Australian Institute of Company Directors

25 January 2024

Pre-Budget Submissions
Treasury
Langton Cres
Parkes ACT 2600

Via email: PreBudgetSubmissions@treasury.gov.au

Dear Treasury

FY2024-2025 Pre-Budget Submission

Thank you for the opportunity to provide a submission to help inform the Commonwealth Government's upcoming 2024-2025 Budget (**Budget**).

The Australian Institute of Company Directors' (**AICD**) mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership of 51,000 reflects the diversity of Australia's director community, comprised of directors and leaders of not-for-profits (**NFPs**), large and small and medium enterprises (**SMEs**) and the government sector.

Australian Companies are operating in an increasingly complex regulatory environment with a multitude of new compliance obligations, technology and sustainability issues on board agendas. Organisations are feeling pressure, particularly where legislative and regulatory reform measures begin to overlap or where there is a high degree of uncertainty or a lack of skills to comply with new regulatory obligations.

While well-designed regulation is often necessary to address an issue, obligations that are too heavy handed can negatively impact on productivity and economic growth. Almost one in five directors now cite regulatory requirements and red tape as a top economic challenge, as revealed by the AICD's biannual survey of the director community- the Director Sentiment Index (**DSI**).

The cumulative effect of regulation needs to be looked at holistically and harmonised across Government. For example, over the past year, Government has been consulting on three significant pieces of reform which the AICD has been closely engaged on: 1) the introduction of mandatory climate reporting; 2) the 2023-2030 Australian Cyber Security Strategy; and 3) the review of the Privacy Act.

Each of these consultations will have major business implications. This is in addition to further significant reforms that are being proposed in other key policy areas such as workplace relations.

The AICD's submission outlines key areas where we consider Government should prioritise corporate governance related reforms, while providing broader commentary from the AICD Chief Economist on the macro-economic outlook drawing on the AICD's DSI.[1]

1. Executive Summary

The AICD offers the following principal observations to inform Budget deliberations:

- Critical reforms are underway in the adjacent policy areas of Australia's cyber security and privacy law settings, while Government also considers a future regulatory framework for artificial intelligence (**AI**). A coordinated approach across portfolios and relevant agencies must be taken to ensure that regulatory changes are consistent, appropriately sequenced and do not unnecessarily overlap. A high priority should also be placed on reducing, not adding to, the regulatory burden for smaller and NFP entities in the design of new obligations in these areas.

- The introduction of Australia's mandatory climate reporting regime provides an opportunity to facilitate high quality, comparable disclosures in support of Australia's climate change goals. However, it is critical that the legislative design does not undermine the policy intent for the regime. While supportive of the Government's recent exposure draft legislation to introduce climate reporting in Australia, the AICD has concerns with certain aspects, including the exclusion of transition pathway disclosures from the transitional liability relief mechanism and the application of the regime to smaller and NFP entities.

- The introduction of climate reporting and the heightened liability risks it presents in the disclosure landscape should also be considered as part of the ongoing statutory review of changes made to Australia's continuous disclosure regime. The re-introduction of a 'no-fault' continuous disclosure obligation could significantly hamper the comprehensive adoption of mandatory climate reporting, by encouraging a bare bones approach to limit legal risks.

- Australia's NFP sector continues to face considerable challenges in an increasingly resource constrained environment. NFP directors are being required to commit more time and rigorous focus to the operations of their NFPs, amidst the impact of tougher governance standards resulting from recent Royal Commissions and workforce shortages. We encourage Government to prioritise a comprehensive review of regulatory frameworks that apply to NFPs, a harmonisation of fundraising laws across the country, and the delivery of capacity-building initiatives for NFPs responding to extensive Royal Commission recommendations in the care sector.

- Given the increasing complexity of regulation and legislative frameworks in Australia, the AICD recommends consideration of regulatory review mechanisms that would complement the work of Government. This includes an expert and independent body to support Treasury's policy-making related to corporate law and corporate governance, as well as an Australian regulatory grid focused on ensuring that

[1] AICD Director Sentiment Index (available here).

regulatory changes in the financial services sector are approached cohesively.

- AICD's DSI results indicate that the cost of living, labour shortages, inflation and interest rates are the top economic challenges facing Australian businesses.

- AICD members, through the DSI, have highlighted addressing housing affordability/supply, productivity growth, and energy policy as the top three areas for short term policy intervention. Climate change, Australia's ageing population, productivity growth and energy policy are the highest ranking longer term priority areas requiring Government's attention.

These issues are discussed in further detail below.

2. Corporate governance reforms – suggested priority areas

Outlined below are key areas where we encourage the Government to focus its attention on, along with the desired policy outcome.

a) Cyber security

The AICD has in recent years engaged extensively on Government consultations and proposed reforms in the cyber security and data management policy areas, including the Government's recent consultation on its *2023 – 2030 Australian Cyber Security Strategy* (**Cyber Strategy**), the *Security of Critical Infrastructure Act 2018* (**SOCI Act**) and *Privacy Act 1988* (**Privacy Act**).[2]

The AICD was pleased to see many issues raised by the AICD and other stakeholders considered in the Government's Cyber Strategy released in November 2023, including a focus on collaboration and partnership with industry, threat sharing and support for small businesses and NFPs.

We look forward to engaging closely with the Department of Home Affairs on the design of reform proposals. However, at a high level, we provide the following principled policy recommendations for implementation of the Cyber Strategy:

- **Streamline existing cyber security obligations and address regulatory gaps:** It is critical that the introduction of any new cyber security legislation consolidates and harmonises existing obligations, rather than layering additional regulatory requirements over existing regimes (for example, requirements under the SOCI Act and APRA Prudential requirements such as CPS 230). The AICD has received consistent feedback from directors on the existing complexity and overlapping nature of cyber security and data management regulatory obligations in Australia. Legislative complexity can create greater challenges for achieving compliance, impose additional costs for both the regulated population and the regulator, and risk uncertainty in legislative interpretation;

- **Coordination with regulation in adjacent policy areas:** Over the past year, the Government has been developing its Cyber Strategy while in parallel contemplating

[2] AICD submissions: 2023-2030 Australian Cyber Security Strategy (available here); Review of the Privacy Act (available here); and Exposure Draft – Security Legislation Amendment (Critical Infrastructure Protection) Bill 2022 (available here).

fundamental related changes to the Privacy Act under the Attorney General's portfolio (discussed below). These two important initiatives are both focused on strengthening Australian cyber security and data management practices, but are not necessarily aligned. This risks layering new regulatory obligations on top of an already highly complex cyber security and data privacy landscape. It is essential these two areas are looked at holistically as part of the policy process; and

- **Targeted support for SMEs and NFPs:** Building the cyber security resilience of SMEs and NFPs should be a priority area, as it is key to improving Australia's overall resilience. The AICD was pleased to see the Government's recent Cyber Strategy include proposals to strengthen SME cyber security capabilities. However, we are concerned with proposals under the Cyber Strategy to apply a mandatory ransomware reporting obligation to entities with $10 million annual revenue which will capture many SMEs and NFPs that do not have the resources to meet these requirements. In our view, mandatory ransomware reporting requirements should be limited to large businesses (with a $50-100 million annual revenue threshold being more appropriate), and Government should instead focus on incentivising voluntary reporting by SMEs and NFPs.

The AICD remains committed to supporting directors to improve their knowledge of cyber security best practice through extensive guidance materials and educational offerings. In 2022, we released the Cyber Security Governance Principles (**Principles**), developed in collaboration with the Cyber Security Cooperative Research Centre.[3] The Principles are one of the AICD's most downloaded resources (over 20,000 to date) and we have had strong feedback on their utilisation across our membership – from large, listed companies through to charities and other NFPs.

We plan to soon publish an additional cyber governance resource that will build off the Principles. This new resource will assist boards governing through a cyber crisis and to recover effectively. The resource will also reflect some of the key learnings from large scale cyber and data breach incidents over the past 18 months.

b) Data and privacy settings

The AICD has engaged closely on consultations concerning data and privacy protections over recent years. Most notably, this has included the review of Australia's Privacy Act and consultation on Safe and Responsible AI in Australia.[4]

<u>Privacy Act Review</u>

We note the Government's response to the116 recommendations of the Privacy Act Review last year, agreeing to or providing in-principle support for most of the key reform proposals. Were the proposals to be legislated, they would create a far more prescriptive and demanding privacy regime in Australia and there would be considerable costs for businesses of all sizes in complying.

The AICD is particularly concerned with the recommendation for a wholesale removal of the current exemption for small business (less than $3m in turnover) from the Privacy Act. In our

[3] AICD CSCRC Cyber Security Governance Principles, October 2022 (available here).
[4] AICD submission, Privacy Act Review Final Report (available here). AICD submission, Safe and Responsible AI in Australia (available here).

view, the costs and regulatory challenges in all small businesses meeting these requirements are likely to outweigh potential benefits. We favour an approach that focuses instead on higher risk sectors where there is greater potential exposure, and the removal of the exemption is proportionate to those risks – in other words, where small businesses would not have to meet the full suite of Privacy Act obligations.

<u>Regulation of AI</u>

The AICD welcomed the opportunity to engage last year with the Department of Industry, Science and Resources on its Safe and Responsible AI consultation.

We understand from the Government's interim response to that consultation released this month that it will consider possible legislative vehicles for introducing mandatory safety guardrails for AI in high-risk settings. In doing so, we encourage Government to have regard to the following considerations:

- **Australia has an existing legislative framework which provides regulatory oversight of AI development and use**. For example, there are a range of technologically-neutral laws which address the potential for system errors or misuse of AI systems including the *Copyright Act 1968*, Privacy Act, *Competition and Consumer Act 2010*, *Fair Work Act 2009* and laws related to anti-discrimination, cyber, data protection, tort and contracts. Sector-specific laws also have application to AI including: financial services laws; laws for administrative and public sector; and laws related AI applications, such as surveillance and health medical device laws. This existing framework should be reviewed and updated before considering the introduction of a new AI specific laws. In particular, more work needs to be done to raise awareness and provide guidance on the existing obligations (such as around privacy and data protection) and how they apply in the AI context.

- **Regulatory developments in jurisdictions such as the European Union (EU), United States (US), United Kingdom (UK) and Canada should be closely monitored**. Broad regulatory alignment with key overseas jurisdictions is important for us to remain competitive with international markets, facilitate interoperability with our trading partners and to mitigate any comparative regulatory lag.

- **The use of non-regulatory mechanisms (such as principles, standards and industry-specific codes) should be considered** to supplement and complement any regulatory framework for responsible AI.

The AICD supports the Government's proposal in its interim response to work with industry to develop a voluntary AI Safety Standard, implementing risk-based guardrails for industry and establish an expert advisory body to support the development of options for further AI guardrails.

The AICD is committed to promoting directors understanding of the risks and opportunities associated with the use of AI. Last year we facilitated a series of webinars on understanding AI in the governance context and will be releasing a new resource for directors later in 2024.

c) Policy settings that encourage high quality and robust disclosures

Climate and sustainability standards

The AICD supports the establishment of a mandatory climate reporting framework in Australia aligned to the global baseline set by the International Sustainability Standards Board (**ISSB**). We have engaged closely on the proposed design of the regime, informed by extensive consultation with our members, stakeholder groups and legal experts.

The AICD welcomes the release of the Government's exposure draft legislation *Treasury Laws Amendment Bill 2024: Climate-related financial disclosure* (**Exposure Draft**).

The AICD will be providing detailed commentary on the Exposure Draft through the dedicated Treasury consultation. However, we wish to provide some brief comments on the following key issues which, if left unaddressed, would undermine the desired policy outcomes of a climate reporting regime. That is, to facilitate high quality, comparable disclosures in support of Australia's climate change goals:

- **Transitional Liability Relief:** The AICD supports a three-year regulator only enforcement period (**Transitional Liability Relief**). However, as currently proposed in the Exposure Draft, we are concerned that this relief mechanism will be of little utility should it be limited to disclosures relating to Scope 3 emissions and scenario analysis only, rather than also capturing forward looking statements, especially transition plans. All climate-related forward-looking disclosures suffer from a high degree of measurement and outcome uncertainty and are highly novel in the Australian market. For example, transition pathway disclosures will be dependent on inherently uncertain inputs and assumptions such as the degree to which offsets and emerging technology is relied upon, the availability of resources as well as evolving policy settings. The nature of these forward-looking disclosures presents material liability risks to Australian companies and directors. It is critical therefore that the Transitional Liability Relief apply to all forward-looking disclosures, including transition plans, in order to encourage fulsome disclosures during the initial years of this complex new reporting regime;

- **Directors' declaration and assurance:** The AICD is concerned that there is no clear timetable for mandatory reasonable assurance over disclosures required by the proposed Sustainability Standards, with the question being left for future decision by the Auditing and Assurance Standards Board (**AUASB**). Instead, there is only limited assurance of select aspects of the reporting regime from the outset of reporting (scope 1 and 2 emissions for Group 1 entities from FY25)), with reasonable assurance over all disclosures not anticipated before FY31. A clearer and accelerated pathway is required to allow entities and their auditors to plan effectively. While we understand the policy rationale for requiring directors to attest to compliance with the Sustainability Standards, such a declaration must be suitably qualified/modified. In particular, it should reflect the uncertainty inherent in implementing such a complex new reporting, and the lack of reasonable assurance currently available. Indeed, it is as yet unclear as to what a fully compliant Sustainability Report would look like;

- **Group 3 entities and concept of materiality:** The AICD continues to have concerns with the breadth of Group 3 entities proposed to report under the regime. As currently drafted, Group 3 entities would be required to report where they face material climate-related risks or opportunities as determined by the materiality definition in the yet-to-be-finalised Australian Sustainability Standards. It is unclear whether the Exposure Draft proposes that Group 1 and 2 entities be required to disclose under the regime *regardless* of materiality. While we do not understand that this is the intention, if that were the case, it would be a major deviation from the ISSB standards which require entities to undertake their own materiality assessment rather than having it deemed. Moreover, the current drafting does not provide relief from the regulatory burden of reporting under the regime for those Group 3 entities that *do* face material climate risks and opportunities. The AICD strongly encourages Government to consider increasing the revenue threshold for Group 3 entities from $50 million to $100 million to ensure that that only those entities sufficiently resourced to report are required to comply with the regime and/or adopt a simplified reporting regime which reflects the more limited resources and likely impact on Australia's emissions profile of relevant Group 3 entities;

- **Application to NFPs**: we are concerned that the regime, as currently drafted, would capture NFP entities despite the ISSB standards being drafted for application to for-profit entities and the needs of their investors. To date, we are not aware of any significant consultation with the NFP sector regarding the regime's potential application. In our view, any coverage of NFPs must be preceded by detailed consultation with the sector and a comprehensive cost-benefit analysis being undertaken. Our own assessment is that many NFPs will be relatively immature in their understanding of climate change issues, and that they would require significant upskilling, and external support, in order to comply with the proposed regime.

Continuous disclosure laws

The AICD last year provided a submission to the statutory review of changes made to Australia's continuous disclosure laws made by *Treasury Laws Amendment (2021 Measures No. 1) Act 2021* (**Continuous Disclosure Review**).[5]

Our submission reiterated our strong support for the permanent changes made to Australia's continuous disclosure regime in 2021, being the re-introduction of a fault element in the continuous disclosure provisions, and extension to misleading and deceptive conduct provisions (**2021 Amendments**). While not a radical modification, the 2021 Amendments have brought better balance to the disclosure laws involving complex, time-sensitive, judgment calls on disclosure.

The 2021 Amendments have brought Australia's continuous disclosure regime closer into line with major overseas markets, although the threshold for liability, in key respects, remains lower in Australia than in leading capital markets such as the United States and United Kingdom.

Critically, since the 2021 Amendments took effect, the disclosure landscape has evolved. Australia's climate reporting regime will introduce new, complex challenges for the provision of forward-looking information as discussed above. The exclusion of breaches of continuous disclosure obligations from the application of the Transitional Liability Relief means that private litigants may still bring actions against entities from the commencement of the regime where an entity fails to update disclosures made in its Sustainability Report (for example, where an announced climate target can no longer be met due to a change in external factors).

[5] AICD submission, Statutory Review of Reforms to Australia's Continuous Disclosure Laws, (available here).

The AICD therefore strongly encourages Government to consider the interaction of the forthcoming climate reporting regime with Australia's continuous disclosure and misleading and deceptive conduct laws. In particular, there would be an unacceptably high level of exposure for entities and directors should the 2021 Amendments be repealed and sections 674A and 1041H revert to a 'no fault' test.

In our view, the re-introduction of a no-fault continuous disclosure obligation could significantly hamper the comprehensive adoption of mandatory climate reporting, by encouraging a bare bones approach to limit legal risks.

d) NFP sector reforms

The NFP sector is a major focus of the AICD's work with a majority of our members involved in the governance or management of NFPs, many of them making contributions as directors on a voluntary basis.

The AICD has long advocated for promoting sound NFP governance practices, reducing the regulatory burden on NFPs and charities, and incentivising sector innovation and efficiency. It faces considerable challenges in an increasingly resource constrained environment.

Last year, the AICD contributed to the Government's consultation on its NFP Sector Development Blueprint.[6] We have urged Government to consider the following priority areas:

- A comprehensive review, led by the ALRC, of legal structures, regulatory frameworks and governance duties that apply to NFPs and charities. Such a review should include examining the taxation framework as it applies to NFPs and charities, including the deductible gift recipient (**DGR**) regime, of which the Productivity Commission recently recommended reforms to simplify the regime;

- Harmonising fundraising laws across the Commonwealth through remaining States and Territories implementing the National Fundraising Principles;

- Increasing stability in NFP funding arrangements through longer term contracts. This includes investment in internal governance and capacity building as a component of government and state funding agreements; and

- Implementing remaining recommendations of the 2010 Productivity Commission Contribution of the Not-for-Profit Sector Report (**2010 PC NFP Sector Report**). Very few of the recommendations have been fully implemented, including on improving data collection and building knowledge on effectiveness and excellence.

<u>Aged Care and Disability Royal Commissions</u>

The AICD's 2023 NFP Governance and Performance Study highlighted that NFP directors are being required to commit more time and rigorous focus to the operations of their NFPs, amidst the impact of tougher governance standards resulting from recent Royal Commissions and workforce shortages.[7]

[6] AICD submission, Developing a Not-for-Profit Sector Development Blueprint, (available here).
[7] AICD Not-for-Profit Governance & Performance Study 2022-23 (1 February 2023), (available here).

Feedback from members who have served on the governing bodies of aged care and disability service NFP providers have reflected concern with the increasing regulatory and reporting burden, as well as proposals for more punitive measures to be imposed, without demonstration of the value added to quality and safe service provision.

Accordingly, we encourage Government to have regard to the Council of Australian Governments (**COAG**) Principles in the design of any new legislation concerning director liability and associated penalties in the care sector. The COAG Principles provide clear rationale for when it is appropriate for directors and officers of an entity to be liable for an offence committed by the organisation.[8]

It is critical in our view that government, in implementing recommendations of the recent Royal Commissions in the care sector, prioritise the delivery of capacity-building initiatives, targeted training and guidance to support NFP providers meet the regulatory changes ahead.

e) Governance and regulatory review mechanisms

Given the increasing complexity of regulation and legislative frameworks in Australia, the AICD makes the following recommendations for regulatory review mechanisms that would enhance policy-making.

Reinstating CAMAC

The AICD considers there is a need for expert and independent body to support the Government's policy-making related to corporate law and corporate governance in Australia.

While it was beyond the exact scope of the Australian Law Reform Commission's (**ALRC**) recently completed Inquiry into the Legislative Framework for Corporations and Financial Services Regulation to make a formal recommendation, we note that the ALRC agreed with the AICD and others that the reestablishment of a body such as CAMAC would support the Government in policy development.[9]

During the period of 1989 to 2014, the former Corporations and Markets Advisory Committee (**CAMAC**) played an important role in the development of corporate law – identifying, explaining and analysing corporations and financial services law as well as market related matters. The AICD considers that CAMAC demonstrated a significant degree of independence and a non-partisan approach to policy proposals given its structure, the expertise of its members and legal committee, and its broad consultation on issues at hand.

In the years following CAMAC's abolition, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry prompted a significant package of law reform and changes to regulators' powers and mandates. However, consultations on complex policy reforms were often undertaken in a short timeframe by Government with limited opportunities for input from stakeholders.

The reinstatement of a CAMAC-equivalent body could play a useful complementary role to that of Treasury, which must retain its role as the principal body tasked with providing policy advice to the Government. A body similar to CAMAC could by contrast however, focus on

[8] COAG Principles (2012), (available here).
[9] ALRC Report 141, Confronting Complexity: Reforming Corporations and Financial Services Legislation, November 2023, p. 207 (available here).

longer term inquiries that are not tied to the political issues of the day and configure itself with the necessary expertise relevant to the inquiry at hand. Its independence would also align with heightened stakeholder expectations around evidence-based policy informed by expert advice.

<u>Regulatory grid</u>

The AICD considers that an Australian regulatory grid, focused on ensuring that new regulatory and legislative changes in the financial services sector are approached cohesively, would be a welcome and sensible policy development.

A form of a regulatory grid is utilised by financial regulators in the United Kingdom (UK) to ensure that the regulatory pipeline of initiatives is coordinated and sequenced. In other words, it allows the financial services industry and other stakeholders to understand – and plan for – the timing of regulatory initiatives that may have a significant operational impact on them.

The UK grid is published and updated twice a year by members of the Financial Services Regulatory Initiatives Forum (**Forum**), which includes the UK Treasury, Financial Conduct Authority, Bank of England, Prudential Regulation Authority and the pension, payments and competition regulators.

The AICD has consistently raised concerns with the Australian Prudential Regulation Authority (**APRA**) about the volume of regulatory change via new and amended prudential requirements. As a result, not only is a significant compliance burden placed on entities, particularly smaller entities, but consumers may also bear the significant costs of regulatory change through higher priced products.

We understand that the concept of a regulatory grid in Australia has been raised with Government by other stakeholders that have identified 130 different regulatory initiatives in the coming 18 months – two years that will impact the banking industry alone. We encourage Government to consider this future reform area as a priority for the financial services sector.

3. Macro-economic environment: director community observations

We would also like to draw Treasury's attention to the data provided by the AICD's twice-yearly surveys of director opinion, as captured by our AICD DSI.

The AICD has been polling our members since 2011 and now has more than a decade of data on director views on economic performance and risks as well as on priorities for policy and reform. A detailed overview of the DSI and its findings relevant to the budget has been provided by the AICD Chief Economist, Mark Thirlwell, as Attachment A to this submission. A few key points are set out below.

Negative sentiment amongst directors – cost of living, skills, inflation and interest rates

The headline message from our latest survey in the second half of 2023 is that director sentiment has fallen further into negative territory - the third consecutive negative result for the DSI and the softest result since the second half of 2020.

Directors participating in the survey identified factors related to the cost of living, labour shortages, inflation and interest rates as the top economic challenges facing Australian businesses. The latest survey also reveals a sharp increase in the share of respondents identifying productivity growth as a top economic challenge – doubling since the first half of 2023.

Regarding preferred priorities for government policy, in the short term (that is, over the next three years), our DSI results show directors ranking housing affordability/supply, productivity growth, and energy policy as the top three areas requiring government attention. Over the longer term (the next 10 to 20 years), directors rank climate change, Australia's ageing population, and (jointly) productivity growth and energy policy as their top priorities.

Concerns about government debt and deficits are relatively low on directors' list of economic and policy concerns. Cybercrime and data security continues to top the list of issues most likely to keep directors 'awake at night'.

Directors see compliance and regulation as weighing on board risk appetite. Indeed, the results show a rise in the share of directors citing regulation requirements/red tape as a top economic challenge, climbing from a low of 12 in the second half of 2022 to 19 per cent (almost one in five directors) in the second half of 2023.

Further analysis of these issues is included at **Attachment 1**.

4. Next steps

We hope our submission will be of assistance to Treasury. If you would like to discuss any aspects further, please contact Christian Gergis, Head of Policy at cgergis@aicd.com.au, or Laura Bacon, Senior Policy Adviser, at lbacon@aicd.com.au.

Yours sincerely,

Louise Petschler
GM Education & Policy Leadership

ATTACHMENT 1:
WHAT THE AICD's DIRECTOR SENTIMENT INDEX (DSI) TELLS US ABOUT DIRECTOR VIEWS ON THE ECONOMY AND THE BUDGET

Key messages from the latest DSI

- Directors identified the cost of living, labour shortages, and inflation and interest rates as the top economic challenges facing Australian businesses in the second half of 2023 (H2:2023). There was a particularly sharp increase in the share of respondents citing the cost of living as a top economic challenge

- While labour shortages are still seen as a pressing issue (85 per cent of directors think there is a skills shortage in the Australian workforce and 69 per cent say their organisation has been affected by labour market issues) there are also indications that labour market pressures have eased relative to last year.

- The latest survey reports a sharp increase in the share of respondents identifying productivity growth as a top economic challenge – it has doubled since the H1:2023 DSI.

- Turning to directors' views on government policy priorities, in the short term (that is, the next three years), directors now view housing affordability/supply, productivity growth, and energy policy as the top three areas requiring government attention. Over the longer term (the next 10 to 20 years), they rank climate change, Australia's ageing population, and (jointly) productivity growth and energy policy as their top priorities.

- The share of directors nominating housing affordability/supply as a top short-term issue has risen from 19 per cent (less than one in five directors) in H1:2022 to 34 per cent (more than one in three directors) in H2:2023. It is now the highest ranked short-term priority for government.

- Concerns about government debt and deficits are relatively low on directors' list of economic and policy concerns.

- According to the DSI, director dissatisfaction with personal income taxation settings is high. In the context of any future review of Australia's taxation system, our survey results indicate that directors would prioritise reform to personal income taxation and state-based taxes such as payroll taxes.

- Directors are also dissatisfied with current levels of government support for innovation and research and development (R&D) and with current government spending on education and training.

- Cybercrime / data security continues to top the list of issues most likely to keep directors 'awake at night', followed by legal and regulatory compliance and then by structural change / changing business models.

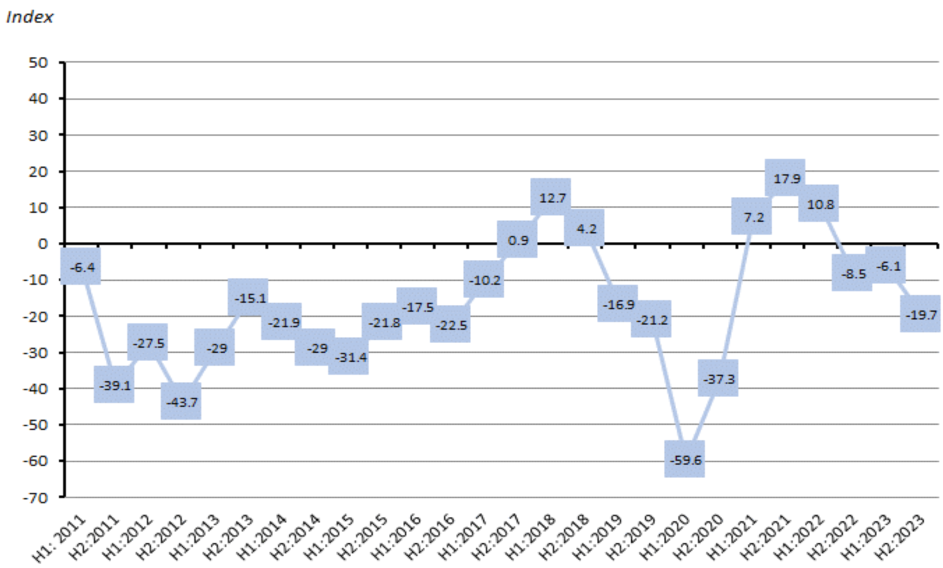
- Directors see compliance and regulation as weighing on board risk appetite. Related, recent survey results show a rise in the share of directors citing regulation requirements/red tape as a top economic challenge, climbing from a low of 12 per in the H2:2022 DSI to 19 per cent (almost one in five directors) in the current DSI.

About the AICD's Director Sentiment Index (DSI) The DSI reports the views of the Australian Institute of Company Directors (AICD) members with current directorships, making it a valuable indicator of the opinions of directors on a range of issues including the Australian economic and business environments, government policy, and governance regulation. The first DSI was published in 2011 and since then, the DSI has been conducted twice a year, each year. The most recent DSI covers the second half of 2023, H2:2023. The underpinning survey was conducted online between 18 September and 2 October 2023 and captured the views of a representative sample of 1,352 directors. Along with a range of individual results, the DSI also reports an aggregate score that captures overall sentiment based on a subset of survey questions. A score of zero represents a neutral outcome while a positive score is associated with director optimism and a negative score with director pessimism. The formula underpinning the construction of this aggregate DSI score was revised and refined in 2021, which impacts direct comparability with previous results. More information about the DSI, including the results of all previous surveys, is available from the AICD website.

Director sentiment slipped into negative territory in H2:2022

The overall DSI score for H2:2023 was -19.7. That was the third consecutive negative reading and the softest result recorded since H2:2020 (which returned a DSI score of -37.3).

Australia: Overall Director Sentiment Index (DSI) Score

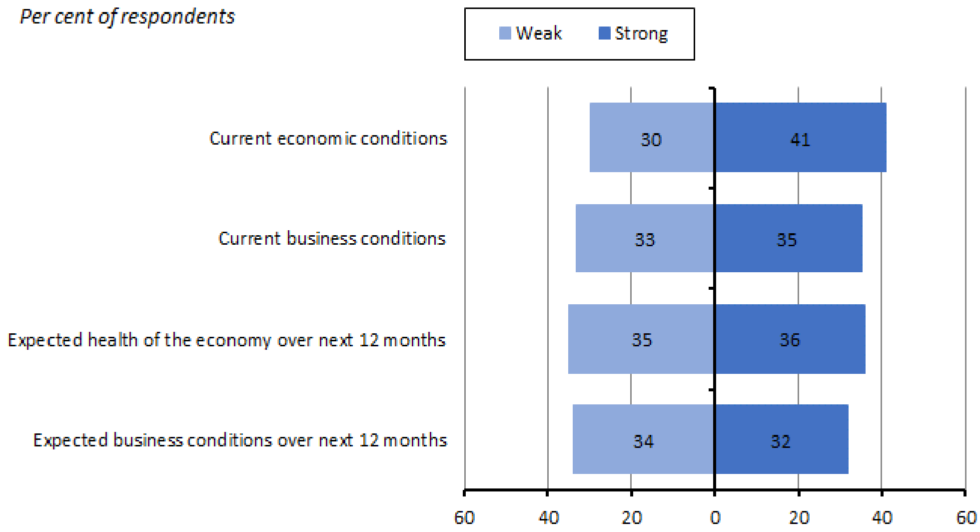


Source: AICD Director Sentiment Index (DSI), H2:2023. Zero indicates a neutral reading for the DSI with positive readings associated with optimism and negative readings with pessimism. Note series break at H2:2021 reflecting revisions to index construction.

At the time of the H2:2023 DSI, directors were relatively more positive about current economic and business conditions than they were about expected business and economic conditions over the next 12 months.

Australia: Current and future economic and business conditions

Per cent of respondents

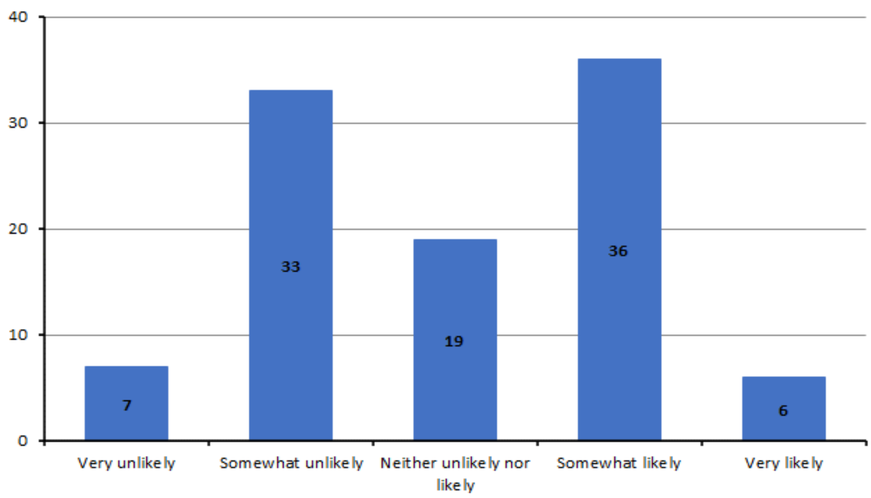


Source: AICD Director Sentiment Index (DSI), H2:2023. Note: (1) Weak combines very weak and somewhat weak and strong combines quite strong and very strong; (2) Share of respondents answering 'neither weak nor strong' is not shown.

At the time of the survey, directors were divided over the likelihood of Australia falling into a recession over the year ahead. Around 42 per cent of respondents thought it likely that Australia would have fallen into recession within the next 12 months, while 40 per cent thought a recession was unlikely.

Australia: Likelihood of a recession in the next 12 months.

Per cent of respondents



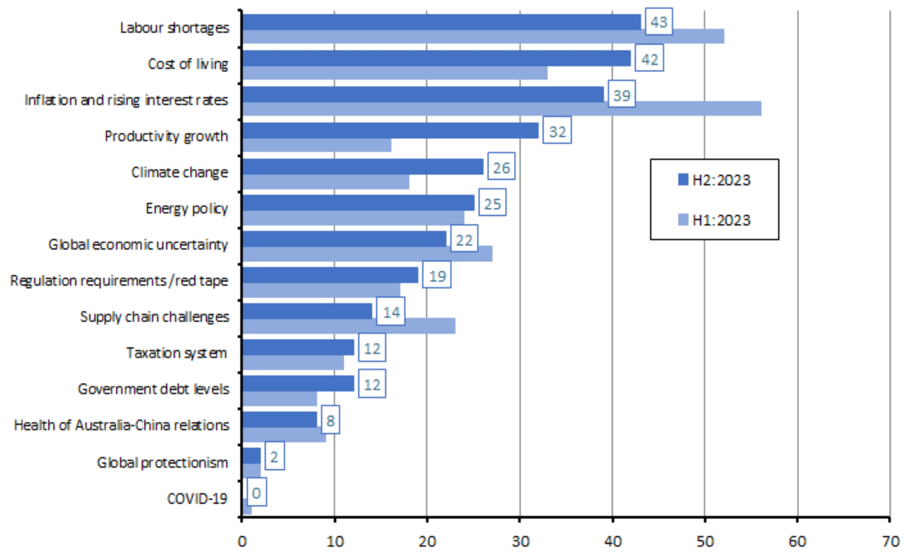
Source: DSI H2:2023. Question: *'How likely or unlikely do you think that it is Australia will be in a recession within the next 12 months?'*

Key economic challenges facing Australian businesses

A core question asked in every DSI survey asks directors to identify the top three economic challenges facing Australian businesses. According to our most recent results, directors continued to identify labour shortages as the most important economic challenge (43 per cent of respondents), although there were also indications that pressures on this front were easing. After peaking at 60 per cent of respondents in the H1:2022 and H2:2022 surveys, the share of respondents citing labour shortages had eased to 52 per cent by the H1:2023 survey before falling again in H2:2023.

Australia: Main economic challenges facing Australian businesses (top three)

Per cent of respondents

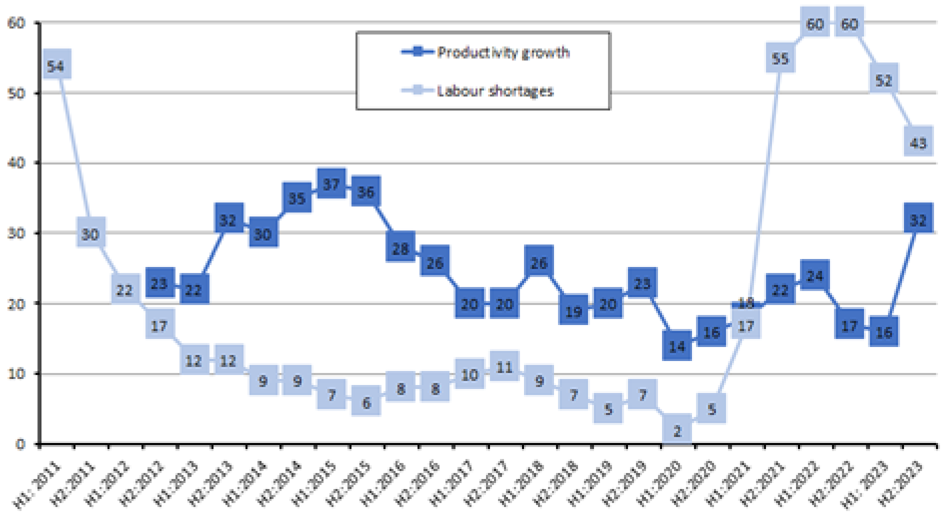


Source: AICD Director Sentiment Index (DSI), H2:2023.

Results from elsewhere in the survey reported that 85 per cent of directors still think there is a skills shortage in the Australian workforce (down from 94 per cent in H1:2023), 71 per cent think skilled migration levels – despite overseas migration rates running at record highs – are not keeping up with labour demand (down from 83 per cent in the previous DSI), and 69 per cent say their organisation has been affected by labour market issues (down from 74 per cent). Interestingly, one in three directors now think that the implementation of AI systems and workforce automation can resolve current skill shortages.

Australia: 'Top three' economic challenges: Labour shortages vs productivity

Per cent share of respondents indentifying issue as a top three economic challenge



Source: AICD Director Sentiment Index (DSI), various. Note list of options can vary across years. For example, COVID-19 included from H1:2020. Global economic uncertainty first included as an option in H1:2012. The option relating to labour shortages changed wef H1:2018. Until then, the wording referred to 'skilled labour shortages'. H1:2018 added 'labour shortages' as an option and from H2:2018 the question only referred to 'labour shortages'.

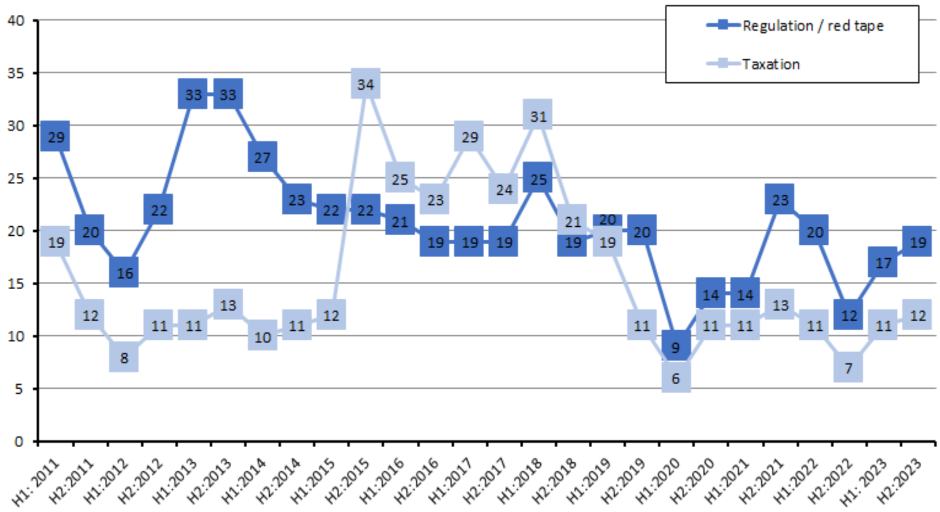
The cost of living has become a much more pressing economic issue for directors and has risen rapidly up the rankings. It was cited as a top three economic challenge by 24 per cent of respondents in H2:2022, by 33 per cent in H1:2023 and by 42 per cent of respondents in the current DSI – just behind labour shortages. In contrast, the share of respondents citing inflation and rising interest rates as a top economic challenge has dropped markedly, falling from 56 per cent in the first half of this year to 39 per cent in the second half.

Another notable change in the latest DSI is the rise in the share of respondents citing productivity as a top economic challenge: this has doubled, jumping from 16 per cent in the first half of this year to 32 per cent in the current DSI.

More ‘traditional’ budget issues – captured in the DSI ‘economic challenges’ question in the form of options around taxation and government debt levels – continue to be viewed as relatively less pressing, ranking below both current problems such as labour shortages, inflation, and the cost of living and below ‘structural’ challenges such as climate change, energy policy, and productivity growth. Tax reform, for example, peaked as a DSI priority issue for directors between 2015 and 2018 but has since faded in relative importance. Notably, since 2019 a larger share of directors has seen regulation / red tape as a more pressing economic challenge than taxation:

Australia: 'Top three' economic challenges: Taxation vs 'Red tape'

Per cent share of respondents indentifying issue as a top three economic challenge



Source: AICD Director Sentiment Index (DSI), various. Note list of options can vary across years. For example, COVID-19 included from H1:2020. For regulation, option was 'too much regulation' from H1:2011 and then 'too much regulation / red tape' from H2:2012. For taxation, option was 'tax levelstoo high' from H1:2011, 'ineffective taxation system' from H2:2015, 'ineffective taxation system / taxation system' in H1:2018 and 'taxation system' from H2:2018.

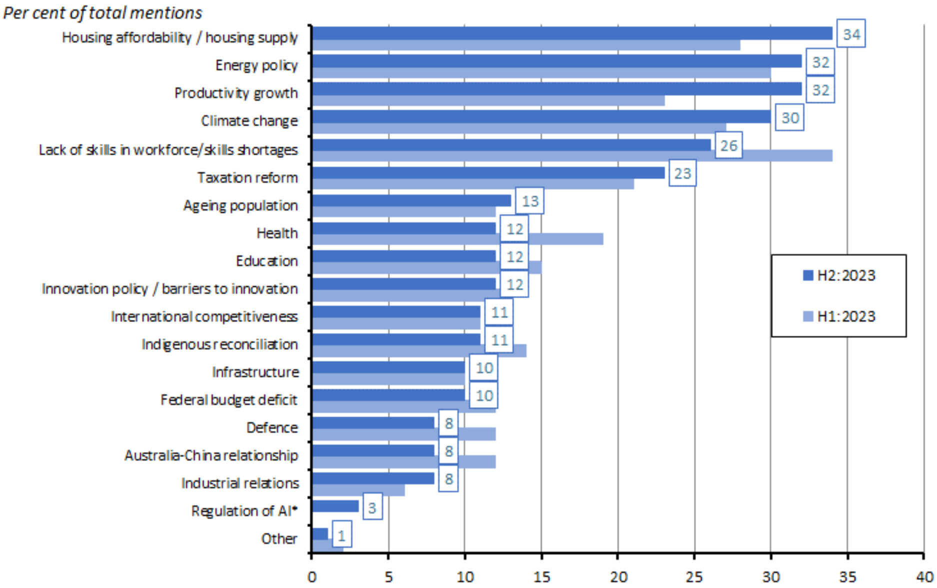
Indeed, there has been a steady rise in the share of directors citing regulation requirements/red tape as a top economic challenge, climbing from a low of 12 per in the H2:2022 DSI to 19 per cent (almost one in five directors) in the current DSI.

Government debt has been ranked relatively lowly for most of the history of the DSI, in keeping with Australia’s modest levels of public debt compared to many of our developed economy peers. In the H2:2023 DSI, only 12 per cent of respondents cited it as a top economic challenge. Granted, this was up from eight per cent in the H1:2023 DSI and seven per cent in the H2:2022 survey, but it was still below the peak of 17 per cent reached in the H1:2016 DSI.

Policy priorities for Government

A second set of long-running DSI questions relates to the policy priorities directors would like to see addressed by the Federal Government. These are classified by the survey into priorities for the short term (that is, within the next three years) and longer term (for the next 10 to 20 years). According to the H2:2023 DSI, directors think that housing affordability / housing supply, energy policy and productivity growth should top the Government’s policy priority list in the short term, followed by climate change. The sharp rise in the share of directors’ nominating productivity growth as a policy priority is consistent with the jump in the share of directors nominating productivity growth as a top economic challenge noted above.

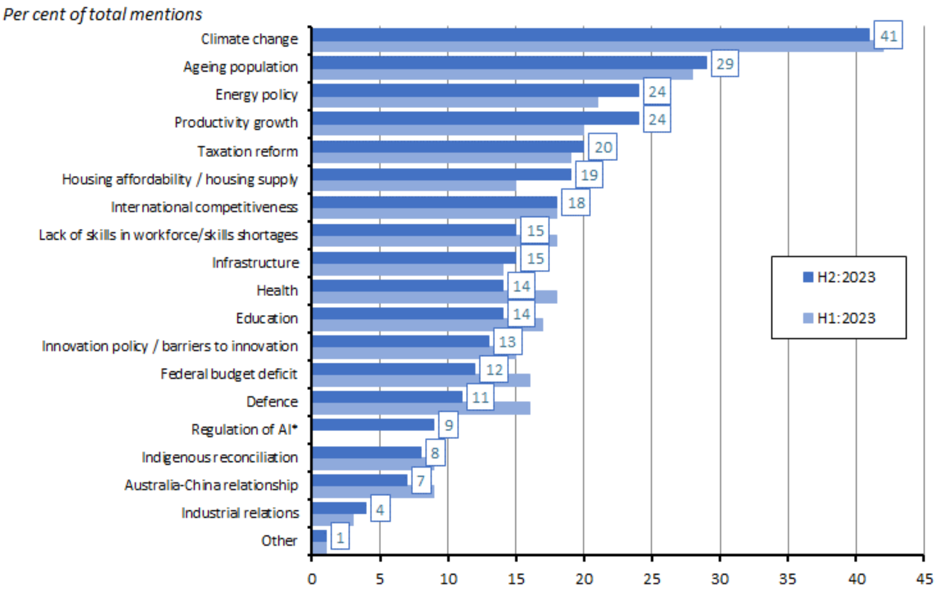
Australia: Issues Federal government should address in the short term (top three)



Source: AICD Director Sentiment Index (DSI), H2:2023. The short term here refers to the next three years.

The share of directors nominating housing affordability/supply as a top short-term issue has risen from 19 per cent (less than one in five directors) in H1:2022 to 34 per cent (more than one in three directors) in H2:2023, making it the highest ranked short-term priority for government. Elsewhere in the survey results, more than one third of directors reported that the housing market has negatively impacted their business, with 27 per cent saying that it has had a somewhat negative impact and six per cent reporting a very negative impact.

Australia: Issues Federal government should address in the longer term (top three)

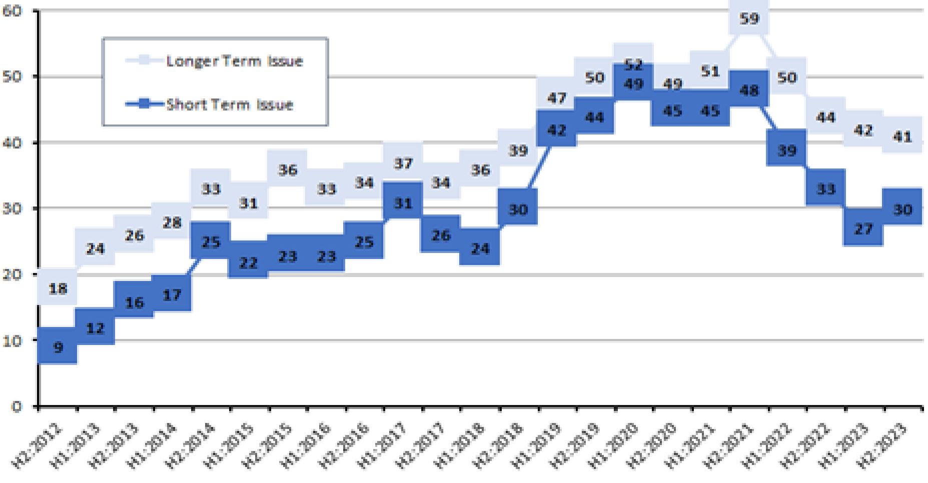


Source: AICD Director Sentiment Index (DSI), H2:2023. The longer term here refers to the next 10 to 20 years. * New option in H2:2023.

Regarding the longer term, the top three policy priorities nominated by directors comprise climate change, Australia's ageing population, and (tied in the rankings) energy policy and international competitiveness.

Australia: Climate change as a Federal Government policy priority

Per cent share of respondents selecting climate change as a top policy priority for the Government

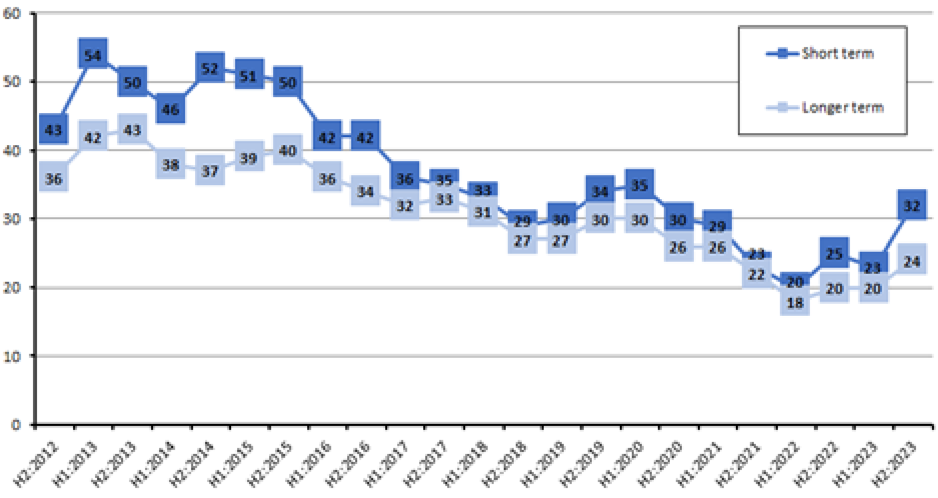


Source: AICD Director Sentiment Index (DSI), various issues. Respondents are asked to nominate the top issues they think the Federal Government should address in the short and longer term. Respondents were asked to select their top five policy choices until H1:2021. From H2:2021, they are asked to select their top three policy choices. Short term refers to next three years, longer term to next ten to 20 years. Note, options can vary across surveys.

Climate change continues to be cited as the most important long-term policy issue – nominated by 41 per cent of directors as a top policy issue in the latest DSI. While this is still well-ahead of second placed ageing population (29 per cent), the share of respondents citing climate change as a long-term issue has trended downwards in recent surveys, falling from a peak of 59 per cent in H2:2021. There has also been a parallel fall in the share of respondents nominating it as a short-term policy priority, although note that in this case there was an uptick in this share in the latest DSI. It is likely that this recent trend to some extent reflects adjustments in priorities in response first to the pandemic and then to its aftermath.

Australia: Productivity growth as a Federal Government policy priority

Per cent share of respondents identifying productivity growth as a top policy issue for the Government

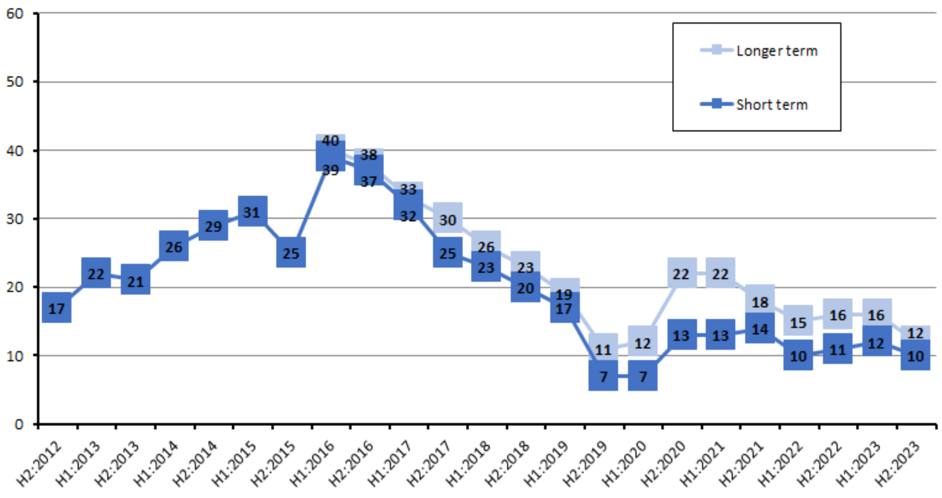


Source: AICD Director Sentiment Index (DSI), various. Respondents are asked to nominate the top issues they think the Federal Government should address in the short and longer term. Respondents were asked to select their top five policy choices until H1:2021. From H2:2021, they were asked to select their top three policy choices. Short term refers to next three years, longer term to next ten to 20 years. Note, options can vary across surveys.

Turning to the traditional budget issues of deficits and taxation, the history of DSI results suggests that the salience of the deficit issue peaked in 2016. More recently, the expansion of government deficits in response to the pandemic did trigger a rise in the share of respondents nominating the deficit as a policy priority relative to the low reached in H2:2019 and H1:2020. Since then, however, the subsequent period of budget repair has seen the deficit slide again as a priority.

Australia: The Budget Deficit as a Federal Government policy priority

Per cent share of respondents identifying the budget deficit as a top policy issue for the Government

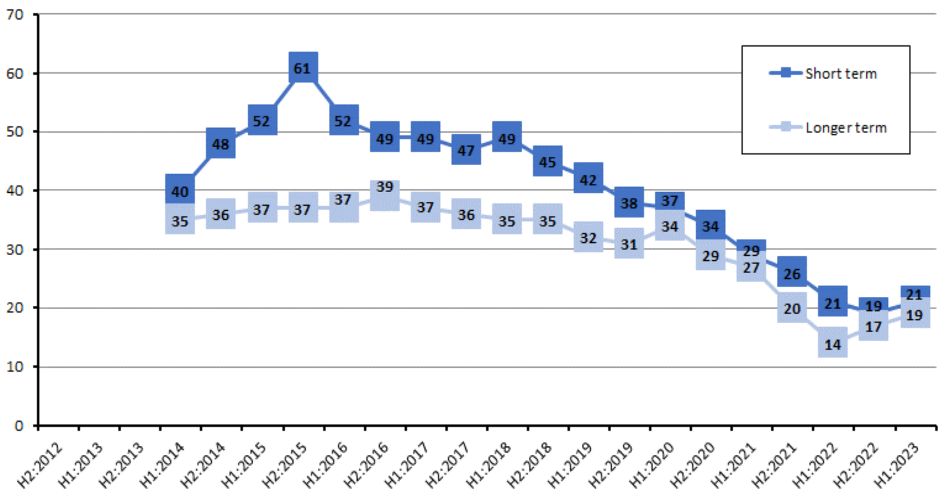


Source: AICD Director Sentiment Index (DSI), various. Respondents are asked to nominate the top issues they think the Federal Government should address in the short and longer term. Respondents were asked to select their top five policy choices until H1:2021. From H2:2021, they were asked to select their top three policy choices. Short term refers to next three years, longer term to next ten to 20 years. Note, options can vary across surveys. The budget deficit was not included as a longer term option between H1:2013 and H2:2015.

According to our DSI results, the importance of tax reform as a short-term government priority peaked in H2:2015 and in H2:2016 as a longer-term priority.

Australia: Tax Reform as a Federal Government policy priority

Per cent share of respondents identifying tax reform as a top policy issue for the Government



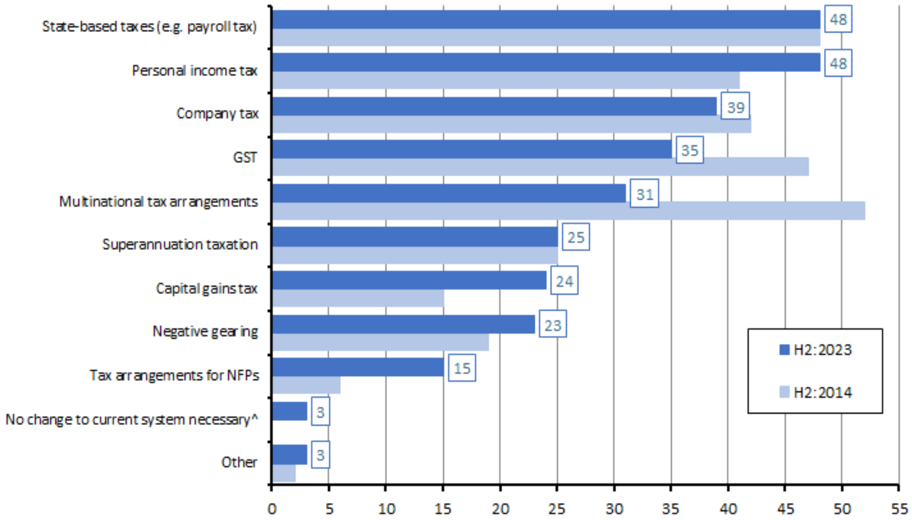
Source: AICD Director Sentiment Index (DSI), various. Respondents are asked to nominate the top issues they think the Federal Government should address in the short and longer term. Respondents were asked to select their top five policy choices until H1:2021. From H2:2021, they were asked to select their top three policy choices. Short term refers to next three years, longer term to next ten to 20 years. Note, options can vary across surveys.

The share of directors nominating tax reform as a priority hit lows in H1:2022 (longer term) and H2:2022 (short term) but has risen modestly in the latest DSI.

The DSI also provides data on the type of tax reform that directors would prioritise. According to our H2:2023 survey results, state-based taxes such as payroll tax are seen as the (joint) most pressing target for reform, along with personal income tax. Company tax is ranked in third place.

Australia: Priorities for tax reform (top three)

Per cent



Source: AICD Director Sentiment Index (DSI), H2:2023 and H2:2014. Note question frames the top three priorities for tax reform in the context of a possible review of the current taxation system. ^Not offered as an option in H2:2014

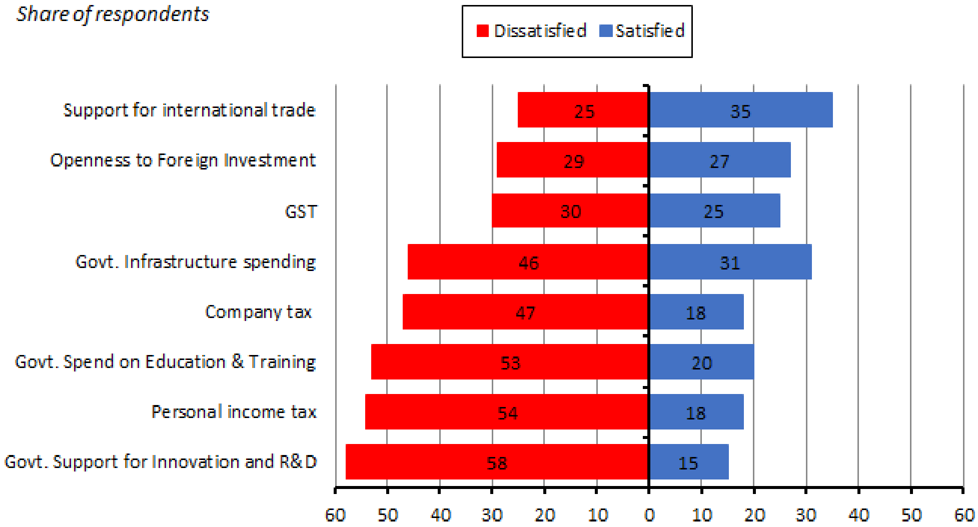
Further down the rankings, the DSI results suggest that since we first started asking this question in H2:2014, directors have become less focused on reform of multinational tax arrangements and the GST, and more concerned about taxation relating to negative gearing, the capital gains tax, and tax arrangements for NFPs.

Satisfaction with government policies

The DSI also asks directors about their satisfaction with current policy settings.

Australia: Satisfaction with Government policy settings / priorities

Share of respondents



Source: AICD Director Sentiment Index (DSI), H2:2023. Note: (1) Dissatisfied combines Very and Somewhat Dissatisfied responses and Satisfied combines Very and Somewhat Satisfied responses; (2) Share of respondents reporting 'Neither Satisfied Nor Dissatisfied' is not shown here.

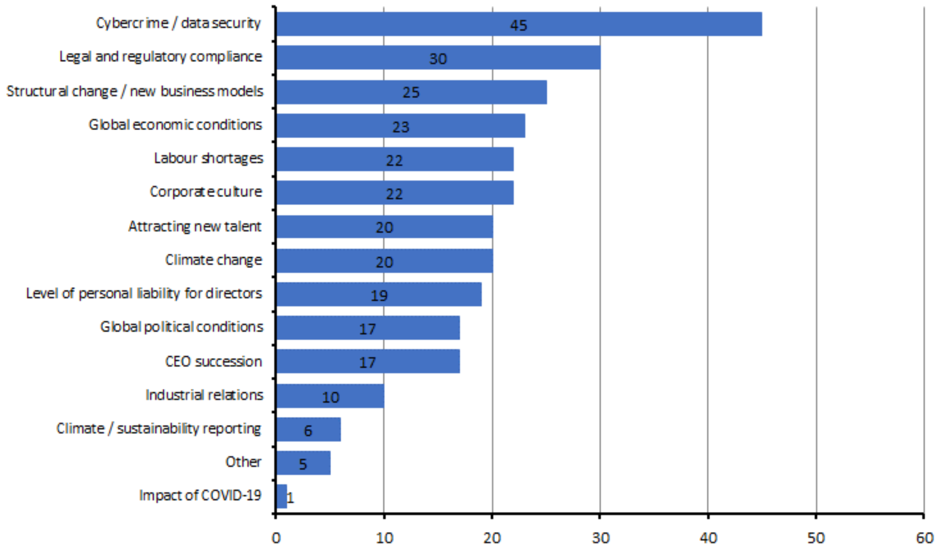
According to our latest results, (net) satisfaction is highest for the support for international trade, openness to foreign investment, the GST, and the current level of infrastructure spend while it is lowest for government support for innovation and for research and development (R&D), for personal income tax settings, and for government spending on education and training.

The issues that keep directors 'awake at night'

Finally, the DSI includes a regular overview of the top issues that are likely to keep respondents 'awake at night' as a director on their board.

Australia: Issues most likely to keep directors awake at night (top three)

Per cent of respondents



Source: AICD Director Sentiment Index (DSI), H2:2023.

According to the H2:2023 DSI, cybercrime and data security continues to top directors' worry lists, followed by legal and regulatory compliance, and the impact of structural change and new business models. In a separate question, 59 per cent of respondents said that compliance and regulation had impacted their board's risk appetite.

Mark Thirlwell
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