BCA
Business Council of Australia

Greater transparency of proxy advice

Submission to Treasury Consultation Paper

June 2021

Contents

Key points 2
Overview 3
BCA priority reforms 4
The need for reform 4
Support for BCA priority reforms 7
Comparable regulation in comparable jurisdictions 10
Comments on specific proposals in the Consultation Paper 11
Response to Consultation Paper questions on independence 12

Key points

- Proxy advisers are an important part of Australia's corporate governance system and provide a valuable service for investors.
- They are part of a system that imposes obligations of accountability and transparency on companies. Similar standards should apply to proxy advisers as apply to all other participants in financial markets.
- The BCA strongly supports Options 3 and 4 in the Consultation Paper to require engagement and transparency between proxy advisers and companies and to require proxy advisers to make materials accessible to companies, in order to address concerns regarding factual accuracy.
- These reforms will be to the benefit of the shareholders that proxy advisers represent, as they will ensure a transparent, two-way flow of information with companies, to enable shareholders to make fully informed decisions. They will not in any way limit the freedom that proxy advisers currently have to make any recommendations they deem fit.
- Importantly, these reforms represent the existing practice of many proxy advisers, including under codes of conduct in other jurisdictions that proxy advisers have voluntarily signed up to. They also reflect recent developments in the regulation of proxy advisers in the United Kingdom and the United States.
- Currently, proxy advisers are not subject to any obligation to provide their advice, research or recommendations to companies. This allows inaccurate reports to be provided to shareholders, with little or no opportunity for companies to respond to inaccuracies. This can result in proxy advisers making recommendations that negatively impact the value of companies, or influence shareholder votes based on misconceptions. This also often results in companies having discussions with shareholders about information from proxy advisers without having access to the information themselves.
- These reforms should also be accompanied by stronger measures to require proxy advisers to disclose and manage any actual or potential conflicts-of-interest, in line with best practice in other jurisdictions.
- BCA members do not believe it should be necessary for proxy advisers to be independent of funds, as independence itself will not necessarily improve the quality of proxy advice. Provided that proxy advisers are required engage with companies and act in a sufficiently transparent manner, they should not be prevented from maintaining their current ownership arrangements.
- The proposed reforms outlined in this submission are modest and measured changes that will improve the quality of proxy advice and benefit shareholders and companies alike. They do no more than ensure that Australia's system of regulation keeps pace with best practice elsewhere.

Overview

This is the submission of the Business Council of Australia (BCA) in response to the Treasury Consultation Paper *Greater transparency of proxy advice*, released in April 2021 (the Consultation Paper). The Consultation Paper followed the Treasurer's announcement of proposed reforms to the regulation of proxy advisers on 30 April 2021.[1] This announcement indicated that the consultation process would consider reforms that would require proxy advisers to:

1. Obtain an Australian Financial Services License (AFSL) for the provision of proxy advice;
2. Provide their research and voting recommendations to the company that is the subject of their report at least five business days before providing it to their clients;
3. Notify their clients how to access the company's response to the report; and
4. If their client is a superannuation fund, be independent from their client.

The BCA strongly supports proposals 1, 2 and 3. The fourth proposal is unlikely to be necessary if the first three are implemented. In particular, the BCA strongly supports the two proposals to require engagement by proxy advisers with companies and enable their clients to be provided with the companies' responses. These are modest and necessary changes that will enhance the operation of financial markets by introducing higher standards of accountability for proxy advisers and, most importantly, improve the quality of the service they provide to investors. They will update the regulatory regime governing proxy advisers to better reflect the significant role they play in the economy.

These changes will be to the benefit of shareholders and markets more broadly. Ultimately, the company and company directors have strict obligations to act in their best interests of shareholders and provide accurate and timely information. Similar obligations should also apply to those who advise shareholders. These obligations should work in tandem to drive higher standards of accountability for all parties who have responsibilities to shareholders.

The consequences of incorrect proxy advice can be far-reaching because of the consequential loss it can cause. It can affect confidence in a company by large shareholders that adversely impacts its share price. It can change the outcome of voting at meetings by preventing the election of suitable candidates to company boards or, more significantly, prevent a significant corporate action from being undertaken such as a takeover or restructure.

The proposed reforms will assist in better enabling shareholders to make fully informed decisions. They will not diminish the freedom that proxy advisers currently have to make recommendations to their clients as they see fit. Moreover, the priority reforms supported by the BCA are consistent with reforms recently introduced in comparable jurisdictions, with the agreement of proxy advisers. Such reforms will update Australia's system of regulation to keep pace with international best practice, which we currently lag.

[1] "*Greater transparency of proxy advice*", media release, Treasurer and Minister for Superannuation, Financial Services and the Digital Economy, 30 April 2021

BCA priority reforms

Members of the BCA strongly support for the following three reforms. These are measured and incremental changes that reflect the practice adopted elsewhere, in particular reforms recently implemented in the United Kingdom and recently proposed in the United States.

Opportunity to review and respond before publication

Proxy advisers should be required to provide their report to the company at least five days before circulating it to investors, as proposed in the Consultation Paper, providing the company with an opportunity to correct factual and other errors, or even disagree with the analysis if they wish.

This will materially improve the quality of the reports. Importantly, it will not impose any limits on the ability of proxy advisers to provide advice or adopt certain positions. The advisers will remain free to say whatever they like. Nor is there any loss of intellectual property in a report that is going to be provided to the company and widely distributed.

Identification of the shareholders to whom the report will be sent

Proxy advisers should be required to provide this information to aid the company in managing the relationships with their shareholders. This will also create material efficiencies for company management, ensuring a timely flow of information between the company and shareholders to better enable shareholders to make fully informed decisions.

Proxy advisers should be licenced

Proxy advisers should be required to hold an AFSL where they do not already do so. They are providing a form of financial advice and should be required to meet and uphold similar standards to others who also provide financial advice. Licensing obligations should incentivise them to provide a higher quality product, as they will be able to be held accountable not just by their immediate clients but also through regulatory scrutiny. While the UK and US largely do not have comparable licensing obligations, proxy advisers are subject to regulatory obligations similar to what would be achieved by an AFSL (as outlined below).

The need for reform

Proxy advisers now play a significant role in financial markets through the advice they provide to institutional investors on how these investors should exercise their rights as shareholders. The importance of this role is steadily growing.

In recent years the increasing presence of Exchange Traded Funds (ETFs) as investors in listed companies has led to proxy advisers exercising even greater influence. ETFs in general do not cast votes on corporate matters and fund managers often mandate them to vote in accordance with the recommendations of a specific proxy adviser. It is important to note that in many cases, typically involving non-Australian funds, the funds are contractually obliged to always vote in accordance with the adviser's position, regardless of the feedback provided by the company. When this occurs, proxy advisers cease to be 'advisers' and are direct proxies, acting on behalf of shareholders. However, the current regulatory regime does not impose on them similar obligations of accuracy and accountability that the company itself has to its shareholders.

Companies that are the subject of proxy advice are required to meet a range of obligations to ensure accurate and timely disclosure of information. Australia's continuous disclosure regime is one of the most stringent in the world in terms of the obligations it imposes on companies to release information. Whilst some proxy advisers adhere to similar standards, there is currently no legal requirement for them to do so. There is a very rigorous standard for company directors and a much lower standard for proxy advisers.

The absence of enforceable standards

In comparison to listed companies and other forms of financial advice, proxy advisers are currently subject to lower standards and, as a result, lower expectations. In many cases proxy advisers provide high-standard advice, but in other cases the quality of their advice can be variable. The regulatory regime should require them to uphold similar standards of accuracy that apply to other participants in financial markets. Nor are they subject to sufficient standards regarding the management of potential or actual conflicts-of-interest. For these reasons it has been said that they are the most "opaque" part of Australia's system of corporate governance.

There is currently no obligation on proxy advisers to engage with a company before issuing their reports. Whilst some advisers choose to do so, where this does not occur it is not uncommon for reports to include factual inaccuracies or information that is out-of-context. In some cases, proxy advisers are willing to correct the information they provide. In other cases, they are not, as set out in the examples below.

Shareholders are entitled to accurate advice and transparency about the justifications for the recommendations made by their advisers. Whilst advisers can conduct themselves in an appropriate manner, the current regulatory regime does not require them to do so. The gaps in the regime have enabled some advisers to engage in practices that fall short of the obligations that apply to companies.

At present there is no effective regulatory restraint on advisers acting recklessly in relation to inaccurate information. The system relies, to an extent, on the goodwill of advisers. Companies are unable to effectively respond to inaccurate statements given the tight timeframes that are often involved. Reforms recently proposed in the USA are intended to address this issue introducing a new requirement that clients of advisers be *"provided with an efficient and timely means of becoming aware of any written responses"* by companies. [2]

Similar obligations have also been introduced in the United Kingdom, where proxy advisers are now encouraged to abide by a code of conduct and are required to "*provide a clear and reasoned explanation*" if they do not do so.[3] The most relevant code of conduct is the "Best Practice Principles" produced by the Best Practice Principles Group (BPPG), which is outlined in detail below. These Principles require proxy advisers to disclose how they provide companies with the opportunity to review information used in their reports and inform clients of any amendments to their reports as a result of factual errors.

Options 2 and 3 set out in the Consultation Paper propose solutions that will address these issues and give companies the opportunity to engage with proxy advisers on their reports prior to publication, in order to enhance the efficacy and accuracy of the reports.

The variable quality of proxy advice

The quality of the reports produced by proxy advisers is variable. In some cases, the advisers' work is of a very poor quality, with material factual errors or fundamental misunderstandings or confusion as to the substance and effect of proposals to be put to a meeting of shareholders. These problems are more likely when the adviser is not based in Australia and/or acting for a foreign-based fund.

In two similar cases, a financial services company and a resources company proposed several amendments to their constitutions to improve governance arrangements. Due to proxy advisers making recommendations against the proposals, a number of amendments had to be withdrawn. The proxy advisers had clearly misunderstood that the intention and effect of the proposed amendments would have helped institutional shareholders and were for other shareholders perfectly innocuous. In each case, the proxy advisers' reports had been outsourced to offshore staff with no understanding of Australian market practice.

In one case in 2016, the proxy advice from ISS was criticised for being based on a factually inaccurate analysis that was the result of a 'formulaic' approach. In this case ISS had committed to providing the report to the company prior to it being published but reneged on this commitment, requiring the company to correct the

---

[2] US SEC Press Release – *"SEC Adopts Rule Amendments to Provide Investors Using Proxy Voting Advice More Transparent, Accurate and Complete Information"*, 22 July 2020: https://www.sec.gov/news/press-release/2020-161
[3] *The Proxy Advisers (Shareholders' Rights) Regulations 2019*

inaccuracy at its AGM. This was described by the company chairman as being *"contrary to what I would regard as common practice or good governance"*.

Where poor quality advice is prepared, companies spend an inordinate amount of time and money attempting to communicate with their investors to correct falsehoods or errors and rectify the damage done. This is particularly difficult for companies with large shareholder registers at times when a meeting is imminent.

Companies have also experienced problems with inconsistent positions taken by proxy advisers. In some cases, advisers have informed a company that they are supportive of a meeting resolution yet have then published reports recommending a vote against it, often having misunderstood the proposal and not left the company sufficient time or opportunity to address the issue.

In another case, a proxy advisor made a recommendation against the re-election of a director to the board of an industrial company (A), based on unfounded concerns they had about his performance on the board of another company (B). Their reasoning contained factual errors, but they refused to correct their advice. Company A was forced to attempt to contact shareholders to address the erroneous advice. Shortly thereafter, when the same director came up for re-election to the board of company B, the same proxy advisor supported their re-election to that board.

In a further case, a proxy adviser firm based its negative recommendation on the remuneration reports of a "peer group" of companies that it selected to benchmark the company that was the subject of its report. This group was not comparable with the company in terms of size, scope or complexity of operations. Each company in the "peer group" was, on average, one-fifth of the size, with not one single "peer" being larger. On the basis of this "peer group", the proxy adviser concluded that the executive remuneration levels were "too high" and recommended a "No" vote on the remuneration report resolution. In these circumstances, the company should have had the opportunity to outline its concerns to the proxy adviser prior to the publication of its report and suggest more relevant remuneration comparisons.

The need for engagement between proxy advisers and companies

A further problem with the current regime is that proxy advisers are free to distribute reports to investors without any prior engagement with the company, or the company being informed as to which investors will receive the reports. This compromises the open exchange of information between companies and investors that is essential for properly functioning markets.

It is very important for companies to know which investors receive reports on their company so they can present their view of the proxy adviser's assessments and recommendations to the investors before they cast their votes. Enabling companies to respond to advisers' recommendations should be an uncontroversial principle. It will also be a powerful tool to improve the quality of proxy advisers' work. Where minor mistakes have been made, it will enable companies to correct factual or contextual inaccuracies. In more serious cases where the advice is actually erroneous or reckless, investors will see the company rebuttals and the advisers will be accountable for the material and recommendations they have made. Whilst this will be embarrassing on some occasions for certain advisers, it will invariably act as an incentive for advisers to improve the depth of their research, the quality of their analysis and accuracy of their conclusions and recommendations.

Timeliness of proxy advice

Companies welcome the opportunity to engage proactively with proxy advisers. Where such engagement works well, this enables the company to provide information to the advisers well in advance of meetings, to better enable them to provide timely and accurate advice and appropriate recommendations.

This also enables advisers to foreshadow recommendations to vote against board proposals. In these circumstances, there ought to be sufficient time for the company to engage with the adviser, to ensure that the factual information on which such a recommendation is based is accurate, in context and fully understood in

terms of its intended purpose and effect. This will not in any way limit the freedom of the adviser to recommend against a company proposal.

Support for BCA priority reforms

The priority reforms outlined above are consistent with several previous reform proposals in Australia, as well as practices that have been implemented with the agreement of proxy advisers in other jurisdictions. These are as follows.

2018 ASIC Review

In June 2018, the Australian Securities and Investments Commission (ASIC) released a "*Review of proxy adviser engagement*". This Review considered some of the same matters raised in the Consultation Paper.

The Review noted that the key concerns identified by companies in its consultation process were instances where proxy advisers:

- appeared unwilling to engage with companies
- provided very short response times to companies to clarify issues
- failed to correct inaccuracies in reports

The Review included a proposal for "*good practice recommendations to encourage more effective engagement between companies and proxy advisers*."[4] Whilst it did not recommend that advisers be required to provide draft reports to companies, it did recommend that where they do so:[5]

- advisers should endeavour to provide sufficient time for the company to consider the request and respond
- proxy advisers may wish to provide draft reports in a 'controlled way', for example without including voting recommendations or opinions that will be included in the final report, in order to reduce disputes as to whether inaccuracies relate to facts or opinions
- advisers be transparent about their engagement with companies and any changes made to their reports as a result.

The findings of the ASIC review support the case for reform in these areas. The ASIC recommendations reflect what should be industry best practice. There is no reason why its recommendations should not be given effect as mandatory requirements under the regulatory regime.

Australasian Investor Relations Association Code

The Australasian Investor Relations Association (AIRA) published a draft Code for the engagement between listed companies and proxy advisers (Code) in May 2017.[6] This Code proposed that the following Principles should apply to proxy advisers:

1. Proxy advisory research should be factually accurate
2. Proxy advisory firms should be adequately resourced
3. Proxy advisory firms should be provided appropriate feedback
4. Management of conflicts of interest

[4] Page 3
[5] Page 8
[6] "*Clear, correct and conflict-free: Code for engagement between listed companies and proxy advisers*", Australian Investor Relations Association, 3 May 2017

5. Proxy advisory firms should report on a regular basis

Principles 1 and 3 relating to factual accuracy and appropriate feedback reflect the priority reforms proposed by the BCA. Principle 4 relating to management of conflicts of interest is also consistent with the approach taken by the BPPG outlined below. The endorsement of these principles by AIRA further demonstrates that they have broad support and ought to be uncontroversial.

The BCA endorses the following specific recommendations made by AIRA in its 2017 draft Code[7]:

Proxy advisory firms should:

- *Offer the company to which the research relates a small window of opportunity to review draft voting recommendations and correct factually inaccurate information;*
- *Be willing to engage with companies early and remain reasonably responsive to their consultation (including throughout peak periods if the issue is sufficiently important); and*
- *Take appropriate measures to verify information relied upon in undertaking their research.*

In relation to the management of conflicts of interest, the BCA further endorses the following AIRA recommendations in the draft Code[8]:

To manage actual or perceived conflicts of interest, proxy adviser firms should:

- *Implement a "Conflicts of Interest Policy" that details the appropriate restrictions and disclosure mechanisms for dealing with actual or perceived conflicts of interest;*
- *Install and maintain an information barrier between the research sector and corporation services sector of the proxy advisory firm's businesses;*
- *Prohibit employees from making comments in the media regarding companies which are the subject of their voting recommendations; and*
- *Publicly report any breaches of the "Conflicts of Interest Policy" on its website*

The AIRA report notes that[9]:

> *"Some proxy advisory firms have expanded their service offering to include the provision of ancillary governance and remuneration services… One concern is that if adequate information barriers are not established, listed companies may feel pressure to use the ancillary services provided by the firms."*

The BCA shares this concern. We are aware of examples of Australian listed companies that have been the subject of negative reports by proxy advisory firms in relation to remuneration and ESG issues then being approached by other arms of the same firm offering their assistance to rectify those issues. This represents an undeniable conflict of interest. Such practices diminish the credibility of proxy advisers and should not be able to arise. An effective regime for managing conflicts of interest should prevent them from arising.

In one case, a proxy advisory firm has both a research arm (which produces the recommendations to shareholders) and an advisory arm, which seeks to engage with the company based on the research team's negative reports. The advisory arm purports to offer proprietary advice on how best to affect the outcome of reviews by the research arm. The fact that the two arms have a common owner presents an inherent conflict - the more the research arm issues negative recommendations, the more potential work there will be for the advisory arm. In this case, prior to the company's AGM, it received multiple proposals from the advisory arm of the proxy adviser offering advice to the company on various issues. The proposals were based on the assessment and reporting of the firm's research arm, which rated the remuneration, governance structures and disclosures of the company in certain areas as "low".

---

[7] Principle 1, Recommendations (c)-(e), page 4
[8] Principle 4, Recommendations (a)-(d), page 7
[9] Page 7

The day after the AGM, the company received an email from the advisory arm of the firm noting the close voting result, raising its prior approaches to the company and strongly recommending its advisory services. The email attached:

- A screenshot of the proxy adviser firm's "in house" profile document on the company which included scores purporting to measure disclosure practices on a scale of 1 to 10, where "10" is the "*worst disclosure practices/highest concern*" in key governance areas. The remuneration report was scored at 9, with seven "*red flag*" ratings in the remuneration profile; and
- A proposal for the proxy advisory firm to provide advisory services to the company, whereby it would receive *"feedback and suggest[ed] enhancements and changes that will align [the company's] reporting with [the proxy adviser's] policy, (and) best practice and ensure it is presented in terms most likely to secure a positive response"* in future meetings.

The email suggested that the company could then be confident of improving its scores to *"meet the [firm's] expectations and practices"*. The offer from the proxy adviser firm was not acted on. The inherent conflict of interest was self-evident.

The Best Practice Principles Group

The Best Practice Principles Group (BPPG) is a UK-based organisation comprising proxy adviser firms and other firms that provide *"support services to professional investors and other capital markets participants"*.[10] It has produced its own Best Practice Principles (Principles)[11] by which its members agree to abide. Its members include Institutional Shareholder Services (ISS) and Glass Lewis. These firms both operate in Australia and have voluntarily agreed to abide by the Principles in relation to their proxy advice in other jurisdictions.

The Principles provide useful guidance for suitable reforms in Australia to ensure that proxy advisers apply best practice. Notably, the Principles include the following:

- Quality of Research: Advisers should have systems and controls in place to reasonably ensure the reliability of the information used in the research process. Advisers should disclose to what extent companies have the opportunity to verify, review or comment on the information used in research reports, analysis or guidance.[12] Advisers should alert clients to any verified factual errors or material revisions to published research or analysis without delay. Alerts should explain the reasons for any revision in a transparent and understandable way.[13]
- Communications: Advisers should inform clients about the nature of any dialogue with relevant parties in their research reports, which may also include informing clients of the outcome of that dialogue.[14]
- Timeliness: Advisers have a responsibility to provide clients with adequate and timely services, subject to the availability of source information from companies and shareholder resolution proponents.[15] Advisers should disclose how and to what extent relevant stakeholders can submit supplementary information for consideration in their research and analysis, taking into account relevant deadlines.[16]
- Conflicts of interest: Advisers must disclose without delay to their clients, on a case-by-case basis, actual or potential conflicts of interest or business relationships that may influence their research, advice or recommendations.[17]

The Principles recognise the desirability of engagement by advisers with companies and of those companies having the opportunity to verify and comment on factual information prepared by advisers. If the proxy adviser

[10] bppgrp.info
[11] https://bppgrp.info/wp-content/uploads/2019/07/2019-Best-Practice-Principles-for-Shareholder-Voting-Research-Analysis.pdf
[12] Principle One Guidance, 3(c)
[13] Principle One Guidance, 3(h)
[14] Principle Three
[15] Principle One Guidance, 7(a)
[16] Principle One Guidance, 7(b)
[17] Principle Two

industry can agree to abide by such principles outside Australia, there is no reason why equivalent principles should not also apply in Australia.

Comparable regulation in comparable jurisdictions

The BCA priority reforms propose that Australian practice should keep up with international best practice. At present, Australia is an outlier. Recent reforms in the United Kingdom and United States provide strong support and precedent for the proposed reforms.

United Kingdom

The Consultation Paper refers to recent reforms to the regulation of proxy advisers in the United Kingdom, stating that:

> *"the United Kingdom amended regulations in 2019 to require proxy advisers to disclose actual or potential conflicts of interests, disclose information about their research capabilities and how the research supports the advice and recommendations and disclose instances where there are deviations from the proxy adviser firm's code of conduct or why the firm has not adopted a code of conduct."*

These reforms were implemented in the *Proxy Advisors (Shareholders' Rights) Regulations 2019 – 2019 No. 926* (UK). The focus of these Regulations is on enhancing transparency in dealings with companies and protecting against conflicts of interest through public disclosure. They reflect the same concerns regarding engagement and accuracy of advice that are currently being expressed in Australia.

United States

The Consultation Paper also refers to similar reforms in the USA, stating that:

> *"The SEC adopted the final amendments which will come into effect in December 2021. The amendments specify that proxy voting advice generally constitutes a solicitation. They also provide exemptions from the information and filing requirements of the proxy rules, where the proxy adviser provides conflict of interest disclosure in their advice and has policies and procedures that:*
>
> - *ensure advice is made available to companies the subject of their reports before or at the time it is provided to their clients; and*
> - *they provide a mechanism for their clients to view any written statements by the companies in relation to their advice before the relevant meeting."*

As with the UK reforms, the US measures are primarily focussed on public disclosures to prevent conflicts of interest. The UK and US reforms are proportionate, workable and in response to clearly identified problems. They demonstrate that similar reforms in Australia should not be controversial.

On 1 June 2021, the US Securities and Exchange Commission (SEC) announced that it would review *"whether to recommend that the Commission revisit its 2020 codification of the definition of solicitation as encompassing proxy advice"*, among other matters.[18] This means that the implementation of the US reforms may now be unlikely, but it does not mean that the principles on which they are based are not sound and should not be followed. Proxy adviser firms in the US had been preparing to comply with the proposed new regulations. If global proxy advisory firms can comply with these regulations in US – the world's largest capital market – then there is no reason their Australian arms or domestic firms cannot manage similar requirements.

---

[18] *"Statement on the application of the proxy rules to proxy voting advice"*, SEC Chair Gary Gensler, 1 June 2021: https://www.sec.gov/news/public-statement/gensler-proxy-2021-06-01?utm_medium=email&utm_source=govdelivery

Comments on specific proposals in the Consultation Paper

The Consultation Paper proposes four specific reforms. The BCA's response to each of these proposals is as follows.

1. Requiring an Australian Financial Services License for the provision of proxy advice

Of the four major proxy adviser firms operating in Australia[19], all currently hold AFSLs for at least a portion of the services they provide.[20] Some already satisfy this requirement in relation to proxy advice, for example Ownership Matters.

If, as the proxy adviser firms have pointed out, they already hold AFSLs for other reasons, then there is no practical reason why they would not be able to accommodate being licensed for other purposes.

A requirement to hold an AFSL in itself will not address the key issues identified in this submission. However, it is desirable to have a recognised and consistent standard of conduct that applies to proxy advisers. An alternative approach may be to implement a proxy adviser-specific code of conduct, which is the approach that has been adopted in the UK (as outlined above). Ideally, both measures should be adopted.

2. Provide their research and voting recommendations to the company that is the subject of their report at least five business days before providing it to their clients

It is highly desirable for there to be an enforceable obligation on proxy advisers to engage with companies prior to the publication of reports.

Proxy advisers have been described as "gatekeepers" between listed companies and their largest shareholders. It is always preferable for such "gates" to be open so that companies and shareholders can engage in a two-way sharing of information. Where advisers publish recommendations without allowing a company an opportunity to respond, the gate to its shareholders is closed and the flow of information is one-way and unilateral.

The Consultation Paper states that it is already the policy of some proxy advisers to provide pre-publication drafts of reports to companies,[21] but feedback received from BCA members is that proxy advisers do not consistently follow their policies. Proxy advisers have on various occasions chosen not to engage with companies on their reports, or more seriously, have declined to correct factual errors when they are pointed out, notwithstanding their formal policy. Whilst such policies are desirable, they provide no assurance that they will be adhered to. Compliance is entirely at the discretion of the proxy adviser firms. As such, it is both desirable and necessary that the obligation to engage with companies and correct errors are enforceable obligations.

The BCA is concerned, given the timeframe of a minimum 28-day notice period for company meetings, that having only five days may not be sufficient in all cases for either companies or advisers to achieve the improvements in accuracy that are potentially required.

3. Notify their clients how to access the company's response to the report

This proposal is strongly supported and reflects recent reforms in the USA and UK (see above).

4. If their client is a superannuation fund, be independent from their client

Proxy advisers play an important role in providing a service to funds on a scale that the funds may not be able to provide themselves. Proxy advisers' level of independence from funds is not the key issue requiring reform.

---

[19] CGI Glass Lewis, Institutional Shareholder Services Australia (ISS), Ownership Matters, Australian Council of Superannuation Investors (ACSI)

[20] ASIC *Review of proxy adviser engagement practices*, June 2018, page 4

[21] ASIC *Review of proxy adviser engagement practices*, June 2018, page 5

Where an adviser has a relationship with a fund this should be publicly disclosed in an appropriate way (notably, this is in any event generally the case). This issue is considered further below in the following section.

Response to Consultation Paper questions on independence

The Consultation Paper has sought responses to six specific questions on the detail of the proposed reforms relating to independence from superannuation funds. These questions and the BCA's response are as follows:

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

The effect will vary depending on the nature of the arrangements between superannuation funds and their advisers. Overall, the proposals are intended to enhance the flow of information between listed companies and superannuation funds as shareholders.

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

The proposed options ought not impact on superannuation funds other than the requirement for independence. This would impose obligations on certain funds to put in place new arrangements to enable their advisers to be sufficiently independent. Once such arrangements are in place, the onus to comply with the reforms will rest with the advisers rather than the funds.

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 AGM?

As outlined above, the proposed requirement to provide reports to companies five business days prior to issue may not be sufficient in all cases for companies to consider reports, especially taking into account the further period then required for the proxy adviser to consider and amend their report if warranted. In some cases, up to ten days may be more appropriate. It is desirable for trustees (i.e. funds) to publish their proxy voting policies. This should not be controversial.

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

Responses of funds to proxy adviser recommendations should be provided on the web site of the fund, with proxy advisers required to provide their clients with links to those responses. Funds will still be free to adopt whatever policies they wish in terms of whether, or to what extent, they will follow the proxy advice. This should also be uncontroversial and should not affect the freedom that funds currently have to accept or reject the recommendations.

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

The Consultation Paper assumes that a greater degree of independence between superannuation funds and advisers is required. The BCA does not believe it is necessary for proxy advisers that currently have established relationships with superannuation funds to terminate those relationships in order to meet a new level of independence. A lack of independence is not the cause of the problems identified above, nor will a requirement for independence result in these issues being resolved.

It should be acknowledged that there are benefits in proxy adviser firms having a role in superannuation funds, in order to provide specialised advice services that individual funds may not be able to provide themselves. This creates economies of scale and the opportunity for more efficient engagement by businesses with multiple

funds via their proxy. It should also, in principle, improve the quality of advice received by the funds, given the expertise and resources of the advisers.

Where problems arise, they arise as a result of actual or potential conflicts of interest due to the relationship between the adviser and the funds, rather than a lack of independence *per se*. In such circumstances, what is necessary is a robust mechanism for dealing with such conflicts, rather than a blanket requirement for independence.

A more important issue than independence is ensuring sufficient transparency of arrangements between advisers and funds. In this respect the Principles developed by the BPPG outlined above provide helpful guidance to its proxy firm members which could serve as an appropriate model for Australia. The Principles do not require independence between advisers and funds but instead require that any potential conflicts of interest be appropriately disclosed and managed. The objective is to ensure transparency rather than mandate independence. The Principles provide that:

> *Proxy adviser firms should consider how the following non-exhaustive list of potential conflicts may materially impact their operations and how these potential conflicts may be addressed:*
>
> - *A firm's ownership or shareholder base/structure, such as when a firm is owned by an investor that owns shares in companies under coverage or when the investor is owned by an issuer under coverage;*
> - *A firm's employee activities, such as board memberships and stock ownership, etc.;*
> - *Investor-client influence on the firms, such as when an investor who is a client of the firm is a shareholder proponent or is a dissident shareholder in a proxy contest;*
> - *Companies' influence on the firm, such as when a firm provides consulting services to companies under coverage for research;*
> - *Influence of other investor clients.* [22]

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

The proposal to require independence from superannuation funds is not considered by BCA members to be a necessary reform. The quality of engagement with companies and the integrity and accuracy of advice are more important. These goals can be achieved without advisers being required to be independent. Conversely, independence would be no guarantee of achieving such goals.

[22] Principle Two Guidance, 3(a)

BUSINESS COUNCIL OF AUSTRALIA

42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 www.bca.com.au

© Copyright June 2021 Business Council of Australia ABN 75 008 483 216

All rights reserved. No part of this publication may be reproduced or used in any way without acknowledgement to the Business Council of Australia.

The Business Council of Australia has taken reasonable care in publishing the information contained in this publication but does not guarantee that the information is complete, accurate or current. In particular, the BCA is not responsible for the accuracy of information that has been provided by other parties. The information in this publication is not intended to be used as the basis for making any investment decision and must not be relied upon as investment advice. To the maximum extent permitted by law, the BCA disclaims all liability (including liability in negligence) to any person arising out of use or reliance on the information contained in this publication including for loss or damage which you or anyone else might suffer as a result of that use or reliance.