# Highlights of Report of Committee on Corporate Governance

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The SEBI Committee on Corporate Governance was formed on June 2, 2017 under the Chairmanship of Mr. Uday Kotak (hereinafter referred to as the "Committee") with the aim of improving standards of corporate governance of listed companies in India. The Committee comprised of 24 members. The Committee was requested to submit its report to Securities Exchange Board of India (hereinafter referred to as "SEBI") within four months. The Committee came up with its recommendation report dated 5th October, 2017 on the various issues towards enhancing Corporate Governance (hereinafter referred to as the "Report").[1]

Recognising the need of running a company in either the *"Raja" (Monarch) model or the "Custodian" (Trusteeship) model, the Committee recognized that the indian entities need to work on Custodian model which works on Gandhian principles and accordingly,* the aim of forming the committee was to highlight issues which may lead to improved corporate governance of *equity listed companies* and the Committee was to accordingly make recommendations. The major terms of reference of the Committee were:

1. Ensuring independence in spirit of Independent Directors and their active participation in functioning of the company;
2. Improving safeguards and disclosures pertaining to Related Party Transactions;
3. Issues in accounting and auditing practices by listed companies;
4. Improving effectiveness of Board Evaluation practices;
5. Addressing issues faced by investors on voting and participation in general meetings;
6. Disclosure and transparency related issues, if any;
7. Any other matter, as the Committee deems fit pertaining to corporate governance in India.

The Committee also received comments from the Ministry of Corporate Affairs and the Ministry of Finance. The Report further suggests some recommendations vide amendment to existing provisions as also insertion of new provisions in order to implement the provisions. The recommendations of the Committee are such that may require implementation by relevant authorities/regulators in aim to enhance corporate governance practices by equity listed companies. The amendments are proposed to be made effective on piecemeal basis based on the nature and complexity in order to provide smooth transition time, i.e. some from 1st April, 2018[1] while some from 1st October, 2018 and thereafter.

## Need for review of Corporate Governance now

The focus of the companies is primarily to create long term value for protection of its stakeholders at large. This however seems is not being achieved in spirit given the recent event on boards of corporate not only in the nation but also internationally. Some of the issues recognised by the Committee are:

a) pace in change of market conditions requiring companies and boards to quickly adapt to the technological and demographical changes

[1] The report can be seen at: http://www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html

b) increasingly complex regulatory environment
c) focus of the board on short-term quarterly performance rather than long-term performance of the company wherein the board is not far sighted but is inclined on meeting short-term objectives than long-term strategies
d) increase in number of passive institutional owners
e) outperformance of private equity owned companies than the publicly listed ones because of the belief that directors in PE-owned companies are believed to spend far more time on strategy and risk management, have deeper functional and industry expertise and engage more actively in talent management.
f) significant value erosion in several Public Sector Enterprises (PSEs)

The above factors therefore call for need to review the Corporate Governance measures in the country by way of better board structures, rigorous checks and balances and striking a balance between devotion of time to quarterly reviews, audit reports, budgets and matters crucial to the future direction of the business.

## Highlights of recommendations

In order to meet the objectives of:

a) Shaping governance for long-term value creation
b) Shaping governance to protect shareholder interests
c) Building regulatory capacity for enhancing governance of listed entities

the following aspects have been discussed by the Committee alongwith necessary recommendations with respect to amendments/insertions for implementation in the relevant laws *inter-alia*, Companies Act, 2013 (hereinafter referred to as the "Act") and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (hereinafter referred to as the "Listing Regulations")[2].

### *A) Board structures*

This comprises of the review of composition and role of the boards so as to achieve the desired objective.

| Particulars | Current provision | Recommendation | Rationale |
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| **Minimum number of directors on Board (Regulation 17 of the Listing Regulations)** | Act read with rules issued thereunder requires a minimum of three directors on the board of a public limited company. There is no similar requirement in the Listing Regulations. | Insert Regulation for a *minimum number of 6 directors* in all the listed entities. | In view of the additional functions and obligations of the board of a listed entity, relative to unlisted entities, it is crucial that a sufficient number of directors with diverse backgrounds and skill sets are |

[2] The Listing Regulations can be viewed at: http://www.sebi.gov.in/sebi_data/attachdocs/1441284401427.pdf

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| | | | available on the boards of listed entities to fulfill these functions and obligations. |
| **Gender Diversity on the Board (Regulation 17 of the Listing Regulations)** | The Act and the Listing Regulations require atleast one woman director on the board of the listed entity | The Committee recommends amendment to the Listing Regulations by providing that every listed entity have *at least one independent woman director* on its board of directors. | The provision was originally inserted for gender diversity and to have a positive impact.<br>To further improve gender diversity on corporate boards, the Committee recommends that every listed entity have at least one independent woman director on its board of directors. |
| **Directors' attendance (Regulation 17 of the Listing Regulations)** | The Act provides for the automatic vacation of the office of director if a director is absent from all meetings of the board of directors held during a 12-month period. There is no requirement for minimum attendance of directors in meetings of the board of directors under the Listing Regulations. | Insertion of a new sub-regulation providing that if a director does not attend atleast half of the total number of board meetings over two financial years on a rolling basis, his/her continuance on the board should be ratified by the shareholders at the next annual general meeting. | In order to carry out the fiduciary duties effectively, it is important for all directors to attend a minimum number of meetings in order to enhance their contribution of skill, time and value towards serving the longterm interests of all stakeholders. |
| **Disclosure of Expertise/Skills of Directors (Disclosure under Schedule V of the Listing Regulations)** | Companies Act and SEBI LODR Regulations require the disclosure of a brief profile of a director on his/her appointment, including expertise in specific functional areas. However, there is no specific requirement under the Companies Act or SEBI LODR Regulations for listed entities to disclose the required and available expertise of the board on a regular basis. | It is recommended to insert a new clause in Schedule V to the effect that the board of directors of every listed entity should be required to list the competencies/expertise that it believes its directors should possess and actually possess and disclose competencies of its board members against every identified competency/expertise without disclosing names in the annual report for financial year ending March 31, 2019. However, detailed disclosures of competencies of every board member, along with | The Committee acknowledged that while a board of directors may seek external expert advice on various matters, given the collective responsibility and the need for the board to make informed business judgment, a balanced wholesome board with complementary skill-sets amongst the directors is |

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| | | their names, should be required w.e.f. March 31, 2020 | imperative. |
| **Approval for Non-executive Directors on Attaining a Certain Age (Regulation 17 of the Listing Regulations)** | The Act provides that a person may be appointed/continue as Managing Director (*hereinafter referred to as "MD"*), whole-time director or manager on attaining the age of 70 years by passing a special resolution. However, no such provision exists for non-executive directors. | Insertion of new Regulation recommending provision requiring a special resolution on a similar basis should be inserted for listed entities for the appointment/continuation of NEDs on attaining the age of 75 years for the relevant term. All shareholders should be permitted to vote on such a resolution. | The Committee recognizes that while age itself may not be a determinant of efficiency or capability of a person or the basis for disqualification of a director, a higher level of shareholder endorsement may be required for directors to continue in their position beyond a certain age. The Committee further noted that non-executive roles on a board also require significant commitment of time. |
| **Minimum number of board meetings** | The Act and the Listing Regulations require at least four meetings of the board every year with a maximum gap of one hundred and twenty days between any two meetings. | It is recommended to amend the existing Regulation to increase the minimum number to five meetings wherein atleast once the board shall discuss strategy, budgets, board evaluation, risk management, environment, sustainability, governance and succession planning. | Considering that the boards should also focus on other strategy areas apart from financials, it is recommended to bring the change for focusing on other critical aspects |
| **Quorum for board meetings** | Act requires a quorum of one-third of the total strength of the board of directors or two directors, whichever is higher, for every board meeting. SEBI LODR Regulations do not prescribe any quorum. | To insert a new sub-regulation under Regulation 17 to provide that quorum for every board meeting of the listed entity should be a minimum of three directors or one-third of the total strength of the board of directors, whichever is higher, including at least one independent director. | In view of the increased obligations of the boards and in the interest of all stakeholders, especially minority shareholders, a higher quorum alongwith the presence of at least one independent director is required for every board meeting. |

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| **Separation of the Roles of Non-executive Chairperson and Managing Director/CEO** | Act states that an individual shall not be appointed/reappointed as the chairperson of a company as well as its MD/CEO at the same time unless the articles of such company provide otherwise or the company does not undertake multiple businesses. The Listing Regulations do not mandate separation of the posts of chairperson and chief executive officer | It is proposed to amend and insert Regulation 17 and Schedule II that in case of all listed entities which have public shareholding of forty percent or more at the beginning of a financial year shall ensure that the Chairperson of the board of such listed entity shall be a non executive director, on and from that financial year. The recommendation is to also extend this to all listed companies wef the year 2022. | Several corporate governance codes for best practices recommend this, a few jurisdictions require it, and many companies are actively debating whether to undertake it to ensure *inter-alia* that board tasks are not neglected by a combined chairperson/MD. Such separation, at least at the stage of introduction of the construct, may be more relevant where public shareholders constitute a large portion of the shareholding of a company. |
| **Maximum number of directorships** | The Act provides that the maximum number of public companies in which a person can be appointed as a director shall not exceed ten and Listing Regulations provide for cap on directorship for independent directors | Recommendation for insertion of a new regulation for restricting the number of directorships in listed entities to overall being 8 and thereafter reducing it further to 7 wef April 01, 2020. | In light of increased responsibility of corporate boards, multiple directorships beyond a reasonable limit may lead to a director not being able to allocate sufficient time to a particular company, thus hindering their ability to play an effective role. |

### *B) Controlling Shareholders and Related Party Transactions*

A majority of Indian listed entities continue to be promoter driven, with significant shareholding held by promoter/promoter group. Therefore, protection of the interests of minority shareholders, especially those of retail shareholders assumes even greater importance. In this context, checks and balances on interactions and relationships between listed entities and the promoters/significant shareholders is crucial for good governance. Changes have been proposed in line with provisions of SEBI (Prohibition of Insider Trading) Regulations, 2015 (hereinafter referred to as the "PIT Regulations") as well.

| Particulars | Current provision | Recommendation | Rationale |
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| **Sharing of information with the controlling promoters/shareholders with nominee directors** | The PIT Regulations restrict communication/procurement of information of Unpublished Price Sensitive Information (UPSI) except for legitimate purpose etc. However, there is no provision enabling sharing information with select group of shareholders either under the PIT Regulations or the Listing Regulations. | A new chapter (IV-A) is recommended to be inserted as *"Information Rights of certain Promoters and Significant Shareholders"* provide an enabling transparent framework regulating the information rights of certain promoters and significant shareholders to reduce subjectivity and provide clarity for ease of business.<br><br>Amendments are also proposed by way of insertion of new regulation in the PIT Regulations. | The Committee has highlighted the need of flow of information to the ultimate controlling stakeholders being the promoters wherein the information flows from formal/informal channels and that while there is substantive law for restriction on flow of UPSI except for purposes mentioned, the ground reality is different from the legal framework. |
| **Re-classification of Promoters/Classification of Entities as Professionally Managed** | The Act is silent on reclassification of promoters, while the SEBI LODR Regulations permit reclassification of promoters in limited circumstances. | Proposes recommendation to existing Regulation 31A as also insertion of new sub-regulation. | Where there is no identifiable promoter/promoter group, the 1% threshold to be able to classify the entity as professionally managed is too low and merits an increase to 10%. Also, the Listing Regulations do not deal with a situation where there are multiple and distinct parties classified as promoters, and one of them wishes to be reclassified. |
| **Disclosure of Related Party Transactions** | The Act and the Listing Regulations contains provisions on approval and disclosure of Related Party Transactions (RPTs) in the board's report. approval of the shareholders in certain cases, etc. | Insertion of new regulations u/s 33, 34 as:<br>A) Half yearly disclosure of RPTs on a consolidated basis, in the disclosure format required for RPT in the annual accounts as | In order to strengthen transparency on related party transactions and to cover all transactions with promoters, as because certain promoters/promoter |

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| | | per the accounting standards, on the website of the listed entity within 30 days of publication of the half yearly financial results. Copy of the same to also be submitted to the stock exchanges. Penalty to be imposed for non-compliance in terms of penalty as applicable u/r 33.<br>B) All promoters/promoter group entities that hold 20% or above in a listed company to be considered *"related parties"* for the purposes of the Listing Regulations.<br>C) Disclosures of transactions with promoters/promoter group entities holding 10% or more shareholding be made annually and on a half yearly basis (even if not classified as related parties). | group entities were not getting categorised as related parties under SEBI LODR Regulations on account of not strictly falling under the definition of "related parties" under the relevant accounting standards and thereby transactions with such persons were not getting categorised as RPTs under the SEBI LODR Regulations. |
| **Approval of Related Party Transactions** | Unlike the Act, the Listing Regulations provide for a blanket restriction on voting by related parties in case of material RPTs | The recommendation seeks to align the provision with the Act, however, seems to be more confusing and conflicting with the intended change. It is proposed to amend exiting Regulation 23 so as to allow the related parties to vote but not to approve the | Similar to the Act, the Listing Regulations may be amended to allow related parties to cast a negative vote, as such voting cannot be considered to be in conflict of interest. |

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| | | relevant transaction. Either the recommendation seeks to provide that the related parties may vote even negative and not necessarily affirmative but the proposed language of the Regulation suggests otherwise.<br>***This is proposed to be implemented with immediate effect.*** | |
| **Royalty and Brand Payments to Related Parties** | No specific provisions in the SEBI LODR Regulations pertaining to payments made pertaining to brand and royalty to related parties | Insertion of a new sub-regulation for providing that payments made by listed entities with respect to brands usage/royalty amounting to more than 5% of consolidated turnover of the listed entity may require prior approval from the shareholders on a "majority of minority" basis. This sub-limit of 5% will be considered within the overall 10% limit to determine material related party transactions | Keeping in mind that companies make payment towards brand/royalty usage, in order to ensure better disclosures by the Company, on the value a company derives from a brand or technology for which it has agreed to pay royalty, brand, or technical fees to the parent company/promoters |
| **Remuneration to Executive Promoter Directors** | Act prescribes a ceiling on the compensation that can be paid to directors, there are no specific provisions in the SEBI LODR Regulations on the maximum remuneration. | Insertion of a new clause under Regulation 17 for providing remuneration payable to executive directors with approval of members. shareholder approval by special resolution should be required if the total remuneration paid:<br>a) to a single executive promoter-director exceeds Rs. 5 crore or 2.5% of the net profit, whichever is higher; or<br>b) to all executive promoter-directors exceeds 5% of the net profits.<br>Net profits should be | In order to take care of the disproportionate payments made to executive promoter directors as compared to other executive directors, recommendation has been made that this issue should be subjected to greater shareholder scrutiny. |

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| | | calculated under section 198 of the Act. | |
| **Remuneration of Non-executive Directors** | The Act requires the approval of shareholders for any remuneration payable to such directors exceeding 1% of the net profits in case there is a managing director or whole time director or manager and 3% in other cases. As per SEBI LODR Regulations, the board is required to recommend all fees and compensation to be paid to non-executive directors. | Insertion of a new sub-clause under Regulation 17 to provide that where the remuneration of a single non-executive director exceeds 50% of the pool being distributed to the non-executive directors as a whole, shareholder approval should be required. Voting by promoters will be however allowed. | Based on available data vide disclosures, it was noted that certain non-executive directors, generally promoter directors, were receiving disproportionate remuneration from the total pool available *vis-à-vis* all other non-executive directors. |
| **Materiality Policy** | Regulations require listed entities to formulate a policy on materiality of related party transactions and on dealing with related party transactions | Amendment is proposed to amend and insert new sub-regulation in Regulation 23 necessitating laying of clear threshold limits and also reviewing the policy in every 3 years | It is noted that while the companies have formulated policy but have not spelt out any threshold limits for determining materiality and therefore, enforcement in such cases becomes difficult. |

### *C) Other important recommendations*

#### Minimum number of board of directors

It is recommended to substitute the existing Regulation on requirement of minimum number of independent directors to atleast 50% of the board members irrespective of the Chairperson being executive or non-executive. It is recommended to be implemented in a phased manner, making it mandatory for top 500 listed companies w.e.f. April 01, 2019 and thereafter for all the companies from April 01, 2020 to provide transition time.

#### Eligibility criteria for independent directors

It is also recommended to amend the regulation wrt eligibility of an independent director wherein it is being mandated that the ID should not be a member of the promoter group either, which currently is not provided.

### Submission and serving of annual reports

It is recommended that Regulation 36 and 36 be amended to provide sending of annual reports to shareholders in soft copy whose email address is registered not only with the listed entity but also with the depository, w.e.f. 1st April, 2018.

For such purpose, it is proposed to link the Aadhar with the demat account of the shareholder so as to also register their mobile numbers and email address.

### Disclosure of credit rating on website

It is recommended to amend Regulation 46 to provide that listed entity may be required to disclose all credit ratings obtained by the entity for all its outstanding instruments annually to stock exchanges and also on its website which shall be updated on a regular basis as and when there is any change, w.e.f. 1st April, 2018.

### Utilisation of Proceeds of Preferential Issue and Qualified Institutional Placement

Apart from disclosure on proceeds utilization of public issues, it is proposed to insert a new clause under Schedule V, for better transparency, appropriate disclosures may be required on utilisation of proceeds of preferential issues and QIPs till the time such proceeds are utilised.

### Prior Intimation of Board Meeting to Discuss Bonus Issue

in view of the price sensitive nature of bonus issues, advance notice for consideration of bonus issue by the board should be required to be submitted to stock exchanges. Accordingly, it is recommended that the proviso to Regulation 29 in the SEBI LODR Regulations may be dropped.

### Timeline for Annual General Meetings of Listed Entities

Initially, the top 100 listed entities by market capitalization (as at the end of the previous financial year) may be required to hold AGMs by August 31, 2018, i.e. within five months from the end of the next financial year. The same may be extended to other entities in a phased manner based on the experience gained, by way of insertion on new Regulation 43A.

Changes have also been suggested in provisions for institution of independent directors, audit and account procedures, disclosures as also certain recommendations have also been made for public sector enterprises.

## Conclusion

The changes have been proposed to be made effective on and from April 01, 2018, while the provision with respect to approval of related party transactions is proposed to be made effective with immediate effect. Considering that few recommendations make us believe that their enforcement will lead to greater participation, transparency and serious business on the company's board, one needs to set on job and do detailed homework to be done by the management and the professionals, if made effective sooner, we need to be on our toes and look forward to the enforcement of these recommendations.

However, what is to be seen is that the MCA and the other fraternities such as the Institute of Chartered Accountants of India have expressed their dissent on some of the recommendations by the Committee

based on either jurisdictional grounds of that the provisions are inconsistent with the Act.[3] The issues were also addressed to the Committee vide MCA's letter dated 3rd October, 2017 appended to the Committee Report.

[3] The news can be read at: http://www.livemint.com/Companies/gKoGH2kWxLwRdKFI11s1nL/MCA-regulatory-bodies-express-dissent-on-Uday-Kotak-panel-p.html