

May 2021



# CIO Dialogue

## With Proxy Advisors

in partnership with



# CIO Dialogue with Proxy Advisors

## Background

Proxy advisors provide research on corporate governance issues. Their mainstay service is providing voting recommendations on shareholder resolutions to institutional investors.

Proxy Advisors are entities which research and give opinion/recommendations to investors, generally institutional investors, on agenda items that get presented to shareholders for vote. They came into existence when the regulators pushed institutional investors to exercise their voting rights.

However, Proxy Advisors have managed to establish themselves as an indispensable force in the capital markets. Even though the progress they have made in being the driver of better corporate governance practices till now is commendable, there is a long and challenging road which lies ahead of them. However, to bring a palpable change, proxy advisors will need support of the investors, regulators, companies, and other stakeholders.

To discuss the challenges that are faced by proxy advisors and their evolving relationship with asset managers, National Stock Exchange (NSE) and Institutional Investor Advisory Services (IiAS) collaborated to host a roundtable, on 24 March 2021, between proxy advisors and some institutional investors.

This CIO Dialogue with Proxy Advisors was moderated by Sandeep Parekh. Sandeep Parekh is the founder Finsec Law Advisors, Mumbai and chaired the SEBI Working Group on Issues of Proxy Advisors.

This was the fourth in the series of CIO Dialogues. The first two CIO Dialogues were held with [auditors](#) and [rating agencies](#), at NSE. The third CIO Dialogue with [index providers](#) was held virtually.

## Proxy Advisors: Drivers of better governance practices

***Proxy advisors have found a place in the Indian market microsystem as agents that strengthen corporate governance practices. Because they provide non-binding voting advise, their ability to effect change is limited to their power to influence rather than control. As a nascent industry, how proxy advisors engage with market participants – investors, corporates, regulators, and other stakeholders - will determine their ability to drive better corporate behavior, and determine their path ahead.***

Domestic proxy advisors first entered Indian capital markets in 2010<sup>1</sup>. Their advent coincided with SEBI's regulation that mandated mutual funds to articulate a voting policy<sup>2</sup> – with a view that this will push mutual funds to vote on shareholder resolution. With the environment beginning to take an early look at the stewardship responsibilities of asset managers, this was a fortuitous time for domestic proxy advisors to enter capital markets. In USA too, proxy advisors emerged after the US SEC pushed institutional investors to exercise their voting rights in 2010. Similar practices were soon implemented in other geographies like UK, Australia, Korea, and France.

In [March 2010](#) SEBI asked mutual funds to have a voting policy and to disclose their voting eventually in March 2014 asking them to disclose the rationale for their voting decision – a unique practice that is not found globally.

SEBI recognized the critical role that proxy advisors played in capital markets. In recognizing proxy advisors as legitimate market participants, SEBI decided to regulate proxy advisors through the SEBI (Research Analysts) Regulations, 2014 (Annexure A). Following this, three domestic proxy advisors and one global proxy advisor registered themselves with SEBI (Annexure B). India is an exception – most markets globally do not regulate proxy advisors.

The regulatory push towards stewardship responsibilities continued, with Insurance Regulatory and Development Authority of India (IRDA) mandating implementation of stewardship and fiduciary obligations for Insurance Companies in 2017 and Pension Fund Regulatory and Development Authority (PFRDA) doing the same for pension funds in 2018. In 2020, SEBI asked mutual funds and all categories of AIFs, to adopt a stewardship code in relation to their investment in listed equities.

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<sup>1</sup> IiAS was incorporated on 24 June 2010, InGovern on 14 October 2010 and Stakeholder Empowerment Services on 14 June 2012.

<sup>2</sup> SEBI [Circular](#) for Mutual Funds

With the heightened compulsion to vote on shareholder resolutions and engage with investee companies on issues other than financial performance (such as governance, acquisitions, compensation etc.) asset managers have begun subscribing to the services of proxy advisors. Because of their increasing ability to influence voting, asset managers are keen to understand how proxy advisors execute their fiduciary responsibility towards the capital markets, and the structures and processes that they have in place to be fair, transparent, and objective.

Proxy advisors have voting policies that are publicly available (Annexure C) – and they have been publishing these well before SEBI made doing so mandatory. These form the framework based on which proxy advisors recommend voting FOR or AGAINST on a shareholder resolution. Reading of the voting guidelines will give asset managers a sense of the proxy advisor’s approach to shareholder resolutions – how much of the voting recommendations are likely to be rule-based, how much principle-based, and the nature of decisions that are contextual. Global proxy advisors have their own set of global best practices that they bring to the table.

Once proxy advisors became regulated, some provisions of insider trading regulations also began to apply. Therefore, all proxy advisors have their own securities trading policies (Annexure D), and they have compliance procedures to ensure that analytical teams are not conflicted. However, given that proxy advisors rely on publicly available information, and that they make neither price recommendations nor buy-sell recommendations, this aspect has had a limited impact on the industry.

In the backdrop of their experiences with rating agencies and audit firms, asset managers are concerned with how proxy advisors are managing conflict of interest.

Conflict of interest occurs when the proxy advisor sends out voting recommendations on companies to which it has provided some other services or on listed investors, or their own shareholders that are listed or on companies on which some of their board member may sit. Regulations require proxy advisors to disclose conflict of interest in every specific document, including the safeguards that have been put into place to mitigate or manage the conflict.

Conflict of interest is ubiquitous for all financial services, and accordingly, proxy advisors have their own structures in place to manage and mitigate this conflict (Annexure E). While rating agencies and audit firms have an inherent conflict of

interest sown into the business model, proxy advisors are the least conflicted since (most of) their revenues are investor-facing.

Conflict of interest issues for domestic proxy advisors are also relatively muted because they provide non-binding voting advisory – investors have the final say on how they will vote on the shareholder resolution. This is unlike global proxy advisors, which at times actually hold the proxies for the asset managers.

The one difference in the process followed by the proxy advisors is regarding engagement with companies before sending out their voting recommendations. Not all proxy advisors do so. Asset managers, in contrast, prefer these firms to engage with companies prior to deciding on their recommendations as it provides them with a more comprehensive, context-based voting advise. This saves their analysts time in terms of getting clarity from companies over issues that can well have been sorted out with the proxy advisor.

Regulators too believe that companies have a right to respond to proxy advisories and have mandated that proxy advisors carry the company's response if it comes after the release of the voting advisory report.

While there may be a case for this citing principle of natural justice, the implementation in this manner is discriminatory at several levels. Once companies respond to proxy advisors, the dissemination of the company's response is sent only to that particular proxy advisor's clients. To this extent, dissemination of material information is not being made consistently to all sets of the company's shareholders. Companies are better placed in filing the response or any other incremental information with the stock exchange for uniform dissemination. The other discriminatory aspect is that SEBI does not compel any other market participant (like equity research houses) to carry the company's point of view – singling out proxy advisors is inequitable treatment.

The advocacy role of proxy advisors has played an important part in shaping new regulations. From pushing companies to articulate a dividend policy, to having better gender diversity on boards, proxy advisors have advocated to improve governance standards at different levels. Their advent has pushed companies to become more transparent, recognize the push back, and correct behavior.

But the success and influencing capabilities of proxy advisors are centrally driven by how investors react. Over the years, investors have become more vocal in exercising their franchise, and voting on shareholder resolutions has provided the much-needed push-back to corporate India. While corporate governance practices of Indian companies have improved, there is still a long way to go. Proxy

advisors and asset managers need to work together to set clear expectations of governance practices for corporate India.



For the list of participants at the roundtable, please write to [solutions@iias.in](mailto:solutions@iias.in)

## ANNEXURE A: List of regulations that apply to proxy advisors

1. [Securities and Exchange Board of India \(Research Analysts\) Regulations, 2014](#)
2. [Procedural Guidelines for Proxy Advisors \(enforcement was subsequently pushed to 1 January 2021\)](#)
3. [Grievance Resolution between listed entities and proxy advisors \(enforcement was subsequently pushed to 1 January 2021\)](#)

## ANNEXURE B: Proxy advisors in India (alphabetical order)

| # | Name of the proxy advisor                       | Nature        | Website   |
|---|---|---------------|---|
| 1 | InGovern Research Services (InGovern)           | Domestic      | <a href="http://www.ingovern.com/">http://www.ingovern.com/</a>             |
| 2 | Institutional Investor Advisory Services (IiAS) | Domestic      | <a href="https://www.iiasadvisory.com/">https://www.iiasadvisory.com/</a>   |
| 3 | Institutional Shareholder Services (ISS)        | International | <a href="https://www.issgovernance.com/">https://www.issgovernance.com/</a> |
| 4 | Shareholders Empowerment Services (SES)         | Domestic      | <a href="https://www.sesgovernance.com/">https://www.sesgovernance.com/</a> |

## ANNEXURE C: Voting Guidelines

| # | Name of the proxy advisor                       | Website link to the voting guidelines   |
|---|---|---|
| 1 | InGovern Research Services (InGovern)           | <a href="http://www.ingovern.com/about/policies/">http://www.ingovern.com/about/policies/</a>   |
| 2 | Institutional Investor Advisory Services (IiAS) | <a href="https://www.iiasadvisory.com/voting-guidelines">https://www.iiasadvisory.com/voting-guidelines</a>   |
| 3 | Institutional Shareholder Services (ISS)        | <a href="https://www.issgovernance.com/file/policy/active/asiapacific/India-Voting-Guidelines.pdf">https://www.issgovernance.com/file/policy/active/asiapacific/India-Voting-Guidelines.pdf</a> |
| 4 | Shareholders Empowerment Services (SES)         | <a href="https://www.sesgovernance.com/assets/pdfs/proxy-advisory/1614338711_1598358602.pdf">https://www.sesgovernance.com/assets/pdfs/proxy-advisory/1614338711_1598358602.pdf</a>             |

## ANNEXURE D: Securities Trading Policy

| # | Name of the proxy advisor                       | Website link to the policy  |
|---|---|---|
| 1 | InGovern Research Services (InGovern)           | <a href="http://www.ingovern.com/about/policies/">http://www.ingovern.com/about/policies/</a>   |
| 2 | Institutional Investor Advisory Services (IiAS) | <a href="https://www.iiasadvisory.com/about#policies">https://www.iiasadvisory.com/about#policies</a>   |
| 3 | Institutional Shareholder Services (ISS)        | <a href="https://www.issgovernance.com/file/duediligence/code-of-ethics-nov-2020.pdf">https://www.issgovernance.com/file/duediligence/code-of-ethics-nov-2020.pdf</a> |
| 4 | Shareholders Empowerment Services (SES)         | <a href="https://www.sesgovernance.com/pdf/1622113436_Employee-Trading-Policy.pdf">https://www.sesgovernance.com/pdf/1622113436_Employee-Trading-Policy.pdf</a>       |

## ANNEXURE E: Conflict of Interest Management Policy

| # | Name of the proxy advisor                       | Website link to the policy  |
|---|---|---|
| 1 | InGovern Research Services (InGovern)           | <a href="http://www.ingovern.com/about/policies/">http://www.ingovern.com/about/policies/</a>   |
| 2 | Institutional Investor Advisory Services (IiAS) | <a href="https://www.iiasadvisory.com/about#policies">https://www.iiasadvisory.com/about#policies</a>   |
| 3 | Institutional Shareholder Services (ISS)        | <a href="https://www.issgovernance.com/file/duediligence/code-of-ethics-nov-2020.pdf">https://www.issgovernance.com/file/duediligence/code-of-ethics-nov-2020.pdf</a> |
| 4 | Shareholders Empowerment Services (SES)         | <a href="https://www.sesgovernance.com/disclosures">https://www.sesgovernance.com/disclosures</a>   |

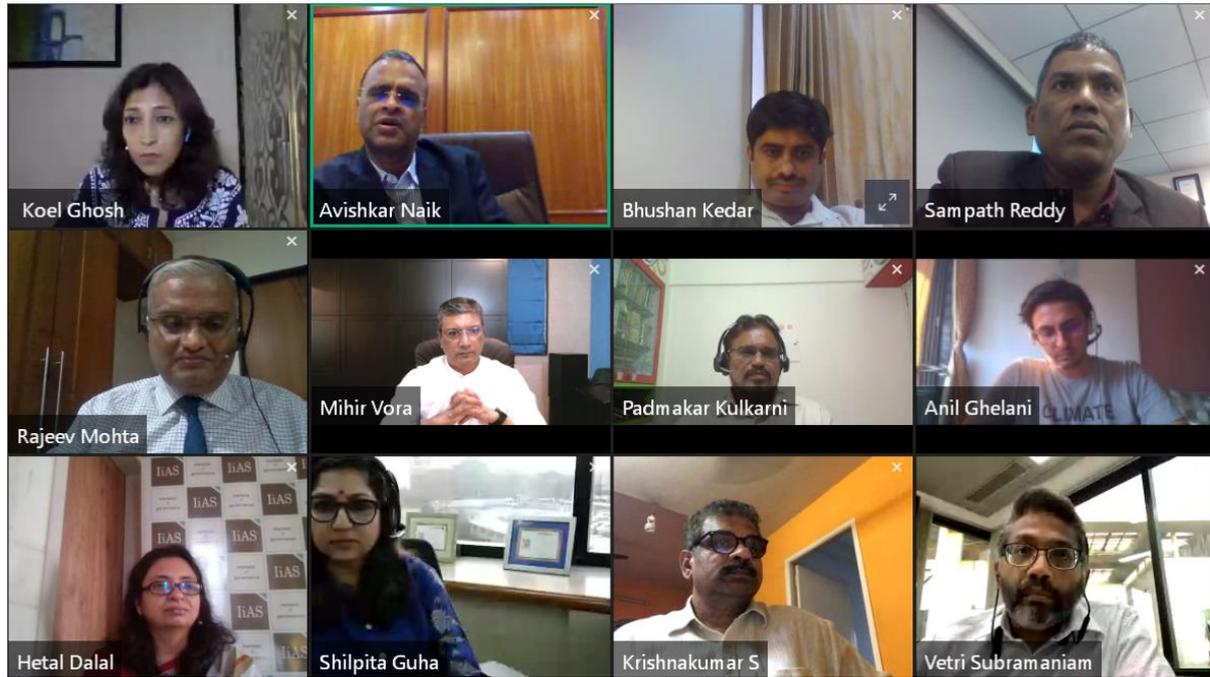
### **CIO Dialogue with Rating Agencies held in February 2020**



### **CIO Dialogue with Auditors held in November 2019**



## CIO Dialogue with Index Providers held in February 2021



*Please note that Mukesh Agarwal, CEO - NSE Indices, is sharing screen space with Avishkar Naik.*

## **About NSE**

The National Stock Exchange of India Ltd. (NSE) is the leading stock exchange in India and the second largest in the world by nos. of trades in equity shares from January to June 2018, according to World Federation of Exchanges (WFE) report.

NSE has a fully integrated business model comprising our exchange listings, trading services, clearing and settlement services, indices, market data feeds, technology solutions and financial education offerings. NSE also oversees compliance by trading and clearing members and listed companies with the rules and regulations of the exchange.

## **About IiAS Research Foundation**

The IiAS Research Foundation has been established by IiAS to serve as a platform for market participants i.e., business leaders, board members, academics, investors, issuers, and intermediaries to interact on the practice of corporate governance and their approach to ESG. It aims and to foster debate around regulations, corporate and investor behaviour, and capital markets.

## **About IiAS**

Institutional Investor Advisory Services India Limited (IiAS) is an advisory firm, dedicated to providing participants in the Indian market with independent opinions, research and data on corporate governance issues as well as voting recommendations on shareholder resolutions for ~ 800 companies that account for over 95% of market capitalization. IiAS is a SEBI registered research entity (proxy advisor registration number: INH000000024).

IiAS has equity participation by Aditya Birla Sunlife AMC Limited, Axis Bank Limited, Fitch Group Inc., HDFC Investment Corporation Limited, ICICI Prudential Life Insurance, Kotak Mahindra Bank Limited, RBL Bank Limited, Tata Investment Corporation Limited, UTI Asset Management Company Limited and Yes Bank Limited.

## Disclaimer

The CIO Dialogue is a series of roundtables organised by Institutional Investor Advisory Services India Limited (IiAS) through its subsidiary, IiAS Research Foundation in collaboration with National Stock Exchange (NSE) to discuss the general trends and developments in corporate India. These discussions are being held for educating investors and understanding the issues prevalent in the capital market. This report carries a synopsis of the discussions held at the aforementioned event; it is neither a legal interpretation nor a statement of IiAS' policy. This document is not intended to be and must not be taken as the basis for any voting or investment decision and/or construed as legal opinion/advice. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of the individual topics referred to in this document (including the merits and risks involved). The information given in this document is as on the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. IiAS reserves the right to make modifications and alterations to this statement as may be required from time to time. The discussions or views expressed herein may not be suitable for all investors. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information provided in this document remains, unless otherwise stated, the copyright of IiAS. All layout, design, original artwork, concepts and other Intellectual Properties, remain the property and copyright of IiAS and may not be used in any form or for any purpose whatsoever by any party without the express written permission of the copyright holders. Neither NSE, nor IiAS or any of their affiliates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the report or any the information present in this report. The disclosures of interest statements incorporated in this document are provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. This report may not be reproduced in any manner without the written permission of IiAS or NSE. Any use of the document is subject to the laws of India and courts exclusively situated in Mumbai, India.

