

# Proxy Advisory Framework and the Role of Company Secretaries

Proxy advisory firms have become significant intermediaries in the corporate governance landscape of the Indian corporate market. Since the inception of the first proxy advisory firm in 2010, the industry has experienced substantial growth. These firms play a crucial role by making suggestions to investors after analysing corporate governance practices of companies. Their major functions include making voting recommendations, proxy voting, policy advocacy, and providing education and spreading awareness among stakeholders. However, despite their benefits, these firms face several issues and challenges. They are sometimes accused of personal biases, inadequate research practices, and providing unreliable information. Additionally, there are concerns about their independence, particularly in cases of conflict of interest.



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## INTRODUCTION

**E**merging as relatively recent entities in the corporate realm, proxy advisory firms are independent organisations that provide research, analysis, and recommendations to shareholders regarding corporate governance issues and matters to be voted on at company meetings (Ganie et al., 2023). Their primary function is to assist

institutional investors, such as mutual funds, pension funds, and other asset managers, in making informed voting decisions during shareholder meetings. In fact, the term ‘proxy advisory’ originates from the idea of ‘proxy votes,’ wherein a shareholder grants authority to another individual (in this case, a proxy advisory firm) to vote on their behalf regarding resolutions presented by the management (Subramanian, 2016).

As per Regulation 2(1)(p) of the SEBI (Research Analysts) Regulation, 2014, a proxy adviser means “any person who provide advice, through any means, to institutional investor or shareholder of a company, in relation to exercise of their rights in the company including recommendations on public offer or voting recommendation on agenda items<sup>1</sup>.”

Proxy advisory firms have swiftly assumed a pivotal role by aiming to provide voting recommendations to the clients backed by research and explicitly highlighting pros and cons of a decision. The significance of proxy advisory firms has been amplified with the implementation of enhanced corporate governance regulations as outlined in the Companies Act, 2013, and SEBI (LODR) Regulations, 2025. Numerous instances exist where the counsel provided by proxy advisors has contributed to the implementation of improved governance practices within companies. For instance, in 2018, the Global Funds opposed the appointment of Deepak Parekh as the non-executive chairman of HDFC. Their rationale was grounded in Parekh’s simultaneous directorship in eight companies, raising concerns about his ability to manage multiple roles judiciously (Gopakumar, 2018, August 1). Similarly InGovern raised red flags over Care (subsidiary) ESOPs to the executive chairperson of Religare Enterprises (REL), Rashmi Saluja (Chatterjee, 2023, November 15). More notably, two proxy advisory firms, Institutional Investor Advisory Services India Ltd (IiAS) and Institutional Shareholder Services (ISS), opposed the proposal to appoint Anant Ambani on the Board of Reliance Industries Ltd (Vyas, 2023, October

<sup>1</sup>. Securities and Exchange Board of India (Research Analysts) Regulations, 2014, The Gazette of India. September 1, 2014, PP. 1-32.

20) a proposal which was later disregarded by the shareholders (Moneycontrol News, October 28, 2023)). InGovern, however, had taken a different stand on the issue (Kurup, 2023, October 11).

The growing prevalence of proxy advisory services in India is evident, as institutional investors increasingly turn to their recommendations when exercising voting rights in listed companies. Furthermore, proxy advisors typically uphold companies to elevated corporate governance standards beyond legal requirements, theoretically promoting increased transparency and helping shareholders in making well-informed decisions without the need for personal research. When Proxy advisors' reports portray the company positively in terms of decision-making and legal compliance, it instils confidence in investors. This increased confidence can lead to greater investments in the company. Consequently, companies are incentivized to adopt and maintain good governance policies to align with the recommendations provided by proxy advisors.

## REGULATORY FRAMEWORK

Proxy Advisory Firms in India are regulated by the market regulator SEBI through its regulation; SEBI (Research Analysts) Regulation, 2014 (hereinafter referred to as "Regulations") and Circular; Procedural Guidelines for Proxy Advisors dated August 3, 2020 (including its amendments) and Grievance Resolution between listed entity and proxy advisors dated August 4, 2020. A few of the important regulations are discussed for the understanding of the governance of the proxy advisory firms in India.

### 1. Registration

In order to operate as a proxy advisor in India, one must obtain a certificate of Registration from the Securities and Exchange Board of India (SEBI) by submitting an application in Form A, as provided in the first schedule of the regulations, along with non-refundable application fees.

The regulations also outline specific qualification requirements for individuals seeking registration or partners of a firm. Additionally, there are minimum net tangible assets criteria stipulated: individuals or partnership firms must have a minimum net tangible assets value of not less than Rs 1 Lakh, while Limited Liability Partnerships (LLPs) or Body Corporates must maintain a capital adequacy of a net worth of not less than Rs 25 Lakhs. Net worth is defined as the aggregate value of paid-up share capital plus free reserves (excluding reserves created out of revaluation), reduced by the aggregate value of accumulated losses. However, there is no specified business model to operate as a proxy advisor. There are three prominent advisory firms operating in India which are InGovern Research Services Private Limited, Stakeholder Empowerment Services and Institutional Investor Advisory Services India Limited (IIAS). There is no compulsory standardisation of business

models as yet and therefore proxy advisors in India can have different business models. These are free to adopt to any business structure be it sole proprietor, LLP, company or even a not for profit organisation.

Foreign proxy advisors intending to operate in India are mandated to enter into an agreement with SEBI-registered proxy advisors in India. This regulatory requirement by SEBI serves to protect the Indian proxy advisors and the Indian market from potential volatility introduced by foreign players. Furthermore, this regulation provides a level of assurance to Indian proxy advisors as they are not obligated to meet the minimum qualification requirements or possess expertise in the Indian market to release reports.

### 2. Management of Conflict of Interest

When personal interests intersect with broader concerns, potential conflicts of interest emerge. Given the unique nature of proxy advisory roles, it is imperative to minimise or effectively manage any such conflicts to prevent any adverse impact. It is crucial to keep the conflicting interest at bay when giving voting recommendations or research reports to keep them unbiased and unclouded from personal opinions and interests. Regulation 15 mandates the establishment of internal policies and procedures to address potential conflicts of interest. These policies as framed by these firms are easily accessible on their respective websites.

According to this regulation, proxy advisers shall have a written internal policy that should govern the dealing and trading of securities of the company that could lead to; actual or potential conflict of interest. Furthermore, they are required to ensure the reliability of their research and prevent the misuse of research reports for market manipulation. Additionally, mechanisms must be in place to ensure the independence of research activities from other business operations such as sales, customer acquisition etc. Conflict of interest is also addressed in terms of regulation 19 wherein disclosure of material conflict of interests is mandated in the research report.

### 3. Disclosure Requirements

In May 2019, the working group formed to provide input on issues concerning proxy advisors released its report. In this, in relation to the conflict of interest where the subject company is promoters/ shareholders of the proxy advisor, the working group recommended that the proxy advisors should be allowed to make a recommendation provided the relationship is fully disclosed and the conflict of interest is detailed. It said in its report *"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."*

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As mentioned earlier Regulation 19 extensively deals with the disclosure requirements in the research report. It requires the proxy advisors to disclose all the material information about itself, material conflict of interest, beneficial or actual ownership among others.

#### 4. Code of Conduct

All Proxy advisors have to abide by the Code of conduct outlined in the Third Schedule as mentioned under Regulation 24(2) read with Regulation 23(1).

Schedule Third encompasses areas like honesty and good faith, diligence, confidentiality, conflict of Interest, compliance among others in the Code of conduct that have to be observed by the Proxy Advisory firms. It is worth noting that these standards are not merely advisory or recommendations. The Code of Conduct have to mandatorily followed by the Proxy Advisory firms; emphasising the relevance of governance in these firms as well. It is of utmost importance for all businesses to adopt good governance practices irrespective of the type of business they are engaged in, and it is evident from this that SEBI itself is very clear about its position on good governance practices. Through this Code of Conduct the senior management itself is tied with the responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures. (Point 8 of Code of Conduct, Third Schedule to Regulation)

In addition to this, they are also required to abide by the procedural guidelines issued by the Board vide Circular dated August 3, 2020. These guidelines clearly indicate the Board's intention to enhance transparency in the operations of proxy advisory firms. As per this Circular, firms are required to establish policies for voting recommendations, which must be reviewed annually. They must also disclose the methodologies and processes used in their research, as well as establish clear procedures to identify, manage, and mitigate potential conflicts of interest arising from other business activities. Furthermore, they must have a documented process for communication with clients and companies. The

Circular also mandates a sharing policy, requiring firms to share reports simultaneously with clients and companies, with this policy being publicly disclosed on their website. Additionally, they must disclose any conflicts of interest in every document where advice is given, with a focus on potential areas of conflict and the measures taken to address them.

#### 5. Grievance Redressal

The work of proxy advisors is of such a nature that differences of opinion are inevitable which can often lead up to serious grievances.

The SEBI Working group was formed with a threefold objective one of which was to advise on the framework for resolution between corporates and proxy advisors. Prior to this listed Companies had litigation as the only available route to seek redressal for their grievances. (ITC Ltd. slapped a Rs 1,000 crore defamation suit against Institutional Investors Advisory Services in 2017 for alleged defamatory remarks against its Director in its Research report (ET Bureau, September 6, 2017)).

The Working Group Report in its recommendation said the disputes between the corporates and proxy advisors needs to be first examined by SEBI and only thereafter may the person approach the court of law. It further added that *"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 second guessing the opinions of the proxy advisors."*

In response to the recommendation of the Working Group in its Report, SEBI came out with a circular dated August 4, 2020 addressing the framework for grievance resolution between listed entities and proxy advisors. SEBI in its circular has allowed the listed entities to approach it in case of grievances against Proxy Advisors, where-in-after it will examine the matter for non-compliance of Regulations, Circulars and Code of conduct. However, SEBI has not mandated listed companies to approach it as a first step, as indicated by the use of the word "may" in the circular instead of "shall." This raises the question of whether listed entities can still pursue legal action without seeking redressal from SEBI first.

### FUNCTIONS OF PROXY ADVISORY

1. **Voting Recommendations** - A key function of the Proxy Advisory firms is to provide voting recommendations to the institutional investors regarding the resolutions placed for the shareholders' approval. They conduct thorough research taking in view multiple factors like legal regulations, company's policies and market conditions to give



a recommendation. The recommendations advise institutional investors to vote either 'for' or 'against' the proposed agenda items.

2. **Proxy Voting** - The Companies Act allows the shareholders to appoint a proxy to vote on its behalf in the shareholders meeting. Proxy advisory firms play a crucial role in this process by acting as proxies for their clients, enabling them to cast their votes effectively during these meetings. Moreover, they assist institutional investors in understanding and managing the practical aspects of voting, particularly in online meetings, ensuring that votes are cast efficiently and in a timely manner as per the company's specifications.
3. **Corporate Governance Analysis** - Proxy Advisory firms conduct in-depth analysis of corporate governance practices of listed companies in India. They examine Board efficiency, Board diversity, compensation packages, status of regulatory compliance, protection of shareholders rights etc. Recommendations provided by these firms often prompt companies to enhance their compliance and governance frameworks to align with industry standards.
4. **Policy Advocacy** - The proxy advisory firms assists the Company in implementing policies that promote corporate governance practices leading to transparency, accountability and shareholders rights protection. They ensure that these policies serve the

larger interests of shareholders rather than benefiting specific groups or individuals.

5. **Education & Awareness** - The voting participation of retail investors is still very low in Indian companies. They are either unaware or indifferent towards the proposals put up by the company and fail to understand its impact on their investment goals. Proxy Advisory firms play this role of bringing awareness and educating the retail investors. They conduct awareness campaigns, publish research reports, and organise seminars and workshops to disseminate information and raise awareness about governance issues among investors, companies, and other stakeholders.

## ISSUES & CHALLENGES

1. **Lack of awareness** - There is a lack of awareness as to the role and objectives of the proxy advisory firms, especially amongst the retail and minority shareholders. This may often lead to non-adherence to the recommendations made by the proxy advisors after thorough and in depth research, which might also limit the impact of the proxy advisory firms on corporate governance. Institutional Investors and the Listed Companies may be less inclined towards the services of the proxy advisory firms if they are not fully aware of the value proposition and benefits offered by these firms. This reduces the effectiveness of the process and also impedes the growth of such advisory firms.

2. **Non acceptance from the corporate world** - Establishing trust and confidence with companies is crucial for proxy advisors to thrive and positively impact the corporate governance framework but these firms encounter challenges in gaining acceptance from the corporate world due to allegations of personal biases, inadequate research practices, unreliable information, and at times misleading the investors.
3. **Global Competition** - Indian proxy advisory firms are mandated to seek registration with the SEBI in order to conduct their operations within the country. In contrast, foreign proxy advisory firms are not subject to the same registration requirement when providing services related to Indian listed companies. As a result, these foreign firms operate without direct regulation from SEBI. This regulatory asymmetry creates a competitive disadvantage and high competition for Indian proxy advisory firms. The Working Group recommended in its report that *“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.”*
4. **Shareholders Participation** - Often, not all shareholders of the Company vote on matters presented before them, resulting in only a handful of shareholders casting their votes, primarily the promoter or promoter group. Institutional investors, despite holding significant shareholdings, may not exert enough influence on resolution decisions, undermining the impact of voting recommendations made by proxy advisors. Additionally, retail investors rarely participate in meetings due to factors such as lack of awareness or incentives to vote.
5. **Methodology Criticism** - The methodology employed by proxy advisory firms in their research often faces criticism. Research is inherently subjective and applying the same methodology to different resolutions may yield varying recommendations due to unique variables specific to each company. This discrepancy can lead to friction between companies and proxy advisory firms, casting doubt on the reliability of the applied methodology.
6. **Questionable Independence in case of conflict of interest** - While conflicts of interest are disclosed, they remain unregulated. Some firms may also have affiliations with institutional investors, leading to questions about their independence and the potential for biased recommendations. Despite disclosures complying with regulations, reliability issues may

still arise especially when conflicts of interest are alleged. This uncertainty makes it challenging to rely solely on the report, leading to concerns about biases.

## OPPORTUNITIES FOR AND LIKELY ROLE OF COMPANY SECRETARIES IN RELATION TO PROXY ADVISORY FIRMS

As governance professionals, Company Secretaries play a crucial role in ensuring the smooth and compliant functioning of an organisation. They are responsible for corporate governance, legal and secretarial services, corporate laws advisory and representation services, financial market services, banking services, finance and accounting services, securities compliance and certification services, taxation services, international trade and WTO services, as well as corporate communications and public relations. Thus, the sphere of work for Company Secretaries is continually expanding, and the introduction and expansion of proxy advisory firms open up newer avenues for professionals.

Regulation 26, regarding the appointment of a compliance officer as per the code of conduct, mandates that Proxy Advisory firms comply with all regulatory requirements applicable to conducting their business activities. This necessitates the presence of a person well-versed in compliance and other laws. While the regulation does not explicitly mention Company Secretaries, these professionals, being governance experts and often serving as Compliance Officers, can undertake this task with great ease and responsibility.

The role of a Company Secretary in Proxy Advisory Firms may involve a range of responsibilities aimed at ensuring effective corporate governance and facilitating informed decision-making for institutional investors. Here are key aspects of their role:

1. **Regulatory Compliance:** Company Secretaries can play a crucial role in ensuring the coordination of operations and recommendations within a Proxy Advisory Firm with regulatory frameworks. This involves ensuring compliance with relevant laws and guidelines. By staying informed about regulatory changes, market trends, and emerging governance issues, Company Secretaries not only contribute to the ongoing education of the Proxy Advisory Firm's team but can also aid in their professional development.
2. **Corporate Governance Expertise and Research Oversight:** Leveraging their expertise in corporate governance, Company Secretaries can contribute to the development of sound governance principles and practices within the Proxy Advisory Firm. They may play a role in establishing and maintaining an effective internal governance structure ensuring accountability and responsibility and guide the activities of the Proxy

Advisory Firm, especially in relation to formation of policies regarding research methodologies and voting recommendations. They may also provide oversight and guidance to the research team, ensuring that the analysis and recommendations produced align with established governance standards and legal requirements.

3. **Stakeholder Communication and Public Advocacy:** Company Secretaries may be involved in communicating with various stakeholders, including clients, regulators, and the public, to ensure transparency and maintain the Proxy Advisory Firm's credibility. Engaging in public advocacy for improved corporate governance practices, participating in discussions, and contributing thought leadership to promote awareness and understanding of governance issues among stakeholders.
4. **Legal Advisory and Representations:** Offering legal advisory services, Company Secretaries can assist in the interpretation of legal frameworks affecting proxy advisory activities and help to navigate legal complexities. Company Secretaries can also assist in establishing and maintaining positive relationships with regulatory bodies, participating in industry forums, and contributing to the development of industry-wide standards and regulations governing proxy advisory services.
5. **Environmental, Social, and Governance (ESG) Integration:** A Company Secretary can also help in integrating ESG considerations into the Proxy Advisory Firm's assessments and recommendations, reflecting the increasing importance of sustainability and social responsibility in investment decisions. They can also collaborate with technology teams to integrate advanced technologies and data analytics tools enhancing the efficiency and effectiveness of ESG integration into the overall business operations of the proxy advisory firms.

## CONCLUSION

Proxy advisory firms can serve as torchbearers of corporate governance and provide a much-needed impetus to stakeholder activism. Operating as independent organisations, these firms can earn the trust of both retail and institutional investors, provided the inherent challenges related to independence, conflicts of interest, and methodology are promptly addressed. It is too early to comment on the effectiveness of these proxy advisory firms, as the concept is still developing, and the recommendations put forth by these firms have yet to gain significant influence on voting decisions. However, the potential role of these firms cannot be discounted. The introduction of proxy advisory firms opens up multifaceted avenues for corporate professionals, including governance professionals or Company Secretaries.

With their expertise and knowledge in the governance and legal realms, they can play a crucial role in enhancing the governance framework and compliance in Indian corporates. In fact, the involvement of Company Secretaries in proxy advisory firms reflects the broader trend of recognizing the importance of governance expertise in providing valuable guidance to institutional investors and promoting responsible corporate behaviour.

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