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1 June 2021

Mr Robert Jeremenko/Mr Ben Dolman
Market Conduct Division/Retirement Income Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

Email: mcdproxyadvice@treasury.gov.au

Dear Mr Jeremenko and Mr Dolman

CONSULTATION PAPER – GREATER TRANSPARENCY OF PROXY ADVICE

On behalf of the Australian Council of Superannuation Investors (ACSI), thank you for the opportunity to make a submission in relation to the Treasury Consultation – Greater Transparency of Proxy Advice.

ACSI is an investor association that exists to provide a strong, collective voice on environmental, social and corporate governance (ESG) investment issues on behalf of our members, who include 36 Australian and international asset owners and institutional investors. Our members recognise that ESG risks – such as corporate governance failures - will have a material impact on investment outcomes.

ACSI's aim is to promote and enhance the financial success of Australia's leading companies over the long term, which is not only in the best financial interest of our members' beneficiaries, but of the economy and nation as a whole. We do this by:

- producing detailed research on key governance issues such as CEO pay and board composition. We also provide our members with voting research and recommendations.
- engaging with Government, regulators and other market participants to promote policy settings that protect shareholder rights and the interests of superannuation funds' investments over the long-term.
- undertaking regular company engagement. ACSI regularly meets directly with the boards of ASX listed companies to discuss, understand and address ESG issues.

Over the past twenty years our work has contributed to improvements to a range of governance standards in the Australian market including the moderation of executive remuneration and termination payouts, better alignment of remuneration with performance of listed companies and raising awareness of the need for company boards to account for their decisions and performance.

Over time our work has contributed to companies being governed by more deeply skilled, diverse and experienced boards of directors, a shift from short to long-term strategic focus and enhancement of Australia's reputation as an investment destination. These improvements support long-term value creation which benefits the members of Australia's superannuation funds.

Our approach to stewardship incorporates research and, importantly, extensive engagement with management and the board of our members' investee companies, before and after the provision of our non-binding voting advice to subscribers.

We trust that the following submission will provide you with sufficient facts, context and perspectives to provide clarity on our practice. I trust our comments are of assistance. Please contact me or Kate Griffiths, ACSI's Executive Manager – Public Policy and Advocacy, should you require any further information on ACSI's position.

Yours sincerely

Louise Davidson AM
Chief Executive Officer
Australian Council of Superannuation Investors

SUMMARY

ACSI supports proposals to standardise disclosure of voting activities.

Superannuation funds and asset managers already provide a significant level of public transparency on their voting practices, guided by existing law, and the enhanced industry standards developed by ACSI and the Financial Services Council.

To support better practice in disclosure across the market, a consistent industry standard could be established, similar to the UK Stewardship Code. Disclosure requirements come, however, with a compliance cost – which needs to be balanced against the value offered to clients of asset managers and members of superannuation funds.

Disclosure by superannuation funds or asset managers should focus on how the voting process works and how final voting decisions made rather than proxy advice as it is a single input to the voting decision. This could be achieved in a number of ways, and discussion should focus on the rationale for voting decisions on contentious resolutions. Treasury should consider engaging the industry to develop a Code that promotes best practice and operates on a 'comply or explain' basis for the entire market.

The Consultation Paper misunderstands current market practice in relation to independence

There is no rationale provided in the Consultation Paper to support the conclusion that superannuation funds should not be members of organisations that produce proxy advice.

ACSI membership is a cost-efficient tool for superannuation funds' management of their stewardship obligations. Superannuation funds vote their shares in order to protect the retirement savings entrusted to them by their beneficiaries. It would cost far more for ACSI members to undertake engagement activity and research on an individual basis. Companies also benefit from these efficiencies, with the ability to meet with a number of their shareholders at one time, while maintaining the flexibility to also meet separately where requested.

When it comes to voting, our members act independently. Individual funds are not jointly involved in determining ACSI's voting recommendations, nor do they jointly determine their voting decisions. This divergence is clearly evident in funds' existing disclosures of how they voted. There is no requirement for ACSI members to follow any of the recommendations we make. Divergence of views between investors, and between researchers, is part of a functioning market.

There is already a competitive market for proxy advice in Australia. Superannuation funds can, and do, receive advice from many sources.

The Consultation Paper misses the key issue of independence in proxy advice which is ensuring that researchers are independent from the listed companies that their research relates to. ACSI has always ensured that it is free from this conflict and is not owned by, nor receives income from, any listed company.

Proposals aimed at facilitating engagement could have the opposite effect and would impact the timeliness, cost and independence of advice.

The proposal to allow companies to review proxy advice in advance of clients is inconsistent with market practices overseas, including the US and UK positions referenced in the Consultation Paper. Australia would be the only jurisdiction where companies are given a legislative right to vet investment research that provides analysis of executive remuneration and other matters considered at company meetings.

The US SEC considered imposing a similar '5 day' rule during the Trump administration in 2019. The '5 day' proposal was abandoned, with the Securities and Exchange Commission (SEC) noting a need for investors "to make informed voting decisions without imposing undue costs or delays that could adversely affect the timely provision of proxy voting advice[1]".

ACSI is concerned that the Consultation Paper's '5 day review' window for companies does not consider the tight deadlines for the preparation of research ahead of company meetings. A meeting agenda is typically released only 28 days ahead of the relevant meeting and at least 75% of ASX300 meetings occur in a short window. Adding a review period would likely result in either research being rushed to meet this deadline, an increase in cost, or investors receiving research much closer to the cut-off date for voting. This proposal would undermine the opportunity for a dialogue between companies and investors ahead of voting.

[1] SEC, Exemptions from the Proxy Rules for Proxy Advice: A Small Entity Compliance Guide, June 2020 - https://www.sec.gov/corpfin/exemptions-proxy-rules-proxy-advice-secg

Our practice is to meet with companies before we formulate our recommendations, then provide a copy of advice to companies at the same time (or immediately after) it is provided to members. This allows companies to engage directly with investors and to understand ACSI's perspectives on key governance issues.

These proposals have the clear potential to impact the independence of advice, depending on the obligations that are imposed on researchers and the veto powers that are given to companies. Sharing proxy research with companies in advance would be inconsistent with existing obligations under the Australian Financial Services Licensing regime, which prohibits researchers from communicating the recommendations or opinions of investment research to companies before they have been received by clients.

OVERVIEW

ACSI support for transparency and accountability

Australia enjoys a highly engaged capital market where the dialogue between institutional investors and listed companies is very strong – particularly when compared to more fragmented and adversarial markets such as the United States. Market practice demonstrates that Australian asset managers and superannuation funds are well aware of their fiduciary obligations and take their stewardship responsibilities seriously, including voting their shares at company meetings.

We agree with the assertion in the Consultation Paper that '*given the millions of Australians who have their superannuation savings invested in shares, it is critical that the voting rights attached to the members' superannuation assets are managed to maximise the retirement savings of Australians and for the sole purpose of retirement benefits*'. It is for this exact reason that ACSI was established in 2001 to provide detailed investment research on corporate governance in Australian listed companies.

We have long supported transparency and accountability. Our recommendations are informed by a transparent set of Governance Guidelines that are publicly available. In addition, we hold over 300 meetings each year with listed companies to inform our approach.

We also support transparency and accountability for our members. In May 2018, ACSI, along with its members developed the Australian Asset Owner Stewardship Code, which aims to increase the transparency and accountability of stewardship activities in Australia. Signatories to the Code already go beyond the regulatory requirements to make disclosures in respect of their approach and outcomes regarding key stewardship activities, including voting. The majority of our members publicly disclose their voting activity on a resolution by resolution basis on their websites.

In order to provide information that is of value to superannuation fund members and other stakeholders, discussion in relation to appropriate disclosure by investors should focus on how the voting process works rather than whether recommendations from proxy advisers were followed. This is because there are often a number of inputs into investor voting decisions and so a singular focus only on proxy advice risks being misleading as it ignores the many other inputs. Should further regulation be considered necessary, we recommend that Treasury focus on the rationale for voting decisions on contentious resolutions, and consider engaging the industry to develop a Code that promotes best practice across the industry (including both investment managers and funds) while allowing investors to adopt processes appropriate to their membership, size and resources, with the best financial interests of their beneficiaries paramount.

Ability of trustees to act in the best financial interests of members would be compromised

We are very concerned that some of the proposals set out in the Consultation Paper will hamper the ability of trustees to act in the best financial interests of their beneficiaries. The measures also represent increased cost for no benefit.

We are particularly concerned by the suggestion in option 2 of the Consultation Paper that membership by superannuation funds of an organisation that provides proxy advice is problematic.

There is no rationale provided in the paper to support such a conclusion and we are unable to identify the problem that the proposal seeks to solve. The suggestion in the Consultation Paper that shared membership of an organisation that produces proxy advice somehow results in joint determination of voting positions is wholly incorrect. Individual member funds make their own voting decisions, and member funds are never jointly determine their voting positions through ACSI.

This approach is based on a misconception of how ACSI operates. In considering whether to join ACSI, or subscribe to ACSI's voting research investors are bound by their fiduciary duty. That is, trustees must be of the view that entering into the relevant agreement is in the best financial interests of their members. ACSI membership is an effective tool for efficient management of a superannuation fund's stewardship obligations and operates in the best financial interests of beneficiaries.

There is no international precedent for the proposal that a fund should not be a member of an organisation that also provides proxy advice. Significant efficiencies arise from ACSI's model and provision of engagement and proxy advice services. There are many examples of organisations with a similar structure that harness significant efficiencies for their members and clients, while retaining appropriate independence.[2]

Furthermore, in the context of independence in investment research, the relationship in focus is that between

[2] For example the UK's Investment Association, Federated Hermes EOS, Eumedion Corporate Governance Forum

researcher and the companies they are assessing, rather than between adviser and client. This is consistent with current ASIC regulatory guidance.[3] Indeed, alignment (whether contractual or membership based) between adviser and client promotes a focus on beneficiaries' best financial interests.

The Consultation Paper also suggests that proxy advisers may have broader objectives than the best financial interests of beneficiaries. While proxy advisers are not subject to the trustees' fiduciary duty, advisers must be focused on superannuation fund members' best financial interests for their advice to be relevant and commercial. Indeed, alignment (whether contractual or membership based) between a fund and its adviser is necessary and in our 20 years of operation, we have remained focussed on the best interests of our members' beneficiaries in everything that we do.

Proxy advisers are already appropriately regulated and demonstrate good practice

The Treasury paper suggests widespread impacts of proxy research but fails to acknowledge that the vast majority of proxy advice is uncontentious and provides recommendations in line with the company board's recommendations. In 2020, of the 1,321 resolutions proposed at meetings of the ASX200, 91.2 per cent of ACSI recommendations were in line with board recommendations.[4]

The Consultation Paper suggests that proxy advisers have a high degree of influence in the outcome of company resolutions. As outlined above, the actual number of contentious resolutions is low[5], and an independent review by ASIC found 'the extent of influence of proxy adviser recommendations on the voting outcomes of company resolutions is overstated'[6]. Further, the statistics actually suggest that the largest influence in voting position is recommendations made by the relevant board. Of the 1,321 resolutions proposed in 2020 in the ASX200, there were just 36 resolutions (2.7 per cent) where the result did not reflect the board's recommendation.[7]

These statistics demonstrate that the impact of governance research on voting outcomes continues to be overstated.

Proxy advisers are already subject to appropriate regulation. Proxy advisers in Australia hold AFS licenses and are subject to provisions in the Corporations Act prohibiting misleading or deceptive conduct. There has also been a recent and extensive review of practice by the regulator.

In 2017 and 2018, the Australian Securities and Investments Commission undertook a detailed review of proxy advisor research and released its Review of proxy adviser engagement practices (ASIC Review). ASIC did not identify issues in the market. While there can be differing views between investors, proxy advisers and companies, this is a sign of a well-functioning free market. Proxy advisers are subject to provisions in the Corporations Act, both as part of the AFSL regime and in relation to misleading or deceptive conduct and ASIC has found no evidence of wrongdoing. Similarly, the Consultation Paper does not provide any evidence of poor practice that breaches these conditions or highlights inadequacy of existing regulations.

The Consultation Paper requests views on the adequacy of the current regulatory regime and the options proposed for development. Clearly, the current regulatory regime is adequate, given that a thorough and recent review of market practice by the regulator did not establish poor practice across the market, nor establish a need for further regulation.

Industry practice already demonstrates a recognition by providers that their advice needs to be informed, accurate and of good quality to best support their clients, and retain their business. Existing regulation of providers supports this approach.

The options are out of step with international approaches

While the Consultation Paper refers to recent regulation in the United States and the United Kingdom, the options proposed in the paper do not reflect the regulation in place in either of those markets.

In particular, in the United States, the Securities and Exchange Commission (SEC) abandoned the proposal that companies be provided with proxy reports in advance of clients. The final rules remain controversial and the subject of litigation.

In the UK, regulation provides for disclosure by proxy advisers, but does not take a prescriptive approach. The

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[3] ASIC Regulatory Guide 79

[4] This is even higher in respect of director appointments at 94.2 per cent.

[5] ASIC Report 578 Review of Proxy Adviser Engagement Practices page 7

[6] ASIC Report 578 Review of Proxy Adviser Engagement practices page 4

[7] Within these 36 cases, 13 were driven by substantial shareholders vying for control and 18 were either non-binding, did not significantly reduce the board's discretion or were withdrawn by the company for uncontentious reasons.

UK regime allows advisers to adopt an appropriate code of conduct and make corresponding disclosure. The UK Stewardship Code is widely recognised, as it provides principles that apply across the market, including fund managers, asset owners, and service providers. As set out above, the UK Stewardship Code encourages alignment of adviser with the best interests of their clients. Consistent with the principles of sound regulation, the UK Stewardship Code supports the whole of the market to adopt good practice, while retaining flexibility for market participants to choose the practices that best suit its business and clients, and disclose accordingly. This approach is preferable to disproportionately targeting one aspect type of investor, as is the focus of the Consultation Paper.

Development of a code that covers the entire market, including superannuation funds and fund managers, would be a more appropriate outcome, that would be consistent with the international approach. There are useful examples in Australia, such as the industry-developed Banking Code, which is enforceable by ASIC, the Australian Asset Owner Stewardship Code, or international examples, such as the UK Stewardship Code that operates on a comply or explain basis.

Further detail on the operation of ACSI, the Australian and International landscape and an analysis of the options set out in the Consultation Paper is below.

How ACSI Operates

ACSI provides a strong voice on environmental, social and governance (ESG) investment issues on behalf of 36 Australian and international asset owners and institutional investors.

Given the operation of fiduciary duty, ACSI members must be of the view that joining ACSI is in the best financial interests of their beneficiaries. Both ACSI membership and subscription to ACSI's voting services requires consideration and renewal on an annual basis and therefore the value to superannuation fund members is regularly considered by trustees.

Through research, engagement, advocacy and voting advice, ACSI supports its members in exercising their ownership rights. Active ownership allows institutional investors to enhance the long-term value of retirement savings entrusted to them to manage. Exercising voting rights is a critical mechanism for investors to protect their investments and promote accountability in listed companies. This is long-established in the Australian market, as Justice Neville Owen commented in the Final Report of the HIH Royal Commission in 2003 '*Shareholder apathy can play a part in undesirable corporate governance. If shareholders as owners are unwilling or unable to exercise their powers or make themselves heard, directors and management will lack guidance or constraint from those whose interests they are supposed to serve*.[8]'

Shareholders in Australian companies vote on a wide range of issues, as enshrined in the Corporations Act. Often these issues involve complex proposals, and investors need to exercise their votes in an informed way, which is why they seek external research, including 'proxy advice,' to help in their decision-making.

ACSI is known for its long-term outlook, its evidence-based views, and is respected as a thought leader on key issues. Among other things, ACSI:

- conducts a constructive engagement program with company boards about material ESG issues, with the aim of promoting long-term shareholder value and minimising risk;
- provides voting recommendations to help our members exercise their voting rights in an informed way;
- conducts a research program that ensures our activity is informed by evidence-based analysis and research.

ACSI's objectives and operations are completely aligned with trustee duties and the best financial interests of superannuation fund members. This fundamental principle is clearly articulated in our Governance Guidelines:

> One principle underpins everything we do. We are focussed on financially material ESG risks and opportunities over the long-term, to protect and enhance the retirement savings that are entrusted to our members.[9]

Over the past twenty years we have worked with this sole objective in mind, providing expert research to our members, advocating for the protection of shareholder rights and working to improve governance standards in Australian companies.

Our Governance Guidelines articulate the issues that we focus on in our engagement meetings and the factors we take into consideration when determining our voting recommendations. ACSI's Guidelines are updated every two years in consultation with our members. We also seek feedback from a broad group of stakeholders[10], to ensure that the evolving regulatory and governance landscape is reflected. Our Guidelines are publicly available, and we share all updates to the Guidelines with listed companies.

We operate transparently and hold over 300 meetings with listed companies each year to inform our research. The majority of our recommendations support recommendations made by the relevant listed company board. The number of controversial items of business at listed company meetings is relatively small, at around 13 per cent.[11] As part of its Review, ASIC identified that of the approximately 1,125 items of business at general meetings of the ASX200, there were 148 proxy recommendations that were not in line with the company's recommendation, with an average vote of 17 per cent against these resolutions. This is consistent with our experience.

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[8] Justice Neville Owen in The Failure of HIH Insurance at 6.3 page 121

[9] ACSI Governance Guidelines, page 4

[10] This included seeking input from organisations such as the Australian Institute of Company Directors (AICD), Australian Securities Exchange (ASX); Australian Shareholders Association (ASA) Australasian Investor Relations Association (AIRA), Governance Institute, Financial Services Council (FSC) Australian Securities and Investments Commission (ASIC) Asian Corporate Governance Association (ACGA) and other proxy advisers.

[11] ASIC Report 578 Review of Proxy Adviser Engagement Practices page 7

Where there is a controversial resolution, we seek to understand the company's position, and we ensure that this information is communicated to our members and incorporated into our voting recommendations. On occasion, we will have a difference of opinion with the company, and make corresponding recommendations. Our members can choose whether to follow those recommendations in their voting decisions. Further, not all of our members subscribe to our voting research. Members will also seek advice elsewhere, and our recommendations may not be the same as other advisers. Investors make their own voting decisions, which may (or may not) follow a proxy adviser's recommendation. Our view is that this is indicative of a well-functioning free market.

Where material new information is provided by a company, we revisit our recommendations and consider whether change is necessary. The majority of cases that require a change occur where a resolution is withdrawn in which case we update and notify our members as appropriate. ACSI's approach is to share its research with the relevant company once it has been prepared for subscribers. Under this practice, ACSI has shared hundreds of reports with issuers over the past decade and has never had a significant factual error identified in its research.

Australian practice - ASIC Review of Proxy Engagement Processes

Many of the issues considered in the Consultation Paper have already been the subject of detailed review.

ASIC's 2018 Review was the culmination of an extensive program of work that, among other things, reviewed 80 adviser reports where an 'against' recommendation was made (recognising that in the majority of cases, proxy adviser recommendations support company board recommendations). The ASIC Review did not establish widespread issues in the market, rather noted that the policies of proxy advisers reflect a willingness to engage, a desire to ensure independence and a willingness to receive feedback in relation to potential factual errors.

The ASIC Review notes:

- proxy advice is only one input into voting decisions[12]. The Review observed examples of large institutional investors voting differently to the recommendation of their proxy adviser(s);[13]
- the extent of influence of proxy adviser recommendations on the voting outcomes of company resolutions is overstated. In particular, ASIC identified that of the approximately 1,125 items of business at general meetings of the ASX200, there were 148 proxy recommendations that were not in line with the company's recommendation, with an average vote of 17 per cent against these resolutions;[14] and
- of the 80 reports ASIC reviewed, engagement with companies occurred in the vast majority. Of the remainder, there were significantly more cases of companies refusing to engage (or not responding to an engagement invitation) than there were proxy advisers declining an engagement meeting[15].

ASIC recommended[16] that:

- The focus of engagement should be on ensuring investors receive independent, well-informed recommendations based on accurate information. Engagement should be an opportunity for proxy advisers to ensure the factual bases or contexts for conclusions are correct, and it should not be viewed as an advocacy opportunity by companies to influence an adviser's recommendation.
- It is up to the proxy advisers as to how it wishes to strike a balance between the sometimes competing priorities of engaging with companies (including fact-checking), maintaining independence from companies (including preventing receipt of non-public information and avoiding undue influence), and managing timing constraints in their engagement policies.
- Proxy advisers should clearly explain and make available their policies in relation to engagement.
- Voting guidelines, which set out the factors that the proxy adviser takes into consideration when providing voting recommendations, should be easily accessible to assist companies to understand proxy advisers' views on a particular issue.

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[12] ASIC Report 578 Review of Proxy Adviser Engagement Practices page 4

[13] ASIC Report 578 Review of Proxy Adviser Engagement Practices page 7

[14] ASIC Report 578 Review of Proxy Adviser Engagement Practices page 4.

[15] ASIC Report 578 Review of Proxy Adviser Engagement Practices, page 6. Of the 80 reports ASIC reviewed, engagement with companies occurred in in 65 cases. In 11 cases, the proxy adviser offered to engage but the company declined or did not response. In two cases, the company requested engagement but the proxy adviser declined, and in two cases there was no contact with the company

[16] ASIC Report 578 Review of Proxy Adviser Engagement Practices, page 8

- If it is intended that a draft report will be provided to the subject company, proxy advisers may wish to consider doing this in a controlled way, for example, without communicating recommendations or opinions that would be included in the final report.
- Proxy advisers should be transparent about engagement in their reports, including considering disclosing the nature, extent and outcome of engagement, and a summary of the company's view on a particular issues where that view is different from the proxy advisers', or any additional information that has been provided by the company as a result of engagement.

International Practice

While the UK and the US have, in the past few years, regulated in respect of proxy advice, the international provisions are generally focused on disclosure rather than prescriptive requirements. Indeed, some of the options set out in the Treasury Consultation paper are similar to initial proposals made by the SEC under the Trump administration.

Those proposals were the subject of significant criticism on the basis that claims of errors in reports were not established and that if implemented, the proposals would increase cost and compromise independence and quality. Ultimately, the proposal was significantly modified before approval. In particular, in late 2019, the SEC proposed to mandate company review of research reports prior to publication, as noted above, these rules were abandoned due to concerns over the costs and delays that they would create for investors.[17]" Modified rules were ultimately approved by the SEC in 2020 effectively requiring that proxy advice is made available to companies at the time advice is sent to clients.[18]

The United Kingdom's Proxy Advisors (Shareholders' Rights) Regulations 2019 set requirements for proxy advisers to:

- publicly disclose a code of conduct and explain how they have followed it. (Advisers can use the Principles in the UK Stewardship Code for Service Providers);
- disclose and implement a conflicts of interest policy;
- give assurance about the accuracy and reliability of their advice, including disclosures relating to:
  - the essential features of the methodologies and models applied;
  - the main sources of information used;
  - the procedures put in place to ensure that research, advice and voting recommendations are of an adequate quality and are prepared by staff who are suitably qualified;
  - whether the adviser takes account of national market, legal, regulatory and company-specific conditions, and if so, how;
  - the essential features of the voting policies applied for each market;
  - whether the adviser has a dialogue with the company, or with persons who have a stake in that company, and if so, the extent and nature of the dialogue; and
  - policies regarding the prevention and management of potential conflicts of interest.

The UK has had a Stewardship Code since 2010. The UK Stewardship Code 2020 states that it 'sets high stewardship standards for those investing money on behalf of UK savers and pensioners, and those that support them.' It defines stewardship as the' responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society'. The Code provides guidance to the whole of the market by setting out principles for asset managers and asset owners, along with separate principles for service providers (including proxy advisers). The UK Code operates on a 'comply or explain' basis. The Code promotes the identification and response to systemic risk by service providers[19], supports the integration of material ESG issues and requires an explanation of how clients' views and feedback are taken into account in the provision of their services[20], along with any conflicts of interest[21].

[17] SEC, Exemptions from the Proxy Rules for Proxy Advice: A Small Entity Compliance Guide, June 2020 - https://www.sec.gov/corpfin/exemptions-proxy-rules-proxy-advice-secg
[18] SEC, Rule 14a-2(b)(9).
[19] UK Stewardship Code principle 4
[20] UK Stewardship Code principle 5
[21] UK Stewardship Code principle 3

1: Disclosure of trustee voting.

The Consultation Paper is seeking views on whether superannuation funds should be required to disclose more detailed information in relation to their voting policies and actions for each financial year. The details to be disclosed could include how votes were exercised, whether any advice was received from a proxy adviser and who provided the advice.

If proxy advice is received, views are also sought on disclosure to include information on whether the voting actions taken were consistent with the proxy advice.

Current requirements and market practice:

Funds are already required to make disclosures in relation to their voting activity. The Superannuation Industry (Supervision) Act[22] requires funds to make certain information publicly available on their website. Relevantly, this includes the following information:

- a summary of the conflicts management policy;[23]
- the proxy voting policies;[24] and
- a summary of when, during the previous financial year, and how the entity has exercised is voting rights in relation to shares in listed companies.[25]

Many funds already go beyond the regulatory requirements to provide more detailed disclosures, including disclosure in relation to how the fund voted on each resolution of a listed company in which it is invested. This includes providing resolution level disclosures in relation to their voting activity, whether they receive proxy advice, and which advisers they use. ACSI's website transparently discloses the identity of its members.

Further, in May 2018, ACSI, along with its members developed the Australian Asset Owner Stewardship Code. The Code supports the transparency and accountability of stewardship activities in Australia. The majority of ACSI members are signatories to the Code. Signatories to the Code are required to disclose their approach and outcomes regarding key stewardship activities: voting, engagement, policy advocacy and the selection, appointment and monitoring of external asset managers. The Code is principles-based, which allows asset owners to approach stewardship in a manner that is consistent with the spirit of the principles and reflective of their size, resourcing, membership and investment policies, with members best financial interests paramount.

Response to Consultation proposals

ACSI supports the principle of greater transparency of voting practices. This is demonstrated by the development of the Australian Asset Owner Stewardship Code, and our support for enhanced disclosure, as far back as 2012 during consultation on the My Super legislation.

Discussion on any further disclosure obligations should focus on how the voting process works, rather than whether recommendations from proxy advisers were followed. This is because there is not one single determinative factor in a fund's voting decision. Rather it is the outcome of a number of considerations which are taken into account, with beneficiaries' best financial interests paramount. While a fund may (or may not) vote in line with proxy advice, ultimately a vote is the product of a number of inputs, particularly in respect of contentious resolutions. Some funds may also receive advice from more than one proxy adviser and more than one fund manager.

In order to provide information that is of value to superannuation fund members, consideration of further options for disclosure should therefore primarily focus on how the voting process works. Disclosure of voting policies and procedures, including how decisions are made (which could include, generally, whether proxy advice is received and how it is used), is preferable to whether individual voting decisions were consistent with proxy advice received.

Given the current practice of funds and the existing industry codes, our view is that any further guidance should aim to drive consistency across the entire market. Should further regulation be considered necessary, we recommend that Treasury consider engaging the industry to develop a Code that promotes best practice and operates on a 'comply or explain' basis for the entire market, including managers and funds. Discussion should focus on promoting an understanding of how the voting process works, including the rationale for contentious votes. This approach would allow investors to adopt processes appropriate to their membership,

[22] Superannuation Industry (Supervision) Act 1993 (Cth) section 29QB
[23] Superannuation Industry (Supervision) Regulations 1994 Reg 2.38(2)(m)
[24] Superannuation Industry (Supervision) Regulations 1994 Reg 2.38(2)(n)
[25] Superannuation Industry (Supervision) Regulations 1994 Reg 2.38(2)(o)

size and resources, and explain why they have done so, with members best financial interests paramount. There are useful examples in Australia, such as the industry-developed Banking Code, which is enforceable by ASIC, or international examples, such as the UK Stewardship Code, which can be adopted under the relevant UK regulations.

Any further regulation would need to demonstrate that it is clearly in the best financial interests of beneficiaries – that is, a clear benefit to beneficiaries should be identified to support the cost of compliance with any additional regulation.

We set out additional information in response to the specific questions posed in the Consultation Paper below.

2: Demonstrating independence and appropriate governance.

The Consultation Paper seeks views on whether proxy advisers should be required to be 'meaningfully independent' from a superannuation fund they are advising, along with views on whether proxy advice should be provided to and used by superannuation funds on an 'arm's length' basis. The Paper seeks feedback on whether trustees should be required to outline publicly how they implement their existing trustee obligations and duties around independent judgement in the determination of voting positions.

Current market practice:

Funds already operate independently of their proxy advisers. Funds independently consider both whether to receive advice, and whether to follow the advice received, guided by their fiduciary duty.

Proxy advisers' recommendations are one part of research. Voting research provides more than just voting recommendations, it assists funds identify which of the thousands of resolutions each year may be contentious and worthy of further, more detailed consideration. There are also other inputs into a trustee's voting decisions. They include advice from fund managers, third party data providers, 'sell-side broker research' and investors' direct engagement with their investee companies.

ACSI's members do not collectively determine their voting positions through ACSI. In addition, there are many examples of funds voting differently from their proxy adviser's recommendations. Not all members subscribe to ACSI's voting research[26], and in relation to contentious resolutions, practice shows that our members vote differently to our recommendations on many occasions.

In early 2019, ACSI undertook an internal review of its 2018 voting recommendations for the ASX200 compared to the company's recommendations and three member funds' voting decisions[27].

The vast majority (85 per cent) of the resolutions followed the company board's recommendation and were not contentious. Of the remaining 256 resolutions (that is, where ACSI recommended against the resolution or at least one fund opposed the board's recommendation), the data shows that voting decisions were not the same across the three member funds in 58 per cent of cases. The voting decisions by individual funds differed from ACSI's recommendation between 15 per cent and 44 per cent of the time. The range reflects the different approaches taken to different resolutions. These examples clearly demonstrate that ACSI members act independently. This analysis also doesn't consider the underlying rationale for a particular vote, it focuses only on whether it was consistent with other funds or with ACSI recommendations.

Further, in the context of proxy advice, the relationship that is the focus of regulatory guidance[28] and existing market practice is that between proxy adviser and the companies they are assessing. For example, ASIC's Review discusses independence in the context of a proxy adviser from the companies that are the subject of their reports[29] and 'maintaining independence from companies (including preventing receipt of non-public information and avoiding undue influence)[30]. Internationally, the focus in also on alignment with the best interests of clients.[31]

Proxy advisers' recommendations are already made independent of both their clients and the subject companies. Funds and other clients may have input into the overarching principles that guide proxy advisers' recommendations. For example, ACSI members have input into ACSI's Governance Guidelines, which are the principles that guide the exercise of professional judgement in making voting recommendations. The

[26] Currently 19 of ACSI's 36 members subscribe to ACSI's voting research.
[27] The three funds were selected on a random basis as a representative sample as aligning and comparing nearly 2000 resolutions across the 19 subscribers (at that time) was not practical.
[28] ASIC Regulatory Guide 79
[29] ASIC Report 578 Review of Proxy Adviser Engagement Practices page 6
[30] ASIC Report 578 Review of Proxy Adviser Engagement Practices page 8
[31] UK Stewardship Code principle 3

Guidelines are principles based, so as to allow appropriate flexibility and judgement in considering voting recommendations. In exercising its judgement when making recommendations, ACSI is entirely independent from any one member, and from its members as a whole.

In addition, proxy advisers in Australia hold AFS licenses, under which they have an obligation to ensure services are provided efficiently, honestly and fairly, have appropriate arrangements for the management of conflicts of interest and maintain competence to provide the services [32]. AFSL compliance is audited.

Response to Consultation proposals

ACSI strongly opposes this proposal and sees no basis or rationale for it. Contrary to the stated aims of the consultation, this has the capacity to cause harm to the beneficiaries of our member funds, through increased cost and less effective risk management.

It is unclear what is meant by 'meaningful independence' and which trustee duty 'around independent judgement in the determination of voting positions' is the subject of consideration. In any event, the suggestion in the Consultation Paper that membership of an organisation that provides proxy advice somehow results in joint determination of voting positions is wholly incorrect. Our member funds determine their own voting positions. As set out above, proxy advice is one input into a voting decision, and there are many instances where funds do not follow a proxy adviser's recommendation.

The Consultation Paper also asserts, without presenting any evidence, that proxy advisers may have broader objectives than the best financial interests of beneficiaries. Clearly, proxy advisers are not subject to the same duty as superannuation fund trustees. However, for advice to be of benefit to trustees, advisers must be focused on members' best financial interests. Indeed, alignment (whether contractual or membership based) between adviser and clients promotes a focus on beneficiaries' best financial interests. As set out above, ACSI's objectives and operations are completely focused on trustee duties and the best financial interests of superannuation fund members.

Our model offers significant efficiencies by eliminating the need for trustees to undertake detailed company research themselves. The model also provides efficiencies for ASX listed companies, where they can engage collectively rather than on an individual basis.

The proposal also lacks generality, a core principle of the rule of law. There is no sound argument as to why one type of shareholder – a superannuation fund – requires regulation of how voting rights are exercised when other investors do not. Why should, for example, fund managers be able to have equity in their proxy adviser whereas superannuation funds should not?

There are no international precedents for the suggestion that a fund should not harness the significant efficiencies that come from membership of an engagement and proxy adviser. Conversely there are many examples of organisations with a similar structure that harness significant efficiencies, for example the UK's Investment Association which has an Institutional Voting Information Services, Federated Hermes EOS, which is owned by an investment manager, and others including BTPS and management, offers stewardship services in respect of engagement, voting and advocacy. Eumedion Corporate Governance Forum also offers its members various services in the field of corporate governance and sustainability (including alerts for controversial resolutions), with membership open to all institutional investors that hold shares in Dutch listed companies.

Therefore, no regulatory change is required to demonstrate independence and appropriate governance over funds voting decisions. Funds are already required to disclose their proxy voting policies, which incorporate the factors taken into account in voting, how voting operates in practice and how judgement is applied in determining the ultimate voting positions.

In addition to the information set out above, below are our views in relation to the specific questions posed in the Consultation Paper below.

Consultation questions

1. How would the proposed options affect superannuation fund members?

ACSI supports the principle of greater transparency of voting practices, including disclosure of voting policies and procedures, along with disclosure of voting outcomes. However, there is risk that some of the additional disclosure proposed (in relation to whether proxy advice was followed in specific cases) would adversely impact beneficiaries by imposing a significant regulatory burden for no benefit. In addition, such disclosures could be misleading, given that there is not one single

[32] *Corporations Act 2001*(Cth) sections 912 A(1)(a); 912A(1)(aa) and 912A(1)(e)

determinative factor in a fund's voting decision. Rather voting is the outcome of a number of considerations which are taken into account, with beneficiaries best financial interests paramount.

The discussion on 'meaningful independence' fails to take account of the significant efficiencies that come from shared membership of an engagement and proxy service provider, and therefore would compromise the best financial interests of superannuation fund members. It is also out of step with international comparators.

Current market practice demonstrates that the decision of how an individual superannuation fund or asset manager wishes to vote is made independently of the advice received.

2. *What impact would the proposed options have on superannuation funds in complying with these regulatory requirements?*

Disclosure of voting actions and policies (including whether or not the fund has engaged the services of a proxy adviser) is already widely regarded as good practice across the market. More detailed disclosure in respect of whether voting actions taken are consistent with proxy advice would be misleading. Such disclosure is not recommended. Alternatives that focus on promoting an understanding of how the voting process works, with a focus on the rationale for contentious votes on a comply or explain basis should be the subject of further industry consultation.

3. *What should be the regularity and timing of reporting? For example, should trustees be required to provide their proxy voting policy to members ahead of an AMM?*

Proxy voting policies are already required to be disclosed on a fund's website.

4. *What other information on how voting is informed by proxy advice should be disclosed by superannuation funds and why?*

Disclosure should promote an understanding of how voting considerations happen in practice, including the many factors that go into a voting decision. This is usually done through disclosure of voting policies.

5. *What level of independence between a superannuation fund and a proxy adviser should be required?*

The primary relationship in focus when considering independence should be between the adviser and the company upon which the advice is being prepared.

Funds should retain discretion to choose whether to receive proxy advice, and to vote in the manner in which they consider best supports the best financial interests of their beneficiaries, consistent with current regulation.

6. *Which entity should the independence requirement apply to (superannuation fund or proxy adviser)?*

The proxy adviser should be independent of the company that is the subject of research and advice.

Funds should retain discretion to choose whether to receive proxy advice, determine their own voting positions, regardless of whether they take advice or not, consistent with current regulation and practice.

3: Facilitate engagement and ensure transparency.

The Consultation Paper is seeking views on whether proxy advisers should be required to provide their report containing the research and voting recommendations for resolutions at a company's meeting, to the relevant company before distributing the final report to subscribing investors. If so, the Paper also seeks views on appropriate time periods.

Current market practice:

Proxy advisers generally provide copies to companies at the same time, or shortly after they are provided to clients. This approach is consistent with the recommendations set out in ASIC's Review and with the approach recently adopted in the United States by the SEC.

ACSI already has a good level of engagement with listed companies across Australia. Effective engagement is based on a commitment to understand the perspectives of the company. Each year, ACSI holds over 300 meetings with listed company representatives, to support our understanding, and ensure company information is taken into account when providing our advice. We actively seek to discuss contentious resolutions with the relevant company. We do not refuse company requests for meetings.

ACSI's standard process is that companies receive our advice free of charge at the same time, or immediately after it is published to subscribers. That allows companies to both respond to us and directly to their investors. Companies have an opportunity to respond to the research reports we produce. ACSI has shared hundreds of reports with issuers over the past decade and has never had a significant factual error identified in its research. Where minor points have been identified – which are usually typos - our reports are updated accordingly. One recent example of a minor factual error was in relation to a director's age. While this did not go to our recommendation, we updated the report accordingly.

Response to Consultation proposals

Given the current levels of engagement between investors and companies in Australia, and existing practice outlined above, there is no need for regulatory intervention to facilitate engagement. The Consultation Paper has not identified issues that require remedy.

Requiring proxy advisers to provide their recommendations to companies in advance of clients would compromise quality and provide an inconsistent standard across the market. For example, there is no equivalent sell-side requirement to provide reports to companies. ASIC's Regulatory Guide 79 is clear that research should not be shared outside the research provider before the report is provided to clients. While fact checking is acceptable, this needs to be done in a carefully controlled way without communicating the recommendations contained in the report.[33] There have also been examples in the market where companies have used proxy advisers' recommendations in an attempt to influence other advisers' recommendations – clearly problematic when considering the independence of advice. This could be exacerbated if companies are provided with recommendations in advance.

If implemented, the proposal would result in a reduction in quality or an increase in costs, given the relevant timelines. This would act to adversely impact the best financial interests of beneficiaries. Notices of meeting are generally provided 28 days ahead of the relevant meeting. Compressing the timeline to provide proxy advice to companies in advance would either compromise the time available to research and analyse company data, or the investors' time to analyse the advice and form their own opinion on voting. The proposal would also effectively reduce the time available for engagement between companies and investors on issues that have not been previously discussed (for example shareholder proposals).

In addition, there is no international precedent for the proposal that reports be provided to companies in advance of clients. The option outlined in the Paper is similar to one proposed by the Securities and Exchange Commission (SEC) in the United States, which was the subject of significant criticism, and ultimately the SEC did not proceed with the proposal that companies be provided proxy advice in advance of clients.

This proposal also lacks generality. Why should proxy research be subject to these rules, but not other investment research like sell side research analysis, which sometimes includes information related to voting items? Why not short seller's research? These have far greater potential to impact financial market integrity and companies than does proxy advice.

Therefore, our view is that current market practice is appropriate.

In the event a regulatory response is considered necessary, relevant standards should reflect current practice and international standards, for example the provision of the report to companies at the same time or immediately after it is provided to clients. This could be achieved through an appropriate Code that supports the whole of the market to adopt good practice, while retaining flexibility for market participants to choose the practices that support engagement that best suit it, and disclose accordingly.

4: Make materials accessible.

The Consultation Paper seeks feedback on whether proxy advisers should be required to notify their clients on how to access the company's response to the report. This could be through providing a website link or instructions on how to access the response elsewhere.

Current market practice:

Companies have clear lines of communication to their investors. ASX listed companies have the ASX platform available to them as an appropriate channel to ensure all investors are equally informed. Companies can also communicate directly with investors, including where they disagree with an advisor's opinions.

The Australian market features a high-level of engagement between companies and their owners. Consistent

[33] ASIC Regulatory Guide 79 Paragraph 79.141

with ASIC's recommendations, ACSI's voting recommendations include (as appropriate) information on the nature, extent and outcome of engagement, and a summary of the company's view on a particular issues where that view is different from ours, along with additional information provided by the company through engagement. Where material new information is provided by a company, we revisit our recommendations and consider whether change is necessary. For example, in October 2020 we changed our recommendation from 'against' to 'for' in respect of two resolutions after the company publicly announced changes to its incentive hurdles for executive pay. In May 2021, we issued an updated report after additional information was provided about a company's incentive hurdles, although in that case we did not consider a change in recommendations was necessary.

Response to Consultation proposals

There is ample opportunity for companies to communicate with their investors ahead of company meetings. Nonetheless, where a company provides a link to additional information that is not market sensitive, proxy advisers could reasonably pass that on to clients.

Consultation questions

7. How would the proposed options affect the level of engagement by proxy advisers with companies?

Given the existing good levels of engagement across the market, option 3 will not provide any additional benefit. It will only add red tape that potentially compromises independence and quality, with no gain for members of superannuation funds.

Requiring proxy advisers to provide their recommendations to companies in advance of clients would also provide an inconsistent standard across the market. The proposal would result in a reduction in quality and/or an increase in costs, adversely impacting the best financial interests of beneficiaries. Compressing the timeline to provide proxy advice to companies in advance would either compromise the time available to research and analyse company data, or the investors' time to analyse the advice and form their own opinion.

ACSI already provides a copy of our advice to the subject company, free of charge, at the same time or immediately after it is provided to members.

8. Would the proposed options mean that investors are more likely to be aware of a company's position on the proxy advice they are receiving?

No, as set out above, investors are already aware of the company's position.

Companies communicate their voting recommendations directly to investors, though the notice of meeting and other documentation. Companies' voting recommendations are presented on the first page of each of our reports.

In addition, ACSI already takes the company's perspective into consideration when formulating our recommendations. The vast majority of recommendations in the Australian market are in line with the company's approach. The remaining contentious recommendations are the subject of detailed consideration, by companies, advisers and investors. On the rare occasions that a company provides us with material new information, we consider whether our advice requires updating. Where that information is material, we pass it on to our members.

9. What is the most appropriate method for proxy advisers to notify their clients as to where the company's response to its report is?

It is most appropriate for companies to directly notify investors of information that they consider investors need to know.

Companies are best placed to assess the appropriate way to communicate with their investors, whether through the ASX platform, or otherwise, given a company's obligations to communicate market sensitive information through the ASX platform. Nonetheless, if it is considered there is a need for proxy advisers to also pass that information on to clients, electronic notification would be most appropriate.

10. If proxy advisers were required to provide their reports to companies in advance of their clients, what would an appropriate length of time be that allows companies to respond to the report and for the report to be amended if there are any errors?

There has been no evidence of errors across reports that require response. For the reasons set out above, proxy advisers should not be required to provide their reports to companies in advance of their clients.

The proposal in the Consultation Paper that companies be provided with a proxy adviser's recommendations in advance of clients is inconsistent with other parts of the market, out of step with international examples and would result in increased cost and decreased quality, neither of which is in the best financial interests of the members of Australia's superannuation funds.

11. Are there any requirements that should be placed on companies during this period, such as confidentiality? Are there any requirements that should be placed on proxy advisers during this period, such as not making their recommendation otherwise publicly known?

As set out above, proxy advisers should not be required to provide their reports to companies in advance of their clients. Where reports are provided to companies at the same time (or immediately after) they are made available to clients, intellectual property rights remain with the proxy adviser who should determine the conditions under which the advice is provided.

5: Ensuring advice is underpinned by professional licensing.

The Consultation Paper seeks opinions on whether proxy advisers should be required to obtain an AFSL for the provision of proxy advice. The Paper sets out that the purpose of the license would be to ensure that there is appropriate oversight of proxy advisers and that they have the necessary care and skill required.

Current market practice:

ACSI holds an AFSL and we understand that the other proxy advisers in the market all hold an AFSL.

Response to Consultation proposals

The Consultation Paper does not outline why or how the AFSL regime should be extended, nor take into account that proxy advisers already hold an AFSL. The Consultation Paper states that the purpose of the license would be to ensure that 'proxy advisers are making assessments on issues that have a material impact on the conduct of business in Australia with appropriate regulatory oversight and the necessary care and skill required'.

As was outlined in ASIC's Report, proxy advisers are already subject to regulatory oversight. ACSI holds an AFSL, and takes compliance with the relevant provisions seriously. We have never breached any of the requirements of our license.

In addition, we must comply with s1041H of the Corporations Act which states that a person must not engage in conduct, in relation to a financial product or a financial service, that is misleading or deceptive or is likely to mislead or deceive. This applies whether or not the activity is conducted under an AFSL.

If poor practice is identified, ASIC can take action against ACSI (or any other proxy adviser) under either of these provisions. ASIC has well-established powers to impose individual license conditions, or even cancel a license, in the event that a provider that does not comply with the terms of its AFSL.[34]

Proxy advisers are already required to ensure care and skill, in the preparation of their advice. This is for a number of important reasons, including to ensure compliance with AFSL conditions and the misleading or deceptive conduct prohibitions, and to ensure that advice meets the needs of clients, who in turn have obligations to act in the best financial interests of their beneficiaries. Advisers are accountable to their clients through both the Corporations Act provisions, and contractually.

The detailed and recent review of the industry by ASIC indicates that appropriate oversight already exists. ASIC reviewed policies, practices and reports from proxy advisers and did not find evidence of harm or wrongdoing in the market. ASIC's recommendations have been widely adopted, indicating that proxy advisers generally appreciate the need for continued good practice.

In addition, it is possible that particular rules around proxy advice would create licensing obligations for a range of opinions from other participants across the market such as proxy solicitors, and even media, on a variety of issues such as executive pay or shareholder proposals.

Consultation questions

12. Is the AFSL regime an appropriate licensing regime through which to regulate the provision of proxy advice?

Given that proxy advisers already hold an AFSL, it is unclear what additional regulation the option proposes.

[34] ASIC Regulatory Guide 98

Proxy advisers are already subject to the AFSL regime, along with regulatory oversight through additional provisions of the Corporations Act which apply whether or not the activity is conducted under an AFSL. In addition, there is already significant oversight and scrutiny over the practices of proxy advisers, as demonstrated through ASIC's Review.

There has been no case made for the establishment of any industry wide conditions that would apply only to providers of proxy advice. There is no evidence of harm that would provide the rationale for such further regulation, and no basis for such a distinction.

13. Would coverage under the AFSL regime result in an improvement in the standard of proxy advice?

No. The standard of advice is already high. Neither clients of advisers, nor companies have pointed to significant quality issues across the market.

Proxy advisers are already subject to regulatory oversight, through the AFSL regime and through other provisions of the Corporations Act. Proxy advisers must comply with s1041H of the Corporations Act which states that a person must not engage in conduct, in relation to a financial product or a financial service that is misleading or deceptive or is likely to mislead or deceive. This applies whether or not the activity is conducted under an AFS licence.

In addition, proxy advisers are subject to the very high expectations of their clients, who as superannuation fund trustees must ensure that funds spent on proxy advice is in the best interests of their members. This is a clear incentive for proxy advisers to ensure that their product is relevant, of high quality and focused on the best financial interests of superannuation fund beneficiaries. Failure to do so would soon see a provider's clients seek advice elsewhere.