

C.I.I. Roundtable on Corporate Governance

CHALLENGES AND WAY FORWARD

28th February, 2014

New Delhi

1

OUTLINE OF PRESENTATION

- Background: Notification of substantial Sections of Companies Act, 2013;
- Main issues impacting Corporate Governance.
- Provisions on Corporate Governance that will enter into force from FY 2014-15;
- Recent SEBI Review of Clause 49 listing Agreement;
- Challenges and Way Forward

2

BACKGROUND

- Enactment of new Companies Act on August 30, 2014;
- 98 sections already notified;
- Wide consultation in framing rules that provides for flexibility in addressing implementation issues;
- Notification of substantive sections shortly; starting with Section 135 on C.S.R. notified on 27/2/2014.
- Implementation will start from F.Y. 2014-15.
- Dual regime of two Acts i.e. Act of 2013 and Act of 1956 shall continue for some time during 2014-15;

Main issues impacting Corporate Governance.

1. To provide comfort to stakeholders that their interests are taken care of, and the entity is well managed. Internal conflicts increases risk perception of entity.
2. Reduction of risks increases confidence of investors, resulting in enhanced value of the corporate.
3. Corporate Governance based on 3 pillars; i) legal and regulatory framework; ii) their implementation and iii) enforcement, including penalties for non-compliance.
4. Rules under Companies Act, 2013, provide for implementation and enforcement. Also contained under SEBI Act, Listing Agreement and regulations.
5. In India, from no governance norms to the present best and stringent – failure in implementation of voluntary guidelines has led to changes in law.

5

Salient Provisions on Corporate Governance

- Company management and governance; (Chapter 7, 11-13)
- Prospectus and Share capital; (Chapter 3 & 4)
- Audit Accountability; (Chapter 10)
- Definition of fraud; statutory recognition of Serious Fraud Investigation Office; (Section 211/212-447)
- Stakeholders concept - introduced for the first time in defining duties of directors;
- Compliance, Enforcement and Transparency; (Many Sections)
- Right of shareholders and protection of minority; (Chapter 16)

6

Company Management and Governance

- Composition of Board of Directors; (149) including selection/ appointment, powers, tenure etc.
- Board meetings; (173) Shareholders meeting, participation of shareholders.
- Independent Directors (Tenure and Code); Woman Director; (149)
- Dealing with related Party Transactions; [188rw, 134(3)(h)]. Also investments/borrowings.
- Board of Directors evaluation; separate meeting of IDs; [134(3)(L), Section IV, Para VII/VIII]
- Concept of Lead ID not provided. But holding separate meeting of IDs allowed; whoever chairs such meeting likely to be seen as (unofficial) Lead ID; (Schedule IV/Para VII)
- Constitution of different Committees of the Board [Audit Committee, Nomination and Remuneration Committee and Stakeholders Relationship Committee] [177 & 178]
- Databank for IDs (Recent MoU between I.I.C.A. and I.O.D., U.K.(150)
- Whistle blower (Vigil) Mechanism (177(9) & 410)

7

Prospectus and Share Capital

- Detailed disclosures regarding objectives for raising capital to be described in Prospectus; (Section 26 + Rules)
- Exit offer to minority shareholders in case of variation in terms of contracts/objects referred in Prospectus;[Section 27, 13(8)]
- Detailed disclosures and safeguards provided in case of private placement of securities; (42)
- Delegated power to SEBI for listed companies on certain matters retained; (24)

8

Strengthening of Audit Accountability

- New disqualifications (like not having business relationship beyond a limit) for appointment as auditors provided to ensure independence; [141(3)]
- Rotation of auditors provided; Individual auditor to have maximum one term of 5 years; audit firm to have maximum two terms of 5 years each; [139(2)]
- Cooling off period of 5 years in both cases; [139(2)]
- Auditor not to render non-audit services;[144]
- Recommendation of audit Committee required for appointment of auditors. [139(ii)]

9

Definition of fraud and Serious Fraud Investigation Office

- Fraud as a term defined for first time in context of corporates which is wider than existing law; [447]
- SFIO recognized in the Statute; Adequate powers given to SFIO, but with safeguards.[211&212]
- Punishment for fraud provided and linked to offences involving fraud; [447 & 10 other sections]
- Special courts to be established or designated for adjudication of offences;[435]
- Quantum of punishment enhanced vis-a-vis Companies Act to deter wrong doings. [various sections]

10

Stakeholders concept while defining duties of directors

- Directors to act in good faith to promote the objects of company for benefit of its members as a whole, and in best interests of employees, shareholders, community and protection of environment; [166]
- IDs to balance conflict of interest of stakeholders;
- CSR Implementation a responsibility of Board of Directors. [135]- Notification issued.

11

Compliance, Enforcement and Transparency

- Indian Corporate Law is a hybrid – Based on hard law, mandatory or rule based, as opposed to soft law that is principle-based i.e. voluntary comply or explain e.g. in UK (UK Combined Code);
- Companies Act, 2013 provides for
 - i) various disclosures through financial statements;
 - ii) Board's report,
 - iii) Event based decisions and filings in the Registry,
 - iv) would raise levels of transparency and empower investors and other stakeholders;[136,134,398-399]

12

Rights of Shareholders and protection of Minority

- Rights of shareholders provided for obtaining relevant information and participate in decision making process; [136, 101]
- Protection of minority shareholders from oppression and mismanagement; [241-245]
- Class action suits recognised; [245]
- Option for listed companies to appoint small shareholder director. [151]

13

Recent SEBI's Review of Clause 49 of Listing Agreement

- Most of the new proposals on Corporate Governance are in alignment with corresponding provisions in the Companies Act, 2013; They include: (ANNEX. A)
- On some matters, SEBI propose more stringent requirements than in the Companies Act such as (ANNEXURE 'B')
- SEBI also considering some additional elements for Clause 49 on which Cos Act is silent; such as (ANNEXURE 'C')
- Section 1(4) of new Companies Act provides for harmony with Special Laws. Intention is to make Companies Act as minimum benchmark for companies regulation and sectoral regulators may prescribe additional requirements. Delegated powers to SEBI on certain matters retained. [24]

14

Challenges and Way Forward

1. I.D.'s - Do multiple directorships matter? If so, what should the limit be? Should that limit be set externally or left to individual judgement?
2. IDs may have to devote more time; to ensure detailed discussions and record dissent in case of disagreement;
3. Capacity Building and appointment of Women Directors required, presently less than 300 Women Directors.
4. Presently, most W.D.'s are related to promoter. Need to increase their numbers. Training for Directors through MoU between IICA and IoD, U.K.

15

Challenges and Way Forward

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- Minority shareholders – Need for promoting a healthy debate.
- **Implementation of Whistle Blower Policy:** No point in merely having a policy on paper without building trust between the employees and Audit Committee;
- Whistle blowers need to be protected.

16

Challenges and Way Forward

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- Confidence of investors, including international investors, gets improved when standards of corporate governance are robust; Proposed MoU between I.I.CA. and I.F.C. to promote Corporate Governance through capacity building;
- Compliance of Corporate Governance in 'spirit' more important than in 'Letter';
- Enforcing legal and regulatory compliance requirements through new institutes –NCLT, NFRA.
- Should names of non-compliant companies be disclosed?

17

Challenges and Way Forward

Developing a mechanism for evaluating performance of Board of Directors

- One size does not fit all. Depends on stage and complexity of each company. Each Board has to decide its own mechanism for strengthening Corporate Governance norms internally;

- For M.C.A.; (i) Promoting its role as a facilitator as well as a Regulator; (ii) Address difficulties that corporates face; (iii) Obtain feedback on CSR implementation and (iv) evaluating outcome of CSR spend;

- Ultimately, good Corporate Governance should come from within and not merely to comply.

18

Thank you!