1 June 2021

Market Conduct Division
The Treasury
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Via email: MCDproxyadvice@treasury.gov.au

The Financial Services Council **(FSC)**[1] supports transparency and accountability around the use of proxy advice, to help ensure that registered superannuation entities act on advice that is in the best interests of their members. Given the increasingly significant influence proxy advice has in the market, transparency and accountability are particularly important in the context of a mandatory superannuation system where asset managers, Responsible Entities and Registrable Superannuation Entities (RSEs) play a key role as the stewards of significant amounts of capital on behalf of their clients and members.

It should be noted that proxy voting is only one element of effective asset stewardship, which also includes engagement with a company board and management and monitoring on matters such as strategy, performance, risk, capital structure, corporate governance including culture and remuneration, and financially-material social and environmental issues. Often voting decisions reflect the outcome of such engagement and monitoring activity.

The FSC has taken a leadership position on proxy voting with *FSC Standard 13: Voting Policy, Voting Record and Disclosure* **(Standard 13)** and the *FSC Standard 23: Principles of Internal Governance and Asset Stewardship.*[2] These standards are binding and enforceable on our members. The 2019 review of Standard 13 indicated that a principles-based approach to proxy voting reporting and disclosure provided the best balance of transparency with usefulness. Much of what is proposed in the consultation paper is already domestic and international best practice, as evidenced by their inclusion in the FSC's standards. Similar to the proposed reform options, under FSC Standard 13 scheme operators must disclose proxy voting policies, proxy voting records, the engagement of proxy advice, and to what extent such advice is relied on.

The FSC views much of what is included in these proposed reforms as uncontentious and existing global best practice, although we caution against unnecessary additional disclosure for its own sake. We support raising governance standards and transparency across the funds management and superannuation sectors. The FSC's recommended changes are operational in nature.

The FSC's main area of concern is the proposed requirement for proxy advisers to give companies 5 days' notice of their recommendations and analysis, before issuing their reports to their clients, who include many

[1] The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advice licensees and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses. The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

[2] FSC Standards can be found here: https://fsc.org.au/resources/fsc-standards-and-guidance-notes/standards

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fund managers as well as superannuation funds. This could have a significant impact on the current proxy voting processes of funds. Further details are spelled out in the submission below.

1. Ensuring independence between superannuation funds and proxy advice

Option 1: Improved disclosure of trustee voting. Under this option, superannuation funds would be required to disclose more detailed information in relation to their voting policies and actions for each financial year. The details to be disclosed could include how votes were exercised, whether any advice was received from a proxy adviser and who provided the advice. If proxy advice is received, disclosure could include whether the voting actions taken were consistent with the proxy advice.

The FSC supports the improved disclosure of proxy voting. We agree that any advice given by proxy advisers should be acted on by trustees only if it is in line with their obligation to act in the best interests of their members. No other consideration would be appropriate.

The FSC has led best practice on the disclosure of proxy voting through the *FSC Standard 13: Voting policy, Voting Record and Disclosure*. The policy principles in Option 1, particularly disclosing voting record, whether advice was received from the proxy adviser and the extent to which the advice of the proxy adviser has been relied on are already addressed under Standard 13, in particular Section 8.3 (a)-(h), Section 8.5, Section 8.6, and Section 10.2.

Standard 13 includes requirements for FSC members to:

- Set out the role of voting in the context of the scheme operator's stewardship activities such as the role of voting in its engagement processes - 8.3(a).
- Describe the governance arrangements under which the voting policy is maintained – 8.3(b).
- Disclose who has responsibility for making proxy voting decisions, that is, whether an operator exercises its voting rights directly, engages the services of proxy voting advisers (including listing the names of third party proxy advisers) or outsources it to the fund managers of the scheme – 8.3(c).
- Disclose conflicts of interest, including those that may result in the scheme choosing not to vote – 8.3 (e).
- Disclose statements of any principles used to guide voting decisions including any principles on voting preferences, voting considerations around board composition, remuneration, diversity, climate change and ESG matters, circumstances where the scheme operator may abstain and approach to potentially contentious issues such as shareholder resolutions, instances of voting against management recommendation and resolutions contentious in the media. – 8.3(h).
- Disclose to scheme members the voting policy of the scheme – 8.4.
- Disclose details of delegation of proxy voting decisions and oversight, including details of any arrangements where the scheme operator contracts with proxy voting advisers, investment managers, custodians and other intermediaries or where scheme operators authorise investment managers and other third parties to exercise their voting rights on their behalf in accordance with the scheme operator's voting policy. – 8.5.
- Disclose the use of proxy voting advisers in the scheme operator's voting policy including the role played by the proxy voting advisers (including whether advice or final decisions), the extent to which the scheme operator relies on the advice and recommendations provided by the proxy adviser when deciding how to vote, and the name and other relevant details of the proxy advisers used – 8.6.

- Have disclosure on voting policy and voting record be made readily available on the scheme operator's website in a consistent and easy to understand format – 10.1.
- Publish at least annually a summary of the scheme operator's voting record for the previous financial year at the minimum of entity and resolution level including where the voting has been inconsistent with the operator's voting policy and the reason for the inconsistency – 10.2.

Further to the above requirements, some investment managers disclose annual voting summary reports which include details on the number of votes made in alignment with or divergent from proxy recommendations, although it should be noted that votes that align with proxy recommendations could be made for reasons other than the reasons given in the proxy advice.

In the context of superannuation, it is common for fund trustees to retain the voting authority independently of their fund managers. To manage this authority the trustee and their fund managers enter into a contractual arrangement to allocate the authority to exercise voting rights. Similarly, some trustees contract out voting authority to fund managers. This reflects the view taken by many asset owners that proxy votes are part of the economic asset that they are asking their external managers to manage.

In either scenario, the inclusion of voting rights in mandates between superannuation funds and fund managers demonstrates that voting rights have value and underscores the need for transparency in their exercise. However, care should be taken about requiring overly prescriptive detail about the rationale for votes. Given that funds typically hold thousands of stocks, requiring disclosure of rationale at an individual stock level would impose an onerous disclosure burden on funds while not necessarily improving transparency for beneficiaries. Further, RSEs may have multiple investment managers voting on their behalf, which would add to the complexity and cost of the existing proxy and reporting process.

As far as we are aware, only two jurisdictions globally (The Netherlands and South Korea) require the disclosure of rationale at an individual stock level, and this requirement covers only domestic equities. In the case of the UK, requiring pension funds to disclose voting behaviour and rationale for 'significant votes'[3] have resulted in a substantial volume of bespoke reporting, much of which has been shifted onto asset managers' stewardship teams, with little discernible benefit for the end beneficiary so far. The reasons for this include vague guidance from the regulator on what specifically needs to be reported on, asset owner consultants applying their own interpretation to the vague guidance, resulting in a variety of differing types of reporting requests, and differing client reporting periods resulting in multiple reporting requests for the same individual funds, all of which results in a data dump onto institutional asset owners.

8.6 of the FSC Standard 13 in particular provides best practice in requiring the disclosure of the scheme operator's policy on the role played by proxy voting advisers and how that advice is used. This strikes the right balance by providing transparency on the extent to which the scheme operator is influenced by proxy advice but does not require a vote-by-vote disclosure with reasons.

Treasury should also consider how the voting process itself can be improved to facilitate better transparency. Scheme operators that appoint external managers and outsource voting processes are reliant on external managers to produce reporting for them, or they need to contract with proxy voting clearinghouses to get access to their own voting data. The data received may not be fit for disclosure

[3] see https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/dc-investment-guide.ashx

purposes. To create better transparency of voting decisions, other parties in the voting process such as a custodian and fund administrators should also be covered by these requirements.

Member feedback has raised concerns that the disclosure of proxy voting advice received, who provided the advice, and if actions were consistent with advice would be very difficult to implement in a fund of fund situation where a superannuation fund has multiple investment managers, and these mangers are instructed to direct votes on behalf of the superannuation fund.

Where the superannuation fund does not hold the stocks directly and has instructed managers to vote on their behalf, each manger may consider various sources of information when determining how to vote, including multiple providers of proxy advice. There would be a considerable effort to collating this information across all equities holding (noting that multiple managers may hold the same stock and use different proxy advisers), and such a requirement to disclose would add complexity and cost to the existing proxy voting and reporting process. In designing the proxy voting standards for FSC members, consideration was given to the information that is most relevant to members, when seeking to understand how a superannuation provider makes decisions regarding voting.

Recommendation: *Improved transparency and disclosure of voting is welcome. The FSC's Standard 13 provides best practice guidance on disclosure. Care should be taken about being too prescriptive. Attention should be paid to the role that other service providers play in the proxy voting ecosystem in providing useful voting data and supporting appropriate disclosure.*

Option 2: Demonstrating independence and appropriate governance. Under this option, proxy advisers would be required to be meaningfully independent from a superannuation fund they are advising to ensure that proxy advice is provided to and used by superannuation funds on an 'arm's length' basis. Trustees could also be required to outline publicly how they implement their existing trustee obligations and duties around independent judgement in the determination of voting positions.

The FSC supports measures to ensure that advisory companies are demonstrably independent from the superannuation funds they are advising.

FSC members procure the services of three proxy voting advisers in Australia: CGI Glass Lewis, International Shareholder Services (ISS), and Ownership Matters. Other advisers may be used offshore for international voting support. FSC members utilise the services of these proxy advisers in three ways: 1) for research, 2) for voting advice and recommendations, and 3) for voting execution, administration, and reporting support through the provision of various IT platforms and vote transaction administration services.

While the FSC has no view on the structural independence of proxy advice companies, we support a requirement that the proxy advice itself should be demonstrably independent from the superannuation fund they are advising to ensure that proxy advice is provided to and used by funds at an 'arm's length' basis. There should be appropriate governance mechanisms to ensure the independence of voting research, voting recommendations, and vote decision making from the receipt of voting advice. We believe that the guidance provided to members by Standard 13's requirements in Sections 8.3 and 8.6 on the *Voting Policy and the Use of Proxy Advisors* provides sufficient direction for FSC members.

Increased disclosure requirements around any conflicts of interest would also help increase confidence that the highest standards of governance are being followed. It would help ensure the significant influence proxy advisers wield is not used inappropriately.

FSC Standard 13 addresses conflict of interest. Under section 8.3(e), a scheme operator must set out the circumstances under which they may choose not to vote such as where there is a conflict of interest or where exercising voting rights may not be in the interest of members. As already noted above, scheme operators must disclose the details of arrangements with proxy voting agencies and the extent to which they rely on the advice of proxy advisers.

It is the FSC's understanding that the majority of proxy advisers have Conflicts of Interest policies, as this is a requirement of their AFSLs and is recognised governance best practice. Where these policies and disclosures do not exist, we support further disclosure in this area.

Recommendation: *The FSC's Standard 13 provides best practice guidance on the use of proxy advisers and conflicts disclosure. The FSC also recommends Treasury explore introducing independent governance mechanisms to ensure the independence of voting research, voting recommendations, and vote decision making.*

2. Facilitating engagement between companies and proxy advisers

Option 3: Facilitate engagement and ensure transparency. Under this option, proxy advisers would be required to provide their report containing the research and voting recommendations for resolutions at a company's meeting, to the relevant company before distributing the final report to subscribing investors. For example, a period of five days prior to the recommendation being made publicly available would give enough time for both the company and proxy adviser to comment and for the proxy adviser to amend the report in response if warranted.

Option 4: Make materials accessible. Under this option, proxy advisers would be required to notify their clients on how to access the company's response to the report. This could be through providing a website link or instructions on how to access the response elsewhere.

The FSC supports the proposal of activities to improve the accuracy of proxy voting research and to build engagement between companies and proxy advisers. Corporate engagement during the process of preparing the report and recommendations is key. Institutional investors would therefore naturally welcome measures that increase the accuracy and trustworthiness of proxy advice. Such measures would enhance the confidence of investors when making decisions during a very busy period.

It should be noted that *ASIC REP 578: Review of Proxy Adviser Engagement Practices* published in 2018 found that proxy advisers currently show:

- 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;
- a willingness to receive feedback from companies in relation to potential factual errors and to correct material factual errors; and
- provide their research and recommendations to company management for fact checking and feedback prior to publishing.

Despite these findings, there is a risk that proxy firms do not engage, or engage in a limited manner, with companies that are the subject of their report given there is no enforceable minimum standard for engagement to ensure accuracy. Companies may not be given access to reports, even after they are published, unless they have paid to subscribe to the research. This is common to the investment

research industry, and applies not only to proxy research but also to sell-side, ESG, investment fund and broker research. The clear risk of limited engagement is that reports that are relied on by shareholders contain factual inaccuracies.

The FSC has operational concerns with the measure, as requiring proxy advisers to provide their report to the relevant company 5 days before the recommendation is made public could affect our members' ability to implement proxy voting processes. As well as impacting superannuation trustees, this proposal impacts fund managers who do proxy voting on behalf of their clients, whether in pooled funds or under a delegation in institutional mandates. Member feedback has highlighted that introducing new timeframes for review, feedback and disclosure into the current process will have unintended consequences on a scheme operator's ability to execute its votes in a timely manner, and where outsourced, an investment manager's ability to meet its fiduciary and contractual obligations to its clients.

This requirement may have the unintended consequence of limiting the ability of companies to openly engage and inform voting decisions by creating timeliness issues for markets with very high volumes during AGM and proxy voting seasons. The *Corporations Act 2001* section 249HA requires at least 28 days notice for a listed company's AGM. An AGM may have 10-15 resolutions being raised at each meeting, with over 200 AGM meetings being held in an eight-week window in October and November. In other global markets, the timeframes and windows are similar, however the volumes are much larger.

Institutional investors do not typically execute their votes until near the cut-off date so that issuer companies have enough time (around 10 days) to provide additional feedback and information on the voting recommendations. Adding a 5-day pre-notification period would risk making this process unachievable in the time available. Indeed, the AGM process involves a complex 'proxy plumbing' process involving share registries, custodians, sub-custodians, proxy advisers and voting agents to manage institutional voting, mostly at a very intense time of year for company management and investor relations teams.

We note that in the United States, a previous proposal for companies subject to reports to 'pre-vet' proxy advice was considered. The Securities Exchange Commission decided that proxy advisers should share their reports with companies simultaneously with sharing them with investors, rather than at a time prior.[4] The FSC's preference is for investor clients and companies to receive simultaneous access to the voting recommendations with sufficient time for clients to review the report, while supporting a requirement for proxy advisers to notify clients on how to access the company's response to the report under option 4.

Proxy advisers should allow companies to provide feedback, corrections and additional information. Indeed, as noted above in the ASIC REP 578, most proxy advisers already do this. FSC members have also indicated that in many cases, proxy advisers already inform clients of any additional information or corrections given by issuer companies. A good consultative process would give companies the opportunity to receive feedback on potential resolutions ahead of an AGM. This would lead to fewer contentious resolutions that would otherwise receive a large "against" vote actually reaching AGMs.

We also believe that after the release of the report, if the company wishes to respond with further information or corrections, this should be shared with investor clients as soon as possible so that investors have enough time to make informed voting decisions. We believe that the proposed Option 4 would help achieve this.

[4] see https://www.sec.gov/rules/final/2020/34-89372.pdf

Recommendation: *Proxy advisers should have a publicly available policy that sets out how they will engage with companies ahead of publishing. They should allow companies to respond to any factual inaccuracies and controversies. This could include a requirement on proxy advisers to disclose whether or not they have engaged with a company prior to publishing proxy research so that the degree of engagement with a company and the factual accuracy of information can be verified.*

The FSC advises against a formal setting of five days to vet final drafts of advice given the likely impacts on scheme operators in conducting their shareholder obligations. Instead, we recommend Treasury adopt the simultaneous access approach of the SEC and are supportive of further disclosure by proxy advisers on the quantum of engagement, factual accuracy and verification status of the research and recommendations. We also support the proposal to make any responses or clarifications by companies to proxy research available to users.

We also recommend the Government consider encouraging corporates to disclose notices of AGMs earlier than the minimum 28 days set out in the Corporations Act 2001, to extend the time available for engagement and consultation. We believe this is in the best interests of corporates as it will likely lead to fewer shareholder resolutions being raised, and fewer resolutions being rejected, improving the efficacy of the voting process for all.

3. Requiring suitable licensing for the provision of proxy advice

Option 5: Ensuring advice is underpinned by professional licensing. Under this option proxy advisers would be required to obtain an AFSL for the provision of proxy advice. The purpose of the license would be to ensure that proxy advisers are making assessments on issues that have a material impact on the conduct of business in Australia with appropriate regulatory oversight and the necessary care and skill required.

Whilst proxy advisers hold AFSL licenses, we note the particular AFSL they hold does not cover their provision of voting research and advice.

As with any other investment-related research and advice provided to financial services market participants, we believe that it is critical to ensure their research and advice is reasonable and factually accurate. We draw comparison to similar requirements placed on sell-side research in this regard in terms of reasonable basis, factual accuracy, distinction of opinions and disclosures around conflicts of interest.

In drawing this comparison to sell-side research, we also recognise the material impact proxy recommendations can have on the governance and activities of an investee company, and the material financial outcomes that can follow once votes are processed and actioned.

Given the material nature of their advice, other investment research service providers who are AFS licensees are required to comply with RG79. Extending the scope of RG79 to apply to proxy advisers would address many of governance, independence, and conflict of interest areas the Treasury is seeking to improve.

The application of RG79 to the proxy voting advisory sector also supports our recommendation of simultaneous access, as prior disclosure of research recommendations before publication to clients is actively discouraged by RG79.141. ASIC stipulates:

"Research report providers should ensure that research reports or information about their contents are not communicated outside the research report provider before the report is provided to clients in the normal

course of business. This does not mean that a research report provider cannot check the factual accuracy of parts of a research report with a product issuer before it is provided to clients. However, we expect that this checking would be done in a carefully controlled way (e.g. without communicating the recommendations or opinions also contained in the report).”

The FSC also highlights the application of RG112 to the proxy voting advisory sector. Again, requiring proxy advisers to hold an AFSL and extending the scope of RG112 to apply to proxy advisers would further address many of the independence, conflict of interest and transparency issues the Treasury is seeking to resolve.

We support the proposed requirement under Option 5 that the provision of proxy advice should be covered under an AFSL. This would mean that the provision of proxy advice would need to be provided efficiently, honestly and fairly and that there would be appropriate regulatory oversight on the provision of proxy advice to ensure the general obligations under the Corporations Act were being met.

Recommendation: *The AFSL requirements of proxy advisers should be extended to cover proxy research and recommendations, and compliance requirements applied from ASIC RG79 and ASIC RG112.*

If you wish to follow up on this submission or have any questions, please contact Chaneg Torres, Policy Manager at ctorres@fsc.org.au

Kind regards,

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