# CONSULTATIVE PAPER ON REVIEW OF CORPORATE GOVERNANCE NORMS IN INDIA

IIAS Analysis and Standpoint

INSTITUTIONAL INVESTOR ADVISORY SERVICES

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# Introduction: Consultative Paper on Review of Corporate Governance Norms in India

On 4 January 2013, the Securities and Exchange Board of India ("SEBI," or "the Board") issued its Consultative paper reviewing the corporate governance norms in India. The paper primarily seeks to align the corporate governance provisions in clause 49 of the Listing Agreement with those provided in the new Companies Bill, 2012 (as passed by Lok Sabha). In addition, SEBI also aims to broaden the scope of corporate governance in listed entities by strengthening the existing regulatory framework.

In the paper, SEBI has posed and requested public comment on a series of relevant questions. Throughout the rest of this presentation, we have analysed and compiled our comments on each of the proposed clauses. Our views are reflected alongside the proposed amendments by way of the following symbols:

| | |
|---|---|
| FAVOUR | IIAS is in favour of the proposed clause. |
| AMEND | IIAS is broadly in favour with a few changes. |
| DISCUSS | IIAS would like to see greater discussion on this. |
| NEW | IIAS wants this to be included in combination with what SEBI has proposed |

## *Clause 11.1:* ***Appointment of independent director by minority shareholders***

**IIAS View:**
Discuss

### SEBI's Proposal:

In an attempt to bring more transparency in appointing directors, both independent and professional, SEBI is of the opinion that listed companies beyond a market cap maybe mandated to appoint atleast one small shareholder director.

### Current Regulations

As per section 252 of companies act, public companies with the following criteria may appoint small shareholders:

- Having a paid-up capital of 50 million rupees or more
- Or having 1000 or more as shareholders (- shareholders holding shares of nominal value of not more than Rs.20,000 or such other sum as may be prescribed)

Clause 151 of the Companies Bill has a similar provision as prescribed. The bill also provides that independent directors maybe selected from a database of directors detailing their names, qualifications etc. The agency providing this information has to be authorized by the central government.

### IIAS View

Though clause 149(6) of the companies bill and clause 49(I)(A) of the listing agreement specify the eligibility of an independent director, IIAS is of the opinion that individuals having a certain comfort level with controlling shareholders are often nominated for the role of independent directors.

However, IIAS believes that the appointment of small shareholder directors may not be a feasible solution to this problem as controlling shareholders may exhibit their influence over such directors.

IIAS feels that the appointment of lead independent directors to represent the minority shareholders maybe a more pragmatic solution. Further the same objective may be achieved through greater accountability of directors.

## *Clause 11.2: Cumulative voting for appointment of independent director*

**IIAS View:**
Amend

### SEBI's Proposal:

When companies have multiple openings for directors on its board, shareholders can choose to cast all their votes to a single nominee or split them amongst a smaller set of directors. This has already been provided in the Companies Act and SEBI believes it is best left for the company to provide for this option through its articles.

### Current Regulations

The existing and proposed regulations provide for cumulative voting as a non-mandatory requirement. Section 265 of the Companies Act, 1956 permits a company to adopt the principle of cumulative voting through a provision in its articles of association (AoA). In such a case, appointments will be made once in every three years and it is not permissible for a director appointed to be removed from office during his tenure.

### IIAS View

In India, with average promoter holding more than 50%, a proportional representation for the election of directors via a Cumulative Voting system is a suitable alternative.

For this system to be effective in developing markets such as India, it is important that companies make timely and adequate disclosures about the nominated directors. Equally important is the greater willingness on the part of institutional investors to work collaboratively on their voting strategy.

**Amendments proposed**:
IIAS believes that cumulative voting should be made mandatory. This gives minority shareholders the ability to vote 'for' and elect their desired candidate, and, equally important, to vote 'against' and stop a proposed appointment. Incorporating such a system would not only give a boost to corporate democracy but also reduce the clout of the promoter group in stacking up the board with its chosen nominees.

## *Clause 11.3 & 11.4: 'Formal letter of appointment' & 'Certification course and training for independent directors'*

**IIAS View:**
Favour

### SEBI's Proposal:

SEBI is of the view that companies should issue formal letter of appointment to non-executive directors or NEDs (including independent directors) while appointing them on board. This is inline with the voluntary guidelines of Ministry of Corporate Affairs. This information should be disclosed to shareholders at the time of obtaining their approval for director appointments and displayed on company websites and stock exchanges for listed companies.

SEBI has proposed conducting an induction course, devised by National Institute of Securities Markets (NISM), for independent directors . This would cover their role, expectations from stake holders, risk managements etc.

### Current Regulations

MCA guidelines as highlighted above.

### IIAS View

IIAS has consistently encouraged better disclosures from companies on appointments of NEDs and independent directors through its voting recommendations. Defining clear expectations and fiduciary duties from NEDs will hold the directors accountable for their actions.

It is important that this clause be made mandatory for all listed companies as this will provide the much needed clarity in the appointment of shareholder directors in PSU banks in India. As per the current system, the list of eligible directors is available to shareholders only on the day of AGM or EGM.
On remuneration, IIAS re-iterates the importance of standardizing the various heads under compensation payable to NEDs. This is further discussed in Clause 11.22.

IIAS believes 'on-boarding' to be more beneficial and effective, than general director training. 'On-boarding' is an induction program regarding the company's business, its operations and strategy. This will help the new directors understand what drives a company's business and its business risks. SEBI should encourage companies to have an appropriate programme in place.

## SEBI's Proposal:

SEBI proposes to exclude nominee directors from independent directors and categorize them as non-executive directors. SEBI is of the opinion that as nominee directors are appointed by institutions or lenders, precedence may be given to safeguard the interests of the nominating body over the overall interest of the company and other minority shareholders.

## Current Regulations

As per clause 49 of the listing agreement, nominee directors appointed by public financial institutions, (as defined in Section 4A of the Companies Act) and corresponding new banks (as defined in section 2(d) of the Banking Companies Act, 1970 or the Banking Companies Act, 1980) shall be deemed to be considered as independent directors.

The companies bill 2012 defines an independent director as a director other than a nominee director. Further it says that nominee directors are directors nominated by financial institution or appointed by the government to represent its interests. A similar recommendation has been made by Narayana Murthy CG Committee Report, 2003.

## IIAS View

The proposal is in-line with IIAS policy.

IIAS supports the classification of nominee directors as non-independent directors as this will negate the conflict of interest that exists in the role played by nominee directors. The treatment of nominee directors as non-independent would further bring in fresh vacancies on the board for the appointment of new independent directors in order to comply with composition of board structure as defined under clause 49 I(A) of the listing agreement.

## *Clause 11.6:* ***Mandate minimum and maximum age for Independent Directors***

**IIAS View:**
Favour

### SEBI's Proposal:

SEBI proposes to examine the possibility of setting a minimum and maximum age for independent directors. However, the regulatory body has not explicitly stated any particular maximum or minimum age limit for independent directors. SEBI is of the opinion that prescribing a specific age limit for independent directors in general may not serve the intended purpose as it may differ based on the line of business the company is involved in.

### Current Regulations

As per clause 49 I (A) iii (g), an independent means a non-executive director of the company who is not less than 21 years of age. Currently, neither clause 49 or the companies bill has made provisions for mandating the maximum age of independent directors.

### IIAS View

IIAS is in favour of setting up a minimum age limit for independent directors. This can be fixed either at the age of 25 subject to a minimum of five years work experience. In case appointment is proposed for candidates below this age limit, the existing provision under part I (C) of Schedule XIII of the companies act for appointment of whole time directors requiring shareholder or central government approval be applied. It is important that a brief profile of the candidate such as work experience, background, qualifications etc. are clearly disclosed to shareholders during the time of approval.

IIAS favours a mandatory retirement age for all directors. Further, each company should have a retirement age not just independent directors, including chairman and managing director. IIAS believes that this will also help companies with succession planning.

## *Clause 11.7: Mandating maximum tenure for independent director*

**IIAS View:**
Amend

### SEBI's Proposal:

SEBI has proposed to mandate the tenure of independent directors in line with the Companies Bill. As per the Bill, an independent director may hold office for five consecutive years. He maybe re-appointed for second consecutive term on passing of a special resolution by the company and with necessary disclosures of the appointment on the board's report.

### Current Regulations

The non-mandatory requirement of clause 49 of the listing agreement, states that an independent director may serve on the board of a company for not more than an aggregate period of nine years.

As per the voluntary guidelines of the Ministry of Corporate Affairs, an individual can function as an independent director for not more than six years. He maybe appointed for a maximum of three terms with a cooling off period of three years with no association with the company in any way.

### IIAS View

IIAS favors limiting the tenure of independent directors to two terms of five years each. After ten years, a director will not be eligible for re-appointment for a period of another five years. This will, to an extent, ensure that independent directors do not develop a cozy relationship with the management.

IIAS recognizes that companies may see merit in continuing with a director beyond the statutory limit of 10 years. The companies could re-appoint them as 'non-independent' directors, to continue to benefit from their experience. However, complying with the ratio of independent to non-independent directors, as per clause 49, should be mandatory.

**Amendment proposed:** Further, the current period served by independent directors should be taken into consideration while calculating the tenure of directors. Company's should be given three years to comply with this. This will enable directors to 'retire' on completion of their existing term.

# *Clause 11.8:* ***Requiring Independent directors to disclose reasons of their resignation***

**IIAS View:** Favour

## SEBI's Proposal:

SEBI proposes to require independent directors to disclose in writing the reason for their resignation to the company and the registrar within 30 days. The company shall also inform the registrar and the detail the facts of the resignation in the director's report in the immediate following general meeting. This is inline with the provisions of the Companies Bill for resignation of directors.

## Current Regulations

Though clause 49 mandates companies to replace independent directors resigning from the board within 180 days, it does not require disclosure for the reason of resignation.

## IIAS View

IIAS is in favor of such disclosures.

Further, in case of violation of governance code, directors may also make use of the whistle blower's policy.

## *Clause 11.9 and 11.10: 'Clarity on liabilities and on remuneration of independent directors' and 'Performance evaluation of independent director'*

**IIAS View:** Amend

### SEBI's Proposal:

In order to bring in risk-return parity, SEBI has recommended that independent directors be paid remuneration by balancing the fixed and variable pay. This could be through sitting fees, reimbursement of expenses for participation in board and committee meetings and as commissions as a percentage of profits.

Further SEBI has also proposed to introduce a process for evaluating the board 's performance by an external experts committee. As per SEBI, this evaluation should be based on director's attendance and contribution to board/ committee meetings.

### Current Regulations

Clause 49 states that prior shareholder approval is required for payment of any remuneration to independent directors including the grant of maximum number of stock options .
Both Clause 49 and the Companies Bill require the board to evaluate the performance of independent directors (excluding the director himself)

### IIAS View

IIAS believes that making independent directors accountable, together with objective performance evaluation of directors, will help make these directors responsible for their actions. Having a clear framework of director's liabilities is desirable. SEBI may also evaluate the possibility for companies appointing an external committees to evaluate board performance.

**Amendment proposed:**

- Regarding compensation of the independent directors, this could based on percentage of profits, but the cap should be stated in absolute amounts.
- ESOP's for directors needs to be debated.

## *Clause 11.11: **Lead Independent Director***

**IIAS View:**
Amend

### SEBI's Proposal:

SEBI proposes that companies employ the concept of 'Lead Independent Director'. A lead independent director will act as the chief of all non-executive and/ or independent directors and co-ordinate the decisions and activities of all these directors; Companies having an Independent Chairman may act as the lead independent director. In order to avoid the formation of a 'Power Centre' by such an act, SEBI also proposes to mandate that the lead independent director be rotated every three years.

### Current Regulations

Currently there no such provisions incorporated under any other CG guidelines/ Reports

### IIAS View

IIAS believes that lead independent directors should play an active role in some of the key governance areas of the companies such as 'Related Party Transactions.' It is in favour of such appointments.

<u>**The following amendments maybe considered:**</u>

- Lead independent directors should have a term of five years, in line with the term of their appointment instead of three years as proposed by SEBI.
- SEBI may also consider capping the number of lead independent directorships to three per person. Further a director may be appointed as lead independent director only in their second term on the board.

# *Clause 11.12:* ***Separate meetings of Independent Directors***

**IIAS View:**
Amend

## SEBI's Proposal:

In line with the Companies Bill 2012, SEBI proposes to mandate separate meetings for independent directors atleast once a year. The objective of this meeting will be to:

- Examine and disclose in the annual report the inefficiencies in the internal control systems and governance practices in the company
- Review the performance of the Board as a whole including the Chairman and non-independent directors.

## Current Regulations

As stated above, the Companies Bill 2012 emphasizes on separate meetings for independent directors.

## IIAS View

IIAS believes that separate meetings will encourage exchange of ideas amongst independent directors (IDs). In case inefficiencies and governance issues in the company is presented by independent directors in their report, the management should address these concerns and bring in a system of checks and balances that ensures proper functioning in these areas.

**Amendments proposed:** The meetings maybe chaired by the lead independent directors and held atleast once an year. Further they should meet 1. at the time of a significant related party transaction 2. major corporate event

# *Clause 11.13:* ***Restriction on the number of independent directorships***

**IIAS View:**
Amend

## SEBI's Proposal:

SEBI proposes to examine limiting the number of independent directorships for an individual. This will enable the independent directors to dedicate sufficient time to the agendas of both the committee and board meetings and contribute effectively to the company. Unlike the current provisions on maximum directorships, SEBI intends to propose a maximum cap on number of independent directorships of listed companies as these demand higher degree of commitment.

## Current Regulations

Presently, the guidelines restrict the number of directorships based on public companies:

- Section 275 of the Companies Act restricts the number of directorship of a person to fifteen public companies
- Companies Bill proposes to restrict the number of directorships of a person to ten public companies
- The Voluntary Guidelines issued by MCA restricts independent directorships to seven public companies

## IIAS View

NEW

**Amendment proposed:**

- Given the increased responsibilities and compliance in listed entities, IIAS favours directorships in not more than seven listed companies and a total of 12 directorships. However for those in full time employment, the total directorships should be restricted to six public companies (- listed or otherwise).
- IIAS also believes that the number of directorships be linked to the size and market capitalization of companies.
- Further the directorships in offshore or foreign companies should be counted and disclosed by all directors and form a part of the 'CG Report.'

## *Clause 11.14: Separating the position of Chairman and that of the Managing Director / CEO*

**IIAS View:**
Favour

### SEBI's Proposal:

SEBI proposes to segregate the role of the chairman and the managing director/ CEO of the company. As per SEBI, this will promote balance of power and avoid unfettered decision making by one individual and conflicts of interest. SEBI proposes to align the requirements of clause 49 with the Bill.

### Current Regulations

The Companies Bill 2012 states that no individual maybe appointed as the chairman and the managing director/ CEO of the company unless:

- The articles of the company do not provide for these
- The company is not engaged in multiple businesses

### IIAS View

IIAS favors the segregation of roles of the chairman and managing director/ CEO. This along with the existing provisions of clause 49 on board composition requires:

- One third of board to be independent with a non-executive (non-promoter) chairman
- Half the board to be independent with an executive/promoter chairman

**IIAS View:**
Favour

## SEBI's Proposal:

SEBI intends to examine to make the nomination committee responsible for ensuring board members are from divergent background and gender in order to maintain board diversity. SEBI is of the opinion that diversity on board will widen perspectives in decision making by avoiding similarity of attitude. And that this will also help companies better understand and connect with their stakeholders

## Current Regulations

The Companies Bill states that companies appointing more than 15 directors on its board shall have atleast one woman director.

## IIAS View

IIAS favours greater diversity on the board.

IIAS believes that members from diverse backgrounds such as qualifications and work experience can bring in a mix of ideas during boardroom discussions. This enhances board effectiveness and avoids homogenous thinking. In its policy for evaluating the parameters for board composition, IIAS favours boards having atleast one woman director.

## *Clause 11.16: **Succession Planning***

**IIAS View:**
Favour

### SEBI's Proposal:

SEBI proposes to mandate that listed companies ensure plans are in place for smooth succession of senior managerial personnel prior to their re-appointments. SEBI may also mandate disclosure of succession planning to boards and shareholders at regular intervals of time.

### Current Regulations

Currently there no such provisions incorporated under Indian CG guidelines/ reports

### IIAS View

**Related Report -** Larsen Toubro Ltd AGM on 24 August 2012

IIAS believes that succession planning is key to the proper functioning of the company.

As highlighted in the clause mandating maximum tenure of directors, companies must set maximum age thresholds for all its directors. This will force companies into succession planning. Any exception has to be put to shareholders to vote, with the remuneration committee explaining why such an extension is being proposed.

## *Clause 11.17 and 11.18:* ***'Risk Management' and 'Reporting of the internal auditor'***

**IIAS View:**
Amend

### SEBI's Proposal:

SEBI intends to examine whether a defined risk management framework, its compulsory monitoring, and disclosure to shareholders at specific time interval be laid down in the listing agreement. SEBI also wishes to examine the feasibility of delegating the ultimate responsibility of risk management to the board, audit committee or the risk management committee.

SEBI is of the opinion that in order to effectively asses the internal controls, risk management, and governance of the company, the internal auditor must directly report to the audit committee.

### Current Regulations

Clause 49 (IV) C of the listing agreement states that risk management and minimization procedures be reviewed by the board at periodically to ensure risk control through a properly defined framework.

The Companies Bill requires that the board disclose the risk management policy in its report with the elements of risk that may threaten the existence of the company. The evaluation of risk management system is indicated as the audit committee's responsibility.

### IIAS View

Currently the companies Act 1956, brings the reporting and review of financial statements and adequacy of internal control systems as well as risk management under the purview of the audit committee.

As auditing of financial statements, risk control and management go hand in hand, IIAS recommends that the risk management committee and the audit committee be combined. The internal auditor should report directly to the chairman of the audit committee.

NEW

**Amendments Proposed:** If an external firm is the 'internal auditor,' its term should be restricted to a maximum of five years.

**IIAS View:**
Amend

## SEBI's Proposal:

SEBI is of the opinion that continued association of auditors with a company may lead to a friendly relationship between the auditors and the management. This may affect auditor independence and therefore compromise their judgment on the financial statements of the company.

SEBI proposes to mandate the rotation of audit firms after each term of five years to break this long term associations with the company. The audit firm maybe re-appointed for a second term with a new audit partner. This is inline with the Companies Bill 2012.

## Current Regulations

According to MCA, in order to maintain independence of auditors, an audit partner should be rotated every three years and an audit firm should be rotated every five years. A cooling period of three years should elapse before a partner can resume an audit assignment for the company. This period should be five years for the firm.

## IIAS View

In a recent survey we conducted regarding the attitude of institutional investors towards corporate governance, investors cited the quality of accounts as being most critical while deciding whether to invest in a company highlighting the primacy investors accord to audit reports.

Vintage auditors tend to develop a certain level of comfort with the company management, thereby compromising the integrity of the audit process. Further mandatory rotation will bring a fresh perspective on the financials and will keep the current auditors on their toes as they will be aware that a new auditor may detect any irregularities in the accounting process.

Continued >>

# *Clause 11.19:* ***Mandatory rotation of audit partners (Contd.)***

**IIAS View:**
Amend

## IIAS View

We welcome appointing auditors for a maximum of two terms of five years each.

**Amendments proposed:**

NEW

- SEBI should clarify that audit firms within the same 'audit network' will not qualify as auditor rotation.
- The existing tenure of audit firms should be considered for the rotation of these firms.
- SEBI may consider the system of joint auditors, with auditors have the right to review the all documents and joint and several liability. This will help develop more firms, including local firms. Further, it will ensure some continuity in audits, as shown below.

REDRAW

| Joint Auditors | Upto years (Terms) | | | |
|---|---|---|---|---|
| | 5 | 10 | 15 | 20 |
| Audit firms | B | B | D | D |
| | A | C | C | E |

'A' and 'B' are appointed as auditors. 'A' is appointed for 5 years, 'B' for 10 years. After 5 years, 'A' is replaced by 'C,' who is appointed for 10 years. This will enable 'C' to continue as auditor, when 'B' retires and 'D' appointed, allowing continuity.

***Related Reports***

**Auditor Rotation:**
A formality or a fiduciary responsibility?

**CII-IIAS Institutional Investors Survey:**
Institutional Investors: Driving Force for Good Governance

## *Clause 11.20:* ***Making Whistle Blower Mechanism a compulsory requirement***

**IIAS View:**
Favour

### SEBI's Proposal:

With an intent to avoid scam in corporate houses in India, SEBI proposes to implement a vigil mechanism for both directors and employees for a suspected fraud or violation of the company's code of conduct or ethics policy. In line with the Companies Bill, SEBI recommends that the whistle blower policy come under the purview of the audit committee. Any such acts of violation may be investigated by a non-executive director.

SEBI has stressed that identity of the whistle blower be protected to avoid victimization. Further, the policy should ensure that frivolous accusations are not made to harass management.

### Current Regulations

Presently, both the MCA Voluntary guidelines and clause 49 (non-mandatory) provide for such mechanisms.

### IIAS View

IIAS favors putting in place  a whistle blower policy.

IIAS agrees that this should be under the ambit of the audit committee. In case any of the reported incidences is found to be true, the chairperson of the audit committee should ensure that appropriate actions are taken and a framework is established to avoid such incidents in future.

Should the identity of the person be leaked, the committee should look into the matter closely and plug the gaps that led to this issue.

## *Clause 11.21, 11.22 & 11.23: 'Making the Remuneration committee a mandatory one and expanding its scope' ,'Enhanced disclosure of remuneration policies' and 'Stakeholders Relationship Committee'*

**IIAS View:** Amend

### SEBI's Proposal:

In alignment to the Companies Bill, SEBI has proposed that listed companies constitute a remuneration and nomination committee consisting of atleast three non executive directors having atleast half as independent directors.

This committee will be responsible for identifying candidates for board appointments based on selection criteria, and evaluating performance of board members. The committee will ensure that remuneration of directors is aligned with proper performance benchmarks and company's goals, and sufficient balance exists between fixed and variable pay of all directors.

Further the regulatory body has stated that listed companies disclose the ratio of remuneration to each director to the median employee remuneration in its board report.

### Current Regulations

As per the non-mandatory requirement of Clause 49, the remuneration committee will comprise of atleast three non-executive directors and chaired by an independent director while the Voluntary guidelines of MCA state that the committee should comprise of atleast three members with majority as non-executive directors and atleast one independent director.

Both clause 49 and Clause 178 of the Companies Bill require the constitution of Stakeholder Relationship Committee chaired by a non-executive director.

### IIAS View

**Related Report** - Jindal Steel Power Ltd AGM on 26 September 2012

IIAS favors appointing a remuneration and stakeholder committee in line with the Companies Bill. The formation of the remuneration committee must be made mandatory and should comprise of atleast 50% independent directors. IIAS has observed instances in Indian Companies where the absence of a remuneration committee has led to abuse of high remuneration to controlling shareholders.

Continued >>

## *Clause 11.21, 11.22 & 11.23: 'Making the Remuneration committee a mandatory one and expanding its scope' ,'Enhanced disclosure of remuneration policies' and 'Stakeholders Relationship Committee'*

**IIAS View:**
Amend

### IIAS View

NEW

**Amendments proposed:**

- Though clause 49 lists the disclosures on directors remuneration, IIAS finds the current disclosures regarding compensation inadequate. These are open-ended with regard to both the value of perks, as well as bonus payments. As bonus cannot be decided upfront, being paid for 'performance' IIAS suggests that the fixed salary be decided and voted upfront, while the bonus amount is put to vote, in the subsequent year based on the company performance. This will ensure that the compensation committee makes a well-argued case for the total compensation.
- IIAS believe compensation details for executive directors (including CEO/Chairman) should be standardized and disclosed. In case they receive money from an offshore subsidiary/ associate firm, whether as salary or consultancy fees or under any other head, this too should be disclosed.

## *Clause 11.24 and 11.28: 'Mandating e-voting for all resolutions of a listed company' and 'Improving investor education and awareness for better participation and deliberations at General Meetings'*

**IIAS View:** Favour

### SEBI's Proposal:

As per the circular issued by SEBI in July 2012, all listed companies (starting with top 500 listed companies) were to provide e-voting facility to investors for all resolutions passed by postal ballot. SEBI now proposes that companies conduct all resolutions passed in general meetings via postal ballots or e-voting in order to encourage wider shareholder participation.

SEBI also proposes to increase investor education and awareness as this improve the quality of shareholder deliberations with management during meetings.

### Current Regulations

Presently, both Section 192 (A) of Companies Act 1956 and Companies Bill provide for passing of resolutions through electronic voting.

### IIAS View

IIAS believes that mandating e-voting will improve investor participation in meetings and bring transparency in voting:

- Encourage wider participation from shareholder community including retail shareholders
- No possibility of casting invalid votes
- Counting of votes is accurate and the whole voting process is transparent
- Increase shareholder participation in crucial corporate decisions
- Allow investors including NRIs to cast their vote till the last day
- Reduces administrational effort and paper work for institutional investors.

**IIAS View:**
Amend

## SEBI's Proposal:

SEBI is of the opinion that RPTs can be regulated in two ways:

- Through approval based controls requiring approval of the board/ shareholders
- Through disclosure based controls as required under AS-18

## IIAS – Holistic View

Broadly, IIAS in favor of introducing greater transparency in RPTs as suggested by SEBI. However, in order to make the system more effective we propose the following changes.

NEW

**Classification of RPTs:**

- **Recurring** - periodic, mostly every year – usually related to sale and purchase of goods and services, royalty, loans and interest payments etc.
- **Non-recurring** – one time exceptional item – usually corporate guarantee, investments and divestments, M&A etc. should always be put to shareholders for approval, with the lead independent director recommendations

The classification of items as recurring and non-recurring itself should be defined by SEBI. The approval may vary depending on the pre-defined thresholds.

| Threshold * | | Approval Process |
|---|---|---|
| 1 | < 0.1% of gross assets | No approval, disclosure to be made |
| 2 | Between 0.1%-2.5% of gross assets | Pre-approved by audit committee |
| 3 | > 2.5% of gross assets | Put to shareholders vote through a special resolution, with recommendation of independent directors |
| | | |

* for the purpose of this letter, we have used gross assets, but the threshold - tunover, profits etc. Will need to be decided by SEBI

# *Clause 11.25: **Abusive Related Party Transactions***

**IIAS View:**
Amend

## IIAS View

NEW

- Similar recurring RPT to be grouped and aggregated to calculate the threshold.
- Disclosures should be on an on-going basis.
- **Disclosures**: These should be standardized and include:
  - Date of transaction
  - Parties to the transaction
  - Level/degree/nature of association with related parties
  - Rationale for transaction
  - Pricing
  - Economic benefit for all interested related parties
  - Monitoring Mechanism
    - Audit committee to report details on transactions, after shareholder approval
    - Auditor report should comment on this

Companies have got blanket exemption from disclosing quantitative details vide Press Note 2/ 2011 dated 08th February 2011 issued by the Ministry of Corporate Affairs. We believe this information is critical for investors and should be disclosed. All subsidiaries/associate companies should declare both profit and loss as well as balance sheet data.

**Royalty**:

- Royalty should be with prior approval of shareholders with majority of minority (i.e non-controlling/non-promoters) investors approving the transaction or by way of a special resolution.
- Any change in the existing arrangements should also be subject to such approvals. Further, royalty agreements should be approved for between three to five years, and put to shareholders to vote at the end of the agreement period.
- Complete statement and explanation should be given and should be to a large extent linked to increase in profitability rather than based on turnover.

**IIAS View:**
Amend

(a) Requiring approval by shareholders for divestment of major subsidiaries:

**SEBI's Proposal:**

Current regulations do not provide for shareholder approval when a company sells shares of its subsidiary. As there have been instances where controlling shareholders have transferred shares of company's major subsidiaries to themselves at improper valuations, SEBI proposes to require listed companies to obtain shareholder approval in case of divestments by amending the listing agreement.

**Current Regulations**

Presently this concern is not addressed under Indian regulations

**IIAS View**

IIAS is in favour of this proposal.

**Amendments proposed:**

IIAS is of the opinion that SEBI should mandate listed companies to require the approval of shareholders for divestments in all subsidiaries. Further the company should disclose:

- Atleast three years financial statements of the subsidiary including balance sheet data and profit & loss statements.
- The reasons for the divestment and investment by the related party.

**IIAS View:**
Amend

(b) Immediate and continuous disclosures of material RPTs:

**SEBI's Proposal:**

As RPTs are presently disclosed to shareholders only annually, the investors have access to this information after the transactions have already been executed. Therefore, SEBI proposes amend the reporting requirement under the listing agreement as well as firm up on suitable threshold limits of RPTs.

**Current Regulations**

As stated above, presently RPTs are disclosed only annually to shareholders.

**IIAS View**

**IIAS favours the proposal with two amendments:**

- The disclosures need to be standardized and should include the six critical details as mentioned.
- Depending on the recurring or non-recurring nature and the amount of the transactions, these need to be vetted by the audit committee and/ or be put to shareholders to vote.

(c) Prohibiting/regulating grant of affirmative rights to certain investors:

**IIAS View:**
Amend

## SEBI's Proposal:

SEBI intends to prohibit companies from granting 'superior rights' to certain class of investors. These rights such as anti-dilution rights, right to appoint nominee directors, access to privileged information may lead to oppression of minority shareholders as they do not hold these privileges.

## Current Regulations

Currently, the grant of these rights are not in violation to the clauses of the listing agreement or SEBI regulations.

## IIAS View

**Related Report** - Manappuram Finance Ltd AGM on 02 August 2012

Inline with the SEBI proposal, IIAS is against the grant of such rights to any class of shareholders/ investors. Sometimes special rights are given to sponsors and/or to private equity investors. We agree with the concerns voiced by SEBI and believe these rights should fall-off at the time of the company's listing

NEW

**Amendments proposed:**

- That these rights be clearly defined by the regulatory body. For example, distinction should be made between director nomination rights and veto rights on corporate actions.
- The lead independent director vet such agreements executed with private investors and ensure compliance.
- Companies that have granted such rights be moved to 'Trade to Trade' segment.
- Prohibiting promoters also from entering into such agreements with companies through memorandum and articles.

(d) Approval of major RPTs by 'Majority of the minority' and (f) Approval of Managerial Remuneration by disinterested shareholders

**IIAS View:**
Favour

## SEBI's Proposal:

SEBI is of the opinion that as several abusive RPTs are executed between group companies of controlling shareholders, it is important to take the approval of majority of minority shareholders. Currently, as controlling shareholders have a dominant holding in the company, putting these RPTs for approval to all shareholders does not serve the intended purpose.

This includes related party transactions such as managerial remuneration to the executives of promoter/ promoter groups. In this regard, though Companies Act specifies a certain limit on managerial remuneration, SEBI proposes to mandate the approval of disinterested/ minority shareholders.

## Current Regulations

Clause 188 of the companies Bill 2012 prohibits interested shareholders from voting in RPTs.

## IIAS View

**Related Report** – Royalty payments and minority shareholders

**NEW**

IIAS favors that such related party transactions be approved by atleast 50% of the disinterested/ minority shareholders. In context to managerial remuneration, these should be put to vote by disinterested shareholders should the proposed remuneration exceed a predefined multiple of the (median or average) employee salary

(e) Pre-approval of RPTs by Audit Committee and encouraging them to refer major RPTs for third party valuation

**IIAS View:**
Amend

## SEBI's Proposal:

SEBI intends to mandate the prior approval of the audit committee for major RPTs and restructuring proposals. Presently, though, the audit committee reviews RPTs at regular intervals, these are post the execution of these transactions and therefore do not serve much purpose.

## Current Regulations

The Companies Bill empowers the audit committee to approve as such or modify RPTs including inter-corporate loans and investments etc. Audit committee also have complete authority to investigate matters falling under its domain, may seek help of external sources for advice, and have complete rights to access information contained in the records of the company.

## IIAS View

IIAS favors pre-approval of recurring transactions such as sale and purchase of goods and services, royalty, loans and interest payments by the audit committee depending upon the amount (should be defined by SEBI).

**Amendments proposed:**

- The audit committee should monitor details of the transaction post shareholder approval and report their findings in their report.
- The third party report should be enclosed with the RPT section in the company filings.

**IIAS View:** Favour

(g) Expanding the scope of Related Party Transactions

**SEBI's Proposal:**

Presently the disclosures made by companies under related party transactions are as per Accounting Standard 18 (AS-18). As, RPTs defined under AS -18 have limited coverage, SEBI proposes to adopt Indian Accounting Standard 24 (Ind AS-24) that corresponds to the International Accounting Standard 24 (IAS 24). SEBI is of the opinion that as Ind AS-24 has a wider coverage and specificity with regard to disclosures under RPT and will be useful to align the requirements of the listing agreement with it.

**Current Regulations**

As discussed under 'IIAS View'

**IIAS View**

IIAS welcomes adopting the principles of disclosures under Ind AS-24. IIAS is of the opinion that Ind AS-24 covers the necessary disclosures, relative to AS-18, that will help shareholders evaluate the financial position of the company, its transactions and outstanding balances or any other form of commitments it may have with related parties. Key difference in disclosures between AS 18 and Ind AS-24 is:

- Ind AS 24 requires disclosures of compensation for Key Managerial Personnel (KMP) under different categories such as parent company while AS-18 requires compensation details for KMP for the entity only.
- Ind AS 24 mandates the amount of the transactions with related parties while AS 18 requires 'Volume of transactions either as amount or proportionate basis'
- Ind AS 24 covers disclosures in case of joint ventures while as per AS 18 co-ventures and co-associates are not related to each other.

## *Clause 11.26:* ***Fiduciary responsibility of controlling shareholders***

**IIAS View:**
Favour

### SEBI's Proposal:

SEBI has proposed a framework specifying the fiduciary responsibilities of controlling shareholders (Promoters) towards the listed company and its shareholders.

It has proposed to mandate a 'relationship agreement' between the controlling shareholders and the company that clearly defines the duties and responsibilities of such shareholders. Any amendments to the agreement will be put to shareholder vote specifying the cumulative effects of all changes since the vote.

### Current Regulations

No guidelines specified under current regulations.

### IIAS View

IIAS has consistently advocated transparency in actions of controlling shareholders. Mandating the provisions outlined above will help bridge the growing trust deficit between the controlling and non-controlling shareholders.

It maybe important for SEBI to lay down a principles based, rather than a rule based approach.

## *Clause 11.27 and 11.29: 'Strengthening Private Sector Enforcement' and 'Provision for regulatory support to class action suits'*

**IIAS View:** Favour

### SEBI's Proposal:

SEBI is of the opinion that corporate governance standards can be improved in India by strengthening the private sector enforcement. In this context, the regulatory body proposes to encourage proxy advisory firms, assign higher enforcement power to stock exchanges, and improve investor education awareness and support to investor associations and groups.

SEBI also proposes to provide monetary support to SEBI recognized investor associations to undertake legal proceedings against companies.

### Current Regulations

Regulation 5 (2) of SEBI (Investor Protection and Education Fund) and clause 245 of the Companies Bill 2012 provides for legal proceedings/ class actions suits. Clause 125 of the Companies Bill also provides for reimbursement of expenses in such suits.

### IIAS View

IIAS believes that SEBI should lay down specific governance roles to stock exchanges where the companies are listed. Stock exchanges maybe required to have separate committees that evaluate corporate actions which may directly or indirectly affect minority shareholders. These include restructuring of business, mergers and acquisitions, spin offs, etc. Further these stock exchanges may seek the help of independent (third party) agencies.

Proxy advisory firms are focused towards governance research and data. It therefore makes sense for SEBI to encourage and support such agencies and identify roles to involve them in more meaningful ways to promote better governance practices. IIAS continually tracks governance issues across companies and alerts investors of any activities that adversely affects shareholder rights.

**IIAS View:** Amend

## SEBI's Proposal:

SEBI understands that institutional investors play a critical role in establishing credibility and effectiveness in corporate governance system. SEBI is of the opinion that monitoring portfolio companies and effectively exercising its ownership rights in such companies will enhance the overall governance standards. In order to encourage institutional investors to actively participate and work with corporates, SEBI has proposed the following measures:

a) Institutional investors should have a clear policy on voting and disclosure of voting activity
b) Institutional investors to have a robust policy on managing conflicts of interest
c) Institutional investors to monitor their investee companies
d) Institutional investors to be willing to act collectively with other investors where appropriate
e) Institutional investors to establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value

## Current Regulations

Through its circular in March 2010, SEBI mandated mutual funds to disclose their general voting policies and procedures along with the actual votes exercised on their websites and annual reports. The initiative was to bring greater participation from institutional investors in shareholder meetings and improve corporate governance.

## IIAS View

Institutional Investors are sophisticated clients with expertise in understanding financial statements and data. These investors are knowledgeable about their company's history and its management behavior. Nevertheless, they hold a fiduciary responsibility to all unit holders and should strive to engage actively with companies on governance issues.

Continued >>

## IIAS View

IIAS favors the SEBI initiative.

**Amendments proposed:**

- SEBI should mandate institutional investors to vote 'For' or 'Against' in meetings of investee companies. 'Abstaining' from voting should not be considered a vote. There may be exceptions viz. when a fund house abstains from voting on its sponsor controlled company's resolutions.
- The voting policies of most asset management companies require clarity in framework. Aligning this with actual votes casted is a step towards good corporate governance.

IIAS is of the opinion that institutional investors should work collectively in the cases where initial dialogues with company management have failed. Early in 2012, IIAS spearheaded one such initiative where a listed entity was merging with promoter companies at unfair valuations. This experience shows that companies are willing to 'listen' to collective voices.

**IIAS View:**
Favour

## SEBI's Proposal:

In the case of non-compliance with provisions of the listing agreement, SEBI proposes to impose monetary penalty on companies, directors, promoters as well as prevent them from accessing capital markets directly or indirectly.

SEBI also proposes to incorporate the following measures to monitor company's adherence to compliance:

- Verifying the compliance reports made by companies by stock exchanges/ SEBI. In case of any violations, SEBI to impose penalties on board, compliance officer etc.

## Current Regulations

Clause 49 prescribes listed companies to provide a detailed compliance report every quarter and corporate governance report annually. Companies also need to provide a compliance certificate from auditors/ company secretaries to stock exchanges and shareholders. The submission of these reports are time bound post closing of quarter or annually.

## IIAS View

Inline with the recommendations of SEBI, IIAS is of the opinion that defining the role of proxy advisory firms in this context will be beneficial. Considering the number of listed companies presently, and the volume of such compliance reports, it may not be feasible for regulatory bodies and stock exchanges to investigate the disclosures in detail. SEBI may, therefore, evaluate the possibility of outsourcing monitoring of compliance related issues of companies to such firms as they provide the required expertise on the governance arena.

# Annexures

# **Annexure:** Formal letter of appointment

## Ministry of Corporate Affairs

**Appointments to the Board**

i. Companies should issue formal letters of appointment to Non-Executive Directors (NEDs) and Independent Directors - as is done by them while appointing employees and Executive Directors. The letter should specify:

- The term of the appointment;
- The expectation of the Board from the appointed director; the Board-level committee(s) in which the director is expected to serve and its tasks;
- The fiduciary duties that come with such an appointment along with accompanying liabilities;
- Provision for Directors and Officers (D&O) insurance, if any,
- The Code of Business Ethics that the company expects its directors and employees to follow;
- The list of actions that a director should not do while functioning as such in the company; and
- The remuneration, including sitting fees and stock options etc, if any.

ii. Such formal letter should form a part of the disclosure to shareholders at the time of the ratification of his/her appointment or re-appointment to the Board. This letter should also be placed by the company on its website, if any, and in case the company is a listed company, also on the website of the stock exchange where the securities of the company are listed.

# **Annexure:** Treatment of nominee directors as non-independent

## Narayana Murthy Committee Report on CG

**Nominee directors**

3.8.1 Exclusion of nominee directors from the definition of independent directors

3.8.1.1 It was suggested that nominee directors should be excluded from the definition of independent directors.

3.8.1.2 The Committee felt that the institution of nominee directors creates a conflict of interest that should be avoided. Such directors often claim that they are answerable only to the institutions they represent and take no responsibility for the company's management or fiduciary responsibility to other shareholders. It is necessary that all directors, whether representing institutions or otherwise, should have the same responsibilities and liabilities.

3.8.1.3 If the institution, whether as a lending institution or as investing institution, wishes to appoint its nominee on the Board, such appointment should be made through the normal process of election by the shareholders.

3.8.1.4 The Committee noted a dissenting view that FI nominees should not be granted any Board representation rights. Management should treat them on par with other investors and disseminate the same information that other shareholders would obtain. By virtue of their Board seat, FIs are placed in an advantageous position over the other shareholders, in terms of company price-sensitive information.

3.8.1.5 Based on the above distinction, the Committee makes the following mandatory recommendation:

## Clause 49

**Non executive directors' compensation and disclosures**

All fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, including independent directors, in any financial year and in aggregate.

Provided that the requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 1956 for payment of sitting fees without approval of the Central Government.

# **Annexure:** Separate meetings of Independent Directors

**Companies Bill 2012**

**Separate Meetings:**

(1) The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management;
(2) All the independent directors of the company shall strive to be present at such meeting;
(3) The meeting shall:
(a) review the performance of non-independent directors and the Board as a whole;
(b) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
(c) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

## Voluntary Guidelines - MCA

**Number of Companies in which an Individual may become a Director:**

i. For reckoning the maximum limit of directorships, the following categories of companies should be included:-

- public limited companies,
- private companies that are either holding or subsidiary companies of public companies.

ii. In case an individual is a Managing Director or Whole-time Director in a public company the maximum number of companies in which such an individual can serve as a Non-Executive Director or Independent Director should be restricted to seven.

**Companies Bill 2012**

(*1*) No person, after the commencement of this Act, shall hold office as a director, including any alternate directorship, in more than twenty companies at the same time:

Provided that the maximum number of public companies in which a person can be appointed as a director shall not exceed ten. *Explanation*.— For reckoning the limit of public companies in which a person can be appointed as director, directorship in private companies that are either holding or subsidiary company of a public company shall be included.

(*2*) Subject to the provisions of sub-section (*1*), the members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as directors

(3) Any person holding office as director in companies more than the limits as specified in sub-section (*1*), immediately before the commencement of this Act shall, within a period of one year from such commencement,—

(*a*) choose not more than the specified limit of those companies, as companies in which he wishes to continue to hold the office of director;

(*b*) resign his office as director in the other remaining companies; and

(*c*) intimate the choice made by him under clause (*a*), to each of the companies in which he was holding the office of director before such commencement and to the Registrar having jurisdiction in respect of each such company.

(*4*) Any resignation made in pursuance of clause (*b*) of sub-section (*3*) shall become effective immediately on the despatch thereof to the company concerned.

Continued >>

**Companies Bill 2012**

(*5*) No such person shall act as director in more than the specified number of companies,—

(*a*) after despatching the resignation of his office as director or non-executive director thereof, in pursuance of clause (*b*) of sub-section (*3*); or (*b*) after the expiry of one year from the commencement of this Act, whichever is earlier.

(*6*) If a person accepts an appointment as a director in contravention of sub-section (*1*), he shall be punishable with fine which shall not be less than five thousand rupees but which may extend to twenty-five thousand rupees for every day after the first during which the contravention continues.

# **Annexure:** Appointment of key managerial personnel.

**Companies Bill 2012**

Provided that an individual shall not be appointed or reappointed as the chairperson of the company, in pursuance of the articles of the company, as well as the managing director or Chief Executive Officer of the company at the same time after the date of commencement of this Act unless,—

(*a*) the articles of such a company provide otherwise; or
(*b*) the company does not carry multiple businesses:

Provided further that nothing contained in the first proviso shall apply to such class of companies engaged in multiple businesses and which has appointed one or more Chief
Executive Officers for each such business as may be notified by the Central Government.

# **Annexure:** IIAS Policy – Board Composition

**IIAS evaluation parameters for board composition**

| Parameters | Result | Risk Level |
|---|---|---|
| Is the chairman of the board an independent director? | No | Low |
| Proportion of independent directors on the board | 30%[1] | Moderate |
| Proportion of non-executive directors on the board | 80% | - |
| Is there at-least one woman director on the board? | Yes | - |
| Does the company have a policy on the retirement age of directors? | No | Low |
| Does the company have a policy on the tenure of directors? | No | Low |
| Do all the board committees have at least one independent director? | Yes | - |
| Is there any whistleblower policy for the independent directors? | No | Low |
| Proportion of promoter and promoter relatives on board | 10% | - |
| | **Overall** | **Low** |

**Companies Bill 2012**

No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint—

(*a*) an individual as auditor for more than one term of five consecutive years; and

(*b*) an audit firm as auditor for more than two terms of five consecutive years:

Provided that—

(*i*) an individual auditor who has completed his term under clause (*a*) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;

(*ii*) an audit firm which has completed its term under clause (*b*), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term:

Provided further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years:

Provided also that every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this sub-section within three years from the date of commencement of this Act:

Provided also that, nothing contained in this sub-section shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.

# **Annexure:** Remuneration Committee (Non-mandatory)

**Clause 49**

**Remuneration Committee:**

i. The board may set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.
ii. To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors may comprise of at least three directors, all of whom should be non-executive directors, the Chairman of committee being an independent director.
iii. All the members of the remuneration committee could be present at the meeting.
iv. The Chairman of the remuneration committee could be present at the Annual General Meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries.

# **Annexure:** Remuneration Committee

## Voluntary Guidelines of MCA

i. Companies should have Remuneration Committee of the Board. This Committee should comprise of at least three members, majority of whom should be non executive directors with at least one being an Independent Director.

ii. This Committee should have responsibility for determining the remuneration for all executive directors and the executive chairman, including any compensation payments, such as retirement benefits or stock options. It should be ensured that no director is involved in deciding his or her own remuneration.

iii. This Committee should also determine principles, criteria and the basis of remuneration policy of the company which should be disclosed to shareholders and their comments, if any, considered suitably. Whenever, there is any deviation from such policy, the justification/reasons should also be indicated/disclosed adequately.

iv. This Committee should also recommend and monitor the level and structure of pay for senior management, i.e. one level below the Board.

v. This Committee should make available its terms of reference, its role, the authority delegated to it by the Board, and what it has done for the year under review to the shareholders in the Annual Report.

**Clause 49**

**Remuneration of Directors**

i. All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company shall be disclosed in the Annual Report.
ii. Further the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:
a. All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.
b. Details of fixed component and performance linked incentives, along with the performance criteria.
c. Service contracts, notice period, severance fees.
d. Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.
iii. The company shall publish its criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report.
iv. The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.
v. Non-executive directors shall be required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. These details should be disclosed in the notice to the general meeting called for appointment of such director

## Companies Bill

*(1)* The Board of Directors of every listed company and such other class or classes of companies, as may be prescribed shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one-half shall be independent directors:

Provided that the chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

(*2*) The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director's performance.

(*3*) The Nomination and Remuneration Committee shall formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.

(*4*) The Nomination and Remuneration Committee shall, while formulating the policy under sub-section (*3*) ensure that—

(*a*) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;

(*b*) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

(*c*) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals:

Provided that such policy shall be disclosed in the Board's report.

Continued >>

**Companies Bill**

(*5*) The Board of Directors of a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board.

(*6*) The Stakeholders Relationship Committee shall consider and resolve the grievances of security holders of the company.

(*7*) The chairperson of each of the committees constituted under this section or, in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.

(*8*) In case of any contravention of the provisions of section 177 and this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both:

Provided that non-consideration of resolution of any grievance by the Stakeholders Relationship Committee in good faith shall not constitute a contravention of this section.

*Explanation.*—The expression ''senior management'' means personnel of the company who are members of its core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads.

## Companies Bill

(*1*) Except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as may be prescribed, no company shall enter into any contract or arrangement with a related party with respect to—

(*a*) sale, purchase or supply of any goods or materials;
(*b*) selling or otherwise disposing of, or buying, property of any kind;
(*c*) leasing of property of any kind;
(*d*) availing or rendering of any services;
(*e*) appointment of any agent for purchase or sale of goods, materials, services or property;
*(f)* such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
(*g*) underwriting the subscription of any securities or derivatives thereof, of the company:

Provided that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a special resolution:

Provided further that no member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party:

Provided also that nothing in this sub-section shall apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm’s length basis.

Continued >>

**Companies Bill**

*Explanation.*— In this sub-section,—
(*a*) the expression "office or place of profit" means any office or place—
*(i)* where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;
*(ii)* where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;
*(b)* the expression "arm's length transaction" means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.
(*2*) Every contract or arrangement entered iinto under sub-section (*1*) shall be referred to in the Board's report to the shareholders along with the justification for entering into such contract or arrangement.
(*3*) Where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a special resolution in the general meeting under sub-section (*1*) and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be voidable at the option of the Board and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.

Continued >>

## Companies Bill

(*4*) Without prejudice to anything contained in sub-section (*3*), it shall be open to the company to proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.
(*5*) Any director or any other employee of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section shall,—
(*i*) in case of listed company, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both; and
(*ii*) in case of any other company, be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

# **Annexure:** Postal ballot – Resolutions covered (Current regulations)

**Companies (Passing of the Resolution by Postal Ballot) Rules, 2011**

- Preferential allotments of shares
- Buyback of shares of own shares by the company under sub-section (1) of section 77A
- Alteration in the Object Clause of Memorandum
- Alteration of Articles of association in relation to insertion of provisions defining private company
- Issue of shares with differential voting rights as to voting or dividend or other wise under sub-clause (ii) of clause (a) of section 86
- Change in place of registered office outside local limits of any city, town or village as specified in sub-section (1) of section 293
- Giving loans or extending guarantee or providing security in excess of limits prescribed under sub-section (1) of section 372A
- Election of a director under proviso to sub-section (1) of section 252 of the act.
- Variation in rights attached to a class of shares or debentures or other securities as specified under section 106.