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INSIGHT

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Corporate Governance Report - A Ready Reckoner

BACKGROUND

The Committee on Corporate Governance (“CG Committee”) was constituted by SEBI on June 2, 2017 under the chairmanship of Mr. Uday Kotak with the aim of improving standards of corporate governance of companies with listed equity in India. The committee comprised of representatives from the corporate sector, government, industry bodies, lawyers, academicians, consulting and accountancy firms, stock exchanges and proxy advisors. Our managing partner, Mr. Cyril Shroff, was also a member of the CG Committee. The final report submitted by the CG Committee to SEBI was released on October 5, 2017.

RECOMMENDATIONS

Set out below is a summary of recommendations of the CG Committee along with the suggested timelines for implementation:

1. Composition and Role of the Board of Directors

Given the rising responsibility of the board of directors and the widened ambit of stakeholders, the CG Committee has recommended a holistic

re-assessment of the composition and role of the board by way of:

- a. increase in the minimum number of directors of a listed entity to six (6) with at least one (1) independent woman director (w.e.f. 01.10.2018);
- b. ratification by the shareholders of continuance of a director of a listed entity in case the director has not attended at least half of the total number of board meetings held over a period of two consecutive financial years on a rolling basis, commencing from the financial year immediately succeeding the appointment date (w.e.f. 01.04.2018);
- c. special resolution of shareholders for appointment or continuance of a non-executive director who has attained the age of 75 years (w.e.f. 01.10.2019);
- d. number of directorships held in listed companies to be limited to eight (8) (w.e.f. 01.04.2019) and seven (7) (w.e.f. 01.04.2020);
- e. formal updation of knowledge of directors, and mandatory interaction between non-executive directors and senior management of listed entity, at least once every year



- (w.e.f 01.04.2018);
- f. increase in mandatory board meetings annually to five (5). Boards to discuss strategy, succession planning, budgets, risk management, ESG (environment, sustainability and governance) and board evaluation at least once a year (w.e.f 01.04.2018);
 - g. quorum for board meetings of listed companies to be higher of one-third of total strength or three (3) directors, and to include an independent director (w.e.f. 01.10.2018);
 - h. separation of the roles of the Chairperson and the CEO/MD for listed companies (in a phased manner, w.e.f. 01.04.2020 for all listed entities with minimum 40% public shareholding, and if deemed fit by SEBI, w.e.f. 01.04.2022 for all listed entities);
 - i. a confirmation to be provided by the boards to ensure autonomy of the boards is not impacted due to matrix reporting structures (w.e.f. FY ending 31.03.2019); and
 - j. disclosures to be made of the required and available skills and expertise of the board members (w.e.f. 31.03.2019) as well as observations from board evaluations.

ID (including a specific confirmation that there are no other material reasons) (w.e.f. 01.04.2018);

- e. minimum remuneration for IDs to be INR 5 lakhs with separately specified minimum sitting fee for board and committee meetings (w.e.f. 01.04.2018, applicable to companies based on market capitalisation);
- f. mandatory Directors & Officers (D&O) insurance for IDs of top 500 listed entities (w.e.f. 01.10.2018);
- g. mandatory induction and training of IDs on a periodic basis as specified (w.e.f. 01.04.2018);
- h. prohibition on appointment of alternate directors for IDs (w.e.f. 01.04.2018); and
- i. appointment to fill casual vacancy in the office of the ID to be subject to shareholders' approval in the next general meeting (w.e.f. 01.04.2018).

2. The Institution of Independent Directors

The institution of independent directors (“IDs”) forms the backbone of the corporate governance framework. To further strengthen this institution and bring in a better balance of the risk-reward aspects, the CG Committee has recommended:

- a. revision of the eligibility requirements of IDs to ensure “spirit of independence” and regular assessment of the “independence” by the board (w.e.f. 01.04.2018);
- b. increase of number of IDs to at least half of the board (in a phased manner, w.e.f. 01.04.2019 for top 500 listed entities, and w.e.f. 01.04.2020 for all listed entities);
- c. appointment of a “Lead Independent Director” where the chairperson is not an ID (w.e.f. 01.10.2018);
- d. disclosure of reasons for resignation of an



3. Board Committees

Given that the constitution of committees enables effective governance through small-group discussions, focus and diligence on various aspects, the CG Committee has made recommendations to enhance effective functioning of board committees by way of:

- a. increase in minimum number of audit committee meetings to five (5) every year and one (1) mandatory meeting of all other

- board committees on an annual basis (w.e.f. 01.04.2018);
- b. quorum for meetings of NRC and SRC to be higher of two (2) members or one third of total members, and to include at least one (1) ID (w.e.f. 01.04.2018);
- c. revisions to the composition of committees such as increase in number of IDs on NRC from half to two thirds (w.e.f. 01.04.2019) and SRC to have minimum three (3) directors with one (1) being an ID (w.e.f. 01.04.2018);
- d. the membership and chairpersonship of NRC and SRC to be considered for determining the limit on membership and chairpersonship (w.e.f. 01.04.2018);
- e. NRC to recommend the remuneration payable to the senior management to the board (w.e.f. 01.04.2018);
- f. role of SRC increased to include *inter alia*, active engagement and communication with the stockholders and review of measures taken for effective exercise of voting rights by shareholders (w.e.f. 01.04.2018);
- g. audit committee to scrutinise the end utilization of funds infused into subsidiaries (subject to certain thresholds) (w.e.f. 01.04.2018);
- h. top 500 listed entities to constitute risk management committee and role of risk management committee to include cyber security (w.e.f. 01.04.2018); and
- i. discretionary constitution of information technology committee to focus on digital and technological aspects.

4. Enhanced Monitoring of Group Entities

The CG Committee recognised that shareholders of listed holding companies value the entire business structure at the time of investment, and concluded that it is important for the boards of such listed companies to ensure that good governance trickles down to the entire structure. In this context, the CG Committee has recommended reduction of threshold for determination of “material subsidiary” from the

current 20% to 10% and all material unlisted Indian subsidiaries to undertake secretarial audit (w.e.f. 01.04.2018). Further, the CG Committee has recommended that a guidance be issued by SEBI to listed entities to adopt a monitoring mechanism for their group entities by constituting a dedicated group governance unit.

5. Promoters/Controlling Shareholders and Related Party Transactions

Given that a majority of Indian listed entities continue to be promoter driven, the CG Committee recognised that checks and balances on interactions and relationships between listed entities and the promoters/significant shareholders is crucial for good governance. In this context, in acknowledgment of the business reality, the CG Committee has recommended that the regulatory framework be amended to provide an enabling transparent mechanism regulating the information rights of controlling promoters (including promoters of the promoter) and significant shareholders (i.e. public shareholders who have a nominee director) subject to certain conditions (w.e.f. 01.04.2018). The enabling framework recommended by the CG Committee provides an option for execution of an agreement between the listed company and the eligible shareholder including the specified minimum principles. The execution/ termination of such agreement is subject to disclosure.

The CG Committee also considered the extant process for re-classification of promoters as public shareholders and has recommended easing of the thresholds for a professionally managed company and providing pathway for re-classification of a promoter in a listed company with multiple promoters (subject to specified thresholds and conditions) with immediate effect. Further, to enhance regulation of related party transactions (“RPTs”), the CG Committee has recommended increased disclosures (such as bi-annual disclosures of the RPTs), classification of all promoter related entities that hold 20% or more as related parties,

review of policy on materiality by the board at least once every three years, and requirement of shareholders' approval for brand/ royalty payments above the specified threshold (w.e.f. 01.04.2018). The CG Committee has also recommended additional requirement of shareholders' approval in case the remuneration payable to an executive promoter director or a non-executive director exceeds the specified thresholds (w.e.f. 01.04.2018).

6. Disclosures and Transparency

Given that disclosure and transparency underpin good governance and the efficient functioning of the markets, the CG Committee has made recommendations to enhance the extent of and ease of access to disclosures, in relation to:

- a. timing for disclosure of annual report on the website as well as subsidiary accounts, consolidated disclosure of mandated information on the website (including credit ratings), and requirement of stock exchange disclosures to be in XBRL format and those on the website to be in searchable format (w.e.f. 01.04.2018);
- b. disclosure of holders of depository receipts, changes in specified key financial indicators, utilisation of funds raised through capital issuance, and long term/ medium term strategy (w.e.f. 01.04.2018);
- c. disclosures on details of directorships to include names of listed entities where the person is a director along with category of directorship (w.e.f. 01.04.2018);
- d. disclosure of the fact of the board not accepting the recommendation of any committee, which is mandatorily required, along with reasons thereof (w.e.f.

01.04.2018);

- e. provision of a certificate that the directors of the listed entity are not debarred or disqualified from appointing and continuing as directors (w.e.f. 01.04.2018); and
- f. disclosure of basis of valuation in valuation reports for schemes of arrangement and exposure of commodity risks.

The CG Committee has also recommended removal of the requirements to disclose schedules of analyst/institutional investor meetings and to provide advance notice for consideration of bonus issue by the board, with immediate effect.

7. Accounting and Audit related issues

Financial statements are the primary document that stakeholders rely upon. Given this, the CG Committee acknowledged that a good audit and appropriate levels of disclosure are pre-requisites for reliable financial statements. In this context, the CG Committee has recommended:

- a. mandatory quantification of audit qualifications (with a few exceptions), enabling auditors to independently seek external expert opinions and increased periodic disclosures of financial statements (i.e. consolidated financial statements on a quarterly basis and cash flow statement on a half yearly basis) (w.e.f. 01.04.2018);
- b. group audits be undertaken by making the auditor of the holding company responsible for the audit opinion of all material unlisted subsidiaries and requiring internal financial controls to extend to the whole group;
- c. enhanced disclosures in respect of auditors



- such as disclosure of reasons of resignation of auditors, total fee for audit and non-audit services in the annual report and credentials of proposed new auditors, proposed fee and material change in audit fee from previous year (as applicable, with rationale) at the time of appointment (w.e.f. 01.04.2018); and
- d. full implementation of IND-AS as currently scheduled without extension, for all listed entities including banks, NBFCs and insurance companies.

For effective monitoring and enforcement, the CG Committee has recommended that SEBI have clear powers to act against auditors and other third party fiduciaries with statutory duties in cases of gross negligence and fraud. In this context, the CG Committee has also recommended certain steps for strengthening the role of the Institute of Chartered Accountants of India and the Quality Review Board.

8. Investor Participation in Meetings of Listed Entities

The CG Committee has observed that increased and better participation by constituents enhances good governance by promoting accountability of the board and the management and has recommended reduction in the timelines for holding of AGMs after the end of the financial year and the requirement of live one way webcasts of shareholder meetings and extension of e-voting timelines till after the meeting for top 100 listed entities (w.e.f. 01.04.2018). Also recommended is a sunset period for voting rights on treasury stock (i.e. voting rights should be non-exercisable w.e.f. 01.04.2021), disclosure of recommendations of the board in respect of proposed resolutions (w.e.f. 01.04.2018) and adoption of stewardship code across Indian financial sector based on global best practices.

9. Governance Aspects of Public Sector Enterprises (“PSE”)

Given the prominent role the PSEs have in the economic development of our country, the CG Committee has recommended that to enhance governance concerning PSEs and to improve shareholder value, the PSEs should fully comply with the provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“SEBI LODR Regulations”) and that the government should assess and examine governance issues of PSEs based on certain guiding principles such as (i) establishing a transparent mandate for PSEs and disclosure of their objectives and obligations; (ii) ensuring independence of the PSEs from administrative ministry; and (iii) consolidating the ownership of the government stake into independent holding entity structure(s) by 01.04.2020.

10. Leniency Mechanism

The CG Committee has recommended that SEBI should be empowered to grant leniency and offer protection against victimisation to whistle-blowers on a case by case basis. This is intended to create structural incentives for persons connected with the commission of an infringement to come forward and disclose such violations and assist the regulatory authorities.

11. Capacity Building in SEBI for Enhancing Corporate Governance in Listed Entities

The CG Committee observed that the efficacy of its recommendations depends critically upon SEBI’s detection and enforcement capabilities and has recommended that, in line with global best practices, SEBI should enhance the number and skill-sets of its human resources, increase usage of data science and technology, and strategically work with other agencies, especially for monitoring and enforcement purposes.

WHAT'S NEXT?



The CG Committee builds upon the slew of governance reforms brought about by the Companies Act, 2013 and the SEBI LODR Regulations. It seems to not only draw from the experience gained by plugging the loopholes, but also sets stepping stones in uncharted territories where the business and ground reality is currently at variance from the extant regulatory framework. The CG Committee report is a welcome step with its wide-ranging recommendations and nuanced and realistic approach in setting the goal posts for the next level of mandatory governance standards for the Indian corporate sector.

The report of the CG Committee is open for public comments till November 4, 2017 and once the comments are received, the SEBI Board will consider the recommendations (including timelines for implementation) along with the public comments received, with full discretion.

Disclaimer

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