4 June 2021

Market Conduct Division
Treasury
Langton Cres
PARKES ACT 2600

Via email: mcdproxyadvice@treasury.gov.au

Dear Sir/Madam

## Greater transparency of proxy advice

CPA Australia and Chartered Accountants Australia and New Zealand (the major accounting bodies) welcome the opportunity to provide comments on the *Greater transparency of proxy advice* consultation paper.

The major accounting bodies represent over 200,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

This submission contains our response to the consultation paper provided by Treasury, containing five options aimed at strengthening the transparency and accountability of proxy advice, including:

- Disclosure of trustee receipt of proxy voting advice, and actions taken by trustees
- Requirement for proxy advisers to be independent of trustees whom they advise
- Requirement for proxy voting reports to be provided to companies ahead of shareholder votes
- Requirement for proxy advisers to make any responses by companies to their reports to be made available to clients, and
- Requirement for proxy advisers to hold an Australian Financial Services Licence (AFSL)

The major accounting bodies do not support any of the five options contained in the consultation paper. We are concerned at the number of assertions that have been made in the consultation paper without substantiation, examples, or adequate explanation. Additionally, we believe that a number of the consultation paper's assertions, ostensibly aimed at proxy advisers, could equally be made by policy makers to require access to any advice provided on a confidential basis by trusted advisers to superannuation fund trustees.

It is the major accounting bodies view that the government should require APRA regulated super funds to publish their annual financial statements.

Our detailed comments are contained in the attachment to this letter.

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For further information in relation to our submission, please contact Richard Webb, Policy Advisor Financial Planning and Superannuation at CPA Australia at richard.webb@cpaaustralia.com.au or Tony Negline, Superannuation Leader at Chartered Accountants Australia and New Zealand at Tony.Negline@charteredaccountantsanz.com .

Yours sincerely

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**Attachment**

# Response to consultation

## Executive summary

This consultation seeks feedback on five policy options which would see changes made to the treatment of policy advice provided to Australian Prudential Regulation Authority (APRA)-regulated superannuation trustees. The consultation paper (page 3) suggests that there is a lack of public information available to verify that superannuation trustees – obliged to act in the best interests of their members – are acting in a manner consistent with their legal obligations. It is noted, legislation currently before Parliament proposes that the duty to act in the best interests of members be replaced with a narrower duty to act in the best financial interests of members.

Currently, proxy voting disclosure requirements for trustees of APRA-regulated superannuation funds is outlined in section 29QB of the *Superannuation Industry (Supervision) Act 1993* (the "SIS Act") and regulation 2.38(2) of the *Superannuation Industry (Supervision) Regulations 1994* (the "SIS Regulations"). These requirements are limited to public disclosure of the fund's proxy voting policy, as well as details of how and when the fund exercised its voting rights at annual general meetings (AGMs) of listed companies for the previous financial year.

The policy basis for this consultation is best outlined in a paragraph from page 5:

> *There is also scope to also ensure that the role of proxy advisers in advising and interacting with trustees is appropriate and transparent. Trustees have specific fiduciary and statutory obligations to their members, including to act in the best interests of members and to maintain high standards of governance. Proxy advisers are not subject to the same framework, and therefore may have broader objectives than those that a trustee is required to consider.*

The major accounting bodies agree that superannuation fund trustees should be held to the highest standards of governance, transparency and efficiency to ensure assets are managed to satisfy their fiduciary obligations to their fund's beneficiaries. While the proposition above suggests that proxy advisers should be subject to the same checks as superannuation trustees, the paper does not comment on other advisers to superannuation trustees, nor does it discuss examples of 'broader objectives' which proxy advisers might possess.

It also does not properly address a most important point: That is, that it is trustees which have the fiduciary relationship with members, not third-party providers. It therefore follows that trustees should be allowed to determine which advice they follow, or not follow, based upon their members' best interests. The consultation paper does not provide a compelling argument as to why this specific set of advice and decisions need to be interrogated, compared to other instances where advice is provided to trustees, and decisions ultimately made as a result of that advice.

In addition, there are other entities with similar fiduciary relationships with their investors as superannuation fund trustees, including entities responsible for Managed Investment Schemes

(MIS), Exchange Traded Funds (ETFs) and Listed Investment Companies (LICs). Given the stated policy basis, we question why these entities would not also be subject to the options proposed in this consultation paper, especially in light of the size of the MIS funds under administration—a little over $4 trillion[1]—, the lion's share of which is administered on behalf of superannuation funds.

The options for discussion in this consultation paper are:

> Option 1: Trustees would be required to disclose additional information regarding proxy voting undertaken throughout the year, including:
>
> - How votes were exercised
> - Whether advice was received from a proxy adviser, and
> - Who provided the advice.
>
> Option 2: Requirement that proxy advisers be meaningfully independent from the fund that they are advising, so that advice provided is at an 'arm's length'. Additionally, trustees would be required to disclose how they determine voting positions as part of their existing obligations and duties.
>
> Option 3: Requirement that proxy advisers provide reports of research and voting recommendations to the relevant company prior to distribution to investors.
>
> Option 4: Requirement that proxy advisers make company responses to their report accessible to their investors.
>
> Option 5: Requirement that proxy advisers be licensed through the AFSL regime.

The major accounting bodies have a number of significant concerns in relation to the proposals contained in this consultation paper. We do not support the five options proposed.

The consultation paper does not clearly identify the issues, experienced by members of superannuation funds, that the proposals seek to address. We are concerned about the intention and purpose of the proposals. In addition to advice from proxy advisers, trustees rely on specialist advice in relation to listed companies from a number of sources such as asset consultants, investment managers, taxation specialists, legal advisers and others. We are concerned that the arguments in this consultation paper could be made for the publication or transmission of any information which is presently confidential between an adviser and the fund which is their client, such as a valuation report written by a financial analyst.

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[1] ABS, 2021. *Managed Funds, Australia, March 2021*. [online] Available at: https://tinyurl.com/v33utf5w [Accessed 3 June 2021].

## International regulation of proxy advice

We note that the effects of changes in the USA and the UK are entirely different, addressing different intended policy outcomes, with the only issue common being that it affects proxy advisers. Consequently, we are not certain whether the policy basis for translating these international changes to the Australian environment is strong, or whether these changes even have relevance to Australia.

As the consultation paper further notes, Australia has powerful laws in relation to misleading and deceptive conduct under section 1041H of the *Corporations Act 2001*, which we observe are further strengthened by complementary provisions in the *Australian Securities and Investments Commission Act 2001* (section 12DA). The major accounting bodies urge consideration of longstanding substantive laws such as these in the first instance, if significant market failures or information asymmetries are proven to exist.

## Independence

We agree that registrable superannuation entities should be held to the highest standards of governance, transparency and efficiency. However, the section of the paper addressing the need for proxy advisers to be independent of superannuation funds does not make a case in support of Options 1 and 2, which are the subjects of this section.

Whilst the paper notes that it is rarely the case that superannuation funds publish detailed information regarding the proxy advice they have received, the paper fails to make the case as to why this is necessary.

We consider that the consideration of how to vote on matters put to shareholders at AGMs or extraordinary general meetings is an important issue, and one that investors should take seriously. Superannuation fund trustees themselves make a variety of decisions in relation to listed companies, in addition to voting decisions, many of which could be directly influenced by advice provided by specialists. These could be decisions to invest, research into the operations and management of an entity, or the management of risks such as environmental, sustainability and/or governance risks.

The consultation paper ultimately asserts that proxy advisers should be independent of trustees, however, it does not make a case as to why this is desirable. Also, the paper does not specify examples of how funds might be looking to use advice provided to them in a less than 'arm's length' way.

There are several questions which the consultation paper has not addressed, including:

1. What is the benefit to members of trustees being independent from proxy advisers?
2. Where a proxy adviser is jointly owned by more than one trustee, how is this different to services rendered by a proxy adviser owned by a third party who has more than one trustee as clients?
3. If the concern is market manipulation, what does the case for this problem look like?
4. How is proxy advice different to other services provided to trustees, such as investment management?

It is important to re-iterate a most important point; that is, that trustees have the fiduciary relationship with members, not third-party providers. It is members' best interests which determine which advice trustees follow, or not follow. We are not certain that this principle is properly considered in the consultation paper.

## Who are proxy advisers?

Whilst we understand that there are a number of entities providing proxy advice to trustees for whom it is envisaged that the options in this paper would apply, the reality is that superannuation trustees can receive advice in relation to proxy vote direction from a number of sources. These include:

1. 'Proxy advisers' themselves.
2. Persons directly employed by the trustees, in the case of funds which carry out proxy advice within the operations of the trustee.
3. External investment managers, who can provide advice in relation to the exercising of proxies in a variety of situations:
    a. Where investment managers undertake investment management as an agent of the trustee under a mandate, it is possible that the investment manager may advise the trustee on voting;
    b. In situations where investment managers undertake investment management as an agent of the trustee under a mandate, it is also possible that investment managers reserve the right to vote without input from the trustee, and
    c. Where entities separate from the trustee operate a pooled investment which the fund invests in, it is often the case that the entity operating the pooled investment determines its own voting policy without input from the trustee.
4. Asset consultants, who may advise trustees to vote certain ways to preserve aspects of the portfolio they have recommended.
5. Members (in the case of certain wrap or masterfund operations permitting such directions), who can sometimes advise trustees of their preference of how proxy votes should be exercised.
6. Members (in the case of unsolicited requests by members where trustees do not permit such directions) who may communicate a preference to trustees who then reserve the right to disregard such requests.
7. Third parties, in the case of unsolicited requests which may come from members of the general public.

It is possible that in the case of unsolicited requests, trustees may ultimately determine that material provided as part of an unsolicited request forms part of the rationale for the trustees' decisions in relation to exercising a proxy. Furthermore, it is also possible that upon declining an unsolicited request, the trustee may still choose to exercise their proxy in a way which coincides with the request. It is not clear how the proposals in this consultation paper will be affected by such decisions.

We consider that targeting one of these types of entities at the exclusion of all other information sources is inconsistent with the policy objectives outlined in the consultation paper. It is possible that moves to publish proxy reports may have the unintended consequence of

superannuation funds taking their proxy advice function in-house, which would have the reverse outcome of that intended. Proxy "advice" from employees of the trustee would remain confidential.

### Collective funding of advisory services

*Prudential Standard SPS 515 Strategic Planning and Member Outcomes* (SPS 515) makes it a requirement that APRA-regulated funds undertake an annual business performance review. Subsection 52(9) of the SIS Act requires funds to undertake an annual outcomes assessment, for which the main requirements are itemised in SPS 515.

Both obligations require funds to assess the impact of scale on the fund's operations. APRA provides guidance in *Prudential Practice Guide SPG 516 – Business Performance Review* (SPG 516) that confirms that funds should explore scale-related discounts, bargaining power with service providers and the pooling of risk.

However, on page 5 of the consultation paper it notes that:

> *There are also questions therefore as to whether superannuation funds should be jointly involved in determining their voting positions, including through shared ownership of a proxy adviser.*

This sentence highlights two issues which need to be addressed. Superannuation funds engage in a variety of activities designed to generate economies of scale for a number of reasons, most of which are in the best interests of members, but also to satisfy the requirements addressed in SPS 515 and the SIS Act. Activities engaged in for the benefits of scale include outsourcing, pooling and investing through jointly owned investment vehicles.

The sentence also asks whether funds should be jointly involved in shared ownership of a proxy adviser. We note that if shared ownership of a proxy adviser was removed as an option, this would remove one avenue for funds to achieve economies of scale. We question if this is in the best interests of members.

Again, it seems that the consultation paper has made an assertion without showing examples. If 'questions' exist over pooled service arrangements, why were none of these mentioned in the consultation paper? Additionally, we note that other advisory services are provided to superannuation trustees through collective arrangements. It is not clear why proxy advice is being singled out.

Finally, we note the use of the term 'arm's length'. This is a term which is already used in superannuation to denote transactions between funds and related parties undertaken at ordinary commercial rates. However, the term is used in cases where there is a possibility that inappropriate arbitrage between tax environments is likely to occur. In the case of APRA-regulated funds, the use of pooled arrangements is usually undertaken to save members money and is unlikely to result in this kind of arbitrage.

We suggest that 'arm's length' may result in more expensive commercial rates being incurred by trustees on behalf of their members, which potentially is not in their members' best interests.

## Privity of contract and market sensitivity

Privity of contract is an important legal concept. The major accounting bodies raise the question of whether the potential interference by companies, which are the subject of proxy voting reports, imposes third parties into a contractual relationship between the provider of the service and the trustees?

On page 6 of the consultation paper, the proposition is presented that:

> *Business representative groups have raised the importance of companies being able to engage with proxy advisers and being able to present their views to the investors who receive the reports, including in situations where a company may disagree with some of the research or recommendations in the reports.*

Options 3 and 4 propose that that proxy advice reports would be given to the subject company for review and feedback, ahead of the voting date. This raises two questions:

1. What other arrangements do trustees undertake with trusted advisers which allow for interference by third parties, and
2. Given the potential market sensitivity of such reports, has appropriate regard been given to the increased risk of providing these reports to companies which are the subject of such reports, ahead of votes?

In an analogous situation of a financial analyst writing a report on a company, it is not clear that it would be acceptable for a company to disagree with the research, provide an equally market sensitive response to the proxy adviser and be required to make the report public, ahead of actioning by an investor.

We also believe that this correspondence between listed companies and third parties needs to be considered in the context of the continuous disclosure obligations, due to its potential market sensitivity.

## Accountability concerns

The major accounting bodies are particularly concerned that there may be an impact on the accountability of boards and management. We note that the board of a company is ultimately responsible to their shareholders. Making specific investors undergo heightened compliance hurdles leading up to a vote is likely to limit these investors' ability to exercise, or interest in exercising, their oversight powers.

Furthermore, making voting less attractive to investors is potentially inconsistent with the notion of shareholder primacy and erodes the powers the law reserves for them in general meetings.

## Making proxy advisers subject to the Australian Financial Services (AFS) Licensing regime

We offer no substantive comments in relation to this option. However, we note that proxy advice would not be a typical financial service. It is not clear if the consultation paper is seeing proxy

advice as being similar to financial product advice—that is, advice to buy, hold, sell, or make changes to a financial product—or another kind of financial service.

We note that other types of financial services requiring the issuance of an AFSL include market making, dealing, insurance claims, operating a scheme, custodial and depositary services and crown-sourced funding. All of these services generally involve an exchange of funds, or advice regarding an exchange of funds.

There is a breadth of financial and non-financial advisory services which can be provided to trustees. Consideration should have been discussed in the consultation paper to having proxy advisers operate under a separate licensing regime entirely.

Additionally, we note that proxy advice is a service provided to wholesale investors. It appears counterintuitive to attempt to regulate a service in this way, when for similar services such as financial product advice, certain regulatory exemptions are provided when advice is provided to wholesale clients.

Finally, we note the comment on page 7 of the consultation paper that:

> *The investors that proxy advisers sell their service to are for the most part seeking financial returns for their members and clients, especially superannuation funds that are required to act in the best interests of their members.*

Given that a statement regarding the "seeking of financial returns" could theoretically embrace all services provided to superannuation funds, financial and non-financial, we have concerns about whether mandatory licensing of proxy advisers would be an appropriate. Indeed, we note that the proposed best financial interests duty contained in the "Your Future Your Super" Bill presently before Parliament, would essentially require contracted services to be provided if (and only if) instrumental in seeking financial returns.

We believe therefore, that the "seeking of financial returns" criterion provided in the quote above as a basis for AFS Licensing is overly broad and would provide a policy basis for regulating almost everyone.

## Other comments

We note that Option 1 asks for consideration of the disclosure of how votes were exercised. This is already required by 2.38(2)(o) of the SIS Regulations.

It is not clear why the disclosure requirements discussed in this consultation paper are limited to how a superannuation fund trustee voted in relation to directly held listed entities. We would consider that how a trustee voted in relation to holdings in unlisted companies and trusts would be of material interest to members of superannuation funds. Given the recent consultation by Treasury on draft regulations to give effect to the legislated (but not yet effective) portfolio holdings disclosure requirements, we believe it is appropriate to extend this proxy voting disclosure requirement to unlisted entities.

Finally, we note that APRA regulated super funds are required to provide an annual report to members that includes their financial statements. This means that prospective members have

no visibility about a fund's financial affairs other than that provided in Product Disclosure Statements. The major accounting bodies believe that there is merit in the government requiring APRA regulated super funds to make publicly available their annual audited financial statements.

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