SWINBURNE UNIVERSITY OF TECHNOLOGY

1 June 2021

Market Conduct Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: MCDproxyadvice@treasury.gov.au

RE: COMMENTS ON THE CONSULTATION PAPER *GREATER TRANSPARENCY OF PROXY ADVICE*

Dear Sirs and Madams

We thank you for the opportunity to offer comments on the Consultation Paper *Greater Transparency of Proxy Advice*. We offer these comments in our personal capacities as corporate governance experts. Our views do not necessarily reflect the views of our employer or any organisation with which we are associated or of which we are a member.

Overall comment

We are broadly supportive of reforms that strengthen the transparency of proxy advice, but we contend that the consultation paper does not clearly articulate a presently-existing policy 'problem' or mischief that requires regulatory reform, the first requirement of the Commonwealth Office of Best Practice Regulation when assessing regulation.[1] The consultation paper invites submissions on six options for regulatory reform without articulating the problem or mischief they are designed to address.

Considering the important supportive role that proxy advisors play in shareholder engagement, we urge the Government to consider a softer approach to their proposed regulation. The focus must be on advancing quality in proxy advice, rather than to make it more difficult to operate as a proxy advisor. Importantly, there is a real risk that the regulation will have the effect of imposing further compliance costs on the ultimate beneficiaries of institutional investors, a risk that runs counter to the object and spirit of the proposed legislative amendments introduced by the *Your Future, Your Super Package*, currently before the Parliament.

[1] Commonwealth of Australia, Department of the Prime Minister and Cabinet, *Regulatory Impact Analysis Guide for Ministers' Meetings and National Standard Setting Bodies* (2020) <https://pmc.gov.au/resource-centre/regulation/regulatory-impact-analysis-guide-ministers-meetings-national-standard-setting-bodies>.

Centre for Astrophysics and Supercomputing

Swinburne University of Technology
PO Box 218, Hawthorn VIC 3122 Australia
T +61 3 9214 4834 F +61 3 9214 8512 E kglazook@swin.edu.au

With these caveats in place and subject to the comments below, we offer in principle support for Options 1, and 4, but not for Options 2, 3 or 5.

Ensuring independence between superannuation funds and proxy advice

The commentary in the discussion paper presumes a situation where institutional shareholders, and superannuation funds in particular, automatically follow proxy advisers' recommendations and by doing so, do not have sufficient regard for the best interests of members and standards of governance expected of trustees. We note the absence of any reference to empirical studies that might provide support for this assumption. A 2018 study by ASIC suggests the opposite is the case. Based on 2017 annual general meeting data, ASIC found that 'against' recommendations by proxy advisers were not sufficiently significant overall to alter the outcome of resolutions during the 2017 AGM season:

> Clients of these proxy advisers have strongly represented to ASIC that they do not follow proxy advisers' recommendations automatically, but make their own voting decisions. There were also reports of large institutional shareholders deciding to vote against resolutions that were the subject of a 'for' recommendation by proxy advisers.[2]

That said, we acknowledge there is value in consistent reporting by funds regarding their exercise of shareholder voting rights. We prefer 'Option 1: Improved disclosure of trustee voting'. This could be achieved very easily with minor amendments to the current disclosure requirements in terms of s 29QB of the Superannuation Industry (Supervision) Act 1993 (Cth) ('SIS Act') read with Regulation 2.38(2)(n) and (o) of the Superannuation Industry (Supervision) Regulations 1994. In fact, it may be achieved by amending the regulations alone, thereby excluding the need for legislative amendment.

We also note that asset managers play a vital part in the investment decisions and activities of asset owners including superannuation funds, but reference to their role is largely absent from the consultation document. Often, asset owners delegate much of their investment decisions and activities, including active voting, to asset managers. They therefore play a vital role, also in the monitoring of proxy advisors. Much of the reporting expected in terms of amendments to the SIS Act and/or Regulations will in fact originate from reporting done by asset managers. For this reason, asset managers in the European Union are required to independently disclose the extent to which they use proxy advisors in their engagement activities.[3]

We further propose, as an alternative or addition, that improved soft law in the form of an updated investor stewardship code, which applies across the institutional investor spectrum, be considered. Such a code

---

[2] ASIC, *REP 564 Annual general meeting season 2017* (January 2018) 9-10 <https://asic.gov.au/media/4633282/rep-564-published-29-january-2018.pdf>, cited in ASIC, *ASIC review of proxy adviser engagement practices* (June 2018) 7 < https://asic.gov.au/media/4778954/rep578-published-27-june-2018.pdf>.

[3] *Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as Regards the Encouragement of Long-Term Shareholder Engagement* 20 May 2017 EN OJ L 132/1, inserted Article 3(i)(1).

should include asset owners, asset managers, investment and ESG consultants and proxy advisors. The current bifurcated nature of the stewardship codes leads to inconsistencies. Furthermore, since the codes are overseen by the Australian Council for Superannuation Investors ('ACSI') and the Financial Services Council ('FSC') respectively, some asset owners and service providers fall outside of the scope of application of the provisions of the current codes. This includes proxy advisors.

Such a unified stewardship code could include a principle similar to the current Principle 8 for asset owners and asset managers of the UK Stewardship Code 2020: 'Signatories monitor and hold to account managers and/or service providers.' The guidance under the principle provides as an example the disclosure of asset managers of how they have monitored proxy advisors to ensure that voting has been executed according to the asset manager's policies. A principle such a this makes it clear to asset owners and asset managers that they retain the duty to oversee advice from service providers, including proxy advisors, and to apply independent judgment to intervene when necessary. Disclosures must explain how this has been done in a particular organisation. However, the detail of monitoring is left open to the asset owner or asset manager to decide.

We further refer you to Principle 12 for asset owners and asset managers of the UK Stewardship Code 2020, which provides that 'signatories [should] actively exercise their rights and responsibilities'. Under this principle, it is expected that asset owners, like superannuation funds, would set the expectations for asset managers of how they want voting to be exercised in their behalf. It is recommended in Principe 12 that institutional investors disclose their voting policy, including any house policies and the extent to which funds set their own policies; the extent to which investors use the default recommendations of proxy advisors; in the case of asset managers, the extent to which clients may override a house policy; and the policy in the case of asset managers on allowing clients (asset owners) to vote directly in segregated and pooled accounts. Detailed disclosure is recommended for equity assets, including the proportion of shares that were voted in the year of consideration and why; links to full voting records including votes withheld; explanations of some or all of their voting decisions, especially where the vote was against the board, against shareholder resolutions, a vote was withheld or the vote was not in line with voting policy; the extent to which voting decisions were executed by another entity – a direct reference to proxy voting – and how such voting was monitored, and; an explanation of how they have monitored what shares and voting rights they have. Such disclosures must cover the past 12 months.

The UK Stewardship Code 2020 includes a separate list of six principles that apply to all service providers of institutional investors, including proxy advisors. There is no reason why a similar form of soft law could not be introduced in Australia. As in the case with asset owners and asset managers, service providers must disclose how they have applied the six principles in their activities before they may claim sound stewardship. The principles are as follows:

- Principle 1: Signatories' purpose, strategy and culture enable them to promote effective stewardship
- Principle 2: Signatories' governance, workforce, resources and incentives enable them to promote effective stewardship
- Principle 3: Signatories identify and manage conflicts of interest and put the best interests of clients first
- Principle 4: Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system

- Principle 5: Signatories support clients' integration of stewardship and investment, taking into account, material environmental, social and governance issues, and communicating what activities they have undertaken
- Principle 6: Signatories review their policies and assure their processes

It is further recommended that oversight of such an investor stewardship code should move to a regulator. The model used in the United Kingdom could serve as a useful example here. In the UK, the Financial Reporting Council ('FRC') takes oversight of the disclosures of institutional investors with the UK Stewardship Code 2020. Compliance with the code remains voluntary, but only those institutional investors who adhere to the principles of the code as reflected in their annual disclosures will be allowed to be published as 'signatories' of the code on the FRC's website. The list is revised annually.

Independent oversight of this nature will benefit the accessibility of disclosures of all institutional investors from a central portal. Furthermore, while industry bodies will still contribute to the compilation and regular revision of the stewardship code, they will not find themselves in the position of both a soft law regulator and a soft law regulated actor. This would be the case if a stewardship code were also applicable to service providers, including proxy advisors. Finally, such a shift in oversight could see a move to an 'apply and explain' regime for compliance with the stewardship codes – all principles must be adhered to before an institutional investor may claim sound stewardship, but the way in which such compliance was achieved may differ between entities. This is the approach now adopted in the UK and the proposed model for adoption in South Africa.

It must be noted that the FRC has oversight of both stewardship disclosures and is the regulator for purposes of the oversight of proxy advisors.[4] It makes sense to have these disclosures vested in one place of oversight.

The soft law approach should be more cost efficient for institutional investors and service providers, as compliance with hard law measures usually implies additional resources and other administrative costs. An increased expenditure like this would not be in line with the spirit of the legislative amendments introduced by the *Your Future, Your Super Package*, which had a limitation of expenditure that would not be in the best financial interest of ultimate beneficiaries in mind.

Option 2 is not appropriate on a number of grounds. First, while independence from issuers is essential and conflicts of interest should be disclosed at all times to ensure the reliability and objectivity of proxy advice, there is no real cause to expect such independence from the users of the advice. As noted above, it is not clear from the consultation document what the mischief is that gives rise to Option 2. Moreover, since only one of the four chief proxy advice services in Australia enjoys a close connection with members (users), it leaves the impression that this suggestion is aimed at a particular entity. As such, the proposed option 2 would amount to a law regulating one proxy adviser. Note that the combined options preferred above still require of asset owners and asset managers to account for how they have monitored service providers including proxy advisors, and how they have intervened when deemed appropriate.

---

[4] UK *Proxy Advisors (Shareholders' Rights) Regulations* 2019 (SI 2019/926) Part 3.

Collaboration between institutional investors for purposes of engagement with companies is a principle globally promoted in investor stewardship.[5] The well-organised collaboration that ACSI and the Financial Services Council offer in Australia should be fostered rather than suppressed. Option 2 would go in the opposite direction.

Facilitating engagement between companies and proxy advisors

We prefer 'Option 4: Make materials accessible'. Regulation of proxy advisors should generally take a similar form as the regulation of credit rating agencies.[6] There is some similarity in the role that proxy advisors and credit rating agencies play in that they offer opinions to clients based on research where those clients are time poor and cannot access information effectively without such assistance. Also, similarly to credit ratings agencies, there are very few market players who have gained acceptance as reliable or trustworthy.

One of the key tenets of the regulation of credit rating agencies that resulted after the global financial crisis is to ensure the independence of credit rating agencies from the companies on whose creditworthiness they are asked to opine.[7] This is achieved through annual disclosures of their largest clients and through separation of the provision of rating activities from other consulting activities. Conflicts of interest must be disclosed and carefully managed.[8] Such independence is likewise desirable when it comes to the functioning of proxy advisors. While the dissemination of recommendations to companies and to the public generally should be allowed, it is inadvisable to allow for companies to attempt to change the opinion of the proxy advisors prior to them sharing such advice with their clients. Proxy advisers must be allowed to remain independent. However, companies should have the opportunity to prepare a response and it should be convenient for asset owners and asset managers to access such responses before the relevant general meeting in order to consider their response. It is probably best if companies publish such responses on their own websites. If the publication of proxy advice to clients were made subject to the addition of a link to a company's response, the latter could block such publication by not providing a response. Instead, proxy advisors could be asked to either state that the company has not yet prepared a response or offer a link to the company's website where a response is offered. A response could include any correction of facts, if necessary.

We will not offer any opinion on appropriate timelines, as we are not best placed to say what would be most efficient.

Require suitable licensing for the provision of proxy advice

A careful costing of the introduction of a licensing regime for proxy advice must be undertaken to ensure that costs are not ultimately diverted to the beneficiaries of institutional investors who employ the proxy

---

5 See the UK Stewardship Code, Principle 10; *Directive (EU) 2017/828* (n 1) inserted Article 3(g)(1)(a); ICGN *Global Stewardship Principles* (2020) par 4.5.

6 For the model used in the European Union, see *Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on Credit Rating Agencies* OJ L 302.

7 See, for instance, *Regulation (EC) No 1060/2009* (n 4) Article 6 and Annex 1.

8 Ibid Article 6(a) and Article 6(b).

advice services. Again, this will be counter the spirit of the legislative amendments introduced by the *Your Future, Your Super Package*.

International hard law regulation of proxy advisors has focused on increasing the transparency with which they pursue their functions. This includes requirements for the adoption of an internal code of conduct and that they should effectively report on their adherence to that code.[9] Similarly to the regulation of credit rating agencies,[10] a model code of conduct is usually offered,[11] but proxy advisors are free to adapt the model code of conduct to suit their internal needs and specific circumstances. It is further usual to prescribe the annual disclosure of information about how the advisors prepare their research, advice or voting recommendations so that users may gauge the robustness of their processes.[12] In the European Union and in the UK, the information that must be disclosed includes: the essential features of methodologies and models applied by the proxy advisors; their main information sources; quality assurance processes put in place and the qualifications of staff; whether, and if so how, they take national market, legal and company specific conditions into account; the essential features of voting policies applied for each market, and; whether they have direct dialogue with the companies that they research and with the stakeholders of the company and if so, the nature and extent thereof.

As mentioned above, actual or potential conflicts of interests or business relationships that may influence the objectivity of the proxy advisors, and how this is prevented and managed, must be disclosed.[13] In the European Union, this information must be publicly available on the websites of the proxy advisors for at least three years after disclosure to enable users to determine how the proxy advisors have performance over time.[14] Access must be free of charge.

In the UK, proxy advisors need not necessarily be a licensed financial service provider, but must apply to the FRC to be added to the public list if proxy advisors maintained by the FRC.[15] Admission must be granted to the list.[16] The list is not a licensing regime, but rather a means to publish legitimate providers.

We see little utility in the Option 5 proposal to extend the AFSL licencing regime to cover proxy advisers' advice on company related matters. We contend that the conception of their role in company related matters

---

9 See *Directive (EU) 2017/828* (n 1), inserted Article 3(j)(1); the *UK Proxy Advisors (Shareholders' Rights) Regulations* (n 2) reg 3.

10 See *Regulation (EC) No 1060/2009* (n 4).

11 The IOSCO *Code of Conduct Fundamentals for Credit Rating Agencies* (March 2015) is the usual one recommended for credit rating agencies. See https://www.iosco.org/library/pubdocs/pdf/IOSCOPD482.pdf.

12 *Directive (EU) 2017/828* (n 1), inserted Article 3(j)(2); UK *Proxy Advisors (Shareholders' Rights) Regulations 2019* (n 2) reg 4(1).

13 *Directive (EU) 2017/828* (n 1), inserted Article 3(j)(2)(g) and inserted Article 3(j)(3); *UK Proxy Advisors (Shareholders' Rights) Regulations 2019* (n 2) reg 5.

14 *Directive (EU) 2017/828* (n 1) Recital 25, inserted Article 3(j)(2).

15 *UK Proxy Advisors (Shareholders' Rights) Regulations 2019* (n 2) Part 6.

16 *UK Proxy Advisors (Shareholders' Rights) Regulations 2019* (n 2) reg 31(6).

as financial advisers is misconceived, save where their advice relates to financial products, as is presently the legal case.

In the wake of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (February 2019), it is clear that proxy adviser research on Australian companies must consider their financial and non-financial performance and risk management strategies. In the final report of the Royal Commission, Commissioner Hayne criticised financial institutions for their immature and one-dimensional focus on the voice of financial risk at the expense of all other organisational risks and specifically, the voice of their customers.[17] Detailed government and regulatory reports have since considered the impact that this has for prudential regulation,[18] director and officer oversight[19] and executive remuneration.[20]

Commissioner Hayne's findings relied heavily on the findings and recommendations of APRA's *Prudential Inquiry into the Commonwealth Bank of Australia* (April 2018), which concluded that the 'voice of risk' and the 'customer voice' had been diluted by the stronger 'voice of finance',[21] findings which the Prime Minister, Mr Scott Morrison, then in the position of Treasurer, stated was a 'wake up call' for every board member in this country'.[22] The research and insight offered by proxy advisors play a vital role in assisting institutional investors in monitoring the extent to which corporate Australia has heeded this call.

We are not opposed to proxy advisers being licenced, but we contend that they should have their own licensing system which more accurately reflects and acknowledges the role they play in the corporate governance ecosystem and preserves their necessary independence from corporations about whom they undertake research and give advice. We would advocate for a licensing system modelled on the regulation of credit rating agencies, subject to the risk of cost transfer considerations discussed above.

---

17 Commonwealth of Australia, *Final Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1*, (1 February 2019 [401-406], <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>.

18 Commonwealth of Australia (The Treasury), *APRA Capability Review* (June 2019) < https://treasury.gov.au/sites/default/files/2019-07/190715_APRA%20Capability%20Review.pdf>.

19 Commonwealth of Australia (ASIC Corporate Governance Taskforce), *Director and officer oversight of non-financial risk report* (October 2019) < https://download.asic.gov.au/media/5290879/rep631-published-2-10-2019.pdf>.

20 APRA, *Draft Prudential Standard CPS 511 – Remuneration*, July 2019, <https://www.apra.gov.au/sites/default/files/draft_prudential_standard_cps_511_remuneration_v2.pdf>APRA, *Revised Draft Prudential Standard CPS 511 – Remuneration*, November 2020, <https://www.apra.gov.au/sites/default/files/%5Bdate%3Acustom%3AY%5D-%5Bdate%3Acustom%3Am%5D/Revised%20Draft%20Prudential%20Standard%20CPS%20511%20Remuneration%20-%20Clean%20-%20November%202020.pdf>.

21 APRA, *Prudential Inquiry into the Commonwealth Bank of Australia* (April 2018) 11 <. https://www.apra.gov.au/sites/default/files/CBA-Prudential-Inquiry_Final-Report_30042018.pdf>.

22 Peter Ryan, 'APRA launches scathing criticism of Commonwealth Bank, Scott Morrison puts boards on notice', ABC News Online (1 May 2018) < https://www.abc.net.au/news/2018-05-01/cba-forced-to-put-aside-a-billion-dollars-extra-by-apra/9713646>.

We are happy to further articulate our views should you seek further advice or information on the matters discussed here.

Your sincerely,

Dr Natania Locke & Ms Helen Bird
Senior lecturers, Swinburne University of Technology