



Australian Government
The Treasury

Greater Transparency of Proxy Advice

Regulation Impact Statement
The Treasury

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Executive summary

The Government made a commitment to review the regulation of proxy advice in Australia as part of the 2021-22 Federal Budget. This Regulation Impact Statement (RIS) considers the appropriateness of the current regulatory settings and sets out options to improve the accountability and oversight of the proxy advice market and the transparency of its use by institutional investors.

Proxy advice principally involves the provision of recommendations for shareholders on how to vote on resolutions put at a company's Annual General Meeting (AGM). Proxy advisers may provide other services such as research (including data, analytics, and insights) into Environmental, Social and Governance (ESG) issues typically in relation to public companies, governance advice and voting administration services. There are four main proxy advisers currently operating in Australia.

Services provided by proxy advisers can be an efficient way for institutions to obtain information to assist with their decisions regarding how to exercise voting rights on behalf of members and beneficiaries. Given the breadth of an institutional investor's shareholdings and the volume of meetings which occur during peak AGM season, proxy advice is a significant and influential input into their decision-making process. The implications of these decisions can play a key role in determining the future success of a company and have far-reaching effects on the allocation of capital in Australia's financial markets.

Financial services in Australia are regulated through the Australian Financial Services (AFS) licensing regime, however, the current regulatory settings do not provide a clear framework of obligations relating to the provision of proxy advice, despite the significant contribution proxy advisers make to capital markets. The existing legislative uncertainty creates complexities for both businesses and regulators of the proxy advice market.

At the same time, the absence of consistent disclosure requirements around proxy voting behaviour for Australia's largest institutional investors, the superannuation sector, makes it difficult for members to understand how trustees are exercising their duties on behalf of members.

To address these concerns, the Government canvassed a number of options to better regulate proxy advice through a public consultation process between 30 April 2021 and 4 June 2021 on the consultation paper '*Greater transparency of proxy advice*'. The Consultation Paper invited feedback on five policy approaches. These were to require:

- proxy advisers to obtain and hold an AFS licence for the provision of proxy advice;
- proxy advisers to provide their research and voting recommendations to the company that is the subject of their report at least five business days before providing it to their clients;
- proxy advisers to notify their clients how to access the company's response to the report;
- proxy advisers to be meaningfully independent from their client if their client is a superannuation fund; and
- superannuation funds to make publicly available more detailed information on their voting record, including whether a vote was consistent with any proxy advice received.

Based on feedback received through the consultation period, a number of regulatory approaches have been considered. These include *Option 1 – maintain the current settings*, *Option 2 – extend existing regulatory arrangements*, and *Option 3 – introduce a new sector-specific regulatory regime*.

In considering Option 1, it was concluded that Government intervention is required to provide a clear and consistent set of expectations for the proxy advice sector which is commensurate with the significance of the sector to the efficient allocation of capital in Australia. Uncertainty in the current legislative settings is deemed unsuitable for the long term.

Option 2 leverages the existing AFS licensing framework to remove current exemptions and classify the provision of proxy advice as a financial service. This would provide certainty for proxy advisers and regulators and includes enhancements to superannuation fund voting disclosure. Additional obligations regarding independence and enhanced transparency to facilitate better engagement with investors is considered.

Option 3 assessed the creation of a bespoke regulatory regime centred by a code of conduct designed specifically for the proxy advice market. This option considers elements from regimes introduced in other international jurisdictions, such as the United Kingdom. Under this option proxy advisers would be required to provide more comprehensive disclosures around their methodologies and share reports with companies five days prior to publishing the recommendations to their clients. These measures focus on establishing minimum standards of engagement between companies and proxy advisers. For superannuation funds, this option considers disclosures which focus on disclosing the voting process and rationale for voting activity in further detail.

This analysis concludes the preferred approach is to leverage the existing AFS licensing framework to ensure consistency in the standards that apply across the financial sector, and improve the transparency and independence of proxy advice (Option 2).

Introduction

What is proxy advice?

Proxy advice is principally a set of recommendations for shareholders on how to vote on resolutions put at a company's AGM. Resolutions may relate to strategic or commercial decisions, the composition of a company's board, executive remuneration and changes to a company's name, type, or constitution. Some resolutions are required under the *Corporations Act 2001* (Corporations Act) and some may be required by a company's own constitution. The outcomes of these resolutions will have a direct impact on shareholder returns.

Proxy advisers provide their recommendations in a proxy advice report to a range of institutional investors, such as superannuation funds, asset owners, pension funds and other major investors. Investors can use the proxy advice report and other sources of information to arrive at a vote decision.

There are four main proxy advisers in Australia, each with their own proxy voting guidelines and policies that outline the underlying principles that guide their voting recommendations. Proxy advisers abide by bespoke engagement policies that outline how they engage with companies.

Apart from the proxy advice report, proxy advisers may provide other services such as research (including data, analytics, and insights) into ESG issues typically in relation to public companies, governance advice and voting administration services.

Consumers of proxy advice

Proxy advice is a valuable source of information for many institutional shareholders, particularly those with diversified holdings in a large number of companies.

The largest class of investor on the Australian Stock Exchange (ASX) 200 are domestic institutional investors, owning in aggregate about 43 per cent of issued capital¹. Superannuation funds are a core component of domestic institutional investors. As at 30 June 2021, superannuation funds with more than four members owned 20 per cent of the total market value of the listed equity on the ASX².

It is common for institutional investors to engage the services of proxy advisers given the volume and complexity of company resolutions that they may be entitled to vote on in a year.

The number of shareholder proposals being put to Australian listed companies has increased each year since 2017. Proposals relating to ESG issues have also been increasing in number and prominence³. This is consistent with an increasing trend across OECD countries of the integration of

¹ Orient Capital, *Understanding share ownership trends in Australia*, 2019

<https://www.linkgroup.com/docs/OC_Understanding_Ownership_Trends_in_Australia.pdf>

² APRA quarterly superannuation performance statistics, June 2021 <<https://www.apra.gov.au/quarterly-superannuation-statistics>> and ASX Historical Market Statistics, June 2021

<<https://www2.asx.com.au/about/market-statistics/historical-market-statistics>>

³ Australian Centre for Corporate Responsibility, *Super Votes: How Australia's largest superannuation funds voted on ESG resolutions in 2020*, September 2021 <<https://www.accr.org.au/downloads/accr-supervotes-202109-final-5.pdf>>

ESG issues into investment decisions⁴ and the concept of stewardship⁵ as a defining feature of institutional ownership.

Regulation of proxy advisers internationally

Recent reviews in the United Kingdom (UK), India, Canada, and the United States (US) have looked at options to strengthen the oversight of proxy advisers, with a focus on transparency and accountability, given their unique role in financial markets and the significant influence that proxy advisers have.⁶

The UK has developed the UK Stewardship Code⁷, recently updated in 2020, which is supervised by the Financial Conduct Authority (FCA). Regulations require proxy advisers to publicly disclose a code of conduct and explain how they have followed it. This includes disclosures around actual or potential conflicts of interest or business relationships that may influence the advice; disclosures on the essential features of the models and methodologies applied when preparing advice; the main sources of information used; procedures in place to ensure that research, advice and voting recommendations are of adequate quality; and the details of the extent and nature of any dialogues held with companies that are the subject of their advice. These reforms were broadly supported by key stakeholders such as State Street Global Advisors who stated they are a “strong supporter of the principles of good stewardship that are embodied in the UK Stewardship Code.”⁸ This sentiment of support is consistent with the Financial Reporting Council’s consultation feedback statement⁹.

India introduced a new regime for proxy advisers in August 2020 by way of Procedural Guidelines for Proxy Advisers¹⁰. This regime increases disclosure requirements for proxy advisers and mandates certain activities such as requiring the proxy adviser to share the recommendations with the subject company at the same time as sharing them with their client. The company has the right to respond with comments or clarifications and the proxy adviser is bound to relay these comments to their clients through an addendum.

In 2015, the Canadian Securities Administrators (CSA) issued guidance to proxy advisers. More recently however, Canada’s Capital Markets Modernisation Taskforce (CMMT) formed in February 2020 has made recommendations to establish a new regulatory framework that would provide companies with the right to respond to reports from proxy advisers, as well as restricting conflicts of

⁴ OECD, *Investment governance and the integration of environmental, social and governance factors*, 2017, 23-24 <<https://www.oecd.org/finance/Investment-Governance-Integration-ESG-Factors.pdf>>

⁵ Investor stewardship refers to engagement with public companies to promote corporate governance practices that are consistent with encouraging long-term value creation for shareholders in the company. See for example: Harvard Law School Forum on Corporate Governance, *The Investment Stewardship Ecosystem*, 2018

⁶ Financial Reporting Council, *Feedback Statement; Consulting on a revised UK Stewardship Code*, October 2019, page 10 <<https://www.frc.org.uk/getattachment/2912476c-d183-46bd-a86e-dfb024f694ad/191023-Feedback-Statement-Consultation-on-revised-Stewardship-Code-FINAL.pdf>>

⁷ Financial Reporting Council, *The UK Stewardship Code 2020*, October 2019 <<https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code-Dec-19-Final-Corrected.pdf>>

⁸ State Street Global Advisors, *Statement on the UK Stewardship Code*, April 2019, page 1, <<https://www.ssga.com/library-content/pdfs/ic/statement-on-the-uk-stewardship-code.pdf>>

⁹ Financial Reporting Council (n 6)

¹⁰ Securities and Exchange Board of India, *Procedural Guidelines for Proxy Advisers*, 3 August 2020 <https://www.sebi.gov.in/legal/circulars/aug-2020/procedural-guidelines-for-proxy-advisors_47250.html>

interest (particularly in relation to consulting services) by limiting the services proxy advisers can offer.¹¹

The US proxy advice market shares key similarities with Australia's in that both markets have a very concentrated number of proxy advisory firms servicing a large number of institutional investors.¹² The Securities and Exchange Commission (SEC) introduced reforms for proxy advisers, commencing in December 2021, which aim to improve the transparency of proxy advice¹³. These reforms centre on increasing the transparency of conflicts of interest through enhanced disclosure requirements and clarify the scope of fraud liability for proxy advisers. Additional reforms including the requirement for proxy advisers to share their advice with companies in a timely manner and for proxy advisers to notify their clients where a company had made a written response to the voting advice were also considered. While these considerations were generally supported by public companies, investors and proxy advisers expressed concerns about the impact this could have on the independence and timeliness of proxy advice¹⁴.

¹¹ Capital Markets Modernization Taskforce, *Final Report*, January 2021 <<https://files.ontario.ca/books/mof-capital-markets-modernization-taskforce-final-report-en-2021-01-22-v2.pdf>>

¹² Roisman, E, *Too important to regulate? Rolling back investor protections on proxy voting advice*, 17 November 2021, <https://www.sec.gov/news/statement/roisman-proxy-advice-20211117>

¹³ Securities and Exchange Commission, SEC Adopts Rule Amendments to Provide Investors Using Proxy Voting Advice More Transparent, Accurate and Complete Information, June 2020, <https://www.sec.gov/news/press-release/2020-161>

¹⁴ Submissions of the US reform are available here: <https://www.sec.gov/comments/s7-22-19/s72219.htm>

1. The problem

1.1 The potential impact of proxy advice is significant and can be influenced by some investor clients

It is widely accepted that proxy advisers play an influential role in Australia's capital markets. However, with domestic institutional investors owning up to 43 per cent of issued capital on the ASX200, and only four proxy advisers operating in Australia, the potential influence of each proxy adviser on Australia's capital markets is significant.

Institutional investors are increasingly seeking proxy advice to help inform how they vote on company resolutions to assist in meeting their fiduciary responsibilities to members and beneficiaries. While institutional investors take into account a range of information when making voting decisions, the reliance on proxy advice has grown in line with the volume and complexity of company resolutions coming forward, and the narrow window in which AGMs occur¹⁵.

The influence of proxy advice is strengthened by the fact that institutional investors are more likely to cast their votes at AGMs than other investors. Australian Institute of Company Directors' (AICD) analysis indicates that in circumstances where around 40 per cent of a company's shareholder register is advised by one or more of the proxy advisers, if only 50 per cent of the total shareholders vote on resolutions at the AGM, more than 85 per cent of the votes actually cast on company resolutions are advised by proxy advice firms¹⁶.

While this example demonstrates the aggregate influence of proxy advice, the high concentration in the proxy advice market suggests the recommendations from a single proxy adviser could be significant to the voting outcomes for individual companies and more broadly to the market. In this context, if even just one proxy adviser were to provide poor quality advice, or advice which had been unduly influenced by another investor client, the ultimate impact of this on the efficient allocation of capital across the economy could be far-reaching.

An example of these effects can be illustrated through resolutions on remuneration reports. In its inquiry into Executive Remuneration in Australia, the Productivity Commission noted that proxy advisers "often follow their own guidelines when deciding or recommending how to vote. Thus such guidelines can influence remuneration practices through the threat of a negative vote on companies' remuneration reports or at board elections"¹⁷.

In 2011, Australia introduced the 'two-strikes rule' as a tool for improving company accountability to shareholders. If a company's remuneration report receives votes against of 25 per cent or more for two consecutive years (two strikes) it triggers a vote to spill the board which could result in all non-executive directors facing re-election. Australia is seeing an increasing trend in the number of strikes, with institutional investors taking a greater interest in ESG related issues and a greater focus

¹⁵ Evidence to House of Representatives Standing Committee on Economics, Inquiry into common ownership and capital concentration in Australia, Canberra, 22 September 2021, p. 29 (Edward John, Executive Manager, Governance, Engagement and Policy, Australian Council of Superannuation Investors)

¹⁶ Australian Institute of Company Directors, *Submission to Treasury Consultation on Greater Transparency of Proxy Advice*, June 2021, p. 4 <[https://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/policy/pdf/2021/aicd_proxyadviceSubmission030621-\(002\).ashx](https://aicd.companydirectors.com.au/-/media/cd2/resources/advocacy/policy/pdf/2021/aicd_proxyadviceSubmission030621-(002).ashx)>

¹⁷ Productivity Commission, *Executive Remuneration in Australia*, 19 December 2009, p. 135 <https://www.pc.gov.au/inquiries/completed/executive-remuneration/report/executive-remuneration-report.pdf>

on corporate accountability. The largest number of strikes since the rule was introduced occurred in 2020 where 25 of the ASX300 companies received a strike¹⁸.

The implications of a company facing one strike and even the threat of a board spill can be significant, including the reputational damage a company may sustain. While this provides shareholders with the opportunity to protect long term value creation by ensuring remuneration incentives are appropriately aligned with company performance and preventing excessive remuneration for directors, studies have shown that receiving a strike can have a negative effect on share price. Research indicates that markets recognise a strike as a “value-destroying” sign with empirical analysis finding evidence of a “negative and significant market reaction around the announcement of a strike, and negative abnormal returns of -18.7 per cent over the 12 months following receipt of a strike”.¹⁹

The central role of a small number of proxy advisers in distributing voting advice to a large number of institutional investors, particularly during busy voting periods, creates an opportunity for more active clients to influence the content and direction of that advice to align with their desired outcomes. This is particularly the case where there are shared ownership or governance arrangements between a proxy adviser and their client. In this circumstance investors cannot be assured that the advice they are receiving from a proxy adviser is independent. The potential for incentives to influence proxy advisers is prominent as activist investment funds are becoming more prevalent in Australia.²⁰ Activists often require support from other shareholders to implement their strategies. Founder of US hedge fund Lone Star Value, Jeff Eberwein indicates the rules in Australia are very favourable to activism and he notes the key to gaining influence is “to find companies with lots of institutional shareholders, and particularly ones that vote with ISS and Glass Lewis”²¹.

Proxy advice is a key input into voting decision making, and given the structure of the proxy advice market, any influence exerted by clients has the potential to affect the decisions made by the remaining client base of the proxy adviser.

In addition to playing a strong role in shaping shareholder voting behaviour, studies have found that proxy advisers can also play a strong role in the actual development of company proposals²². Research by Larcker, McCall and Ormazabal (2014) found evidence of companies in the US developing proposals for executive compensation plans which were designed to align with the published guidelines of key proxy advisers, in a bid to secure a positive vote outcome²³. Law firm Arnold Bloch Leibler also

¹⁸ Glass Lewis, *2020 Proxy Statistics Australia*, 2021

¹⁹ Bugeja, Martin and da Silva Rosa, Raymond and Shan, Yaowen and Walter, Terry Stirling and Yermack, David, Lower Defeat Thresholds for Minority Shareholders and Corporate Governance: Evidence from the Australian “Two-strikes” Rule (June 28, 2020). CIFR Paper No. 130/2016, <<https://ssrn.com/abstract=2876925>>

²⁰ Geddes, V, *Activist Investing Comes of Age*, 2 June 2016 <https://www.firstadvisers.com.au/activist-investing-comes-age-2/>

²¹ Arnold Bloch Leibler, *Shareholder activism in Australia: A review of trends in activist investing*, 2016, <<https://abl.sfo2.cdn.digitaloceanspaces.com/public/Expertise/ABL-Shareholder-Activism-Report.pdf>>

²² Hayne, C and Vance, M, *Information Intermediary or De Facto Standard Setter? Field Evidence on the Indirect and Direct Influence of Proxy Advisors*, *Journal of Accounting Research* Vol 57, Issue 4; Spatt, C, *Proxy advisory firms, governance, market failure, and regulation*, *The Review of Corporate Finance Studies*, 10(1), 136-157, 2021

²³ Larcker, David F. and McCall, Allan L. and Ormazabal, Gaizka, *Outsourcing Shareholder Voting to Proxy Advisory Firms* (October 30, 2014). *Journal of Law and Economics*, Vol. 58, No. 1 (February 2015), pp. 173-204, Rock Center for Corporate Governance at Stanford University Working Paper No. 119, Stanford University Graduate School of Business Research Paper No. 14-27 (2105R), IESE Business School Working Paper No. WP1096-E

highlights an example of an Australian listed company that was “too fearful to hire a new chief executive from the USA for fear of a proxy adviser led shareholder backlash”.²⁴

Given that shareholder voting is such an important mechanism for promoting corporate accountability in Australia’s markets, clients should have confidence that the advice they are purchasing is based on sound research and analysis, which is independent of other interested parties.

1.2 Current settings create uncertainty around proxy adviser obligations

The four main proxy advisers in Australia each hold an AFS licence which authorises them to provide general financial product advice to wholesale clients. This authorisation relates to advice on interests in managed investment schemes (excluding investor directed portfolio services) and advice on securities.

Most of the services provided by proxy advisers, however, relate to advising clients on how to exercise the *voting rights* which may be attached to these interests in managed schemes or securities.

Advising another person in relation to how voting rights may or should be exercised is not currently a financial service by virtue of Regulation 7.1.30 of the Corporations Regulations 2001 (Corporations Regulations). With this exemption, the core activities of proxy advisers are not appropriately captured within the AFS licensing framework.

This has created a situation in which there are two categories of proxy advice – one that is regulated by the AFS licensing regime and one that is not²⁵. At present, when dealing in financial products (but not when making recommendations regarding the exercise of voting rights attached to securities) proxy advisers are obligated to:

- do all things necessary to ensure the financial services covered are provided efficiently, honestly, and fairly²⁶;
- have adequate arrangements in place to manage conflicts of interest²⁷;
- have adequate resources (including financial, technological, and human resources) to provide the financial services and to carry out supervisory arrangements²⁸;
- maintain the competence to provide those financial services²⁹; and
- not engage in conduct in relation to a financial product or a financial service that is misleading or deceptive, or likely to mislead or deceive³⁰.

These obligations establish a benchmark of conduct that is deemed necessary to protect consumers of financial services. However, these benchmarks do not currently apply to the provision of advice to clients on the exercise of voting rights.

²⁴ Arnold Bloch Leibler, *Proxy advisers have “outsized, perverse impact” on Australian market*, 31 May 2021
<<https://www.abl.com.au/insights-and-news/proxy-advisers-have-outsized-perverse-impact-on-australian-market/>>

²⁵ All four major proxy advisers currently hold an AFSL for advice they provide to wholesale investors in respect of votes relating to dealings in financial products.

²⁶ *Corporations Act 2001* (Cth) s 912A(1)(a)

²⁷ *Corporations Act 2001* (Cth) s 912A(1)(aa)

²⁸ *Corporations Act 2001* (Cth) s 912A(1)(d)

²⁹ *Corporations Act 2001* (Cth) s 912A(1)(e)

³⁰ *Corporations Act 2001* (Cth) s 1041H

Like with all businesses, there is the potential for the quality of proxy advice to be compromised by conflicts of interest. As outlined in ASIC’s Regulatory Guide 181 Licensing: Managing conflicts of interest, this includes “actual, apparent and potential conflicts of interest”³¹.

In the case of proxy advice, this is particularly relevant where proxy advisers concurrently provide voting advice to shareholders about a company, and consulting services to the same company, including to support the development of management proposals³². This is a longstanding concern of companies, investors, and governments and was raised by stakeholders during consultation.

The Business Council of Australia (BCA) raised concerns in their submission regarding practices whereby listed companies have received a negative proxy advice recommendation and are then approached by a different arm of the same proxy advice firm, offering consulting services to address these issues. They cite the specific scenario where “the more the research arm issues negative recommendations, the more potential work there will be for the advisory arm”³³. This is supported by commentary from law firm Arnold Bloch Leibler, which is concerned with the practice “whereby proxy advisory firms provide corporate consulting services to companies, at the same time as advising shareholders how to vote on those same companies, in relation to structuring their remuneration reports”³⁴. These conflict concerns have been raised in other jurisdictions, particularly in relation to the business practices of the largest global proxy adviser (who also operates in Australia).³⁵

Conflicts of interest may also arise where proxy advisers hold interests in the companies they are advising on³⁶. However, currently the AFS licensing requirement to manage conflicts of interest does not apply comprehensively to the full range of proxy adviser activities.

In addition, recognising the level of expertise required to provide a high-quality financial service, the AFS licensing regime appropriately requires financial service providers to maintain minimum levels of competence and skill. In order to provide good quality advice, it is expected that proxy advisers must possess a strong understanding of the impacts of director remuneration and incentive structures, the ability to scrutinise company financial records, and be fluent in corporate governance matters, among other things³⁷, yet, along with the AFS licensing obligations outlined above, this is also not a legal obligation under the current settings.

Mixed views from stakeholders regarding the extent to which the existing AFS licensing arrangements apply to proxy advice (outlined in section 5) highlights the need for further clarity for the industry. It is not appropriate for this level of uncertainty to continue noting that carrying on a financial services business without an AFS licence is a criminal offence under section 911A of the Corporations Act.

³¹ ASIC, *Regulatory Guide 181 Licensing: Managing conflicts of interest*, Issued 30 August 2004

<<https://download.asic.gov.au/media/1241003/rg181.pdf>>

³² Fagan, M, *Third-Party Institutional Proxy Advisors: Conflicts of Interest and Roads to Reform*, 51 U. Mich. J. L. Reform 621, 2018

³³ Business Council of Australia, *Greater Transparency of Proxy Advice Submission to Treasury Consultation Paper*, June 2021, p. 8

<https://www.bca.com.au/submission_to_treasury_consultation_paper_greater_transparency_of_proxy_advice>;

³⁴ Arnold Bloch Leibler, *Submission on consultation paper – greater transparency of proxy advice*, page 2, 4 June 2021 < <https://abl.sfo2.cdn.digitaloceanspaces.com/public/ABL-8747180-3-ABL-Submission-Treasury-Market-Conduct-Division-Greater-transparency-of-proxy-advice.pdf> >

³⁵ Fagan, M, *Third-Party Institutional Proxy Advisors: Conflicts of Interest and Roads to Reform*, 51 U. Mich. J. L. Reform 621, 2018

³⁶ Fagan, M n. 43

³⁷ See for example, the submission from Ownership Matters to Treasury’s consultation paper on proxy advice reforms <<https://ownershipmatters.com.au/submission-to-treasury-on-proxy-advice-reforms/>>

1.3 The quality of proxy advice can be improved

Submissions to Treasury made by the BCA and Australasian Investor Relations Association (AIRA) cite examples of proxy reports containing inaccurate information or assertions that were out-of-context³⁸. In 2017, the Australian Securities and Investments Commission (ASIC) undertook a roundtable with proxy advisers, industry representatives and relevant industry groups to discuss concerns raised by participants. These concerns centred around instances where proxy advisers appeared unwilling to engage; provided very short response times to companies to clarify issues and failed to correct inaccuracies in reports³⁹.

Business representative groups have raised the importance of companies having the chance to engage with proxy advisers and respond to their advice, particularly in situations where a company has reasonable grounds to disagree with the research or recommendations presented in the report. This is relevant where proxy advisers employ standardised approaches and methods of research that produce one-size-fits-all recommendations on company resolutions; these can fail to account for specific detail or nuances behind proposals or broader environmental contexts⁴⁰. An example of a standardised approach is the practice of some proxy advisers defaulting to a 'do not support' vote for directors sitting on more than five boards⁴¹.

ASIC has reported that it received 13 complaints about 3 separate proxy reports since the publication of its 2018 report into proxy advisers (up until 17 June 2021)⁴². Two of these complaints related to factual errors in the proxy report and these were lodged by the company that was the subject of the report. The third report attracted numerous complaints from interested parties including the subject company, non-institutional shareholders, and members of the public, and the complaints involve claims the proxy report contained misleading information that impacted the company share price.

In 2017, AIRA undertook a survey of listed entity views on proxy advisers and engagement practices⁴³. 52 listed entities of varying sizes participated, including six New Zealand listed entities. The entities were asked whether they had engaged with the proxy advisers prior to their most recent AGM. The responses against each of the proxy advice firms varied, with engagement not occurring up to 30 per cent of the time. Where engagement *did* occur, 29 per cent to 65 per cent of the meetings were considered by the subject company to be either successful or very successful. The same survey also highlighted that subject companies found 38 instances of factual errors, of which only two reports were corrected and reissued.

Despite the significant impact proxy advice can have on a company, and the high value placed on engagement by companies and investors, proxy advisers are not currently required to engage with the companies that are the subject of their advice, either before or after providing the reports to investors.

³⁸ Business Council of Australia (n 44); Australasian Investor Relations Association, *Submission to Treasury Consultation Paper on Greater Transparency of Proxy Advice*, 1 June 2021, <<https://www.aira.org.au/common/Uploaded%20files/AIRA%20Documents/Submissions/210531%20AIRA%20Submission%20to%20Treasury%20Proxy%20Advisor%20Consultation%20v2.docx>>

³⁹ ASIC, *Review of proxy adviser engagement practices*, June 2018, <[Report REP 578 ASIC review of proxy adviser engagement practices](#)>

⁴⁰ Hayne, C and Vance, M, *Information Intermediary or De Facto Standard Setter? Field Evidence on the Indirect and Direct Influence of Proxy Advisers*, *Journal of Accounting Research* Vol 57, Issue 4

⁴¹ Malenko, A, Malenko, N and Spatt, C, *Creating controversy in proxy voting advice*, National Bureau of Economic Research Working Paper Series, July 2021

⁴² Commonwealth, *2021-22 Budget Estimates*, Senate, question on notice no. 226, 15 June 2021

⁴³ AIRA (n 48)

1.4 Superannuation fund voting disclosure is insufficient

Superannuation fund providers currently publish varying levels of detail when it comes to their voting records. These funds make decisions on behalf of around 16 million Australians who have money invested in superannuation (as at 30 June 2020⁴⁴) and members should be able to identify what voting actions have been taken by superannuation trustees. This is important given the results of votes on company resolutions at AGMs can impact shareholders and affect financial returns for superannuation fund members.

Voting rights are becoming more concentrated with a smaller number of institutional investors due to the rapid growth of index investing and increasing consolidation within the superannuation industry. In the superannuation sector, some trustees currently contract out voting authority to external fund managers with the Financial Services Council noting “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”.⁴⁵

As superannuation funds consolidate and look to benefit from economies of scale there is a trend to bring more assets, and therefore voting rights, in-house⁴⁶. Increasing consolidation in the superannuation industry is expected to continue in the future, particularly following the introduction of the *Your Future, Your Super* reforms, with seven mergers announced between July 2020 and April 2021⁴⁷. Financial services researcher, Rainmaker Information, predicts that by 2025 Australia’s 10 largest super funds will hold 80 per cent of the market⁴⁸.

Despite the increasing concentration of voting power with superannuation funds, the current regulations only require superannuation funds to publish a summary of the fund’s voting activity for the previous financial year⁴⁹. The Australian Centre for Corporate Responsibility (ACCR) found that only 22 out of the top 50 superannuation funds published complete voting records in 2020⁵⁰. Some superannuation funds publish an overview of their voting activity with a high-level summary of how many meetings were voted on and total resolutions, while some funds will disclose a comprehensive list of all resolutions considered, the voting actions taken and how this compares with the recommendation made by company management. The existing practices of full disclosure by some superannuation funds indicates that increased transparency in relation to voting activity can be undertaken in a cost-effective manner.

Research by the Responsible Investment Association Australasia (RIAA) shows that 86 per cent of Australians expect their superannuation or other investments to be invested responsibly and

⁴⁴ Australian Taxation Office (ATO), *Super data: Multiple accounts, lost and unclaimed super* <<https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/super-statistics/super-accounts-data/multiple-super-accounts-data/>>

⁴⁵ Financial Services Council, *Submission to Treasury Consultation Paper – Greater Transparency of Proxy Advice*, 1 June 2021, <https://fsc.org.au/resources/submissions>

⁴⁶ Orient Capital, *Understanding Share Ownership – Australia 2019 update*, November 2019 <<https://insights.linkgroup.com/insights/?page=Ownership-Trends-in-Australia-2019-Update>>

⁴⁷ KPMG, *Super Insights 2021: An industry under transformation*, May 2021 <<https://assets.kpmg/content/dam/kpmg/au/pdf/2021/super-insights-report-2021.pdf>>

⁴⁸ Rainmaker Information, *Big super funds getting bigger, squeezing out competition*, 23 August 2021 <<https://www.rainmaker.com.au/media-release/big-super-funds-getting-bigger-squeezing-out-competition>>

⁴⁹ 2.38(2)(o) Superannuation Industry (Supervision) Regulations 1994

⁵⁰ Australian Centre for Corporate Responsibility, *Super Votes: How Australia’s largest superannuation funds voted on ESG resolutions in 2020*, September 2021 <<https://www.accr.org.au/downloads/accr-supervotes-202109-final-5.pdf>>

ethically⁵¹. The lack of consistent and standardised reporting on voting actions makes it difficult for members to understand how superannuation funds are implementing their stated investment and governance approach in practice, in order to assess whether the fund is meeting members' expectations. As such Super Consumers Australia suggest "there is scope to improve the consistency in disclosure of trustee voting for... consumers."⁵²

⁵¹ Responsible Investment Association Australasia, *From Values to Riches 2020: Charting consumer expectations and demand for responsible investing in Australia*, 2020
<<https://responsibleinvestment.org/wp-content/uploads/2020/03/From-Values-to-Riches-2020-full-report.pdf>>

⁵² Super Consumers Australia, *Greater Transparency of Proxy Advice*, June 2021, p.3,
<<https://www.superconsumers.com.au/2021>>

2. The need for government intervention

Proxy advisers play a valuable role in strengthening the accountability and transparency of companies to their shareholders, therefore the regulation of the sector should be commensurate with the influence attached to that role.

Government action is required to create certainty around the regulatory settings for proxy advice and set uniform expectations to improve transparency and engagement between proxy advisers and companies. This will better facilitate institutional investors in exercising their stewardship responsibilities for the benefit of members and investors.

The previous section established that a small number of proxy advisers can have a significant impact on the voting behaviour of institutional investors in the Australian market, which has the potential to adversely affect companies that are the subject of their advice. It further identified that the current regulatory framework does not adequately manage the risks of conflicts of interest or relationships of influence between major clients and proxy advice firms, and that inconsistencies in disclosure obligations and areas of ASIC oversight lead to a lack of transparency and accountability for the conduct of actors in the proxy advice sector. These characteristics of the current proxy advice sector indicate a need for reforms to improve regulatory oversight and disclosure, and to better manage potential conflicts of interest.

Many asset managers in Australia are signatories to existing stewardship codes that seek to address some of the concerns raised in section 1. However, as the codes are voluntary they do not apply uniformly across all participants in the proxy advice market, including proxy advisers. The Financial Services Council (FSC) developed Standard 23: Principles of Internal Governance and Asset Stewardship, along with Standard 13: Voting Policy, Voting Records & Disclosure⁵³, and many members of the Australian Council of Superannuation Investors (ACSI) are signatories to the Australian Asset Owner Stewardship Code⁵⁴. A submission from Dr Natania Locke and Ms Helen Bird, Senior Lecturers at the Swinburne University of Technology, noted that “the current bifurcated nature of the stewardship codes leads to inconsistencies”⁵⁵.

Regulation 7.1.30 in the Corporations Regulations effectively creates two categories of proxy advice – one that is regulated by the AFS licensing regime and one that is not. Given the important role of proxy advice in assisting investors to form decisions on matters that could have a financial impact, a broader range of proxy advice should be captured by the AFS licensing regime.

Superannuation funds are appropriately subject to an extensive range of regulatory requirements given the significant role they play in managing the retirement savings of millions of Australians. Improving transparency facilitates more effective member engagement with the superannuation system by ensuring members can receive simpler and clearer information about how funds manage their money, including through the exercise of voting rights. Requiring superannuation funds to

⁵³ Financial Services Council, *Standard No 13 Voting Policy, Voting Record & Disclosure and Standard No 23 Principles of Internal Governance and Asset Stewardship* available at <https://www.fsc.org.au/resources/fsc-standards-and-guidance-notes/standards>

⁵⁴ Australian Council of Superannuation Investors, *Australian Asset Owners Stewardship Code*, May 2018 <https://acsi.org.au/wp-content/uploads/2020/01/AAOSC_-_The_Code.pdf>

⁵⁵ Locke, Natania and Bird, Helen, *Comments on the Consultation Paper Greater Transparency of Proxy Advice*, 1 June 2021

disclose further information about their voting behaviour is consistent with Recommendation 3.6 from the Final Report of the Super System Review which recommends “[a]ll large APRA funds publish their proxy voting policies and procedures and disclose their voting behaviour to members on their websites”⁵⁶.

Public consultation (detailed in section 5 of this regulation impact statement) highlighted concerns by the majority of stakeholders that there was little evidentiary basis for increased regulation provided in the consultation paper, however it is worth noting that a wide range of views were provided across the submissions. Many drew attention to a review of proxy adviser engagement practices undertaken by ASIC in 2018, which did not raise significant concerns regarding the proxy advice market. The review, however, did highlight notable differences in the engagement policies of each of the proxy advisers, with ASIC encouraging proxy advisers and companies to work together to ensure shareholders have accurate information. The consultation process also revealed that some stakeholders continue to have concerns with the proxy advice industry.

The objective of Government intervention is to provide consistency in regulation across proxy advice services and in regulatory oversight, enhance transparency and boost accountability. This is consistent with the experience in other international jurisdictions. With the changing landscape of Australia’s capital markets, particularly in the superannuation context, there is increased risk to the economy and the Government is taking a long-term view to maintain integrity and confidence in Australia’s financial system.

⁵⁶ Cooper, Jeremy, *Super System Review: Final Report*, June 2010 <<https://treasury.gov.au/publication/super-system-review-final-report>>

3. Policy options

The following policy options have been developed in response to information gathered through the public consultation process. Stakeholder feedback on the consultation paper informed the development of these options and the options and the estimated regulatory burden have not been subsequently consulted on.

3.1 Option 1 – Maintain the current settings

Proxy advisers will continue to be required to hold an AFS licence for a portion of the services they provide – giving advice to investors on company resolutions relating to dealings in financial products, such as takeovers and capital raisings. Currently, each of the four major proxy advisers hold AFS licences authorising the provision of general financial product advice to wholesale clients for interests in securities and managed investment schemes.

Proxy advisers will retain complete discretion over how and the extent to which they engage with the companies that are the subject of their reports. The four major proxy advisers each have their own policies on how they engage with companies and fact-check their research, with some material differences in approaches⁵⁷. For example, one proxy adviser makes its proxy reports available to companies for a fee, while the other main proxy advisers advise they supply reports to companies for free at the same time as they are provided to investor clients.

Proxy advice is not currently defined in Australia’s financial services laws, and as such providers of this advice do not have additional obligations specific to their sector, including obligations around independence.

With respect to superannuation voting disclosure, as per regulation 2.38 of Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations), superannuation funds are required to publish their proxy voting policies and a summary of their voting activities for the previous financial year. This information must be published on the website and kept up to date at all times⁵⁸. For proxy voting policies this generally requires updating the website within 20 business days of when the policies commence or change, and for the voting summary, within 20 business days of the last day of the Registrable Superannuation Entity (RSE) licensee’s most recently completed financial year⁵⁹.

3.2 Option 2 – Extend existing regulatory arrangements

Option 2 would predominately use existing regulatory arrangements to strengthen the regulation of proxy advisers. The option would broaden the AFS licensing regime to apply to proxy advice and introduce obligations aimed at improving accountability and transparency.

This option closely aligns with the options considered in the consultation paper (see section 5). Option 2 would:

- a. extend the AFS licensing regime to cover a greater range of proxy adviser activities;
- b. require proxy advisers to be meaningfully independent from their clients;

⁵⁷ ASIC, *Review of proxy adviser engagement practices*, June 2018, <[Report REP 578 ASIC review of proxy adviser engagement practices](#)>

⁵⁸ 29QB of the *Superannuation Industry (Supervision) Act 1993*

⁵⁹ ASIC, *Regulatory Guide 252: Keeping superannuation websites up to date*, June 2014, <<https://download.asic.gov.au/media/1247177/rg252.pdf>>

- c. require proxy advisers to provide a copy of their recommendations to companies at the same time as the recommendations are provided to investors; and
- d. require superannuation funds to disclose more detailed information on their voting actions.

Further details on these elements are below.

The contravention of any prescribed condition of an AFS licence is a civil penalty. Non-compliance with the requirements of section 29QB of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) is a strict liability offence that attracts a 50-penalty unit fine. No changes are being proposed to the penalty arrangements that already apply to the relevant sections of the legislation. More detail on penalties is outlined in section 7 of this statement.

Option 2a - Extend the AFS licensing regime to cover a greater range of proxy adviser activities

The Corporations legislation would be amended to ensure that proxy advice in relation to voting rights attached to securities or managed investment schemes would constitute a financial service, and therefore would fall within the scope of the AFS licensing regime. To ensure the changes are appropriately targeted at proxy advice that has the most potential to cause harm (because it influences a large proportion of voting activity), the definition of proxy advice (as a subset of voting advice) would be limited to the following circumstances:

- a. advice is provided to certain institutional investors; and
- b. a fee, charge or other amount is paid or payable by the entity or another entity in connection with the provision of the voting advice; and
- c. the advice makes a definitive recommendation on how to vote on a particular resolution; and
- d. the provision of this advice is a significant component of the adviser's business.

Assessing whether the provision of proxy advice is a significant business activity of the provider is intended to reduce the risk that the regulations would capture stakeholders who might incidentally provide advice akin to proxy advice in the course of their usual business activities. This includes, for example, investment managers, legal practitioners, and advocacy groups. This targeted definition is designed to ensure that general research and advocacy are not captured under these reforms.

These changes would fill the existing gap in the licensing of proxy advice. All proxy advice purchased and provided to institutional investors would be captured by the AFS licensing regime and be subject to the relevant regulatory requirements.

This option would ensure that the statutory obligations set out in the Corporations Act apply broadly to proxy advice, including the requirements to provide services efficiently, honestly and fairly, maintain competence to provide the financial services, and have adequate arrangements in place to manage conflicts of interest. Various enforcement provisions are available under the Corporations Act for breach of AFS licensee obligations, including the issue of pecuniary penalty orders⁶⁰.

Option 2b – Proxy advisers to be meaningfully independent from their clients

The Corporations legislation would be amended to introduce an obligation on proxy advisers to be independent of their institutional investor clients, given the unique levels of influence these providers play in Australia's capital markets. The aim would be to promote ownership and governance structures of proxy advisers which support the exercise of objective and impartial judgment when providing

⁶⁰ *Corporations Act 2001* (Cth) s 1317G

proxy voting advice. This includes in the establishment and ongoing management of proxy voting guidelines and engagement policies on an arms-length basis.

Proxy advisers should consider factors such as whether the client and the proxy adviser share any governance arrangements, for example, whether personnel from the client hold positions in the proxy adviser entity or whether they share common owners. Consideration should also be given to whether the client participates in decision-making of, or otherwise influences, the business and operations of the proxy adviser, which may include decisions about key staff, board members, corporate governance matters or financial decisions.

As outlined in section 1, the advice provided by proxy advisers can have a wide reach in the economy and for this reason the disclosure and management of conflicts of interest alone is not considered appropriate to mitigate the unique risks associated with their potential influence. The independence obligation is intended to reduce the risk that large or more active investor clients of proxy advisers may influence the advice prepared by those advisers, which could in turn affect the decisions made by the remaining client base.

Option 2c - Proxy advisers to provide a copy of their proxy reports to companies at the same time they are provided to investors

The Corporations legislation would be amended to require proxy advisers to share their proxy advice reports with the company that is subject of their report. This requirement would be triggered at the time the proxy adviser provides the report to the client.

This requirement would establish a minimum level of engagement between proxy advisers and companies, ensuring that subject companies are aware of the proxy adviser recommendations and the basis of those recommendations prior to an AGM and in time for them to issue a response or further information.

It would also provide subject companies with an understanding of the research applied as a basis for the recommendations and present an opportunity for companies to identify any factual errors that may impact the analysis. This is also expected to foster improved engagement between subject companies and investors.

It is notable that some proxy advisers already make their reports available to the subject companies as a matter of practice. This obligation would crystallise this practice and standardise the approach across the proxy advice industry.

Option 2d - Superannuation funds to disclose more information on their voting actions

The SIS Regulations would be amended to prescribe the minimum amount of information superannuation funds are required to disclose on their website about how they have exercised their voting rights in relation to shares in listed companies. This requirement would provide members with more consistent information about the voting activities undertaken by superannuation funds, regardless of their superannuation provider, allowing for better comparability. The purpose of this requirement is to provide greater transparency about how superannuation funds implement their stewardship policies.

The disclosure requirements would apply to superannuation funds, but not the managed investment scheme market. This reflects the fact that participation in the superannuation industry is compulsory for millions of Australians, while participation in a managed investment scheme is an investment choice made with prior knowledge of the level of disclosure provided by that particular scheme. With

superannuation belonging to millions of Australians, and assets under management exceeding \$3.4 trillion,⁶¹ it is critical that the industry is held to the highest standards of transparency and accountability. Limiting the prescriptive disclosure obligations to the superannuation sector only will assist in minimising the regulatory impact of these reforms, noting that some in the sector are already providing detailed disclosure. The additional regulatory impact of extending these obligations is not expected to be significant.

The disclosure would be separated into two voting statements, with different levels of detail to cater to varying degrees of member engagement. The first is a summary providing a high-level overview of voting activity and the second is a more detailed disclosure of all resolutions. Both statements will be required to be published on a 6-monthly basis, reflecting information from the previous half-year.

The summary would require the following information:

- number of meetings where voting rights were exercised;
- number and types of resolutions in relation to which voting rights were exercised;
- proportion of resolutions voted as for, against and abstained;
- where proxy advice was received on any resolutions, the name of the licensee(s) who provided that advice.

The detailed disclosure would require the following information to be disclosed for each resolution where the superannuation fund has exercised their voting rights:

- name of the company;
- date of the resolution;
- the type of meeting at which the resolution was made;
- a description of the resolution;
- whether the resolution was proposed by the company or a shareholder;
- the recommendation made to shareholders by the company if a recommendation was made; and
- how the fund voted on the resolution – for, against or abstained.

3.3 Option 3 – Introduce a new sector-specific regulatory regime

Option 3 would be a new regime that is specific to the proxy advice sector and includes greater disclosure requirements for trustees of superannuation funds seeking proxy advice.

Option 3 was developed following the consultation paper (see section 5) and incorporates alternative solutions proposed by some stakeholders. Option 3 would:

- a. require proxy advisers to adhere to a bespoke regulatory regime centred by a code of conduct;
- b. require proxy advisers to provide a copy of their draft report to companies for review and direct investors to the company's response; and
- c. require superannuation funds to disclose more detailed information on their voting policies and actions, including an explanation of rationale for voting decisions.

Further details on these elements are below.

⁶¹ APRA, Quarterly Superannuation Statistics, Australia, Published 23 November 2021.

As with Option 2, the proposed penalties for non-compliance with this option will align with the existing penalties that apply to a breach of AFSL obligations. For superannuation funds non-compliance with the requirements of section 29QB of the SIS Act is a strict liability offence that attracts a 50-penalty unit fine. More detail on penalties is outlined in section 7 of this statement.

Option 3a – Bespoke regulatory regime for proxy advice

An alternative to expanding AFS licensing under Option 2a would be to require proxy advisers to disclose, publish and adhere to a code of conduct.

A new proxy advice regulatory regime could be modelled off the UK approach⁶², where under the *Proxy Advisors (Shareholders' Rights) Regulations 2019*, proxy advisers are required to:

- disclose reference to a code of conduct which they apply, and report on the application of the code. If proxy advisers apply a code of conduct but depart from its recommendations, they must declare the parts of the code from which they depart, why they depart from it and indicate any alternative measures adopted. Where proxy advisers do not apply a code of conduct at all, they must explain why this is the case.
- disclose information on their research capabilities and how they produce their advice and voting recommendations (e.g., models, methodologies, information sources and resources). This information must be published on the proxy adviser's website and be freely available for 3 years following publication.
- identify and disclose any actual or potential conflicts of interests or business relationships that may influence the preparation of their research.

For this approach it would be incumbent upon the proxy adviser to develop and adopt its own code of conduct. It would also be open, though not mandatory, for proxy advisers in Australia to collaborate on the development of a code. If a joint code was developed, this could apply uniformly across all proxy advisers.

Under the UK model, the financial regulator is empowered to enforce the disclosure requirements, with the ability to sanction breaches through public censure and/or financial penalties. Similar powers of enforcement would be provided to ASIC under this option, to manage compliance with proxy adviser disclosure obligations.

This option encourages proxy advisers to be more accountable for their actions through the disclosure obligations attached to the code of conduct, but winds back the direct requirements placed on proxy advisers as considered in Options 2a and 2b.

Option 3b - Proxy advisers to provide a copy of their draft report to companies for review and directing investors to the company's response

Proxy advisers would be required to provide their proxy advice report (including voting recommendations) to the subject company five days prior to distributing the final report to their client. This would allow the subject company the opportunity to review the report for factual inaccuracies, comment on assertions and recommendations, and for the proxy adviser to incorporate these into the final report, if warranted.

⁶² See information on the UK Financial Conduct Authority website, <<https://www.fca.org.uk/markets/primary-markets/proxy-advisors>>

Proxy advisers would be required to notify their clients on how to access a company's response to the report where relevant. This could be through providing a website link or instructions on how to access the response elsewhere.

These reform proposals build on Option 2c by placing a higher burden on proxy advisers to engage with companies and by requiring specific direction towards the subject company's response.

Option 3c - Superannuation funds to disclose more detailed information on their voting policies and actions, including explanation of rationale, for each financial year

With respect to superannuation voting disclosure, this option would require superannuation funds to disclose a summary of their voting activity along with full voting records (as in Option 2d), disclose the recommendations provided by proxy advisers for each resolution, and explain their rationale for each voting decision.

This option would also prescribe the minimum standard set of information a superannuation fund's proxy voting policy must contain to further improve consistency of information being provided across the superannuation sector. The penalties for non-compliance with these disclosure obligations for superannuation obligations are the same as Option 2 and outlined in section 7 of this statement.

As outlined in Option 2d, limiting the prescriptive disclosure obligations to superannuation funds only will assist in minimising the regulatory burden associated with the package of reforms.

4. Impact analysis

4.1 Option 1 – Maintain the current settings

This option would maintain the status quo, and therefore there would be no new regulatory costs on business, individuals, and community groups. Proxy advice firms and superannuation funds would continue to operate as usual and would not be required to change any existing business practices.

In the absence of any further regulation, the problems outlined in section 1 of this analysis will persist, and in the context of the rapidly growing superannuation sector and increasing levels of consolidation, these problems have the potential to grow over time. The larger part of proxy adviser services will not require specific licensing, notwithstanding the influence and impacts this advice may have on institutional investors and their members, other shareholders, and subject companies. Proxy advisers would not be required to be independent of their clients. It will be for proxy advisers to determine how they will engage with subject companies, including if, and when, they make reports and recommendations available for review. Companies must rely on proxy advisers to provide them with the opportunity to correct and respond to any adverse recommendations.

Superannuation funds will continue to disclose varying levels of detail regarding their voting activities, limiting the transparency around how superannuation funds are putting their stewardship policies into practice.

4.2 Option 2 – Extend existing regulatory arrangements

The implementation of Option 2 is expected to result in an increase in regulatory burden. The costing model is sensitive to assumptions due to uncertainty around the behavioural responses of businesses, and in particular noting, the time required for certain activities can vary significantly.

The assumptions and methodology applied to this analysis are outlined in detail in Appendix A.

Option 2a - Extend the AFS licensing regime to cover a greater range of proxy adviser activities

Broadening the application of the AFS licensing regime will require proxy advisers to adhere to the appropriate statutory obligations in the course of providing fee-for-service proxy advice to institutional investor clients. These obligations include providing services honestly and fairly, having adequate arrangements in place to manage conflicts of interest, and maintaining competence to provide those services. Such obligations establish a baseline of conduct that promotes market integrity and consumer protection.

Consistent treatment of proxy advice will eliminate any misunderstandings and uncertainty about how the AFS licensing regime applies to certain forms of proxy advice. Institutional investors, subject companies and other shareholders will be assured that the conduct of proxy advisers is subject to regulatory oversight and scrutiny that is consistent with the important role they play in financial markets. This supports confidence in the proxy advice sector and in institutional investor stewardship. The benefits associated with improved market confidence are unquantifiable.

While it may be considered that extending the AFS licensing regime to proxy advice could act as a barrier for new entrants into the proxy advice market, providing legislative certainty regarding the obligations and expectations for new proxy advisers serves to reduce the level of risk for new entrants and existing providers.

These changes are expected to result in a small cost to the proxy advice industry. It is not anticipated that these costs are likely to have a significant flow on effect to the fees charged by the proxy advisers for their services. Changes to service fees and terms of engagement are also likely to be contingent on any contractual agreements in place between the proxy adviser and their client.

Each of the four main proxy advisers already hold AFS licences authorising the provision of general financial product advice to wholesale clients for interests in securities and managed investment schemes. As proxy advisers already have systems in place to comply with AFS licensing requirements, only minor modifications to business practices will be required to ensure the scope of these policies and practices appropriately apply to the provision of proxy advice. It is notable that at least one of the four main proxy advice firms, Ownership Matters, has stated that it operates under the assumption that all its proxy advice is subject to the AFS licensing regime⁶³.

Any additional legal advice or training is likely to be minimal, as proxy advisers are already familiar with the requirements and obligations that come with holding a AFS licence. Proxy advisers will be required to vary their existing AFS licences to include the institutional voting services authorisation.

Noting all costs are incurred in the first year, the total upfront cost of the extension of the AFS licensing regime is estimated to be around \$90,000 (sector-wide cost). Alternatively, expressed as an average annual impact, the cost is about \$9,000 per year over ten years.

Option 2b – Proxy advisers to be meaningfully independent from their clients

Requiring proxy advisers to be independent of their clients would ensure advice is provided to institutional investors on an arms-length basis, improving the accountability of those advisers and increasing confidence in the quality of the advice.

The four main proxy advisers in Australia provide advice based on a set of proxy voting guidelines, which may be developed in collaboration with clients. With up to 30 AGMs occurring in a single week during peak seasons, there is a risk that these standard guidelines become de facto rules due to volume and time pressures⁶⁴.

The independence obligation will remove the opportunity for more active clients to seek to influence the advice prepared by proxy advisers, including through the development of voting guidelines, which could then have the effect of influencing the decisions made by the remaining client base of the proxy adviser. This separation significantly reduces the risk that one or a few investor clients could attempt to influence the voting decisions of competing investors to achieve their desired vote outcome.

The costs and potential impacts relating to the introduction of a principles-based obligation for proxy advisers to be independent of their clients will depend on the specific actions taken by proxy advisers. As an example, they could respond by adjusting their governance arrangements or they could choose to cease providing proxy advice to a client that is not independent. An alternative option may involve internal planning and consultation with clients, owners or members to determine the course of action to address the independence requirement.

⁶³ See the submission from Ownership Matters to Treasury's consultation paper on proxy advice reforms <<https://ownershipmatters.com.au/submission-to-treasury-on-proxy-advice-reforms/>>

⁶⁴ Australian Institute of Company Directors, *Institutional Share Voting and Engagement: Exploring the links between directors, institutional shareholders and proxy advisers*, 2011 <<http://www.companydirectors.com.au/~media/875F338434474CCC80CA71B22DE7BBAE.ashx>>

It is expected that these responses will be informed by legal advice unique to the structure of the proxy adviser entity and the nature of the commercial arrangements proxy advisers have with their clients.

It is anticipated that proxy advisers will need to consider factors such as whether the client and the proxy adviser share any governance arrangements, for example, whether personnel from the client hold positions in the proxy adviser entity. This could lead to the recruitment of new board members who are independent from the proxy adviser's clients. Consideration could also be given to the interaction between the proxy adviser and the client entity in determining whether there is any joint decision-making or influence regarding the business and operations of either entity, key staff members, or financial decisions.

If a proxy adviser does need to cease providing proxy advice to a client because it is unable to satisfy the independence obligation, it is expected that the client's business need to continue obtaining proxy advice will continue. This may require the client to source proxy advice from an alternative provider. The fees for an arrangement with an alternative proxy adviser may be higher or lower than their current arrangements as this will be subject to commercial negotiations.

If an entity ceases to provide proxy advice altogether, it is expected this will result in foregone revenue. This analysis assumes proxy advisers respond in a manner which involves the continuation of their business of providing proxy advice.

It is not possible to definitively determine the potential effects of an independence obligation on overall competition in the proxy advice market. The counterfactual effect on competition of retaining a non-independent entity is uncertain. On the one hand, if a non-independent proxy adviser exits the market or is prevented from entering the market as a result of this proposal, there would be an increase in market concentration relative to the counterfactual. On the other hand, such entities could in practice constrain the supply-side options of their clients and limit the ability of other providers, including potential new entrants, to compete in this segment of the market.

However, the benefits to large investors, and thus beneficiaries and superannuation fund members, of advice that is objective and impartial are expected to be significantly higher than the regulatory costs of this reform.

The total annual impact of independence on business is estimated to be around \$68,000 per year over ten years (sector-wide), comprising of \$65,000 on one proxy adviser and \$1,000 on each of the other three.

Option 2c - Proxy advisers to provide a copy of their recommendations to companies at the same time they are provided to investors

Requiring proxy advisers to share their reports with companies will establish a minimum standard of engagement between proxy advisers and subject companies. Companies will have greater oversight of where a recommendation to vote against a resolution has been issued, including the basis for the recommendation, and can tailor their engagement strategy with key shareholders to understand their positions and provide additional clarification or commentary where appropriate. This includes the opportunity to issue corrections to the market in a timely manner on any factual errors that may affect the analysis contained in the report. Like investors, companies also have a short window of time between the meeting notice being issued and the actual AGM occurring to undertake engagement with shareholders. Having access to the recommendations and analysis provided by proxy advisers is expected to enable companies to undertake a more efficient and risk-based approach to their engagement strategies.

The current practices vary across the proxy advice market and these reforms will assist to bring uniformity to the sector. Three of four proxy advisers state that, as a matter of practice, they already provide a copy of their proxy report to subject companies at no cost, at the same time or after it is provided to clients⁶⁵. This option will not alter these practices, except to crystallise it within the regulations and ensure it continues, while standardising this level of engagement uniformly across the proxy advice sector.

One proxy adviser currently makes proxy reports available to subject companies for purchase. This proxy adviser will be required to modify its existing practice of engagement to ensure its proxy advice reports are always provided to subject companies within the required timeframe. It may require a small additional labour cost to facilitate the sharing of these reports, depending on the level of modification and the technology systems in place to facilitate communication with companies.

As with the extension of the AFS licencing requirement, this is not expected to result in a flow on effect to the fees charged by proxy advisers given the negligible impact.

The estimated average annual cost to one proxy adviser is \$3,000 over ten years, to reflect the increased labour costs associated with changing practices to share reports with companies. This proxy adviser is also expected to experience a loss in revenue as the reports will be required to be shared with companies at no charge. This information is not publicly available and as such this analysis has not quantified this impact. Nil costs are incurred by other proxy advisers as they advise that their processes would already be compliant.

Option 2d - Superannuation funds to disclose more detailed information on their voting actions

Prescribing the minimum amount of information to be disclosed by superannuation funds will provide members with more quality information regarding the actions being taken by their superannuation fund. Members will have increased oversight to hold their superannuation fund to account on how they are actioning their stewardship responsibilities in practice. It is beneficial for members to understand how closely superannuation fund actions align with the fund's stated voting policies. This is particularly relevant where members may be invested in options that are advertised to promote a more sustainable and ESG focus. Having access to the detailed voting records will further complement the recent reforms to the notice for the Annual Member Meeting (AMM).

Pairing the summary with a more detailed disclosure of voting activity will provide transparency that appeals to members across varying levels of engagement.

The summary will provide members with a high-level overview of how their superannuation fund is exercising their voting rights across the portfolio. The detailed disclosures will allow for more engaged members to have oversight of the specific voting actions taken for different investments. The Australian AGM seasons often attract media attention and superannuation fund members may be interested in understanding the specific actions taken by their superannuation fund, particularly for contentious proposals. This is consistent with the trends currently being observed that superannuation fund members are increasingly interested in their super fund's consideration of ESG and climate factors⁶⁶. Providing additional disclosure will allow for the opportunity for this information to be disseminated into more usable formats by market commentators, financial advisers, analysts and journalists, which may assist in increasing member engagement.

⁶⁵ ASIC, *Review of proxy adviser engagement practices*, June 2018, <[Report REP 578 ASIC review of proxy adviser engagement practices](#)>

The primary costs associated with superannuation voting disclosure relate to up front administrative costs. We anticipate that affected superannuation funds which currently do not disclose the proposed minimum requirements would seek legal advice, update internal record keeping systems to collate and process data and provide training to directors and executives on the new requirements.

There would be a small regular compliance cost for superannuation funds associated with the ongoing disclosure of voting actions and preparing the annual summary. However, it is notable that many funds already implement comprehensive voting disclosure so these funds would have negligible compliance costs.

It is possible that the additional costs associated with these disclosure requirements may be passed on to members through the form of increased fees, which could then have the effect of reducing net investment returns for members. This is not guaranteed however as demonstrated by the experience with the implementation of other recent reforms to superannuation. The Protecting Your Super package resulted in only a small number of funds attributing fee increases to implementation of the reforms. Further, Treasury analysis estimates 37 out of 81 MySuper products active as at 30 June 2021 have actually reduced their fees relative to the September 2020 quarter⁶⁷ (prior to the announcement of Your Future, Your Super). These fees reductions have occurred despite reforms imposing additional transparency and broader compliance obligations on the industry.

Option 2 is not expected to impact on individuals and community groups. Enhancing voting disclosure does not impact individual rights, obligations, or entitlements, and will not affect their leisure time as the information is voluntary for members to review and free to access if they so choose.

The net benefit to individuals from improvements to superannuation fund disclosure cannot be quantified.

The total annual impact of disclosure on superannuation funds is estimated to be around \$2.2 million per year over ten years (sector-wide).

Total Regulatory Burden Estimate for Option 2

A summary of the estimated regulatory burden is at Table 1 and further information on the methodology and assumptions used in the calculation of these estimates are at Appendix A.

Table 1: Regulation burden estimate table (Option 2)

Average annual regulatory costs (from business as usual)				
Change in costs (\$ millions)	Business	Community Organisations	Individuals	Total change in costs
Total, by sector	2.3	-	-	2.3

⁶⁷ APRA Quarterly superannuation statistics, June 2021.

4.3 Option 3 – Introduce a new sector-specific regulatory regime

The implementation of Option 3 is expected to result in a large increase in regulatory burden. As with Option 2, the costing model is sensitive to assumptions due to uncertainty around the behavioural responses of businesses. Option 3 is not expected to impact on individuals and community groups.

The assumptions and methodology applied to this analysis are outlined in detail in Appendix A. Option 3 was developed to incorporate a number of alternative solutions put forward by stakeholders.

Option 3a - Bespoke regulatory regime for proxy advice

This option would establish a bespoke regulatory regime for proxy advice, separate to the AFS licensing regime. This would achieve similar benefits as outlined in Option 2a whereby the conduct of proxy advisers is subject to heightened regulatory oversight and scrutiny, and improvements to the quality of proxy advice reports, albeit not to the same level achieved under the AFS licensing framework. However, this option comes at a higher compliance cost given a more bespoke set of disclosure obligations placed on proxy advisers. Disclosure obligations under the new regime, including the requirement to disclose and adhere to a code of conduct, will support conduct norms that promote market integrity and consumer protection.

We estimate that proxy advisers would incur moderate costs in adapting to a new regulatory regime. Proxy advisers would be required to navigate and familiarise themselves with a new set of disclosure requirements and develop systems to ensure compliance. While this would necessitate legal advice and staff training, we do not expect this to result in significant shifts in business operations or require restructures.

Proxy advisers would each be expected to adopt a code of conduct. Each of the four main proxy advisers publish guidelines⁶⁸ or policies⁶⁹ that outline how they develop proxy voting recommendations, some of which have been developed in collaboration with their clients. It is likely the code would initially draw on these documents, as well as leveraging off global developments such as that of the UK Stewardship Code. The purpose of a code of conduct will be to ensure that the policies that guide the proxy adviser's activities and services are located within a single document that is transparent to investors, companies and the general public. As part of their obligations under the regulations, proxy advisers would be required to prepare and publish an annual statement of compliance to provide clients with an understanding of how the code is being implemented in practice.

A key distinction of the bespoke regime would be to disclose further information on research capabilities and the methodologies used to implement the proxy advice. This provides subject companies and investors with a greater understanding for the basis of certain recommendations and allows ASIC to have greater regulatory oversight of the overall advice process. These requirements are likely to entail moderate compliance costs for proxy advisers. We expect that these will need to be modified to provide greater detail addressing the disclosure requirements, including on research methodology.

⁶⁸ CGI Glass Lewis, < <https://www.glasslewis.com/wp-content/uploads/2021/07/Voting-Guidelines-Australia-GL.pdf?hsCtaTracking=1b56c341-10c5-43bb-b5bb-c78db1cdd52f%7C7feec965-69fe-4885-82ce-44afabe48c70>>; Institutional Shareholder Services Australia, <<https://www.issgovernance.com/file/policy/active/asiapacific/Australia-Voting-Guidelines.pdf>>; Ownership Matters, <<https://ownershipmatters.com.au/voting-guidelines/>>

⁶⁹ Australian Council of Superannuation Investors, < <https://acsi.org.au/policies/>>

The average annual impact of implementing a bespoke regulatory regime is estimated to be \$84,000 (sector-wide cost) over ten years. This is comprised of an upfront cost of \$171,000 and \$74,000 in subsequent years, across the sector.

Option 3b - Require proxy advisers to provide a copy of their draft report to companies for review and directing investors to the company's response

This option requires proxy advisers to provide both the proxy report and recommendations to subject companies five days before it is provided to institutional investors. Building in a review period will benefit companies by ensuring they have the opportunity to correct factual inaccuracies and provide any relevant context, ahead of the report being finalised and provided to the investor. Reducing the risk of factual inaccuracies of proxy reports will provide investor clients with greater confidence in using this information as one of many inputs into their decision making on voting. This is expected to contribute towards higher quality advice (given the reduced risk of factual inaccuracies) that supports responsible decision-making by institutional investors.

A practical consequence of this option is that proxy advisers will need to finalise draft reports and recommendations at least five days earlier, compared to current circumstances. This is likely to place an additional burden on proxy advisers, who already operate under time constraints. Proxy advisers are commissioned to provide advice within the typical 28-day period between meeting agendas being released and shareholder voting taking place. They have a short window to review meeting papers, undertake their research of subject companies, and formulate voting recommendations on company resolutions. The time pressures on both proxy advisers and institutional investors are compounded during the busy AGM season, during which up to 30 meetings are occurring in a single week⁷⁰. While the company review may allow for more thorough fact-checking, there remains a risk that the initial analysis prepared by the proxy adviser is of a lower quality due to the shortened time period for preparing the research. In order for proxy advisers to meet their obligations under this option whilst maintaining existing service levels, it is likely that additional staff will need to be recruited. Currently, none of the four main proxy advisers make draft reports available to subject companies prior to publication as a matter of course. Institutional Shareholder Services (ISS) Australia provides draft reports at its discretion, where there is sufficient time to do so⁷¹. We expect this option would result in higher compliance costs when compared to Option 2 and it is possible some or all of the costs of increasing staffing levels to comply with the new requirements will be passed on to clients.

The total annual impact of the requirement on proxy advisers to provide a copy of their draft report to companies for review and directing investors to the company's response is estimated to be \$7.2 million (sector-wide cost) over ten years. This is comprised of an average annual cost of \$1.8 million to each proxy adviser.

Option 3c - Require superannuation funds to disclose more detailed information on their voting policies and actions, including explanation of rationale

Requiring superannuation funds to disclose the voting recommendations provided by proxy advisers and their rationale at an individual resolution provides an even greater level of transparency on decision making.

⁷⁰ Australian Institute of Company Directors, *Institutional Share Voting and Engagement: Exploring the links between directors, institutional shareholders and proxy advisers 2011*

<<http://www.companydirectors.com.au/~media/875F338434474CCC80CA71B22DE7BBAE.ashx>>

⁷¹ ASIC, *Review of proxy adviser engagement practices*, June 2018, <[Report REP 578 ASIC review of proxy adviser engagement practices](#)>

While proxy advice is just one input into the decision-making process, disclosing the proxy advice recommendation received for each resolution would allow members to better understand the extent to which the voting decisions from superannuation funds align with the proxy adviser recommendations. There would also be a clearer demonstration of the extent to which superannuation funds access multiple sources of proxy advice.

Much of the feedback from stakeholders indicated that improvements to the disclosure regime should be focused on the decision-making process. Many cited that disclosing the voting recommendation received from a proxy adviser could inappropriately infer a causal relationship between the proxy advice and the voting decision taken by the fund. To this end disclosing the rationale for why certain voting decisions have been taken would provide this additional insight for members, which would be more valuable than disclosure of the voting outcome alone, as considered in Option 2d.

Given that this disclosure of rationale for each voting decision taken would be much more significant than collating and publishing data, and noting the volume of resolutions that superannuation funds vote on each year, it is expected that this level of disclosure would impose an unacceptable regulatory burden on business compared with Option 2d.

The impact on businesses includes that of Option 2d with additional costs to disclose voting rationale. As this new obligation is not current practice it is anticipated to affect all superannuation funds.

We estimate the total annual impact of disclosure on superannuation funds to be around \$5.2 million per year over ten years (sector-wide).

Total Regulatory Burden Estimate for Option 3

A summary of the estimated regulatory burden is at Table 2 and further information on the methodology and assumptions used in the calculation of these estimates are at Appendix A.

Table 2: Regulation burden estimate table (Option 3)

Average annual regulatory costs (from business as usual)				
Change in costs (\$ millions)	Business	Community Organisations	Individuals	Total change in costs
Total, by sector	12.5	-	-	12.5

5. Consultation

5.1 Consultation process

The Government announced its intention to review the regulation of proxy advice in Australia as part of the 2021-22 Federal Budget. At the time the decision to consult was made, this RIS had not been assessed by the Office of Best Practice Regulation (OBPR). Appendix B outlines further details on the status of this RIS at each decision point.

On 20 April 2021, Treasury released a consultation paper titled '*Greater transparency of proxy advice*' on the Treasury website⁷² inviting submissions until 4 June 2021. The consultation paper identified options and posed discussions for consideration. The options sought to address different elements of the proxy advice market including; the legislative framework that applies to proxy advisers, accessibility of materials by companies which are the subject of proxy advice and the use of proxy advice services by superannuation funds.

The consultation paper invited feedback on five policy approaches. These were to require:

- proxy advisers to obtain and hold an AFS licence for the provision of proxy advice;
- proxy advisers to provide their research and voting recommendations to the company that is the subject of their report at least five business days before providing it to their clients;
- proxy advisers to notify their clients how to access the company's response to the report;
- proxy advisers to be meaningfully independent from their client if their client is a superannuation fund; and
- superannuation funds to make publicly available more detailed information on their voting record, including whether a vote was consistent with any proxy advice received.

Treasury received 84 written submissions, of which 19 were submitted on a confidential basis. Table 3 shows the submissions received by the type of stakeholder.

Table 3: Submissions received on the consultation paper by stakeholder type

Stakeholder Type	Number of Submissions
Proxy Advisers	4
Industry Organisations	24
Superannuation Funds	13
Institutional Investors	23
Listed Companies	6
Legal Services	2
Corporate Consulting/Advisory	4
Academics	2
Individuals	6
TOTAL	84

⁷² Department of the Treasury, *Greater Transparency of Proxy Advice*, May 2021, <<https://treasury.gov.au/consultation/c2021-169360>>

Treasury held bilateral meetings with a number of stakeholders, including regulators, proxy advisers, companies, investors, shareholders, and other relevant bodies. These meetings took place during the public consultation period.

5.2 Main themes raised in consultations

A summary of responses to the options canvassed in the consultation paper are outlined below:

- Extending the AFS licensing regime was supported in principle by many stakeholders, though some questioned whether it was necessary on the basis that it already applies to some of their activities.
- Advance provision of a proxy adviser report to the company that is the subject of the report was supported predominantly by listed companies and associated bodies, but investors, were concerned that requiring provision five days in advance would either result in them receiving the proxy advice later or the quality being diminished. Proxy advisers raised concerns that providing the reports to companies ahead of their clients may compromise the independence of their advice. An alternative suggestion mentioned by a number of stakeholders included a recommendation for proxy advisers to share reports with companies at the same time as clients.
- The requirement for proxy advisers to notify their clients how to access the company's report was supported by a variety of stakeholders, though other stakeholders said companies have existing mechanisms, most notably ASX announcements, by which they can reach their investors.
- The proposal for independence between proxy advisers and superannuation funds had partial support, however an independence obligation on proxy advisers received increased support when the scope was broadened to independence from all institutional investor clients.
- Improved disclosure of superannuation fund trustee voting was met with broad in-principle support, with many stakeholders rejecting the need for disclosure of specific proxy recommendations on each holding, in favour of a regime that is meaningful to members and discloses the principles and processes that funds apply to voting decisions.

Some stakeholders requested further information regarding the objectives and need for reforms in this area. The following sections outline the key themes that were highlighted during the consultation process and details of the feedback received.

Requiring proxy advisers to obtain and hold an AFS licence (relates to Options 2a and 3a)

The proposal to extend the AFS licensing regime to cover proxy advice did not attract views from all stakeholders that provided submissions. Of those that did express views, the results were mixed.

Stakeholders that did not support extending the AFS licensing regime believe the existing laws and licensing obligations are adequate.

5.2.1 Stakeholder Comments

- Ownership Matters indicate that it holds an AFS licence *“because we accept that every element of our product and service offering is already regulated under Section 766A and 766B of the Corporations Act”*. It further notes *“every research report we produce may influence decisions within our client group related to the buying or selling of securities, voting decisions ‘in relation’ to those securities or a combination of both”*. In this context Ownership Matters highlight that it does not rely on the exemptions in section 7.1.30 of the Corporations Regulations 2001.
- Similarly, ISS Australia does not support the requirement to extend the coverage the AFS regime to proxy advice, stating *“we are not aware of any aspect of ISS proxy research processes as referenced by the Treasury that are deficient and requiring of increased regulation”*. It further notes that it does not see any benefit to institutional investors from expanding the AFS Licensing regime.
- The Australian Shareholders’ Association (ASA) *“consider the existing laws require suitable licensing for the provision of proxy advice which is in the nature of financial advice. As noted in the paper, proxy advisers must comply with applicable provisions of the Corporations Act, and we emphasise providers of proxy advice must also meet client expectations for efficient and effective delivery of a service which enhances their assessment of the sustainable returns by the companies in which they are long term investors”*.
- The Australian Council of Trade Unions (ACTU) raised concerns that extending the AFS licensing regime may be *“an unnecessary increase in regulation in a sector that is already highly regulated”*. It further suggests this *“could reduce competition in the proxy advice market by increasing barriers to entry, reducing the capacity for non-specialist proxy advisers to comment on upcoming votes – even when that commentary is not aligned to the recommendations of existing proxy advisers”*.
- A joint submission from CPA Australia and Chartered Accountants Australia and New Zealand did not offer substantive comments with respect to the licensing regime, however they *“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”*.

While the majority of stakeholders noted that the existing proxy advisers do currently hold AFS licence authorisations (at least for a portion of their services), support for extending the regime was focused on the benefits of consistent regulatory oversight regarding services being exercised with the proper skills required.

5.2.2 Stakeholder Comments

- The Association of Superannuation Funds of Australia (ASFA) considers the expansion of the AFS licensing regime to be *“a reasonable proposal given the nature of activities undertaken by proxy advisers. We are not aware of any issues with the current standard of advice; however, coverage would ensure that proxy advisers are required to meet on an ongoing basis the high standards required of AFSL holders, including in relation to conduct and competency”*.
- The Australasian Investor Relations Association (AIRA) supports the expansion of the AFS licensing regime *“to ensure proxy advisers making assessments on issues that have a material impact on the conduct of business in Australia have appropriate regulatory oversight and the necessary care and skill required to make those assessments. AIRA believes the AFSL is an appropriate licensing system with which to regulate the provision of proxy advice, however, there needs to be additional layers of self-regulation against international best practice standards”*.
- In support of expanding the licensing requirements, the Business Council of Australia (BCA) is of the view that proxy advisers *“are providing a form of financial advice and should be required to meet and uphold similar standards to others who also provide financial advice. Licensing obligations should incentivise them to provide a higher quality product as they will be able to be held accountable not just by their immediate clients but also through regulatory scrutiny”*.

One alternative put forward was for Government to consider developing a bespoke licensing/regulatory regime that would apply specifically to proxy advisers, recognising the unique role they play in financial markets. Others suggested that the Government engage with industry to develop a code or a standard set of principles that reconcile with international best practice standards.

5.2.3 Stakeholder Comments

- Arnold Bloch Leibler submit *“the reality is that most of the work undertaken by proxy firms is not classified as providing financial services. In effect, they are licensed for only a small, relatively inconsequential portion of their services and otherwise operate without oversight. A more appropriately designed licensing system for proxy advisers could operate as an expansion of the existing AFSL regime”*.
- Dr Natania Locke & Ms Helen Bird, Senior Lecturers at the Swinburne University of Technology propose *“improved soft law in the form of an updated investor stewardship code, which applies across the institutional investor spectrum be considered. Such a code should include asset owners, asset managers, investment and ESG consultants and proxy advisers.”* They further propose *“oversight of such an investor stewardship code should move to a regulator”*.
- CGI Glass Lewis is of the view that their primary services *“providing institutional shareholders advice on corporate governance matters up for vote at companies’ meetings, as well as helping them implement their voting policy and execute votes are qualitatively different than the financial services that require an AFSL today”*. They further suggest *“if Treasury determines that additional regulatory oversight of proxy advisers is warranted, however, CGI Glass Lewis believes that the Best Practices Principles provide a more tailored and appropriate benchmark for proxy advisers’ conduct than the general standards applicable to AFSL licensees”*.
- KPMG suggests *“adopting a code of conduct model, like the one in the UK, could be an alternative way to achieve consistency in approach, disclosure on research parameters and potential conflicts”*.

Requiring proxy advisers to provide their research and voting recommendations to the company that is the subject of their report (relates to Options 2c and 3b)

The proposal for proxy advisers to share the reports with companies 5 days prior to sending it to their clients would, in the view of some stakeholders, address concerns raised regarding the quality of advice.

5.2.4 Stakeholder Comments

- Law firm Herbert, Smith, Freehills (HSF) notes *“it is not uncommon for proxy adviser reports to contain factual inaccuracies or for proxy advisers to misunderstand information about the company in the course of making voting recommendations. This is problematic because many significant institutional investors will make their voting decisions having regard to the proxy advice they receive (and may even be required to follow the recommendations of a particular proxy adviser) and their votes, in aggregate, significantly impact the voting outcomes for most ASX listed companies”*.
- The BCA notes this engagement *“will be to the benefit of the shareholders that proxy advisers represent, as they will ensure a transparent, two-way flow of information with companies, to enable shareholders to make fully informed decisions. They will not in any way limit the freedom that proxy advisers currently have to make any recommendations they deem fit.”* The BCA considers that providing the companies with the opportunity to review and respond before publication will *“materially improve the quality of the reports”*.
- AICD strongly supports the proposal to provide companies with the opportunity to review advice ahead of publication to the clients. They note *“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”*.
- Listed company carsales.com also indicated support, noting *“a consultation period of 5 business days would be reasonable to allow for a company to evaluate the report, locate any additional materials necessary and provide an informed response to the advisor prior to publication. In our view, this period strikes the optimal balance between allowing proxy advisers to operate efficiently and providing complete and accurate information to institutional shareholders”*.

Practical considerations, in particular around the timing were proposed by some as needing to be considered to prevent negative outcomes elsewhere.

5.2.5 Stakeholder Comments

- UniSuper is *“concerned that the example 5-day review period could further shorten the time available for investors to review external research and engage with the relevant company. The unintended consequence of this proposal could be to limit the timeframe for the important direct dialogue between companies and investors ahead of voting decisions being made”*.
- The ASA does not support the proposal to provide companies with reports 5 days prior as *“it introduces additional time burdens on the process”*. They note, they attend approximately 50-60 AGMs in a month during peak season, and given the timing of the AGM process, *“there are 18 working days available to evaluate and communicate all that is required to vote at the company meeting”*. This period is shortened by 1 or 2 working days if an intermediary such as a custodian is utilised.

Some stakeholders suggested an alternative proposal to share reports with the companies at the same time or immediately after it is provided to clients. Some commented that allowing companies to review the information prior to the report being provided to the client compromises the independence and objectivity of the advice.

5.2.6 Stakeholder Comments

- ACSI highlights its *“standard process is that companies receive our advice free of charge at the same time, or immediately after it is published to subscribers. That allows companies to both respond to us and directly to their investors”*. It notes that given existing practices and the current levels of engagement between investors and companies in Australia that there is no need for regulatory intervention to facilitate engagement.
- Aware Super states *“while we respect listed companies’ right of reply, providing information on proxy voting to investee companies 5 days prior to sharing this information with subscribing investors, diminishes the effectiveness of our voting rights which is not in the interests of members. We recommend larger shareholders (subscribing investors) and investee companies receive proxy adviser recommendations at the same time”*.

Concerns were raised by some stakeholders regarding the protection of intellectual property, and the interaction these reforms may have with other research reports such as sell-side research.

5.2.7 Stakeholder Comments

- The Stockbrokers and Financial Advisers Association (SAFAA) suggest *“the effect of this proposal would be that a sell-side broker who prepared an opinion for clients that voiced concern about the board or criticised a board-sponsored resolution or the remuneration structures of a listed entity – which could influence the voting intentions of shareholder clients at general meetings – would be required to send the report to the company before it went to clients. SAFAA considers that a government requirement for an entity to provide private intellectual property to a third party that is the subject of that research outside of contractual arrangements is entirely inappropriate”*.
- While not directly responding to the proposal on sharing reports with companies, the Australian Financial Markets Association (AFMA) raises concerns that new regulations on proxy advice *“may directly or indirectly pick up activities which were not intended to be regulated under the policy objective of new legislation.”* They note that *“independent sell-side research is a distinct and already closely regulated area, as demonstrated in ASIC’s Regulatory Guide 264. Accordingly, AFMA submits that any new regulation should expressly exclude independent sell-side research”*.

Alternative methods were suggested to achieve a similar or better outcome, with focus towards improved and more frequent engagement between companies and proxy advisers.

5.2.8 Stakeholder Comments

- EOS at Federated Hermes does not support the proposal and suggest *“rules that address the proxy voting process should encourage engagement activities by institutional investors, with the goal that these activities become an integral part of the activities of institutional investors, rather than a periodic consideration prompted by shareholder meetings”*.
- Neuberger Berman supports *“the ability for issuers to have their information accurately represented in research but strongly believe that could easily be achieved through better, clearer disclosure in existing issuer documents, rather than through detailed review of the work of an independent party. As investors, we find it confusing that companies would spend time and money working to secure ‘favourable’ views of a third party that owns no shares instead of engaging in constructive dialogue with shareholders and their advisers who cast the votes”*.

Mixed views were held regarding the scope of this proposal, with some suggesting the scope should be widened, while others suggested it could be further refined.

5.2.9 Stakeholder Comments

- Peter Wells, from the University of Technology Sydney proposes *“A proxy report should be made available to the company one month prior to the relevant meeting. The company response should be required at least 14 days before the relevant meeting and made available to the public at this time”*.
- AIRA recommends *“only when a proxy adviser proposes to recommend against a Board recommended resolution, should it be required to share its report with the company and allow it three business days to respond”*.

Requiring proxy advisers to notify their clients how to access the company’s response to the report (relates to Option 3b)

The proposal to require proxy advisers to provide clients with access to the company’s response to the proxy advice attracted mixed views. Of those who were supportive of the proposal, there was no clear consensus regarding the most appropriate method for sharing the response.

5.2.10 Stakeholder Comments

- Dimensional Fund Advisors indicated that requiring proxy advisers to *“notify clients on how to access the issuer’s response to the report, for example, via a website link, would be an appropriate way to facilitate engagement and transparency”*.
- Aware Super would *“support a common portal or sharing of company responses to any proxy recommendations and proxy advisers notifying us of this response”*.
- Law Council of Australia supports the opportunity for companies to correct factual inaccuracies in reports (as considered above) and suggest *“an obligation to facilitate access to the company’s response may be appropriate, if the report is not updated or corrected in a timely manner”*.

Stakeholders, predominantly institutional investors who rejected the proposal, cited the company's ability to share information directly with the market via the ASX.

5.2.11 Stakeholder Comments

- Plato Investment Management notes *"This requirement is not necessary as any company can make their response to a proxy advisor report available to all investors using existing channels, e.g., via an ASX announcement"*.
- Martin Currie notes *"The role of the ASX is to enable issuers to provide continuous disclosure to an informed equity market. A company can make an announcement on its website or via the ASX, so this proposal is both unnecessary and would be an additional cost"*.
- CGI Glass Lewis has already adopted a solution to this proposal *"Glass Lewis introduced the RFS, through which companies that purchase Glass Lewis' research reports can opt to have a statement responding to Glass Lewis' research transmitted to Glass Lewis clients through its client and voting platforms."* They note that *"any regulation on this topic should not be so prescriptive as to inhibit developing market practices"*.
- The ASA highlights that *"if any such company response to the proxy adviser's report was to be provided to their clients, it should be made publicly available to all shareholders. If not, there will be less rather than greater transparency"*.

Requiring proxy advisers to be meaningfully independent from their client if their client is a superannuation fund (relates to Option 2b)

Some investor stakeholders outlined that they make decisions independently of proxy advisers and other investors, and that the influence of proxy advice is overstated.

5.2.12 Stakeholder Comments

- Cbus notes *"a range of inputs inform our voting positions, including proxy recommendations from two advisers, inputs from our internal investment teams and external fund managers who are responsible for investment decisions, stakeholders and insights from company engagement (throughout the year and where necessary ahead of the AGM). With this information we form our own views based on the best financial interest of our members over the long-term"*.
- AustralianSuper *"exercises our voting rights independently. We are in no way obliged or required to follow voting recommendations from external third parties, including proxy advisers. Our approach is informed by the desire to produce outcomes that create and/or enhance company value and ensure that value is appropriately distributed"*.
- On Rest's involvement with ACSI - *"Membership of ACSI allows Rest to contribute to the ACSI governance guidelines, which are principles based. These guidelines do not require individual ACSI members to follow the ACSI voting recommendations and Rest assesses all voting guidance on its merits"*.
- The RIAA submitted the findings of their Responsible Investment Super Study 2019 which found *"of the 30 [RSE's] providing responses to how they voted in 2018-19, two funds voted with the company board and five funds voted with the proxy voting adviser on every occasion. In contrast to this, three funds voted independently of board and proxy voting advisers on at least 10% of occasions"*.

ACSI members are able to contribute to the Governance Guidelines which are the principles that guide the advice. Some proxy advisers offer customised advice services tailored to the clients own voting policies. Some stakeholders commented that the tailoring of these policies suggest it would be appropriate for the actual votes cast to align with these tailored recommendations.

5.2.13 Stakeholder Comments

- Vision Super notes *“customisation of services is now a common feature of the market, and our proxy advice is customised to Vision Super’s policies and guidelines, which are rooted in acting in the best interests of our membership. This means that Vision Super and other clients of a proxy adviser will receive different voting recommendations”*.

There was a general consensus across consulted stakeholders that proxy advisers play a valuable role and create efficiencies for institutional investors when compared to undertaking analysis in house.

5.2.14 Stakeholder Comments

- The Australian Institute of Superannuation Trustees (AIST) describes the current proxy advice model as *“a responsible way to harness the expertise of others in a cost-effective way for members”*.
- ACSI describes its membership as *“a cost-efficient tool for superannuation funds’ management of their stewardship obligations”*. They also note *“it would cost far more for ACSI members to undertake engagement activity and research on an individual basis. Companies also benefit from these efficiencies with the ability to meet with a number of their shareholders at one time, while maintaining the flexibility to also meet separately where requested”*.
- The Principles for Responsible Investment (PRI) *“understands that there may be significant efficiency to RSE Licencees and benefit to members in investing a proxy adviser that specialises in advising a class of similar investors with similar investment objectives (such as long-term investment horizons which may require a greater emphasis on ESG risk management)”*.

When it comes to an independence obligation some stakeholders submitted that independence should exist between a proxy adviser and the companies which are the subject of their advice. This is similar to some of the feedback received when considering the option for companies to review reports ahead of publication to clients.

5.2.15 Stakeholder Comments

- Proxy adviser Ownership Matters submits *“There is a public interest in the providers of financial product advice being independent of the companies that they are analysing”*.
- Super Consumers Australia (SCA) agrees, outlining *“it is more important that there is independence between proxy advisers and the companies they are advising on. Proxy advisers need to impart a level of critical thinking and scepticism to ensure they are not simply mouthpieces of companies”*.

Some stakeholders supported the principle of introducing meaningful independence between proxy advisers and clients.

5.2.16 Stakeholder Comments

- AIRA supports the introduction of an independence principle suggesting *“reforms around meaningful independence of proxy advisers from institutional investors and the management of conflicts of interest should focus entirely on ensuring the objectivity and integrity of proxy adviser research, reports and recommendations”*. They note that the principle could be applied not just to superannuation funds but also institutional investors.
- Similarly, Arnold Bloch Leibler writes *“Proxy advisers should be required to show evidence that they are independent from the superannuation funds and institutional investors who form their customer base and that they have sufficient resources, qualifications and expertise to advise investors in the Australian market”*.
- Milford Asset Management writes that the independence requirement should apply to both superannuation funds and proxy advisers. *“We believe superannuation funds should engage meaningfully independent proxy advice”*.

Others suggested that confidence in proxy advice can be increased through stronger conflicts of interest management.

5.2.17 Stakeholder Comments

- Guerdon Associates recommends *“Proxy adviser disclosure of conflicts of interest, as required under their AFSL licence, be rigorously enforced”*.
- The Council of Institutional Investors (CII) calls for an evaluation of existing conflict of interest disclosures as a first step. *“CII has historically supported and continues to support requiring proxy advisors to disclose details of potential conflicts in their research reports to clients”*.
- The experience in Canada, as outlined by the Canadian Coalition for Good Governance is the Canadian Securities Administration *“expressly rejected a prescriptive regulatory approach and opted instead to issue guidance to proxy advisory firms focusing on identification, management and mitigation of actual or potential conflicts of interest”*.

Requiring superannuation funds to make publicly available more detailed information on their voting record, including whether a vote was consistent with any proxy advice received (relates to Options 2d and 3c)

There was broad in principle support for improved transparency around voting disclosure to benefit members, with some superannuation funds able to demonstrate high levels of existing transparency around their voting activities.

5.2.18 Stakeholder Comments

- ASFA stated they are *“generally supportive of enhanced disclosure requirements where there is a clear benefit to the consumer that will help them make more informed decisions and improve their financial outcomes”*.
- Members of the Governance Institute of Australia *“fully support the principle of greater transparency, especially as it relates to retail investors and superannuation fund members as this will enable fund members to understand how funds as stewards of their assets are exercising their voting power”*.

While some stakeholders were supportive of disclosing proxy advice recommendations, many were concerned that public disclosure of proxy advice recommendations for each holding would be misleading for members.

5.2.19 Stakeholder Comments

- On disclosing proxy advice recommendations Vanguard notes *“it is not material to disclose, and if anything would only lead to misconceptions about there being some kind of causal link between those recommendations and our voting decisions”*.
- Industry Super Australia considers *“a narrow focus on whether voting is consistent with proxy advice is not by itself meaningful because such advice is only one input among others into the voting decision. It may be more meaningful to focus additional disclosure on contentious votes and how voting in this context is consistent with the best interests of members”*.
- Superannuation fund Hostplus *“considers a range of factors in making its voting decisions (including but not limited to the reports of a range of proxy advisers, recommendations from external investment managers, input from the internal investment team and results of direct company engagement), it would not be helpful to members to compare Hostplus vote decision for each item against the advice of one or more proxy advisers, as this would not provide information on how the fund reached its voting decision”*.

Concerns around the regulatory burden and compliance costs associated with enhanced disclosure were raised.

5.2.20 Stakeholder Comments

- HESTA indicated support for improved transparency but is *“concerned that the proposals canvassed by the consultation paper may increase regulatory cost and complexity without bringing a corresponding benefit to fund members”*.
- The FSC suggests *“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”*.
- In contrast, Milford Asset Management’s experience suggests increased disclosure on voting would not be onerous or costly, highlighting *“many funds are already disclosing a version of this information in a range of formats”*.

Stakeholders made suggestions on how disclosure could be improved, with some pointing to the UK Stewardship Code as a suitable reference point.

5.2.21 Stakeholder Comments

- Aware Super recommends *“disclosure of whether an investor has supported company resolutions, rather than whether the investor has supported proxy adviser recommendations”*.
- ACSI suggests *“to support better practice in disclosure across the market, a consistent industry standard could be established, similar to the UK Stewardship Code”* They further suggest that disclosure *“should focus on how the voting process works and how final voting decisions are made”*. An example of this in practice could include disclosing rationale for voting decisions on contentious resolutions.

Some stakeholders including Ownership Matters, Arnold Bloch Leibler, IFM Investors and the Principles for Responsible Investment Association called for disclosure requirements to apply to all institutional investors, not just superannuation funds.

5.2.22 Stakeholder Comments

- IFM Investors writes *“insofar as there is a need for individuals to receive more information about proxy voting decisions, beyond policies and a summary of voting, that need would exist regardless of the product. Savings invested in managed investment schemes are also required to be invested in the best interest of beneficiaries; it is not clear why retirement savings would be subject to differential proxy voting disclosure requirements”*.

Super Consumers Australia and NSW Young Lawyers both supported the inclusion of voting materials to be provided to members with the Annual Members’ Meeting notice. Many others put forward that updating the information at least annually on the superannuation fund’s website would be appropriate.

5.2.23 Stakeholder Comments

- The Law Society of New South Wales Young Lawyers *“submits that the obligation to disclose trustee voting should be included in an annual report provided by superannuation trustees at the same time as the notice of an Annual Member Meeting”*. They cite the reasons to include the significant disclosures already required to be provided with the meeting notice introduced through the Your Future, Your Super reforms along with the costs of additional disclosure obligations should this be a separate communication to members.

5.3 How stakeholder feedback informed the development of options

Stakeholder feedback to the consultation paper informed the development of Options 2 and 3.

Option 2 closely aligns with the options posed in the consultation paper with the following changes:

- Amends the requirement for proxy advisers to share their reports with companies at the same time as providing the advice to their clients, rather than 5 days prior (which is considered in option 3);
- Removes the obligation for proxy advisers to facilitate their clients’ access to any company responses to the proxy advice;
- Amends the obligation placed on proxy advisers to be independent of all clients of proxy advice, not just where the client is a RSE; and
- Removes the requirement for superannuation funds to disclose the proxy advice recommendation received for each resolution.

Option 3 was developed to incorporate a number of alternative solutions put forward by stakeholders. Specifically, option 3:

- Makes the reforms sector specific (in preference to using the existing AFS licensing framework);
- Adopts a principles-based stewardship code;
- Removes the independence requirement between proxy advisers and superannuation funds; and
- Places a greater focus on the reasoning and processes behind voting decisions for superannuation fund voting disclosure.

Further consultation has not been undertaken following the development of the specific options considered in this analysis.

6. Option selection

Option 2 is the preferred option because it would improve the consistency, transparency, regulation and regulatory oversight of proxy advice, while balancing the cost of compliance for proxy advisers and institutional investors.

The benefits of improved transparency and accountability with each of the options considered are based on qualitative assessments. It is difficult to calculate a quantitative net benefit, given significant constraints in valuing the impacts of improved transparency, accountability, and market confidence. A greater emphasis has been placed on minimising the regulatory burden associated with the reform package, noting the similar benefits achieved from both Option 2 and Option 3.

Option 2 is estimated to create a regulatory cost to business of \$2.3 million per year over 10 years, compared to \$12.5 million per year over 10 years under option 3. Given that each of these reform packages are expected to generate similar benefits, option 2 generates the highest net benefit overall.

Measures to ensure the treatment of proxy advice is consistent with other financial services requiring proxy advisers to be independent of their clients are expected to support confidence and enhance transparency in the proxy advice sector.

Promoting confidence in the proxy advice sector will help institutional investors in addressing ESG issues, which can form part of a risk mitigation strategy and create value opportunities for investment portfolios. This is particularly important in a long-term investment horizon as is the nature of superannuation investments. These reforms are aimed to protect the integrity of the proxy advice sector to help facilitate the promotion of good corporate governance in Australia. This in turn will promote investor confidence to compete for capital⁷³, promoting growth in Australia's financial markets.

Stakeholder feedback from the consultation process informed this decision-making process and this is outlined below.

6.1 Extend the AFS licensing regime to cover a greater range of proxy adviser activities

Option 2a addresses the problems outlined in section 1, while balancing the regulatory impacts to the proxy advice sector. Proxy advice on remuneration reports, director elections and shareholder proposals have financial implications for both companies and investors and should be subject to equal regulatory treatment as the provision of financial services. Extending the AFS licensing regime as it applies to proxy advice ensures appropriate regulatory oversight and standards of conduct apply across the sector. This approach was generally supported by stakeholders during consultation.

Comments were raised in consultation regarding the importance of proxy advisers being independent from the companies they advise on. Bringing proxy advice into the AFS licensing regime will ensure the conflicts of interest management obligations apply to this relationship.

When compared to Option 3a, Option 2a leverages the existing licensing regime to minimise costs to both business and government. Each of the main proxy advisers already hold AFS licences for a portion of their services and are therefore familiar with the relevant legal requirements. It is expected that

⁷³ ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th Edition February 2019, <<https://www.asx.com.au/documents/regulation/cgc-principles-and-recommendations-fourth-edn.pdf>>

they can leverage their existing systems and processes in place to comply with the new obligations. We estimate some limited upfront costs will be incurred by proxy advisers in adapting to the new requirements.

While other alternative reforms were considered the more cost-effective approach considered in option 2 is to adapt the existing legislative frameworks.

6.2 Independence between proxy advisers and clients

Option 2b reduces the scope for the major investor clients of proxy advisers to influence the direction and content of proxy advice and help ensure institutional investors arrive at their voting decisions independently. This will address the uniquely influential role that proxy advisers play in Australia's financial markets and protect the integrity of the advice they provide to a wide range of investors.

Some stakeholders suggested that enhanced disclosure of conflicts of interest would achieve a similar outcome to that of independence, however requiring independence is expected to be more effective at addressing the risks outlined in section 1. There is an additional benefit provided by this independence obligation in addition to conflicts management which is greater than the risk it is mitigating in the event conflicts management is not effective.

The consultation paper initially solicited feedback from stakeholders regarding an independence requirement between proxy advisers and superannuation funds. Most stakeholders suggested that superannuation funds are already acting independently of proxy advisers in their application of proxy advice to their decision making. They cite their internal processes and the process of proxy advisers as evidence, along with variation in actual voting practices compared to recommendations. As a matter of good governance some stakeholders supported a broad structural independence requirement applying across all institutional investors which has informed the option ultimately adopted.

As outlined in section 1, given the central role of the small number of proxy advisers in distributing advice to a large number of investors, regulation is needed to ensure that clients can be confident the proxy advice is provided on an arms-length basis. This is particularly important noting the time pressures that investors face during the peak AGM season.

Option 2b is considered the most appropriate, as a direct obligation on proxy advisers to be independent of their clients will provide a long-term regulatory framework to minimise the potential for clients to influence future proxy advice.

6.3 Require proxy advisers to provide a copy of their reports to companies at the same time they are provided to investors

Following the consultation Option 2c was significantly revised to consider the feedback provided by stakeholders. Company stakeholders considered it beneficial to have access to proxy advice reports prior to proxy advisers sending the advice to their clients as this would be expected to facilitate improvements to the accuracy of the advice. During consultation however, proxy adviser stakeholders highlighted the already short window of time available for them to prepare their advice between the meeting notice and the deadline for institutional investors providing their voting instructions. They cautioned that reducing this time frame further would significantly impact on their operations and ability to meet contractual arrangements. It also has the potential to reduce the window of time investor clients have for considering the proxy advice prior to making their voting decision. In addition, proxy advisers raised concerns regarding the sharing of intellectual property with entities that are not paying for their services, before their clients have had the opportunity to access the advice.

To balance these considerations, Option 2c requires proxy advisers provide a copy of their proxy advice report to the subject company at the same time it is provided to clients. This goes towards addressing the problems identified in section 1 regarding the accuracy and transparency of proxy advice. This approach establishes a minimum level of engagement between proxy advisers and subject companies, building on the recommendations put forward in ASIC's review of proxy adviser practices. Companies can use this information to facilitate improved engagement with their shareholders in the most appropriate manner, whether that be to undertake direct engagement or via market announcements on the ASX. It is expected that through this engagement, companies will be afforded the opportunity to clarify any factual matters with key shareholders, while minimising the impact on the timeframes and business practices of proxy advisers.

Option 2c achieves a desirable balance between benefit and cost. Furthermore, as a matter of practice, three of four proxy advisers advised they already share their proxy reports with subject companies at the same time as providing to their clients.

Option 3b would mandate an even greater level of engagement between these participants, however stakeholders have indicated this option would be much more onerous and costly.

6.4 Facilitating access to company responses

Option 2 does not include a requirement for proxy advisers to provide their clients with instructions on how to access a company response to the proxy advice report, as posed in the consultation paper. Feedback from many stakeholders indicated this would increase costs for the proxy adviser and noted that companies already have the opportunity to communicate directly with shareholders via their websites and on the ASX.

6.5 Superannuation fund voting disclosure

During consultation, superannuation fund stakeholders in particular, were concerned about disclosing the specific recommendations received from proxy advisers, citing that this advice is just one input considered when forming a voting decision. Their concerns note that disclosing this information has the potential to overstate the influence of the proxy advice given voting decisions have a limited range of outcomes (e.g., for, against, abstain).

Taking this feedback into consideration, Option 2d would require superannuation funds to disclose full details of their voting activity, including the details of proxy advisers engaged, but they would not be required to disclose the specific recommendations provided by the proxy adviser for each resolution.

Implementing a standardised disclosure regime would ensure members have access to the same information, regardless of their superannuation provider, to better understand what decisions are being made on their behalf. Given the increasing trend towards ESG investing, this can play a key role in how superannuation funds position themselves to attract new members. Having a standardised set of information which members can access will make comparability across funds much easier and allow members to make more informed decisions when it comes to their choice of superannuation provider.

While the UK Stewardship code referenced by many stakeholders requires the rationale to be disclosed on certain voting actions, and as considered in Option 3c, the costs associated with this level of disclosure are significantly higher, given superannuation funds may vote on tens of thousands of resolutions per annum across domestic and international holdings. The AIST submission notes a representative superannuation fund with approximately \$20 billion funds under management might

vote on over 13,900 resolutions in a year⁷⁴. The additional costs associated with requiring a rationale to be provided for each vote exceeds the benefit of the increase in transparency that it would provide. Superannuation funds are able to provide additional information to their members to supplement the mandated disclosures should they choose to do so. Should members have questions relating to specific decisions taken by the superannuation fund, they would have the opportunity to raise these questions during the AMM.

Some stakeholders called for the disclosure to apply more broadly to all institutional investors rather than superannuation funds. However, as previously noted the compulsory nature of superannuation as well as the scale of assets under management (currently in excess of \$3.4 trillion)⁷⁵ means that it is critical that the superannuation industry is held to the highest standards of transparency and accountability. Limiting the disclosure requirements to the superannuation industry will provide a wide range of Australians with greater transparency over their compulsory investments, while ensuring the marginal increase in the regulatory burden of this reform package is minimal as many funds already provide extensive disclosure.

⁷⁴ Australian Institute of Superannuation Trustees, *Submission to Treasury's Consultation Paper Greater Transparency of Proxy Advice*, 4 June 2021

⁷⁵ APRA, *Quarterly Superannuation Statistics*, Australia, Published 23 November 2021

7. Implementation and evaluation

The chosen option will be implemented through amendments to the Corporations Regulations and the Superannuation Industry (Supervision) Regulations 1994.

The amendments bringing proxy advice under the AFS licensing regime will commence from 1 July 2022. The independence obligation and obligation to provide reports to subject companies will apply from 1 July 2022 and under new contracts entered into or renewed on or after commencement of the regulations, to allow time for proxy advisers to transition into the new arrangements. This means the obligations only apply once proxy advice becomes a financial service. Superannuation fund disclosure obligations will commence from 1 July 2022, publishing on a six-monthly basis and reflect information from the previous half-year.

7.1 Implementation challenges and risks

The existing framework for corporations and financial services regulation is complex. For the regulated population, this can lead to difficulties navigating the law and understanding the obligations and expectations placed on them. In the lead up to regulations coming into effect, Treasury will work with ASIC to ensure clear communications on the reforms are provided to proxy advisers and other key stakeholder groups. This may be in the form of Regulatory Guides or Information sheets issued by ASIC.

The complexity in the legislative framework means there is a risk that, notwithstanding robust drafting processes, the regulations inadvertently place obligations on stakeholders that were not intended to be captured by the reforms. These matters will require ongoing monitoring by Treasury, in conjunction with ASIC. If required, ASIC may grant exemptions from obligations to hold an AFS licence, by exercising powers under section 926A of the Corporations Act.

While there is a small risk that proxy adviser firms will seek to restructure their fee structures in order to avoid capture by the regulations, we consider this will be difficult for the four proxy advisers whose businesses are structured around proxy advice services.

There is a risk that superannuation funds may not have fully implemented systems and processes to effectively record the relevant data in time for the required disclosure. This risk is mitigated by the fact that the first reporting date does not fall due until 1 July 2022. ASIC guidance generally provides for a further 20 business days from the reporting date, for funds to provide the updated information on their website. Treasury considers this to be low risk given that superannuation funds are already required to provide a summary of their voting activity under existing obligations. Many superannuation funds already disclose detailed voting records. Further, there is an expectation that superannuation funds already collect and store this data as part of prudent record-keeping in their usual course of business.

7.2 Reviewing and monitoring effectiveness

Treasury has well-established relationships with key stakeholders in financial services markets. Ongoing dialogue, both through formal consultation rounds on associated matters and ad-hoc meetings will present an opportunity for stakeholders to provide feedback regarding the reforms. Stakeholders are welcome to contact Treasury with feedback and views at all times. Treasury will continue to monitor these settings and provide advice to Government as appropriate.

ASIC is the regulator of the AFS licensing regime and will oversee the new licensee requirements under the reforms. The contravention of any prescribed condition on an AFS licence is a civil penalty. If a Court is satisfied that a person has contravened a civil penalty provision, the Court must make a declaration of contravention⁷⁶. Once such a declaration has been made, ASIC can seek a pecuniary penalty order⁷⁷. For bodies corporate, the maximum penalty is the greater of:

- 50,000 penalty units;
- three times the benefit derived and detriment avoided; and
- 10 per cent of the annual turnover of the body corporate for the 12-month period ending at the end of the month in which the body corporate contravened, or began to contravene, the civil penalty provision (up to an amount of no more than 2.5 million penalty units).

Under subsection 911A(1) of the Corporations Act, a person who carries on a financial services business in this jurisdiction must hold an AFS licence covering the provision of the financial service(s). Failure to comply with this subsection is a criminal offence. For individuals the penalties can be a maximum of five years imprisonment and / or a fine of up to 600 penalty units (currently \$133,200). For corporations the penalties are up to 6,000 penalty units (currently \$1.33 million).

ASIC will assume responsibility for monitoring compliance with the superannuation disclosure obligations and will communicate with trustees about their requirements as needed.

If a superannuation trustee fails to publish information as required, they will breach their obligation to make certain information publicly available on the fund website under section 29QB of the SIS Act.

Non-compliance with the requirements of section 29QB of the SIS Act is a strict liability offence that attracts a 50-penalty unit fine. This is \$11,100 at present, with a penalty unit being \$222 from 1 July 2020.

⁷⁶ *Corporations Act 2001* (Cth) ss 921A(5A) and 1317E

⁷⁷ *Corporations Act 2001* (Cth) s 1317G

Appendix A – Regulatory costs – methodology and assumptions

Standard data and assumptions

The following standard data and assumptions were applied in estimated the costs associated with Option 2 and 3:

- There are 4 proxy advice providers in Australia.
- Legal advice is estimated to cost \$500 per hour (including GST).
- Australian Bureau of Statistics (ABS) data is used for earnings of managers, the hourly cost of labour is \$107.06 for executives (90th percentile), \$74.44 for directors (75th percentile) and \$50.00 for staff (median)⁷⁸. These amounts are scaled up by a 1.75 multiplier to account for non-wage labour on-costs and overhead costs.
- Based on limited available information regarding proxy adviser workforces, the estimated average staffing levels per firm are:
 - 7 executives;
 - 7 directors; and
 - 11 staff.
- There are 149 APRA-regulated superannuation funds excluding eligible rollover funds and small APRA funds⁷⁹ (based on APRA quarterly statistics as at 30 June 2021).

Estimated regulatory costs for Option 2

Option 2a – Extend the AFS licensing regime to cover a greater range of proxy adviser activities

Upfront Legal Costs

- Each proxy adviser will seek legal advice following introduction of regulations to understand the impacts on business operations.
- Given the regulatory changes will be relatively minor, it is estimated that 5 hours of solicitor's time will be required. This is a non-recurring cost.

Upfront Training

- Minor updates to training systems and materials will be required. We estimate this to require:
 - 1 hour with an executive, 3 hours with a director, and 6 hours with a staff member.

⁷⁸ 6333.0 Characteristics of Employment, Australia, August 2020

⁷⁹ APRA, Quarterly Superannuation Statistics, Australia, Published 24 August 2021

- Upfront training will be required to ensure staff are aware of the broader application of the AFS licensing regime to proxy advice services. We estimate:
 - 4 hours of training time for 7 executives, 7 directors, and 11 staff.
- Costings do not include training for future years, as we expect this will be built into existing training systems catered to the AFS licensing regime.

Compliance Costs

- Review and adjust processes / roles to ensure the broader gamut of proxy advisory activities are compliant with AFS licensing conditions and obligations. This is for the first year only, noting that systems and processes should already in place to ensure compliance with the AFS licensing regime. We estimate this to require:
 - 1 hour with 7 executives, 2 hours with 7 directors, and 2 hours with 11 staff.
- Proxy advisers will be required to vary their existing AFS licences to include the institutional voting services authorisation (an 8-page form). We estimate this to require:
 - 1 hour with an executive and 2 hours with a staff member.

Total

- Noting all costs are incurred in the first year, we estimate the total upfront cost of the extension of the AFS licensing regime to be around \$90,000 (sector-wide cost). Alternatively, expressed as an average annual impact, the cost is about \$9,000 per year over 10 years.

Option 2b – Require proxy advisers to be meaningfully independent from their clients

If proxy advisers chose to amend their governance arrangements in order to meet the independence requirement, the following assumptions have been incorporated into the methodology:

- Legal advice would be sought by proxy advisers:
 - 3 proxy advisers will have minor impacts and would each seek 20 hours of legal advice on the effect of the independence obligation.
 - 1 proxy advice provider would seek 100 hours of legal advice on the effect of the independence obligation, including on behalf of its 34 office holders.
- Upfront costs for internal planning and stakeholder consultation for one proxy adviser which includes:
 - 15 hours with 14 Board member executives and 4 directors for internal planning; and
 - 5 hours with 24 directors from the member council for stakeholder consultation.
- If necessary, recruitment costs of \$35,000 for each of the 14 new executives recruited based on an industry estimate of the cost of hiring an executive⁸⁰.

We estimate the total annual impact of independence on business to be around \$68,000 per year over ten years (sector-wide), comprising of \$65,000 on one proxy adviser and \$1,000 on each of the other three.

⁸⁰ <https://www.hcamag.com/au/specialisation/employee-engagement/this-is-how-much-it-costs-to-hire-one-employee/192036>

If proxy advisers chose to no longer provide proxy advice to some clients in order to meet the independence requirement, they may not face direct costs, but would have forgone revenue.

Option 2c – Require proxy advisers to provide a copy of their proxy reports to companies at the same time they are provided to investors

In addition to the standard data and assumptions, the following additional assumptions are applied in costing this option:

- Costings assume each proxy adviser provides proxy reports on up to 350 company meetings each financial year, noting the four proxy advisers primarily focus on ASX300 companies.
- Three of four proxy advisers currently conform to this practice, at no charge to subject companies. As such, we estimate no material cost impact on these firms.
- It is estimated an additional 5 minutes per report will be required for the remaining proxy adviser to provide the report to the subject company electronically. This is on the basis that this firm already offers to share its proxy reports with subject companies, for a fee.

Compliance with Prescribed Obligations

- We estimate the annual impact of this component on the affected proxy adviser to be an additional 5 minutes of processing time for 350 proxy reports.

Total

- Based on the above, the estimated average annual cost to one proxy adviser is \$3,000. Nil costs are incurred by other proxy advisers as they are already compliant.

Option 2d – Require superannuation funds to disclose more information on their voting actions

To determine the costs associated with superannuation fund disclosure, the following assumptions have been incorporated into the methodology:

- 44 per cent (based on the ACCR's finding mentioned in section 1.3) of the superannuation funds already publish complete voting records, therefore only 56 per cent of funds would have additional regulatory burden.
- Upfront set up costs of \$10,000 per affected superannuation fund to put in place systems to collect data on the voting actions. This may include marketing and IT development along with internal approvals.
- Upfront costs of training in each affected superannuation fund:
 - 40 hours for 1 staff and 5 hours for 1 director to prepare training materials and deliver the training; and
 - 2 hours in training for 9 directors and 10 executives.
- Ongoing costs for collating, preparing and clearance of the voting summary and detailed disclosure of voting activity includes 120 hours for 2 staff and 20 hours for 1 director.

We estimate the total annual impact of disclosure on superannuation funds to be around \$2.2 million per year over ten years (sector-wide).

Estimated regulatory costs for Option 3

Option 3a – Bespoke regulatory regime for proxy advice

In addition to the standard data and assumptions, the following additional assumptions are applied in costing this option:

- The below factors will limit the costs of developing and adopting a code of conduct:
 - To meet AFS licensing obligations, each of the proxy advisers will already have process/systems in place for quality assurance, record keeping, and managing conflicts of interest.
 - ACSI already has a code of conduct. However, this is likely to require updating to comply with the new regulatory regime.
- Costings assume each proxy adviser provides proxy reports on up to 350 company meetings each financial year, noting the four proxy advisers primarily focus on ASX300 companies.

Upfront Legal Advice

- Each proxy adviser will seek legal advice on the changes to the law to understand the impacts on their business operations.
- Given the regulatory change is significant and introduces a bespoke regime for proxy advice, we estimate 10 hours of solicitor's time will be required. This is a non-recurring cost.

Development, adoption and maintenance of a Code of Conduct

- Under the new regime, proxy advisers will each be expected to develop and formally adopt a code of conduct.
- We estimate the following time for the development of a code of conduct:
 - 2 hours with an executive, 4 hours with 2 directors, and 8 hours with 2 staff.
- We estimate the following time for the adoption of a code of conduct:
 - 1 hour with 7 executives.
- As a matter of practice, we expect each proxy adviser will conduct an annual review of its code of conduct (commencing from the second year of these reforms being implemented). As part of this process, proxy advisers may update the code to reflect evolving industry standards and client expectations. We estimate this to require:
 - 1 hour with an executive, 2 hours with a director, and 5 hours with a staff member.

Training

- Training systems and materials will require updating to reflect the new regulatory regime. This is a first-year cost only, noting the cost of maintaining training system and materials forms part of standard business practice. We estimate this to require:
 - 2 hours with an executive, 5 hours with a director, and 8 hours with a staff member.
- Existing proxy adviser staff will require upfront training to ensure they understand the new regulatory regime, disclosure requirements and the company's new code of conduct. This is a first-year cost only. We estimate this to require:
 - 6 hours with 7 executives, 7 directors, and 11 staff.

- Following the first year's upfront training, recurring annual training is required to ensure staff remain alert to the requirements of the regulatory regime and the company's code of conduct. We estimate this to require:
 - 2 hours with 7 executives, 7 directors, and 11 staff.

Compliance Costs

- Proxy advisers will be required to update compliance processes and systems to align with the new disclosure requirements imposed by regulations, including by ensuring staff understand these updates. We estimate this to require:
 - 1 hour with 7 executives, 2 hours with 7 directors, and 2 hours with 11 staff.
- An annual audit and review of business operations will be required to ensure compliance with regulations. We estimate this to require:
 - 5 hours with executive, and 10 hours with 2 directors.
- We estimate the time incurred for implementation of disclosure requirements and record keeping activities as follows:
 - 15 minutes of additional staff processing time for 350 reports annually.

Total

- We estimate the average annual impact of implementing a bespoke regulatory regime to be \$84,000 (sector-wide cost). This is comprised of an upfront cost of \$171,000 and \$74,000 in subsequent years, across the sector.

Option 3b – Require proxy advisers to provide a copy of their draft report to companies for review and directing investors to the company's response

In addition to the standard data and assumptions, the following additional assumptions are applied in costing this option:

- We hypothesise proxy advisers will be required to increase existing director/staff levels by one-third to meet this requirement (maintaining existing quality/service levels). This incorporates the below factors.
 - The development of proxy advice occurs within the time constraints of the AGM/share voting process, with meeting papers released not less than 28 days before meetings.
 - While this requirement will result in some increased labour time (e.g. reviewing subject company responses to draft reports), the compressed timeframes mean reports must be completed more quickly.
 - Existing staff cannot be compelled to work more than their usual hours. This means proxy advisers will need to expand their workforces to meet the shorter deadlines.
 - A CGI Glass Lewis analysis suggests a 5-day review period could result in investors losing at least 38 per cent of deliberation time (assuming no change to report preparation timeframes)⁸¹.
 - There is otherwise limited public information available regarding the time required to formulate proxy reports and voting recommendations.

⁸¹ CGI Glass Lewis, *Submission to US Securities and Exchange Commission*, February 2020, < [s72219-6745349-207938.pdf \(sec.gov\)](https://www.sec.gov/submitter/2019/20190221/cglgls.htm)>

Compliance with Prescribed Obligations

- Proxy advisers will need to satisfy the prescribed requirement to provide companies with a copy of the report 5 days prior to sending to the client.
- We anticipate an expansion of the proxy adviser workforces is required to complete proxy reports within compressed timeframes, review the responses/feedback of subject companies (following 5-day review period), and finalise reports and voting recommendations. The additional staff are as follows:
 - 2 executives, 2 directors and 4 staff employed on a full-time basis.

Total

- We estimate the total annual impact of the requirement on proxy advisers to provide a copy of their draft report to companies for review and directing investors to the company's response to be \$7.2 million (sector-wide cost). This is comprised of an average annual cost of \$1.8 million to each proxy adviser.

Option 3c – Require superannuation funds to disclose more detailed information on their voting policies and actions, including explanation of rationale

The same methodology as in option 2d is used for option 3c as well as the following new assumptions:

- The disclosure of voting rationale is a new requirement that is expected to affect all 149 superannuation funds.
- The average superannuation fund votes on 13,900 resolutions per year.
- The amount of time it takes to disclose the rationale is 1 minute per resolution.
- Therefore, each fund is estimated to incur an ongoing cost of two staff spending 115 hours each per year to report and disclose the voting recommendation and rationale.

We estimate the total annual impact of disclosure on superannuation funds to be around \$5.2 million per year over ten years (sector-wide).

Appendix B – Status of the RIS at each major decision point

Decision to release a consultation paper

A consultation paper was released on 30 April 2021, inviting submissions from stakeholders until 4 June 2021. The draft RIS had not been reviewed by the Office of Best Practice Regulation at the time of releasing the consultation paper.

Final policy decisions and introduction of legislation

This RIS has been prepared following the consultation, prior to the Treasurer making a final decision regarding legislation to implement reforms.