RESPONSIBLE INVESTMENT CONSULTING
RESPONSIBLE INVESTMENT NEWS

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Mr. David Sullivan
Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
Parliament House
Canberra ACT 2600

By email: corporations.joint@aph.gov.au

Dear Sir, Madam,

Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Shareholder Engagement and Participation

Responsible Investment Consulting is pleased to contribute to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Shareholder Engagement and Participation.

About Responsible Investment Consulting

Responsible Investment Consulting is an independent consulting business, specialising in providing advice on the implementation of responsible investment practices across institutional investment portfolios.

We produce the weekly newsletter ***Responsible Investment News,*** which provides institutional investors with a regular update on the latest responsible investment issues in Australia and globally.

Our consulting services include advice on the integration of environmental, social and governance issues into investment processes and investor engagement programs.

Institutional investor engagement

Institutional investors in Australia are increasingly recognising that their fiduciary responsibilities require them to be active owners of assets and to actively engage with management on issues that have the potential to impact shareholder value.

Shareholder engagement is a key mechanism for institutional investors to implement an active ownership policy. This can take place in a number of ways including by voting proxies, individual dialogue with company representatives or collaborative engagement activities.

Over the next few years it is likely we will witness an increase in the level of engagement between companies and Australian institutional investors.

One of the reasons for this expected increased level of engagement is the fact that a significant number of Australian institutional investors have endorsed the United Nations Principles for Responsible Investment (PRI). Currently 34 Australian organisations, including 15 superannuation funds, have endorsed the PRI's six principles. Globally over 230 institutions have endorsed the PRI, representing over USD $10 trillion.

The PRI provide institutional investors with a framework to incorporate environmental, social and governance issues into investment processes. Of importance to the debate on engagement is PRI Principle 2, which commits signatories to 'be active owners' and to 'incorporate environmental, social and governance issues into ownership policies'. Amongst the likely approaches to implement this principle are engagement activities.

Though institutional investors will increasingly seek to engage with companies, there are significant impediments to such engagement.

Developing an engagement capability is costly. To the extent that the costs of engagement increase management expense ratios there is a disincentive for investment institutions to commit significant resources to developing engagement capability.

Even where an institution commits significant resources to establish an engagement capability there is no guarantee that they will be able to create a dialogue with a company. If a company chooses not to respond to a request t to engage there is little an individual investor can do.

Australia's regulatory environment for listed companies does not facilitate engagement. ASX's Corporate Governance Principles, which provide guidance to listed companies on governance issues, have been built around obligations to disclose information and have not moved further to facilitate engagement.

While communication is critical to assist investors to make informed investment decisions, unless there are mechanisms for investors to engage with companies on the information they are receiving, investors will ultimately be limited in their ability to be active owners.

Investor demand for information that is not contained in market disclosures often leads investment analysts to regularly contact companies.

There are many reasons why investment analysts seek information directly from companies. Often it is because analysts need to clarify a company's treatment of financial accounting in order to be able to accurately value the company.

The relationship that exists between analysts and companies has the potential to lead to conflicts of interest. The need to regulate these relationships was effectively recognised last year when Finsia and the Australasia Investor Relations Association developed a voluntary code of conduct between analysts and companies[1].

From a company perspective the demand for engagement, whether it be to supply additional information, or to communicate views places pressure on a company's resources.

Where a company does respond to an engagement request there is no mechanism for the response to be distributed to other market participants beyond making an announcement to the market. This is a highly inefficient practice and can result in a company entering multiple dialogues on similar issues, wasting valuable company resources. It is also counter to the principle that market participants should have equal and timely access to material information.

A model for shareholder engagement

We believe that Australia's regulatory system for listed companies should facilitate investor engagement.

Parliamentary democracy could provide an example model to facilitate investor engagement. There are a number of mechanisms by which Governments of the day are publicly accountable to the Parliament, including Question Time, Estimates Committees and Questions on Notice.

There is merit in a formal process of Questions on Notice applying to publicly listed companies. Questions on Notice would introduce a formal process for engagement, and would ensure that the market is made aware of both the question, and the answer.

We submit the following proposal for a system that would facilitate investor engagement.

Proposed rules for investor engagement framework:

[1] '*Principles for Building Better Relations Between Listed Entities and Analysts.*'

- To submit a question a shareholder would need to be registered through a password protected web portal
- A company would control registration process. Registration should be made available to registered shareholders with a minimum $100,000 investment. At the company's discretion the portal could be opened to a wider group of investors and stakeholders.
- Answers to questions would be available to all registered participants.
- A company would control posting of questions and would at its own discretion determine if a question was appropriate. This would prevent the portal being used in inappropriate ways such as circulating market rumour.
- At its discretion a company could elect not to answer a question, citing a range of reasons including commercial confidentiality. The question and answer would be published on the portal
- A company would not be held liable for individual statements on a web-portal
- Registered participants could submit comments as well as questions
- Answers to questions should be provided within 30 days
- In the first three years the scheme would only apply to ASX 50 companies with a review at the end of this period

International experience

Our proposal is based upon similar ideas that are being discussed internationally. In the United States the Securities and Exchange Commission is currently considering new models for engagement between companies and shareholders.

We would encourage the committee to consider the following documents:

SEC 17 CFR PART 240 Shareholder Proposals

http://www.sec.gov/rules/proposed/2007/34-56160.pdf

Benefits

Responsible Investment Consulting believes that there are significant benefits of such a proposal.

- Reducing the costs of engagement would encourage institutional investors to engage with companies.
- The development of an efficient investor engagement framework would place Australia at the leading edge of corporate accountability.
- Market transparency would be improved with significantly less opportunities for conflicts of interest between investment analysts and companies. To the extent that the market is better informed, investment capital would be more efficiently allocated.
- For companies seeking to determine what should be considered as material business risks the feedback from registered participants would

provide indicators of areas of most concern to investors. This kind of feedback would assist a company in determining whether their judgments on materiality were sound.

We would be happy to expand on any of the issues outlined in this submission.

Please do not hesitate to contact me at gordon@responsibleinvestment.com.au.

Yours sincerely,

Gordon Noble

Gordon Noble
Principal