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PROXY ADVISORY REGULATORY REGIME UPDATE: DECODING THE LATEST SEBI CIRCULAR

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In the past we have discussed at length the role played by proxy advisors and the regulatory framework set up by the Securities and Exchange Board of India which can be found [here](#). This update discusses the latest SEBI Circular dated 31 December 2020, which amends the SEBI Circular titled 'Procedural Guidelines for Proxy Advisors' dated 3 August 2020.

Proxy advisors ("PAs") are often monikered 'influencers of India Inc', and rightly so as they stand in a fiduciary relation to shareholders (majorly institutional investors) and provide voting recommendations, based on which the shareholders exercise their share denominated voting power in respect of the company in which the shares are held. The voting, whether for or against the resolution, goes a long way for the company, as it dictates not only its corporate decisions but also impacts its corporate governance, which eventually determines its valuation and commercial future. Needless to say, a lapse in judgement in voting could adversely affect and change the course of the company for decades to come.

Acknowledging these factors, the Securities and Exchange Board of India ("SEBI"), as a proactive market regulator had recognised PAs as intermediaries and attempted to regulate them through SEBI (Research Analysts) Regulations 2014. It later instituted a regulatory regime by way of circulars dated 3 August 2020 being 'Procedural Guidelines for Proxy Advisors' ("Procedural Guidelines") and dated 4 August 2020 being 'Grievance Resolution between listed entities and proxy advisors' (collectively referred to as "SEBI Circulars"). The effective date of the SEBI Circulars initially was 1 September 2020 but was deferred to 1 January 2021 based on representations made by PAs and taking into consideration impact of the COVID-19 pandemic.

On 31 December 2020, SEBI released a new circular ("Amending Circular") deferring the effective date for the following compliance requirements under the Procedural Guidelines to 1 February 2021:

- a. Action in case of material revision or identification of factual error; and
- b. Publication of sharing policy on the website relating to simultaneous sharing of report with shareholder and company, receiving inputs/ clarifications from company and PA issuing addendums/ revisions, if any.

Barring these two compliances, the SEBI Circulars have come into force with effect from 1 January 2021.

The Amending Circular also amends the Procedural Guidelines in respect of actions to be taken by a PA in case of material revision or identification of the factual error. The said amendments are two-fold, and detailed as follows:

- a. Introduction of a timeline for 'communication' of material revision or factual error (being within 72 hours) as opposed to simply 'alerting' the shareholder of such revision or error within 24 hours; and
- b. Additional responsibility on the PA to ensure that there is 'adequate time' for the shareholder (referred to as client in the Amending Circular) to make an 'informed decision'.

In respect of the introduction of a timeline to 'communicate', SEBI has pedantically attempted to create a distinction between the words 'communicate' and 'alert', which is interesting not only from a legal perspective but also from an English semantics point of view. It is probably the first time such distinction is sought to be made, let alone by a regulator. And it opens up a Pandora's box, questioning the real difference between the two in law, especially when neither are defined in recognised legal dictionaries nor judicial precedents. It also brings related questions to the fore like - evidentiary aspect aside, can alerting be a mere oral exchange of words/ warning to the shareholder given by the PA? Does communication necessarily mean issuing a new final report or addendum?

Based on the phrasing, one may take a view that 'alerting' is merely apprising the shareholder of the existence of the factual error or need for material revision, while 'communication' entails pointing out to the parts in the recommendation report where such factual error has been identified or material revision is required to be made and issue a revised report. In this sense, it also reflects attention to detail on the part of SEBI and recognition of practical hindrances that the PA may face in carrying out material revisions or correcting factual errors, and thus provides them an additional window of 48 hours to address it in a nuanced and comprehensive manner rather than providing an awry knee jerk reaction, which may be incomplete or not entirely correct in the rush to meet the erstwhile 24 hour deadline for merely 'alerting'.

In respect of the additional responsibility of the PA, it must be noted that the qualifications of 'adequate time' and 'informed decision' on part of the shareholder increase the regulatory compliance burden of the PA.

- In a practical setup, where PA is already delivering on crunched deadlines, there might be little to no time for providing 'adequate time' and scope for 'informed decision'. There is a likelihood that PA may not be able to provide 'adequate time' despite delivering on revisions and thus may be open to regulatory action if the circular is to be read strictly.
- Additionally, the qualifier 'adequate' is vague and akin to standards of reasonableness in constitutional law, which is something that experts are still grappling with. Thus, given no standard yardstick, PAs may find themselves in a sticky place to prove that adequate time was provided as a matter of compliance.
- Lastly, there is inadequate guidance on how a shareholder is expected to arrive at an 'informed decision', even more so for the PA to showcase that the shareholder did so, since the onus is on the PA under the Amending Circular. In

this regard, considering the fact that not every shareholder would be open to sharing their internal processes for decision making with the PA, the PA could consider developing and sharing a suggested SOP for fast track decision making, along with the revised report, for the shareholder, to follow with flexibility, for making the final voting decision. The SOP reflects the diligence and intention to abide by the SEBI Circulars on part of the PA, without being intrusive on shareholder affairs.

Through SEBI, India is one of the few jurisdictions that effectively regulates PAs, and thus is at the forefront of setting a global regulatory precedent, almost at par with the United States. However, time shall be the true test of how effective it proves to be.

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