Proxy advisers, regulation and conflicts of interest declarations

Proxy advisers continue to be criticised for their influence on issuer resolutions. This is bound to happen given that Australia, despite having the sixth largest publicly traded capital market in the world, is still quite a small pond. That is, 6 individuals employed by proxy advisers with the say on their recommendations covering more than $2 trillion of invested capital.

The regulation of proxy advisers was to be reviewed by CAMAC (see HERE). Unfortunately is CAMAC was abolished before it could complete its review. Nevertheless, proxy advisers appear to be relatively well regulated in Australia relative to elsewhere in the world. Proxy advisory firms in Australia are required to be an Australian Financial Services Licensee (AFSL) and subject to the Corporations Act requirements and ASIC’s policy on managing conflicts of interest.

Regulatory Guide RG 181 sets out ASIC’s policy on:

- its general approach to compliance with the statutory obligation to manage conflicts of interest in section 912A(1)(aa) of the Corporations Act
- guidance for licensees generally on controlling and avoiding conflicts of interest, and
- guidance for licensees generally on disclosing conflicts of interest. It also includes some issues for licensees to consider in complying with their obligations.

The three significant proxy advisory firms in Australia appear to have different approaches to disclosure of potential conflicts of interest.
CGI Glass Lewis (Glass Lewis) explains its approach to conflicts on its website and states that it does not offer consulting services to corporate issuers or directors, or to proponents of shareholder proposals or dissident shareholders in control contests.

Glass Lewis also state that both OTPP and AIMCo, its owners, are clients of the firm, and that neither OTPP nor AIMCO is involved in the day-to-day management of its business. Moreover, Glass Lewis excludes OTPP and AIMCo from any involvement in the formulation and implementation of its proxy voting policies and guidelines, and in the determination of voting recommendations for specific shareholder meetings. When either OTPP or AIMCo has a reportable stake in a corporate issuer, Glass Lewis discloses the conflict on the cover of the relevant research report.

Ownership Matters is a privately owned firm and has no statement on its website or in its reports on the management or disclosure of potential conflicts of interest.

ISS states in its reports that it provides consulting services to issuers and that the subject of their report may be or may have been a client.

ISS also names its owners and that procedures exist to restrict the owners’ involvement in the proxy analysis.

ISS notes that its institutional clients can contact it if they wish to understand the extent to which the subject of their proxy analysis has also used ISS’ other services.

Despite extensive criticism of proxy advisers and conflicts of interests, US regulators have only recently indicated action to increase the transparency of the way in which the advisory firms operate with a view to ensuring stakeholders recognise the potential for conflicts of interest. The proposed approach is similar to the approach being used in Australia. However, we expect that the level of compliance in the US will be more
consistent than in Australia.

In the last week of May, the House subcommittee on Capital Markets and Government Sponsored Enterprises ("the subcommittee") held a hearing on a legislative proposal, the Proxy Advisory Firm Reform Act of 2016. The bill, if enacted, will require proxy advisory firms to:

- register as investment advisors with the Securities and Exchange Commission (SEC), and
- disclose potential or actual conflicts of interest posed by engaging in consulting services to issuers.

The proposed legislation attempts to ensure the proxy advisors’ processes for producing voting recommendations are accurate, reliable, and transparent.

For now, it is uncertain if and when the bill will advance through the legislative process. The May/June issue of *NACD Directorship* (the NACD is the US equivalent of the AICD) reports that the influence of proxy advisors in the US has been offset in recent years by the increased use of analytical tools, other research by institutional investors, and especially because of the increased level and quality of engagement between companies and their major investors.

There is support for this trend in Australia as well.

Large Australian institutional investors have invested more in their own governance expertise for assessment and engagement in recent years. Consequently, many issuers have had more success in direct engagement with larger institutional investors as they demonstrate more capability to think for themselves on the issues, rather than accept proxy advisers’ recommendations without question.

At the same time, institutional investors’ use of proxy advisers has not declined, and the proxy advisers have also
become more efficient in producing their analyses and reports, as well as offering their institutional investor clients more tailored services.

Unfortunately, proxy advisers do not appear to be paid more for their regular subscription services. This is unfortunate, because higher fees would contribute to better qualitative assessments by higher level advisers and fewer tick-the-box assessments by less experienced analysts.