Governance Institute of Australia

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Market Conduct Division
The Treasury
Langton Crescent PARKES ACT 2600
By email: mcdproxyadvice@treasury.gov.au

Dear Sir / Madam,

Submission on Greater transparency of proxy advice

Who we are

Governance Institute of Australia is a national membership association, advocating for our network of 40,000 governance and risk management professionals from the listed, unlisted, not-for-profit and public sectors.

As the only Australian provider of chartered governance accreditation, we offer a range of short courses, certificates and postgraduate study. Our mission is to drive better governance in all organisations, which will in turn create a stronger, better society.

Our members have primary responsibility for developing and implementing governance frameworks in charities and not-for-profit organisations, public listed, unlisted and private companies, as well as the public sector. They have a thorough working knowledge of the operations of the markets and the needs of investors. We regularly contribute to the formation of public policy through our interactions with Treasury, ACNC, ASIC, APRA, ACCC, ASX and the ATO.

Our thought leadership on proxy advice

Governance Institute members have a strong interest in the policy settings relating to proxy advice. We have examined policy issues relating to proxy advice periodically over many years to promote good practice in the sector. [1] Our members' aim has always been to promote better engagement between companies and their owners and to encourage transparency. They see the relationship between companies and proxy advisers as one of mutual obligation.

The practices our members have encouraged include: companies issuing their Notice of Meeting as early as possible; companies establishing ongoing dialogue with proxy firms outside the AGM season; ensuring the chairman and other appropriate directors are available to explain to proxy advisers the complexities of decision-making; being proactive in engaging with proxy advisers; and not "shooting the messenger" but understanding why there is a negative recommendation. In return proxy advisers should contact companies in advance of publication of their reports with respect to ambiguity or contentious issues in companies' publicly available documents; provide companies with an explanation for negative recommendations; correct factual errors immediately and if already released to their member base, advise their member

[1] See Governance Institute of Australia (formerly Chartered Secretaries Australia), 2008, *Better Communication Between Entities and Proxy Advisory Services* and Governance Institute of Australia, 2014, *Improving engagement between ASX-listed companies and their institutional investors*: *Principles and Guidelines*.

base of the corrections; and provide a copy of their report upon request by the relevant company.

Governance Institute welcomes the opportunity to participate in this consultation and thanks Treasury for the meeting with Governance Institute representatives on 20 May 2021.

Executive Summary

- Proxy advisory firms play an important role in the Australian governance landscape. Any changes to the regulatory regime should be targeted to policy refinements for the benefit of all market participants and should promote the better functioning of the market as a whole.

- Governance Institute members see the central policy issue as one of promoting better engagement between companies and their owners through the conduit of proxy reports. Where our members do see room for improvement in industry practice is a more uniform mechanism for the timely correction of factual errors, and a process to facilitate better engagement between companies and their owners on negative recommendations in proxy reports under the significant time constraints of AGM timetables.

- Our members would support greater transparency for superannuation fund members on how their voting power is exercised and the influences on those voting decisions, as this will enable fund members to understand how funds as stewards of their assets are exercising their voting power.

- Governance Institute members do not, at this point, foresee major improvements in engagement arising from changes to the Australian Financial Services License (AFSL) regime. Our members support improved clarity on how the Australian Financial Services License (AFSL) regime applies to proxy advice but as the major proxy advice firms already hold AFSLs, they do not see a direct link between changes to the regime and improved engagement in the sector.

- At this stage of the company reporting season with uncertainty about the continuing COVID-19 pandemic, Governance Institute members' foremost concern is resolving the regulatory uncertainty on virtual and hybrid AGMs, digital shareholder communications and electronic document execution and ensuring a satisfactory long-term regulatory outcome on these matters. They consider that if there are limited resources to pursue policy reform that these urgent issues should take priority.

General comments

The role of proxy advice in Australia's governance landscape

Australia's governance landscape is complex. Companies, institutional investors, retail investors and proxy advisers all play key roles. Governance Institute members see proxy advisers playing an important role in the engagement between companies and their owners. In their experience, proxy advisers can also provide valuable feedback as to how owners may respond to a particular issue. Our members do not generally see, nor would they wish to see in future, an adversarial relationship between companies and proxy advisers. Our members acknowledge the valuable contributions of the firms operating in Australia. They also consider that the Australian Shareholders Association (ASA) plays an important role in engaging with retail shareholders which should be considered when policy decisions are made that may affect that association.

Treasury's consultation paper appears to indicate a level of concern with the influence of proxy advice in the Australian market. Our members consider that the influence of proxy advice has increased together with the quantum of funds under management in the Australian market and that the range of matters on which proxy advice is provided has broadened, but that its influence varies widely depending on the size, location and type of institutional investor.

The investment landscape is complex. A change in the market in recent years is the increased presence of large Australian-based institutional investors that vote significant shareholdings on behalf of the beneficiaries of superannuation funds and other pooled investment vehicles. While this may appear concerning and add weight to the proposals for reform, it should be considered that these large funds often subscribe to multiple proxy firms simultaneously, so the weight of any one adviser's recommendation is diminished. At the same time these large investors operate in-house ESG, remuneration and research teams who use proxy reports as only one input to their voting decisions.

There are also large index funds operating offshore that traditionally passively replicated indices and were heavily influenced by proxy firms on voting. However, these large index funds now maintain internal stewardship teams and have strong views on various issues, especially ESG matters. Where the influence of proxy firms is greater is lower down companies' registers, where there are investment firms, often domiciled overseas but with relatively small shareholdings and no in-house resources, who may rely on one, at best two, proxy subscriptions to inform their voting decisions. Some of these investors are large offshore investors but their Australian shareholding is small relative to their size and they do not maintain any internal expertise in Australian governance. Proxy reports will be important for these investment firms, who are in different time zones and are often difficult for companies to contact. This has been exacerbated in recent years by the move by many investors to separate the teams with which companies usually engage, from the teams carrying out the voting. When aggregated, these smaller investors can play a significant role in the outcome of resolutions.

Governance Institute members report that it is standard practice for companies to seek to engage with proxy advisory firms, and that proxy firms are relatively receptive to engagement, although this depends on various factors. Engagement is usually heaviest in the weeks leading up to the AGM, but can occur at other times of the year. Engagement is conducted formally through in-person meetings, typically with a company's chair, remuneration or other committee chair, the company secretary and other senior company representatives, as well as informally by telephone and email. Proxy firms are typically most receptive to engagement early in peak reporting season if the company's board is making what is seen as a contentious recommendation.

Our members report that some proxy firms are more willing than others to continue to engage on a contentious proposal after they have formed their view. Some proxy firms already allow companies to request corrections to factual errors and allow companies' responses to a proxy report to be issued to the proxy firm's clients. This practice varies between the proxy firms and appears to vary from company to company, depending on the strength of the relationship between the company's representatives and the personnel at the proxy firm assigned to cover the company. The common experience of Governance Institute members is that the advisory firms strive to be accurate and fair, but that practice varies widely, and that the time constraints, especially during peak reporting season, impose significant challenges on all parties. They also report that some firms take a more 'rules based' approach to company proposals.

In terms of competition and diversity of views in the sector, our members support in principle any arguments for increased competition. There are four major firms operating in the sector. We note that the US industry is dominated by two proxy advisory firms with heavily concentrated market share. By contrast there are multiple stockbroking and investment banks which provide fundamental research on companies.

Our members note, as a positive, that Australia has a domestic proxy advisory industry. Companies appreciate the fact they can engage with proxy firms in the same time zone and can meet regularly in person to discuss their businesses and explain the rationale behind meeting proposals. This level of engagement should be promoted, not constrained. Our members wish to emphasise that any policy decisions maintain a ‘level playing field’ to have equal impact on Australian owned firms as overseas owned firms.

Scope for improved industry practice

Governance Institute members recognise the importance of company boards engaging with owners as an integral part of good governance. They also acknowledge that sometimes not all owners wish to or are available to participate in engagement. In those scenarios, the accuracy of proxy reports, and companies’ ability to make their case where a proxy report provides a dissenting view, takes on a higher level of importance in the highly time-constrained environment of peak reporting season.

Where our members see the most room for improved industry practice is the ability of companies to engage in a timely way with their owners on proxy reports recommending against company proposals. Due to the requirements of the Corporations Act, proxy advisory firms operate under significant time constraints, which are exacerbated during the mid-September to mid-November peak period. At least one proxy advisory firm has a policy of no engagement with companies after their Notice of Meeting (NOM) has been issued, which further reduces the opportunities for engagement. Some proxy firms have fewer resources than others to facilitate engagement. In the experience of our members, the global proxy firms also take a more inflexible approach to the application of globally set rules and a lack of clarity over whether comments made by local representatives are consistent with those rules. There can also be a lack of transparency about those policies and the related assessment methodology (although companies are in some cases invited to pay for insights into the methodologies). These factors act as a constraint and a barrier to productive engagement. Our members are in favour of proxy advisers providing prior notice of an impending proxy report recommending voting against the board’s recommendations and a framework that facilitates all parties engaging in dialogue on the issue.

A consistent, uniform and timely process or mechanism for companies to correct factual inaccuracies would also be helpful. Many of our members report positive experiences when attempting to correct factual inaccuracies. They report that in many cases their requests for factual amendments are acted upon in a timely, professional manner, and amended reports being reissued to proxy advisers’ clients promptly. However, their experience does vary and there is room for a more uniform and transparent process or mechanism for engagement on disagreements which are not strictly factual but may be matters of interpretation or industry expertise. An example would be the choice of a peer group for remuneration comparisons.

Implementation

We note that this consultation process has no public commitment from government for immediate action. These measures would benefit from further consultation, and our members consider that 2021 is not the year for any regulatory action on this matter as there is already a significant amount of corporate law reform on the legislative agenda. Our members would also appreciate further clarity on where in the regulatory regime any change would be located.

Specific comments on consultation options and questions

Option 1: Improved disclosure of trustee voting

Governance Institute members are inclined to support this proposal. They fully support the principle of greater transparency, especially as it relates to retail investors and superannuation fund members as this will enable fund members to understand how funds as stewards of their assets are exercising their voting power. We note that a number of overseas markets have Stewardship Codes and while at least one group acting on behalf of institutional investors has adopted a Stewardship Code there is no general code in Australia as is the case in the UK. This measure may enable companies to better understand their owners and methods to engage with their owners.

Option 2: Demonstrating independence and appropriate governance

Governance Institute members are so far unconvinced, on the evidence provided, of the benefit this measure would bring to the sector and of the connection between this proposal and the policy issues identified outlined in the consultation paper.

Option 3: Facilitate engagement and ensure transparency and Option 4: Make materials accessible

Governance Institute members propose, as an alternative, that companies be given a right to receive, upon request or a standing request, prior notification if a proxy firm intends to issue a report recommending voting against a company's recommendations on a proposal on the agenda for a shareholder meeting. This notification would not necessarily need to contain the proxy firm's full report. Our members respect that these reports are the intellectual property of the proxy firm and are of a sensitive commercial nature and are also designed for wholesale investors. However, companies would benefit, in the highly compressed, time-sensitive environment of an AGM, from an early notification that would enable them to increase their direct engagement with owners, to promote the overall informed nature of the market. A long notice period would not be required and would not be practical. Two business days of notice, on a confidential basis, before the proxy report is issued to the company would promote more effective shareholder engagement.

Further, our members would support a consistent and uniform process or mechanism whereby companies are able to request corrections of factual inaccuracies and for amended reports to be reissued to clients via the same communication method as the original publication. This process or mechanism would not necessarily need to be legislated, so long as it was consistent across the sector. Nor would this process or mechanism need to occur before the report is sent to clients. Governance Institute members would be satisfied if this occurred after the publication of the original report, provided errors were corrected and communicated promptly.

Some proxy advisers will also send, where requested by a company, a company's written response to a proxy report containing a negative recommendation, to its clients. Governance Institute members consider this to be a positive aid to shareholder engagement and should be encouraged.

Option 5: Ensuring advice is underpinned by professional licensing

Our members consider that AFSL coverage does not appear closely linked to the policy issue of most concern, which is promoting engagement between companies and their owners. They do note that the ASFL regime may not cover the entirety of advisory services provided by these firms. Governance Institute members have heard differing views on the level of coverage of the regime. Treasury observes in the consultation paper that proxy advisers are only caught by the AFSL regime for a limited range of activities, whereas firms in the sector appear to refute that. This variance of views is prima facie evidence of a lack of regulatory clarity that should be resolved.

If you wish to discuss any of the issues raised in this letter, please contact Catherine Maxwell.

Yours faithfully,

Megan Motto
CEO