

Power of proxy advisors in corporate democracy

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Learning objective

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Proxy advisors

Meaning and role

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Relevance of proxy advisors

In view of significant institutional ownership in listed entities

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Regulatory landscape

Global overview and laws in India

04

Practical aspects

Probable questions relating to working of proxy advisors

Proxy advisors: meaning & role

- SEBI (Research Analysts) Regulations, 2014 defines proxy advisors as:
 - *"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.*
- Some proxy advisors in India:
 - Stakeholders Empowerment Services;
 - Institutional Investors Advisory Services;
 - InGovern Research Services.
- Global names:
 - Institutional Shareholder Services Inc.;
 - Glass Lewis & Co.;
 - Segal Marco Advisors;
 - Institutional Voting Information Service; etc.

Role of Proxy advisors:

- Analyzing the proposals at general meetings and recommending voting decisions;
- AGMs may be concentrated during a certain period of the year
 - May not be feasible for investors to gather information and knowledge about all the companies
- Recommendations of proxy advisors assists in
 - Having considered understanding of different agenda items;
 - Taking informed voting decision;
 - Optimisation of limited resources;
 - Exercising voting decision in a timely and informed manner.

Institutional ownership

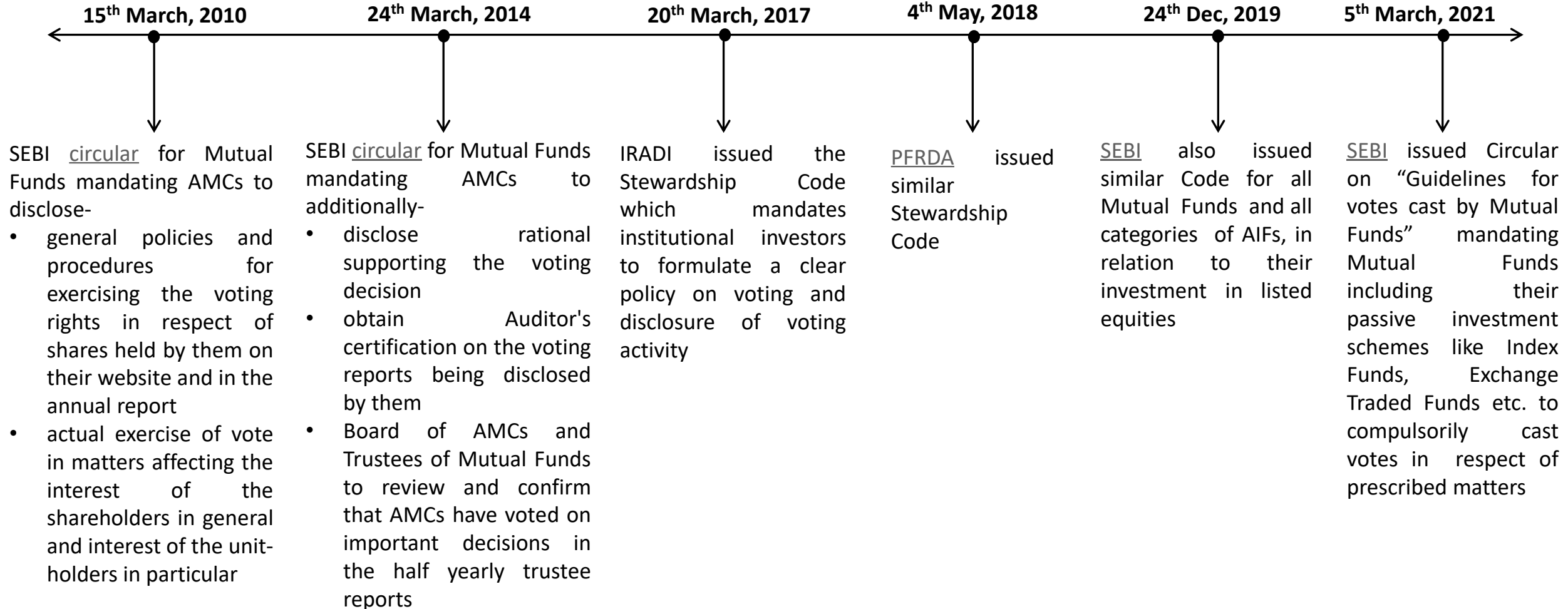
- Institutional investors (viz. Mutual funds, pension funds, insurance companies, provident funds etc.)
 - holds significant chunk of company's share capital
 - Generally have vote with millions of shares at general meetings or on items to be passed by ballots.
- Primary strength of institutional investors' lies in making investments;
 - and may not have adequate expertise or infrastructure to-
 - ensure proper corporate governance of the portfolio investees;
 - exercise voting powers in the best interest of concerned stakeholders.
- At the end of 2020, globally, institutional investors represented 43% of the global market capitalization of listed companies, equivalent to almost USD 44 trillion



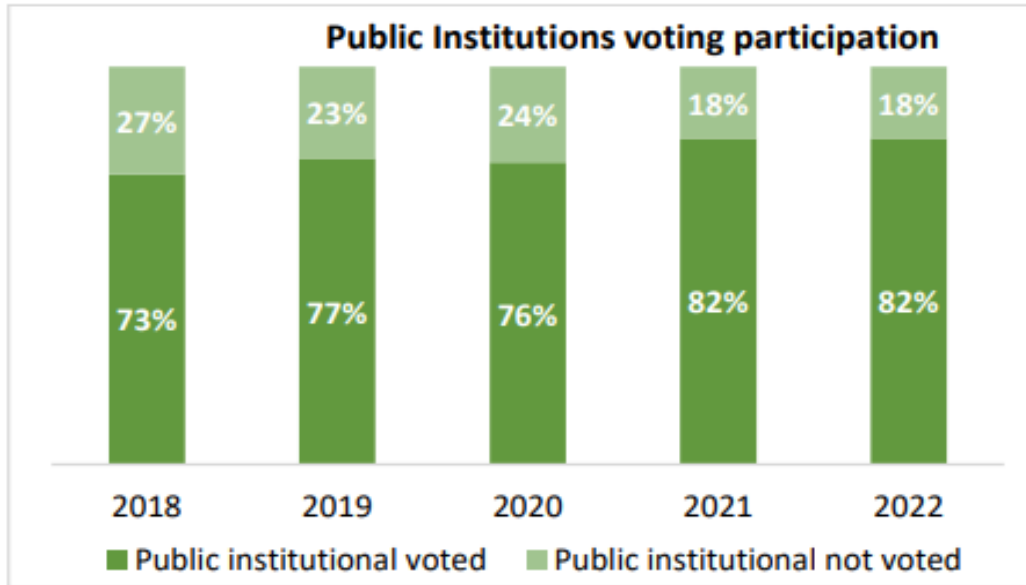
Institutional ownership in Indian listed companies (2001-2018)

Source: OECD (2020), Ownership structure of listed companies in India

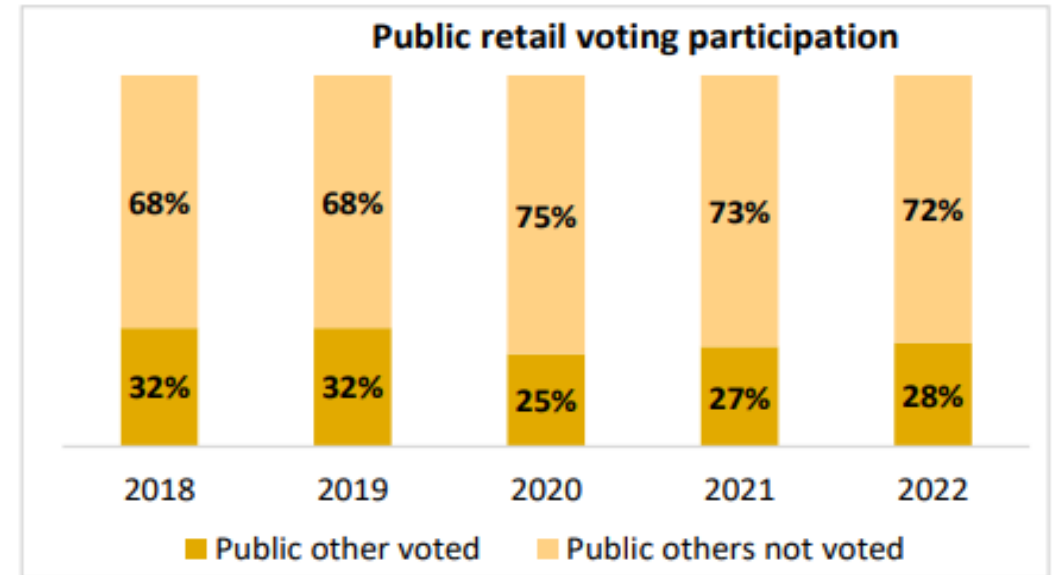
Enhanced role of institutional investors



Shareholder's participation



- Increase in voting participation by institutional investors from 73% in 2018 to 82% in 2022

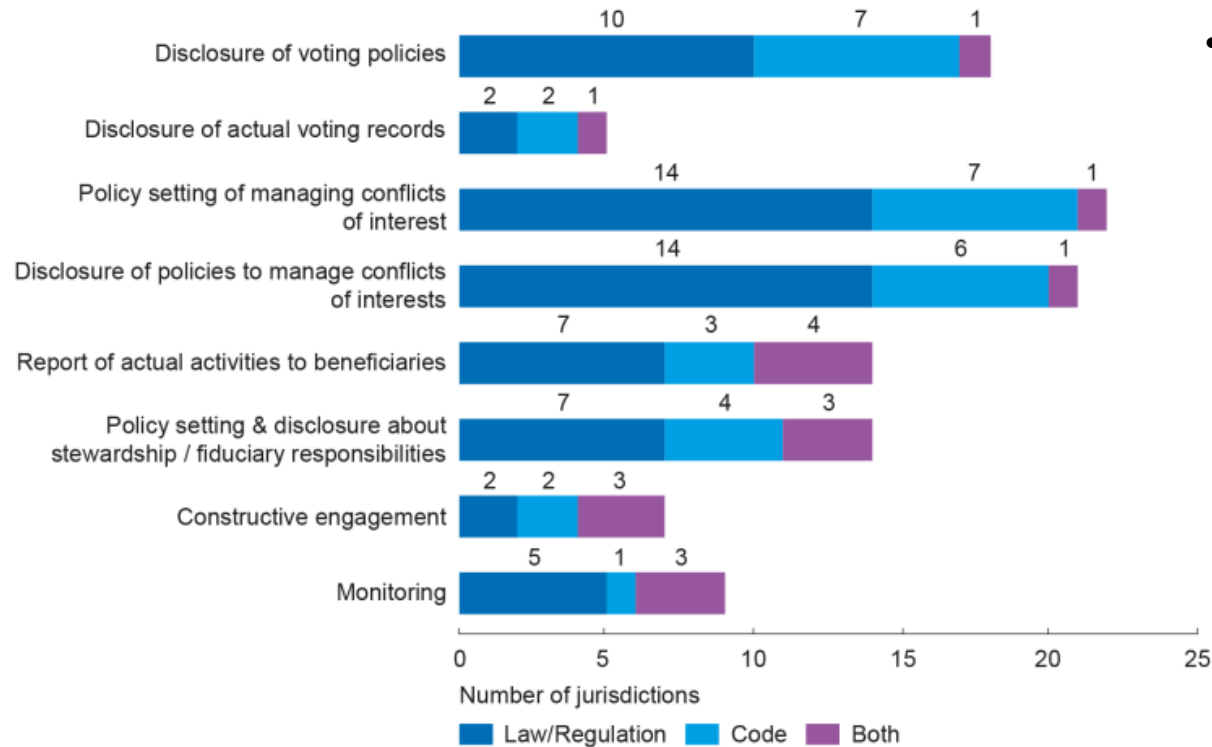


- Decrease in voting participation by retail investors from 32% in 2018 to 28% in 2022

Regulatory landscape

Navigating the regulatory landscape

Requirements and recommendations for proxy advisors



Note: Based on information reported from 50 jurisdictions.

- The results of the OECD survey of 50 jurisdictions shows-
 - jurisdictions have taken varying approaches to regulation of proxy advisors
 - a number of jurisdictions have established stand-alone laws or regulations specifically applicable to proxy advisors, in some cases supplemented by additional guidance
 - most common reported requirements involve policy setting and disclosure related to conflicts of interest

Glimpse of Indian regulatory regime

❑ **SEBI (Research Analysts) Regulations, 2014** was the 1st law in India that brought proxy advisors under the legal radar

- The Regulations broadly mandates –
 - i. registration with SEBI to undertake the proxy advisory business in India;
 - ii. formation of internal policies and procedures for functioning;
 - iii. maintenance of records of the recommendations made;
 - iv. disclosures with regard to ownership and material conflicts of interest in the recommendations made;
 - v. disciplinary code of conduct [Discussed in later slide]

❑ **SEBI Circulars:**

1. Circular dated 3rd Aug, 2020 read with Circular dated 31st Dec, 2020
 - Prescribes the procedural guidelines for proxy advisors [Discussed in later slide]
2. Circular dated 4th Aug, 2020
 - Provides for grievance resolution between listed entities and proxy advisers
 - provides liberty to listed entity to approach SEBI for examining the matter for non-compliance by proxy advisors with
 - the provisions of the Code of Conduct;
 - the procedural guidelines for proxy advisors.

Procedural guidelines for proxy advisors

❑ Formulation of voting recommendation policies:

- disclosing circumstances when not to provide voting recommendation
- Policy to be reviewed at least once in a year
- Updated policy to be disclosed to the clients

❑ Disclosure requirements:

- methodologies and processes followed in the development of the research and recommendations to the clients

❑ Compliances in cases of material revisions:

- alert clients within 24 hours of receipt of information about any factual errors and any impending material revisions to their reports.
- Any material revisions to the report shall be communicated to the clients within 72 hours of receipt of the information, while ensuring that adequate time is available for clients to make an informed decision

❑ Communication with clients:

- Proxy Advisors to have a stated process for communication with its clients and the company

❑ Disclosures in the recommendations:

- legal requirement vis-a-vis higher standard suggested in the report if any, and the rationale behind the recommendation of higher standards

❑ Conflict of interest:

- Disclosure of conflict of interest on every specific document where they are giving their advice.
 - Disclosures to especially address possible areas of potential conflict and the safeguards that have been put in place
- Establishment of clear procedures to disclose, manage and/or mitigate any potential conflicts of interest resulting from other business activities undertaken by them

❑ Sharing of report & addendum:

- Mandatory sharing of the report with the company and the client simultaneously
- if the company has a difference of opinion, issue an addendum report after considering the view point of the Company and revise recommendation, if required

Impact of SEBI circulars

Year	Reports	Addendums	% of Addendums as to reports
2018	1,148	77	6.71%
2019	1,223	91	7.44%
2020	1,103	112	10.15%
2021	1,113	193	17.34%
2022	1304	259	19.86%

Reports vs. Addendums issued by SES in last 5 years

- Inference-
 - The ratio of addendums to reports issued by SES has increased by almost three times to 19.86% from 6.71% from 2018 to 2022
 - Number of companies covered by SES have remained relatively in the same range
 - Addendums issued by SES have increased every year, both in relative and absolute terms

Code of conduct for proxy advisors

Honesty and good faith

- Act honestly and in good faith

Diligence

- Act with due skill, care and diligence and ensure that the research report is prepared after thorough analysis

Conflict of interest

- Effectively address conflict of interest which may affect the impartiality and make appropriate disclosures to address the same

Insider trading or front running

- Proxy advisors and its employees shall not engage in insider trading or front running of its own research report

Confidentiality

- Proxy advisors and its employees shall maintain confidentiality till the report is made public

Professional standard

- Proxy advisors and its employees shall maintain high professional standard while preparing the report

Compliance

- Compliance with all the regulatory requirements applicable for the conduct of its business activities

Responsibility of senior management

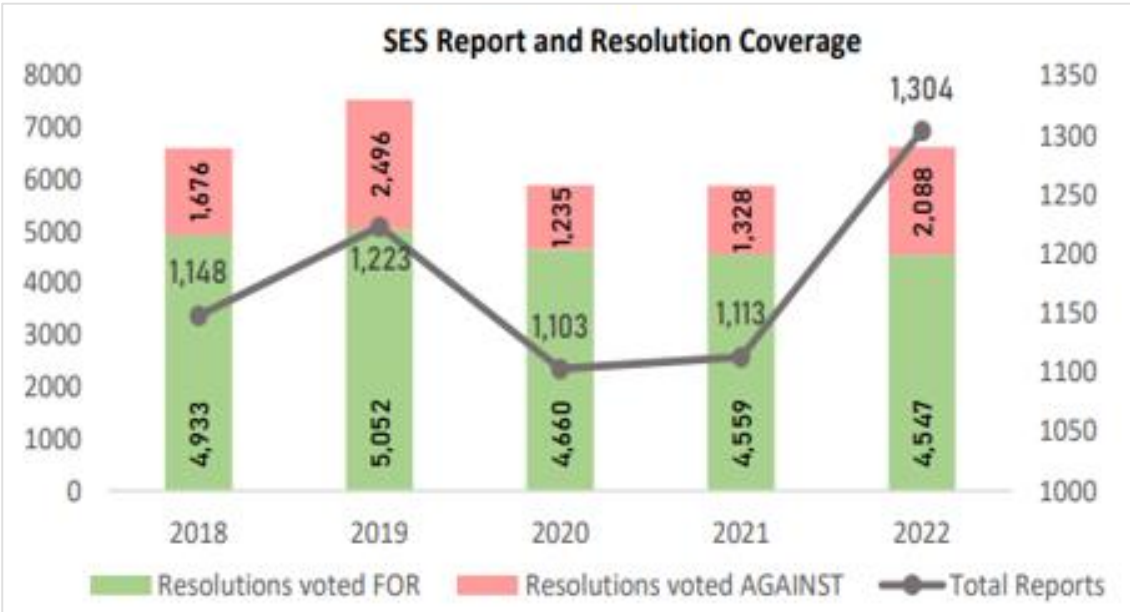
- Senior Management shall bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures.

Practical aspects

Are Proxy advisors trying to form their own law?

- Re-appointment of IDs:
 - Sec 149(10) of Companies Act, 2013 provides, “*Subject to the provisions of section 152, an independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be **eligible for reappointment on passing of a special resolution by the company** and disclosure of such appointment in the Board's report*”
 - SES takes a negative view if a company is re-appointing IDs as additional director and seeking shareholders approval on post facto basis from a retrospective date
- Non-disclosure of relevant extract of Annual Return / Annual Return
 - SES takes a negative view in case Annual Return or MGT 9 information of relevant FY is not given in public domain at least 21 days prior to AGM
- Transition of directors from IDs to NIDs:
 - Reg. 25(11) of LODR required IDs who **resign** from the board of the listed entity to serve a min. cooling off period of 1 year before appointment as an **executive/WTD in the same/group companies**.
 - SES held that same rule to apply in case of transition from IDs to NE-NIDs
 - Further, such transition shall also include all forms of cessation (including retirement)

Are shareholders blindly following the recommendations?



* Results mentioned herein are limited to the reports issued by SES

Are views of different proxy advisors consistent?

Resolution	No. of resolutions	SES		IIAS	
		For	Against	For	Against
Appointment/re-appointment of EDs	8	4	4	6	2
Appointment/re-appointment of NEDs	7	6	1	4	3
Appointment/re-appointment of IDs	14	12	2	10	4
RPTs	15	9	6	15	0
ESOPs	14	5	9	7	7
Divestment of stake in material subsidiary	4	0	4	0	4
Approval u/s 186	1	1	0	0	1
Alteration to AOA	7	2	5	4	3
	70	39	31	46	24

* Study based on a sample of 70 resolutions on which recommendations were given by both SES and IIAS

Thank you!
