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Stewardship Code for India – IRDA intensifies the agenda

IRDA's announcement¹ earlier this week of a mandatory stewardship code for insurers will further strengthen markets. Insurance companies, one of the largest market participants, will be compelled to vote on shareholder resolutions and engage with companies to address governance issues. This will intensify the current corporate governance debate in India.

The Insurance Regulatory and Development Authority of India (IRDA) is the first of the regulators to implement a stewardship code in India. An agenda that SEBI began, requiring mutual funds to vote on shareholder resolutions, has morphed into a larger and more structured agenda of engagement with investee companies for the insurance sector. As a part of the code, insurers will not only be required to vote on shareholder resolutions, but also engage with companies to address specific issues.

Box 1: Defining a stewardship code

Hermes, an institutional investor, has defined stewardship code as “a set of principles or guidelines aimed primarily at institutional investors, who hold shares, and thus, voting rights in companies. Implying that it is part of the fiduciary duty of investors to behave as good owners of companies, stewardship codes require investors to monitor and, where necessary, engage with companies on material matters, including environmental, social, governance, strategy, performance and risk issues and to vote their shares at company AGMs and EGMs”.

A stewardship code has three principal elements:

1. Voting on shareholder resolutions

Insurers have been inconsistent in voting on shareholder resolutions. While some insurers are proactive and have been voting, others have waited for a regulatory push. As a part of the stewardship code, insurers will now have to disclose how they have voted on shareholder resolutions, along with the rationale for the vote – in a format defined by IRDA.

2. Engagement

An engagement mechanism is less tangible than voting on shareholder resolutions. It entails periodically speaking to or meeting management of investee companies to address issues, which may be related to (and not limited to) environmental, social and governance (ESG), remuneration, strategy, and performance.

The outcomes of these discussions are not easily quantifiable, and therefore, the success of these efforts may be less measurable. However, engagement efforts have yielded results in the past. Investors have collaborated and provided critical push-back to companies in India, though at times the companies views prevailed: in recent times, to Maruti Suzuki India Limited (on Suzuki setting up the Gujarat plant), Siemens Limited (on the sale of the metals technologies business), and Max

¹ https://www.irdai.gov.in/ADMINCMS/cms/frmGuidelines_Layout.aspx?page=PageNo3096

Financial Services Limited (on the non-compete fees being paid to promoters).

3. Disclosures

SEBI has compelled mutual funds to vote on shareholder resolutions since 2010. SEBI did this by steadfastly increasing the disclosure requirements – from having a voting policy, to ensuring that mutual funds disclose how they voted, to disclosing the rationale for their votes. SEBI has been successful in its efforts: mutual funds’ abstention from voting on shareholder resolutions is down to 10% in 2016² from earlier levels of over 80%. Disclosures on voting and engagement is the cornerstone on which Stewardships rests. Since it compels fund managers to disclose their voting and engagement, it shines a spotlight on these decisions.

IRDA has listed out a set of principles (Box 2 below), and asked insurers to craft a stewardship code that best suits their investment philosophy. This allows insurers room to think about how they wish to engage with investor companies, and which issues they will address. It may well be that an insurer may decide to engage only on specific transactions and not engage on operational issues. Having said so, that insurers will be compelled to think about every issue and make this decision will itself ensure that they will be more active than they were before. But, the power of the stewardship code lies in its encouragement of collaboration with other investors. This will help insurers punch above their weight.

Box 2: IRDA’s Principles of Stewardship Code

All insurers are required to formulate a stewardship code under the following principles:

1. Formulate a policy on the discharge of stewardship responsibilities and publicly disclose it
2. Have a policy on managing conflicts of interest in relation to stewardship and disclose it publicly
3. Monitor investee companies
4. Establish clear guidelines on when and how insurers will escalate their stewardship activities
5. Be willing to act collectively or collaborate with other investors where appropriate
6. Have a clear policy on voting and disclosure of voting activity
7. Report periodically on stewardship and voting activities

Global trends

Stewardship Codes have been implemented by several countries (Table 1 below): in about half of these, the code has been implemented by a regulatory or a quasi-regulatory body and in the remaining half investor or industry associations have jointly decided to sign on the code. The more recent adopters have been Asian countries, and therefore, it is inevitable that India also have its own stewardship code. Although all country codes have the same seven principles, they vary a bit in their detail.

Table 1: Countries that have implemented a stewardship code

Countries	Name of the code	Body	Nature of Body
United Kingdom	The UK Stewardship code	Financial Reporting Council	Quasi Regulator
Canada	Principles for Governance Monitoring, Voting and Shareholder Engagement	The Canadian Coalition for Good Governance	Industry Body/Association
Japan	Principles for Responsible Institutional Investors	Financial Services Agency	Quasi Regulator
Italy	Italian Stewardship Principles	Assogestioni	Industry Body/Association

² Source: www.iiasadrian.com

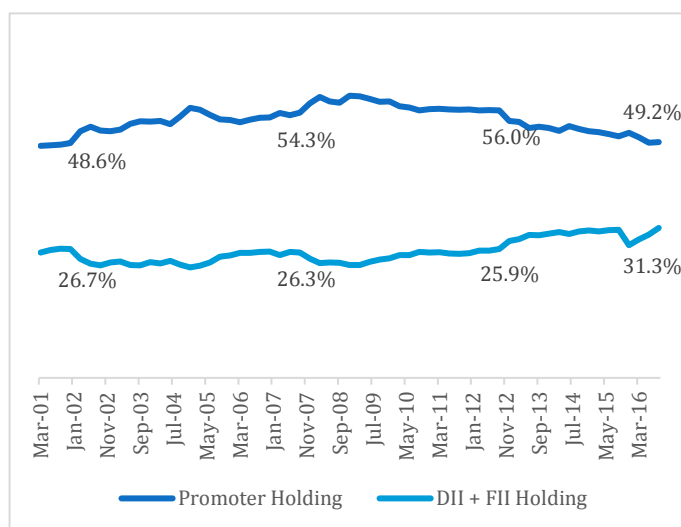
Hong Kong	Principles of Responsible Ownership	Securities and Futures Commission	Quasi Regulator
Malaysia	Malaysian Stewardship Code	Securities Commission, Malaysia	Quasi Regulator
The Netherlands	Best Practices for Engaged Share-Ownership	Eumedion	Industry Body/Association
South Africa	Code for Responsible Investing in South Africa	Institute of Directors South Africa	Industry Body/Association
Switzerland	Guidelines for Institutional Investors governing the exercise of participation rights in Public Limited companies	Ethos, Swiss Foundation for Sustainable Development	Industry Body/Association
Taiwan	Stewardship Principles for Institutional Investors	Financial Supervisory Committee	Quasi Regulator

Brazil, Kenya, Korea, Singapore and Thailand are in the process of implementing their respective stewardship codes

Beyond the peer pressures of other countries, there are two major changes that have resulted in an increased environment for investor engagement:

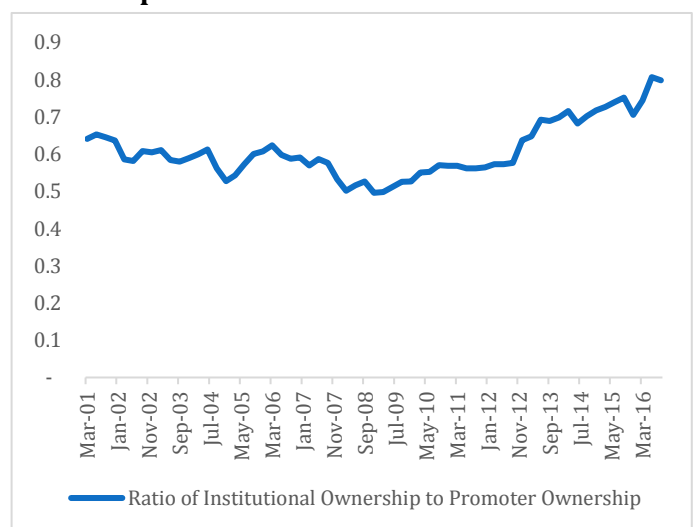
- At a broader market level, the institutional holding in companies has crossed a 30% threshold – empirical evidence suggests that this is the ‘active engagement threshold’ (Chart 1 and Chart 2 below). With the increasing institutional ownership, the ‘Wall Street Walk’ becomes that much more difficult, leaving institutional investor better placed in engaging with company managements rather than simply exiting the stock.
- The recent regulatory environment³ has empowered investors to a point that companies will listen. And investors have begun to wield their power: IiAS’ data on shareholder resolutions shows that 48 resolutions have been defeated over just the past 30 months. While this may be extremely low as a percentage of the resolutions that are passed, the defeated ones have left a lasting impression on boards and they are likely to be careful about what they take to shareholders. Recent market push-back on some of the large transactions have also made corporate India wary of taking investors for granted.

Chart 1: Ownership Pattern of Indian equities



Source: ACE, Bloomberg

Chart 2: Increasing proportion of institutional ownership



Source: ACE, Bloomberg

³ Driven largely by the Companies Act 2013 and the SEBI (Listing Obligations and Disclosure Requirements) 2015

What next?

While IRDA has taken a leap on behalf of the insurance sector, other regulators are working on a Stewardship code too. It is important to bear in mind that there is nothing like a sector-specific “Stewardship code.” The code is common for all investors. Now that the ball is set rolling, regulators in the financial sector need to quickly coalesce their thinking into one uniform code. The market needs an Indian Stewardship Code. This alone will empower shareholders to act collectively and give them the voting power to take to task recalcitrant boards.

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