

Participation of Mutual Funds in Corporate Governance - Reality Check

In the recent past, a large number of retail investors have participated in the securities markets through the mutual fund route. As investors have placed their faith on the mutual funds, it is a reasonable expectation that mutual funds, as stewards, shoulder greater responsibility in ensuring long term sustainability of investee companies. This can be accomplished through a constructive engagement and participation with the investee companies. Voting effectively is one of the vital instruments available with the mutual funds to achieve this objective. The present Article throws light on how mutual funds had exercised their vote on the resolutions brought forward by the investee companies during the last seven years.



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INTRODUCTION

An investor invests money in the equity of a company with the belief that its management will run the company in the interests of all the shareholders. The responsibility of guiding the management in achieving long term goals of the corporation is entrusted with its Board of Directors. The corporate governance framework in India and elsewhere stipulate that publicly listed companies shall seek the approval of shareholders on crucial matters. The Companies Act has a provision to list out items on which shareholder approval is to be taken either in a meeting or through postal ballot. On observing that investors, both institutional and retail, often opt to vote with feet (sell away their holdings) rather than engaging with issuers as well as exercising their power to vote and influence company decisions, the Companies Act now has made it mandatory for companies to offer electronic voting facility which enables household and institutional shareholders to exercise their voting rights at their convenience.

Owners of a company can be categorised into promoters (founders or controlling shareholders), institutional shareholders and household (retail shareholders). While household shareholders may be justified in focusing on short term goals (financial performance), the role of controlling shareholders and institutional shareholders in the governance

of the company should ideally be focussed on 'sustainable performance' rather than just wealth maximisation.

In the dynamic business world, companies need to be agile and respond to changing business circumstances with appropriate strategic response. Company Board and management design and execute such strategic responses. Strategic response may involve wide ranging corporate actions which require shareholder approval. The strategic responses may add or destroy value of the company. The strategic response should be calibrated and should not get contaminated with intentions to benefit only the controlling shareholders. While household shareholders may not be able to appreciate and participate in such corporate decision making process in an organised fashion, institutional shareholders are duty bound to partake in such corporate actions. Institutional shareholders have the benefit of being managed by professional managers and representative of public interest; being non-responsive or indifferent to the corporate proposals can be construed as dereliction of their duty.

The mechanisms like 'well diversified board composition', 'institution of independent directors', 'statutory and internal audits', 'secretarial audits', 'defined role of KMPs' etc., are various checks and balances put in place to enhance the corporate governance standards. However, the active participation of institutional investors will be more powerful than all of these elements since their active participation can qualitatively impact the corporate decision-making process. With their active participation, they can propose new resolutions or reject the resolutions proposed by the management. The fear that institutional shareholders may oppose resolutions will make management and Board of Directors of companies to 'think twice' before proposing any resolutions.

REGULATORY INITIATIVES

Regulators across the globe have witnessed muted response of institutional shareholders' though they have the potential to change the course of corporate decisions. Resultantly, regulators prescribed a code whereby institutional shareholders have to necessarily shoulder the responsibility as a steward. This code is now popularly known as 'Stewardship Code'.

Mutual funds hold substantial stake in almost all listed companies in India. The Asset Under Management (AUM) of Mutual Funds has grown exponentially, which is around 14% of total market capitalization as on December 31, 2021. The total number of accounts or folios as on December 31, 2021

*The views expressed are personal views of the author

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stood at 12 crores, wherein the maximum investment is from retail segment - stood at about 9.74 crores.

As such, the Mutual Funds are not mere pooled investment vehicles but “pillars of trust” of millions of investors. The trust has two dimensions – one that their investment is protected and that MFs will behave responsibly in protecting value of investments vis-a-vis the companies in which mutual funds have invested. Such protection is possible only if mutual funds are alert in monitoring and responding to various corporate decisions being taken by the invested companies.

SEBI through a Circular issued in 2010 nudged the Mutual funds to take an active role in corporate decision-making process and to disclose on their website their policies on exercising voting rights and pattern of voting.

In order to further improve transparency as well as encourage AMCs to exercise their voting rights diligently and in the best interest of the unit holders, AMCs were required by SEBI in March 2014 to record and disclose specific rationale in support of their voting decision (for, against or abstain). This report was mandated to be made public every quarter by AMCs. Further, AMCs were also required to publish summary of the votes cast across all investee companies and its break-up in terms of total number of votes cast.

Apart from the quarterly disclosure, AMCs are required to obtain Auditor’s certification every year on the voting reports being disclosed by them. Board of AMCs and Trustees of Mutual Funds are required to review and ensure that AMCs had voted on important decisions that may affect the interest of investors and the rationale recorded for voting decision is prudent and adequate.

In December 2019, SEBI introduced a Stewardship Code applicable for all Mutual Funds in relation to their investment in listed equities. As Alternative Investment Funds (AIFs) have evolved as another important vehicle of pooled investments, this Code is equally applicable for AIFs too. The Code has come into effect from July 2020 onwards. Apart from SEBI, the other financial sector regulators viz. Insurance Regulatory and Development Authority of India (IRDA) and Pension Fund Regulatory Authority (PFRDA) have also issued similar guidelines for insurance companies and pension funds respectively.

Stewardship code is a more comprehensive prescription for active engagement of institutional shareholder with an investee company to ensure preservation of value and improvement in governance standards. The regulatory measures introduced will usher a sense of responsibility and ownership by MFs and AIFs on the affairs of their listed investee companies.

The stewardship code prescribed by SEBI lays out six principles which need to be adhered to by MFs and AIFs and these principles are:

Principle 1

Institutional Investors should formulate a comprehensive policy on the discharge of their stewardship responsibilities, publicly disclose it, review and update it periodically.

Principle 2

Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.

Principle 3

Institutional investors should monitor their investee companies

Principle 4

Institutional investors should have a clear policy on intervention in their investee companies. Institutional investors should also have a clear policy for collaboration with other institutional investors where required, to preserve the interests of the ultimate investors, which should be disclosed.

Principle 5

Institutional investors should have a clear policy on voting and disclosure of voting activity.

Principle 6

Institutional investors should report periodically on their stewardship activities.

IMPORTANCE OF VOTING DISCLOSURES

One of the key components of stewardship code is establishing and disclosing a stewardship policy, which can be either aligned to long term value creation or explicit objectives around corporate governance. As voting on corporate resolutions is an important tool to achieve these objectives, the stewardship code requires institutional investors to frame a clear policy on voting and disclose the same to shareholders. The disclosure of voting patterns by institutional investors is on the premise that shareholders need a compelling reason to support the promoter’s resolutions and voting yes shall not remain the default option anymore.

Further, under the Companies Act, 2013, shareholder(s) either individually or as a group holding 10% or more, can convene a meeting of the shareholders and find out amicable solutions. Institutional investors, if they work together, can move resolutions at general meetings, whenever required, as the legal framework enables and facilitates active involvement of institutional investors.

As mentioned above, the policy measures for enhancing the role of MFs in ensuring corporate governance were put in place by SEBI and Ministry of Corporate Affairs (MCA) in the year 2014. The present paper has attempted to analyse how the MFs have implemented these regulations in practice. This paper also focuses on the enablers/bottlenecks which have either encouraged or discouraged the MFs in translating them into action points. The approach of the research paper is two-pronged – historical analysis of voting pattern and the recency effect.

1. Historical Analysis

- a. The regulatory measures on voting disclosures came into effect from the year 2014-15 onwards.

- b. Quarterly voting disclosures (available in the websites of these mutual funds) during the initial five years of implementation from 2014-15 to 2018-9 were considered for analysis.
- c. The top 12 mutual funds which constituted nearly as 90% of the total Assets Under Management (AUM) were taken up for study.

Recency Effect

- d. The SEBI stewardship code has been effective from July 2020 onwards.
- e. Analysis of voting disclosures of mutual funds during 2019-20 (preparatory stage) and 2020-21 (implementation stage) will help us to understand how mutual funds have responded to the policy change.
- f. For this purpose, a vibrant mix of select large and small mutual funds in terms of AUM, were taken up for examination.

HISTORICAL ANALYSIS

Voting Policy of MFs

As per Circular issued by SEBI in 2010, every AMC has to disclose its general policies and procedures for exercising voting rights in respect of shares held by it. SEBI had also prescribed the broad parameters based on which the policy needs to be formulated by the AMCs, which include appointment/removal of directors, change in capital structure, mergers & acquisitions, executive compensation including stock options.

On perusal of the policies of the 12 AMCs under consideration, it is seen that the policies of all these AMCs are more or less similar. The policies of these Mutual Funds - whether to vote for or against or abstain and how voting decisions are taken - are focussed on the following parameters stipulated in the SEBI Circular:

- a. Corporate governance matters, including changes in the state of incorporation, merger and other corporate restructuring, and anti takeover provisions
- b. Changes to capital structure, including increases and decreases of capital and preferred stock issuances
- c. Stock option plans and other management compensation issues
- d. Social and corporate responsibility issues
- e. Appointment and Removal of Directors
- f. Any other issue that may affect the interest of the shareholders in general and interest of the unit-holders in particular.

General observations on voting policies of all these 12 mutual fund houses is given below.

How Voting Decision is made

It is observed that every AMC has constituted an Investment Management Committee or Voting Committee, which makes

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decision on the nature of voting based on the facts and circumstances. This Committee is appointed by the Board of Directors of the AMC. The Committee delegates the powers to the Fund Managers of the respective Schemes, subject to effective control and supervision by the Voting Committee or Investment Committee.

The agenda items of investee companies are broadly classified by the Committees into routine and non-routine items. On any resolution, the Fund Managers make recommendation to the management along with rationale/justification for the recommendation. In case the fund manager takes a decision to vote 'against' any agenda item, he/she seeks approval, in writing, from the Investment Committee.

- The Fund manager can recommend a decision to abstain from voting wherever it is felt that information is not sufficient or there is a conflict of interest situation or the fund manager does not want to take a stance on the issue.
- Approval by any majority of the Investment Committee members shall be deemed to be the approval of the Investment Committee.
- The Fund Managers may also seek the analysis and recommendations of a third-party research firm to aid such decisions.

Historical Voting Pattern – All Resolutions

As AMCs were mandated by SEBI to disclose the data on voting from the year 2014-15 onwards, the average number of voting decisions made by each AMCs in each category (for, against or abstain) during the five years period from 2014-15 to 2018-19 was collated. The said data has been captured in the Table given below:

Table 1 – Historical Voting Pattern

S No	Name of the Asset Management Company	Voting Pattern of AMCs on Investee Company Resolutions (Average during last 5 years from 2014-15 to 2018-19)				% of Overall Resolutions		
		For	Against	Abstain	Total	For	Against	Abstain
1	Aditya Birla Sun Life Mutual Fund	2172	8	244	2425	89.60	0.34	10.06
2	Axis Mutual Fund	1749	30	15	1794	97.51	1.65	0.84
3	DSP BlackRock Mutual Fund	2135	39	49	2223	96.01	1.77	2.21
4	Franklin Templeton Mutual Fund	7560	844	177	8581	88.10	9.84	2.06
5	HDFC Mutual Fund	1955	12	166	2132	91.67	0.56	7.77
6	ICICI Prudential Mutual Fund	2254	5	397	2656	84.85	0.19	14.96
7	Kotak Mahindra Mutual Fund	688	2	164	854	80.60	0.23	19.17
8	L & T Mutual Fund	2219	115	217	2551	86.98	4.52	8.51
9	Reliance Mutual Fund	3090	12	274	3376	91.53	0.37	8.10
10	SBI Mutual Fund	1788	181	374	2343	76.31	7.71	15.98
11	Tata Mutual Fund	1512	22	31	1565	96.61	1.41	1.98
12	UTI Mutual Fund	1740	25	704	2469	70.48	1.02	28.50
	Total	28862	1295	2812	32969	87.54	3.93	8.53

Source: Quarterly disclosures of MFs

On perusal of the above data, it is observed that:

- On 87% of instances, the AMCs have voted in favour of investee company resolutions.
- Out of the 12 AMCs under consideration, around 5 AMCs (nearly half) have agreed with the resolutions brought out by investee companies in as much as 90% of instances.
- Overall AMCs have decided to abstain from voting in less than 8% of occasions. This indicates the ability to make firm decisions on the part of voting committee of AMCs.
- AMCs have rejected 4% of resolutions brought in by the investee companies. This include resolutions on appointment of KMPs, mergers acquisitions, executive compensation, etc.

Observation with respect voting patterns on specific areas of corporate resolutions

1. Policy Vs Practice – Resolutions on “Appointment/ Re-appointment of Directors”

In today’s competitive world, there are a number of risks surrounding the operation and sustainability of a company.

These risks include operational risk, financial risk, cyber security threats, etc. It is expected that a director appointed on the Board of a Company will bring in necessary skill sets to the Board room deliberations which will help in handling these risks and help the company in achieving its long-term goals. Therefore, companies pay adequate attention while dealing with appointment/removal of a director to/from the Board. SEBI has also mandated that adequate disclosures shall be made when a person resigns from the directorship of a listed company.

As per the voting policy of the AMCs, the agenda item “appointment/removal of directors” is one of the parameters on which the Fund Manager makes recommendations to the Voting committee/investment committee. The Committee makes the final decision after due deliberations.

In order to understand how AMCs had responded to proposals for appointment or removal of directors on the Board of investee companies, the voting pattern of all the 12 AMCs across all investee companies were analysed. The data for the last five years were taken into consideration for the purpose of this analysis and the outcome of the said exercise has been captured in the table given below:

Table-2 - Voting Pattern – Appointment/Removal of Directors

S No	Name of the Asset Management Company	Voting Pattern of AMCs on Investee Company Resolutions (Average during last 5 years from 2014-15 to 2018-19)				% of Overall Resolutions		
		For	Against	Abstain	Total	For	Against	Abstain
1	Aditya Birla Sun Life Mutual Fund	961	1	101	1063	90.38	0.09	9.52
2	Axis Mutual Fund	710	12	3	725	97.88	1.65	0.47
3	DSP BlackRock Mutual Fund	878	12	29	919	95.52	1.31	3.18
4	Franklin Templeton Mutual Fund	373	30	2	405	91.96	7.45	0.59
5	HDFC Mutual Fund	831	12	157	1001	83.09	1.20	15.71
6	ICICI Prudential Mutual Fund	624	0	172	797	78.36	0.03	21.61
7	Kotak Mahindra Mutual Fund	180	0	165	345	52.18	0.00	47.82
8	L & T Mutual Fund	762	61	114	936	81.37	6.47	12.16
9	Reliance Mutual Fund	1071	3	111	1185	90.36	0.25	9.38
10	SBI Mutual Fund	441	91	119	650	67.74	14.02	18.23
11	Tata Mutual Fund	474	9	11	494	95.99	1.78	2.23
12	UTI Mutual Fund	741	4	346	1092	67.89	0.40	31.70
	Total	8045	235	1331	9612	83.70	2.45	13.85

Source: Quarterly disclosures of MFs

The data from the above Table reveals the following:

- All the AMCs have voted in favour of the investment companies' management proposal on 84% of instances. While AMCs have chosen to abstain from voting on 14% of occasions, they have gone against the management in around 2% of instances.
- Except 4 AMCs, all other AMCs have approved the proposal for appointment/removal of directors made by the investee companies' management on more than 80% of occasions.
- However, these AMCs have chosen to abstain from voting which indicates the inability of the voting committee or investment management committee to express their dissent against investee company proposal. This may be due to lack of sufficient information, or they did not want to take a stance on the issue.
- Around 4 AMCs have not voted against any resolutions in not even 1% of instances. Around 5 AMCs have done so in less than 10% of instances.
- Whenever the AMCs were not sure that the nominated person would not bring value to the Board or creates a conflict of interest situation or the proposal is not in the interests of minority shareholders, the AMCs had either abstained or voted against the nominee.
- An in-depth analysis has been attempted to bring out the exact rationale behind the decisions made by AMCs.

In-depth Analysis of Voting Pattern - Resolution on "Appointment of Directors"

As mentioned above, in nearly 2.5% of instances, the mutual funds have voted against the proposal for appointment or reappointment of directors of investee companies. A study was undertaken to ascertain the exact criterion and reasoning for voting against any resolution. For this purpose, sample resolutions wherein one or more mutual funds had voted against any resolution during the last five years were taken into consideration on random basis.

The resolutions were grouped together based on the "criteria for rejection" adopted by the MFs for the particular resolution. The reasons referred to by the mutual funds for rejecting the resolutions include regulatory investigation, attendance of directors, criteria of independence and directorship in more number of companies.

Regulatory Investigation

When the resolution for re-appointment of Director of one banking company came up for approval, it is observed that as a matter of prudence, the mutual fund belonging to the same group, had abstained from voting to avoid conflict of interest situation. It may be mentioned that regulators had initiated action against the nominee at that point of time.

Attendance of Directors

It is observed that few resolutions for re-appointment of directors had been rejected by MFs since these directors had not attended sufficient number of meetings (at least 33%) in their earlier tenure.

Criteria of Independence

The recent changes in SEBI's LODR require listed companies to consider the "Criteria of Independence" of independent

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directors. It further stipulates that directors who have attained the age of 75 years have to be re-approved by shareholders through a special resolution.

It is seen that MFs have voted against/abstained from voting when investee companies brought resolutions to re-appoint directors who had been serving on the Board for many years on the ground that the length of tenure is inversely proportional to the independence of a director.

Directorship in more number of companies

As per the amendments made to SEBI LODR in 2019, a person cannot be director in not more than six/seven companies as it was felt that the director may not be able to devote considerable time and therefore will not effectively contribute to Board room deliberations. It is seen that when a resolution was brought by one listed entity in the year 2014-15 for appointment of Independent Director, one mutual fund had voted against the resolution on the ground that the person is already a director in nearly 10 companies and his/her ability to contribute further was questionable. This is seen as a best practice by institutional investors even when there was no regulatory requirement in place.

The aforesaid instances indicate that mutual had exercised objective criteria before voting against any resolution. However, it also exhibits the lack of coordination and collaboration amongst MFs on vital resolutions, since it is observed that each MF has taken a different stand on the same resolution.

2. Sectoral Analysis of Voting Pattern – Banking Stocks

Shareholding Vs Net Profit

In addition to the criteria-based analysis, the paper attempts to find out how MFs having reasonable shareholding, had responded to developments in companies belonging to a particular sector. For this purpose, nine listed private banks constituting the Nifty Banking Index were considered for analysis. It was examined as to how MFs had consolidated/withdrawn their investments in response to changes in the financial parameters (net profit) of the investee banking company.

The table given below captures net profit of these banks for a five-year period and also indicates the shareholding of MFs during the corresponding period:

Table 3 – Sectoral Analysis- Shareholding Vs Net Profit

S No	Name of the Private Bank	Net Profit (Rs.Cr.)					Shareholding Pattern of Mutual Funds (%)				
		2014-15	2015-16	2016-17	2017-18	2018-19	2014-15	2015-16	2016-17	2017-18	2018-19
1	Indus Ind Bank Ltd	1,794	2,287	2,868	3,606	3,301	8.52	12.22	13.29	10.47	8.31
2	Yes Bank Ltd	1,998	2,530	3,340	4,233	1,709	8.39	11.39	10.46	10.29	9.54
3	Federal Bank Ltd	1,012	487	853	910	1,283	25.37	25.91	26.45	24.32	22.45
4	Bandhan Bank Ltd	NA	NA	NA	1,345	1,951	NA	NA	NA	1.43	2.41
5	RBL Bank Ltd	NA	NA	446	639	861	NA	NA	7.5	12.32	20.17
6	HDFC Bank Ltd	10,700	12,817	15,288	18,561	22,446	8.29%	10.30	9.87	12.08	13.32
7	ICICI Bank Ltd	12,942	10,926	11,340	9,099	5,689	11.62	14.25	20.04	22.66	27.92
8	Kotak Mahindra Bank	3,065	3,431	4,949	6,147	7,119	1.65	3.92	5.41	7.08	8.39
9	Axis Bank Ltd	7,448	8,357	3,967	464	5,047	6.81	10.58	7.12	8.67	15.35

Source: BSE

It may be seen from the above Table that when investee banking companies had reported continuous profits, the MFs have mostly increased their shareholding. Similarly, when some banking companies had reported less-profits, the MFs had correspondingly reduced their holding in these Banks. Therefore, based on the above examination, it may be construed that MFs have been quick enough to respond to market situations.

Voting Pattern

The paper also tries to study how mutual funds, representing the interests of millions of unit holders, had voted on resolutions brought out by these banking companies during AGMs. The Table given hereunder throws light on how mutual funds had voted in respect of resolutions brought out by these 9 listed banks in 2014-15 and 2018-19:

Table 4 – Sectoral Analysis of Voting Pattern

S No	Name of the Private Bank	Voting Pattern of Mutual Funds (%) 2014-15			Voting Pattern of Mutual Funds (%) 2018-19		
		For	Against	Abstain	For	Against	Abstain
1	Indus Ind Bank Ltd	87%	9%	3%	98%	0%	2%
2	Yes Bank Ltd	86%	4%	1%	97%	1%	2%
3	Federal Bank Ltd	97%	0%	3%	91%	0%	7%
4	Bandhan Bank Ltd	NA	NA	NA	85%	2%	13%
5	RBL Bank Ltd	NA	NA	NA	85%	0%	15%
6	HDFC Bank Ltd	97%	0%	3%	100%	0%	0%
7	ICICI Bank Ltd	100%	0%	0%	87%	6%	6%
8	Kotak Mahindra Bank	88%	3%	9%	100%	0%	0%
9	Axis Bank Ltd	94%	4%	2%	94%	3%	2%

- It is seen that the mutual funds have “voted-in favour” of the resolutions of banking companies on more than 90% of instances.
- It is also observed that all the resolutions proposed by two banking companies have found favour with the mutual funds; however, in case of some banks, the proposals were rejected in as much as 6%.
- The mutual funds had abstained from voting in nearly 15% of instances on the proposals mooted by one banking company in the year 2018-19.
- This indicates that when AMC's were not satisfied with the proposal of the investee banks either due to insufficient information or other reasons, the MFs had chosen to abstain rather than voting against the proposal.

REGENCY EFFECT

The present research endeavours to find out the voting pattern of mutual funds during 2019-20 and 2020-21 on account of two important factors.

1. A large number of retail investors have participated in the securities markets through the mutual fund route

during the last two years, especially during Covid-19. This is indicated by the huge increase in the Asset Under Management (AUM) of the mutual funds, which has grown up phenomenally to around Rs.38 lakh crore. As investors have placed their faith on the mutual funds by making investments with them, it is a reasonable expectation that mutual funds shoulder a greater amount of responsibility in delivering long term returns to the investors. The long-term sustainability of investee companies may be ensured through a constructive engagement and participation. Voting effectively is one of the vital instruments available with the mutual funds to achieve this objective.

2. Vide SEBI Circular issued in December 2019, it has been mandated that Mutual Funds and Alternative Investment Funds have to adhere to the Stewardship Code with effect from April 1, 2020. On account of COVID-19, the effective date was extended to July 1, 2020. Therefore, it would be interesting to compare how mutual funds would have voted during 2019-20 – one year before implementation and also during 2020-21 – after the Code has become effective.
3. For this purpose, the voting pattern of select mutual funds, a vibrant mix of both large and small in terms of AUM, were taken up for analysis. A summary of the voting pattern is captured in the following Table:

Table 5 – Recent Voting Pattern

S No	Name of the Asset Management Company	Voting Pattern of AMC's on Investee Company Resolutions (%)					
		2019-20			2020-21		
		For	Against	Abstain	For	Against	Abstain
1	Aditya Birla Sun Life AMC Limited	96.01	0.27	3.72	94.29	0.08	5.63
2	Axis Mutual Fund	92.72	2.98	4.31	97.32	2.59	0.09
3	Baroda Mutual Fund	96.00	3.89	0.11	97.69	2.08	0.23
4	BNP Paribas Mutual Fund	64.53	2.71	32.76	76.98	1.34	21.68
5	BOI AXA Mutual Fund	77.68	10.99	11.33	85.41	7.06	7.53
6	Canara Robeco Mutual Fund	97.53	2.40	0.07	97.62	2.08	0.30

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7	DSP Mutual Fund	85.70	6.54	7.69	88.25	4.83	6.52
8	Edelweiss Mutual Fund	98.71	0.00	1.29	98.73	0.05	1.21
9	Franklin Templeton Mutual fund	92.18	7.39	0.18	88.95	10.53	0.49
10	HDFC Mutual Fund	88.67	1.51	9.82	88.67	1.51	9.82
	Total	90.44	4.34	5.13	91.06	4.64	4.26

On perusal of the above data, it is observed that:

Voted in Favour

- In around 91% of instances, the AMCs have voted in favour of investee company resolutions during both the years.
- Out of the 10 AMCs under consideration, during 2019-20, around 6 AMCs (nearly half) have agreed with the resolutions brought out by investee companies in as much as 90% of instances.
- However, during 2020-21, there is a slight change in the voting pattern – only 5 AMCs have “voted in favour” in 90% of instances or more.

Abstention

- It may be recalled that during 2014-15 to 2018-19 (historical period), the rate of abstention was high at 8.5%.
- The present analysis indicates that AMCs have abstained from voting only in 5% of occasions in 2019-20 and 4% of instances in 2020-21.
- This shows that there is huge reduction in the abstention rate.
- Therefore, it is a welcome change, reflecting the increased ability of mutual funds to make firm decisions on resolutions brought out by the investee companies.
- One Mutual Fund had abstained from voting in 33% of resolutions during 2019-20; however, the rate of abstention has come down to 22% during 2020-21.

As investors have placed their faith on the mutual funds by making investments with them, it is a reasonable expectation that mutual funds shoulder a greater amount of responsibility in delivering long term returns to the investors. The long-term sustainability of investee companies may be ensured through a constructive engagement and participation. Voting effectively is one of the vital instruments available with the mutual funds to achieve this objective.

- In the case of another Mutual Fund, there is a slight reduction in the rate of abstention from 7.7% to 6.5%.

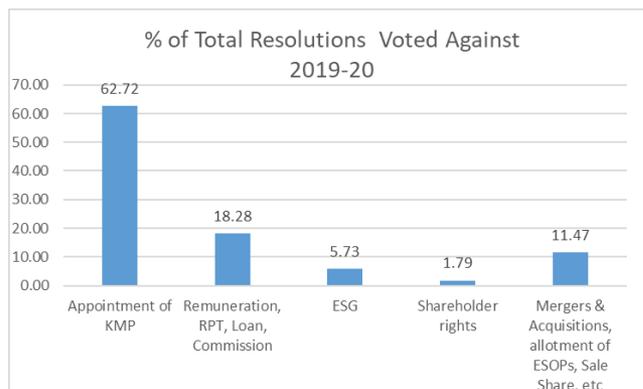
Voted Against

- All the AMCs have voted against the resolutions in around 5% of instances in 2019-20 and this fell down to 4% in 2020-21. This is consistent with the historical average of around 4%.

Nature of Resolutions “Voted Against” – 2019-20

- The following Chart indicates the nature of resolutions on which the mutual funds had voted against during 2019-20 and 2020-21:

Chart – 1 - Nature of Resolutions “Voted Against” – 2019-20



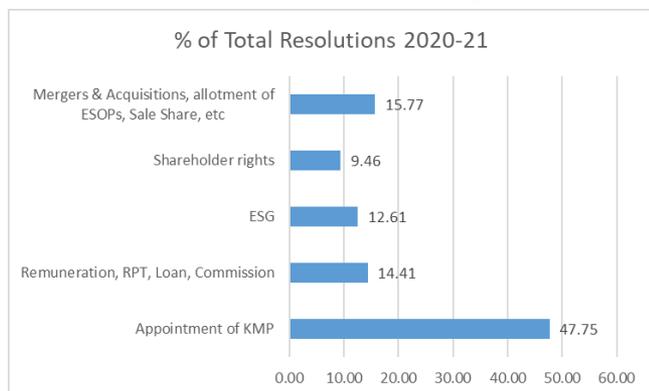
- Appointment of Key Managerial Personnel was one of the key areas on which mutual funds had voted out the proposals brought out by the investee companies during 2019-20. Out of the total resolutions rejected, 63% pertain to appointment of KMPs. This becomes significant given the increased responsibility of KMPs and expectations from shareholders about the ability of KMPs to contribute and deliver for the long-term goals of the investee companies.
- Another area wherein the mutual funds had voted out pertains to financial transactions including executive remuneration, related party transactions, loans and commissions. This suggests that resolution on financial transactions has been drawing the increased attention of mutual funds. This trend is in line with the recent initiatives taken by SEBI requiring investee companies to take approval of shareholders for related party transactions and executive remuneration beyond a threshold.
- Out of the total resolutions voted-against by the mutual funds, 11% relate to Mergers and acquisitions, ESOPs, etc.



- Around 5% of rejected resolutions pertain to ESG related issues. This shows the increased awareness of mutual funds towards issues pertaining to ESG (Environmental, Social and Governance).

NATURE OF RESOLUTIONS “VOTED AGAINST” – 2020-21

Chart – 2 - Nature of Resolutions “Voted Against” – 2020-21



- In line with the past trends, appointment of Key Managerial Personnel continues to be the key area for mutual funds, wherein they did not find merit in the investee company resolutions. This is evident from the fact that out of the total resolutions rejected by the mutual funds, around 48% pertain to appointment of KMPs, though it is less than the 63% recorded during the previous year.
- During 2020-21, the mutual funds did not find favour with around 14% of resolutions pertaining to executive remuneration, related party transactions, loans and commissions. This is better than the rejection rate of 18% recorded during the last year. It can be reasonably construed from this analysis that the investee companies have understood the expectations from institutional shareholders on financial transactions.
- 16% of resolutions rejected by the mutual funds were in the area of Mergers and acquisitions, ESOPs, etc., which is relatively higher than the 11% rejection observed during the previous year. This may be on account of the reason

that these resolutions were not worth pursuing or did not add any value to the shareholders.

- It is worth mentioning that out of the total rejections, nearly 13% of resolutions were ESG related issues. This is much higher compared to the 5% rejection during the last year. This shows the increased sensitivity of mutual funds towards issues pertaining to ESG. This phenomenal change may be setting the trend towards a shift from “shareholders’ wealth maximization” to “stakeholder welfare” – i.e. the investee companies operations and performance should contribute to the welfare of the society and other stakeholders and not merely shareholders wealth maximization.

WAY FORWARD

The recent Stewardship Code stipulated by SEBI requires Institutional investors to monitor their investee companies and put in place a clear policy on intervention in the investee companies. It has also mandated the Institutional investors to have a clear policy for collaboration with other institutional investors, wherever required, to preserve the interests of the ultimate investors

The present analysis reveals that the mutual funds have been active in their approach to voting on resolutions. However, it is seen that every mutual fund has taken a different stand on the same resolutions. Therefore, there is a need for more collaboration amongst MFs as institutional investors, as required by the Code.

As mentioned above, it is observed that as a matter of prudent practice, each MF has devised a criterion for making voting decisions. However, there was no consistency in the stand taken by the same MFs on particular voting criteria. For example, the attendance of directors in the previous tenure was considered as a factor by one mutual fund for voting. While it had voted against the resolution for re-appointment of directors in one company, it has voted for the resolution moved by another company for the same reason. In both the instances, the nominees had not attended even one-third of the Board meetings in previous years.

It can be reasonably construed that though each MF has a voting policy based on the guidelines stipulated by SEBI, there is need for more consistency at the stage of implementation.

As the Stewardship Code prescribed by SEBI has already come into effect, in order to improve the active participation of MFs in the affairs of investee companies and to uphold the trust of millions of unit-holders in MFs, the following are proposed:

1. Frequent consultations/meeting with co-institutional investors before voting on any agenda. AMFI may provide necessary platform for this.
2. Separate meeting of institutional investors at least once in a year to discuss issues surrounding the investee companies around common agenda.
3. Collective engagement by all MFs with the management/ Board of investee companies wherever required. AMFI can play a catalyst role in this scenario.
4. AMFI can also set up a committee to examine ways to harmonious implementation of the new Stewardship Code.

The above steps, if implemented effectively, will usher in a new era of “Institutional Investor Activism” in the country and also help in expanding the reach of MFs beyond cities to villages. ☐