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Market Conduct Division
The Treasury
Langton Crescent
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By email to: MCDproxyadvice@treasury.gov.au

Re Consultation on greater transparency of proxy advice

Thank you for the opportunity to comment on Treasury's consultation in relation to greater transparency of proxy advice and the consultation paper published by Treasury on 30 April 2021.

IFM Investors is an asset manager established more than 25 years ago by a group of Australian industry super funds to help protect and grow the retirement savings of their members. Today, we invest across four asset classes – infrastructure, debt, listed equities and private equity – on behalf of more than 500 like-minded pension funds and other institutional investors worldwide. The $155 billion entrusted to us by these investors incorporates the retirement savings of approximately seven million Australians and more than 30 million working people worldwide.

In the listed equities asset class, we manage $38.3 billion across indexed and quantitative, large caps and small caps strategies. Most of our listed equities investments are domiciled in Australia, making us one of the largest managers of listed equities in Australia. We provide our investment management services to institutional investors through pooled fund structures as well as individual client mandates.

Holders of listed equities enjoy a bundle of rights that attach to the securities. Economic rights, such as to dividends and to residual enterprise value, are often the rights that are front-of-mind. But listed equities also generally have governance rights, which include the right to request certain information, to attend annual and special shareholder meetings, and to vote on certain matters such as director elections, to approve extraordinary transactions, and in respect of shareholder proposals.

In general, maximising long term shareholder value requires the prudent exercise of all rights, including governance rights.

IFM's voting guidelines are disclosed in our ESG Policy, which is publicly available on our website at: www.ifminvestors.com/about-us/responsible-investment. Summary Engagement and Voting Reports as well as the link to a searchable record of our past voting activity is also available on our website at: www.ifminvestors.com/about-us/responsible-investment/stewardship.

General comments

Proxy advisers provide a valuable and cost-effective service in the Australian market that supports good governance and constructive engagement between shareholders and companies. The system on the whole is working effectively and regulatory changes along the lines suggested in the consultation paper are neither desirable nor necessary.

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The consultation's stated purpose is to "assess the adequacy of the current regulatory regime and recommend reform options that would strengthen the transparency and accountability of proxy advice."

However, considering ASIC's recent review of proxy advice,[1] and the absence in the consultation paper of any evidence of problems, the basis for the consultation is obscure.

The consultation paper seeks to engender support for changes to Australian proxy adviser regulation by drawing on changes to such regulation in other jurisdictions, without appearing to fully consider their context. When the consultation paper was issued, it was clear that the recent proxy voting reforms in the United States were politically contentious, subject to court proceedings, and likely to be amended or reversed. They were condemned by sophisticated institutional investors on a nearly universal basis – a fact that should counsel against similar changes in Australia insofar as it is a capital importer and has aspirations to be a financial services hub. Since the publication of the consultation paper, the US Securities and Exchange Commission has determined not to enforce the reforms and begun a process very likely to result in amendment or repeal.[2]

Further, the consultation paper sets out options that would introduce more burdensome regulation than adopted overseas. For example, neither the US Securities and Exchange Commission nor the UK Financial Conduct Authority adopted a requirement for company pre-review of proxy advice.

There are policy reasons why shareholder voting must be free of undue influence by the management of listed companies. The "the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property they do not own" is the unfettered discretion of shareholders to vote to provide that power; corporate law "confers powers upon directors as agents of the shareholders; it does not create Platonic masters."[3]

Overall, the options outlined in the consultation paper could make voting less efficient, which in turn can increase costs to investors and superannuation fund members, increase the cost of capital, and undermine the legitimacy of the powers that directors wield.

1. Additional disclosures

The consultation paper seeks feedback on requirements for additional superannuation fund disclosure of more detailed information on voting policies and actions.

While additional disclosure is often desirable, the option outlined in the consultation paper does not appear to have been considered in a cost-benefit framework, and is not well-specified to achieve the policy intention.

- It would apply only to superannuation funds, not all managed investment schemes and similar products offered to individuals. Insofar as there is a need for individuals to receive more information about proxy voting decisions, beyond policies and a summary of voting, that need would exist regardless of the product. Savings invested in managed investment schemes are also

[1] ASIC, (2018), "ASIC review of proxy adviser engagement practices", Report 578 (stating that "empirical data … appears to suggest that concerns regarding the extent of influence proxy adviser recommendations on the voting outcomes of company resolutions is overstated" id at 9).

[2] In particular, (i) the SEC staff has determined not to recommend enforcement action arising from (a) interpretative guidance regarding proxy voting advice issued in 2019 and (b) 2020 amendments to rules issued under the Securities and Exchange Act of 1934 regarding proxy voting advice, and (ii) the SEC has initiated the process to consider amendment or repeal of those promulgations.

[3] Blasius Industries, Inc. v Atlas Corp. 564 A.2d 651 (1988).

required to be invested in the best interest of beneficiaries; it is not clear why retirement savings would be subject to differential proxy voting disclosure requirements.

- The contemplated disclosures will arguably be of little meaning to the intended users unless accompanied by additional information, including an explanation of the ASX Corporate Governance Principles, and comparative analysis across companies relevant to the matter being voted upon, and the background and rationale behind a fund's decision. The additional contextual information is likely to be costly to produce. In addition, for contentious votes, explaining the rationale could be extensive and might result in unintended negative consequences for the relatively amicable relationships that exist between Australian companies and investors.

- Third, while voting outcomes can be important information, the consultation paper considers requiring disclosure of whether or not an institutional investor received advice from a proxy advisor. It is not clear that this is material, particularly insofar as trustees are responsible for investment strategy.

Before proceeding to develop additional disclosure requirements, a cost-benefit analysis should be undertaken. Self-regulatory solutions already cover a substantial proportion of the assets within the superannuation system: the Australian Asset Owner Stewardship Code requires signatories to disclose their approach and outcomes of proxy voting. ACSI encourages its asset owner members to become signatories to the Code, and IFM's Stewardship approach is aligned to the Code.

2. **Independence and governance**

The consultation paper asks for feedback on whether proxy advisers should be required to be independent from superannuation funds they are advising. As ACSI is the only proxy adviser with close ties to superannuation funds, it can only be construed that this option is singling out ACSI whose membership includes industry super funds alongside other institutional investors.

This option should not be pursued for four reasons.

First, the paper appears to assume the relationship between ACSI and superannuation funds means that funds and their managers don't make their own voting decisions, which is not the case. It says: "There are also questions as to whether superannuation funds should be jointly involved in determining their voting positions, including through shared ownership of a proxy adviser." This appears to be a misapprehension. IFM and superannuation funds do not jointly determine their voting positions through ACSI, nor do they automatically follow the advice provided by ACSI or other proxy advisers.

IFM maintains a Proxy Voting and Engagement Committee (PEC), which is responsible for making voting recommendations to clients on funds managed under bespoke mandates, and making the final voting decisions on behalf of IFM's managed funds. Proxy advice is one input to the PEC's decision making process. The PEC also takes into account investment team insights, as well as information provided by the company directly via engagement meetings. The PEC is comprised of executives from our listed equities and responsible investment teams. Proxy advice serves as an input in to voting decisions, but IFM makes these decisions. For example, in our January to June 2020 summary report we disclose that we voted against management on 32 out of 460 resolutions and voted differently than ACSI's recommendation on 17 resolutions.

Second, it would increase costs on members due to a reduction in efficiency. Membership in ACSI is time and cost effective for funds, as well as for companies, who might otherwise need to meet with Australian

super fund investors individually. In 2020, IFM voted by proxy on approximately 1,500 resolutions at 230 company AGMs. If each superannuation fund were to undertake company research and engagement independently, as well as comparative information on executive remuneration, remuneration structures and directors' comparative performance, substantial duplicative resources would be required, at substantial additional cost to members.

Third, prohibiting investors from having a material interest in a proxy adviser would represent an unfair burden on competition. If regulatory changes affected ACSI's ability to continue to provide proxy advice to its members, this would serve only to provide the other three advisers with additional clientele and/or increase the workload of companies' investor relations team, management and board.

Fourth, having a strategic interest in a service provider is emerging best practice in institutional investment, and helps reduce principal-agent issues. Major investors globally are pursuing strategic investments in managers and other agents to lift alignment, and enhance access to information or transactions.[4] Industry super funds also use joint ventures that are collectively owned by multiple industry superannuation funds, which have been analysed by academic and APRA researchers – with the conclusion that member outcomes are improved.[5] ACSI is an example of the efficient pooling of resources to help support superior member outcomes. The nature of the relationship between ACSI and not-for-profit superannuation funds is a beneficial one that helps ensure the services provided by ACSI are well-suited for its members and their beneficiaries.

In the context of proxy voting advice, the 'independence' that policy makers should pursue is ensuring that the advice is developed without undue influence from the parties soliciting proxy votes. The advice provided by ACSI and other proxy advisers in the Australian market meets this requirement.

3. Facilitating engagement and transparency

The consultation paper seeks feedback on a requirement that proxy advisers provide their research and voting recommendations to the relevant company for review and comment before distributing the report to their investor clients (p. 6). An indicative five-day pre-review period is cited. This is problematic for two key reasons.

First, pre-review of proxy voting advice by companies who are the subject of the analysis impairs the capacity of investors to receive impartial advice.

Investors require their advisors to be free of influence from the companies regarding which the advice is provided.

For example, securities analysts under US regulations are prohibited from providing pre-publication review of research reports to a subject company.[6] This is part of the reason the US Securities and Exchange

[4] One major investor whose strategic investments in agents is public is the US$750 billion National Pension System of South Korea, which has taken stakes in AGP, BC Partners, and Hines, as well as a JV with Allianz. Local Government Pension Schemes in the UK have established collective entities to invest in infrastructure.

[5] See, Kevin Liu and Elizabeth Ooi (2018), 'When boards use related parties: outsourcing and superannuation fund performance', 59 *Accounting & Finance Journal* 715, and sources cited therein.

[6] FINRA Rule 2241.

Commission's Investor Advisory Committee opposed[7] a similar proposal by the SEC (and the SEC ultimately declined to require proxy advisors to provide companies with a pre-review, as did the UK Financial Conduct Authority). Similarly, *ASIC Regulatory Guide 79* specifies that research reports go first to clients and that if any fact checking is done with product issuers, it must be carefully controlled (without communicating recommendations or opinions contained in the report).

Mandating company pre-review of advice that investors have commissioned, before the investors themselves get to see it, has the potential to skew or impair the impartiality of the advice.

Second, the time allocated to companies for review would substantially reduce the time investors themselves have to review and consider voting information before making decisions.

The vast majority of Australian company AGMs are compressed into a few months of the year – March to April and again from September to November (where up to 15 AGMs may be held in a week). There is already a tight timeframe between when the company publishes their Notice of Meeting and the AGM. Proxy votes are generally required a week before the AGM date. Allocating time in this process for a company pre-review not only jeopardises the independence of the advice, it reduces available time for digesting information and making considered decisions.

4. Making materials accessible

The consultation paper seeks feedback regarding a requirement that proxy advisers notify their clients on how to access the company's response to the report. While we do not oppose this option, it is difficult to see any benefit or how it would increase investors' awareness of a company position. Companies already provide their opinion and rationale on their recommendations via their Notice of Meeting, which is then outlined and reflected within the proxy adviser's report and recommendations. In addition, the company can use ASX announcements as an additional means of communication with investors if their position changes post the Notice of Meeting.

We note that at least one proxy adviser additionally provides both companies and proponents of shareholder proposals, the opportunity to publish a 'report feedback statement' and have these provided directly to their institutional investor clients.

5. Requiring suitable licensing for the provision of proxy advice

ACSI and other proxy advisers hold an Australian Financial Services Licence (AFSL) covering certain activities and the paper provides little rationale to expand this further.

The consultation paper states that "assessing the appropriateness of a proposed executive remuneration package, the performance of a director and whether they should be re-elected", requires a high degree of expertise to assess.

The consultation paper provides no evidence that the market is being poorly served by low quality advice from unqualified advisers. In IFM's experience, proxy advisers who provide guidance on such matters are specialists whose knowledge on remuneration and governance standards is based on significant experience and expertise. Increasing coverage under the AFSL regime would not necessarily result in an improvement

[7] Other reasons included that there was no evidence any benefit would arise from requiring a pre-review. SEC data from over 17,000 shareholder votes over three years indicated that the number of possible factual errors identified by companies themselves in their proxy supplements was 0.3% of proxy statements – and none of those was shown to be material or to have affected the outcome of the related vote. Compared to credit rating agency reports and broker security analyses, where independence from company pre-review is maintained for similar reasons, this is very small.

in the standard of proxy advice. The institutional investor clients of proxy advisors are sophisticated, subject to significant regulation, and have well-established duties.

Conclusion

The use of shareholder governance rights inevitably can result in circumstances where the opinions of investors, proxy advisors, and company management differ. Some directors may view the prospect of not being re-elected to the Board, or having a remuneration plan rejected, as evidence of too much shareholder influence, enabled by proxy advisors. But this perspective is not a fair reflection of the facts. The vast majority (over 90%) of shareholder proxy voting is aligned with management recommendations. Equally, efficient and effective shareholder voting is a critical accountability device, and fundamental characteristic of the corporate form.

Thank you again for the opportunity to comment. Please contact zachary.may[at]ifminvestors.com if you would like to discuss in further detail.

Yours sincerely

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