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Dividends: SEBI mandates a policy

On 8 July 2016, SEBI amended the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2016, to make it mandatory for the top 500 listed companies to formulate and disclose a dividend distribution policy. In order to help companies through this transition, IiAS has put together a sample template that can be used by boards as a guiding reference for drafting their dividend policies.

In the new regulations, SEBI has asked companies to include the following information in the dividend policy:

a) the circumstances under which the shareholders of the listed entities may or may not expect dividend
b) the financial parameters that shall be considered while declaring dividend
c) internal and external factors that shall be considered for declaration of dividend
d) policy as to how the retained earnings shall be utilized
e) parameters that shall be adopted with regard to various classes of shares

While SEBI guidelines have presented what is the regulatory minimum disclosure requirement, IiAS believes there are best practices that companies can follow, which will enhance the communication to shareholders, and also provide companies the flexibility to make deviations from the policy, as and when required.

i. Specify a Target Payout Ratio/Range

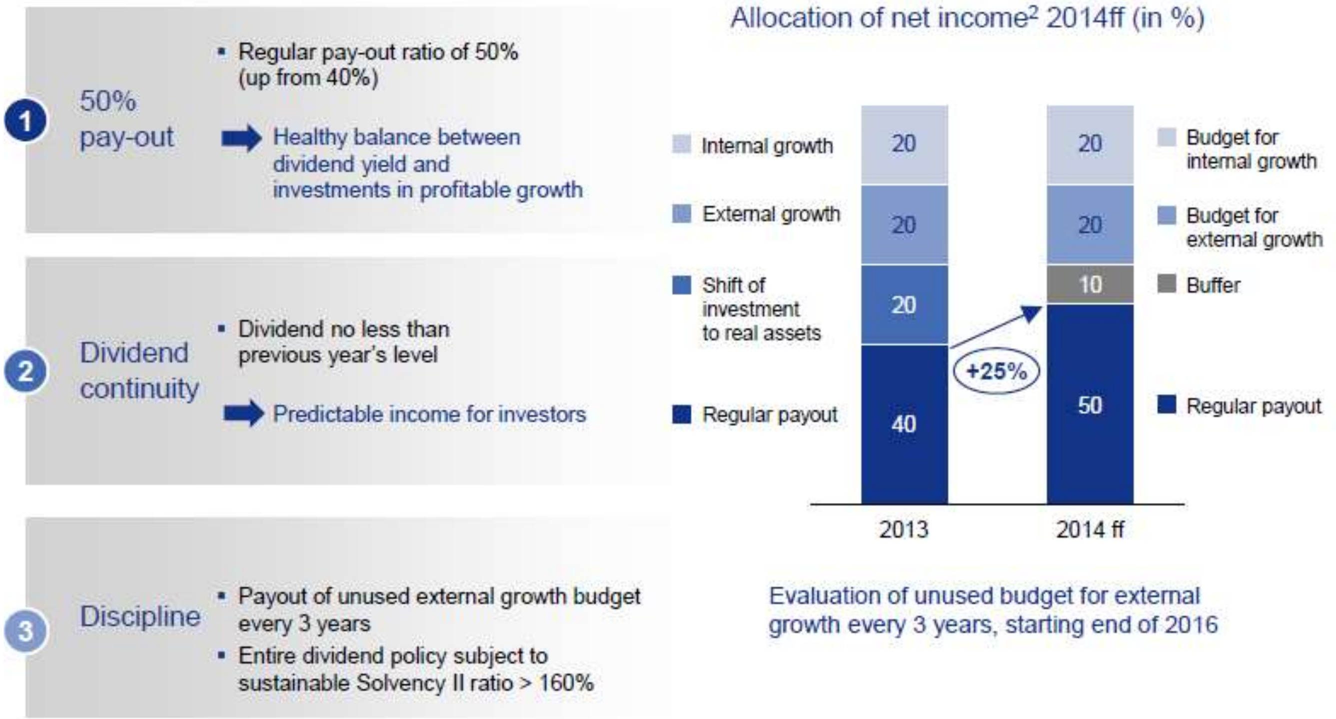
Traditionally, dividend discussions have been related to the par value of the share or to dividend per share. IiAS believes the conversation must change and focus on the dividend payout ratio – that is, how much of the profits generated during the year will be paid as dividend to shareholders. In articulating a dividend policy, IiAS recommends that companies must specify a target payout ratio (or payout range).

As an example, the Singapore Exchange (SGX) on its website states that: *"From FY 2016 onwards, SGX's dividend policy is to declare a base dividend of 5 cents per share per quarter, an increase of 1 cent per share. For each financial year, SGX will pay as dividend an amount which is no less than 80% of the annual net profit after tax or 20 cents per share, whichever is higher".*

Another good example is the Germany-headquartered Allianz Group, which has put out a detailed policy covering (refer fig. 1):

- Target payout ratio
- Dividend Continuity
- Dividend Discipline
- Allocation of net income

Figure 1: Allianz Group Dividend Policy



1) This dividend policy represents the management's current intention and may be revised in the future. Also, the decision regarding dividend payments in any given year is subject to specific dividend proposals by the management and supervisory boards, each of which may elect to deviate from this dividend policy if appropriate under the then prevailing circumstances, as well as to the approval of the annual general meeting
2) Net income attributable to shareholders

Source: Allianz Website

ii. **Utilization of cash balances**

With no foreseeable usage, the idle cash lying on the books is generally a drag on overall returns, and often lead to sub-optimal capital allocation decisions. IiAS therefore encourages companies with surplus funds, to clearly communicate their strategy for cash retention.

For this, companies must first identify and disclose the excess cash available for distribution using a pre-defined metric - such as a multiple of average profits or average capex or any other parameter(s) deemed appropriate by the board. Companies not proposing to distribute the excess cash must disclose how the cash will be utilized.

iii. **Disclosures on policy deviation**

Under the current regulations, companies are required to provide a commentary on the dividend payout in the Directors' Report section of the annual report. With the recent amendments to SEBI LODR, the entire dividend policy also needs to be published in the annual report.

IiAS recognizes that there may be situations where the board may need to deviate from its stated policy. In such cases, companies must provide the rationale for the deviations, along with the expected timelines within which the company proposes to revert back to the stated policy.

iv. **Approval Process**
The surplus cash belongs to all shareholders. Shareholders therefore, must be given an opportunity to express their opinion on the dividend policy. This can be achieved through a consultation process or through a shareholder vote in the company's general meetings. At the very least, the dividend policy must be approved by a company's Board.

Irrespective of the mode chosen by the company, the dividend policy must clearly state whether the final policy has been approved by the board or by shareholders and the process to be followed in case of updates/amendments to the policy.

Independent of the regulatory requirements, IiAS believes dividend policies must be specific to business needs: therefore, companies may take their time in finalizing an optimal dividend policy which balances the agendas of the management and different classes of stakeholders.

In order to help companies through this transition, IiAS has put together two separate templates (one for banks/financial services companies and one for the rest) that can be used by boards as a guiding reference for drafting their dividend policies.

Sample Template for Dividend Distribution Policy (General)

Introduction

The objective of this policy is to provide clarity to stakeholders on the cash and profit distribution strategies of the company. The Board of Directors ('Board') will refer to this policy before giving their recommendations on the nature and quantum of dividends for any financial year.

Periodicity *(the company may choose any of these options)*	**Option 1:**	Dividends (both, equity and preference) will generally be declared once a year, after the announcement of the full year results and before the Annual General Meeting (AGM) of the shareholders. In certain years, which includes special occasions and years in which the company has made exceptional gains, the company may choose to declare a special dividend for its shareholders.
	Option 2:	Dividends (both, equity and preference) will generally be paid *two / four* times a year: 1. The first interim dividend will be declared after the announcement of the first quarter results. This dividend is likely to aggregate not more than ●% of the annual dividend. 2. The second interim dividend will be declared after the announcement of the half-yearly results. This dividend is likely to aggregate not more than ●% of the annual dividend. 3. The third interim dividend will be declared after the announcement of the third quarter results. This dividend is likely to aggregate not more than ●% of the annual dividend. 4. The final dividend will be declared at the company's AGM and will aggregate not more than ●% of the annual dividend. In certain years, which includes special occasions and years in which the company has made exceptional gains, the company may choose to declare a special dividend for its shareholders.
Dividend Eligibility *(the company may choose from these options)*	**Option 1:**	The company has only one class of equity shareholders and does not have any issued preference share capital. Therefore, dividend declared will be distributed equally among all shareholders, based on their shareholding on the record date.
	Option 2:	The company has two classes of equity shareholders – Class A (with differential voting rights) and Class B (ordinary shares carrying one vote per share). Class A shareholders will be paid ● times the dividend paid to Class B shareholders.
	Option 3:	The company has issued preference share capital aggregating Rs. ● bn. These shareholders will be eligible to receive dividend at the stipulated rate, in the year that the company makes profits.
Target Dividend *(the company may choose from these options)*	**Option 1:**	The dividend payout in each financial year, including interim dividends, will be at least ●% of annual post-tax profits. Special dividends, if any, will be declared in addition to the regular dividend payout.

	Option 2:	The dividend payout in each financial year, including interim dividends, will be between ●% and ●% of annual post-tax profits. Special dividends, if any, will be declared in addition to the regular dividend payout.
	Option 3:	The dividend payout in each financial year, including interim dividends, will be the *lower / higher* of: ○ ●% of annual post-tax profits. ○ ●% of free cash flow generated during the year ○ ●% return on equity ○ Cash in excess of ● times the average of the preceding three years' profit ○ Cash in excess of ● times the average of capital expenditure spends over the past three years Special dividends, if any, will be declared in addition to the regular dividend payout.
	Option 4:	The company has adopted a progressive dividend policy, intending to maintain or grow the dividend each year. The base payout ratio currently is ● % and is expected to grow, in accordance with the growth of the business, to a level of ● % of post-tax profits over the next ● to ● years.
	Option 5:	Over a three-to-five year period, the company will ensure average shareholder return (on equity shares) through dividends of over ●%.
	Option 6:	Preference shareholders will be eligible to receive dividend at the stipulated rate of ●%, in the years that the company makes profits. In case the company does not report profits, no dividend will be paid to preference shareholders.

Considerations while deciding dividend

The Board will consider the following factors before making any recommendation for the dividend:

Financial Factors	Non-Financial Factors
○ Profits earned during the financial year ○ Accumulated reserves ○ Earnings stability ○ Future capital expenditure ○ Cost of raising funds from alternate sources ○ Cash flow position ○ Leverage profile and, under exceptional circumstances, the amount of contingent liabilities	○ Inorganic growth plans ○ Stage of business cycle ○ Economic environment ○ Legal and regulatory framework ○ Past dividend trends ○ Reinvestment opportunities ○ Investor demands

Use of retained earnings

In any given financial year, the retained earnings of the company are expected to be used across the following activities:

- Capital expenditure
- Inorganic growth
- General corporate purposes, including contingencies
- Correcting the capital structure

The annual report of the company will provide the expected distribution of the retained earnings over the next three years across these activities.

Deviations from the policy

The Board may not recommend any dividend or may recommend a lower payout for a given financial year, if:

- The company has reported a net loss for the year
- Cash flow from operations is negative
- The credit protection or capital adequacy metrics of the company are weak
- The company is undergoing any form of debt restructuring
- The company has been prohibited to declare dividends by any regulatory authority
- The company has implemented, or intends to implement, a share repurchase (buyback) scheme or any other alternate profit distribution measures
- Any other extraordinary circumstances

If the company does not declare any dividend or if the final payout for the year is lower than the target ratio, the Board will provide a rationale for the deviation from the policy in the annual report.

Dividend Information

Information on dividends paid in the last ● years will be made available on the company website in the following format:

Year	Dividend per Share (Rs.)	Dividend Yield (%)	Payout Ratio (Standalone) (%)	Payout Ratio (Consolidated) (%)
2012				
2013				
2014				
2015				
2016				

Policy Approval and Updates
(the company may choose any of these options)

Option 1: This policy will be reviewed annually by the board. Any changes or revisions to the policy will be communicated to shareholders in a timely manner.

Option 2: Once the board has approved of the policy, it will be presented for shareholder approval through an ordinary resolution at the company's next AGM. All subsequent changes or revisions to the policy will also require shareholder approval in the similar manner.

Availability

- The most recent version of this policy will be available on the company's website. The link to the policy is given here: <<insert link>>
- The policy will also be disclosed in the company's annual report.
- To access previous policies, shareholders may write to us at <<investor relations' email address>>, or look up previous annual reports.

Sample Template for Dividend Distribution Policy (Banks)

Introduction

The objective of this policy is to provide clarity to stakeholders on the cash and profit distribution strategies of the bank. The Board of Directors ('Board') will refer to this policy before giving their recommendations on the nature and quantum of dividends for any financial year.

The dividend policy conforms to the Reserve Bank of India (RBI) guidelines as provided under notifications dated 23 April 2004 and 4 May 2005.

Dividend Eligibility

In accordance with the RBI guidelines, the bank will be eligible to declare dividends in any financial year, only if it meets the following statutory provisions:

- The bank must have reported profits during the year
- The bank must have a
  - Capital to Risk (Weighted) Assets Ratio (CRAR) of at least 9% for preceding two completed years and the financial year for which it proposes to declare dividend
  - Net Non-Performing Assets (NPA) ratio of less than 7%

  In case the bank does not meet the above two- year CRAR norm, but has a CRAR of at least 9% for the financial year, it will be eligible to declare dividend provided its Net NPA ratio is less than 5%.
- The bank must have complied with the prevailing regulations/ guidelines issued by RBI and the provisions of the Banking Regulation Act, 1949.

Periodicity *(the bank may choose any of these options)*

Option 1: Dividends (both, equity and preference) will generally be declared once a year, after the announcement of the full year results and before the Annual General Meeting (AGM) of the shareholders.

Option 2: Dividends (both, equity and preference) will generally be paid *two / four* times a year:

1. The first interim dividend will be declared after the announcement of the first quarter results. This dividend is likely to aggregate not more than ●% of the annual dividend.
2. The second interim dividend will be declared after the announcement of the half-yearly results. This dividend is likely to aggregate not more than ●% of the annual dividend.
3. The third interim dividend will be declared after the announcement of the third quarter results. This dividend is likely to aggregate not more than ●% of the annual dividend.
4. The final dividend will be declared at the bank's AGM and will aggregate not more than ●% of the annual dividend.

Nature of Dividend *(the bank may choose from these options)*	**Option 1:**	The bank has only one class of equity shareholders and does not have any issued preference share capital. Therefore, dividend declared will be distributed equally among all shareholders, based on their shareholding on the record date.
	Option 2:	The bank has issued preference share capital aggregating Rs. ● bn. These shareholders will be eligible to receive dividend at the stipulated rate, in the year that the bank makes profits.
Target Dividend *(the bank may choose from these options)*	**Option 1:**	The dividend payout in each financial year, including interim dividends, will be at least ●% of annual post-tax profits. However, in any given year, the payout ratio will not exceed 40%[1].
	Option 2:	The dividend payout in each financial year, including interim dividends, will be between ●% and ●% of annual post-tax profits. However, in any given year, the payout ratio will not exceed 40%[1].
	Option 3:	The bank has adopted a progressive dividend policy, intending to maintain or grow the dividend each year. The base payout ratio currently is ● % and is expected to grow, in accordance with the growth of the business, to a level of ● % of post-tax profits over the next ● to ● years. However, in any given year, the payout ratio will not exceed 40%[1].
	Option 5:	Over a three-to-five year period, the bank will ensure average shareholder return (on equity shares) through dividends of over ●%. However, in any given year, the payout ratio will not exceed 40%[1].
	Option 6:	Preference shareholders will be eligible to receive dividend at the stipulated rate of ●%, in the years that the bank makes profits. In case the bank does not report profits, no dividend will be paid to preference shareholders. For the purpose of this section, dividend payout ratio will be calculated as a percentage of 'dividend payable in a year' (excluding dividend tax) to 'net profit during the year'. The net profits will exclude any extra-ordinary profits/income. If there are any auditor qualifications, the net profits will be suitably adjusted to that effect.

[1] The maximum dividend payout in any given financial year will be subject to the following conditions:

Category	**CRAR**	**Net NPA Ratio**			
		Zero	**More than zero but less than 3%**	**From 3 % to less than 5%**	**From 5% to less than 7 %**
A	11% or more for each of the last 3 years	Upto 40%	Upto 35%	Upto 25%	Upto 15%
B	10% or more for each of the last 3 years	Upto 35%	Upto 30%	Upto 20%	Upto 10%
C	9% or more for each of the last 3 years	Upto 30%	Upto 25%	Upto 15%	Upto 5%
D	9% or more in the Current year	Upto 10%	Upto 10%	Upto 5%	Nil

Considerations while deciding dividend

The Board will consider the following factors before making any recommendation for the dividend:

Financial Factors	Non-Financial Factors
• Profits earned during the financial year	• Inorganic growth plans
• Capital adequacy	• Stage of business cycle
• Earnings stability	• Economic environment
• Future capital requirements	• Legal and regulatory framework
• Cost of raising funds from alternate sources	• Past dividend trends
• Quantum of non-performing assets	• Reinvestment opportunities
• Amount of contingent liabilities	• Investor demands
	• Auditor qualifications

Use of retained earnings

Not applicable (although it is a SEBI requirement)

Deviations from the policy

The Board may not recommend any dividend or may recommend a lower payout for a given financial year, if:

- The bank has reported a net loss for the year
- The credit protection or capital adequacy metrics of the bank are weak
- The bank is undergoing any form of debt restructuring
- The bank has been prohibited to declare dividends by any regulatory authority
- The bank has implemented, or intends to implement, a share repurchase (buyback) scheme or any other alternate profit distribution measures
- RBI or any other regulator has restricted the bank from paying dividends
- Any other extraordinary circumstances

If the bank does not declare any dividend or if the final payout for the year is lower than the target ratio, the Board will provide a rationale for the deviation from the policy in the annual report.

Dividend Information

Information on dividends paid in the last ● years will be made available on the bank website in the following format:

Year	Dividend per Share (Rs.)	Dividend Yield (%)	Payout Ratio (Standalone) (%)	Payout Ratio (Consolidated) (%)
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Option 1: This policy will be reviewed annually by the board. Any changes or revisions to the policy will be communicated to shareholders in a timely manner.

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Availability:

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