

CONSULTATION RESPONSE

THE AUSTRALIAN TREASURY: GREATER TRANSPARENCY OF PROXY ADVICE

04 June 2021

INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US \$100 trillion in assets under management. Over 190 signatories, managing AUD \$1.1 trillion are based in Australia.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to the Australian Treasury's consultation paper *Greater Transparency of Proxy Advice*.

ABOUT THIS CONSULTATION

On 30 April 2021, Treasury released a consultation paper [Greater Transparency of Proxy Advice](#), noting the intention is to “help assess the adequacy of the current regulatory regime and help develop reform options that would strengthen the transparency and accountability of proxy advice”, with additional measures proposed specifically where a proxy adviser is providing a service to a superannuation trustee.

The Australian Treasury has invited submissions addressing five proposals across three key themes, supplemented by a range of questions for each proposal.

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SUMMARY

PRI signatories have committed to being active owners and to incorporate ESG issues into ownership policies and practices. Proxy advisory firms conduct the important and necessary work of providing high quality, independent analyses, linking them to voting recommendations based on institutional investors' stated priorities. Many institutional investors use proxy advisory firms' recommendations to supplement their research and understanding of multiple, detailed, and sometimes dense proxies for their portfolio. Without confidence in the impartiality of proxy firms' recommendations, investors — particularly smaller and mid-size investors — would lack the capacity required to synthesize all relevant information to vote their proxies and would thus have difficulty fulfilling their fiduciary duties.

The PRI's key recommendations are:

- Placing complex and detailed disclosure obligations on superannuation trustees would not result in any material benefit to members and may add additional costs and confusion to the detriment of members.
- Existing legal obligations are adequate in ensuring that advice provided to superannuation trustees by proxy advisers is independent.
- Requiring proxy advisers to provide companies with a draft report should be limited to correcting errors of fact, and not be an opportunity for companies to contest voting recommendations of proxy advisers.
- Removing Option 3 and Option 5 would improve this proposal as there is a lack of evidence these options would have a material impact on the level of engagement between proxy advisers and companies or on the standard of proxy advice.

DETAILED RESPONSE

BEST INTEREST OBLIGATIONS AND INVESTMENTS

Superannuation funds have a fiduciary duty to act in their member's best interests, for which it is already well established to refer to financial interests, irrespective of any potential change to the superannuation legislation under the pending Your Future, Your Super reforms.

A key consideration for superannuation trustees in meeting the best interests obligation is the long-term financial investments undertaken by the superannuation fund on behalf of members.

Superannuation fund investments are unique from other investment vehicles given the long-term investment horizon that must be considered to ensure a robust and secure financial future for their members, as these investments support many members over the course of their working life and often, well into retirement.

Recent guidance released by APRA supports the requirement that institutions assess the risk of their investment over the long-term and notes that trustees should be considering an investment horizon “potentially extending to 2050 and beyond”.¹

The ability to exercise shareholder voting rights as a shareholder forms part of this responsibility, whereby a trustee with a significant holding can engage with the company to try to mitigate the risks identified.

The PRI considers the engagement of proxy advisory firms to be a prudent and cost-effective method for superannuation trustees to obtain an independent source of investment information that can be utilised to supplement the existing research the trustee and investment managers already perform.

CHANGING LANDSCAPE

The consideration of ESG risks that have a long-term financial impact and investor preferences have changed over time. This is evidenced via investor action as in the recent case of Mark McVeigh V Retail Employees Superannuation Pty Ltd, whereby a member of superannuation fund REST undertook legal action for the perceived failure to take climate change risks into consideration within investment decisions. McVeigh’s charge was that REST was in breach of its fiduciary duties by not acting in his “best interests” to protect his retirement savings.

Whilst a determination was not made by the Court, it did prompt REST to acknowledge the material risk associated with climate change on investments and undertake action to manage their investments accordingly. It further enhanced the visibility of ESG factors in investment decision making by superannuation fund trustees and other institutional investment firms.

This position is further supported through the release of Draft Prudential Practice Guide CPG 229 Climate Change Financial Risks for APRA-regulated institutions, including superannuation trustees, which aims to outline prudent practices in relation to climate change financial risk management.

Within the guidance, APRA clearly sets out its position regarding the financial risks of climate change, noting:

“Liability risks stem from the potential for litigation if institutions and boards do not adequately consider or respond to the impacts of climate change. A prudent APRA- regulated institution would take a strategic and risk-based approach to the management of the various risks and opportunities arising from climate change, recognising the unique nature and far-reaching potential impacts of a changing climate. It is important for institutions to understand the interaction between climate risks and their business activities, as well as the compounding effect climate risks may have on an institution’s other risks...”

The in-depth and complex nature of the research required to identify, mitigate and manage climate risk is vast. APRA acknowledges this complexity and notes that a prudent institution is likely to require

¹ “Prudential Practice Guide Draft CPG 229 Climate Change Financial Risks”, Australian Prudential Regulation Authority (APRA) (April 2021), p15.

data from multiple sources, including specialist consultants and counterparties to form a conclusive position on the risk of an investment.

The PRI considers the use of proxy advisers within this process to be imperative in identifying and providing research on ESG risks to investors for their voting decisions.

ENSURING INDEPENDENCE BETWEEN SUPERANNUATION FUNDS AND PROXY ADVICE

Option 1: Improved disclosure of trustee voting

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

The proposed option of requiring disclosure of more detailed information in relation to RSE Licensee voting policies and actions for each financial year is an extension of the existing obligation for proxy voting policy and voting record to be disclosed on the fund's website.²

The PRI considers that this information may be useful to members where disclosed, however notes that it is unlikely that there will be a significant level of interest or engagement with such information for most members.

Expanding the scope of information that is required to be disclosed to include how votes were exercised, whether any advice was received from a proxy adviser and who provided the advice, and proxy advice is received, disclosure of whether the voting actions taken were consistent with the proxy advice would be unlikely to benefit many members.

ASIC's 2018 Report on Proxy Adviser Engagement Practices found that "many institutional investors have advised ASIC that proxy adviser reports are only one input into their voting decision processes." The report also found that "proxy adviser firms often have different views on the same issue and many institutional investors will subscribe to more than one proxy adviser's reports."³

Furthermore, imposing such disclosure obligations on RSE Licensees will result in complexities where RSE Licensees investment mandates delegate authority for exercising shareholder rights to investment managers and responsible entities of managed investment schemes which RSE Licensees invest in.

It is not clear why the proposed options would apply exclusively to once class of shareholders (being RSE Licensees), or whether such obligations would extend to how shareholder voting rights are exercised by other intermediaries in the supply chain such as investment managers or responsible entities of managed investment schemes such as exchange traded funds.

² Superannuation Industry (Supervision) Act 1993 (Cth) s 29QB (1); Superannuation Industry (Supervision) Regulations 2001 s 2.38(2)(n)-(o).

³ Australian Securities and Investment Corporation (ASIC), *ASIC review of proxy adviser engagement practices*, (June 2018) available at <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-578-asic-review-of-proxy-adviser-engagement-practices/>.

The PRI also has concerns that disclosing such information would impose additional administration and analysis costs on RSE Licensees (which would ultimately be borne by members) and introduce new risks that the information is misunderstood by members.

The PRI is generally supportive of changes which would require the disclosure of how independent judgement is exercised in relation to how RSE Licensees implement their existing trustee obligations and duties around independent judgement in the determination of voting positions as part of a proxy policy. However, the PRI does not support creating complex and unworkable disclosure obligations which will be inaccessible and of little benefit to the majority of superannuation fund members.

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

The proposed expansion of the scope of information that is required to be disclosed to include how votes were exercised, whether any advice was received from a proxy adviser and who provided the advice, and proxy advice is received, disclosure of whether the voting actions taken were consistent with the proxy advice, **would not have any impact on an RSE Licensee's compliance with the existing regulatory obligations.**

Requiring disclosure of such information does not affect whether the RSE Licensee is performing its duties and exercising its powers in compliance with the relevant regulatory requirements, including if the *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* were to pass into law in its current form.

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

Any changes to the law that require RSE Licensees to make additional disclosures (as outlined above) **should be aligned with the existing disclosure obligations and timeframes** for keeping such information on the fund's website up to date under the *Superannuation Industry (Supervision) Act 1993*.⁴

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

It is the PRI's view that there would not be any benefit to asset owners, investment managers, or beneficiaries if further information on how voting is informed by proxy advice is required to be disclosed.

Option 2: Demonstrating independence and appropriate governance

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

The PRI recommends that the independence between an RSE Licensee and a proxy adviser should be consistent with that which is already required between an RSE Licensee and an

⁴ Superannuation Industry (Supervision) Act 1993 (Cth) s 29QB (1); Superannuation Industry (Supervision) Regulations 2001 s 2.38(2)(n)-(o).

outsourced service provider⁵ or an investment of the fund,⁶ and does not find it necessary to require the proxy adviser not be a related party or that the RSE Licensee does not have any interest in the proxy adviser.

The PRI understands that there may be significant efficiency to RSE Licensees and benefit to members in investing in a proxy adviser that specialises in advising a class of investors with similar investment objectives (such as long-term investment horizons which may require a greater emphasis on ESG risk management).

There is no evidence to suggest that proxy advisers have any inappropriate or disproportionate influence on RSE Licensee voting, with ASIC finding in its 2018 report that “concerns regarding the extent of influence of proxy adviser recommendations on the voting outcomes of company resolutions is overstated.”⁷

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

The existing obligations on RSE Licensees (of fund investments being maintained at arms-length) are appropriate in ensuring that dealings with proxy advisers are independent, even where the fund may have invested in the proxy adviser and is consistent with the approach required of other service providers to RSE Licensees.

FACILITATING ENGAGEMENT BETWEEN COMPANIES AND PROXY ADVISERS

Option 3: Facilitate engagement and ensure transparency

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

The PRI strongly supports active engagement between shareholders and the companies in which they invest. This should occur through various activities year-round, and not fall to only voting resolutions at the Annual General Meeting (AGM). The PRI recommends the Treasury remove Option 3 requiring proxy advisers to provide their report to the relevant company before subscribing investors as there is a lack of evidence that additional regulation is necessary.

A prudent Board of Directors would be seeking to understand their investors requirements and values, with a view of how these investors may feel toward any resolutions put forth at the AGM. This is especially prevalent in the case of an institutional investor that may hold a large stake in the company and has significant voting power.

Proxy advisers act in accordance with their client’s stated objectives and provide advice that enables the investor to best meet those objectives. Given that proxy advisers are paid to provide accurate

⁵ Superannuation (prudential standard) determination No. 3 of 2012 - Prudential Standard SPS 231 – Outsourcing.

⁶ Superannuation Industry (Supervision) Act 1993 (Cth) s 109.

⁷ ASIC, *ASIC review of proxy adviser engagement practices*, (June 2018) available at <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-578-asic-review-of-proxy-adviser-engagement-practices/>.

advice, it is unclear why Option 3 implies that proxy advisers are sub-optimally engaging with issuers and additional regulation is required. An in-depth review of proxy advice policies and engagement practices conducted by ASIC in the 2017 AGM season⁸ found Australia's largest proxy advisers policies noted "a willingness to engage with companies and make a copy of their report available to companies either prior to or after publication; a desire to ensure independence from the companies that are the subject of their reports; and a willingness to receive feedback from companies in relation to potential factual errors and to correct material factual errors". Furthermore, some proxy advisers now allow registrants to review certain data included in recommendations before they are conveyed to clients.⁹

In relation to proxy adviser engagement, ASIC notes "there was no consensus on any specific areas in which existing industry guidance on the engagement process was deficient and should be updated" and "whilst we encourage the development of best practice in this area, the pursuit of new industry best practice guidance may not be fruitful at this stage given the existing guidance that already covers engagement between companies, institutional investors and proxy advisers."

In 2019, the US Securities and Exchange Commission (SEC) proposed a similar requirement to disclose a copy of the proxy advisor's report to the company prior to the client, however, it was not included in the final rules¹⁰ after most commenters opposed the proposal, citing lack of evidence that the issuers' concerns about factual errors were legitimate.¹¹ Similarly, the US Department of Labor (DOL) finalised rules related to proxy voting December 2020.¹² Under the new administration, the DOL issued a non-enforcement order of the rule¹³ and will review the rule under an Executive Order issued on May 20, 2021.

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

In their 2018 report, ASIC recommends that where a copy of the analysis is provided to the company for fact-checking before publishing the report, any voting recommendations or opinions should be omitted to ensure only the facts are considered.¹⁴

⁸ Australian Securities and Investment Corporation (ASIC), *ASIC review of proxy adviser engagement practices*, (June 2018) available at <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-578-asic-review-of-proxy-adviser-engagement-practices/>.

⁹ See, e.g., Glass Lewis, *Issuer Data Report*, (allowing issuers to review certain data but not recommendations as a whole prior to proxy votes) available at: <https://www.glasslewis.com/issuer-data-report/>.

¹⁰ U.S. Securities and Exchange Commission, *S7-22-19 Exemptions from the Proxy Rules for Proxy Voting Advice*, (July 22, 2020) available at: <https://www.sec.gov/rules/final/2020/34-89372.pdf>.

¹¹ U.S. SEC, *S7-22-19, Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice* at 39 (November 5, 2019) available at: <https://www.sec.gov/rules/proposed/2019/34-87457.pdf>.

¹² U.S. Department of Labor (DOL) Employee Benefits Security Administration, *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, Final Rule* (December 16, 2020) available at: <https://www.federalregister.gov/documents/2020/12/16/2020-27465/fiduciary-duties-regarding-proxy-voting-and-shareholder-rights>.

¹³ U.S. DOL, *Statement Regarding Enforcement of its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans*, (March 10, 2021) available at <https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf>.

¹⁴ ASIC, *ASIC review of proxy adviser engagement practices*, (June 2018) available at <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-578-asic-review-of-proxy-adviser-engagement-practices/>.

The inclusion of voting recommendations in draft reports would be likely to increase the likelihood of companies attempting to exert undue influence over proxy advisers rather than focusing on rectifying any errors of fact. Limiting the scope of any obligation to provide a draft report to a company it relates to in advance of the client to the research only would therefore promote the integrity of any voting recommendations made by proxy advisers to their institutional investor clients.

The PRI recommends that any requirement placed on a proxy adviser to supply the company with a report prior to an institutional investor should be confidential and limited to correcting errors of fact, should not include voting recommendations and therefore, should not be used as an opportunity for companies to contest voting recommendations of proxy advisers.

Option 4: Make materials accessible

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

The PRI does not support requiring proxy advisers to notify their clients on how to access the company's response to the report as it could be costly to proxy advisory firms and investors. It could also harm the independence or objectivity of the advice which could negatively impact the market more broadly. Instead, companies could make their response visible and accessible on their website for investors that wish to compare.

REQUIRE SUITABLE LICENSING FOR THE PROVISION OF PROXY ADVICE

Option 5: Ensuring advice is underpinned by professional licensing

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

The PRI recommends the Treasury remove Option 5 as it is unlikely it would have a material impact on the standard of proxy advice. Proxy advisers are likely to already hold an AFS License in relation to "giving advice to wholesale investors on votes that relate to dealings in financial products." This means that arrangements such as adequate resources should already be in place to satisfy the general licensing requirements.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of the Treasury to improve proxy voting advice for investors in Australia.

Any question or comments can be sent to policy@unpri.org.