Restoring balance in disclosure
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Regulatory reform

Putting clarity into vague continuous disclosure obligations will curb the class action feast and make companies more confident about taking risks and creating jobs.

Substantial fiscal support has been required during the COVID-19 pandemic – more than $300 billion from the federal government alone. But not every economic support measure hits the bottom line. Some of the most effective initiatives have been regulatory changes that have given businesses the flexibility to adapt to a highly uncertain environment.

Among them are virtual AGMs, the use of electronic signatures, stronger protections against the threat of insolvency, and freeing up credit for small business.

Changes to continuous disclosure also played a role. Early last year, we introduced a fault element which ensured breaches of continuous disclosure obligations would only occur where companies had failed to disclose price-sensitive information, and had done so with "knowledge, recklessness or negligence".

Given the volatility in markets and the heightened level of uncertainty around forecasts, this change gave management and boards the confidence to keep the market informed without being exposed to the risk of opportunistic class actions.

In fact, according to Treasury, while the temporary fault element was in place there was an increase in the number of material announcements to the market relative to the same period in the previous year.

The effectiveness of this temporary change was reinforced by a comprehensive report into the regulation of the class action industry by the parliamentary joint committee on corporations and financial services. It recommended the Australian government legislate to make permanent these temporary changes. Legislation has passed the Parliament this week to do exactly that.

The joint committee report made clear the number of class actions in Australia has increased dramatically, with Federal Court data showing class action filings had increased by 325 per cent in the past decade.

Over the same period, evidence to the joint committee inquiry demonstrated the cost of directors' and officers' insurance increased by more than 250 per cent. The cost of these class actions and higher insurance premiums is ultimately borne by shareholders. It is also, according to the joint committee, having a detrimental effect on the ability of companies to attract and retain the best possible people to sit on public company boards.

Under the former regime, directors faced the risk of personal liability for what could have been unintentional breaches. Removing strict liability does not alter the legal obligation to disclose material information, with the Australian Securities Exchange noting that the changes "should not reduce the quality of disclosures by listed entities".

It is a view shared by the corporations committee of the Law Council of Australia, which said in its submission on the bill: "these reforms will not lead to a lower standard of conduct, more limited disclosure or an inability to successfully prosecute cases of significant concern". Rather, the reforms would address the "technical imbalance in continuous disclosure laws that has contributed to inflated insurance".

The corporations committee was "strongly supportive of the proposed reforms", which it said "strike an appropriate balance".

Both the Law Council and the parliamentary joint committee have also pointed out that the inclusion of a fault element will bring Australia's regime more in line with that of comparable countries such as the US and Britain. In two of the largest capital markets in the world, plaintiffs bringing an action for breach of continuous disclosure rules are required to prove fault.

One of the significant consequences of these legislative changes to continuous disclosure is to encourage the private sector, in the words of the Business Council of Australia, "to invest, take risks, and create jobs".

The pendulum had swung too far. This sensible and measured reform helps restore the balance. It also complements other actions we have already taken to ensure there is appropriate oversight of litigation funders, who are now required to hold an Australian Financial Services Licence.

Further reforms to ensure litigation funders do not receive disproportionate rates of return at the expense of class action members are also being considered.

This pandemic has created enormous challenges for our community, including those in business. Our focus from day one has been to provide the economic support that is needed, be it fiscal or regulatory, to enable business to recover from COVID-19 and be stronger on the other side.

Our continuous disclosure reforms are just one change designed to achieve exactly that.

Josh Frydenberg is the federal Treasurer.

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