

NyaayShastra Law Review

Volume I, Issue 1



NLR

NyaayShastra
Law
Review

ABOUT US

NLR Journal is an online bi-annual journal with a summer and winter edition. The Journal revolves around any Socio-legal Topic and is not strictly restricted to any particular field of law but promotes interdisciplinary research entailing detailed study of law with other disciplines in the contemporary era.

All academicians, Research Scholars, Lawyers and Law Students can submit original manuscripts of Articles, Research Paper, Book Review, Case Comments and Legislative Comments relating to recent development in Law and Legal Studies.

JOURNAL'S OBJECTIVES

1. Provide detailed conceptualisation of socio-economic phenomenon and its interplay with law and policy-making.
2. Encourage interdisciplinary and comparative research to develop a holistic and multifaceted approach towards the complex issues of today's society.
3. Critically and intellectually engage with contemporary issues and the discourse surrounding it.
4. Enable the development of legal intellect, critical analysis and quality research by promoting original legal writing.

SEBI'S NASCENT GUIDELINES ON PROXY ADVISORS: A DOUBLE EDGED SWORD?

*By Yashika Sharma & Nitesh Mahech, law students at University School of Law & Legal Studies,
GGSIPU*

INTRODUCTION

Proxy advisory firms provide research and voting recommendations to help institutional investors vote their shares on issues such as executive compensation and corporate governance. However, there have been several concerns about the proxy advisors on shareholder voting outcomes as it potentially allows advisers to exert pressure on firms to adopt the advisers' preferred practices, which may not be in the best interests of shareholders. This influence has been recognised as the “*éminence grise*” of corporate governance.

PRIOR SCENARIO OF PROXY ADVISORS

In the market structure, proxy advisors have their unique position and for their regulation, the *Securities and Exchange Board of India* (hereinafter referred to as the “*SEBI*”) had already issued [*SEBI \(Research Analysts\) Regulations, 2014*](#). Such regulation in India has been a rarity as in many countries, proxy advisors are not regulated.

Under the *SEBI (Research Analyst) Regulations, 2014*, Regulation-24(2) read with 23(1) mandates proxy advisors to abide by Code of Conduct specified therein. Regulation 24(2) provides that the research analyst or research entity shall abide by the Code of Conduct as specified in the Third Schedule. And, Regulation-23(1) provides that:

- i. all the provisions of Chapter II, III, IV, V, and VI shall apply mutatis mutandis to the proxy advisors;
- ii. the employees of proxy advisors engaged in providing proxy advisors services shall be required to have a minimum qualification of being a graduate in any discipline;
- iii. certification requirements for employees of proxy advisors engaged in providing proxy advisors services shall be as specified by the Board; and
- iv. the time period for compliance with capital adequacy as provided in sub-regulation (3) of regulation 8, for proxy advisors shall be three years.

SEBI's 2020 GUIDELINES ON PROXY ADVISORS

However recently, *SEBI* notified two new circulars in exercise of power conferred by Section-11(1) of the [SEBI Act, 1992](#) providing the [“Procedural Guidelines for Proxy Advisors”](#) and the [“Grievance Resolution between Listed Entities and Proxy Advisors”](#) for the first time in India to have stipulated categorical disclosure requirements for proxy advisors. The said circular has been issued to all the SEBI registered Proxy Advisors and it is applicable with effect from September 1, 2020.

With the above-specified regulations, SEBI decided that the proxy advisors shall also comply with the following procedural guidelines:

- 1. Voting Recommendation Policies and Disclosure:** Proxy advisors shall formulate the recommendation policies and disclose the updated voting recommendation policies to its clients, shall ensure that the policies should be reviewed at least once annually, and the voting recommendation policies shall also disclose the circumstances when not to provide a voting recommendation.
- 2. Methodologies and Processes:** The proxy advisors shall disclose the methodologies and processes followed in the development of their research and corresponding recommendations to its clients.
- 3. Factual Errors or Material Revisions to the Report:** Proxy advisors shall alert clients, within 24 hours of receipt of information, about any factual errors or material revisions to the report.
- 4. Communication:** Proxy advisors shall have a stated process to communicate with their clients and the company.

5. **Reporting:** Proxy advisors shall share their reports with their clients and the company at the same time. This sharing policy should be disclosed by proxy advisors on their website. The timeline to receive comments from the company may be defined by proxy advisors and all comments/clarifications received from the company, within the timeline, shall be included as an addendum to the report.
6. However, if the company has a different viewpoint on the recommendations stated in the report of the proxy advisors, then the advisors, after taking into account the said viewpoint, may either revise the recommendation in the addendum report or issue an addendum to the report with its remarks, as considered appropriate.
7. **Disclose in Recommendation:** Proxy advisors shall clearly disclose in their recommendations the legal requirement vis-a-vis higher standard they are suggesting if any, and the rationale behind the recommendation of higher standards.
8. **Disclosure of Conflict of Interest:** Proxy advisors shall disclose conflict of interest on every specific document where they are giving their advice. Further, the disclosures should especially address the possible areas of potential conflict and the safeguards that have been put in place to mitigate possible conflicts of interest.
9. **Clear Procedures to Disclose:** Proxy advisors shall establish clear procedures to disclose, manage and/or mitigate any potential conflicts of interest resulting from other business activities including consulting services, if any, undertaken by them and disclose the same to clients.

WHY ARE THESE GUIDELINES IMPORTANT?

These intermediaries have revolutionised the corporate governance sphere in India in the past few years by bridging the informational imbalance between the members and the Company. Given the clout, these firms had gained in influencing the shareholders it has become increasingly significant to hold them accountable and make their procedure more transparent. Furthermore, hitherto, any dispute between the Company and Proxy Advisory firms in India was taken up by the Court of law which led to a long drawn court battle. For instance, [in 2017, Consumer goods major ITC Ltd has brought a Rs. 1000 crore lawsuit against one of the proxy advisors for alleged defamatory statements against the Company's directors in one of the reports.](#) However, now any grievance would be reported to the SEBI for redressal. Also, the Proxy advisory firms would now necessarily have to include the Company's viewpoint in its recommendation as an addendum to the report which would ensure cooperation between Listed Entities and Proxy Advisory Firms in promoting the goal of shareholder activism and preventing any chance of friction.

ISSUES WITH THE GUIDELINES

The major contention of proxy advisory firms against the regulations is that it would make the process complex for them and affect their smooth discharge of functions. A few loopholes in the SEBI notification need to be clarified before it becomes effective like whether the proxy advisor can demand a fee from the Company for sharing its recommendation with them and the deadline for issuing the addendum with revised recommendations. Likewise, the comments received from the Company might stand contrary to the report of the firm, this will further cause hindrance for investors to make a calculated decision and cast apprehensions on the advice of proxy advisories thereby beating the very purpose of their existence in the whole scheme of things.

CONCLUSION

From now onwards, SEBI would look into the affairs of proxy advisors with the Code of Conduct specified under Research Analyst Regulations and the new procedural regulations. These measures would prove to be a yardstick for proxy advisors in the discharge of their functions which are in a sense fiduciary. They also signify SEBI's proactive role in raising the standard of corporate governance in India by providing for investor protection and confidence despite the nascency of Proxy Advisors. The Proxy advisory firms are the harbingers of shareholder democracy and as a necessary effect, the information issued by them to the shareholders must be disinterested, legitimate, reliable and neutral. The new regulations are light touch in nature and call for high standard disclosure of the methodologies implemented and conflict of interest if any between the firm and the Company.

NLR

NyaayShastra
Law
Review