20 April 2015

Melissa Lui
Lawyer, Corporations
Australian Securities & Investments Commission

By email to: policy.submissions@asic.gov.au

Dear Melissa,

ACSI SUBMISSION TO ASIC CP228: COLLECTIVE ACTION BY INVESTORS – UPDATE TO RG128

On behalf of ACSI, and further to previous discussions we have held with you and your colleagues over recent months, I am pleased to provide the following comments in response to ASIC's *Consultation Paper CP228 – Collective Action by Investors: Update to RG128*.

About ACSI

ACSI is a collaboration between 31 Australian profit-for-members superannuation funds and 6 major international pension funds and asset owners, who have joined together to efficiently advance their collective ownership rights to improve the management of environmental, social and governance (ESG) investment risks and opportunities by Australian listed companies. Full details on ACSI and its research publications, policy positions and membership are available on our website (www.acsi.org.au).

ACSI's Australian member funds in aggregate manage over $400 billion of superannuation assets on behalf of more than 8 million Australian superannuation fund members. Of this total, approximately 30% is invested in Australian listed equities, which translates to approximately 11% of the average ASX 200 listed company, and growing in accordance with the growth of the Australian superannuation industry generally.

This scale of combined investment in the Australian listed equities market, together with our core mission to advance our members' interests through constructive engagement and exercise of ownership rights, means our members have a particularly strong interest in the subject-matter of ASIC's current consultation. This interest is especially strong given that ACSI's mandate encompasses not only acting *on behalf of* its member funds in undertaking engagements with major listed entities, but also facilitating those funds directly *participating* in collaborative engagements with ACSI and with each other - and indeed with other like-minded institutional investors, both domestic and international, where circumstances warrant.

Summary of ACSI's Recommendations

In the following submission we make one key recommendation for adoption, and two recommendations for further consideration, to enhance what we generally believe to be a very practical and constructive guidance framework proposed by ASIC.

In summary, these recommendations are that:

1. *The wording of RG128 should be amended to explicitly recognise the validity of collaborative and joint engagement by institutional investors with companies on "strategic" issues as a form of collective action that does not trigger the association/relevant interest provisions.*

2. *ASIC should further consider situations in which collective action to lodge Section 249D or 249N notices should not necessarily trigger the association/relevant interest provisions. Such situations include those in which either (or both):*

    a. *the agreement to act collaboratively does not necessarily signify unanimity among all relevant parties as to their actual voting position on the resolution(s) in question (e.g. a situation where investors may be seeking to 'clear the air' over a contentious director appointment, but do not necessarily have the same actual voting intention); or*
    b. *the subject-matter of the resolution(s) is unrelated to a board composition or control-seeking purpose (e.g. it is a shareholder resolution merely to require greater disclosure by the entity of an ESG investment risks issue).*

3. *ASIC should consider whether some amended form of Class Order relief for investors acting collaboratively might still be warranted to provide greater certainty, in line with current market practice (notwithstanding that we agree the existing Class Order CO 00/45 in its present form should be rescinded).*

Detailed Response

At the outset, ACSI would like to place on the record its appreciation for ASIC's explicit recognition of the value of constructive collective engagement by institutional investors that is directed at improving general standards of corporate governance and creating a more informed and efficient market.

These attributes are fundamental to ACSI's core mission and purpose, and we believe make a critical contribution to the advancement of a more transparent, sustainable and equitable financial system and governance environment, thereby enhancing the long-term value of Australian listed equity investments.

Against this background, ACSI's interest in the subject-matter of this consultation is essentially twofold:

- First, our interest in how ASIC proposes to interpret the association and relevant interest provisions of the Corporations Act in cases where more routine forms of collective action, such as collaborative company engagement or issuance of proxy voting recommendations (including the collective discussion of voting advice and its rationale), are undertaken by investors such as our member funds – i.e. activity we would classify as "*active ownership*" by long-term focused fiduciary investors in the best interests of the broader market ; and
- Second, the approach that is proposed in cases where investors at large (which we recognise *may* conceivably include institutions such as our member funds in some circumstances), are acting collectively with different motivations, typically seeking to influence the formal control or ownership of the corporate entity concerned - i.e. "*shareholder activism*" that is typically driven by specific private interests of the parties undertaking the collaboration.

The differences between these two motivations are to our minds quite fundamental, although we recognise that they are not necessarily well distinguished by the wording of current legislative provisions. In this regard, ACSI recognises the challenges facing ASIC in striking a suitable balance between the two types of collective shareholder action, against a background of very broad definitions of the relevant provisions in

the Corporations Act itself (the commentary in paras 128.4-128.9 of the proposed RG 128 Update being especially pertinent in this regard).

On the whole, we believe that the revised draft RG128 - and in particular the Tabular Summary on pp. 12 to 15 of the Consultation Paper of types of conduct that are considered "unlikely" and "likely" to trigger the association/relevant interest provisions – constitutes a useful framework for investors to navigate these complex and ill-defined statutory provisions.

Having said that, on a detailed review of the drafting of the proposed revised RG128, there are three specific questions of detail that we would like to raise, that we believe warrant further clarification in the final RG. These are spelt out as follows.

(1) Meaning of 'Strategic Issues' and 'Proposals'

In the Table on pp. 13-14 of the proposed RG setting out conduct that is considered "more likely to constitute acting as associates or … giving rise to a relevant interest", the second example given is that of "*Institutional investors formulating joint proposals relating to board appointments or a strategic issue*."

The context in which this example appears - in particular its juxtaposition with the examples in the previous Table on pp. 12-13, suggests that ASIC has in mind a categorical distinction between:

- "strategic" issues and other types of issues on which investors might seek to engage collectively with a company, such as voting at AGMs or raising issues relating to a company's "policies and practices"; and between
- conduct that involves the formulation of "joint proposals" as opposed to other mediums for collective engagement such as jointly-organised "discussions", "representations" or "recommendations" for proposed actions to be taken by companies.

The absence of formal definitions of these terms within the proposed updated RG128 makes it difficult to divine ASIC's intentions as to the reach of the relevant conduct in Table 2. We do not necessarily believe that further formal definitions are needed, but do strongly believe that **the RG needs to expressly recognise instances of legitimate dialogue between institutional investors and companies that touches on "strategic" issues, but which should *not* trigger the association and relevant interest provisions** - unless (like other examples cited in Table 2) such discussions have a specific board-composition change or control-seeking purpose.

By way of illustration, many of the collective engagements that ACSI and its members currently undertake with companies are not confined to reactive discussions over individual voting resolutions, director appointments and the like, but rather to more forward-looking and "strategic" discussions about how the company is positioning itself for the future, having regard to the specific macro risks and 'mega-trends' that are affecting the future of the industry in which it operates.

A good contemporary example of this strategic engagement is the dialogue we are now having with many Australian resources and energy companies over their scenario planning for the prospect of significant changes to regulation and pricing of carbon emissions, in the context of current global negotiations over climate policy commitments in Australia and internationally.

Another example would be discussions with, say, media and services sector companies over their preparedness for technological disruption in the transition to a digital economy, or to Australian companies generally regarding their preparedness for significant changes to taxation regulation given the current domestic and international policy focus in this area.

ACSI believes that all of these examples sit squarely in the 'space' of valid (indeed arguably *necessary*) topics of discussion for fiduciary investors with long-term investment horizons, acting in the interests of their underlying beneficiaries.

These types of engagement discussions are also entirely consistent with regulatory trends and best practice developments such as ASIC's recent Guidance on companies' *Operating & Financial Reviews*, and the recently-revised ASX *Corporate Governance Council Principles & Recommendations*.

We expect it that ASIC's proposed RG128 update was not intended to inhibit collaborative engagement activity of this nature. However, for the avoidance of doubt, we strongly recommend that some additional clarification be made in the final version of the document to reflect this.

Recommendation 1

The wording of RG128 should be amended to explicitly recognise the validity of engagement by institutional investors with companies on "strategic" issues, as a form of collective action that does not trigger the association/relevant interest provisions.

(2) Requisitioning of Meetings

Another type of conduct cited in Table 2 as being "more likely" to trigger the association/relevant interest provisions is the joint signing of a Section 249D or 249N notice to requisition a general meeting and/or request the inclusion of an additional resolution to an already-convened meeting of a company (and the equivalent provisions in the case of managed investment schemes).

ACSI notes that there has been some debate in the media among legal commentators about the legality and policy basis of this aspect of the RG.

We do not seek to add to the technical legal commentary on this issue, but do suggest that ASIC further review this area. In particular, we suggest it may be worth obtaining more feedback from the market on likely situations in which an investor's decision to jointly sign onto such a Notice may not necessarily signal an intent among all signatories to vote in a pre-orchestrated way with respect to the meeting/resolution concerned (rather than it being presumed that all signatories will necessarily be acting in concert).

That is, investors should have the ability to formulate joint proposals and be able to discuss with each other how they intend to vote; this is not necessarily the same thing as agreeing to vote in a particular way.

A further scenario that should be explored is when there may in fact be unanimity among the participating investors, but the underlying issue is one that does not have any control-seeking or board-composition purpose (for example, a shareholder resolution seeking improved disclosure on an ESG issue that the relevant shareholders all believe to be material to the company).

We also note that under existing rules and practices, companies are able to disclose the details of those parties who lodge Section 249D or 249N Notices, including details as to the number of securities those parties hold. This mechanism can already, if used by companies, provide the market with greater transparency concerning details of the parties to a collective action without the need to resort to the association and relevant interest provisions.

Recommendation 2

ASIC should further consider[1] situations in which collective action among investors to lodge Section 249D or 249N should not necessarily trigger the association/relevant interest provision. Such situations include those in which either (or both):

(a) the agreement to act collaboratively does not signify unanimity among all relevant parties as to their actual voting position on the resolution(s) in question (e.g. a situation where investors may be seeking to 'clear the air' over a contentious director appointment, but do not necessarily have the same actual voting intention); or

(b) the subject-matter of the resolution(s) is unrelated to a board composition or control-seeking purpose (e.g. it is a shareholder resolution merely to require greater disclosure by the entity of an ESG issue).

[1] Note: ACSI accepts that following such reconsideration, ASIC might still determine that best approach is to reconfirm the formulation in the current draft RG, recognising that it is already expressed to be applied on a case-by-case basis. Our only suggestion is that in this event, ASIC's approach is informed by as wide an understanding of potential market scenarios as is reasonably practicable.

(3) Abolition of Class Order

In our previous discussions with ASIC prior to the finalisation of the RG128 Update, ACSI agreed with the logic of ASIC's argument for revocation of the old CO 00/45 instrument, as being not relevant to the current methods of engagement with companies by institutional investors, and having not been used for many years in practice.

ACSI still maintains this view regarding the revocation of the existing Class Order, but has heard the suggestion being made in other quarters that perhaps a *different* Class Order might be warranted in current circumstances, as a means of providing greater certainty to investors about circumstances in which they can be confident they will not be at risk of falling on the 'wrong side' of the statutory definitions of association and relevant interests.

Again, we do not wish to present a firm legal position on the need for such an instrument at this time (although we expect some individual investors are likely to do so). We would, however, suggest that any steps ASIC can take to rectify the ambiguities in the proposed RG128 Update detailed above, may have the effect of obviating the need for more 'blanket' Class Order relief of this kind.

Recommendation 3

ASIC should consider whether some amended form of Class Order relief for investors acting collaboratively might still be warranted to provide greater certainty, in line with current market practice (notwithstanding that we agree the existing Class Order CO 00/45 in its present form should be rescinded).

Conclusion

In conclusion, ACSI believes that the proposed re-draft of RG128 would benefit from a small number of specific clarifications to ensure that constructive forms of active ownership are not impeded, while at the same time ensuring appropriate market disclosures are in place for other forms of shareholder "activism" that have a more control-seeking or opportunistic commercial purpose.

ACSI would like to commend ASIC for its initiative in preparing the updated RG128, and for the strong recognition of current collaborative corporate governance best practices that it reflects. The comments and suggested clarifications we have raised above are largely at the level of detail and phraseology, and we believe should not be insurmountable to address from the very positive starting framework that ASIC has established.

ACSI would be more than happy to discuss details of this submission with you, and to make available access to our staff and/or members to illustrate practical examples of some of the issues we have raised. Please do not hesitate to contact me should you wish to pursue these discussions.

Yours sincerely,

Paul Murphy
Executive Manager, Institutional Investment & Policy