

SEBI revisits the regulatory framework for Proxy Advisors

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Introduction

Institutional Investors world over have a major role to play in terms of shareholder resolutions and cannot turn a blind-eye towards the affairs of the companies in which they have invested. Institutional investors are financial institutions that accept funds from third parties for investment in their own name but on such parties' behalf. They include pension funds, mutual funds and insurance companies.

Institutional Investors invest large sums of money into companies and thus, they have a say in the decision making process. Where these institutions have a large stake in a company, it becomes all the more important for them to exercise voting powers at a general meeting as their decision impacts all other shareholders including those having miniscule shareholding.

However, considering the number of companies in which Institutional investors have a stake, it is very difficult for them to monitor and analyze each of their investee company's shareholder resolutions and take a decision on each of them. Here comes the role of a Proxy Advisory firm, which will be thoroughly discussed further on in this article.

Emergence of Proxy Advisors

Globally, Institutional investors are encouraged to exercise their voting rights in the investee companies. This expectation arises from a number of principles and codes issued by regulators worldwide such as the UK Stewardship Code¹, ICGN Guidance on Institutional Investors Responsibility² and so on.

In India too, the securities market regulator (SEBI), mandates mutual funds to disclose the manner of exercise of voting rights in respect of shares held by them. Insurance Regulator (IRDAI) has implemented a stewardship code for insurers.

In view of the demand by regulators around the world from investors to exercise their right to vote and uphold shareholder democracy, the concept of Proxy Advisors emerged.

Proxy Advisors (PAs) are entities which research and give opinions to investors, generally institutional investors, on how to vote in shareholder meetings. Internationally, PAs are quite persuasive and are relied upon by institutional investors.

Shareholder's resolutions are no longer a mere formality. Companies are aware that there are PAs scrutinizing their resolutions in order to safeguard shareholder's interest.

Regulatory Framework in India

SEBI regulates the activities of PAs in India under SEBI (Research Analyst) Regulations, 2014 ('Regulations'). As per the Regulations *"Proxy adviser" means any person who provide advice, through any means, to institutional investor or shareholder of a company, in relation to exercise of their rights in the company including recommendations on public offer or voting recommendation on agenda items.*

¹ [https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-\(September-2012\).pdf](https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf)

² https://www.icgn.org/sites/default/files/ICGN%20Institutional%20Investor%20Responsibilities_0.pdf

Under these Regulations, such entities are required to register with SEBI and comply with the provisions pertaining to formation of internal policies and procedures, disclosures in the reports, code of conduct, maintaining record of voting recommendations etc.

Mandatory disclosure of manner of exercise of voting rights in India

SEBI mandates³ Mutual Funds to disclose general policies and procedure for exercising voting rights in respect of shares held by them, in the annual report and on the website of the AMC. Further, AMCs are required to disclose actual exercise of proxy votes in relation to certain matters viz. Corporate Governance matters, changes to capital structures, appointment/ removal of Directors, ESOP and any other issue that may affect interest of the shareholders and interest of unit holders in particular.

Since, insurance companies are significant institutional investors in listed companies and the investment held by them as custodians of policyholders. It was felt that insurance companies should play an active role in the general meeting of investee companies and engage with managements at greater level to improve their governance. Thus, in March, 2017⁴ IRDA had implemented a code for stewardship for the insurer vide Ref No. IRDA/F&A/GDL/CMP/059/03/2017. A stewardship code applicable for all the insurers comprising seven principles modelled on UK stewardship code.

- The UK stewardship code's seven principles are as follows:
 - Publicly disclose their policy on how they will discharge their stewardship responsibilities;
 - Have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed;
 - Monitor their investee companies;
 - Establish clear guidelines on when and how they will escalate their stewardship activities;
 - Be willing to act collectively with other investors where appropriate;
 - Have a clear policy on voting and disclosure of voting activity;
 - Report periodically on their stewardship and voting activities.
- All insurers are required to file a status report to the Authority on an exception basis (comply or explain) on annual basis indicating the reasons/justification for the deviation or non-compliance with the principles indicated in the guidelines.

Constitution of Working Group on Issues concerning PAs

In November 2018, SEBI formed Working Group on Issues concerning PAs (WG) to review the provisions and functional areas in relation to PA.

In addition to recommendations in relation to foreign PA, the report also proposes to mandate FPIs, Portfolio Managers, AIFs, REITs, InvITs etc. who have PAs to ascertain if such PAs have appropriate capacity and capability.

Currently, the PAs registered with SEBI are as under:

³ https://www.sebi.gov.in/sebi_data/attachdocs/apr-2018/1523337972677.pdf

⁴ https://www.irdai.gov.in/ADMINCMS/cms/whatsNew_Layout.aspx?page=PageNo3096&flag=1

- Institutional Investor Advisory Services India Limited (IIAS)⁵
- Stakeholders Empowerment Services (SES)⁶
- Institutional Shareholder Services India Private Limited (ISSIPL)⁷
- Ingovern Research Services Private Ltd (IRSPL)⁸

Pros and Cons of PAs

The Working group understands and highlights the benefits of proxy advisory firms in India in its report. Proxy Advisors compile data for investors and provide voting recommendations, which are generally followed by investors while voting at the meetings of their investee companies. As stated in the report of the Working Group:

“Proxy advisors typically bring out publicly disclosed standards an ideal company should follow, often exceeding the standards laid down by law.”

Below is a table highlighting the benefits and disadvantages of PAs.

Benefits of PAs	Disadvantages of PAs
<ul style="list-style-type: none"> • Help investors vote intelligently, especially when there is a time crunch to read and analyse a lot of data. • Help global investors receive informed analyses and recommendations, taking into account local as well as global good practice principles. • Able to provide a bird’s eye view and a deeper dive into the companies being researched. • Serve as “information-gatherers” for small investors, providing full access to all relevant company meeting materials and disclosed information, as well as voting recommendations. • Increased shareholder activism and pushed companies to adopt higher level of disclosures • collect and translate key materials, translating legal and accounting jargon into plain English, and provide a consistent structure of relevant information across all companies in all markets. 	<ul style="list-style-type: none"> • Apply a one-rule-fits-all-countries approach. • Sets a higher standard, travelling beyond prescription of law. • Not receptive to factual errors being corrected, thus causing outcomes not based on facts.

⁵ Institutional Investor Advisory Services (**‘IIAS’**) has equity participation by Aditya Birla Sunlife AMC, Axis Bank, Fitch Group Inc., HDFC, ICICI Prudential Life Insurance, Kotak Mahindra Bank, RBL Bank Limited, Tata Investment Corporation, UTI Asset Management Company Limited and Yes Bank

⁶ Stakeholders Empowerment Services (**‘SES’**) has equity participation by Mrs. Rekha Gupta (Shareholder), Ms. Sneha Bhandari (Shareholder), Mr. Jitendranath Gupta (Shareholder & Managing Director) and Mr. Jitendranath Gupta jointly with Priya Singh (Shareholder) as on 31st March, 2018.

⁷ Institutional Shareholder Services India Private Limited (**‘ISSIPL’**) has equity participation by Institutional Shareholders Services INC (Shareholder) and Securities Class Action Services LLC (Nominee shareholder of Institutional Shareholders Services INC) as on 31st March, 2018.

⁸ InGovern Research Services Private Limited (**‘IGRSPL’**) has equity participation by Mr. Shriram Subramanian (Director & Shareholder), Ms. Usha Narayan (Director & Shareholder) and Mr. Mohandas Pai (Shareholder) as on 31st March, 2018.

Major issues concerning PAs and Recommendations of the Working Group

Although the advantages of PAs are many, there are certain issues revolving around the same which is the reason behind constituting this working group.

The working group reviews the major issues concerning PAs and has made several noteworthy recommendations in its report⁹.

All Recommendations of the working Group advocate non-regulatory improvements by way of disclosures of conflict of interests, best practices, setting up a code of conduct to be followed by proxy advisors on a comply or explain basis and so on.

The salient recommendations are mentioned below:

A. Disclosure of Conflict of Interest:

- The disclosures should appear on every specific document where they are giving their advice. It should be extended to every place, including news quotes where a proxy advisor makes a statement. Disclosures should especially address possible areas of potential conflict and the safeguards that have been put in place.
- Creation of 'Chinese Walls' between proxy firms and their consultancy firms. There should be clear procedures to handle conflicts of interest.
- Conflict of interest where there is substantial shareholding or inter-locking boards can be addressed by full disclosure rather than banning proxy advisors from having a view on such connected companies.

B. Business Model, Other services and Disclosures

- Disclosures regarding the business model e.g. types of services provided, revenue breakup from various services, categories of clients served and any specific prohibition on services provided.
- The entity/business unit providing services to investors/shareholders should be different from the one providing advisory services to a corporate client.
- Disclosure if consulting services are provided.
- There should be disclosures regarding the provision of other services through subsidiaries, division or associates, and the total income earned by providing such services where it exceeds say 10% of revenues.
- Disclosing the methodologies and processes they use in the development of their research and recommendations, so there is some stated process by which the proxy advisors act.
- Setting parameters around the communications they have with the companies and other stakeholder
- Codes that determine when not to provide a voting recommendation should be clearly disclosed.
- Communication between the proxy advisor and the company should be promptly made public by the company.
- Proxy advisors should make public on their website the following disclosures every year ;
 - i) Shareholding patter and changes during year, if any
 - ii) Audited Balance Sheet, Profit and loss Account and cash flow

⁹ https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxy-advisors-seeking-public-comments_43710.html

- iii) Board of Directors and changes during year, including shareholding of directors and relatives with changes during the year.
- iv) Litigations if any

C. Independence

- Board of proxy advisors should be independent of its shareholders, where such a position creates a serious conflict of interest, real or apparent.

D. Matters that may be reviewed by SEBI:

1. Stewardship Code and Best Practices Code

- Introducing a voting or stewardship code for multiple institutional investors, not just limited to mutual funds, say for all investors who own over 5% shares of a listed company.
- Proxy advisors may introduce a voluntary best practices code for the industry on a 'comply or explain' basis as they develop and evolve.

2. Skill set

- SEBI may review its certification norms and continuing education as appropriate without over-burdening the proxy advisors.

3. Dispute Redressal

- Any dispute arising between Corporate and Proxy Advisors needs to be first examined by SEBI to ascertain the non-compliance, if any, of the proposed additional Code of Conduct for Proxy Advisors. SEBI will give appropriate comments in the matter w.r.t compliance of code of conduct by proxy advisor. Only thereafter, the person may approach the court of law.

4. Regulatory and Other Changes

- SEBI must make changes to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 to make listed companies and their management comply with approaching the panel/SEBI process for any grievances. This provision read with Ss. 15Y and 20A of SEBI Act, 1992 should provide comfort to both proxy advisors and companies against abuse of power.
- Framework may be created for proxy advisors to reach retail investors and encourage them to vote. In order to increase the participation of retail investors in the voting process, necessary link may be available on stock exchange website alongside corporate notice issued in this regard.
- SEBI could consider providing a code of conduct under the RA Regulations which should be followed by foreign proxy advisors as it should also apply to domestic proxy advisors.
- SEBI may review and eliminate the current requirement of networth as it is irrelevant to the work that proxy advisors do.
- SEBI may consider mandating companies to provide complete and timely disclosures, increase release schedule of AGM notices, and provide for vote confirmations. To increase transparency, voting guidelines and policies of proxy advisors may be made public.

5. Technology Review

- SEBI should employ the use of modern technology to democratize and empower investors further as new technologies make it easier to implement such benefits.

Conclusion

The report has been placed for public comments and final changes to the SEBI (Research Analyst) Regulations 2014, are awaited.

At present, none of the shareholder directors of the PA firms holds directorships in equity listed companies and so the recommendation of the Working Group in this regard is already being complied with.

PAs provide substantial value addition to the industry and plays a major role in increasing corporate governance in companies as their recommendations have a major impact on companies workings. The Working groups recommendations seek to provide a non-regulatory framework while promoting the functioning of proxy advisors through creation of best practices codes and seeking more transparency through disclosures by PAs.

Major issues concerning PAs have been addressed in the report and the recommended changes are most certainly welcome.

Annexure – Detailed Recommendations of the Working Group along with Rationale

Sr. No.	Particulars	View	Counter view	Working group recommendations
1	Independence of PA	The level of conflict is substantially lower than other intermediaries like auditors and credit rating agencies, where the company being scrutinised is itself paying the intermediary but PA are paid primarily by institutional investors to scrutinise the workings of companies hence probability of violation of independence of PA is comparatively lower.	There are certain areas where independence of PA may get violated: <ul style="list-style-type: none"> • Shareholding of listed company or its group companies in PA • consulting assignments provided to companies who may in turn be scrutinised in the next shareholder meeting • Any other source of revenue which may result into conflict of interest. 	
2	Restriction on Services	PA should not be offering any remunerative or advisory services and should only give voting recommendation.	PA should have flexible approach to determine the way for handling any issue with respect to conflict of interest. Hence there should not be any restriction on provision of services provided necessary disclosures are made by PA.	Flexible approach is the better where adequate disclosures and clear methodologies are followed.
3	Earning revenue from subsidiary companies through business consultancy, database services etc.	Providing any consultancy or database services may violate independence of PA. Therefore PA should not provide such services and by this PA ensures that it has no financial incentive to develop policies or issue recommendations that make companies feel they need to pay for consulting services in order to achieve a favourable outcome.	Prohibition on PA or their associates from earning revenue from ancillary business activities is not appropriate. Such restrictions may harm more than good because consulting service helps company to provide better corporate governance.	There should be ‘Chinese Walls’ between proxy advisory firms and their consultancy firms. PA must provide disclosures regarding the provision of said services through subsidiaries, divisions or associates if income earned from such services exceed 10% of the revenues.
4	Recommendation on	PA should not make any	Recommendations can be made on	The PA should be allowed to provide said recommendations if

Sr. No.	Particulars	View	Counter view	Working group recommendations
	resolution of the companies which are promoter or major shareholders of PA or of companies whose promoters are partners with promoters of PA.	recommendation on resolutions of: <ul style="list-style-type: none"> • Any company in which it directly or indirectly holds certain percentage of share capital or • Any group company of PA or • Companies which are promoters or shareholders of PA 	resolutions of said companies only if PA makes necessary disclosures and takes appropriate steps to handle conflict of interest if any.	the relationship is fully disclosed and all conflicts of interest are detailed. For handling any potential issues mitigation approach should be adopted rather than imposing any absolute prohibitions.
5	Nature and placement of disclosures by PA	PA should determine type of disclosure and manner of providing those disclosures. Institutional investors are responsible to undertake due diligence of content of disclosures and manner of providing the disclosure.	Generic disclosures would not meet the intent of full and honest disclosure. Therefore enhanced disclosure is required to be made by PA. Disclosures should appear on every voting recommendation of various companies as well as on every document where PA is giving advice.	PA should make enhanced disclosures rather than making generic disclosures on its website.
6	Comprehensive code of conduct to disclose rationale for voting recommendation made by PA			Providing detailed reasoning to public for all recommendations and advices made by PA might affect its business model.
7	Material based on which such recommendations have been made.			If the information used by PA for providing recommendation is not from publicly available sources then PA must made disclosures for the same in voting advisory report of the relevant company only.
8	Guidelines, methodology or the			PA should explain how their voting policies and methodology

Sr. No.	Particulars	View	Counter view	Working group recommendations
	criteria upon which recommendations are based			are developed and updated. PA should also inform timings of policy updates and such policy should be reviewed atleast on annual basis.
9	Conflict of interest and relationship of PA with financial institutions			Disclosures need to be made.
10	Source of income generation			A material source of income (say 10% plus) should be disclosed publicly.
11	Providing corporate governance advice			Provision of such services are part of business model of PA and it should not be restricted but disclosures should be made wherever necessary.
12	Public disclosure of shareholding pattern and financial results of PA	PA are unlisted and therefore public disclosures of financial results would not serve public interest.		Details available in public domain viz. ROC filings should also be made available on website of PA
13	Assessment of past voting recommendations			Recommendation made by PA are subjective with respect to every resolution, hence past recommendations are not appropriate for performance evaluation.
14	Requirement of sufficient skill sets and minimum experience to become eligible employee of PA	Minimum qualification and experience criteria should be adopted from SEBI (RA) Regulation, 2014	No such qualification or experience criteria should be there as every PA has sole right to hire its staff as it sees fit.	PA should have staff with sufficient skill sets.

Sr. No.	Particulars	View	Counter view	Working group recommendations
15	Role of proxy industry in increasing voting in general meeting.	Pressure on investors from regulators and clients to exercise their votes has had more impact on voting levels.	Provision of electronic voting tools, translations of materials, assistance from PA in making informed voting decision and managing complex operational process of voting are some essential reasons for increase in voting in general meeting.	Due to technological advances and improvement in behaviour of institutional investors, voting has increased in general meeting.
16	Robo-voting and Requirement of Stewardship Code	Institutional investors such as mutual funds, etc. owe a fiduciary duty to their unit-holders to act in their best interest. However, the responsibility of fiduciary duty may be undermined in case of 'Robo-voting' and the same needs to be examined.	Every institutional investors have their in-house policy of voting and during such policy formulation process institution compares its own views with views of PA. There should not be any surprise factor if recommendations of PA are same with views of institutional investors since there are many common governance principles used by both institutional investor and PA. Hence using the term Robo-voting is unfair characterisation of management of institutional investors.	There is little evidence of robo-voting and therefore stewardship code is recommended as welcome addition. SEBI should make a stewardship code like UK stewardship code, mandatory for all institutional investors and it should be on a comply or explain basis.
17	Technological advances for increasing ability of shareholders to exercise their votes.	Allow existing voting process to continue for few more years even though it is inefficient, expensive and prone to errors.	Following must be taken into consideration for improving voting process through technological advances: <ul style="list-style-type: none"> • Providing Blockchain facility • Live/online streaming • Real time vote confirmation • Voting kiosks and e-voting awareness • Mobile application • One Time Passwords • Increase the time available between 	

Sr. No.	Particulars	View	Counter view	Working group recommendations
			notice of meeting and the cut-off time for custodians to receive shareholder votes	
18	Nature of communication between PA and corporates	PA should have policies and procedures to create rules for maintaining relationships and communications with public companies. Such interaction facilitates mutual understanding and transparency amongst them.	PA should not receive any information from corporates which is not available to all shareholders. In fact, companies should be encouraged to provide complete and timely disclosures of all material information so that PA can rely on such publicly available information.	Communication between PA and company should be made publicly available.
19	Protecting PA from adverse legal action for holding honest opinions which are dis-liked by companies or individuals	Litigation should not be initiated merely because an opinion is not favourable to the management of a company.	The regulator must protect the freedom of PA to express their opinion but regulator must not become a mechanical defender of PA. Thus there should be a pressure valve for both corporates and PA.	Any dispute arising between Corporate and PA needs to be first examined by SEBI to ascertain the non-compliance, if any, of the proposed additional Code of Conduct for PA. SEBI will give appropriate comments in the matter only thereafter the person may approach the court of law.
20	Nature and intention of providing recommendations	PA should make recommendation purely based on compliance with prevailing laws and regulations and not based on any criteria beyond laws.	PA should make recommendation not only based on compliance but it should also disclose aspirational higher standards they are suggesting to corporates to achieve better corporate governance.	Working group supports the higher standards theory.
21	Recommendation on major moves of a company such as M&A.	PA based on their research and analysis develop their own views with respect to any major corporate transaction. It uses various valuation parameters to determine fair value of	For providing any opinion on corporate events like M&A, person must have special skill sets and qualification to determine and evaluate fair value of such transaction where PA lacks such	Analysis of such major corporate events by PA might create some value addition to the shareholders and therefore there is no reason to restrict PA from providing such

Sr. No.	Particulars	View	Counter view	Working group recommendations
		such transactions but never advise stakeholders to take any particular action other than voting recommendation. Therefore, they should not be restricted from providing opinion on any major corporate moves.	requisites. Therefore PA should not frame its opinions on such transactions.	service.
22	Registration of foreign PA	<ul style="list-style-type: none"> • There should be mandatory registration of foreign PA as it would be equitable for same standards to be applied to all PA recommendations about Indian listed companies or • There should be chaperoning agreement between foreign PA and its Indian counterpart which helps foreign PA to comply with SEBI regulation or • Institutional investors can engage only SEBI registered PA who will provide voting recommendation on resolutions pertaining to Indian Listed Companies 	Registration of foreign PA is not only costly and time consuming but also compromise institutional investors' access to efficient, timely, and independent information.	Registration and chaperoning should be avoided for foreign PA as it would harm Indian standards and reduce competition.
23	Increase in compliance cost and reduce competition.	Regulation is likely to result in higher costs for investors as well as it is likely to limit competition and create entry barrier for potential new PA.		Conducting effective cost-benefit analysis would mitigate any unnecessary costs which could reduce competition. SEBI may review and eliminate the current requirement of net worth as it is irrelevant to the work that PA do.