



## ERGO

*Analysing developments impacting business*

### TIGHTENING THE NOOSE ON PROXY ADVISORS (INFLUENCERS OF INDIA INC)

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The concept of 'proxy advisor' is of western import and despite the nascentcy has slowly and steadily gained importance in the Indian market as a critical intermediary and a rather persuasive influencer of a company's decision making and policies through the shareholders.

Proxy advisors mainly cater to institutional shareholders' needs by providing them with independent and fact-based research inputs and insights, to enable them to make informed decisions in the best interest of the company. The institutional investors who are spared the additional time and effort in *inter alia* understanding the position of the company in the market-place by analysing the market intelligence and data available in the public domain. Their expertise and exposure to different sectors of the industry make them better suited to provide insights into the functioning of the company and its competitive position, in the short term as well as long term.

Accordingly, proxy advisors tend to gain certain vantage owing to the trust reposed in them by the institutional shareholders, which in turn by virtue of the exercise of the voting power by such shareholders has ramifications on the governance and corporate decision making of the company impacting shareholder value, the markets and the economy as a whole.

To regulate the proxy advisors, given their unique position in the market structure, Securities and Exchange Board of India (SEBI) had rolled out the SEBI (Research Analysts) Regulations 2014<sup>1</sup> (RA Regulations) which requires mandatory registration of proxy advisor as a research analyst with SEBI and provides an elementary regulatory framework in terms of management of conflict of interest and disclosure requirements and an eight-point code of conduct. Such regulation was and continues to be a rarity from a global perspective since in most countries proxy advisors are not regulated<sup>2</sup>. These regulations are a testimony to the corporate concern on part of the SEBI to protect investor interest, foster investor confidence, and facilitate capital formation.

Recently, SEBI issued two circulars one dated 3 August 2020 providing 'Procedural Guidelines for Proxy Advisors'<sup>3</sup> (Procedural Guidelines) and the other dated 4 August 2020 providing 'Grievance Resolution between listed entities and proxy advisors' (Grievance Resolution Circular) (collectively SEBI Circulars), which are first of its kind

<sup>1</sup> [https://www.sebi.gov.in/sebi\\_data/commondocs/RESEARCHANALYSTS-regulations\\_p.pdf](https://www.sebi.gov.in/sebi_data/commondocs/RESEARCHANALYSTS-regulations_p.pdf)

<sup>2</sup> Report on Issues Concerning Proxy Advisors dated 24 May 2019 by the SEBI Working Group on Proxy Advisors

<sup>3</sup> [https://www.sebi.gov.in/legal/circulars/aug-2020/procedural-guidelines-for-proxy-advisors\\_47250.html](https://www.sebi.gov.in/legal/circulars/aug-2020/procedural-guidelines-for-proxy-advisors_47250.html)

for the Indian market to have stipulated categorical disclosure requirements for proxy advisors.

The SEBI Circulars reflect some of the key recommendations, *inter alia* in respect of conflict of interest, voting, fiduciary-duty and information sharing and grievance redressal system, which had been suggested by the SEBI Working Group on Proxy Advisors in its 'Report on Issues Concerning Proxy Advisors' dated 24 May 2019 (Working Group Report).<sup>4</sup> Accordingly, it seems that the Working Group Report and the subsequently received public comments form the genesis of the SEBI Circular. However, in the same breath, it must be pointed out that there is certain 'substance over form' variance in the SEBI Circulars in respect of the Working Group Report, for instance, the Working Group Report suggests an amendment to the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 for instituting grievance redressal and code of conduct for proxy advisors, as against the Grievance Resolution Circular which has suggested a remedial model whereby the listed company would approach SEBI in instances of disconcert or non-compliance with the Procedural Guidelines by the registered proxy advisor and SEBI would examine the same.

While the SEBI Circulars seem to have codified the prevalent business practice of the major proxy advisory firms,<sup>5</sup> as a necessary next step, all proxy advisory firms shall be required to do the following, for ensuring compliance with the SEBI Circulars which are effective from 1 January 2021<sup>6</sup>:

- Formulate and adopt:
  - Voting recommendation policy, which includes circumstances of when such recommendation shall not be provided (to be reviewed annually);
  - A stated process to communicate with clients and company and timeline to receive comments from the company;
  - Sharing policy, to ensure sharing of the report with clients and company at the same time; and
  - Conflict of interest policy, to provide for procedures to disclose, manage/mitigate any potential conflict of interest, including from conflict arising from other business activities undertaken by the proxy advisor.
- Disclose:
  - Voting recommendation policy to its clients and sharing policy on the website;
  - Methodologies and processes followed in the development of the research and corresponding recommendations to the client;
  - Factual errors or material revisions in the recommendations, within 24 hours of the receipt of information;
  - Legal requirements or higher standard for recommendations, along with rationale for such higher standard; and

<sup>4</sup> [https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxy-advisors-seeking-public-comments\\_43710.html](https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxy-advisors-seeking-public-comments_43710.html)

<sup>5</sup> <https://www.livemint.com/news/india/sebi-issues-disclosure-standards-for-proxy-advisory-firms-11596457774523.html>

<sup>6</sup> SEBI has provided an extension from the initial implementation date of 1 September 2020, and thus provided a window of further four months for the implementation of the SEBI Circulars, in light of proxy advisor representations and COVID-19 pandemic consideration.

- Conflict of interest in every advisory document issued along with areas of potential conflict of interest and the mitigation plan instituted as a safeguard.
- Ensure accuracy of information relied on for the recommendation by receiving comments/clarification from the company and disclosing the same in an addendum to the report as well as revising the recommendations initially made or issuing remarks basis the company comments/clarification in the addendum.

A few loose ends that remain are whether the proxy advisor can charge the company for sharing the recommendation with the company and time limit for issuing addendum with revised or emphasised recommendation if the recommendation is not materially revised or there is no factual error. Other items that may become contentious in grievance redressal could be the higher standard for recommendation and the rationale.

It is also interesting to note that the disclosure requirement under the SEBI Circular is similar to the 'Rule Amendment for Proxy Voting Advice' adopted by the US Securities and Exchange Commission on 22 July 2020,<sup>7</sup> in respect of disclosure of conflict of interest along with written policies and procedure<sup>8</sup>, company access to advice at the same time as dissemination to the client<sup>9</sup> and client access to the company response<sup>10</sup>.

Proxy advisors are expected to be flag bearers of effective shareholder democracy, and to that extent, the information and inputs provided by them to the shareholder should be unbiased, authentic, and reliable. The SEBI Circulars prove to be a benchmark for transparency, reliability, and independence required of from the proxy advisors in discharging their function which in a sense is fiduciary.

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<sup>7</sup> <https://www.sec.gov/news/press-release/2020-161>

<sup>8</sup> Rule 14a-2(b)(9)(i)

<sup>9</sup> Rule 14a-2(b)(9)(ii)(A)

<sup>10</sup> Rule 14a-2(b)(9)(ii)(B)

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