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PROXY ADVISORY FIRMS AND CORPORATE GOVERNANCE IN INDIA & UNITED STATES: REGULATORY FRAMEWORK AND EMERGING ISSUES

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ABSTRACT :

Proxy Advisory Firms are the newest entrants in India's corporate governance landscape, bringing with them the tools for enhancing the participation of institutional investors while establishing greater corporate accountability through their recommendations on corporate proposal and governance consultancy. In this light, the present paper recognizes the various trends responsible for the advent of the proxy advisory industry such as increased institutional ownership of public stocks, diversified portfolios and shareholder activism. While analyzing the mushrooming of various proxy advisory firms, the paper then undertakes to identify and study the key market players such as "Institutional Shareholder Services" and "Glass, Lewis & Co." in more developed and matured jurisdiction such as the United States and "InGovern Research Services", "Institutional Investor Advisory Services India Limited" and "Stakeholders Empowerment Services" in the context of developing jurisdiction such as India.

The paper then undertakes to analyze the existing regulatory framework of proxy advisors in India, United States and also embarks upon the oversight of International Regulatory Organizations concerning the proxy advisory industry. The paper further by elucidating the emerging issues with proxy advisory firms such as bearing heavy influence on institutional investors, non-transparency and inaccuracy involved in its research methodologies and conflicts of interest through self-dealing and bias. While addressing these criticisms of corporate lobbyists, the paper puts forth both practical implications for the proxy advisory industry worldwide and the policy implications in relation to India and United States. The paper concludes by identifying the importance of independence and equitability in the present proxy advisory industry for paving the way towards greater corporate governance and accountability in future.

Keywords: Corporate Lobbyists, International Regulatory Organizations, Proxy Advisory Firms, Regulatory Framework, Shareholder Activism.

I. Introduction

The aim of corporate governance has always been to improve the outcomes of decision making for the stakeholders involved in corporations and their functions. With the dawn of shareholder activism through the rise in investors attaching significance to their activism, the landscape for corporate governance has dramatically changed. The higher collective emphasis on the large majority of shares, huge investment portfolios, fiduciary obligations, and voting in all these corporations gave birth to a logistical problem. Here is when, Proxy Advisors, which are firms that specialize in research and analysis of corporate data and issue recommendations to guide managers and institutional investors of all stripes tapped into this market niche.

Proxy Advisory Firms are governance intermediaries that are engaged in the function of analyzing corporate proposals and making recommendations to institutional investors for exercising their votes on such proposals.¹ The retail investors also utilize these recommendations, which are public in nature, for exercising their votes.² These firms provide independent consultancy by producing significant research on corporate governance practices of investee firms and assist the investors with voting recommendations at the shareholder meetings on various issues.³ These issues range from the election of the board of directors, compensation design, corporate transactions such as mergers and acquisitions as well as governance policies and procedures.⁴

The word "proxy advisory" is derivative of the notion of "proxy votes"⁵ which bases the shareholder with the right to authorize another person for voting

¹ Paul Rose, On the Role and Regulation of Proxy Advisors, 109 Mich. L. Rev. First Impressions 62 (2010).

² *Id.*

³ D. F. Larcker, A. L. McCall & G. Ormazabal, Proxy advisory firms and stock option repricing, 56(2) J. Accounting and Econ., 149, 169 (2013).

⁴ *Id.*

⁵ Companies Act, 2013 No. 18 of 2013, § 105 (Ind.).

on resolutions on his behalf on such prime corporate resolutions,⁶ While internationally, Proxy Advisory Firms have become an emerging and powerful driver of corporate governance with the industry leader, “Institutional Shareholder Services” controlling about 61% of the market⁷ and runner up being “Glass, Lewis & Co.” in the United States. India only saw these proxy advisory firms dotting its landscape in the last decade, with the first proxy advisory, “InGovern Research Services” mushrooming in 2010 with the addition of “Institutional Investor Advisory Services India Limited” and “Stakeholders Empowerment Services” and in the next two years. The paper discusses these firms and their establishments in detail.

Although their role has earmarked the notions of proper governance in the landscape of corporate law, there is a chorus of issues relating to their working and business model which has also gained the attention of regulators across the globe. Some of the key issues can be identified as unresponsiveness to corrections for corporate demands, inaccuracy in the analysis, lack of transparency in formulation of these recommendations, conflicts of interest for offering consultancy services to corporations whose investors are its proxy clients and unnecessarily raising the bar of good governance for continued employment.⁸ This paper identifies the existing regulatory oversight and further suggests implications for these issues.

II. Background

The proxy advisory industry is a specialized sector within the financial services industry that provides research, analysis, and recommendations to institutional investors regarding shareholder votes in publicly traded companies. These advisory firms help investors navigate complex corporate governance issues, executive compensation plans, and environmental, social, and governance (ESG) factors that may have an impact on their investments. In the early era of the corporate management industry, the prevalent practice amongst professional investors was either to vote with the management or sell their equity⁹ also referred to as the “wall street rule”¹⁰ or “wall street walk”¹¹. This method of voting with their feet or simply quitting the company by selling their shares kept these passive investors out of the decision-making process which led to lacking an incentive for these investors to monitor the performance of these corporations.¹² Passive investors in the context of the proxy advisory industry refer to those who invest in index funds or exchange-traded funds (ETFs) that track specific market indices, rather than actively picking individual stocks. These investors generally adopt a “buy and hold” strategy, seeking to mirror the performance of the underlying index. Passive investors also have a role in proxy voting as they hold shares in a broad range of companies through their index fund investments. Although these investors do not actively manage their portfolios, they still have voting rights as shareholders. Various trends such as diversified portfolios to shareholder activism can be associated with the emergence of the proxy advisory industry.

Emerging Trends for Proxy Advisory Firms

The following trends can be identified for tracing the emergence of the proxy advisory industry:

Increased Institutional Ownership of Public Stocks

At one point of time in history, the majority of the stocks were predominantly controlled or held by a few leading business houses and wealthy individuals. In India, the equity share markets were noticeably shallow and retail investment was almost insignificant.¹³

Institutional investors are organizations that invest on behalf of their members. They can include entities like pension funds, insurance companies, mutual funds, hedge funds, endowment funds, and commercial banks. They have large amounts of money to invest and often hold substantial stakes in a wide array of companies. Because of their size and the amount of capital they control, institutional investors can have significant influence on the markets and individual companies in which they invest. Although institutional investors such as Unit Trust of India (UTI) and development financial institutions (DFIs) held considerably large stakes,¹⁴ their participation was heavily subjected to bureaucratic and governmental influence¹⁵ which contributed to their passivity in the governance process.

⁶ S. Subramanian, Proxy Advisory Industry in India, 13(2) Corp. Ownership & Control 371, 375 (2016).

⁷ James R. Copland, Yevgeniy Feyman & Margaret O’Keefe, Proxy Monitor 2012: A Report on Corporate Governance and Shareholder Activism, 22 (2012).

⁸ Yvan Allaire, The Troubling Case of Proxy Advisors: Some policy recommendations, Policy Paper N°7, Institute for Governance of private and public organizations, 2013.

⁹ Alan R. Palmiter, Mutual Fund Voting of Portfolio Shares: Why Not Disclose?, 23 *Cardozo L. Rev.* 1419 (2002).

¹⁰ *Id.*

¹¹ Jayne Elizabeth Zanglein, From Wall Street Walk to Wall Street Talk: The Changing Face of Corporate Governance, 11 *DePaul Bus. L. J.* 43 (1998).

¹² M. Cappucci, *The proxy war against proxy advisors*, 16(3) N.Y.U. J. L. and Bus. 579, 632 (2020).

¹³ John Armour & Priya Lele, Law, Finance, and Politics: The Case of India, 43 *Law & Society Rev.* 491, 496 (2008).

¹⁴ Jayati Sarkar & Subrata Sarkar, Large Shareholder Activism in Corporate Governance in Developing Countries: Evidence from India, 8 (2000), <http://www1.fee.uva.nl/fm/Conference/cifra2000/sarkar.pdf>.

¹⁵ Omkar Goswami, The Tide Rises, Gradually: Corporate Governance in India, OECD Development Centre, Harv. Bus. Rev. on Corp. Governance, Harv. Bus. Sch. Press (2000).

However, most of the shares of public companies, today, are controlled and owned by institutional investors which comprise professional investment managers and asset owners like pensions and endowments.¹⁶ In the United States, this control is as high as 70% of market value on United States stocks.¹⁷ The greater presence of institutional investors contributes in various shades to the corporate governance mechanism and proxy industry as they not only control a larger percentage of one company but also a broader segment of market as well. A 20% share of S&P 500 companies is collectively held by index fund managers giants namely “Vanguard”, “BlackRock”, and “State Street Global Advisors”.¹⁸ Also, these investors are more likely to vote their shares regarding recent corporate discrepancies and scandals, forcing them to have a higher threshold for monitoring and governing these corporations. For instance, the Big Three discussed above control 25% of votes of S&P 500 company given to the fact that not all shareholders vote their shares.¹⁹

Shareholder Activism and Regulation

Shareholder activism is a way that shareholders can influence a corporation's behavior by exercising their rights as owners. These rights include voting on matters at annual meetings, proposing new corporate governance rules, or publicly expressing their views to apply pressure on management.²⁰ These are often the shareholders who have incurred some dissatisfaction with certain aspects of management of the company and wish to bring changes to these aspects without changing the control.²¹ There are various shades of shareholder activism such as participative shareholder activism where the role of shareholder broadens by assuming responsibility by participating in shareholder meetings and exercising votes.²² There is also interactive shareholder activism which confers direct engagement and strategizing for enhancing shareholder value²³ and combative shareholder activism where the shareholder is involved in hostile takeovers and proxy fights for changing the control of management.²⁴ The combative has been prevalent in the United States undertaken by pension funds and hedge funds activists.²⁵

In the United States, regulatory changes over the past several decades have empowered shareholders and have fostered an environment conducive to shareholder activism. The Securities and Exchange Commission (SEC) has enacted rules that make it easier for shareholders to nominate directors to the boards of companies, allowing activist investors a clearer path to influence corporate decision-making. Disclosure requirements have been enhanced to improve corporate transparency, making it easier for shareholders to hold companies accountable.

Although participative shareholder mainly comprises of institutional investors, various countries have come up with soft laws and self-regulation for greater participation of shareholders in decision making.²⁶ In the Indian corporate landscape, there is a significant predominance of controlling shareholders or promoters. These individuals or families often hold a substantial stake in their companies, which allows them to maintain control over the business's decision-making process and strategic direction. This concentration of ownership is commonly observed in both public and private companies across various sectors in India. Various regulatory reforms in the Indian context involve the voting rights such as the appointment of a proxy,²⁷ electronic voting,²⁸ approval of related party transactions,²⁹ director for minority shareholders,³⁰ relief against oppression and mismanagement,³¹ and class actions suit.³² These reforms have given shareholders a stronger voice and more rights, such as the right to participate in major decisions via special resolutions, increased voting rights, and better access to information.

In the United States, such regulatory reforms involve the Securities and Exchange Commission (SEC) rules in the mid-1980s for shareholders to use

¹⁶ *Id.*

¹⁷ Chuck Callan & Paul DeNicola, 2019 Proxy Season Review, *The Harv. L. Sch. Forum on Corp. Governance* (2019).

¹⁸ Lucian A. Bebchuk & Scott Hirst, The Specter of the Giant Three, 99 B.U. L. Rev., 721, 741 (2019).

¹⁹ *Id.*

²⁰ Bernard Black, Shareholder Activism and Corporate Governance in the United States, *The New Palgrave Dictionary of Economics and The Law* (1998).

²¹ Stuart L. Gillan & Laura T. Starks, The Evolution of Shareholder Activism in the United States, 19 J. Applied Corp. Fin., 55, 73 (2007).

²² Umakanth Varottil, The Advent of Shareholder Activism in India, 1(6) *J. On Governance* 582, 639 (2012).

²³ Marcel Kahan & Edward B. Rock, Hedge Funds in Corporate Governance and Corporate Control, 155 *U. Pa. L. Rev.* 1021 (2007); Thomas W. Briggs, Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis, 32 *J. Corp. L.* 681 (2007).

²⁴ Brian R. Cheffins & John Armour, The Past, Present and Future of Shareholder Activism by Hedge Funds 37 *J. Corp. L.* 51 (2011).

²⁵ Stephen J. Choi & Jill E. Fisch, “On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance” 61 *Vanderbilt L. Rev.* 315 (2008); Randall S. Thomas, The Evolving Role of Institutional Investors in Corporate Governance and Corporate Litigation, 61 *Vanderbilt L. Rev.* 299 (2008).

²⁶ Lisa M. Fairfax, Shareholder Democracy on Trial: International Perspective on the Effectiveness of Increased Shareholder Power, 3 *Va. L. & Bus. Rev.* 1 (2008).

²⁷ Companies Act, No. 18 of 2013, § 105 (Ind.).

²⁸ Companies Act, 2013 No. 18 of 2013, § 108 (Ind.).

²⁹ Companies Act, 2013 No. 18 of 2013 § 188 (Ind.).

³⁰ Companies Act, 2013 No. 18 of 2013 § 151 (Ind.).

³¹ Companies Act, 2013 No. 18 of 2013 § 213 (Ind.).

³² Companies Act, 2013 No. 18 of 2013 § 245 (Ind.).

voting to bring corporate changes³³ It allows activist investors a clearer path to influence corporate decision-making. Disclosure requirements have been enhanced to improve corporate transparency, making it easier for shareholders to hold companies accountable. Further, the Dodo-Frank Act, 2010 provides for various other regulations such as the decision on executive compensation, nominating directors, proxy access and changing the corporate bye-laws.³⁴

Diversified Portfolios

With institutional investors holding a more diversified portfolio, this has added further to the mushrooming of the proxy advisory industry.³⁵ This arrives in the backdrop of modern portfolio theory (MPT) which contributed to the mathematical extension for the notion that larger holding in the portfolio with fewer stocks is riskier than holding well-diversified portfolios of more assets³⁶ and thus making the latter more preferable in nature. Modern Portfolio Theory (MPT) is an investment theory developed by Harry Markowitz in 1952. It argues that it's possible to construct an "efficient frontier" of optimal portfolios, offering the maximum possible expected return for a given level of risk. This theory emphasizes the benefits of portfolio diversification. This extension led to institutional investors dramatically increasing their returns by lowering the risk and holding a larger number of diversified issues. This however contributes to the logistical problem of voting on all these issues and the larger number of proxy ballot each investor has to process and vote. For instance, the number of stocks in average mutual funds has marked an increase of about 100% from 54 in 1979 to 126 in 2014.³⁷

Race to Lower Fees

Another trend is lowering of the advisory fees and expenses for tracking and analyzing a greater number of stocks. Although managing more stocks and trades should have added to these costs, however, the opposite has taken place given to the economies of scale captured by these firms.³⁸ Managing a portfolio of 125 stocks is cheaper to manage a portfolio of 100 stocks as a percentage of assets managed.³⁹ Another reason is the inclusion of investment in passive index funds which becomes another derivative of the modern portfolio theory (MPT)⁴⁰ and has forced the managers to put in less talent and creativity, which are two highly compensated skills.⁴¹ With Vanguard being the first to arrive at this approach, many have followed, marking the estimate of more than 80% of all assets divested to index funds from investments funds.⁴² For instance, This shift from active to passive management has forced the managers to do more in less and thus leading to the allocation of lesser resources for non-core functions such as analyzing and researching proxy votes. Active management involves making individual investment decisions with the goal of outperforming a specific benchmark index. On the other hand, passive management involves replicating an index, aiming to match its performance rather than outperform it. The increasing popularity of passive strategies, such as index funds and ETFs, has been driven by their lower fees and comparable, sometimes even better, long-term performance.

All these trends have scoped towards the creation of a market niche for the proxy advisory industry and their use as a gradually attractive option for institutional investors. Even the Big Three supplement their internal proxy research with external research and related support.⁴³ For reducing their expenses, the investment managers have a robust incentive to approach these proxy advisors.⁴⁴ It is therefore pertinent to analyse its birth and development from these perspectives.

History

The origination of Proxy Advisory Firms dates back to the changes brought forward for the inclusion of institutional investors in the decision-making process, for instance, through enactment of the ERISA ("Employee Retirement Income Security Act") in 1974. The act led to establishing duty for voter proxies to vote in a reasonable manner. Due to such regulatory reforms worldwide, the institutional investors began to analyse and monitor the board

³³ Séan Patrick O'Brien, The 1983 Amendments to SEC Rule 14A-8: Upsetting a Precarious Balance, 19 *Valparaiso U. L. Rev.* 221-281 (1984).

³⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified at 15 U.S.C. § 78n-1 (2018)); Holly J. Gregory, Rebecca Grapsas & Claire Holland, "The Latest on Proxy Access" *Harv. L. Sch. Forum on Corp. Governance* (2019).

³⁵ *Supra* note 12.

³⁶ Harry M. Markowitz, "Portfolio Selection" 7 *J. of Fin.* 77-91 (1952).

³⁷ Lubos Pastor, Robert Stambaugh & Lucian A. Taylor, "Fund Tradeoffs" (*Nat'l Bureau of Econ. Rsch. Working Paper 23670*, Nat'l Bureau of Econ. Rsch., Inc. (2017)).

³⁸ *Supra* note 12.

³⁹ *Supra* note 37.

⁴⁰ *Supra* note 36.

⁴¹ *Supra* note 12.

⁴² *Supra* note 23

⁴³ Lucian Bebchuk, Alma Cohen & Scott Hirst, "The Agency Problems of Institutional Investors" 31 *J. of Econ. Perspectives* 89-100 (2017).

⁴⁴ Tamara Belinfanti, "The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control" 14 *Stan. J. of L., Bus. & Fin.* 384-409 (2009). Ctr. on Executive Compensation, "A Call for Change in The Proxy Advisory Industry Status Quo: The Case for Greater Accountability and Oversight" (2011).

composition, shareholder proposals and their implementation and other matters of prime importance due to their fiduciary duties.⁴⁵ However, due to the large number of portfolios that were to be governed, it was difficult to review all necessary information at the same time.⁴⁶

This marked the birth of the first proxy advisory firm, “Institutional Shareholder Services” in the United States in 1985, which was created for “promoting good corporate governance and raising the level of active and informed proxy voting among institutional investors”⁴⁷ and is currently the globe’s largest proxy advisory firm. Further, more such firms like “Glass, Lewis & Co.” entered the corporate landscape.⁴⁸

India saw mushrooming of these firms only in the last decade, with the establishment of “InGovern Research Services” in 2010 marking the birth of its indigenous proxy advisory industry⁴⁹ with the addition of two more firms, namely “Institutional Investor Advisory Services India Limited” and “Stakeholders Empowerment Services” entering the picture in less than half a decade.⁵⁰ These firms are analyzed in detail in the subsequent part.

III. Dramatis Personae

Proxy Advisory Firms have dotted the corporate governance landscape with various firms such as “Institutional Shareholder Services”, “Glass, Lewis & Co.”, “ProxyVote Plus”, “Segal Marco Advisors”, “Egan-Jones Proxy Services” in the United States, “Minerva Analytics”, “PIRC” (United Kingdom) and “Proxinvest” (France) in Europe.⁵¹ However, in the United States, ISS and Glass Lewis rule the proxy advisory industry by a share of 97%.⁵² Similarly in India, “InGovern Research Services”, “Institutional Investor Advisory Services India” and Stakeholders’ Empowerment Service dominate the proxy advisory industry.

A. INDIA

InGovern Research Services (“InGovern”)

This is the first proxy advisory firm that came up in India in June 2010, started by Mr Shriram Subramaniam. Starting with its “Government Radar”, a proprietary framework for analysis of corporate governance structure, it offers various services in the governance landscape such as Corporate Governance Score Cards, Vote Recommendations, Risk Monitoring Services, Corporate Governance Consulting and Education Services.⁵³ It was approached by Broadbridge for a business tie-up which was finalized in 2011, following which the ProxyEdge voting platform was incorporated in the InGovern’s proxy research and voting.⁵⁴ It has also been joined by various notable corporate personnel as angel investors and advisors such as Mohandas Pai and Shankar Jaganathan.⁵⁵

Institutional Investor Advisory Services India (“IiAS”)

Promoted by Amit Singhvi, ex-CEO, Gujarat Ambuja Cements with Amit Tandon, ex-managing director, Fitch Ratings, IiAS is the second proxy advisory firms that started in India in July 2011.⁵⁶ It is the largest among the three in terms of volume of business and has equity participants as “Fitch Group Inc.”, “ICICI Prudential Life Insurance Ltd.”, “Tata Investment Corporation Ltd.” and “HDFC Ltd.”.⁵⁷ In addition to voting advisory, it assists investors with proxy voting, maintains the history of votes case, providing value advisory services and legal assistance to company management and developing governance scorecards.⁵⁸

Stakeholders’ Empowerment Services (“SES”)

Founded in 2012 by J. N. Gupta, a former senior officer at Securities and Exchange Board of India (SEBI) with Arjun Gupta, formerly at “Ernst &

⁴⁵ Michael R. Levin, Proxy Advisors, http://www.theactivistinvestor.com/The_Activist_Investor/Proxy_Advisors.html.

⁴⁶ *Id.*

⁴⁷ ISS History, <http://www.issgovernance.com/about/iss-history/>.

⁴⁸ Company Overview, Glass Lewis, <http://www.glasslewis.com>.

⁴⁹ Priya Garg, “Ripple, If Not the Waves Effect: Analysing the Way(s) in Which Proxy Advisory Firms Can Affect Corporate Governance in India, in the Long Run” 5 Nat’l L. U. Delhi Student L. J. 111 (2018).

⁵⁰ Bhuma Shrivastava, Proxy Advisory Firms Give a Boost to Shareholder Activism, <http://www.livemint.com/companies/heug8spsw3zxe4suyhecqn/proxy-advisory-firms-give-a-b-00st-to-shareholder-activism.html>.

⁵¹ *Supra* note 12.

⁵² James K. Glassman & Hester Peirce, How Proxy Advisory Services Became So Powerful, Mercatus Center Geo. Mason U. (June 18, 2014), <https://www.mercatus.org/research/policy-briefs/how-proxy-advisory-services-became-so-powerful>.

⁵³ *Supra* note 6.

⁵⁴ S. Subramanian, Proxy Advisory Industry In India, Vol. 13, Issue 2, Corp. Ownership & Control, 371, 375 (2016).

⁵⁵ *Supra* note 6.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ IiAS, <http://www.iias.in/>.

Young” and Amarendra Singh, formerly at “Deutsche Bank”, SES has been registered as a non-profit organization and avoids any kind of association with listed companies and denies all possible conflict of interest.⁵⁹ Operating with very few employees,⁶⁰ it analyses the corporate governance practices of various companies and provides voting recommendations on the same. Further, it also administers corporate governance reports as per client requirements on listed companies.⁶¹

B. Unites States

Institutional Shareholder Services (“ISS”)

“Institutional Shareholder Services” founded in 1985, is the largest and most dominant proxy advisory firm around the world and influences the corporate governance industry through coverage of around 40,000 annual meetings in more than 115 countries with around 1,600 institutional clients.⁶² Its client includes the top twenty-five asset managers, top twenty-four mutual funds and seventeen of the world’s largest public pension funds.⁶³ Owned by Genstar Capital, a private equity firm, ISS holds an estimated market share of over 61% of the proxy advisory industry.⁶⁴ It has defended the proxy advisory industry its business model.⁶⁵ Other than the standard proxy advisory, it also advises client on social responsibility initiatives⁶⁶ known as Social Advisory Services and for public funds, boards structure, performance-based awards, corporate social responsibility and other issues with impact of public good, known as Public Fund Advisory Services.⁶⁷ It also offers international proxy voting,⁶⁸ Mergers and Acquisition Analysis Services⁶⁹ and Proxy Voting Services⁷⁰. On a case-to-case basis, it also provides research on various international⁷¹ and social⁷² issues for its clients.

Glass, Lewis & Co. (“Glass Lewis”)

Glass Lewis was launched in 2003, despite being a latecomer to the industry, it has over 1,300 instructional clients, covering proxy matters for 20,000 company meeting each year and representing asset management of \$35 trillion.⁷³ Similar to ISS, Glass Lewis provides research and analysis to institutional investors through various products. It also supplements research on governance, which is subjective and does not incorporate numerical rating.⁷⁴ Except in rare circumstances, it does not provide consulting services.⁷⁵ It also administers and provides previously published research to rated companies for fees.⁷⁶ Glass Lewis also publishes the “Board Accountability Index” (BAI) which involve adjusting the company’s weight estimated through the presence and absence of 5 “critical corporate governance features” through a market-cap weight algorithm to all S&P 500 companies.⁷⁷ These factors involve the staggered boards, poison pills, limitations on shareholder bylaw amendments, merger and acquisitions requirements and golden parachutes which have a very strong and significant statistical relationship with the performance of the stock in the long term.⁷⁸

The functioning of Proxy Advisory Firms in India is regulated under the Securities and Exchange Board of India (Research Analyst) Regulations, 2014. As stated under sub-clause 2(p), proxy adviser means “any person who provides advice, through any means, to institutional investor or shareholder of a

⁵⁹ Interview with J. N. Gupta, Founder and MD, SES, *Business Standard*, January 24, 2013.

⁶⁰ N Sundaresha Subramanian & Indulekha Aravind, Proxy Warriors, *Bus.Standard*, (Mar. 09, 2013), https://www.business-standard.com/article/companies/proxy-warriors-113030800504_1.html

⁶¹ SES, <http://www.sesgovernance.com/>.

⁶² Nadya Malenko & Yao Shen, “The Role of Proxy Advisory Firms: Evidence from a Regression-Discontinuity Design” 29 *Rev. of Fin. Stud.* 3394 (2016).

⁶³ James Cotter, Alan Palmiter & Randall Thomas, “ISS Recommendations and Mutual Fund Voting on Proxy Proposals” 55 *Villanova L. Rev.* 88 (2010).

⁶⁴ James R. Copland, A Report on Corporate Governance and Shareholder Activism, Proxy Monitor, (2014), https://proxymonitor.org/Forms/pmr_09.aspx

⁶⁵ Letter from Gary Retelny, President & Chief Exec. Officer, ISS, to Brent J. Fields, SEC (Mar. 10, 2019) <https://www.issgovernance.com/file/publications/iss-roundtable-comment-letter.pdf>.

⁶⁶ Institutional Shareholder Services, Social Advisory Services, <http://www.issproxy.com/institutional/research/sirsresearch.jsp>.

⁶⁷ Institutional Shareholder Services, Public Fund Advisory Services, <http://www.issproxy.com/institutional/research/publicfund.jsp>.

⁶⁸ Institutional Shareholder Services, International Proxy Advisory Services, <http://www.issproxy.com/institutional/research/globalresearch.jsp>.

⁶⁹ Institutional Shareholder Services, M&A Insight, <http://www.issproxy.com/institutional/research/mainsight.jsp>.

⁷⁰ Institutional Shareholder Services, Custom Proxy Advisory Services, <http://www.issproxy.com/institutional/research/customresearch.jsp>.

⁷¹ Institutional Shareholder Services, US and International Governance Research Services, <http://www.issproxy.com/institutional/research/globalgovernanceresearch.jsp>.

⁷² Institutional Shareholder Services, Social Advisory Services, <http://www.issproxy.com/institutional/research/socialissues.jsp>.

⁷³ Company Overview, Glass, Lewis & Co., <https://www.glasslewis.com/company-overview/>

⁷⁴ Glass, Lewis & Co., In-Depth Analysis of Unrecognized Risks, <http://glasslewis.com/downloads/overviews/yellowcard.pdf>.

⁷⁵ Glass, Lewis & Co. (Glass Lewis), Conflicts of Interest Disclosure, <http://www.glasslewis.com/company/disclosure.php>.

⁷⁶ *Id.*

⁷⁷ Glass, Lewis, & Co., Board Accountability Index, <http://www.glasslewis.com/solutions/bai.php>.

⁷⁸ *Id.*

company, to exercise of their rights in the company including recommendations on public offer or voting recommendation on agenda items.”⁷⁹ All such firms are under compulsion to abide by these regulations. As stated under these regulations, such firms are required to first register themselves with SEBI (Securities and Exchange Board of India) and comply with some threshold provisions like the formation of internal policies and procedures, disclosures about the entities in reports, maintaining record about the voting recommendations etc. According to the latest procedural guidelines brought out following regulation 24(2) read with regulation 23(1) these firms are to abide mandatorily by the code of conduct.⁸⁰ Further, regulation 23⁸¹ read with regulation 19⁸² deals with disclosures to be made by PAF.

The Securities and Exchange Board of India in regulations issued by it to the mutual funds obliges them to provide disclosure regarding general policies and procedure regarding voting rights of the members and how the number of shares held by them affects the same. All these particulars ought to be disclosed in the AMC's annual reports and on their website.⁸³ In addition to this, AMCs are needed to unveil genuine exercise of proxy votes corresponding to specific issues viz. Corporate Governance matters, changes to capital structures, arrangement/evacuation of Directors, ESOP and whatever other issues that may influence the revenue of the investors and premium of unitholders specifically.

Insurance companies were urged to step up and play an important role in the general meeting of investee companies and improve their governance by engaging with managements at a greater level. Thus, in March 2017, Insurance Regulatory and Development Authority had implemented a code for stewardship for the insurer vide.⁸⁴ The stewardship code applicable for all the insurers comprising seven principles modelled on the UK stewardship code.⁸⁵

In November 2018, working groups were formed keeping in mind to review the working of proxy advisory firms and for keeping a tab on their provisional and functional areas.⁸⁶ In addition to recommendation put forward by these working groups, the reports propose to mandate FPIs, Portfolio Managers, AIFs, REITs, InvITs etc. to ascertain if such proxy advisors have appropriate capacity and capability.⁸⁷

The SEBI circular dated August 03, 2020, codified the various business practices of the firms involved in proxy advisory and these firms need to follow these regulations from 1st Sept. 2020 for ensuring compliance with the SEBI circular.⁸⁸ Various aspects of the same include code of conduct for voting suggestion policy, which incorporates conditions of when such proposal will not be given (to be evaluated yearly); communication policy, which is the expressed cycle to speak with customers and friends, and timetable to get remarks from the organization; sharing policy, in order of guarantee sharing of their analysis report with investors and investee simultaneously; and conflict of interest policy, to accommodate strategies to unveil, oversee/moderate any possible irreconcilable situation, including from strife emerging from different business exercises embraced by the proxy adviser.⁸⁹

Further, the disclosure requirements include disclosure of policies of voting recommendation to clients, publication of such sharing policies on its website, explicit mention of the following in the advisory documents, including recommendations issued to the client:

- Methodologies and procedure followed by the proxy adviser in the advancement of the research and relating proposals in regard to a company;
- Lawful prerequisites or better standard (which is past the fundamental legitimate necessity) applied for reaching up at the recommendations, alongside reasoning for the reception of better quality, rather than the use of the prerequisite by law; and
- Statement on the irreconcilable situation, explicitly referencing territories of likely conflict of interest with the relief proposal organized as

⁷⁹ Sec. & Exch. Board of India (Research Analysts) Regulations, 2014, Gazette of India pt. III sec. 4, (Sept. 01, 2014), https://www.sebi.gov.in/sebi_data/commndocs/RESEARCHANALYSTS-regulations_p.pdf

⁸⁰ Sec. & Exch. Board of India, Procedural Guidelines for Proxy Advisors, (Aug. 03, 2020), https://www.sebi.gov.in/legal/circulars/aug-2020/procedural-guidelines-for-proxy-advisors_47250.html.

⁸¹ Securities and Exchange Board of India (Research Analysts) Regulations, 2014, Gazette of India pt. III sec. 4 (Sept. 01, 2014), Regulation 23.

⁸² Securities and Exchange Board of India (Research Analysts) Regulations, 2014, Gazette of India pt. III sec. 4 (Sept. 01, 2014), Regulation 19.

⁸³ Sec. & Exch. Board of India, Master Circular for Mutual Funds, (Sept. 14, 2016), https://www.sebi.gov.in/sebi_data/attachdocs/apr-2018/1523337972677.pdf.

⁸⁴ IRDAI, Guidelines on Stewardship Code for Insurers in India, (Mar. 22, 2017), https://www.irdai.gov.in/ADMINCMS/cms/whatsNew_Layout.aspx?page=Page No3096&flag=1.

⁸⁵ *Id.*

⁸⁶ Sec. & Exch. Board of India, Report of Working Group on Issues Concerning Proxy Advisors-seeking public comments, Jul. 29, 2019, https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxy-advisors-seeking-public-comments_43710.html.

⁸⁷ *Id.*

⁸⁸ Sec. & Exch. Board of India, Procedural Guidelines for Proxy Advisors, (Aug. 03, 2020), https://www.sebi.gov.in/legal/circulars/aug-2020/procedural-guidelines-for-proxy-advisors_47250.html.

⁸⁹ Jayshree P. Upadhyay, SEBI issues disclosure standards for proxy advisory firms, mint (Aug. 03, 2020), <https://www.livemint.com/news/india/sebi-issues-disclosure-standards-for-proxy-advisory-firms-11596457774523.html>.

protection for guaranteeing that there is no contention.⁹⁰

- Material revisions or factual errors in the recommendations, already shared with the client, to be disclosed to the client within 24 hours of the reception of such information.

Further, it mandated the Proxy Advisory Firms to ensure the exactness of data depending on the recommendations provided by the proxy advisory firms regarding a given company by accepting remarks/explanations from the investee and presenting their report, as well as revising the recommendations initially made to clients.⁹¹

The U.S. Securities and Exchange Commission (SEC) has adopted the long-awaited requisite amendments to keep a check on proxy advisory firms addressing the issues related to proxy advisory voting. This has been a never-ending decade long battle that seems to be finally put to bed by the adoption of these amendments.⁹² There has been two major concern which the SEC tried to deal with, *first*, the requisite amount of accountability that is required for statistical accuracy needed in the area of developing and applying the voting standards and *second*, the conflict of interest as not properly managed and disclosed insufficiently.⁹³ The amendments suggested by the SEC included. SEC, included –

- Putting proxy advisory firms under the check of regulations that govern the solicitation of proxy votes.
- Rule 12a-2(b)(3), Securities Exchange Act, 1934 (“Exchange Act”) was suggested to be amended to contain the important provision related to addressing proxy advisory firms.⁹⁴
- Investment Advisers Act of 1940⁹⁵ (the “Advisers Act”) to be amended to require compulsory registering by proxy advisory firms.⁹⁶

The Investment Company Act of 1940 was passed in order to establish and integrate a more stable financial market regulatory framework following the Stock Market Crash of 1929. It is the primary legislation governing investment companies and their investment product offerings.

In 2003, a rule was passed under the Investment Company Act, 1940 by the SEC, which put an obligation on the registered mutual funds to adopt proper policies and procedures to make sure that the best interest of the clients is taken care of when the proxies are voted and voting records are disclosed in public.⁹⁷

Several questions were left unanswered like how much can investment advisers rely on when it comes to the topic of third-party proxy advisors during completing their fiduciary duty? what are the boundaries under which reliance on the third-party proxy is acceptable? what procedures are there to keep in check conflict of interest? These questions were collectively answered in what came to be known as *Egan-Jones and ISS* no-action letters.⁹⁸ These letters provided a solution that institutional investors and asset managers can rely on the recommendation of third party proxy advisers when it comes to discharging their fiduciary duties provided that this was not an outcome of the conflict of interest and the pre-determined policies were followed when the proxies were voted.⁹⁹ Keeping in check what all critics and blames were put up against these after a series of events and legal battles, the commission finalised the adoption of regulations governing proxy voting advice presented through proxy advisory firms on July 22, 2020.¹⁰⁰

An amendment was made to the Exchange act Rule 14(a)-1(l)¹⁰¹ for the codification of the decade-old notion about the definition of solicitation that when a proxy voting advice is sought by a person or entity, that generally constitutes up as “solicitation”. The SEC demonstrates that a proxy voting advice

⁹⁰ Indian Bus. L. J., SEBI prepares guidelines for proxy advisers, L. Asia Dot., (Sept. 10, 2020), <https://law.asia/sebi-guidelines-proxy-advisers/> (.

⁹¹ Rabindra Jhunjhunwala & Saranya Mishra, India: Tightening the Noose on Proxy Advisors (Influencers of India Inc), Mondaq, (Aug. 07, 2020), <https://www.mondaq.com/india/shareholders/973894/tightening-the-noose-on-proxy-advisors-influencers-of-india-inc>.

⁹² U.S. Sec. & Exch. Comm., Exemptions from the Proxy Rules for Proxy Voting Advice, 17 C.F.R. Pt. 240.14a-2 (“Rule 14a-2”) Release No. 34-89372, <https://www.sec.gov/rules/final/2020/34-89372.pdf>

⁹³ U.S. Sec. & Exch. Comm., Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 17 C.F.R. Pt. 271 & 276, Release No. IA-5325, <https://www.sec.gov/rules/interp/2019/ia-5325.pdf>

⁹⁴ Jason Comerford & Andrew MacDougall, SEC finalizes amendments to proxy rules applying to proxy advisory firms, OSLER, (Aug. 20, 2020), <https://www.osler.com/en/resources/governance/2020/sec-finalizes-amendments-to-proxy-rules-applying-to-proxy-advisory-firms>.

⁹⁵ Investment Advisers Act, 1940 (Title 15 of 1940) (United States).

⁹⁶ U.S. Sec. & Exch. Comm., Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, 17 C.F.R. Pt. 240.14a-9 (“Rule 14a-9”), Release No. 34-87457, <https://www.sec.gov/rules/proposed/2019/34-87457.pdf>.

⁹⁷ U.S. Sec. & Exch. Comm., Final Rule: Disclosure of Proxy Voting Policies Voting Records by Registered Management Investment Companies, <https://www.sec.gov/rules/final/33-8188.htm>.

⁹⁸ Sec. & Exch. Comm. Staff Letter to Kent S. Hughes, Egan-Jones Proxy Services (Washington, D.C.: May 27, 2004); and SEC Staff Letter to Mari Anne Pisarri, on behalf of Institutional Shareholder Services (Washington, D.C.: Sept. 15, 2004).

⁹⁹ *Id.*

¹⁰⁰ Release No. 34-62495, Concept Release on the U.S. Proxy System, <https://www.sec.gov/rules/concept/2010/34-62495.pdf>.

¹⁰¹ General Rules and Regulations, Securities Exchange Act, 1934 17 U.S.C C.F.R. §§ 240.14a-1(l)(1).

firm should qualify for depending on the exemption through such data and recording necessities for their proxy voting advice, “yet just to the degree that such exemption is fittingly custom-made to their unique function in the proxy cycle and encourages the transparency, accuracy, and fulfilment of the data accessible to those making voting choices.”¹⁰²

The SEC amended Rule 14a-1(l)(1)(iii)¹⁰³ by adding paragraph A to make a clearer statement that the terms “solicit” and “solicitation” incorporate any proxy voting advice which prepares a recommendation to an investor concerning its approval on a particular issue for which investor assent is requested, and which outfitted using an entity which sells its expertise by providing such advice and recommendations, independently from different types of venture advice and sells such advice for an expense.¹⁰⁴ To the degree a business which gives proxy advisory services is practising delegated voting authority given to them by the clients, such service, for the most part, won't comprise 'proxy voting advice'— and, in this way, not be a 'solicitation'— under Rule 14a-1(l)(1)(iii)(A)¹⁰⁵.¹⁰⁶ Rule 14a-1(l)(2)¹⁰⁷ was also amended by the addition of paragraph (v), which stipulated that the terms “solicit” and “solicitation” in no sense involve any proxy advisory regarding shareholder voting, served by an individual or firm who provides such advice only in reply to an unforced demand.¹⁰⁸

Further, proxy advisory firms must fit the bill for an exemption to try not to hide away from the need for complying with the filing and reporting prerequisites of the government proxy regulations while giving proxy voting advice. Any individual taking part in a proxy advisory and solicitation is commonly dependent upon the filling of data requisites of the government proxy rules except if an exemption applies. In particular, certain exemptions made accessible to a proxy advisory firm are:

- Rule 14a-2(b)(1)¹⁰⁹, that usually relieves solicitations from individuals who don't pursue the power of acting as a proxy for the other shareholders and who don't have any great interest in the ongoing subject area.¹¹⁰
- Rule 14a-2(b)(3)¹¹¹, that relieves proxy voting advice to a person by a financial advisor with whom the proxy advisory firm already has a business association.¹¹²

For addressing the issue of conflict of interest, SEC paid equal weightage to comments that pointed out pros and cons related to disclosure to the presence of conflicts of interest. Amendment to rule 14a-2(b)¹¹³ was made which it is compulsory for the person who provides any proxy voting advice keeping in consideration either rule 14a-2(b)(1) or (b)(3), they were put under the obligation to provide disclosure about as specified in new rule 14a-2(b)(9)(i).¹¹⁴ According to this, there should be a disclosure of:

- All significant information for the transaction, interest or relation of such proxy voting advisory firms is considered as material for understanding the purpose of the proxy voting advice keeping in view that particular transaction, interest, or relation.
- Steps that can be taken or the policies implemented for identifying and addressing, any concerning conflict of interest arising from transaction, or relation.¹¹⁵

Therefore, the proxy advisory industry was put under an obligation to disclose conflicts of interest. Nonetheless, these businesses were given an option to either make the disclosures through any medium including electronic medium to their proxy voting advisory. For electronic medium platforms such as

¹⁰² *Id.*

¹⁰³ General Rules and Regulations, Securities Exchange Act, 1934 17 U.S.C C.F.R. §§ 240.14a-1(l)(1)(iii)

¹⁰⁴ Bank and Corp. L. Rep., ISS Updates Voting Policies for the 2012 Proxy Season, <http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.21546.12.pdf>.

¹⁰⁵ General Rules and Regulations, Securities Exchange Act, 1934 17 U.S.C C.F.R. §§ 240.14a-1(l)(1)(iii)(A)).

¹⁰⁶ Robyn Bew & Richard Fields, Voting Decisions at US Mutual Funds: How Investors Really Use Proxy Advisers, Tapestry Networks, IRRC Inst., June 2012, http://www.irrcinstitute.org/pdf/Voting_Decisions_at%20US_Mutual_Funds.pdf.

¹⁰⁷ General Rules and Regulations, Securities Exchange Act, 1934 17 U.S.C C.F.R. §§ 240.14a-(1)(2).

¹⁰⁸ Kelly Simoneaux, Hope Spencer & Carley Tatman, SEC Adopts Rules to Regulate Proxy Advisory Firms, Vol. XIII, No. 143, Nat'l. L. Rev., (May 23, 2023), <https://www.natlawreview.com/article/sec-adopts-rules-to-regulate-proxy-advisory-firms>.

¹⁰⁹ General Rules and Regulations, Securities Exchange Act, 1934 17 U.S.C C.F.R. §§ 240. 240.14a-2(b)(1)

¹¹⁰ *Id.*

¹¹¹ General Rules and Regulations, Securities Exchange Act, 1934 17 U.S.C §§ 240.14a-2(b)(3) (United States).

¹¹² SEC Tightens Regulations on Proxy Advisory Firms, *available at*: <https://corpgov.law.harvard.edu/2020/08/18/sec-tightens-regulations-on-proxy-advisory-firms/> (last visited on November 24, 2020).

¹¹³ General Rules and Regulations, Securities Exchange Act, 1934 17 U.S.C C.F.R. §§ 240.14a-2(b)

¹¹⁴ General Rules and Regulations, Securities Exchange Act, 1934 17 U.S.C C.F.R. §§ 240.14a-2(b)(9)(i); Priya Cherian Huskins, Esq., Aug. 19, 2020, SEC Final Rule: Regulating Proxy Advisory Services, <https://woodrufflaw.com/do-notebook/sec-final-rule-regulating-proxy-advisory-services/>

¹¹⁵ Gaffen, David. Proxy Issues, The Wall Street Journal Blogs, May 21, 2007, *available at*: <http://blogs.wsj.com/marketbeat/2007/05/21/proxy-issues/> (last visited on November 23, 2020).

voting platforms for clients can be used which allows the firms to separate the data so that the access as is necessary and intended to be given to each person can be limited based exclusively on the client.¹¹⁶

For supplement guidance, as according to this latest amendments, suitable steps should be taken by the investment advisers to make sure that they take into consideration responses of the issuer about the proxy advisory firm's voting to such a degree that when served with advance notice, it would highly be expected out of it that it will affect the adviser's voting determination.¹¹⁷ Also, a recommendation was put forward by the SEC, under which advisers were expected to disclose the use of extent of their automated voting features of a proxy advisory firm, to which extent they are put in use and what policies are there to have a strong grip on this feature.

Proxy advice business need not ensure compliance with amendments to rule 14a-2(b)(9) until 1st December 2021. This extended period is inapplicable to amendments to rule 14a-1(l) and Rule 14a-9¹¹⁸ as they will become effective 60 days post they are published in the Federal register.¹¹⁹

International Regulatory Organizations

In recent years, international regulatory organization such as "Canadian Securities Administrator" and "European Securities and Markets Authority" have taken several actions for promoting the increased engagement of proxy advisory firms in the market and inclusion of transparency in their work.¹²⁰ These institutions have previously prepared reviews of the proxy advisory industry and have argued for non-intervention of regulatory norms evidencing the lack of market failure in their interaction with institutional investors and corporations.

The 2013 report of European Securities and Markets Authority put out recommendations for creating an industry code of conduct¹²¹ after which a group of proxy advisory firms including the market holders, "ISS" and "Glass Lewis", came up with a set of best practices principles which disclosed, *first*, their general voting policies and research methodology and *second*, policies for communicating with the corporate management, shareholders and other stakeholders such as media and public.¹²² A follow-up report by European Securities and Markets Authority concluded that this establishment of best practices principles has let to a positive impact on the market.¹²³ Similarly, the Canadian Securities Administrators has also come up with a policy for promoting transparency in the process, developing guidelines for proxy voting and fostering synergy amongst market stakeholders regarding the proxy advisory industry.¹²⁴

IV. Emerging Issues with Proxy Advisory

Although the proxy advisory firms have blossomed in the last few decades, they have encountered several grievances from all quarters, and especially the corporate lobbyists. The most common issues include, *first*, that the proxy advisory firms have a large influence; *second*, that proxy advisory firms are inaccurate in their research; *third*, that proxy advisory firms lack the required transparency; and *fourth*, those proxy advisors have a considerable conflict of interest in their functioning.¹²⁵ These are further discussed as below:

Heavy Influence

With the rise in institutional investors, the demand for proxy advisory services has also grown and so has its influence in corporate decisions and voting.

¹¹⁶ ISS FAQs Regarding Recent Guidance from the U.S. Securities and Exchange Commission Regarding Proxy Voting Responsibilities of Investment Advisers (Oct. 17, 2019) ("ISS FAQs"), available at: https://www.issgovernance.com/file/faq/ISS_Guidance_FAQ_Document.pdf. (last visited on November 24, 2020).

¹¹⁷ Release No. IA-5547, Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers (Jul. 22, 2020), available at: <https://www.sec.gov/rules/policy/2020/ia-5547.pdf>. (last visited on November 24, 2020).

¹¹⁸ Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, (effected Sept. 10, 2019) 17 C.F.R.pt. 241.).

¹¹⁹ SEC Adopts 2019 Proxy Voting Amendments, Minus the Bite, Aug. 4, 2020 <https://www.velaw.com/insights/sec-adopts-2019-proxy-voting-amendments-minus-the-bite/>.

¹²⁰ Rep. to the Chairman, Subcomm. on Econ. Pol'y, Comm. on Banking, Hous., and Urb. Affairs, U.S. S., Proxy Advisory Firms' Role in Voting and Corp. Gover. Practices, S. Rep. No. at 17- 47, (Nov. 2016). <https://www.gao.gov/assets/690/681050.pdf>.

¹²¹ ESMA, Final Rep. 84, (Feb. 19, 2013). <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-84.pdf>.

¹²² Best Practice Principles for Shareholder Voting Research, (2022): <https://bppgrp.info/>.

¹²³ Eur. Sec. and Mkt. Authority, Follow-up on the Development of the Best Practice Principles for Providers of Shareholder Voting Research and Analysis (Paris, France, December 2015).

¹²⁴ Canadian Securities Administrators, Guidance for Proxy Advisory Firms, National Policy 25-201 (Montreal, Canada, April 30, 2015), https://www.osc.ca/sites/default/files/pdfs/irps/csa_20150430_25-201-proxy-advisory.pdf.

¹²⁵ *Supra* note 12.

This influence has been referred to as unaccountable and problematic for corporate governance functioning.¹²⁶ Unaccountable influence can significantly hinder the effectiveness of corporate governance. It can undermine key principles like fairness, accountability, and transparency by enabling opaque decision-making processes. Such influence often serves personal or business interests, potentially leading to decisions that are not in the company's or shareholders' best interests. A lack of oversight can allow financial mismanagement and unethical behavior to go unchecked, thereby subverting shareholder rights, especially those of minority shareholders. Further, this argument is guided by strong evidence as 70% of the market shares in United States corporations are controlled by institutional investors¹²⁷ and the two proxy advisory giants, "ISS" and "Glass Lewis" holding 97% of the market of proxy advisory services to institutional investors.¹²⁸ This strong control by proxy advisors has further contributed to the practice of robot voting, where institutional investors automatically vote their shares in line with the recommendations of proxy advisory firms, without necessarily conducting their own analysis or considering the specific circumstances of each individual vote. This adds to the power of tremendous sway in corporate boardrooms.

Inaccuracy

Although, influence is not necessarily bad in nature and heavy influence might also lead to better governance practices, however, the critics have strongly argued that the research produced and recommended by these proxy advisory firms are often inaccurate, leading to poor recommendations and misinformed votes.¹²⁹ Given the substantial amount of data to be analyzed and the resource limitations these firms face, they often involve seasonal employees and offshore contractors. This approach, however, can contribute to higher error rates.¹³⁰ Further given the similar time frame for holding all annual meetings, these advisors have only a few weeks at hand for processing and analyzing the majority of all voting recommendations each year. As reported by COEC's (cost of equity capital) survey of corporate officers, 53% of reports were made for proxy advisors making one or more errors in their final recommendation reports.¹³¹

Non-transparency

Other than inaccuracy, corporate lobbyists also criticized the opacity of methodologies adopted by the proxy advisory industry for the determination of their voting recommendations.¹³² Non-transparency in corporate governance can have serious implications for accountability and potentially hide conflicts of interest. Transparency is a cornerstone of accountability, as it enables stakeholders, including shareholders, to understand and assess a company's actions, performance, and decision-making processes. When transparency is lacking, it hinders the ability of stakeholders to scrutinize and hold those in power accountable, which may lead to unchecked authority and possible misuse of resources. Additionally, a lack of transparency can conceal conflicts of interest. This argument presented has two dimensions, *first*, the "case-by-case" approach followed by the proxy advisory industry that adds to inconsistent recommendations and *second*, the "one-size-fits-all" approach where these firms fail to identify considerable differences between companies.¹³³ This is problematic especially in the case of executive compensation which has been criticized as delusional and destroying the value of "say-on-pay" assessment.¹³⁴ This non-transparency criticism also leads to the weakening of accountability of such firms and raises concerns about undisclosed conflict of interest.

Conflicts of interest

Corporate lobbyists have severely accused proxy advisory firms of being compromised due to conflicts of interest by focusing on favouritism and self-dealing.¹³⁵ "Self-dealing" is a term used to describe situations where individuals or entities in a position of trust or responsibility use that position to further their own interests, often at the expense of the parties they are supposed to represent or serve. For example, a director of a company engaging in transactions with the company that are more beneficial to the director than to the company could be considered self-dealing. This practice is generally frowned upon, as it can lead to conflicts of interest and undermine the trust that shareholders and other stakeholders place in these individuals or entities.

Although, proxy advisors hold a fiduciary duty to not substitute their personal preferences the temptation for enhancing its reputation at the expense of the interests of its clients are too high.¹³⁶ Further, ideological bias is discoverable in issues relating to the environment, social and governance (ESG) with

¹²⁶ *Supra* note 44.

¹²⁷ Chuck Callan & Paul DeNicola, "Proxy Season Review" *Harvard Law School Forum on Corporate Governance* (2019).

¹²⁸ Timothy M. Doyle, "The Realities of Robo-Voting" *Harvard Law School Forum on Corporate Governance* (2018).

¹²⁹ *Supra* note 12.

¹³⁰ *Supra* note 45.

¹³¹ *Id.*

¹³² *Supra* note 12.

¹³³ *Supra* note 45.

¹³⁴ *Supra* note 8.

¹³⁵ *Supra* note 12.

¹³⁶ George W. Dent, Jr., "A Defense of Proxy Advisors" 8 *Michigan State Law Review* 1289 (2014).

evidencing from ISS being more inclined towards proposals of labour unions.¹³⁷ Another issue is offering corporate governance consultation to corporate management while at the same time advising their shareholders on voting recommendations. This is the high mark of conflict of interest with research supporting the bias of proxy advisory firms towards the corporations who use its consulting services.¹³⁸ This puts to question the independence of recommendations presented by the proxy advisors.

V. Implications and Way Forward

In light of these issues, various implications can be put forth for addressing and inculcating the independence and efficiency of the proxy advisory industry and securing the best practices in the corporate governance landscape. By identifying both the practical implications to the above-stated issues argued by corporate lobbyists and policy implications to the regulatory oversight governed by SEBI (India) and SEC (United States), the creation of a herd-like shareholder voting with proxy advisors being the shepherds can be discarded.

Practical Implications

Various practical implications can be identified for empowering institutional investors in the proxy advisory industry. Following prominent solutions can be implemented in this regard:¹³⁹

- Mandatory registration for all proxy as investment advisor while establishing their fiduciary duties.
- Requirement for mandatory issuer research comment and review.¹⁴⁰
- Incorporating regulations for credit rating agencies to proxy advisory industry.
- Modelling Public Accounting Oversight Boards for over-viewing the industry and the voting structure of institutional investors.
- Increasing disclosure requirements for research methodology used by these proxy advisors for drafting ratings or recommendation and further policies for disclosure of easement and interaction with its client base.¹⁴¹
- Setting up a new self-regulatory firm for the industry, with its mandatory rulebook and code of conduct.¹⁴²

While introducing regulations can lead to enhanced outcomes in the industry, it's crucial to monitor for over-regulation, as it may have negative consequences and potentially exacerbate distress.¹⁴³

Policy Implications

In India, although SEBI has come out with a comprehensive procedural guideline,¹⁴⁴ a few loose ends that remain to be dealt with are whether proxy advisory firms can charge fees from the organization by putting forth the recommendations to the company along with time limit for giving additions to its report with modified or underscored proposal if the proposal isn't changed or there is no real blunder. Different things that may get petulant in resolving grievances could be the better quality standard wise for recommending and reasoning.

Another point that grabs the eyeball is that the SEBI Circular disclosure requirement is the same as that of amendment to rules for Proxy Voting Advisory firms adopted by the US Securities and Exchange Commission on 22 July 2020¹⁴⁵, which mainly deals with the conflict of interest with well-written policies and procedures.¹⁴⁶ The conflict is that the dissemination to the client and at the same time¹⁴⁷, companies also have access to the advice given by

¹³⁷ Tao Li, "Outsourcing Corporate Governance: Conflicts of Interest Within the Proxy Advisory Industry" 64 *Management Science* 2951-2962 (2018).

¹³⁸ *Id.*

¹³⁹ *Supra* note 12.

¹⁴⁰ Charles Nathan, "Proxy Advisory Business: Apotheosis or Apogee?" *Harvard Law School Forum on Corporate Governance* (2011).

¹⁴¹ Brian Croce, SEC commissioner takes agency lead on proxy-voting efforts, Pensions and Investments, (Mar.19, 2019), <https://www.pionline.com/article/20190319/ONLINE/190319842/sec-commissioner-takes-agency-lead-on-proxy-voting-efforts>).

¹⁴² Meagan Thompson-Mann, *Voting Integrity: Practice for Investors and the Global Proxy Advisory Industry*, Colum. L. Sch. Policy Briefing No. 3, Millstein Ctr. for Corp. Governance and Performance, 2009.

¹⁴³ Comm'n Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Exchange Act Release No. 86,721, 84 Fed. Reg. 47,416 (Sept. 10, 2019).

¹⁴⁴ Chamber of Com. Of the U.S., Public Company Initiatives in Response to the SEC Staff's Guidance on Proxy Advisory Firms, available at: (Nov. 20, 2020), https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/021874_ProxyAdvisory_final-1.pdf

¹⁴⁵ US. Sec. and Exch. Comm'n, SEC Adopts Rule Amendments to Provide Investors Using Proxy Voting Advice More Transparent, Accurate and Complete Information, (July 22, 2020), <https://www.sec.gov/news/press-release/2020-161>

¹⁴⁶ General Rules and Regulations, Securities Exchange Act, 1934 17 U.S.C C.F.R §§ 240.14a-2(b)(9)(i)

¹⁴⁷ General Rules and Regulations, Securities Exchange Act, 1934 17 U.S.C C.F.R §§ 240.14a-2(b)(9)(ii)(A)).

these advisors which influence both client and companies in their decision making.¹⁴⁸

Huge hopes are pinned on these proxy advisers as they are projected to be the major stakeholders of this modern and effective shareholder democracy, and in this light, the data and information sources given by such firms to the investors must be bona fide and inculcate impartiality and reliability. The circulars issued by SEBI end up being a milestone for setting up a mark for transparency, reliability, and independence that is expected out of these proxy advisory firms to discharge their duties and responsibilities which being fiduciary in its nature.

Similarly, in the United States, the recommendation put forward by the SEC magnifies the positive steps taken in the right path by inculcating more rationality and transparency to the present system governing proxy voting advisory. Now the hot question that is to be answered is whether proxy advisors shall be able to capture the opportunity for improving and inculcating transparency and adequacy in their business tasks so that the interest of these shareholders are served properly as that is the main objective. Public organizations in this manner have a major and significant task to carry out to accomplish a more desirable working system of proxy voting advice. Therefore, high hopes should be pinned that these corporate governance houses will be able to use these amendments as a valuable scale for realising the potential of the SEC staff guidance.¹⁴⁹

VI. Conclusion

The present regulatory oversight in the proxy advisory industry, is without a doubt, not the last, given the changes in a long-running fight between corporate executives and investor activists. It is the current state of a deliberate, long-term exertion by corporate interests to persuade people who control the functioning to reign in the effect of proxy advisors who contribute to the efficient governance process.

Taking the above research into deeper analysis, the idea behind such a vast expansion of proxy advisor firms and increase in regulations for proxy access is not only about levelling the playing field or by getting the maximum value of shareholders but is also based on the notion of reducing or diminishing the unwanted influence of the controlling shareholders on corporate decision making. The main strength for institutional investors in this battle between shareholders and corporate managers. The disagreement with the voting value of shareholders shows the presence of proxy advisors. Shareholder voting is an effective manner for holding these managers accountable for mismanagement and oppressive approaches. One share, one vote, is the idea on which this widely accepted and supported the argument is based.¹⁵⁰ However, voting rights are only effective if voters can vote independently. Thus, the presence of proxy advisors is as important as the presence of equitability and independence in their approach while upholding the best interests of institutional investors. With these goals turning into reality, the road towards greater corporate governance and accountability can be cemented with ease.

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