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Law Council
OF AUSTRALIA
*Business Law Section*

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**Transparency of proxy advice**

This submission is made by the Corporations Committee (**Committee**) of the Business Law Section of the Law Council of Australia in response to the consultation in relation to *Greater Transparency of Proxy Advice* (**Consultation**).

## 1. Overview

The regulation of proxy advice is a controversial issue, and the Committee's members have a range of differing perspectives.

A common element, however, is that there are problems with:

- limits on jurisdictional power to effectively regulate this area on a 'level playing field' basis between proxy advisers in Australia and offshore;
- broader issues of different practices in different segments of the institutional market, within Australia and offshore; and
- the risk of potentially deterring foreign investment into Australia.

We strongly recommend that this consultation paper be withdrawn, and further inquiries be undertaken before proceeding with proposals in this area.

As a general observation, anecdotal feedback suggests that companies' concerns regarding activities of proxy advisers appear to relate more often to offshore proxy advisers.

However, we have not conducted a comprehensive survey and would recommend that more extensive analysis be conducted before implementing regulation.

## 2. Observations

### 2.1. Different types of clients (Options 1 and 2)

Parts of the Consultation appear to distinguish proxy advice to superannuation funds from advice to other funds and wholesale investors. We cannot see a legal or logical rationale for the distinction, and so will not respond to Options 1 and 2 of the Consultation. For example, there are a number of listed investment companies, offshore pension funds, and large institutional investors holding substantial holdings in many listed companies and it is difficult to discern any meaningful basis for applying different principles to their use of proxy advisers, to investors that are Australian superannuation funds.

However, it may be worth making further enquiries to understand the differences between advice by Australian advisers to Australian wholesale investors, and advice

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by offshore advisers to offshore investors – as the latter may not be capable of being regulated by Australian law.

### 2.2. Engagement (Options 3 and 4)

There should be an opportunity for companies to correct factual inaccuracies in reports. However, the relevant time period should be brief, so as not to impede the work of proxy advisers or cause extensions to meeting notice periods, and to ensure that a perception of lack of independence does not arise.

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.

We note that, within Australia, inaccuracies are already regulated by Australian misleading and deceptive conduct laws – although we cannot comment as to whether regulators take action where they have been alerted to inaccuracies in proxy advice.

The jurisdictional limitations of Australian law mean that offshore proxy advisers are generally not subject to Australia's misleading and deceptive conduct laws. There is also no way to require them to engage with Australian companies.

### 2.3. Regulation by Australian Financial Services Licence (Option 5)

We understand that most, if not all, Australian proxy advisers typically hold Australian Financial Services Licences (**AFSL**).

There is a question as to whether that is strictly necessary for all of their activities, but we consider that it is appropriate for it to be a regulated activity – provided that the concept of "proxy adviser" is carefully crafted.

A requirement for proxy advisers to act honestly, efficiently and fairly in the provision of their services to clients is reasonable.

However, that requirement does not directly impose an obligation of honesty, efficiency and fairness towards the company that is subject of the advice (as the company is not the client of the proxy adviser). There are no other articulated standards for the content of advice or methodology used in producing it, under Australian law, other than the general prohibition on misleading and deceptive conduct.

Any concerns a regulator may have about the conduct of an AFSL holder could be dealt with under currents laws with the ultimate sanction being the loss of the AFSL.

### 2.4. Licensing should not deter commentary or activism (Option 5)

Importantly, the requirement for an AFSL should not be used to deter valid shareholder activism nor to effectively stifle bodies that provide reasonable commentary on companies' activities. Freedom of reasonable debate should be maintained, subject to Australia's misleading and deceptive conduct and defamation laws.

If any proposal proceeds at this time – careful consideration should be given to how "proxy adviser" is defined, and whether any exemptions (potentially with conditions) are justified.

For instance, the formalities of obtaining and holding an AFSL for these services may be too onerous for retail shareholder bodies that charge fees for membership, provide commentary to their membership on companies' meeting materials and hold proxies for their members. The cost and obligations of obtaining and holding the relevant form of AFSL need to be considered.

2.5. **Jurisdictional limitations are significant (Option 5)**

A requirement for a proxy adviser to hold an AFSL may be ineffective with respect to offshore proxy advisers, who represent major foreign funds and who may operate entirely offshore.

As a result – an enhanced AFSL regime for proxy advisers may have little or no impact on the quality of the reports produced by offshore proxy advisers, nor their methodology or management of conflicts.

Before additional requirements are imposed on Australian proxy advisers - some consideration should be given to:

- whether this creates (or exacerbates) an unequal playing field relative to foreign advisers; and
- whether the concerns that lie behind the proposals stem from widespread practices in the Australian market, that can be influenced by the additional regulation. We do not have sufficient information to give a definitive view on this – and we submit that it warrants further enquiry.

It is highly unlikely that foreign proxy advisers would submit to Australian jurisdiction. The misleading and deceptive conduct rules in Australia are more onerous than other jurisdictions (where there is typically some form of scienter or fault requirement for liability), so attempts to extend the reach of Australian rules could lead to a withdrawal of services that may have an unintended and disadvantageous effect on participation of major foreign funds in Australian markets.

2.6. **Development of standards or codes of conduct (Option 5)**

Standards or codes of conduct could drive better practices in this area, within Australia, but the content would require more extensive consultation.

A code could include requirements to warn clients that proxy advisers do not have the same duties as the board, and that accordingly their recommendations may not be in best interests of the company.

However, there is a limit to the effectiveness of Australian codes of conduct, where advice is provided wholly offshore.

2.7. **Conflicts of interest (Option 5)**

Concerns have been raised as to the potential for conflicts of interest where proxy advisers seek to provide consulting services to companies, so as to avoid adverse recommendations by the proxy advisers.

As a general principle – we consider that (like other advisers) proxy advisers should manage conflicts of interest, including structurally and by means of disclosure.

This is a matter that would warrant further regulatory investigation to ascertain the extent of this issue, how conflicts are being managed, and whether it is something that is capable of being addressed by Australian regulation.

AFSL holders already have an obligation to appropriately manage their conflicts.

2.8. **Influence and transparency**

There have been concerns raised over the extent and nature of the influence of proxy advice firms over registers of Australian listed companies, and whether it contravenes Australian securities laws.

We observe that, at least anecdotally, these concerns do not appear to be focused on superannuation funds or large Australian institutional investors – but we have not investigated this issue.

There may be a public interest in understanding the extent of influence of different proxy advisers. However, the interaction with Australian securities laws is a complex

question that raises difficult issues, and requires detailed information that is not publicly available. We recommend more extensive consultation.

2.9. **Unpacking issues around 'influence' over voting**

To outline some of the issues regarding influence over voting:

- Most proxy advisers would assert that they merely advise clients and that this, in itself, should not represent control over the voting rights of the shares held by those clients (which would give rise to a relevant interest under Australian securities law) nor any form of association with or between their clients.
- However, the test for control of votes is a practical one – the practical influence a party can exert is taken into account, and the question does not simply depend on enforceable rights.
- As a result – difficult issues arise where there is a pattern of conduct of blindly following that advice, or mandates requiring advice to be followed.
- In exercise of their voting powers, Australian trustees of funds have a duty to act on the best interests of the members of the fund. It would amount to a breach of those duties if trustees abdicated responsibility in the exercise of those powers to proxy advisers or others. Anecdotal feedback suggests that trustees of major Australian funds (including superannuation funds) are cognisant of those duties and do not tend to blindly follow advice, consistent with their duties as trustees.
- However, there is little transparency about the extent and nature of the influence of proxy advisers across different cohorts of wholesale investors, and practices and terms of mandates in offshore markets may differ significantly.
- If analysis were to suggest that lines of de-facto control have been crossed – then the question becomes, '*what are the implications of that'* under existing law. The implications may be requirements for transparency (for instance under the existing substantial holder disclosure regime), or a risk that securities laws have been breached.
- Particularly for foreign proxy advisers – implications that impose onerous obligations or liabilities may lead to the withdrawal of services or may make it impracticable or more costly for foreign investors to maintain investments in Australian companies.

There is simply not enough information available on practices across different segments of the Australian and foreign markets to ground a thoughtful policy response to these issues. We recommend further enquiries be made before proceeding with any specific proposals that may affect investment in Australian markets.

Committee representatives would be happy to discuss any of the matters raised, or provide further detail. If you have any questions, please contact Chair of the Committee, Robert Sultan at robert.sultan@nortonrosefulbright.com.

Yours sincerely,

**Greg Rodgers**

**Chair, Business Law Section**