded the safeguards that the law explicitly provides for shareholders of public companies, and from which proprietary companies are exempt, including:

- restrictions on related party transactions under Chapter 2E;
- restrictions on conflicted directors voting under s.195;
- rules for the appointment and removal of directors under s. 201E and s. 249H(3);
- Australian residency requirements for directors under s. 201A; and
- the requirement to hold annual general meetings under s. 250N.

Accordingly, ASIC will issue a consultation paper on a proposed legislative instrument to modify s. 708, with the effect that offers of scrip in a proprietary company as part of control transactions will be prevented, or restricted to where that offer is made to only a small number of shareholders (for example, to existing substantial shareholders in the target as part of a separate class under a scheme).

Where control transactions involving the offer of proprietary scrip consideration are announced after the date of this media release, but prior to the conclusion of the above consultation, ASIC may consider making individual instruments modifying s. 708 to similar effect. Before making any such instrument, affected parties will be afforded procedural fairness, including the opportunity to provide submissions on the circumstances of their particular transaction.

ASIC notes that it appeared as *amicus* at the second court hearing for a recent scheme to raise the above public policy concerns: see *Capilano Honey Limited (No 2)* [2018] FCA 1925 at [67]-[77].

3. Recent ASX Developments

3.1 Reports

On 4 January 2019, ASX released the ASX Monthly Activity Report for December 2018.

4. Recent Research Papers

4.1 Centre for Corporate Law Research Papers published in 2018

The following research papers and reports were published by members of the Centre for Corporate Law in 2018 and are available on the Social Science Research Network:

- Superannuation Guarantee Contributors as a Tax: The Case for Reincarnation over Reform (2018) by Helen Anderson and Tess Hardy;
- Illegal Phoenix Activity: Practical Ways to Improve the Recovery of Tax (2018) by Helen Anderson;
- Insolvency - It's All About the Money (2018) by Helen Anderson;
- Shelter from the Storm: Phoenix Activity and the Safe Harbour (2018) by Helen Anderson;
- Trends and Developments in Chinese Insolvency Law: The First Decade of the PRC Enterprise Bankruptcy Law (2018) by Stacey Steele, Andrew Godwin, Chun Jin, Changyin Han, Yimin Ren and Weihong Chi;
- The Potential Economic Gains from Increasing Public Law Enforcement Against Illegal Pheonix Activity (2018) by Jasper Hedges and Ian Ramsay and Michelle Anne Welsh and Helen L. Anderson;
- An Evaluation of Debt Agreements in Australia (2018) by Vivien Chen and Lucinda O'Brien and Ian Ramsay;
- Remunerating Corporate Insolvency Practitioners in the United Kingdom, Australia and Singapore: The Roles of Courts (2018) by Stacey Steele and Wee Meng Seng and Ian Ramsay;
- A History of the Corporations and Markets Advisory Committee and its Predecessors (2018) by Ian Ramsay;
- The Experience of Financial Hardship in Australia: Causes, Impacts and Coping Strategies(2018) by Evgenia Bourova, Ian Ramsay and Paul Ali;
- The Hidden Dimension of Business Bankruptcy in Australia (2018) by Lucinda O'Brien, Ian Ramsay and Paul Ali;

- The Vulnerability of Older Australians in Bankruptcy: Insights from an Empirical Study (2018) by Lev Bromberg, Ian Ramsay and Paul Ali;
- Social Impact Bonds in Australia (2018) by Corinne Tan and Ian Ramsay;
- Is a Conflict of Interest under the General Law the same as a Material Personal Interest under the Corporations Act? (2018) by Rosemary Teele Langford and Ian Ramsay;
- Equity Crowdfunding in Australia and New Zealand (2018) by Steve Kourabas and Ian Ramsay;
- Harmful Phoenix Activity and Disqualification from Managing Corporations: An Unenforceable Regime? (2018) by Jasper Hedges, Helen Anderson, Ian Ramsay and Michelle Welsh;
- Shelter from the Storm: Phoenix Activity and the Safe Harbour (2018) by Helen Anderson;
- Catching Pre-Insolvency Advisors: The Hidden Culprits of Illegal Phoenix Activity (2018) by Helen Anderson and Jasper Hedges;
- Depositor Preference and Deposit Insurance Schemes - Challenges for Regulatory Convergence and Regulatory Coordination in Asia (2018) by Angus Chan, Andrew Godwin and Ian Ramsay;
- An Analysis of the Business Objectives of the Largest Listed Companies in Australia, the United Kingdom and the United States (2018) by Ian Ramsay and Belinda Sandonato;
- Cross-Border Cooperation in Financial Regulation: Crossing the Fintech Bridge (2018) by Lev Bromberg, Andrew Godwin and Ian Ramsay; and
- Equity Crowdfunding in Malaysia (2018) by Steve Kourabas and Ian Ramsay.

4.2 Other recent research papers

(a) Legal personhood and liability for flawed corporate cultures

A number of recent corporate law scandals (including the Wells Fargo fraudulent accounts scandal, the Volkswagen emissions scandal, sexual harassment claims at Fox News and CBS, and various banking scandals currently under investigation in a high profile Australian Royal Commission) epitomize the danger posed by flawed corporate cultures. These scandals demonstrate that such organizational cultures can inflict damage on stakeholders, communities and society as a whole. The aim of this study is to explore, from a theoretical and comparative perspective, the issue of accountability for misconduct arising from flawed corporate cultures. This situation raises unique questions as to whom the law should target for misconduct in these circumstances.

The research paper examines two specific types of liability which may be relevant in the context of misconduct arising from defective corporate cultures - (i) entity criminal liability and (ii) personal liability of directors and officers for breach of duty to their company. The study compares these forms of liability in the US, the UK and Australia, to assess the extent to which they are well-suited to providing accountability for misconduct arising from flawed corporate cultures. As this comparative analysis shows, there are significant jurisdictional differences in these areas of law, which, in some cases, make such forms of liability ill-suited to achieve such accountability.

Legal Personhood and Liability for Flawed Corporate Cultures

(b) Index funds and corporate governance: Let shareholders be shareholders

The largest institutional investors have become the de facto "deciders" of corporate law controversies. In this article, the authors take a close look at the financial incentives of the largest institutional investors with regard to the three core areas of shareholder involvement: high profile proxy contests between activist shareholders and boards; broad market wide governance standards; and routine monitoring of portfolio companies through "engagement."

With regard to the highest profile contests that will likely affect firm value, the managers of the three largest index funds - BlackRock, Vanguard and State Street - have direct financial incentives to vote intelligently that are typically larger than any other shareholder, with the occasional exception of very large actively managed mutual funds. With regard to market wide governance standards, the Big Three are better positioned than any other shareholders to set the standards. With regard to routine monitoring, hedge funds and large actively managed funds will often be in a better position to monitor because of their firm-specific knowledge.

The Big Three's financial incentives to become involved in corporate governance derive from their enormous scale and scope. This is important in several ways. First, scale increases the likelihood that their decisions will be pivotal. Second, even at a low percentage fee, their share of increases in firm value will be larger than almost any other shareholder. Third, their scope generates "spillover knowledge" that is valuable in setting market wide governance standards. Fourth, the scale generates reputational incentives to be seen as responsible stewards, both for marketing and to forestall regulation. For a variety of reasons, flow-based incentives are unlikely to be significant.

Although the Big Three's scale and scope produce financial incentives to be responsible and informed "deciders," their incentives and capacity to engage in general monitoring of portfolio companies are not as strong because of their business model and organizational structure. With regard to this sort of monitoring, hedge funds that seek out underperforming companies and large actively managed mutual funds with a pool of analysts and portfolio managers who pick stocks are both better positioned to identify firm-specific problems.

In light of the significant incentives that the Big Three have to play their current roles in corporate governance responsibly, the authors largely disagree with critics who would prevent them from voting or who view their involvement in corporate governance as reflecting significant agency costs.

Index Funds and Corporate Governance: Let Shareholders be Shareholders

(c) Corporate sustainability: A strategy?

The authors explore the extent of adoption of sustainability practices over time and the implications for firm performance. They find that for almost all industries, sustainability practices converge within an industry over time, implying that they spread as common practices. They also find that the extent of convergence across industries is associated with the adoption of sustainability by the industry's market leaders and the relative importance of environmental and social issues compared to governance issues. Further, the authors distinguish between a set of sustainability practices on which companies converge within an industry, which they term "common practices," and a set on which they do not, which the authors term "strategic." The authors subsequently explore performance implications and find that the adoption of strategic sustainability practices is significantly and positively associated with both return on capital and expectations of future performance as reflected in price to book valuation multiples, whereas the adoption of common sustainability practices is reliably correlated only with expectations of future

performance. Overall, the authors provide evidence about the role of sustainability as a long-term corporate strategy and as a common practice.

Corporate Sustainability: A Strategy?

(d) Why do auditors fail? What might work? What won't?

Auditing failures and scandals have become commonplace. In response, reformers (including the Kingman Review in the UK and a recent report of the UK's Competition and Market Authority) have proposed a variety of remedies, including prophylactic bans on auditors providing consulting services to their clients in the belief that this will minimize the conflicts of interest that produce auditing failures. Although useful, such reforms are already in place to a considerable degree and may have reached the point of diminishing returns. Moreover, this strategy does not address the deeper problem that clients (or their managements) may not want aggressive auditing, but rather prefer a deferential and perfunctory audit. If so, auditors will realize that they are marketing a "commodity" service and cannot successfully compete based on their quality of services. Rationally, they would respond to such a market by seeking to adopt a cost-minimization strategy, competing by reducing the cost of their services and not investing in new technology or higher-priced personnel.

What could change this pattern? Gatekeepers, including auditors, serve investors, but are hired by corporate management. To induce gatekeepers to better serve investors, one needs to reduce the "agency costs" surrounding this relationship by making gatekeepers more accountable to investors. This might be accomplished through litigation (as happens to some degree in the US), but the UK and Europe have rules that discourage collective litigation. Thus, a more feasible approach would be to give investors greater ability to select and remove the auditor. This paper proposes a two part strategy to this end:

1. public "grading" of the auditor by the audit regulator in an easily comparable fashion (and with a mandatory grading curve); and
2. enabling a minority of the shareholders (hypothetically, 10%) to propose a replacement auditor for a shareholder vote. It further argues that both activist shareholders and diversified shareholders might support such a strategy and undertake it under different circumstances. Absent such a focus on agency costs, however, reformers are likely only re-arranging the deck chairs on the Titanic.

Why Do Auditors Fail? What Might Work? What Won't?

5. Contributions

If you would like to contribute an article or news item to the Bulletin, please email it to: law-cclsr@unimelb.edu.au.

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