

THE ROLE OF INSTITUTIONAL INVESTORS IN AUSTRALIAN SHAREHOLDER CLASS ACTIONS

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OUTLINE

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 - Important participants – but as group members, not representatives
 - Uncertainties exist over whether there is full participation by institutional investors
- D. Possible reasons for Institutional Investors' Non-Participation
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 - Funding obviates costs and risks
 - Improves corporate conduct
 - Benefits the civil justice system



OUTLINE (cont'd)

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- Develop Internal Guidelines
- Monitor Class Actions
- Manage Data
- Establish and Manage Relationship with Funder
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A. Institutional Investors and Class Actions – A Perfect Fit?

1. **Institutional Investors** include superannuation funds, custodians, mutual funds, investment managers, banks and other authorised deposit-taking institutions, Responsible Entities and insurance companies.
2. Prior to the financial crisis, Australian institutional investors were the largest single class of equity investors in Australia, owning almost half of all listed Australian equities. Strong growth in share ownership had occurred in the years leading up to the crisis, driven by compulsory superannuation increasing funds under management and by an increasing portfolio allocation toward Australian equities.
3. By March 2010, institutional ownership of Australian equities was at the (still substantial) level of 41% - roughly equal to the share held by foreign investors.¹
4. Institutional investors' share of the Australian equities market will continue to grow, with projections that the value of superannuation fund assets alone will reach \$1,699 billion in 2020.²

1. Reserve Bank of Australia, "Ownership of Australian Equities and Corporate Bonds", Bulletin – September Quarter 2010, 2.
2. K Anderson, S Marshall and I. Ramsay, "Do Australian Institutional Investors Aim to Influence the Human Resources Practices of Investee Companies?" (Research Report, University of Melbourne, 2007), 13.



A. Institutional Investors and Class Actions – A Perfect Fit? (cont'd)

5. Institutional investors, both in Australia and overseas, have also adopted a more activist stance towards the companies they invest in, seeking to influence and promote better corporate governance.³ This includes litigation-related activity.⁴

6. Institutional investors that act as trustees in relation to shareholdings that are beneficially owned by others have a duty to preserve the trust's property. This may include a duty to bring or participate in proceedings to prosecute a claim against a listed company for breach of its continuous disclosure obligations, where such conduct has caused loss to the trust and such proceedings are unlikely to be fruitless.⁵

7. The combination of these factors:
 - a high level of share ownership and concomitant exposure to losses from corporate misconduct;
 - fiduciary duties owed by some institutions to the ultimate beneficial owners of the shares they hold; and
 - a strong commitment to improving Australian corporate governance;suggest that Australian institutional investors would be enthusiastic and active participants in shareholder class actions. Is that the case?

3. J Sher, "The Changing Role of Institutional Investors in Australia – A Paradigm Shift?" (2007) 21 Aust J Corp Law 81; R McKay, "Collective Action by Institutional Investors is More Than a Passing Fad", (Australian Council of Superannuation Investors Inc, 2007).

4. S J Choi and J E Fisch, "On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance", (2008) 61 Vanderbilt L. Rev. 315, 330 – 333.

5. *Re Brogden* (1888) 38 Ch D 546, 571; *Elder's Trustee & Executor Co Ltd v Higgins* (1963) 113 CLR 426; *Maitland v Bateman* (1844) 13 LJ Ch 273.



B. The Impact of Institutional Investors in US Class Actions

1. The Private Securities Litigation Reform Act of 1995 (“PSLRA”) enacted a rebuttable presumption that the investor with “the largest financial interest” in a securities fraud class action should be appointed its lead plaintiff.⁶
2. Congress’ explicit intention was to encourage institutional investors who were injured by securities fraud to step forward and lead class actions against the perpetrators.⁷ This was seen as making such actions less “lawyer driven” and more cost effective.
3. The PSLRA has achieved this aim with research showing that institutional investors now make up around 60% of lead plaintiffs in US securities class actions.⁸
4. Research has also found that having an institution as a lead plaintiff results in:
 - lower attorney’s fees;
 - higher settlements;⁹ and
 - valuable corporate governance reforms as part of the settlements;¹⁰than in class actions with non-institutional investor leads.

6. 15 USC § 78n – 4(a) (3) (B) (iii) (I).

7. R S Thomas, “The Impact of Institutional Investors As Lead Plaintiffs: A Key Provision of the PSLRA”, *Lead Counsel* (Labaton Sucharow LLP), Fall 2008, 7 – 8.

8. *Idem*.

9. See, e.g., M Perino, “Institutional Activism through Litigation: An Empirical Analysis of Public Pension Fund Participation in Securities Class Actions” (available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=938722). Cox and Thomas have found that for each one percent increase in provable losses in a class action, the settlement amount increases 0.26%, and if the lead plaintiff is an institutional investor, it increases by an additional 0.04%: Thomas, note 7.

10. Institutional Shareholder Services Inc., “Governance Reforms through Securities Class Actions”, (17 October 2011).



B. The Impact of Institutional Investors in US Class Actions (cont'd)

4. However, a surprising number of US institutional investors with valid claims have been “Missing in Action”:
 - Cox and Thomas (2002) analysed data from two class action settlement administrators and concluded that only 20 – 30% of institutional investors with potential claims in those class actions actually lodged claims with the administrators.¹¹
 - Cox and Thomas (2006), in a more detailed follow-up study of a larger number of class actions, reached a similar result (only 28% of affected institutional investors filed claims).¹²
 - They concluded:

“Thus, our data provide an inescapable and startling conclusion: Financial institutions with significant provable losses fail at an alarming rate (approximately seventy percent) to submit their claims in settled securities class actions. Moreover, not only are their losses significant, but the sums of money they would likely gain by filing claims are also not trivial, both in the aggregate and on an average individual fund basis.”¹³

11. J D Cox and R S Thomas, “Leaving Money on the Table: Do Institutional Investors Fail to File Claims in Securities Class Actions?” (2002) 80 Wash. U. L. Q. 855, 877.
12. J D Cox and R S Thomas, “Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements”, (2005) 58 Stan. L. Rev. 411, 424.
13. Ibid, 425.



C. Institutional Investors in Australian Class Actions

1. So far as I am aware, there has been no equivalent research on Australian institutional investors' propensity to participate in shareholder class actions.
2. However, our experience at IMF indicates that:
 - many Australian institutions are prepared to pursue claims in applicable funded class actions;
 - Institutional investors generally prefer to be group members, rather than representative applicants (though there are exceptions);¹⁴ but
 - we are not certain that all institutions with potentially valid claims participate.
3. Why is this?

14. See e.g. *Clime Capital Limited v. Credit Corp Group Ltd (No 3)* [2012] FCA 218. Caruana and Morabito report that of 22 shareholder class actions that were commenced in the Federal Court between 1992 and 2009, only 4 institutional investors acted as class representatives: J Caruana and V Morabito, "Turning the Spotlight on Class Representatives – Empirical Insights from Downunder", Monash University, 1 July 2012 (electronic copy available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2099942).



D. Possible Reasons for Institutional Investors' Non-Participation

1. What factors may make institutional investors reluctant to join class actions (assuming claims are material and have strong prospects of recovery)?
 - Legal costs, risk of adverse costs orders and management distraction (now largely obviated by litigation funding).¹⁵
 - Direct costs involved in compiling trading data and allocating settlement proceeds (hampered by lack of a mechanism to recover these costs).
 - Uncertainty over legal obligation to sue.¹⁶
 - Concerns with the potential disclosure of confidential, proprietary information.¹⁷
 - Concern with the costs and time involved in proving individual losses (i.e. if the class action is not resolved at the common issues stage).¹⁸
 - Concerns with “commercial conflicts”, possible adverse publicity of trading losses or antipathy towards shareholder class actions.¹⁹
 - Institution has a continuing shareholding in the defendant company or may support a new board.

15. Fear of exposure to adverse costs may be a motivating factor in institutions' preference for group membership, as group members cannot be liable for adverse costs: s43 (1A) Federal Court of Australia Act 1976 (Cth).

16. See, e.g., the article by Richard Gluyas in *The Australian*, 28 September 2012, “Legal doubts on institutions' role in class actions.”

17. Although group members are generally not required to give discovery during the “common issues” phase of a shareholder class action: *P Dawson Nominees v Brookfield Multiplex Limited (No 2)* [2010] FCA 176 at [6]; *National Australia Bank Limited v Pathway Investments Pty Ltd & Anor* [2012] VSCA 168.

18. To date, all shareholder class actions in Australia have been resolved at the “common issues” stage.

19. Murphy and Watson argue that these considerations are improper or irrelevant for a trustee; see B Murphy and A Watson, “Shareholder Class Actions and the Duties and Discretions of Trustees”, Maurice Blackburn Cashman (13 September 2006), 14 – 16.



E. Why Should Institutional Investors Participate in Shareholder Class Actions?

1. There are numerous benefits to institutional investors and their clients if institutions adopt a policy of active participation in all relevant shareholder class actions. These include:
 - improving service to clients and returns to clients or the institution;
 - discharging the institution's fiduciary obligations (where applicable);
 - improving corporate conduct by facilitating the effective enforcement of Australia's securities law;²⁰
 - potentially improving the institution's public profile and reputation;
 - widening the options available to the institution to engage in effective shareholder advocacy;
 - by using a funder, reduced risks and management distraction for the institution; and
 - (if a representative) having input into the litigation, improving (through monitoring) the performance of the lawyers and the funder and potentially achieving the results seen in US institution-led class actions.

20. S H Lim, "Do Litigation Funders add value to Corporate Governance in Australia?", (2011) 29 C & S L J 135.



F. How Can an Institutional Investor Maximise Its Recoveries From Shareholder Class Actions?

1. Develop internal guidelines to determine which class actions you will join.
2. Monitor all potential class actions and identify those which offer potential recoveries to the institution or your clients. Set up a system and assign someone responsibility to do this or use a third party service.
3. Participate! If the class action is conducted on a “closed class” basis (as are most funded class actions), joining the class is essential to achieving any recovery and without strong levels of participation, funded class actions cannot get off the ground.²¹
4. Engage with a litigation funder. This ensures the legal costs of the action are covered, as are any adverse costs. The funder also provides litigation management expertise which reduces your management burden.
5. Collate trading and client data early and audit it for accuracy. It is easier to do this at the outset than 3 or 4 years down the track when the action settles.
6. Inform your clients of the steps you are taking to recover their losses.
7. Monitor and reward the performance of the “class actions recovery department”.



21. M Legg, “Institutional Investors and Shareholder Class Actions: The Law and Economics of Participation”, (2007) 81 ACJ 478, 485.

G. Conclusion

- Many Australian institutional investors currently participate in shareholder class actions. Some actions may not have proceeded without this support.
- IMF works with most of Australia's leading institutional investors and appreciates their commitment to recovering clients' losses and seeking to improve corporate governance through funded litigation.
- Participation in shareholder class actions by institutional investors produces real benefits to the institutions concerned and their clients and improves the fair and efficient operation of securities markets.

