THE LAW SOCIETY OF NEW SOUTH WALES
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Submission on The Treasury's Consultation Paper – *Greater transparency of proxy advice*

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The NSW Young Lawyers Business Law Committee (**the Committee**) make the following submission in response to The Treasury's Consultation Paper – *Greater transparency of proxy advice* (**Consultation Paper**).

NSW Young Lawyers

NSW Young Lawyers is a division of The Law Society of New South Wales. NSW Young Lawyers supports practitioners in their professional and career development in numerous ways, including by encouraging active participation in its 15 separate committees, each dedicated to particular areas of practice. Membership is automatic for all NSW lawyers (solicitors and barristers) under 36 years and/or in their first five years of practice, as well as law students. NSW Young Lawyers currently has over 15,000 members.

NSW Young Lawyers Business Law Committee

The Committee comprises of a group of approximately 1,600 members in all aspects of business law who have joined together to disseminate developments in business law and foster increased understanding of business law in the profession. The Committee reviews and comments on legal developments across corporate and commercial law, banking and finance, superannuation, taxation, insolvency, competition and trade practices.

Introduction

The Committee understands the important role that proxy advisers play in corporate governance in Australia. To this end, we welcome the Treasury's review of the current regulatory regime applying to proxy advisers in Australia.

The Treasury's Consultation Paper provides some useful background about the concerns underpinning its review of the current regulatory regime. In response to the Consultation Paper, we submit:

- The Consultation Paper does not reference evidence of compelling errors or deficiencies in proxy advice that would warrant drastic reforms;
- However, it would be reasonable to require superannuation funds to provide improved disclosure of their proxy voting policies, with that disclosure forming part of the fund's annual report;
- We note that the four major proxy advisers operating in Australia already have policies in place about how and when they will engage with issuer companies to address any errors in their reports,[1] such that in the absence of identified inadequacies in those policies there is no need for further regulatory intervention; and
- No need has been demonstrated to extend the AFSL licencing regime to the provision of proxy advice.

We set out the Committee's response to Questions 2 to 6 and 9 to 13 of the Consultation Paper in detail below.

[1] Australian Securities and Investments Commission, *ASIC review of proxy adviser engagement practices* (REP 578, 27 June 2018).

Proposed Options

Option 1: Improved disclosure of trustee voting; and

Option 2: Demonstrating independence and appropriate governance

Q2. What impact would the proposed options have on superannuation funds in complying with these regulatory requirements?

1. The Committee notes fund managers are required to disclose their use of proxy advisory services,[2] although there is no requirement to disclose the identity of the proxy adviser. The Committee supports the introduction of the disclosure obligation outlined in Option 1 (subject to our response to Question 3 below).
2. The Committee submits that excessive regulatory reform may increase the costs of compliance for superannuation funds, which in turn, may be passed on to super fund members. The Committee considers that there have been a number of reforms impacting superannuation trustees from 2007-2021 (namely, the 2007-2013 Stronger Super Reforms, 2019 Protecting Your Super Reforms, 2019-2020 Putting Members Interest First Reforms and 2021 Your Future Your Super Reforms). The Committee submits that the introduction of new regulations concerning ongoing disclosure should not create an undue burden which could lead to downflow impacts on superannuation trustees to act in the members' best interests.
3. There are reports that Option 2 may significantly affect the current structure of the Australian Council of Superannuation Investors (**ACSI**).[3] The ACSI is comprised of 36 Australian and international asset owners and institutional investors.[4] They manage $1 trillion in retirement assets and on average own 10% of every ASX200 company. They are particularly active in researching ESG related issues, and recently pledged to vote against the re-election of directors they believe to have failed to manage climate risk appropriately. If Option 2 was implemented into law, this would affect ACSI's current structure since ACSI's member entities hold a significant ownership interest in the issuing entity in respect of which ACSI provides voting advice. Accordingly, if Option 2 was implemented into law, ACSI will incur significant costs in obtaining legal advice and restructuring their organisation, and these costs are likely to be passed onto the members in the form of fees.

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[2] See Financial Services Council, *FSC Standard No. 13: Voting Policy, Voting Record and Disclosure* (26 March 2013), which applies to all Financial Services Council members effective 1 July 2014; Jean Jacques Du Plessis et al, *Principles of Contemporary Corporate Governance* (Cambridge University Press, 3rd ed, 2015).
[3] Michael Roddan, 'Push to kneecap super proxy advisers', Australian Financial Review (online, 30 April 2021) <https://www.afr.com/companies/financial-services/push-to-kneecap-super-proxy-advisers-20210430-p57nvp?>.
[4] Australian Council of Superannuation Investors (Web Page) <https://acsi.org.au/about/what-we-do/>.

Q3. 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?

4. The Committee submits that the obligation to disclose trustee voting under Option 1 should be included in an annual report provided by superannuation trustees at the same time as the notice of an Annual Member Meeting for the following reasons:
    (a) At present, the Your Future Your Super Reforms require significant disclosure to be provided to members at the same time as the notice of the Annual Member Meeting;[5] and
    (b) The creation of additional disclosure obligations may be an unnecessary expense considering the size of the investments of superannuation funds. Ian Silk, CEO of AustralianSuper, gave evidence during the Hayne Royal Commission that a once-off direct mail-out to all members costed around $2.3 million.[6]

Q5. What level of independence between a superannuation fund and a proxy adviser should be required?

Q6. Which entity should the independence requirement apply to (superannuation fund or proxy adviser)?

5. In response to Questions 5 and 6 of the Consultation Paper, the Committee submits that proxy advice does not need to be provided to superannuation funds on an arm's length basis. The Committee considers that a superannuation trustee has an obligation to act in the members' best interests. The Committee suggests that, provided that a superannuation trustee is made aware of any activities and relationships that could compromise the independence of proxy advice it receives, the trustee should be free to assess the impact and materiality of any actual or perceived conflicts of interest and decide whether it wishes to proceed with engaging a particular proxy adviser. This aligns with the current principles-based nature of financial services law at large.
6. In the United States, the US Securities and Exchange Commission (**SEC**) in the Final Rules adopted a principles-based approach, allowing proxy advisers to apply judgment in assessing the materiality of conflicts that might pose a risk to the independence of the advice they provide.[7] Proxy adviser firms must adopt and publicly disclose their policies on how a conflict of interest will be identified and disclosed to clients, and how the conflict will be eliminated, mitigated or managed. This independence requirement is imposed on the proxy adviser rather than the client. A similar approach has been

[5] Sarah Simpkins, ''We're actually being squeezed': Super funds pressured by proxy adviser crackdown' (online, InvestorDaily, 5 May 2021) <https://www.investordaily.com.au/superannuation/49218-we-re-actually-being-squeezed-super-funds-pressured-by-proxy-advisor-crackdown>.
[6] Peter Martin, 'New rules mean superannuation funds must heed members' financial interests more closely' (online, ABC, 24 March 2021) <https://www.abc.net.au/news/2021-03-24/super-funds-new-rules-must-act-on-members-financial-interests/100023974>.
[7] *Exemptions from the Proxy Rules for Proxy Voting Advice,* 17 CFR § Part 240 (2020).

adopted in the United Kingdom and the European Union.[8] We suggest that a similar principles-based approach should be adopted in Australia (rather than a prescriptive approach).

Proposed Options

Option 3: Facilitate engagement and ensure transparency; and

Option 4: Make materials accessible

Q9. What is the most appropriate method for proxy advisers to notify their clients as to where the company's response to the report is?

7. The Committee submits that it should not be the responsibility of proxy advisers to notify their clients about a company's response to a proxy adviser report. Assuming that any clarifications or corrections need to be made by a company in response to a proxy adviser report, companies can make their response available to the market via the market announcement platform of their market operator. We consider that, insofar as the company considers that investors could benefit from further clarity or information about the company, that all investors should have the benefit of this information (not just those investors who have commissioned advice from a proxy adviser). This is particularly so if any rebuttal provided by a company has the potential to be price-sensitive within the meaning of s674 of the *Corporations Act 2001* (Cth).
8. While an institutional investor may engage the services of a proxy adviser to obtain an informed view about how to vote, ultimately a superannuation fund trustee exercising voting rights has the obligation to act in the best interests of their members.[10] Therefore, the onus to provide the company's response should not rest with the proxy adviser; rather, it should be the superannuation fund's obligation to ensure that they have reviewed any rebuttal by an issuing company in discharging their duty to their clients.
9. If the Government decides that proxy advisers are responsible for notifying their clients about a company's response to their report, the Committee submits that the Government should not mandate the most appropriate method for notifying their clients of a company's response. Proxy advisers should be able to choose the best way (including the most cost-effective way) to notify their clients of a company's response, such as by circulating a link to the company's response by email. This is consistent with the approach adopted by the SEC in the Final Rules approved on 22 July 2020 (**Final Rules**), which adopted a principles-based (and not a prescriptive) approach to regulation and allowed the proxy adviser to determine how best to make the company rebuttal available to its clients. The SEC adopted this approach to "*provide proxy voting advice businesses the flexibility to satisfy their compliance obligations in a customized and cost effective manner and avoid exacerbating the challenges posed by timing and logistical constraints, while achieving the*

[8] *The Proxy Advisors (Shareholders Rights') Regulation 2019* (UK); *Parliament and Council Directive EU/2017/828 of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement* [2017] OJ L 132/1.

objective of ensuring that proxy voting advice businesses' clients have timely access to more transparent, accurate, and complete information upon which to base voting decisions."[9] The Committee submits a similar approach may be adopted in Australia.

Q10. If proxy advisers were required to provide their reports to companies in advance of their clients, what would an appropriate length of time be that allows companies to respond to the report and for the report to be amended if there are any errors?

10. The Committee considers that in Australia, the four major proxy adviser firms already have established (albeit varying) policies and practices regarding the engagement with companies the subject of their report.[10] Only one of the major firms provides pre-publication drafts to companies for fact-checking. Given that the four major proxy advisers already have established engagement policies, the Committee submits that proxy advisers should not be mandated to provide a copy of their draft report to companies prior to distribution of the report to the proxy adviser's client(s). Providing draft reports to issuing companies could impact their independence (whether the threat to independence is actual or perceived).
11. In the United States, the SEC in its Final Rules adopted a principles-based approach allowing the proxy adviser to determine whether it will provide a pre-publication draft report or final report to an issuing company for fact-checking, depending on the circumstances.[11] We recommend that a similar, principles-based approach be adopted in Australia. The Final Rules demonstrate that there is no need for the engagement policies of each of the proxy advisers to be consistent.

Q11. 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 the recommendation otherwise publicly known?

12. As discussed in our response to Question 10, the Committee submits that proxy advisers should not be mandated to furnish issuer companies with draft reports. However, if the Government adopts this approach, the Committee submits that the issuer company should be subject to confidentiality obligations (subject to the usual carve outs such as sharing the document with professional advisers for the purpose of obtaining advice). The proxy adviser's report is its proprietary information and a fee is required to allow clients to obtain this information; therefore, confidential information (if any) would need to be protected.

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[9] *Exemptions from the Proxy Rules for Proxy Voting Advice,* 17 CFR § Part 240 (2020).
[10] *Australian Securities Investment Commission* (n 1).
[11] *Exemptions from the Proxy Rules for Proxy Voting Advice* (n 8) 191.

Proposed Options

Option 5: Ensuring advice is underpinned by professional licensing

Q12. Is the AFSL regime an appropriate licensing regime through which to regulate the provision of proxy advice?

13. The Committee notes that each of the four major proxy advisers which operate in the Australian market already hold an Australian Financial Services Licence.[12] These entities are licensed to carry on a financial services business to provide general financial product advice only, for interests in managed investment schemes (excluding investor directed portfolio service) and securities to wholesale clients. This enables the licensed proxy advisers to give voting advice which relates to financial products (such as, how to vote on a resolution by a company to buy-back its securities). For voting advice which does not relate to financial products (such as voting recommendations relating to director re-elections and adoption of remuneration reports), the Committee does not consider that the AFSL regime is the appropriate regime to regulate proxy advice. The Committee proposes that voting advice which does not relate to financial products is sufficiently regulated by the prohibition on misleading or deceptive conduct contained in section 1041H of the *Corporations Act 2001* (Cth).
14. If Australia adopted laws requiring proxy advisers to be licensed where they provide voting advice that does not relate to financial products, this licensing requirement would be the first of its kind compared to the position in the United States, United Kingdom, Europe and Canada. In the United States, two Bills were introduced in the Senate in the last five years, seeking to require proxy advisers to be registered with the SEC.[13] The progress of the Bills has stalled on both occasions.
15. Accordingly, the Committee submits that the AFSL regime should not be extended to the provision of proxy advice generally. We submit that proxy advice is sufficiently regulated by the current legislative regime.

Q13. Would coverage under the AFSL regime result in an improvement in the standard of proxy advice?

16. The Committee submits the coverage under the AFSL regime would not necessarily eventuate into an improvement in advice. As noted above, proxy advisers are already required at law to ensure that their reports are not misleading or deceptive or likely to mislead or deceive. The Committee considers that further regulation is not required to improve the standard of proxy advice. The

[12] Ownership Matters Pty Ltd (Licence number 423168), CGI Glass Lewis Pty Ltd (Licence number 307501), Institutional Shareholder Services (Australia) Pty Ltd (Licence number 297008) and Australian Council of Superannuation Investors Limited (Licence No 493441).
[13] Corporate Governance Reform and Transparency Act, HR 5311, 114th Congress (2016); Corporate Governance Reform and Transparency Act, HR 4015, 115th Congress (2017).

Committee submits that further research should be conducted into the adequacy of the current system, before legislative reforms are made.

Concluding Comments

NSW Young Lawyers and the Committee thank you for the opportunity to make this submission. If you have any queries or require further submissions please contact the undersigned at your convenience.

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