ISA submission to Treasury's consultation on the greater transparency of proxy advice

Industry Super Australia (ISA) undertakes policy research and advocacy on behalf of over five million members of industry superannuation funds, to ensure that the policy settings for superannuation are consistent with the objective of maximising their retirement incomes. In this submission we wish to comment on a number of issues raised by Treasury's consultation paper.

Executive Summary

- ISA supports Treasury's suggestion that in order to help improve transparency to members about how their retirement savings are being managed, funds could be required to disclose more details about their voting policies and actions each financial year. In principle, requiring disclosure of a minimum level of consistent detail could provide members with the opportunity to better understand more about how their fund is acting in their best interests over time and relative to others. However, a narrow focus on whether voting is consistent with proxy advice is not by itself meaningful because advice is only one input among others into the voting decision. It may be more meaningful to focus additional disclosure on contentious votes and how voting in this context is consistent with the best interests of members.

- There is currently limited independent evidence about the structure, practices and impacts of the proxy adviser industry in Australia and how it compares with those overseas. Before proceeding further with policy development in this area we encourage the Government to commission an independent review of the industry with a view to establishing a public fact base on the basis of which the need for any reforms can be assessed.

- Superannuation funds who are members of ACSI are 'meaningfully independent' from the companies that ACSI provides advice on. There is no reason to believe that because some superannuation funds have a membership stake in ACSI the advice they receive is used in a manner inconsistent with the best interests of members. There is no member-interest case for the Government to mandate that ACSI change its ownership structure.

- In relation to engagement, the available evidence from ASIC is that proxy advisers are willing to engage with companies, receive feedback and correct errors, and make reports available to companies prior to, or at the same time as, publication. We see no need to impose a uniform engagement regime that will risk undermining the accuracy and quality of reports, increase costs to superannuation funds and their beneficiaries, and which may encourage some companies to attempt to pressurise advisers into changing their recommendations, perhaps via threats of litigation.

- In relation to bringing more proxy adviser activities within scope of the AFSL regime, it is not clear that the quality of advice requires regulation. Further, it is not clear that the AFSL regime is the most appropriate vehicle for regulating advice on topics such as executive remuneration, director appointments and company constitutions. We would welcome further discussion on this, including the views of ASIC.

Disclosure of trustee voting

In the Australian superannuation system, where nearly every worker is required by law to make contributions to a superannuation fund to help fund their eventual retirement, it is important that funds are required to disclose and report information to members and regulators that enable them to assess how funds are acting in the best interests of beneficiaries.

ISA is a strong supporter of members being provided with accessible and useful information that helps them better understand how their savings are being invested, and how they are benefiting from those investments in terms of net returns. For example, we continue to campaign for the introduction of long-delayed choice product dashboards, and we support the introduction of the Portfolio Holdings Disclosure obligations.

We therefore welcome Treasury's suggestion that in order to help improve transparency to members about how their retirement savings are being managed, funds could be required to disclose more details about their voting policies and actions each year. As Treasury note, while some superannuation funds already disclose more than they are required to in relation to voting, practice varies.

However, a narrow focus on whether voting is consistent with proxy advice is not by itself meaningful because such advice is only one input among others into the voting decision. It may be more meaningful to focus additional disclosure on contentious votes and how particular voting decisions are consistent with the best interests of members.

We would welcome further consultation by Treasury on how this area of reform could be implemented in manner that generates meaningful insight and accountability to members.

Limited evidence that reform is needed

Proxy advisers can play an important role as one source of information and advice that subscribing shareholders take into account when deciding how to engage with the listed entities they have acquired an interest in. There is therefore a legitimate public interest in understanding the policies and practices of proxy advisers, and whether any of those policies and practices should be matters of concern. We note that many advisers already disclose their principles and approaches to how they make recommendations.

However, in terms of there being a need for reform in all the areas identified by Treasury, the present consultation is taking place in something of an evidentiary vacuum. Consistent with the principles of evidence-based policymaking, a better approach would be for the Government to commission an independent review of the proxy adviser industry, with a focus on key issues such as engagement, governance, transparency and licensing.

Such a review would help to generate a public 'fact base' on the basis of which it would be possible to have an empirically grounded discussion about what problems exist, and which measures may be best suited to deal with them – such as an industry code, regulatory guidance, or changes to law.

We note that none of the major inquiries into the Australian financial and superannuation systems in recent years have reported any concerns about the role, practices, professionalism or independence of proxy advisers.[1] Where there has been an independent assessment by ASIC of how proxy advisers operate, that assessment did not find evidence of problems that required action by government.[2] We discuss some of ASIC's findings later in this submission.

While some in business occasionally complain about proxy advisors, this is to be expected in a context where advisors sometimes recommend opposition to company resolutions on sensitive topics such as executive remuneration and board composition.

Attributing investor support for critical resolutions to the practices of proxy advisers can serve as a useful distraction from the fact that shareholders may be unhappy with a company's stance on a particular issue, independently of proxy advice. In 2018 then ASIC Commissioner John Price stated:

> "There's a suggestion that institutional investors take proxy advisors say on face value and don't exercise independent judgement. I don't think that's right. Institutional investors in Australia have fiduciary duties that extend to how they vote. Based on my conversations, an independence of mind and rigour is brought to these [institutional investor] decisions."[3]

Any new policy initiatives in relation to proxy advice must be evidence-based. We encourage the Government to commission an independent review of the industry with a view to establishing a public fact base about its policies and practices on the basis of which the need for any future reforms can be evaluated.

Superannuation funds are meaningfully independent

Treasury's paper says that there is scope to ensure that the role of proxy advisors in advising and interacting with superannuation trustees is appropriate and transparent. This is premised on an idea that because proxy advisers are not subject to the same fiduciary framework as trustees, they might have broader objectives than those a trustee is required to consider.

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[1] For example: (I) the 2014 Financial System Inquiry, (ii) the 2018 Productivity Commission inquiry into competition in the Australian financial system, (iii) the 2019 Productivity Commission inquiry into the efficiency of the superannuation system, and (iv) the 2019 Royal Commission into misconduct in the banking, superannuation and financial services industry.
[2] ASIC (2018) Report 578: ASIC review of proxy adviser engagement practices.
[3] https://aicd.companydirectors.com.au/membership/company-director-magazine/2018-back-editions/march/proxy-music

Treasury's paper seeks views on whether proxy advisers could be required to be 'meaningfully independent' from a superannuation fund they are advising to ensure that proxy advice is provided on an arm's length basis.

We have a number of concerns about the suggestions made in Treasury's paper in relation to independence and funds' voting policies.

Firstly, the paper is unclear about what it means for a proxy advisor to "have broader objectives than those that a trustee is required to consider." It might be that Treasury is suggesting that because a proxy adviser may give consideration to a number of environmental, social and governance (ESG) risks as part of developing its voting recommendations, this consideration should lie outside the proper concerns of superannuation trustees.

It is now widely accepted by financial regulators in Australia and around the world that taking account of the risks generated by ESG issues such as climate change is vital to securing the long-term financial interests of investors, including members of pension and superannuation funds. Internationally, the views expressed by the head of the UK Pensions Regulator are widely shared:

> "Global heating has the potential to de-stabilise the social and economic conditions on which we depend for our pensions system. The impact has financial consequences as well.
>
> …we know that trustees are talking about this already, exploring how climate change affects asset prices and looking at the huge opportunities that will come from a global pivot towards low carbon economies. In a world where the climate emergency is real and urgent, this is the prudent approach.
>
> I believe that, wherever the focus lies for trustees, it is absolutely the case that any scheme that does not consider climate change is ignoring a major risk to pension savings and missing out on investment opportunities."[4]

We further note the recent opinion of APRA that "the effects of a changing climate extend to all sectors of the economy…They pose financial risks, as well as provide new business opportunities, to all APRA-regulated entities."[5] To assist superannuation trustees to formulate investment strategies, including the implementation of ESG considerations, APRA will be consulting this year on changes to its practice guide on investment governance (SPG 530).

Secondly, it seems Treasury believes that superannuation funds who jointly own a proxy adviser are then jointly involved in determining their voting positions. Given that there is only one proxy adviser in Australia that is owned by a collective of superannuation funds, we assume Treasury are referring to the Australian Council of Superannuation Investors (ACSI).

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[4] https://www.thepensionsregulator.gov.uk/en/document-library/corporate-information/climate-change-and-environment/climate-change-strategy. For an overview of how environmental, social and governance factors have become part of mainstream financial theory and investment practice around the world see: OECD (2020) Sustainable and Resilient Finance: 2020 OECD Business and Finance Outlook.

[5] APRA (2020) Understanding and Managing the Financial Risks of Climate Change, Letter to all APRA-regulated entities.

Superannuation funds do not jointly determine their voting decisions. Voting decisions are a matter for each fund to decide based on a number of sources of intelligence such as internal and external investment managers and consultants. To better understand the detail of how voting decisions are reached Treasury may wish to discuss this matter further with proxy advisers and the superannuation funds they provide advice to.

Thirdly, a member relationship between a proxy adviser and a client of the adviser (e.g. a member super fund) does not compromise the independence and utility of advice that the adviser provides about a company that the client has a shareholding in. Further, when funds purchase such advice it is obliged by its fiduciary duties to make use of that advice in a manner consistent with the best interests of beneficiaries.

We are not aware of evidence that because some superannuation funds have a member relationship with ACSI, that this in some way results in the provision of inappropriate advice that is inconsistent with the best interests of their members. In the absence of such evidence it is unclear why Treasury have raised the issue of ACSI's ownership structure.

Our view is that the present ownership structure of ACSI is fully consistent with member superannuation funds serving the best interests of their members. We therefore recommend that the Government make clear it does not intend to proceed with this potential reform option.

There are already sufficient opportunities for engagement

Treasury's paper says that currently proxy advisers are not required to engage with companies on their research, report and recommendations, either before or after providing their reports to investors. Treasury reports that business representative groups have raised the importance of companies being able to engage with proxy advisers, partly to communicate information that may impact their final voting recommendation.

In this context, Treasury propose two possible reform options. The first is to require proxy advisers to provide their report and recommendations to the relevant company before subscribing investors. A minimum period of five days could be prescribed, during which the company to comment and for the proxy adviser 'to amend the report in response if warranted.' The second is to require proxy advisers to notify their clients on how to access the company's response to the report, by such means as providing a website link.

We wish to make the following points.

Firstly, Treasury's discussion gives the impression that while business representative groups wish to engage with proxy advisors, there is reluctance by proxy advisers to reciprocate.

However, this impression is not supported by the evidence. ASIC's recent review of proxy adviser engagement found that, while specific engagement practices vary, advisers were willing to engage with companies. Further, they were willing to receive feedback on factual matters and correct factual errors, and to make their reports available to companies either prior to, or at the same time as, publication.

Importantly, ASIC found that the engagement promised by proxy advisers in their policy statements was consistent with actual patterns of engagement observed by ASIC during the 2017 AGM season. In particular, there were significantly more instances of a company declining or not responding to an advisers request for engagement than the reverse.[6]

In short, proxy advisers take engagement with companies seriously and act accordingly. We hope Treasury will factor this evidence into their thinking about what reform options the Government may wish to pursue.

Secondly, the key issue with engagement is not that proxy advisers are unwilling to do so. It is that they should not be compelled by law to adopt a particular model of engagement that must be followed in every circumstance – particularly in the weeks approaching an AGM.

Shareholders enter into a private commercial contract with a proxy adviser to provide information and advice relevant to exercising their voting rights. This generates private intellectual property, the disclosure and distribution of which should be matter for proxy advisers to decide based on what they have agreed with their clients. Some advisors may be happy to provide this property free to a third party before meetings. Some may not be. This should be a matter for advisers and their clients.

We are not aware of a comparable rule in financial regulation that requires privately contracted research to be disclosed to a third party prior to it being provided to a client.

Thirdly, imposing a uniform requirement for pre-meeting disclosure of a report to companies risks undermining the quality and independence of the research and recommendations. The time available to generate accurate good quality advice can be brief. Meeting agendas can sometimes change very shortly before they are scheduled to take place. Proxy advisers must be able to respond to these pressures as they arise.

Having to meet a five-day deadline in every case may increase the risk that reports lack the accuracy and detail that clients of advisors pay for, and which companies say they want to promote. It will also mean proxy advisers having to invest in more resources. In the context of superannuation funds this means increasing costs for beneficiaries.

We are further concerned that Treasury underestimate the problems that may arise from proxy advisers having to provide time for companies to comment on their reports. Treasury say this will provide an opportunity for advisers to amend the report 'if warranted.' This suggests a consensual process of amendment-making, one that might plausibly apply to correcting simple factual errors.

But where matters of interpretation and opinion are involved, there is a risk that some companies may attempt to make use of pre-publication disclosure to pressurise advisers into making unwarranted changes, perhaps via threats of litigation.

It remains the case that a proxy adviser's report is one input among many available to shareholders. Companies have multiple channels of communication available to them, such as ASX announcements, to update the market on what they believe to be inaccurate or unwarranted in an adviser's report.

[6] ASIC (2018) p. 6

In light of the channels that already exist for companies to engage with shareholders, it is unclear why proxy advisers should be responsible for providing a link to a company's response to their report. If a company chooses to respond, it should be a matter for them to alert and engage shareholders. Companies have agency in this process, and it is reasonable to expect that they should take responsibility for communicating to their own shareholders what they think about proxy adviser reports.

Extending the AFSL regime

Treasury's paper notes that the existing regime for financial services is the AFSL regime, but that this presently covers only those activities by proxy advisors that involve providing advice to wholesale investors in respect of votes that relate to dealings in financial products. Proxy advice relating to executive remuneration, board appointments and changes to company constitutions does not presently fall within the AFSL regime.

Treasury suggest that in order to provide appropriate regulatory oversight, and to help secure a sufficient standard of care and skill by proxy advisers, it may be appropriate to have the AFSL regime apply to a broader range of proxy advice activities.

We have two concerns about this potential reform.

Firstly, as with several other reform options being canvassed by Treasury, it is not clear what existing problem this is intended to solve. We are not aware of evidence that the quality of proxy advice on topics such as executive remuneration is poor and requires regulation. While some executives and directors occasionally complain about proxy voting recommendations, this is to be expected in a context where their preferences are being publicly challenged by shareholders.

Secondly, it is not clear that the AFSL regime is the most appropriate vehicle for regulating the quality of proxy advice in relation to matters such as remuneration, director appointments and company constitutions. It would be useful if Treasury could request ASIC's view on this as the responsible regulator and make that view publicly available. We would welcome further discussion on this issue.

Please contact ISA if you have any questions in relation to this submission. We look forward to continuing to engage with Treasury on this important issue.

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About Industry Super Australia

Industry Super Australia (ISA) is a research and advocacy body for Industry SuperFunds. ISA manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of over five million industry super members.

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