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3 June 2021

Market Conduct Division
The Treasury
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Dear Treasury

Greater transparency of proxy advice – consultation paper

Thank you for the opportunity to provide a submission to The Treasury consultation, *Greater transparency of proxy advice*, released 30 April 2021, and for meeting with us to discuss the proposals on 19 May 2021.

The Australian Institute of Company Directors' (**AICD**) mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership of more than 45,000 is drawn from directors and leaders of not-for-profits, businesses and the government sector, reflecting the diversity of Australia's director community. Relevant to this consultation, our membership spans both directors of listed companies as well superannuation trustee directors.

The AICD recognises that proxy advisers fulfil an important function in facilitating the informed voting of holdings in Australian listed entities.

Proxy advice is relied on, and at times followed directly, by institutional investors in Australian listed entities. Proxy advisers have significant influence, advising a substantial proportion of company share registers and an even greater proportion of actual votes cast at general meetings[1]. Proxy advice has a real impact on the strategies and governance of Australia's listed companies, including remuneration, environmental, social and governance (**ESG**) resolutions and board composition. Despite this, as the Treasurer has noted[2], there is currently very limited regulation of how proxy advice is formulated, provided, used and disclosed in Australia.

This is a substantial global sector that boasts of the trillions of dollars of assets they advise, with high market concentration. In Australia – as it is globally – the proxy advice market is operated by two multinational firms owned by overseas private equity and a stock exchange, operating alongside a privately held Australian firm and an ESG specialist adviser to (predominantly) superannuation funds.

Proxy advice that is prepared diligently, free from conflicts and informed by professional engagement plays an important role in supporting market integrity, corporate accountability and governance standards. Director feedback, however, suggests that these expectations of proxy advice are not consistently met in Australia, with variable engagement, analysis and conflicts management cited by listed company directors as areas of concern.

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[1]The dominant global proxy advisory firms will often advise over 20% (and in some cases over 50%) of a large, listed company's register. The influence of proxy advice is increased by the fact that the proportion of shares voted at meetings may be significantly lower than total shares on issue. Institutional investors may also subscribe to more than one proxy advisory service.

[2] https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/greater-transparency-proxy-advice

This submission sets out the AICD's comments on the consultation issues, with responses to specific consultation questions included at Attachment A.

In preparing this submission the AICD has consulted with directors and chairs of ASX-listed entities, directors of responsible superannuation entity (**RSE**) licencees, some proxy advisory firms and stakeholders in governance, superannuation and related areas.

1. Executive Summary

- The AICD strongly supports proposals aimed at lifting the quality and transparency of proxy advisory firm advice. It is a long-standing anomaly that proxy advisory firms are not regulated for their governance voting recommendations, despite their significant influence and the existence of an oligopoly market structure. The extension of the Australian Financial Service Licence (**AFSL**) regime to cover governance voting recommendations is a proportionate regulatory step that would establish proactive obligations on proxy advisers to support quality, accuracy, conflict management and fairness. AFSL coverage would also bring proxy advice on voting resolutions under the regulatory oversight of the Australian Securities and Investments Commission (**ASIC**).

- The AICD strongly supports requiring proxy advisers to engage with issuers on governance voting research. This measure would support confidence in the provision of accurate and informed analysis and recommendations by proxy advisory firms to their institutional clients. This is particularly important in the minority of cases where proxy advisory firms are recommending against resolutions being put forward by the company. Remuneration reports, with often complex calculations and a low threshold for 'strikes' against, are a specific example where fact checking and engagement would be particularly beneficial.

- The AICD supports consideration of options to increase transparency on institutional investor voting behaviour. This is especially relevant for superannuation funds who benefit from a compulsory system that entrusts them with responsibly managing Australians' retirement savings, and where there is a wide range of reporting practices.

- The AICD notes the consultation option that proxy advisory firms be required to be meaningfully independent ('arm's length') from any superannuation fund that they are advising. While we appreciate the potential for perceived conflicts that could arise from client or collective client ownership of proxy advisory firms, we consider that these issues could be addressed by other options canvassed in the paper. Licensing could establish obligations on the independence and quality of proxy advice and proactive conflicts management and disclosure. Such obligations would apply to all proxy advisers regardless of sector or ownership model. We understand that the proposal could also have a disproportionate impact on the Australian Council of Superannuation Investors' (**ACSI**). Superannuation fund directors in feedback to the AICD have expressed concern that an 'arm's length' requirement could inhibit the ability of superannuation funds to access proxy advice to support investment voting decisions.

- The AICD endorses the consultation proposal to exempt the Australian Shareholders' Association (**ASA**) from proxy advice regulation. The ASA is fundamentally different in nature to the four firms listed in the consultation paper. The ASA does not provide commercial proxy advice and has a broader advocacy role representing the interests of retail investors in Australia.

2. Australia's proxy adviser market

(a) The proxy adviser market in Australia

As the consultation paper notes, in Australia there are four main firms offering proxy adviser services to institutional investors:

- Institutional Shareholder Services (**ISS**);
- Glass Lewis;
- Ownership Matters; and
- ACSI.

The AICD understands that Glass Lewis and ISS are majority owned by overseas private equity[3] and the German stock exchange[4] respectively. We understand that ACSI is a public company limited by guarantee with membership drawn predominantly from the Australian superannuation sector and Ownership Matters is a proprietary limited company owned by its management. We have set out the AICD's understanding of the market below, as context for our views on regulatory settings.

(b) Specific proxy adviser functions

Institutional investors and other shareholders subscribe to proxy advisers to undertake research and provide voting advice on resolutions that an issuer/company is putting forward at their AGM. Institutional investors may also subscribe to more than one proxy advice provider.

Proxy adviser reports include analysis of the company's resolutions and recommendations on how their clients (the subscribing institutional investors) should vote. Proxy advisers make assessments against their published proxy guidelines, considering publicly disclosed information from issuers in a notice of meeting and corporate reports, and (ideally) engagement with issuers to understand the company's position and strategy. Governance recommendations relate to voting on the remuneration report and director elections as well as shareholder requisitioned resolutions. Typically, the latter category would relate to shareholder views on a company's approach to ESG-related issues such as climate change.

Proxy advisory firms may also provide other services in the market. Depending on the firm's individual offerings, these may include advice that is covered by the AFSL regime (unlike the current exclusion for governance voting recommendations), consultancy services for investors or issuers, market insights, and integrated platforms through which institutional investors can manage proxy voting.

(c) Influence of proxy advice on listed company resolutions

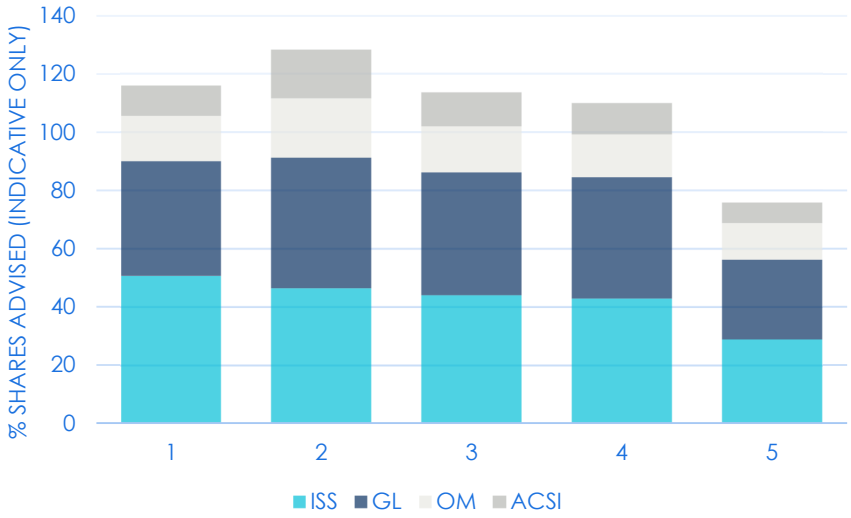
It is important to recognise the influential role which proxy firms play in Australia's capital markets. They are often advising the majority of votes cast at AGMs, with their recommendations regularly followed by investors who are not seeking to actively manage their Australian shareholdings as well as investors with limited capacity or appetite to undertake their own independent analysis. This is particularly so with overseas investors who may have a policy to follow the proxy advice as a default position, and where appetite for direct engagement with Australian issuers may be limited.

[3] https://www.reuters.com/article/us-glasslewis-m-a-pelotoncapital-idUSKBN2B816Z

[4] Deutsche Börse AG holds an 81% ownership of ISS – see https://deutsche-boerse.com/dbg-en/media/press-releases/Deutsche-B-rse-successfully-completes-acquisition-of-ISS-strengthening-the-focus-on-sustainable-investing-2555110

In consulting with listed company directors on Treasury's proposals the AICD has sought indications of the extent to which ASX 50 company share registers are currently understood to be advised by the four main Australian proxy advisers. This information was sought on the basis that it would be de-identified and not attributed to any specific company and is provided on this basis as an indication only.[5]

Based on a sample of ASX 50 firms across different sectors, the feedback we have received shows that a significant proportion of large, listed company registers are advised by one or more of the four proxy advisers. ISS holds the majority of the proxy advice market share based on the AICD's informal sample (advising between 20% and 50% of shareholder votes), followed by Glass Lewis, Ownership Matters and ACSI. The chart below provides five examples indicative of our broader sample feedback (note that total shareholdings advised will exceed 100% where investors subscribe to multiple proxy advisers):



What this demonstrates is that if just one proxy firm recommends against a company resolution it can have a significant influence on the outcome. This is particularly relevant to the non-binding shareholder vote on pay, where a strike is marked where at least 25% of the votes cast at the meeting are against the remuneration report. If a report receives a "no" vote at two successive AGMs, the second AGM must vote on whether to hold a spill motion of the board. Although second strikes and spill motions are rare, the threat that it carries places significant emphasis on boards to ensure that there is strong shareholder support for the remuneration report (thereby reinforcing the influence of proxy firms).

Institutional investors are also more likely to cast their votes at AGMs than other investors, further amplifying proxy adviser influence. As an example, a large, listed entity may have a diverse share register with a mix of institutional investors, retail investors and self-managed superannuation funds. Approximately 40% of the register may be advised by one or more of the four proxy advisory firms. At the listed entity's general meeting, 50% of shareholders vote on resolutions, predominately institutional investors via proxies. In this example, more than 85% of votes actually cast on company resolutions at the general meeting would be advised by proxy firms. This significantly increases the influence that proxy advisers exert on company resolutions, particularly with the 25% threshold for remuneration reports.

[5] This information is based on listed entity estimations, rounded down for the purposes of providing indicative examples.

(d) Public interest in regulating proxy advisers

For the reasons set out above, proxy firm views can have an outsized impact on the operation of Australian listed companies. Given the market influence of proxy advice and highly concentrated nature of the industry in Australia it is reasonable to expect minimum standards and regulatory oversight to apply. It is also reasonable to require that proxy voting recommendations be founded on accurate, considered, and objective research, supported by direct engagement with listed entities.

Proxy advisers operate within an oligopolistic market with high market concentration. Targeted regulation, such as mandating that proxy firms' governance advice be subject to Australian Financial Services licensing, would align governance voting advice with other participants within capital markets including directors, executives, companies, investors and lenders and other research firms.

(e) International review of proxy advisers

Consideration of the appropriate regulation of proxy advisory firms is not confined to Australia. Other jurisdictions have introduced or reviewed options for regulatory oversight of the proxy advisory market. It is appropriate that Australia give consideration to fit-for-purpose regulation for this important sector.

As examples:

- In the United Kingdom, proxy advisers are (since 2019) required to disclose how they:
    - Conduct their business, including whether they apply a code of conduct;
    - Produce their advice and voting recommendations; and
    - Manage conflicts of interests.

  These changes were introduced to increase transparency and help investors and asset managers looking to obtain the services of proxy advisors to make well informed decisions. In doing so, the UK implemented a European Union Directive (the revised European Shareholder Rights Directive ("SRD II") aimed at addressing the risk of low-quality services.

- In the United States, rules set in 2020 by the Securities Exchange Commission (**SEC**) that were due to commence in December 2021 have recently been paused following a direction by the SEC Chair for further review. The rules include requirements that proxy advisors disclose material conflicts of interest in reports, provide companies with copies (at least simultaneously with clients) of reports and circulate issuer responses, and ensure that advice is free from material omissions.

- In Canada, the Ontario Capital Markets Modernisation Taskforce report(January 2021) noted that "multiple stakeholders raised concerns about the disproportionate influence of proxy advisory firms in the current proxy voting process".[6] The Taskforce recommended reforms to increase regulatory oversight of proxy advisers, prohibit conflicted services and increase transparency.#

- In Japan, the Financial Services Agency released the updated Japan Stewardship Code in March 2020. Under Principle 8, proxy firms are expected to have sufficient operational resources to support accurate proxy advice. Proxy advisers are also expected to disclose their engagement with issuers and process for determining recommendations and are encouraged to confirm the accuracy of advice and circulate issuer opinions to clients.[7]

[6] https://www.ontario.ca/document/capital-markets-modernization-taskforce-final-report-january-2021/24-proxy-system-corporate-governance-and-mergers-and-acquisitions

[7] https://www.fsa.go.jp/en/refer/councils/stewardship/index.html

3. Key considerations of AICD members

Concerns raised by senior listed company directors about the proxy advice market are set out in summary below. Most of the AICD's feedback has been from directors of large, listed entities, a cohort which is more likely to be able to secure access to proxy adviser firms. This feedback may over-represent the state of proxy adviser engagement amongst ASX listed companies more generally. Given the significant influence of proxy advisers and concentrated nature of the market, there is understandable reticence to disclose the details of companies' specific engagements with individual proxy firms. Accordingly, examples are provided on an anonymous basis. If Treasury would like to discuss examples, we would be pleased to try and facilitate access to the relevant companies involved.

(a) Level of engagement of proxy advisers with companies

While engagement by proxy advisers with companies is reported to be improving, there appears to be a high degree of variability in engagement practices. While some proxy firms engage professionally with companies through the year, including where they anticipate that they may recommend against a resolution, others decline to engage or only do so during very limited windows.

(b) Accuracy of reports

In most cases companies are offered little to no opportunity to provide feedback on proxy advice. This is especially concerning when the report covers complex material. Directors of Australian listed entities have reported extremely limited windows for fact checking, where this option is provided, and inconsistent and non-transparent processes by proxy advisers for responding to issuer comment or corrections. Such issues may range from calculation errors to a misunderstanding of the operation of a remuneration structure, which would have been avoided through issuer engagement.

(c) Formulaic approach to analysis misses relevant context

Concerns have been raised that proxy firm analysis can be formulaic in approach. For example, one large, listed company reported being benchmarked against other ASX companies despite there being no comparable company in the Australian market. In the issuer's view it would be more appropriate to assess the entity against directly comparable in offshore markets. Due to the relevant proxy's firm's inflexible approach, however, the company was compared against much smaller local entities. The problem of rigid application of proxy guidelines is most acute where it relates to smaller, offshore investors advised by proxy firms. Whereas larger Australian funds might be able to be engaged with directly by companies, this is much more difficult to achieve for smaller investors who may not see value in speaking with a company that represents a small fraction of their global portfolio.

(d) Transparency and disclosure of conflicts of interest

As noted, proxy firms may also provide services to issuers and clients, including consulting relevant to governance resolutions. In some circumstances this could lead to a risk of conflicts where the issuer's resolutions are also the subject of governance voting advice. The AICD considers that management of conflicts should be a key element of regulatory standards. As contemplated in the consultation paper, external oversight of conflict obligations could be exercised by ASIC as part of their AFSL regulatory role.

(e) Issues affecting superannuation funds and investor stewardship

Directors of RSE licensees, in feedback to the AICD, indicated general support for periodic disclosure on fund voting decisions. Directors felt it would be preferable to disclose voting outcomes rather than narrative disclosure with reasoning for those decisions. Directors noted that the rationale for contested or disputed votes could be sought by members at annual meetings.

Directors of superannuation funds consulted by the AICD do not support the required separation of ownership between funds and proxy advisers, noting this would be a significant issue for ACSI. As noted above, the AICD considers that the policy concerns raised in the consultation paper can be effectively dealt with by other regulatory options rather than mandating 'arm's length' requirements.

While the Australian superannuation sector plays an important role in the operation of our capital markets, the same can also be said for other types of institutional investors who routinely access proxy firm advice. If the objective is to ensure that institutional shareholdings are being voted in a responsible manner, informed by high quality proxy advice, then there may be merit in ensuring that minimum stewardship standards are applied across the funds management industry. This could take the form of a stewardship code similar to that which operates in the United Kingdom.

Under the UK Stewardship Code 2020, administered by the Financial Reporting Council, asset owners (including superannuation/pension funds), asset managers and service providers (including proxy advisers) undertake to follow principles on an "apply and explain" basis, including that signatories:

- Purpose, investment beliefs, strategy and culture enable stewardship that creates long-term value for clients and beneficiaries with sustainable benefits for the economy, environment and society;
- Systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities;
- Monitor and hold to account managers and/or service providers;
- Engage with issuers to maintain or enhance the value of assets; and
- Actively exercise their rights and responsibilities.

There is no equivalent in the Australian market. Although ACSI has its own Stewardship Code, as at 27 May 2021, there were only 19 signatories to it. The ACSI Code is also not subject to independent regulatory review. Ideally any such code in the Australian context would align with international standards so as ensure a degree of harmonisation across jurisdictions.

We appreciate that the above may be beyond the scope of the current consultation. However, should there be interest in exploring this concept further, we would be pleased to discuss it with Treasury and relevant industry stakeholders.

Next steps

If you would like to discuss any aspects of the AICD's submission, please contact me on lpetschler@aicd.com.au or Christian Gergis, Head of Policy, at cgergis@aicd.com.au.

Yours sincerely,

Louise Petschler GAICD
General Manager, Advocacy

Attachment A

Responses to consultation questions and options

Ensuring independence between superannuation funds and proxy advice

The AICD supports Option 1 (Voting Disclosure). We have concerns about the proposal that trustees be required to outline publicly how they implement their existing trustee obligations and duties around independent judgement in the determination of voting positions. The AICD does not support Option 2 (Demonstrating independence and appropriate governance) on the understanding that any potential concerns about conflict of interest would be resolved under a licencing regime.

Improved disclosure of trustee voting (Option 1)

In our discussions with directors of RSE licensees, directors confirmed that decisions made on voting positions typically are delegated to internal investment employees or external investment managers. It is rare that the board would determinations on the voting positions of the fund. The only examples we were provided were instances where the voting related to the industry in which the fund operates (in the case of industry funds), where there might be a corporate conflict (in the case of corporate funds) or where there is significant public interest and therefore a risk of reputational damage. In most cases, the board's involvement in voting decisions is limited to the setting of the fund's proxy voting policies.

In our view, this is an appropriate level of delegation. The AICD would not expect that, as a matter of course, directors would be involved in determining individual shareholding voting positions. Their role, with respect to equity investments, is to steward the fund through policies and oversight of investment strategies and controls. It is appropriate to expect that the board delegate to management proxy voting of investment holdings, noting that a fund's individual shareholding in a company would usually be very small compared with the size of their overall portfolio that would typically be in the billions of dollars.

The AICD understands that it is relatively common for a fund's proxy voting policies to disclose that they will typically vote in accordance with a specific proxy adviser's recommendation while retaining the right to over-ride any voting recommendation of voting service providers and/or investment managers. In practice, the degree to which proxy advice is deviated from by a superannuation fund will involve a range of considerations, with the larger funds more likely to do so based on their own internal resourcing and/or direct engagement with companies.

The AICD strongly supports superannuation funds ensuring that they are bringing independent judgement to bear on voting matters, in accordance with their best interests obligation. However, this does not mean that large internal ESG teams must be assembled within each fund. Rather, directors should satisfy themselves that an appropriately robust process is followed before their voting rights are exercised.

The AICD considers additional periodic disclosure of the receipt of proxy advice as proposed in Option 1 to be a reasonable and positive step. A number of funds do this already, albeit with varying approaches.[8] Proxy voting policies should already disclose how each RSE licensee implements its trustee obligations and duties around independent judgement in the determination of voting positions. To the

[8] The FSC's Standard on voting policy, voting record and disclosure suggests that an operator keep a voting record and post it on its website. The standard is available here.

extent there might be concern about the level of disclosure of that policy, that could be a matter dealt with by regulators in the normal course of supervision of funds.

The AICD has concerns with the proposal that funds provide narrative disclosures on their voting decisions, rather than disclosure of voting outcomes. This could impose an unreasonable expectation on funds to disclose the rationale behind often complex considerations. If there is disclosure of a proxy voting policy, voting outcomes and proxy advice received, then where members of the fund (or other stakeholders, such as media) are interested they could request details of the reasoning behind voting decisions.

Additional narrative disclosure might also necessitate the involvement of the board, or a sub-committee of the board, in approving disclosures, which might lead to the board needing to involve itself in decisions that are appropriately within the delegation of management.

Demonstrating independence and appropriate governance (Option 2)

The AICD does not support a requirement for proxy advisory firms to be meaningfully independent from any superannuation fund they are advising. In the AICD's view, alternate regulatory options (including AFSL coverage) can provide effective obligations on independence, informed research and conflicts management that would not require structural changes to proxy adviser ownership structures. We also note concerns expressed to us by directors of superannuation funds that this option could inhibit the ability of superannuation funds to access proxy advice to support investment voting decisions.

With appropriate independence and conduct obligations enforced via licensing, joint ownership of a proxy adviser should prevent joint voting decisions are determined between funds.

Superannuation fund directors have also raised concerns that an 'arm's length' requirement could have a disproportionate impact on the current structure and operations of ACSI. The AICD has a productive and professional relationship with ACSI and appreciates ACSI's commitment to stakeholder and issuer engagement. While we are not aware of any examples of conflicts arising because of ACSI's membership structure, we consider that the risk of conflict could be addressed through the licencing regime and proactive obligations for independence in advice. Similarly, if concerns exist in relation to superannuation funds exercising voting options through their relationship with ACSI, this could be addressed through the existing regulation of the superannuation sector.

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

Some additional disclosure of voting outcomes and proxy advice received may be of benefit to superannuation fund members so that they can view with increased transparency how their fund is making decisions. Other proposals, such as requiring disclosure of how entities are acting in the best interests of members and requiring arm's length advice, are not likely to benefit fund members and may drive-up costs and generate board-level attention for no clear benefit.

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

Additional disclosure of voting records would, in our view, increase costs by a modest amount. Such expense would be justifiable however, given the expected transparency dividend. This anticipates that the form of reporting would note which firms provided proxy advice, the nature of the recommendation (for or against), and then, how funds ultimately voted their shares.

Option 2 would mean that funds currently using ACSI could be required to use a different proxy adviser and/or dedicate additional internal resources to stewardship matters.

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

The AICD supports disclosure occurring on an annual basis on a fund's website in the lead up to the AMM.

4. **Reporting and disclosure of how votes were exercised could be done on an annual basis on a Fund's website in the lead up to the AMM. The proxy voting policy should be required to be current and updated whenever it is amended. It could be circulated to members as part of AMM materials. What other information on how voting is informed by proxy advice should be disclosed by superannuation funds and why?**

For the reasons set out above, we do not believe additional narrative disclosure is warranted. However, we consider that voting policies should make clear which proxy firms are engaged by the fund as currently there is a wide divergence in practice (for example some funds name the firms they engage with, while others do not).

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

In the AICD's view, independence and conflicts management should be proactive obligations dealt with through the AFSL regime (in relation to the proxy adviser) or APRA's prudential supervision (in relation to the superannuation fund). This would be a preferable mechanism rather than seeking to hard-wire strict independence requirements into legislation.

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

Not applicable.

Facilitating engagement between companies and proxy advisers

Based on our conversations with directors, overall, engagement practices across the four proxy advisers have improved over recent years, however variable practices and gaps remain.

The AICD supports the proposal in Option 3 that the proxy advisers' draft report be shared with issuers with sufficient time for review before distribution to clients. This should be supplemented by a right to have the company's response distributed by proxy firms to their clients (Option 4).

Currently, we understand that only one firm offers the opportunity for companies to conduct fact-checking on draft reports on an ad-hoc basis. Engagement practices also vary between proxy advisory firms, ranging from regular dialogue (including where a recommendation against is being contemplated) to a refusal to meet with the listed company. One firm does not engage with companies once the notice of meeting has been published as part of its guidelines. In other cases, directors and chairs report challenges in establishing engagement contact, with multiple meeting requests refused even where outside AGM season. As an example, one ASX 100 chair reported that they had only been able to secure one meeting in over two years with a proxy firm which advises more than a quarter of their register, despite frequent requests to discuss strategy and remuneration. The proxy adviser has recommended against board resolutions during this period.

The AICD supports the consultation paper's suggestion for an advance review period. A mandated minimum timeframe will drive better consistency of practice in engagement. It will ensure that all companies for whom their investors are receiving proxy advice, will have the opportunity to provide their perspective and correct errors, inaccuracies or omissions if they are present.

The AICD rejects the view that an appropriately structured advance review runs counter to ASIC's guidance for the non-disclosure of research reports outside of the research provider before the report is provided to clients. ASIC's RG 79.141 notes that research report providers can check the factual accuracy of research reports with the relevant company before it is provided to clients provided this is done in a carefully controlled way (see also RG 79.25).

As noted in the consultation paper, proxy advisers provide advice on resolutions outside of financial products, such as remuneration reports, board appointments and governance arrangements. We consider it is of critical importance that companies be afforded the opportunity to correct factual errors or potential misunderstandings on these important issues.

The AICD appreciates that the timeframes during AGM season are compressed. Should companies choose not to respond within the set timeframe, proxy advisers must be able to distribute their report to clients. Of course, for completeness, there would be no obligation for proxy advisers to amend their reports if a company's feedback did not persuade them that an amendment was necessary. Ultimately the report remains the opinion of the proxy firm and they must stand by its content.

The AICD also supports proxy advisers notifying their clients when a company has provided a response in relation to a report. This reasonable right of reply mechanism would help ensure that investors are given a balanced picture, particularly on contentious resolutions. The AICD understands that some proxy advisers already proceed on this basis, however in one case circulation of the company's response must be paid for by the company (we understand that this process is separate from corrections to factual errors).

The AICD also supports requirements for companies to keep the proxy advice confidential during any review period, with the primary focus being review of factual and interpretation issues.

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

The AICD supports Option 3 which would impose minimum expectations upon the industry. As the examples highlighted above indicate, there are occasions where there is either no engagement or limited engagement between companies and proxy advisers prior to them finalising their position on voting recommendations. This may be despite multiple attempts by listed companies to seek meetings with proxy firms who advise a significant proportion of their share register.

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

Yes. Options 3 and 4, which the AICD supports, would mean that investors would be provided with information from the company allowing for a more informed conclusion to be reached on voting decisions. It would then be a matter for the investor to determine their position. All that is proposed is the provision of additional information.

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

An active hyperlink to the company's response (where provided) would suffice.

10. 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?

The AICD is supportive, in principle, of the suggested advance review period of five days proposed in the consultation paper. However, we also acknowledge that further consultation will be required with issuers, proxy advisory firms and investors to consider the timing constraints under which advice is issued.

It is, however, critical that the review period provide sufficient time for fact-checking and engagement, and for the proxy adviser to amend its report if a response is required.

Providing issuers with a review period is important given that not all proxy advisers currently give companies indications that they intend to recommend against a company's resolution.

While we understand that some proxy advisers consider any review period unworkable, it is in the public interest that proxy advice be accurate, considered and informed. Regulation should prioritise quality and engagement rather than the maintenance of current staffing levels and business models by proxy advisory firms.

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

It would be reasonable to place confidentiality requirements on both the company and the proxy adviser during this period. Otherwise, it would be difficult for the parties to engage in good faith discussions and the purpose (ensuring that proxy adviser clients receive an accurate and informed picture on resolutions) could be circumvented.

Require suitable licensing for the provision of proxy advice

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

Yes for the reasons set out below.

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

We support a targeted and proportionate level of regulation to support the transparency and conduct of proxy advisers operating in Australia. This includes the proposal that all proxy advisers should hold an Australian Financial Services Licence for governance voting research and recommendations.

AFSL coverage could strengthen the standards and benchmarks for proxy advice across the areas of conduct, conflicts management and competence of advisers as well as their ongoing training and development. It has been anomalous that, up until now, such influential market participants have avoided regulation or oversight of a core part of their business (proxy advice on governance matters).

Currently proxy advisers' AFSLs do not apply to voting recommendations on governance resolutions including director elections and remuneration reports, which are increasingly the focus of investors.[9] These are important resolutions that can have a considerable impact on the operations of companies

[9] The content of AFSLs are a matter of public record and do not cover proxy adviser services given the operation of a specific exemption from financial services licensing.

including their corporate reputation and therefore the value of investors' shareholdings. Increasing the breadth of the AFSL would give ASIC as the corporate regulator, the power to act on conduct concerns, just as they do in other areas of the market. Currently, were ASIC to have concerns regarding, for example poor conflicts management or the competency of staff at a firm, it would have very limited authority to act.

The AICD's consultations with directors have also highlighted the benefit of proxy adviser firms being required to have the appropriate qualifications, skills and experience to carry out their roles. The competency of analysts opining on company resolutions (particularly those related to remuneration structures) is reported to be variable.

AFSL licensing would also require effective management of potential conflicts with capacity for ASIC oversight, which would increase confidence in the independence of proxy advice.

This type of licencing, where proxy advisers are expected to abide by some minimum standards, are also features of other jurisdictions. In the EU, proxy advisers are expected to abide by a code of conduct and disclose information on matters such as the essential features of the methodologies and models they apply and the procedures put in place to ensure quality of the research, advice and voting recommendations and qualifications of the staff involved.[10]

Finally, we understand that given all four proxy advisers currently hold AFSLs, requiring an additional part of their business to be subject to the regime would represent a limited regulatory impost.

For the reasons outlined above, the AICD considers that AFSL coverage is reasonable and proportionate and would support confidence in the quality and independence of the proxy advice market overall.[11]

[10] Article 3j, Directive (EE) 2017/828 of the European Parliament.

[11] For reasons outlined elsewhere in this submission, the AICD continues to support the ASA being excluded from any proposed proxy reforms including AFSL requirements.