भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

SEBI seeks public comments on Report submitted by the working group on Issues related to Proxy Advisers (PA)

1. Background:

(i) Proxy adviser is a person who provides advice to institutional investors 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.

(ii) SEBI regulates the activities of proxy advisors in India under SEBI (Research Analyst) Regulations, 2014. 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.

(iii) SEBI had formed a Working Group with respect to Issues of Proxy Advisors in November 2018. The terms of reference for the working group were as under:

a. To review the provisions pertaining to proxy advisors in SEBI (Research Analysts) Regulations, 2014;

b. To review the functional areas including the rights and obligations of proxy advisors.

c. Any other item relevant to proxy advisory industry including framework for dispute resolution between corporates and proxy advisors.

The working group has submitted a report to SEBI, providing recommendations on various aspects of proxy adviser and also suggested that SEBI may like to obtain public comments on the substantive matters stated in the report before any regulatory review is undertaken.

(iv) In addition to the recommendations of the working group on regulating foreign proxy advisors, as stated at para 83 of the report, it is also proposed that institutional investors like Foreign Portfolio Investors, Portfolio Managers, Alternative Investment Funds, Real Estate Investment Trusts, and Infrastructure Investment Trusts etc. may be mandated to ensure that proxy advisory firms employed by them (if any) should have appropriate capacity & capability to issue proxy advice and such firm is complying with code of conduct for proxy advisers as specified by SEBI.

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2. Public Comments:

Public comments are invited on the proposals contained in the report and para 1 (iv) above, in the following format:

Name of entity/person/intermediary/organization:			
Sr. No.	Recommendation para	Comments/Suggestions	Rationale
	e.g.15, 18 etc.		

Comments/ suggestions may be forwarded by email to naveens@sebi.gov.in and taruns@sebi.gov.in latest by August 18, 2019.

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WORKING GROUP'S
REPORT ON ISSUES CONCERNING
PROXY ADVISORS
MAY, 2019

PREFACE AND TERMS OF REFERENCE

The completion of this report has been possible because of the active participation and wholehearted support of all members of the working group. I take the opportunity to thank my fellow working group members for their valuable time and contributions as well as for the free and frank discussions over the past few months. I am also grateful to the SEBI Chairman, Mr. Ajay Tyagi and WTM, Ms Madhabi Puri Buch for entrusting the working group with this responsibility.

The issue of proxy advisory is gaining traction both in India and worldwide. This report is a sincere attempt to review the rights and obligations of proxy advisors, while safeguarding interests of various stakeholders. The working group has worked according to the following Terms of Reference

a. To review the provisions pertaining to proxy advisors in SEBI (Research Analysts) Regulations, 2014;
b. To review the functional areas including the rights and obligations of proxy advisors;
c. Any other item relevant to proxy advisor industry.

Sandeep Parekh

Chairman, Working Group on Issues of Proxy Advisors

Mumbai, 24th May 2019

Signature of members of the working group

Sandeep Parekh

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JN Gupta

Member

Monika Halan

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ACKOWLEDGMENTS

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TABLE OF CONTENTS

I. INTRODUCTION

1. The term "proxy" may bring up memories of college days where a student filled in the attendance of an absent student and sometimes took notes on his behalf. Proxy advisors in the financial world are a relatively recent addition, commenting on the workings of public companies, sometimes sharing notes and opinions and sometimes even standing in for shareholders in shareholder meetings, even if virtually. More specifically, they are entities which research and give opinions to investors, generally institutional investors, on how to vote in shareholder meetings. Proxy advisors typically bring out publicly disclosed standards an ideal company should follow, often exceeding the standards laid down by law. Internationally, proxy advisors have become quite persuasive, and large and institutional investors have become reliant on their research. They have also caused some concern amongst regulators and corporates. The former because their research can have an impact on companies' workings, and may pose conflict of interest in certain circumstances. The latter because their opinions are often the cause of proposals of dominant shareholders or management being defeated.

a. Emergence of Proxy Advisors

2. In the United States, proxy advisors emerged as a result of expectations of the US Securities and Exchange Commission ("**SEC**") from investors to exercise their voting rights. The establishment of Indian proxy advisors also approximately coincided with Indian regulatory requirements seeking disclosures by Indian mutual funds on their voting records and stance. Similar developments have been seen in a few other major markets: the UK, Australia, Korea, and France.

b. Regulation of Proxy Advisors

3. In almost every country, proxy advisors are not regulated. India is one of the few countries where they are registered and regulated. SEBI (Research Analysts) Regulations, 2014 ("**RA Regulations**") require registration and provide a regulatory conduct framework similar to that adopted for research analysts. This Working Group on Proxy Advisors seeks to review the regulatory framework and suggest any changes based on the past five years of operation of these new entities. The cross-border impact of proxy advisors also raises the question of whether international proxy advisors should be registered and/or regulated by SEBI.

c. A heterogenous mix

4. The Working Group is aware that proxy advisors have varying business models. Even within India, each of the three proxy advisors have very different models. They are also quite lean in earnings/business volume. The two large international proxy advisors are somewhat similar, but they also have materially different business models and differing approaches to being registered. Because of the differing business models, the Working Group is sensitive to the introduction of new regulations which may harshly impact one proxy advisor, but may have no material impact on the others. This would reduce competition and harm investor interest, and the Working Group has tried to remain agnostic to business models.

d. Approach of this paper

5. The Working Group has sought comments from select persons, including institutional investors, experts, proxy advisors and corporates. The comments received weave a rich tapestry of opinion and we have tried to bring out the multiple viewpoints which have emerged, followed by the Working Group's view on each issue.

e. Global regulatory approach

6. We understand that India stands apart in the world as possibly the only country which clearly and explicitly registers all domestic proxy advisors. We have thus been cognizant of the light touch approach taken by global regulators in regulating proxy advisors. Similarly, we understand that one of the two large global proxy advisors has chosen to register with SEBI. In the US, three of the five proxy advisors are registered with the SEC under the Investment Advisors Act, 1940.

II. CONFLICT OF INTEREST, GOVERNANCE AND DISCLOSURES

a. What has been the impact of proxy advisors on corporate governance and compliance?

7. **Nature of Impact: Mostly Positive**

   a. *Benefits to institutional investors*: Institutional investors' managers have a fiduciary responsibility to vote in a manner that is in the best interests of their beneficiaries. It is an important and monumental task that happens during a very compressed timeframe, as shareholder meetings happen based on the calendar set

by corporate law. Thus, proxy advisors help investors vote intelligently, especially when there is a time crunch to read and analyse a lot of data.

b. *Benefits to global investors*: It is not always easy for global investors to have a complete understanding of all local market practices, across what may be highly diversified global investment portfolios. Proxy advisors prepare research reports that help global investors receive informed analyses and recommendations, taking into account local as well as global good practice principles.

c. *Efficiencies of scale and non-duplication of effort*: Instead of thousands of institutional investors doing the same primary research, there are efficiencies of scale if a handful of proxy advisors conduct the same and pass on the benefit of costs and specialization to the investors. As proxy advisors review hundreds of companies across sectors, they are also able to provide a bird's eye view and a deeper dive into the companies being researched.

d. *Benefits to small investors*: Many investors do not have the necessary resources or time to follow and closely analyze all shareholder meeting announcements and have access to all published materials on shareholder meetings, often published in local languages and/or at short notice. Proxy advisors serve as "information-gatherers" for them, providing full access to all relevant company meeting materials and disclosed information, as well as voting recommendations. Many proxy advisors do not share the detailed rationale which is reserved for their paid institutional investors, while providing free recommendation to all investors without charge.

e. *Better public disclosure by companies*: Broadly, proxy advisors keep clients up to date with corporate governance developments, offering specialist insight. Proxy advisors have increased shareholder activism and pushed companies to adopt higher level of disclosures. It has led to higher rates of compliance with corporate governance codes and standards. Additionally, they encourage companies to improve the disclosure of relevant information, increase issuer and market awareness of local and global best practices and contribute to improvements in corporate governance in specific and governance in general. We also understand that some proxy advisors refuse to accept information bi-laterally from the companies, a process which in fact forces companies to communicate with all shareholders without any preferential treatment, and also forces companies to communicate in plain English rather than in financial/legal jargon.

f. *Legal to English translation*: Proxy advisors 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. This allows shareholders to have a better understanding of the companies in which they invest in, resulting in a positive impact to the relationship the company has with its shareholders. Earlier companies considered obtaining shareholders' approval a mere procedural formality, however they are now wary of the fact that there are entities scrutinizing their resolutions, particularly with the interests of minority shareholders in mind. Companies now take additional care in drafting their resolutions, though a lot of improvement in this regard is yet to be achieved. In some cases, consequent to the reports of the proxy advisors, the companies have had to withdraw / amend resolutions put forth to the shareholders for approval due to concerns raised by proxy advisors. In fact, some of the benefits of proxy advisors may be invisible, as people would have altered their actions to escape the critical analysis of proxy advisors. So, a person sitting on too many boards may opt to give up her board seat by withdrawing from the slate of directors up for election. In other words the impact of possible proxy advisor's recommendation would have altered behaviour even though no one will notice the impact.

8. However, while academic studies have shown that some of the high-profile defeat of resolutions have not been primarily caused by the recommendations of proxy advisors, proxy advisors can certainly tip the scales in many cases.

9. **Downsides**

a. *Excessive delegation and alien standards*: Many international institutional investors have outsourced their voting to their custodian with directions given to them to vote in the pattern as recommended by select proxy advisory firms. This, goes the argument, leads to robo-voting without application of mind. Similarly, companies have sometimes asserted, that the pre-occupation with pleasing proxy advisors, leads some companies to adopt policies that may not be in their own long term best interest. There are also concerns that international proxy advisors 'import' standards from foreign markets with very different characteristics, and apply a one-rule-fits-all-countries approach.

b. *Traveling beyond the prescription of the law*: Secondly, it is argued that when the law asserts a standard, proxy advisors setting a higher standard is inappropriate.

For instance, if the Companies Act, 2013, allows a director to hold directorship in 10 companies, the proxy firms which have their own ceiling, of say 7 directorships, without referring to the experience, nature and standing of such person, would be inappropriate.

c. *Auto-correct doesn't work well*: The final 'charge' is that proxy advisors are not receptive to factual errors being corrected, thus causing outcomes not based on facts. While there have been arguments that proxy advisors are not open to factual corrections, we found factual errors both rare and non-contentious. The most contentious issues where a company strongly dis-agreed with a recommendation is almost always an opinion formed by the proxy advisor.

Working Group's recommendation

10. The Working Group observes that the overwhelming evidence supports the positive impact of proxy advisors. The criticisms of the workings are issues which can easily be resolved through market forces and are part of the evolution of both proxy advisors and investors.

b. How to ensure independence of proxy advisors?

11. Independence is an important aspect of proxy advisors' credentials, not too different in spirit from independence expected of equity research providers, audit firms, credit rating agencies, among others. However, it should be mentioned that 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. In the case of proxy advisors, they are paid primarily by institutional investors to scrutinise the workings of companies. There are however multiple areas where proxy advisors may be conflicted or become dependent upon sources of capital or income, which may impact the appearance of or actual independence. The three key areas of conflict are: i) shareholding in the proxy advisor by a listed company or a group which has listed companies; ii) consulting assignments provided to companies who may in turn be scrutinised in the next shareholder meeting; iii) any other source of revenue or relationship (for instance inter-locking board positions) which poses a real or apparent conflict of interest.

12. In order to ensure that a proxy advisor's voting recommendations and analysis are disinterested, and also carry the appearance of disinterest, proxy advisors should have policies and procedures in place with respect to:

    a. *Managing and disclosing conflicts of interests*: Proxy advisors should have a publicly available conflict of interest policy and a clear approach to manage concerns relating to their independence/other risks that may affect reports provided to clients. Communicating their policies and procedures would enable the clients to have enough information to evaluate sufficiency of the controls. Any material conflicts should be clearly stated on individual research reports too. Similarly, any press statement by the proxy advisor on such companies should also have a disclaimer. Proxy advisors should disclose their policy on engagement with companies. The disclosure should also indicate the kind of circumstances in which the proxy advisor would consider participating in the engagement.

    b. *Business Model*: Disclosures regarding the business model should be made public.

    c. *Separate legal entities/units and Chinese Walls*: There should be a clear separation between the proxy voting advice to shareholders and the advice to the (listed) companies regarding advisory services and indices and governance engagement services. The entity/business unit providing services to investors/shareholders should be different from the one providing advisory services to a corporate client. Wherever such services are provided there should be a clear public disclosure.

    d. *Just say no*: Codes that determine when not to provide a voting recommendation.

    e. *Equity Ownership*: Ensuring compliance with the rules of equity ownership applicable to research analysts.

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

    g. *Methodology*: Disclosing the methodologies and processes they use in the development of their research and recommendations – in essence providing justifications to their recommendations. It should include: i. the general approach that leads to the generation of research; ii. the information sources used; iii. the extent to which local conditions and customs are taken into account; iv. the extent to which custom or house voting policies or guidelines may be applied; and, v. the systems and controls deployed to reasonably ensure the reliability of the use of

information in the research process, and the limitations thereof. Further, the institutional/listed shareholders should be excluded from any involvement in the preparation of the voting guidelines or recommendation reports.

h. *Communication*: Proxy advisors should set parameters around the communications they have with companies and other stakeholders. Further, proxy advisors should have and disclose their policies for managing and responding to complaints, comments or feedback about their services. In particular, where clear errors can be identified, as opposed to differing views/opinions, there needs to be a feedback mechanism which is able to correct such clear mistakes.

13. ***Restriction on services***: There is an opinion that proxy advisory firms should not be offering any other remunerative services, including advisory services on the governance structure, drafting of resolutions, explanatory statements, etc. and should only give voting recommendations. Further, proxy advisory firms, it is argued, should refrain from recommending on any corporates where they or their substantial shareholders directly or indirectly hold more than certain percentage of share capital including network companies.

14. ***Call for a flexible approach***: The other view is that each proxy advisory firm should have the flexibility to determine the way its specific actual or potential conflicts of interest should be handled. Public dissemination of a firm's policies and procedures around conflict mitigation and management should provide all interested parties with sufficient information to assess the adequacy of those policies/procedures, enabling them to determine whether a firm can provide impartial proxy research and other services without necessarily requiring a case-by-case evaluation of each potential conflict. This flexible approach is consistent with how U.S.-based investment advisers, such as Institutional Shareholder Services ("**ISS**"), is regulated by the SEC. The Investment Advisers Act of 1940 ("**Advisers Act**") requires registered investment advisers to establish comprehensive compliance programs, including the implementation and enforcement of written policies and procedures reasonably designed to prevent, detect and correct violations of the Advisers Act. This obligation includes the identification of potential conflicts of interest related to the proxy adviser's operations and the adoption of controls reasonably designed to manage those risks. This approach enables each registered entity to tailor its compliance program to the regulatory and business risks posed by its particular business activities. The issue is discussed in more detail below.

Working Group's recommendation

15. The Working Group recommends that a flexible approach is the better one where adequate disclosures and clear methodologies are followed. In addition, the Working Group believes that the disclosures stated in para 12 above should be implemented.

c. Should proxy advisors or their associates be allowed to earn revenue from their subsidiary companies through business consultancy, database services, etc.?

View 1

16. Provision of consulting services affects their independence and creates a problematic conflict of interest that goes against the very governance principles the proxy advisors advocate. By not providing consulting services to the subjects of their reports, proxy advisors ensure that they have 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.

View 2

17. It is neither appropriate nor necessary to prohibit proxy advisors or their associates from earning revenue from ancillary business activities. The key objective of the proxy advisors is to support investors in the exercise of their share ownership (voting) rights. Most of the services provided seek to achieve the same goal as that of the main line of work of the proxy advisors. For instance, if a company were to approach a proxy advisor seeking their view on how they can improve governance standards, and the company is willing to improve various areas of its current management, the ancillary business would support the investors' interest rather than detract from it. A barring of ancillary services may do more harm than good. If the consulting services in fact help a company to provide better governance, any substantive restriction on such services would mean that the good becomes the enemy of the better.

Working Group's recommendation

18. The key is to make sure that the proxy advisor takes appropriate steps to manage, mitigate and/or disclose any potential conflicts of interest resulting from those ancillary business activities. There should be 'Chinese Walls' between proxy advisory firms and their consultancy firms. There should be clear procedures to disclose and handle conflicts of interest. There should be disclosures regarding the provision of other services through

subsidiaries, divisions or associates, and the total income earned by providing such services where it exceeds a certain percentage, say 10%, of the revenues.

d. Should proxy advisors be allowed to provide recommendations on resolutions of companies that are promoters/major shareholders of proxy advisors, or of companies whose promoters have partnerships with promoters of proxy advisors?

View 1

19. There should be an absolute prohibition on making recommendations on resolutions of companies where there is any connection with shareholders/promoters of the proxy advisory firm. Proxy advisory firms should refrain from recommending on any corporates where they directly or indirectly hold more than a certain percentage of the share capital, including network companies of the proxy advisor, or on any corporates which are the promoters/shareholders of the proxy advisors. They should not be allowed to provide recommendations in such cases. The independence of the voting advice must be paramount. It may also happen that proxy advisors, by virtue of such association, may have some additional vital information which otherwise is not available in the public domain leading to information asymmetry.

View 2

20. A more disclosure based approach be taken, where the proxy advisor has policies in place, makes necessary disclosures and takes appropriate steps to mitigate conflict of interest.

Working Group's recommendation

21. The proxy advisors should be allowed to provide aforesaid recommendations if the relationship is fully disclosed and all conflicts of interest are detailed. The recommendation should be aligned to their standard policy and approach/ consistent with their stated methodologies. The key in dealing with any potential issues relating to promoters/major shareholders, is to take appropriate steps to manage, mitigate and/or disclose any potential issues and not impose any absolute prohibitions on such recommendations. Where there is a conflict, the institutional investors will automatically take that recommendation with a pinch of salt. Further regulation may be unnecessary.

e. What should be the nature and placement of disclosures by proxy advisors? Whether a generic disclaimer on their website is sufficient, or whether it should appear at every place they comment on such companies and their affiliates?

View 1

22. There is a view that each proxy advisory firm should have the flexibility to determine the manner in which specific actual or potential conflicts of interest should be handled, including the types of disclosures made and the way those disclosures are provided. Mandated disclosure of specific actual or potential conflicts could serve to undermine the intent of a proxy firm's overarching policies. It should be the responsibility of the institutional investor, prior to appointing a proxy advisor, to undertake adequate due diligence to ensure that they are comfortable with the content of the disclosures and the processes that are described.

View 2

23. Generic disclaimers on the website are of limited practical value and would not meet the spirit/ intent of full and honest disclosure. It is believed that enhanced disclosure is necessary. Therefore, while generic disclosures may be placed on the websites of the proxy advisory firms, disclosures regarding conflicts of interest should appear prominently in the respective companies' voting recommendations. Further, a summary of any major conflicts of interest and the relevant policy could be provided to new clients when initially contracting with a vendor. The disclosures should appear on every specific document where they are giving their advice. Disclosures should especially address possible areas of potential conflict, and also the safeguards that have been put in place. Glass Lewis, a US based proxy advisor, states that it has a compliance committee that meets quarterly to discuss any new potential conflicts of interest that have arisen and need to be addressed and communicated to clients.

Working Group's recommendation

24. The Working Group's recommends for implementing an enhanced standard of disclosure and not merely some boilerplate on the website of the proxy advisors as detailed in the previous para.

f. Should there be a comprehensive code or minimum standards of conduct for proxy advisory firms mandating them to disclose rationale for their voting recommendation:

Working Group's recommendations are singular and as follows:

Reasons for recommendation

25. Requiring a proxy advisor to disclose the reasons for recommendations may be burdensome. The detailed rationale is usually the primary bread winner for the proxy advisor and mandating it to be made public would destroy the business model of most of the proxy advisors.

Material based on which such recommendations have been made.

26. Requiring a proxy advisor to disclose the material based on which recommendations have been made may also be burdensome. Disclosures can be required only if the information used is not from publicly available sources. Such disclosures must be made in the voting advisory report of the relevant company only.

Guidelines, methodology or the criteria upon which their recommendations are based.

27. There is a view that proxy advisors should explain how their voting policies and methodology are developed and updated. They should explain whether and how they incorporate feedback into the development of voting policies. They should disclose the timing of their policy updates and policies should be reviewed on, at least, an annual basis.

Conflicts of interest and all relationships they have with financial institutions and other companies (ownership/advice) including common boards.

28. Conflicts of interest, including ownership, should be disclosed as described above.

All avenues of income generation

29. Disclosing all avenues of income generation would be over-regulation, but a material revenue (say 10% plus) stream should be disclosed publicly.

Any additional tasks undertaken by the proxy advisor, such as providing corporate governance advice to companies.

30. The Working Group recommends that as this is part of the business model of various proxy advisors, this should not be restricted, but should be disclosed as a potential conflict of interest, where appropriate.

Making shareholding and financial results of proxy advisory firms public.

31. The general views received by the Working Group is that proxy advisors are unlisted, and no public interest will be served by disclosing their financials. However, the details available in public domain, for instance filings made to Registrar of Companies ("**RoC**"), should also be publicly available on the website of the proxy advisor.

Past performance/assessment of past voting recommendations.

32. Every instance of recommendation is different as it changes with the nature of the resolution. A blanket mapping of voting recommendations with actual voting outcomes of the past is neither a measure of a proxy advisor's performance nor is it a predictor of how it will recommend in the future.

g. The influence of proxy advisors on corporate governance makes boards of directors overly preoccupied with ensuring favourable recommendations from proxy advisers, by taking pre-emptive steps to ensure that their policies on governance and executive pay will not trigger a negative score when fed into the proxy advisers' standardized algorithm. Does this practice require any intervention, or are market forces sufficient?

33. The general consensus is that no intervention is necessary and market forces are sufficient. The fact that many companies can get their resolutions passed even when opposed by some proxy advisors might suggest that the proxy advisors' power is overstated. Because many companies have convinced themselves that the power is real, they feel it necessary to take pre-emptive action rather than make the case as to why a different approach is appropriate in their case. It is difficult to justify taking action to limit their influence if that influence exists mostly in the mind of companies.

34. It should be noted that, by design, the recommendations of proxy advisers are generally aligned with the views of the shareholders who pay for such analysis and on whose behalf they undertake their analysis. Boards are therefore ensuring support of shareholders when endeavouring to meet the parameters within proxy advisers' recommendations. This is appropriate and aligns the interests of the shareholders with the board and management of their companies, which are sometimes not fully aligned. Boards are answerable to their shareholders and should be concerned about their views, even when they don't agree with them.

35. The view from the feedback received seemed generally to disagree with the view that the influence of proxy advisors on corporate governance makes boards of directors overly preoccupied with ensuring favourable recommendations from proxy advisors. Proxy

voting recommendations by firms are not based on a standardized algorithm, but rather on established proxy voting guidelines of the proxy advisor. It is believed that proxy advisors are facilitators, possibly influencers, but not decision-makers for investors. Studies have shown that over half of the clients of proxy advisors have voting guidelines that differ from the standard proxy advisors voting guidelines. Several institutional investors apply their own custom voting policies with common principles across markets, with regional and market customisation relating to market maturity, market practices, impact of issues, etc. These custom voting policies over-ride any voting recommendation that proxy advisors may have, in case of difference.

Working Group's recommendation

36. The Working Group recommends that non-intervention is a better approach as companies are taking pre-emptive steps, by way of which the governance practices are strengthened. Generally, a proposal which aims to get shareholders' and proxy firms' approval will be well drafted and backed by sufficient disclosures. So, market forces are sufficient.

III. INFRASTRUCTURE AND SKILLS REQUIREMENT

a. Should there be any requirement for firms to have adequate staff with sufficient skill and experience? If so, what should be minimum experience criterion and skill sets required.

37. Under the RA Regulations, every proxy advisor in India is required to register with SEBI. It is provided that the employees of proxy advisors engaged in providing proxy advisory services shall be required to have a minimum qualification of being a graduate in any discipline. Further, the employees of proxy advisors are required to fulfil certain certification requirements as specified by SEBI from time to time.

View 1: There should be some criteria/requirement

38. One view was that existing requirement under the RA Regulations for a research analyst should be adopted for the employees of proxy advisors. The proxy advisors should disclose their operational processes and qualifications of staff. Further, the view was that proxy advisors may be required to renew their NISM certification every two years.

View 2: There should not be any criteria/requirement:

39. A contrary view was that there should not be any additional requirements for staff of the proxy advisors. Each proxy advisor should have the ability to make hiring decisions as it

sees fit, while taking into account the firm's overarching requirement to deliver high quality research and other services to its clients. If required, however, proxy advisory firms could disclose the steps taken to hire and retain individuals who have the qualifications to provide quality proxy research and other services. It is opined that additional requirements will reduce competition and there may be practical difficulties in enforcing such a model given the current realities.

Working Group's recommendation

40. The Working Group believes that clients conduct extensive due diligence when they review and select their proxy advisor(s), and this will ensure that the proxy advisor has staff with sufficient skill sets. SEBI may review its certification norms and continuing education as appropriate without over-burdening the proxy advisors.

IV. VOTING, FIDUCIARY-DUTY AND INFORMATION SHARING

a. Has proxy industry enabled increased voting in general meeting?

41. While the popular view is that the proxy advisory industry has enabled increased voting in general meeting, there are no studies to confirm that clearly. In markets such as the UK, there is some correlation between the increased presence of proxy advisors and increase in voting levels, but whether it is causation or correlation is still unclear. Pressure on investors from regulators and clients to exercise their votes has had more impact on voting levels. For example, due to the mandate by SEBI/IRDA to mutual funds and insurance companies, voting in general meetings has increased.

42. Provision of electronic voting tools and translations of materials has enabled investors to vote in markets where they may previously have been unable to participate. Proxy advisors provide services to its institutional investor clients that assist them in making more informed voting decisions, in managing the complex operational process of voting their shares (proxy voting) and in tracking and reporting their voting activities as they may require (or desire). It is accurate to say that the work of proxy advisors has helped facilitate the ability of institutional investors to vote in general meetings and to do so on the basis of information backed by research.

43. The increase in voting results directly from the determination by investors and asset owners that doing so is a critical priority. It is sparked in part by company meltdowns throughout the globe and egregious governance practices by some companies. Investors have become more active stewards of the assets they manage. They believe that it is their

core responsibility to safeguard their clients' assets through active ownership, monitoring and engagement with issuers. The stewardship code adopted by the UK is gaining traction throughout the world through persuasion rather than by regulatory fiat. This is a good move forward for the investment industry and for the corporate world.

Working Group's views

44. The Working Group believes the advent of proxy advisors along with several other technological advances and behavioral improvements in institutional investors involvement have all contributed towards a more responsible investor, in turn altering the actions of the companies for the better.

b. 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.

45. Using proxy advisors as a source of research to inform decisions does not undermine the exercise of investors' fiduciary duty. The view with respect to robo-voting, particularly as received from institutional investors was as follows.

46. ***"Robo-voting" is not an accurate description***: The primary role of a proxy services provider is to execute votes on behalf of investor clients in accordance with the specific instructions of those clients. Proxy advisors implement client voting policies on their vote management system so that each ballot populates with recommendations based on the specific policies of the client, enabling clients to submit votes in a timely and efficient manner. Using the term "robo-voting" to describe how votes are cast by institutional investors that engage the services of a proxy advisor is an unfair characterization of the management and oversight of the voting process by those investors.

47. Institutional investors employ a variety of methods to oversee the voting process, beginning with their selection of a proxy advisor and continuing throughout the period of availing the services of that proxy advisor. During the policy formulation process, an institution will thoroughly review the policies of its proxy advisor to assess the similarities and differences between the institution's views on certain issues versus the views of the proxy advisor, as noted in its house policy. In some instances, an investor client may elect to implement the same policy as the proxy advisor for some or all of the issues up for vote. In other cases, clients may ask proxy advisors to assist them in applying their own customized proxy voting guidelines. This is mainly because, only

after completing an extensive due diligence process, the institution determines whether the proxy advisor's policy is philosophically aligned with its own policy, as well as with the views of its investment management team, proxy committee, mutual fund board or other decision-making bodies within its organization.

48. The vast majority of institutional investors who engage a proxy advisor are increasingly opting for more detailed policies, with specific views on how to address all issues that may come up on a proxy. More importantly, in many instances in the context of international proxy advisors, their views are so specific to each situation that they will often opt for a case-by-case analysis. The pre-population of voting instructions on a ballot strictly adheres to each client's specific voting instructions. Importantly, when a preliminary ballot is ready for review, the proxy advisor's voting system generally alerts each client and provides clients with all the disclosures and other information they need at their fingertips to review and evaluate the matters up for a vote. Clients can choose to restrict the submission of a ballot until after specified client personnel have reviewed and approved the votes. Clients can also make (and often do make) changes to the preliminary ballot before signing off. And, assuming the voting deadline has not passed, they can even change their vote and resubmit it. Investors take their fiduciary responsibility to vote, engage with issuers, and operate as good stewards quite seriously. This is evidenced by the fact that they regularly audit the voting to ensure their proxy advisor is processing their ballots in accordance with their pre-established instructions.

49. Also worth noting is the fact that the rationale for arriving at a vote decision, especially amongst investors, are often varied, even if the vote is ultimately the same. It should come as no surprise that the voting results may mirror the recommendations issued by proxy advisors as there are many commonly accepted governance principles used by both investors and advisors.

50. ***Stewardship Code***: In the future, SEBI should make a Stewardship Code (like the UK Stewardship Code) mandatory for all institutional shareholders, and such code should be publicly available. This should be on a comply or explain basis. It should be drafted in line with discussions on the stewardship code conducted in Financial Stability and Development Council (FSDC) sub-committee, where SEBI, IRDA, and PFRDA participated. Investors should do their own research before voting, and the rationale of such voting may also be required to be placed on their website. The concept of

Stewardship (e.g. active share ownership etc.) is becoming clear in many jurisdictions, like the UK, Japan, and the Netherlands.

Working Group's recommendation

51. Based on investor feedback, the Working Group believes there is little evidence of robo-voting, and investors have and are taking their job as stewards of corporate India very seriously. Stewardship code is recommended as a welcome addition, even if based on a comply or explain basis for certain large investors.

c. How can the accuracy, transparency, and efficiency of the proxy voting be improved and what steps should regulators consider to facilitate such improvements?

52. Suggested steps received by the Working Group which may be considered:

a. ***Timely disclosure of voting deadlines***: Mandate companies to provide complete and timely disclosures to allow investors to make thoughtful voting decisions in advance of voting deadlines.

b. ***Increase release schedule***: If AGM notices/ materials can be released earlier, it will increase the time available for issuers to engage with investors on any contentious issues. The Asian Corporate Governance Association (ACGA) advocates the release of AGM notices 28 days before date of meeting, which is more than the 21 days prescribed under the Companies Act, 2013.

c. ***Vote confirmation for various investor types***: Votes for international asset managers can pass through several intermediaries (voting agents; sub-custodian banks; local agents) before being submitted. A real-time 'vote confirmation' from the company's record would be beneficial to let the investors/managers know that the vote has been lodged, accepted and counted in the poll.

d. ***Making voting guidelines and policies public***: With regards to transparency, making voting guidelines and policies of proxy advisors should be made public.

d. How recent technological advances can be used to enhance the voting process and the ability of shareholders to exercise their voting rights?

53. The current market infrastructure for voting is at times inefficient, expensive, and prone to errors. Electronic voting has been a significant enabler. There is an opinion that it would be better to allow the existing voting process to continue for a few more years

before attempting any further changes. However, others have suggested some ways to improve it:

a. ***Blockchain***: New technologies, such as blockchain, could be very effective in solving the traditional challenges associated with providing accurate, timely and granular vote confirmations, while also addressing concerns around over/under-voting, investor anonymity and distribution costs.

b. ***Live/online streaming***: Online streaming of the shareholder meeting either through any/ all of the following - transcript, audio and video, and ability to ask questions through these channels. On the success of live streaming of AGMs, the ability to speak at an AGM may also be provided via 2-way video conference.

c. ***Real time vote confirmation***: There is currently no mechanism whereby a vote for a specific holding can be clearly tracked all the way through the voting process from the time the vote is cast by the investor through the time that vote is tabulated and certified by the company through its agent. Given the growing importance of proxy voting, the process must be enhanced to allow proxy voting agents, custodians, third-party intermediaries and, most importantly, shareholders to confirm that in fact the issuer, or its agents, have received and counted their votes properly.

d. ***Voting kiosks and e-voting awareness***: More awareness on e-voting, including creating of voting kiosks in cities where majority of shareholders (in number) reside. Need to make retail shareholders aware of how exactly online voting can be done. SEBI can put up the details at its website and provide a helpline for the purpose.

e. ***Mobile application***: One of the major changes could be introduction of a mobile based voting application. This mobile application can be accessed by retail investors which can act as a platform between the company and the shareholders. Investors may access the following through the application - notice of general meetings and corporate announcements, research reports of the proxy advisors, voting recommendations of the proxy advisors, and voting results of the companies.

f. ***One Time Passwords (OTPs)***: OTPs while voting may be helpful so that voting by unauthorized persons may be avoided. Executives who are authorized to take these important decisions should receive OTPs to ensure accurate voting.

g. ***Increase time available***: Look at ways to increase the time available between notice of meeting and the cut-off time for custodians to receive shareholder votes. Doing so, particularly during AGM season, will allow for more time for validation and cross-checks with issuers and better-informed voting/decision-making by investors.

V. INTERACTION WITH CORPORATES

a. Should the communication between proxy advisors and corporates be institutionalized and regulated to provide proxy advisors with accurate and correct information?

54. Ever since proxy advisory firms commenced their business, there is an on-going debate on the nature of interaction they should be having with the corporates. The Working Group has received views on institutionalization of the communication between proxy advisors and corporates.

View 1

55. One view is that proxy advisors should have policies and procedures to create internal rules around their relationship and communications with public companies, and these policies should be publicly disclosed. It is believed that engaging in dialogue with issuers can help foster mutual understanding, transparency and feedback with respect to a proxy advisor's policies, methodologies and analysis. Therefore, proxy advisors should be encouraged to communicate with companies so long as limitations are established prior to any such engagements.

View 2

56. However, it is also noted that while creating any guidelines for institutionalisation of communication, it should be taken into consideration that proxy advisors should not receive any information that is not available to all shareholders and/or publicly. Receipt of such information would put them in a privileged position and might increase their perceived influence. It goes again the tenets of "fair disclosure" where corporates are interacting/influencing commentary of proxy advisory firms, while not communicating the same to investors at large. Further, proxy advisory firms will also have the risk of any inadvertent non-public and price sensitive disclosure made by corporates. Instead, it is believed that companies should be encouraged to provide more complete and timely disclosure of their meeting materials so that investors and proxy advisors can continue to

rely on publicly available information. They may, at best, get a clarification from the company should the need arise.

Working Group's recommendation

57. The Working Group recommends that communication between the proxy advisor and the company should be made public by the company. Privileged information being shared only with the proxy advisors will detract from improving corporate communication generally, and provide undue power to the proxy advisors to become portals of privileged information rather than the gatherers and analysts of public information.

b. Should proxy advisors be required to invite comments and respond to feedback from corporates?

58. One area of apparent concern was the possibility of factual mistakes based on which a proxy advisor makes a recommendation, that it would not have made were it to have the correct information. Factually, it was brought to the notice of the Working Group that factual errors (where they were pointed out) have been extremely rare and they have been corrected. Two of the three domestic proxy advisors share the research report with the companies simultaneously with sharing it with their investor clients, providing companies a chance to review and correct any factual errors. One of the three does not share its report with the company and under its business model the company must buy the report, the same way as its client-investors do.

59. On the area of whether research should be shared with a company before it is shared with the client-investors, the clear view received is that it should not be the case. There is a concern that if proxy advisors were required to inform corporates of their recommendation before the AGM or before being released to clients: (i) investors would be denied access to independent research; (ii) significant constraints would be placed on the time, investors have to properly consider the analysis in order to develop informed proxy voting decisions; and (iii) issuers could potentially determine an investor's vote selections (even before the investor itself knew) given that investors publicly disclose their policies. There is also a concern that this type of dialogue would exacerbate the lingering misconception that issuers are primarily concerned with the views of proxy advisory firms rather than with those of their shareholders. On receipt of negative recommendations, corporates might try to influence proxy advisors in order to get favourable recommendations. They may also undertake efforts to start a proxy

solicitation, or even a proxy fight, to try to achieve a favourable outcome of the voting, not seldom at the expense of the shareholders.

60. However, in the name of inviting comments and responding to feedback from corporates, there should not be continuing conversation between them, since such interaction could adversely impact perceptions of objectivity. In line with this understanding, there is a view that interaction should be encouraged with a rider that only factual errors should be considered. This will allow the corporate views to be taken on board. In case the interpretation of the company is different from the interpretation of the proxy advisory firms, one view was that the proxy advisors should publish both interpretations along with comments on why it is not in agreement with the company. The alternate view was that the management/dominant shareholder is free to express its opinion on their own website/media/etc. and the proxy advisor should not be forced to publish a view that they do not subscribe to.

Working Group's recommendation

61. The Working Group recommends that except for factual errors, proxy advisors should not be mandated to carry views which they don't subscribe to and the company has enough resources to publicise a differing viewpoint.

c. How to address the issue of protecting proxy advisors from adverse legal action for holding honest opinions which are dis-liked by companies or individuals.[1]

Legal status of the proxy advisors' recommendations

62. Due to the inherent nature of the work, there is bound to be a conflict between the proxy advisors and companies. Before determining how to protect proxy advisors, it is important to establish what legal status their advice has.

63. In Europe, for example, proxy advisors are not currently regulated directly, other than being required to disclose certain information publicly, nor is their advice classified as "investment advice", which would introduce further regulatory obligations and sanctions, and potentially increase liability and exposure to legal action if investors or companies felt the advice was knowingly inaccurate or misleading. The same has been the case in the US to date, though there is a discussion on reviewing that position.

1. [1] Shri J N Gupta, member of the working group, recused from deliberations and group's view on this subject.

Protection from legal action

64. One view the Working Group received was that the proxy advisors must, if requested by company, send unedited response of the company concerned to all its subscribers. In case a company is not satisfied with the response, it may write again to proxy advisors and in case the response is still not acceptable, the Company concerned may approach SEBI under the RA Regulations seeking SEBI's intervention. However, mere differences based on opinion, which are backed with authentic public data and analysis, cannot be the basis of any complaint or litigation. Litigation should not be initiated merely because an opinion is not favourable to the management of a company, especially if opportunity had been given by proxy advisors to the company and same has been duly addressed.

65. The regulator must protect the freedom of proxy advisors to express their opinion. This is important for the future of corporate governance in the country, as corporates with deep pockets may use shareholder money to silence criticism. At the same time, the regulator must not become a mechanical defender of proxy advisors. While the Working Group has not come across any example, any unchecked power given to proxy advisors may result in its abuse. Thus, there should be a pressure valve for both corporates and proxy advisors.

Working Group's recommendation

66. Proxy adviser is a person who provides advice to institutional investors or shareholders of a company, in relation to exercise of their rights in the company including recommendations on public offer or voting recommendation on agenda items. These proxy advisors are required to observe compliance of Code of Conduct specified under SEBI (Research analyst) Regulations, 2014. 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 wrt compliance of code of conduct by proxy advisor. Only thereafter the person may approach the court of law. 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. It should be kept in mind that this process is only available for egregious acts like abuse of power or violations of basic levels of code of conduct, and is not an appellate mechanism

for second guessing the opinions of the proxy advisors. Further, the regulator may consider impleading itself into any litigation, which seeks to by-pass the redressal mechanism, so that the courts can appreciate a more discerning view of the issues and also so that SEBI can assert its exclusive jurisdiction in the matter.

VI. SETTING BASIC INDUSTRY STANDARDS

a. What should the industry standards be for providing recommendations by proxy advisors?

67. Best Practice Principles for Shareholder Voting Research can be followed. Any standards should focus on ensuring the accuracy and integrity of the reports. There is also an opinion that the application of RA Regulations should suffice.

68. A few points as stated by various contributors:

a. Proxy advisors should be able to demonstrate that their reports, analyses, guidance and/or recommendations are prepared to a standard that can be substantiated as reasonable and adequate.
b. Proxy advisors should have systems and controls in place so that they can reasonably ensure the reliability of the information used in the research process.
c. Proxy advisors must have a policy of responding to communication from a company, including conflict disclosure policy.

69. Similar to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and SEBI (Prohibition of Insider Trading) Regulations, 2015, the RA Regulations should provide for the following guiding principles for proxy advisory firms:

a. Fiduciary duties permeate and govern all aspects of the development and dispensation of proxy advice;
b. Enhancing and promoting shareholder value must be the core consideration in rendering proxy voting advice;
c. The proper role of proxy advisory firms is to provide accurate and current information to assist those with voting power to fulfil their fiduciary duty and further the economic best interests of those who entrust their assets to portfolio managers.

b. How to clearly define the roles and responsibilities of proxy advisory firms?

70. The role and responsibility of proxy advisory firms extends to collecting all relevant information in the public domain and, after applying objective criteria, making recommendations having regard to the regulations and the provisions of law. On a macro basis, fair and ethical conduct and compliance with laws must be the pillars of responsibilities of proxy advisory firms. With respect to definition of proxy advisors, RA Regulations cover the definition of a proxy advisory firm.

Best Practice Principles for Shareholder Voting Research defines the roles and responsibilities of proxy advisors fairly well.

c. Should proxy advisors' reports be evaluating only compliance with law? Or can they evaluate higher governance standards as long as they disclose the policy as well as the law?

71. Proxy advisor reports do not generally assess only a company's compliance with law, and proxy advisors are generally focused on evaluating higher governance standards. Compliance with law is a basic expectation. Shareholders are free to make their voting decisions based on the factors that they deem relevant and appropriate for them, including factors and standards that exceed those proscribed by law, applicable exchange standards or otherwise.

Working Group's recommendation

72. Restricting proxy advisors' reports to reflect compliance with the law would render them useless to investors. Besides, if compliance with the law is the only requirement, then the very reason why shareholders retain voting rights on certain matters will be lost. As an aside, it should be noted that while evaluating compliance with law, proxy advisory firms must clearly disclose the legal requirement vis-a-vis the aspirational / higher standard they are suggesting. Further, where higher standards are evaluated, the policy behind it should be disclosed. There is also an opposing view observed by the working group that the recommendations should be based on prevailing regulations and not based on stricter criteria as defined by the proxy advisors. The Working Group does not subscribe to the opposing view and supports the higher standards theory.

d. Should proxy advisors form an opinion on governance, structures, past practices and quality related stuff, or can they also form an opinion on major moves of company such as M&A activities?

View 1

73. Proxy advisors should be able to form an opinion on any issues up for vote at a shareholder meeting. In most cases, a proxy advisor's analysis of the terms of a transaction typically focuses on the process followed by the company's board of directors in determining to enter into the transaction and recommend it to shareholders, the alternatives considered by the board, the analysis and advice provided to the board by its advisors, and the quality and extent of the disclosure provided to shareholders about these matters. While proxy advisors also report their own views of the economic terms of the transaction, they do so by analyzing whether the terms of the transaction are fair to shareholders. They report on the board's consideration of various valuation measures that are applicable to the company, but do not independently determine a fair price for the company's securities or recommend that shareholders take any particular action other than voting for or against a proposal.

74. Therefore, proxy advisors generally shouldn't be restricted from providing opinion on any relevant matters. All matters that come to vote should be allowed as long as the basis of the recommendation is explained and reports are well informed and clear.

View 2

75. However, an alternative but strongly held minority view is that the qualification of proxy advisor to form an opinion on the complex moves such as valuation in M&A activities is doubtful. Assessing and advising on these other activities requires very specialised skills and experience to advising on corporate governance. In addition, it has been asserted that second guessing an expert, and a regulated expert like a valuer, on a share swap ratio, would mean giving too much power to proxy advisors who are not best suited to second guess such numbers.

Working Group's recommendation

76. Given the view that proxy advisors could not possibly intelligently second guess areas such as what ought to be the share swap ratio, we sought from two of the registered proxy advisors the last several 'no' votes where a proposed M&A transactions were proposed by a company. On a review of the detailed rationale as to why the proxy advisors had recommended a 'no' vote, the Working Group is of the considered view that in M&A transactions substantial value addition can be provided through an analytical view of the facts based on publicly available information. The actual process is not second guessing views of experts, and the reports have been highly persuasive with cogent reasons. Based

on the aforesaid, the Working Group recommends that there is no reason to restrict the areas of analysis for a proxy advisor based on the evidence available. In addition, given the highly material nature of these corporate events which sometimes decide the life or death of the corporate juristic entity, an analysis of the event might provide the best value addition that proxy advisors can provide to investors.

e. Should foreign proxy advisors be registered with SEBI to bring them at par with Indian proxy firms? If not, how to apply the SEBI Regulations to foreign proxy advisors with respect to their recommendations regarding voting on Indian listed companies.

77. Currently, foreign proxy advisors need not be directly registered with SEBI under the RA Regulations. Regulation 4 of the RA Regulations provides for certain requirements which are required to be met by foreign research analyst, i.e. to enter into an agreement with research analyst registered with SEBI.

View 1

78. One view received by the Working Group is that registration should be made mandatory, as it would be equitable for the same standards to be applied to all proxy advisors making recommendations about Indian listed companies. However, this should be applicable only for their operations in India/regarding Indian listed companies, and the registration process should be kept simple without any requirement to have a permanent establishment in India. This is the approach the European Union ("**EU**") has taken in the Shareholder Rights Directive, which introduces reporting requirements on proxy advisors. The Directive applies to all advisors that provide advice on companies listed in the EU, even where the advisor is not based in an EU Member State.

View 2

79. There is a contrary view received by the Working Group, which states that requiring proxy advisors to register with the securities regulator of each country it covers as part of its research would not only be costly and time consuming for proxy advisors, but it would also compromise institutional investors' access to efficient, timely, and independent information. Proxy advisors already comply with relevant laws and regulations that apply to them and their specific circumstances, which may vary depending on where they are incorporated or have local operations.

View 3

80. Another view received by the working group proposes chaperoning arrangement between foreign proxy advisor and its Indian counterpart. The said arrangement will help foreign proxy advisors in complying with the requirements of SEBI Regulations.

View 4

81. One more view received by the working group suggests that institutional investors can engage only SEBI registered proxy advisors who will provide voting recommendation on resolutions pertaining to Indian Listed Companies.

82. Further, currently under Regulation 23(1) of the RA Regulations, it has been provided that all provisions of Chapter II, III, IV, V and VI would apply *mutatis mutandis* to proxy advisor (except the limited carve outs for qualification, certification and net-worth requirements). Considering the activities of a research analyst are not the same as activities of a proxy advisor, and provisions under the RA Regulations which are applicable to an Indian proxy advisor may not be applicable to a foreign proxy advisor.

Working Group's recommendation

83. 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. These should be principle based and focused on broad principles of fairness, disclosure and conflict and based on a comply or explain basis. It would be unfair to subject global proxy advisors to regulations by 195 countries. SEBI should, of course, have broad extra-territorial powers where fraud or such serious mischief is suspected. For this no new law is required, and the existing multilateral MMoU of IOSCO (an international body of securities regulators) should suffice.

84. While the Working Group believes in a light touch set of regulations, it recommends that international proxy advisors must have a responsive feedback mechanism and contact email/address for any issues investors/companies may have with its reports. Additionally, as all the recommendations of the Working Group advocate non-regulatory improvements by way of disclosure, best practices etc, we believe the same can be complied with by the foreign proxy advisors as well in a comply or disclose framework on their websites. While the discussions above have focused on the two large international proxy advisors, there are many smaller players, and some may be covering only a handful of Indian companies. Setting new standards for them may result in them blanking out India from their coverage altogether. SEBI should be cognizant of this as it

will adversely impact corporate governance and any extra-territorial operation by way of regulation, code of conduct or chaperoning arrangement (tie up with a domestic proxy advisor) would harm Indian standards and reduce competition. The Working Group also recommends that registration and chaperoning should be avoided for foreign proxy advisors. A comply or explain code of conduct which applies to domestic proxy advisors should apply to them as well.

VII. COST & COMPETITION

a. Increase in regulation leads to increase in compliance cost and reduces competition. How should this be addressed?

85. The feedback received by the Working Group suggests that while the proxy industry is very small, the cost of compliance is already very high. Many institutional investors fear that regulation is likely to result in higher costs for investors, impede quality and independence, and is likely to limit competition and impose barriers to entry of potential new proxy advisory firms. Therefore, the impact on competition must be taken into account when considering any increase in regulation. While prudent regulation is welcome, heavy-handed regulation that impairs the utility of proxy advisors would be unhelpful.

Working Group's recommendation

86. The Working Group recommends that uncomplicated principle based rules, disclosures and conducting a thoughtful cost-benefit analysis of any proposed changes would mitigate any unnecessary costs which could reduce competition. The role of market forces in addressing any potential concerns about proxy advisory firms should be kept in mind. As the domestic proxy advisors are thinly capitalised and some are extremely lean, any undue burden would have a deleterious impact on the industry. For instance, calls for capital adequacy requirements can easily be dismissed as being irrelevant to the business. We need proxy advisors to be competent, honest and efficient. There is no need to have rich proxy advisors, and imposing additional capital requirement will be a self goal of regulation, as it is inconsistent with the object sought to be achieved. SEBI may review and eliminate the current requirement of networth as it is irrelevant to the work that proxy advisors do.

VIII. ADDITIONAL POINTS

a. Share any best practices/model code being followed by proxy advisors in jurisdictions other than India.

87. The Best Practice Principles for Shareholder Voting Research is available at https://bppgrp.info/. The BPPG's Principles are currently under review and a completed update is scheduled for June 2019. These are important best practices of institutional shareholders globally.

b. What is best possible mode for implementation of proposed changes by the working group? Whether through amendment in the law (regulations), through a code of conduct (annexure to the regulations) or through a voluntary best practice standard (based on comply or explain)?

88. ***Amendment in the law***: The Working Group believes that except for one amendment mentioned above with respect to amending the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, no additional changes in the law are required.

89. ***Code of Conduct***: Establishment of and adherence to a global code of conduct, coupled with proper oversight by investors, has proven to be effective in ensuring the quality and integrity of proxy advisory research – without adding an undue burden on investors or inhibiting competition.

90. It is believed that implementing changes proposed by the committee, through law would have the disadvantage of rigidity, and the inability to make changes quickly. Even more importantly, additional legal and compliance burden would reduce competition in an arena where the nascent industry has done a commendable work with a lean model. A principle based, comply or explain, code of conduct is a better option.

91. It is believed that the main issues do not lie with proxy advisors. Placing them under the existing regulatory framework and steps to improve quality/ accuracy of data and their interpretation would be helpful. Beyond this, the primary challenges lie largely with issuers and to an extent with investors. The fact that shareholder votes have become of some consequence will only improve board accountability, shareholder engagement, shareholder protection and market maturity.

92. ***New best practices for proxy firms and stewardship code***: While the code of conduct would set higher principles, an aspirational document called 'best practices' should be evolved by the industry itself. This should not be prescribed by SEBI but be adopted by the domestic and global proxy advisors.

- New/ Specific best practices for proxy advisory firms
- Stewardship Code for institutional shareholders.

c. Any other issue on the subject for deliberation of the working group.

93. It is important to educate the general public about the working of proxy advisors. While only institutional shareholders currently use proxy advisors, a lot of fact collection and views are in public domain, put out by the proxy advisors and free for retail shareholders to use. Investor education would empower investors to use these tools and research, to improve governance standards in India Inc. SEBI should provide a framework to proxy advisors to reach retail investors to encourage them to vote. All financial institutions (domestic / foreign), including FPIs, registered with SEBI must be nudged to vote. Given that proxy advisory industry is working for enhancing governance standard of listed companies, dissemination of their reports to large number of stakeholders beyond their clients must be encouraged.

IX. CONCLUSION AND SUMMARY

94. The Working Group recommends that no further mandatory regulation is required, except for amending the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The amendment would provide that listed companies which are aggrieved by a view of a proxy advisor may approach SEBI for redressal of its grievance. It may further provide a mechanism for the same. SEBI may consider drafting a code of conduct for proxy advisors which may include the following on a 'comply or explain' basis:

a. Disclosure of conflict of interest and how it is managed. The disclosures should appear on every specific document where they are giving their advice. A generic disclosure/disclaimer on the proxy advisor's website is inadequate and 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 also the safeguards that have been put in place.

b. The proxy advisor should take appropriate steps to manage, mitigate and/or disclose any potential conflicts of interest resulting from ancillary business activities. Creation of 'Chinese Walls' between proxy firms and their consultancy firms. There should be clear procedures to handle conflicts of interest.

c. 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.

d. The entity/business unit providing services to investors/shareholders should be different from the one providing advisory services to a corporate client.

e. Disclosure if consulting services are provided.

f. Codes that determine when not to provide a voting recommendation should be clearly disclosed.

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

h. 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.

i. Setting parameters around the communications they have with the companies and other stakeholders. There should be a nudge towards making company disclosures speak for themselves rather than a bi-lateral discussion between a company and proxy advisors.

j. 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.

k. Communication between the proxy advisor and the company should be promptly made public by the company.

l. 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.

m. 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

iii) Board of Directors and changes during year, including shareholding of directors and relatives with changes during the year.

iv) Litigations if any

95. SEBI may review:

a. 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.

b. The Working Group believes that clients conduct extensive due diligence when they review and select their proxy advisor(s), and this will ensure that the proxy advisor has staff with sufficient skill sets. SEBI may review its certification norms and continuing education as appropriate without over-burdening the proxy advisors.

c. The Working Group's view is that except for factual errors, proxy advisors should not be mandated to carry views which they don't subscribe to and the company has sufficient resources to publicise a differing viewpoint.

d. Proxy adviser is a person who provides advice to institutional investors or shareholders of a company, in relation to exercise of their rights in the company including recommendations on public offer or voting recommendation on agenda items. These proxy advisors are required to observe compliance of Code of Conduct specified under SEBI (Research analyst) Regulations, 2014. 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 wrt compliance of code of conduct by proxy advisor. Only thereafter the person may approach the court of law. 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. It should be kept in mind that this process is only available for egregious acts like abuse of power or violations of basic levels of code of conduct, and is not an appellate mechanism for second guessing the opinions of the proxy advisors. Further, the regulator may consider impleading itself into any litigation, which seeks to by-pass the redressal mechanism, so that the courts can appreciate a more discerning view of the issues and also so that SEBI can assert its exclusive jurisdiction in the matter. If the person is still aggrieved with comments of SEBI, only thereafter the person may approach a court of law. 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.

e. In M&A transactions, substantial value addition can be provided through an analytical view of the facts based on publicly available information.

f. Improving the plumbing of voting, and appropriate advocacy, so that retail investors also actively participate in voting in shareholder meetings. A 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.

g. The Working Group believes the advent of proxy advisors along with several other technological advances and behavioral improvements in institutional investors involvement have all contributed towards a more responsible investor, in turn altering the actions of the companies for the better. SEBI should employ the use of modern technology to democratize and empower investors further as new technologies make it easier to implement such benefits.

h. 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. These should be principle based and focused on broad principles of fairness, disclosure and conflict and based on a comply or explain basis. It would be unfair to subject global proxy advisors to regulations as it would have the unintended consequence of international proxy advisors shunning India. This would be a self goal for corporate governance in India.

i. SEBI may review and eliminate the current requirement of networth as it is irrelevant to the work that proxy advisors do.

j. 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.

96. Proxy advisors may introduce a voluntary best practices code for the industry on a ‘comply or explain’ basis as they develop and evolve. The institutional investors may adopt an industry wide stewardship code, on a ‘comply or explain’ basis, concerning

principles that the institutional investors are expected to follow to enhance the governance framework.

97. We recommend that SEBI may like to obtain public comments on the substantive matters stated in this report before any regulatory review is undertaken.