Senate Standing Committees on Economics
Inquiry into Unlawful Underpayment of Employees' Remuneration

Question on notice to Dr Tess Hardy

Senator O'NEILL: *So there is a bit more heavy lifting to be done by the feds. You indicated in your opening remarks that an increase in the risk of detection is going to be critical, plus you mentioned administrative sanctions. This whole area can become very dense and very complicated, but people do understand driving rules. Surveillance is part of it, and automatic fines are quite helpful in keeping us all safe on the roads, even though, if we get one, it's never nice to get that letter in the mailbox. You also raise the question of non-state actors, and we're seeing some of that with the recent AMP matters, with institutional investors having some impact. Are you aware of any jurisdictions where that has been operating and has improved matters?*

Dr Hardy: *Certainly, I think this is an area where it's expanding in other jurisdictions, but it's still very embryonic to some extent. I can take that question on notice and look into it further and chat to some of the colleagues that I was discussing these issues with last night. I'm more than happy to come back to you on that.*

Response

The rising tide of financialisation across liberal market economies, such as Australia, has led to the infusion of 'financial ways of thinking and acting into corporate and government decision-making, into work relations, into media commentary on economic and social issues, and into our homes and home life.'[1] The preferences and decisions of institutional investors, along with banks, insurance companies and other financial actors, are seen to play an important role in shaping the behaviour of other economic players, including corporations.[2] This has the potential to have both negative and positive effects on the quality and dignity of work in Australia.

It has been argued that financialisation reinforces and elevates the primacy of shareholder value, which tends to reward short-termism and discount long-term risks.[3] Prioritisation of the interests of owners has sometimes come at the expense of other stakeholder interests, including employees. Financialisation has been associated with an increasing concentration of capital, a decline of the labour share and growing inequality.[4] Most relevantly, the growing power of financial capital, combined with technological advances and improvements in supply chain management, has been viewed as a key driver of fissured work arrangements – whereby companies seek to shed direct employment, impose demands on subsidiary firms and blur lines of responsibility.[5] This allows lead

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[1] Dick Bryan and Mike Rafferty, *Risking Together: How Finance is Dominating Everyday Life in Australia* (Sydney University Press, 2018) 9–10. See Mark Westcott, Stephen Clibborn and Chris Wright, 'Financialisation and the Growth of Low-Wage, Insecure Work' in Russell Lansbury, Anya Johnson and Diane van den Broek, *Contemporary Issues in Work and Organisations: Actors and Institutions* (Routledge, 2020) 127-142; Mark Westcott and John Murray, 'Financialisation and Inequality in Australia' (2017) 28(4) *The Economic and Labour Relations Review* 519.

[2] David Peetz, 'The Labour Share, Power and Financialisation' (2018) 81 *Journal of Australian Political Economy* 33, 34.

[3] Neil Gunningham, 'Roadmaps and Regulation: Sustainable Finance in Australia' (2020) 37 *Environmental Policy Law Journal* 459, 462.

[4] Peetz (n 2) 44 (citing E Stockhammer, 'Why Have Wage Shares Fallen? A Panel Analysis of the Determinants of Functional Income Distribution' in *Conditions of Work and Employment* (International Labour Office, 2013)).

[5] David Weil, *The Fissured Workplace. Why Work Became So Bad for So Many and What Can Be Done to Improve It* (Harvard University Press, 2014).

firms (and their owners) to reduce labour costs while retaining high levels of control, and maximise centralised profits while minimising accountability for externalities.[6] As Peetz observes: 'Through various mechanisms, financialisation diminishes the power of workers and reduces the labour share of national income, but it also diminishes the incomes and power of many peripheral parts of industrial capital itself.'[7] Placing more commercial pressure on marginal businesses can amplify the risk of wage and superannuation underpayment, and make it more difficult to recover compensation and levy sanctions.

Traditionally, the reform of corporate governance has been viewed as the province of governments and securities regulators, while most institutional investors have generally seen their role as 'being stable and passive holders of listed capital.'[8] However, there is a growing sense that institutional investors have the potential to contribute to efforts to address a range of environmental and social ills, including systemic non-compliance with employment standards regulation. Unlike earlier iterations of corporate social responsibility, responsible investing (i.e. the incorporation of environmental, social and governance (ESG) issues into investment analysis, decision-making and ownership practices)[9] tends to operate according to a 'logic of consequences' - that is, responsible investing is generally rational because it takes into account factors that will ultimately improve the corporate bottom line.[10] In comparison to more traditional modes of ESG, responsible investing is not solely underpinned by a 'logic of appropriateness' and does not overtly appeal to, or rely upon, international moral standards or norms.[11] Instead, the long-term investment horizons and highly diversified investment portfolios may mean that they are more interested in promoting a sustainable financial system.[12] In addition, and more generally, investors have a growing awareness that environmental and social risks affect a company's ability to create long term value.[13] North observes:

> Many investors believe that companies which proactively respond to foreseeable environmental and social harms caused by the entity's activities can enhance their value by minimising their risks, capturing emerging business opportunities and efficiencies, developing productive relationships with stakeholders, and improving their reputation and brand. Conversely, businesses that fail to respond adequately to these challenges risk losing much of their long-term value. These well-documented linkages between a company's capacity and willingness to manage environmental and social risks and its long-term value are driving many institutional investors and others to proactively engage with companies concerning the quality of their risk structures and reporting.[14]

There is increasing evidence of investor-driven governance networks in the UK, the US and here, which seek to advance responsible investing and shape business norms by holding corporations accountable. Many of these investor networks have been motivated by concerns relating to environmental

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[6] Peetz (n 2) 467.
[7] Peetz (n 2) 49.
[8] Bernard Mees and Sherene Smith, 'Corporate Governance Reform in Australia: A New Institutional Approach' (2019) 30 *British Journal of Management* 75, 87.
[9] United Nations Principles for Responsible Investment, *A Blueprint for Responsible Investment* (2017).
[10] Michael MacLeod and Jacob Park, 'Financial Activism and Global Climate Change: The Rise of Investor-Driven Governance Networks' (2011) 11 *Global Environmental Politics* 54, 60.
[11] MacLeod and Park (n 10) 60.
[12] Christine Parker, Rachel Carey, Ella Robinson et al,' Leveraging Investor Driven Governance for Food System Sustainability: A Review of Policies and Commitments of Institutional Investors Engaged in Responsible Investment in Australia' (forthcoming). See also James P Hawley 'Setting the Scene: The Basics and Basis of Responsible Investment' in Tessa Hebb, James P Hawley, Andreas G F Hoepner et al (eds) *The Routledge Handbook of Responsible Investment* (Routledge, 2015) 16-33; Dirk Schoenmaker and Willem Schramade, *Principles of Sustainable Finance* (Oxford University Press, 2019).
[13] Gill North, 'Corporate Management and Communication of Environmental and Social Risks in Australia: Pressures are Mounting' (2018) 33 *Australian Journal of Corporate Law* 227, 227-8.
[14] Ibid.

sustainability and the problem of climate change.[15] Some have been prompted by governance issues exposed in the Global Financial Crisis (GFC). However, the positive role that institutional investors might play in the context of employment standards compliance and enforcement has been largely overlooked in the literature, albeit this is starting to shift.[16] The introduction of modern slavery laws in Australia and elsewhere has been especially significant in this respect.[17]

Institutional investors in Australia are especially well-positioned to steer corporate capital allocation so as to advance human rights and uphold labour standards regulation. Mainly due to the mature compulsory superannuation scheme in this country,[18] institutional investors own the fourth largest pool of investment fund assets in the world and are the largest suppliers of capital to listed companies.[19] Furthermore, in Australia, the biggest institutional investors are the not-for-profit industry superannuation funds, which have union involvement and backing.[20] This suggests that there is a natural convergence between stakeholder and shareholder interests. There is also evidence to indicate that consumers and beneficiaries have an interest in responsible investing with a recent survey revealing that between 85–90 per cent of Australians acknowledge the importance of responsible and sustainable investing.[21] Mees and Smith believe that this makes Australia 'one of the more notable jurisdictions for institutional influence in corporate governance reform.'[22]

The approach of institutional investors to responsible investing has been diverse and the level of ownership engagement varies across different funds. In the past, shareholder resolutions have been the dominant mechanism used by investors and activists to influence corporate decision-making. More recently, this approach has now been supplemented, if not supplanted, by a range of alternative market-based mechanisms, which are designed to 'encourage positive engagement and action from corporations concerning their management and reporting of environmental and social risks'.[23]

Relevant mechanisms include direct engagement with corporations or third-party lobbying via a collective representative, such as the Financial Services Council (FSC), the Australian Council of Superannuation Investors (ACSI) and/or the Responsible Investment Association Australasia (RIAA). These representative or intermediary organisations engage in a range of regulatory activities, including disclosure, information-sharing, monitoring of ESG impacts, and the dissemination of technical resources and metrics for enhanced ESG assessment.[24]

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[15] MacLeod and Park (n 10) 69.
[16] See, eg, Westcott, Clibborn and Wright (n 1).
[17] Jolyon Ford and Justine Nolan, 'Regulating Transparency on Human Rights and Modern Slavery in Corporate Supply Chains: The Discrepancy between Human Rights Due Diligence and the Social Audit' (2020) 26 *Australian Journal of Human Rights* 27.
[18] Bernard Mees and Cathy Brigden, *Workers' Capital: Industry Funds and the Fight for Universal Superannuation in Australia* (Allen & Unwin, 2017).
[19] Parker et al (n 12) 7 (citing Australian Sustainable Finance Initiative. (2019) *What is ASFI?* Available at: https://www.sustainablefinance.org.au/); Anna Young-Ferris and Louise O'Halloran, 'Responsible Investment in Australia' in Tessa Hebb, James P Hawley, Andreas G F Hoepner et al (eds) *The Routledge Handbook of Responsible Investment* (Routledge, 2015).
[20] Mees and Smith (n 8) 80.
[21] North (n 13) 238-9 (citing Emma Pringle, 'Navigating Responsible Investing', *Money Management*, 12 March 2018 <https://www.moneymanagement.com.au/features/expert-analysis/navigating-responsible-investing>).
[22] Mees and Smith (n 8) 76.
[23] North (n 13) 238-9. Gunningham points to a range of other market-based mechanisms being used to promote climate action. See Gunningham (n 3) 461.
[24] Parker et al (n 12). See also Oren Perez, 'The Green Economy Paradox: A Critical Inquiry into Sustainability Indexes' (2016) 17 *Minnesota Journal of Law, Science & Technology* 153.

In addition, the FSC and ACSI have put forward separate stewardship codes in the recent past. Shareholder stewardship codes, which emerged in the wake of the GFC, 'are beginning to influence the norms and expectations of institutional investors around the world.'[25] Such codes are founded on the idea that 'greater engagement by institutional investors is a beneficial corporate governance technique, which operates as a check on centralised managerial power …improves corporate decision-making and provides protection against excessive risk-taking.'[26] It is not yet clear whether the stewardship codes that have been disseminated in Australia will achieve such lofty objectives. For a start, the FSC Code – which is mandatory for its asset-manager members – simply references ESG-focused stewardship as one of several stewardship activities. In comparison, the ACSI Code 'envisages that ESG considerations will play a fundamental role in shaping investors' overall approach towards stewardship',[27] but applies only on a voluntary basis. Notwithstanding some of the limitations of these stewardship codes, Jefferies predicts that they are 'likely to result in increased participation from shareholders in listed companies such as Annual General Meeting ('AGM') participation and communication around financial, environmental and social performance.'[28]

More generally, Bowley and Hill query whether institutional investors will have sufficient incentives to act as stewards 'given the large number of investments in their diversified portfolios, free-riding concerns, the pressure to seek economies in their governance activities owing to industry competition, and conflicts of interest.'[29] They argue that collective action amongst institutional investors may address some of these issues by allowing shareholders to pool their resources, share the costs and strengthen their leverage.[30] However, collective action amongst institutional investors in Australia has been fairly limited thus far, particularly in comparison to growing collective activities amongst investors in the UK.[31]

In addition, there is some limited evidence of institutional investors actively funnelling capital to projects which are geared towards improving environmental and social outcomes, or conversely, deliberately divesting the securities of companies that do not accurately disclose or properly manage environmental and social risks. For example, AE has expressly stated that it is engaging in negative screening in relation to human rights breaches in the food production supply chain and that to attract investment companies must have an ethical sourcing policy 'as an absolute minimum'.[32] Two other prominent retail investors, AMP and Colonial, decided to divest from an Australian fast food company on the basis of their persistently poor record of underpayment. They further noted that this company 'will remain uninvestable for a period of two years, at which point we will review the company's handling of the allegations.'[33]

Another separate way in which investors have sought to shape corporate decision-making is by way of 'informational activism', which has been described as 'the third "wave" of shareholder influence.'[34] In short, 'informational activism' uses 'market forces and informational campaigns to achieve activists'

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[25] Michael Jefferies, 'The Third Wave of Shareholder Influence and the Emergence of Informational Activism in Australia' (2019) 34 *Australian Journal of Corporate Law* 305.
[26] Tim Bowley and Jennifer Hill, 'Stewardship and Collective Action: The Australian Experience' (ECGI Law Working Paper No 491/2020, April 2020) 5-6.
[27] Ibid 15.
[28] Jefferies (n 25) 312-313.
[29] Bowley and Hill (n 26) 16 (citing Edward B Rock, 'The Logic and (Uncertain) Significance of Institutional Shareholder Activism' (1991) 79 *Georgetown Law Journal* 445).
[30] Bowley and Hill (n 25) 16.
[31] Ibid 8.
[32] Parker et al (n 12) 13.
[33] Ibid.
[34] Jefferies (n 25) 307.

objectives rather than using rights pertaining to their actual shareholding.'[35] The key tool of funds using informational activism is a report or white paper – which has ordinarily been compiled by the activist and sets out a critical assessment of the target company's governance, strategy and financial position. These reports are then used for a range of different purposes, including commencing negotiations with the target board, outlining the activist's demands or providing a point of leverage for sell-side analysts and institutional investors.[36] Jefferies argues that informational activism is 'often highly sophisticated, aggressively confrontational, and very public.'[37] While informational activism has been gaining traction in the US for some time, this style of activist intervention has not been widespread in Australia.[38] However, some predict that these types of campaigns are set to increase in the future.[39] Rock observes that:

> Institutional investors are engaging with management in a much more active way than ever before; and, rather than always supporting management, institutional investors are now willing to support hedge funds and other corporate governance activists when they are convinced that doing so will increase firm value. As one hedge fund manager explains, "The brute force of ownership is not required anymore because the big institutional players listen to both sides and are willing to back the activist fund if they believe in them . . . You can win with persuasion and ideas."[40]

The final, important development relating to institutional investors is high profile litigation. One of the most recent, and significant, test cases was run on behalf of an individual beneficiary, Mark McVeigh, against the trustees of Retail Employees Superannuation Trust (REST). The claim alleged that REST had breached its fiduciary duty by failing to act with due care, skill and diligence and failing to act in the best interests of Mr McVeigh by not properly taking into account climate change risks when making investment decisions.[41] In early November 2020, this case was settled out of court. While details of the settlement agreement have not been publicly released, REST published a statement shortly after settlement which confirmed that the fund would join a group of other superannuation funds which have pledged to align investment portfolios to a net zero emissions target by 2050 and report against the Taskforce on Climate-Related Financial Disclosures.[42]

While this is undoubtedly a critical case, it is unclear whether a similar outcome could or would be achieved by an individual beneficiary initiating litigation against a superannuation company on similar grounds. In this respect, it is notable that the Australian Securities and Investment Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) have both cautioned companies, including superannuation funds, that they need to consider and respond appropriately to the challenges arising from environmental and social risks.[43] In particular, APRA has indicated that it intends to closely supervise relevant entities in relation to the risk profile generally, and the quality of their management of emerging environmental and social risks in particular.[44]

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[35] Ibid 327-8.
[36] Jefferies (n 25) 327-8.
[37] Ibid.
[38] Bowley and Hill (n 26) 16.
[39] Jefferies (n 25).
[40] Edward Rock, 'Institutional Investors in Corporate Governance' in Jeffrey Gordon and Wolf-Georg Ringe (eds) *The Oxford Handbook of Corporate Law and Governance* (Oxford University Press, 2018) 364-385, 381.
[41] North (n 13) 244.
[42] Elouise Fowler, 'Rest Super Agrees to Align Portfolio to Climate Goals', *Australian Financial Review*, 2 November 2020. See REST, 'Rest reaches settlement with Mark McVeigh', Press Release, 2 November 2020 <https://rest.com.au/why-rest/about-rest/news/rest-reaches-settlement-with-mark-mcveigh>,.
[43] North (n 13) 229.
[44] Ibid 249 (citing Geoff Summerhayes, 'Australia's New Horizon: Climate Change Challenges and Prudential Risk' (Speech delivered at the Insurance Council of Australia Forum, Sydney, 17 February 2017).

In summary, the role of institutional investors – and their potential to positively influence the way in which corporations manage workplace issues and uphold employment rights – has changed rapidly over the past few years. And yet, it appears that more could be done. Regulation has a crucial part to play in promoting responsible investing and incentivising financial institutions to factor social risks into their decision-making and direct capital flows to better meet policy objectives in relation to employer compliance with wage and superannuation obligations.[45]

One first step would be to improve the way in which ESG information and metrics are collated and disclosed so as to allow for enhanced transparency and accountability.[46] Reliability of this data would be further enhanced by requiring that the information is independently verified by a third party auditor. In line with the findings of the Royal Commission on Financial Services, it is also important to reform corporate culture and address problems associated with short-termism.[47] In particular, it is necessary to move executive remuneration and incentives away from short-term metrics to ones which can be evaluated over the longer term in line with the company's strategic goals. A related mechanism for focusing the attention of senior officers is for regulatory agencies, including ASIC and APRA, to make it abundantly clear that statutory fiduciary duties extend to considering the impacts of systemic non-compliance with labour laws on their business, possibly through the initiation of test cases.[48]

A separate reform – proposed by ACSI – is to enhance the standing and consistency of the stewardship codes which currently apply. In particular, a discussion paper published by ASCI, argued that there should be minimum standards of stewardship and a single stewardship code that applies to all institutional investors. This would not only ensure that the same standards apply to all relevant financial actors, but it would also 'facilitate comparison and assessment of the stewardship practices of different investors.'[49]

The influence of institutional investors – and their potential to address environmental and social crises – has been under-examined, especially in Australia. More research is required on what drives institutional investors to take an interest in these issues, and whether such an interest ultimately affects the management of these risks by corporations. It remains unclear to what extent and under what conditions institutional investors – acting on an individual or collective basis – can make a difference to stemming systemic underpayment of workers in Australia.

[45] Gunningham (n 3) 461.
[46] Ibid 472.
[47] Ibid.
[48] Ibid 476.
[49] Bowley and Hill (n 26) 16.