

Legislative Framework of Corporate Governance in India

Lesson 2

KEY CONCEPTS

- Board of Directors Transparency ■ Audit Committee ■ Key Managerial Personal ■ Whistle Blower Policy
- Chief Risk Officer ■ Fit and proper criteria

Learning Objectives

To understand:

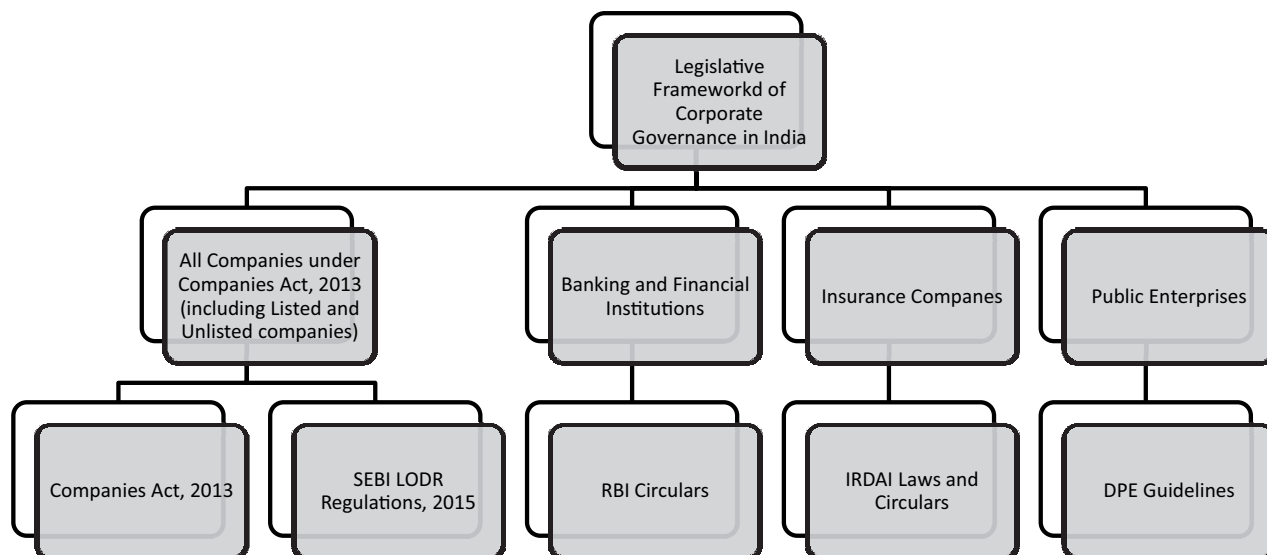
- Legislative framework of Corporate Governance for:
 - Listed and unlisted Companies
 - Banks
 - Insurance Companies and
 - Public Sector Undertakings

Lesson Outline

- Introduction & Legislative Framework
- Provisions of Companies Act, 2013 related to Corporate Governance
- Regulation 4 of SEBI (LODR) Regulations 2015
- Corporate Governance in Banks/Financial Institutions
- Basel Committee on Corporate Governance
- RBI Guidelines on Corporate Governance for NBFCs
- IRDAI Guidelines on Corporate Governance for Insurance Companies
- Stewardship Code for Insurers
- Guidelines on Corporate Governance for CPSE
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

INTRODUCTION

The initiatives taken by Government of India in 1991, aimed at economic liberalization, privatization and globalisation of the domestic economy, led to various initiatives by the Government of India to improve corporate governance mechanism. Today we have a strong mechanism for governing the activities of companies, all listed entities, banks, NBFCs and Insurance Companies.



The companies in our country are formed, registered and regulated majorly by the Companies Act, 2013 or under the previous Companies Act. The erstwhile Companies Act 1956 was completely revamped in 2013 and new Act was framed which is landmark legislation with regard to improving corporate governance of companies. The Companies Act, 2013 clearly indicates focus of regulators toward enhancing the responsibility and accountability of boards. The Act outlines various requirements for Governance, disclosures and enhanced roles, responsibilities and liabilities of the board, its committees and independent directors.

Some of the Provisions of Companies Act, 2013 related to Corporate Governance are:

- Appointment and maximum tenure of Independent Directors;
- Appointment of Woman Director;
- Appointment of Whole time Key Managerial Personnel;
- Performance Evaluation of the Directors and Committee & Board as a whole;
- Enhanced disclosures and assertions in Board Report, Annual Return and Boards' Report with regard to Managerial Remuneration, risk management, internal control for financial reporting, legal compliance, Related Party Transactions, Corporate Social Responsibility, shareholding pattern, public money lying unutilised, etc.
- Stricter yet forward-looking procedural requirements for Secretarial compliances and Secretarial Standards made mandatory;
- Enhanced compliances of Related Party Transactions and introduction of concept of arm's length pricing;
- Enhanced restrictions on appointment of Auditors and mandatory rotation of Auditors;
- Separation of role of Chairperson and Chief Executive Officer;

- Mandatory provisions regarding vigil mechanism;
- Constitution of Audit Committee and Nomination and Remuneration Committee;
- Constitution of CSR Committee;
- Secretarial Audit;
- Constitution of NFRA;
- Mandatory provision of E-voting by certain class of Companies;
- Mandatory Vigil Mechanism.

All such provisions of new Company Law are instrumental in providing a good Corporate Governance structure. Further, the Companies (Amendment) Act, 2017 and the Companies (Amendment) Act, 2019 introduced several amendments to the Companies Act 2013, realigning provisions to improve corporate governance and ease of doing business in India while continuing to strengthen compliance and investor protection.

All the listed entities are regulated by the Securities and Exchange Board of India. SEBI is a regulatory authority established on April 12, 1992. SEBI was established with the main purpose of curbing the malpractices and protecting the interest of its investors. Its main objective is to regulate the activities of Stock Exchange and at the same time ensuring the healthy development in the financial market. In order to ensure good corporate governance SEBI had issued detailed Corporate Governance Norms in form of Clause 49 of Listing Agreement which has been now revised and notified as the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Apart from these, a gamut of legislations like the Competition Act, 2002, the Consumer Protection Act, 2019, the Code on Wages, 2019, the Code on Social Security, 2020, the Industrial Relations Code, 2020, the Occupational Safety, Health and Working Conditions Code, 2020 the environment laws, the Prevention of Money Laundering Act, 2002, Insolvency and Bankruptcy Code, 2016 etc, seeks to ensure good governance practices among the corporate.

NOTE: The Companies Act, 2013 and SEBI (LODR) Regulations, 2015 together deals with virtually all areas affecting Corporate Governance like Board Processes, Board Committees, Corporate Policies and Disclosures, Accounting and Audit related issues, RPTs and Vigil Mechanism, Accounting and Audit related issues, RPTs and Vigil Mechanism, Shareholders and other stakeholders Rights, Compliance risk etc. are discussed at relevant places in the entire study material.

REGULATORY FRAMEWORK – GOVERNING LISTED COMPANIES

Regulation 4 of SEBI (LODR) Regulations, 2015

Chapter II of the SEBI (LODR) Regulations, 2015 provides broad principles for periodic disclosures and obligations of listed entities. The SEBI (LODR) Regulations 2015 covers obligations of listed entities with respect to aspects including

- Board Composition Requirements
- Board Committee Requirements
- Obligation w.r.t. intimations and disclosures to stock exchange
- Requirement w.r.t. Board process and meetings
- Website requirements

- Advertisement mandates
- Requirement w.r.t. policies
- Requirements on share holding pattern
- Requirements w.r.t. corporate actions etc.

These mandates are cores in detail in different chapters of this study material. The principles for periodic disclosures are based on the principles given by International Organization of Securities Commissions (IOSCO) and also have incorporated the principles for corporate governance (in line with OECD principles). These principles underlie specific requirements prescribed in different chapters of the Regulations. In the event of the absence of specific requirements or ambiguity, these principles would serve to guide the listed entities.

Principles governing disclosures and obligations – Regulation 4

- (1) The listed entity which has listed its securities shall make disclosures and abide by its obligations under these regulations, in accordance with the following principles:
 - (a) Information shall be prepared and disclosed in accordance with applicable standards of accounting and financial disclosure.
 - (b) The listed entity shall implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and shall also ensure that the annual audit is conducted by an independent, competent and qualified auditor.
 - (c) The listed entity shall refrain from misrepresentation and ensure that the information provided to recognised stock exchange(s) and investors is not misleading.
 - (d) The listed entity shall provide adequate and timely information to recognised stock exchange(s) and investors.
 - (e) The listed entity shall ensure that disseminations made under provisions of these regulations and circulars made thereunder, are adequate, accurate, explicit, timely and presented in a simple language.
 - (f) Channels for disseminating information shall provide for equal timely and cost-efficient access to relevant information by investors.
 - (g) The listed entity shall abide by all the provisions of the applicable laws including the securities laws and also such other guidelines as may be issued from time to time by the Board and the recognised stock exchange(s) in this regard and as may be applicable.
 - (h) The listed entity shall make the specified disclosures and follow its obligations in letter and spirit taking into consideration the interest of all stakeholders.
 - (i) Filings, reports, statements, documents and information which are event based or are filed periodically shall contain relevant information.
 - (j) Periodic filings, reports, statements, documents and information reports shall contain information that shall enable investors to track the performance of a listed entity over regular intervals of time and shall provide sufficient information to enable investors to assess the current status of a listed entity.
- (2) The listed entity which has listed its specified securities shall comply with the corporate governance provisions as specified in chapter IV which shall be implemented in a manner so as to achieve the objectives of the principles as mentioned below:

- (a) The rights of shareholders- Regulation (4)(2)(a):** The listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:
- (i) Right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes.
 - (ii) Opportunity to participate effectively and vote in general shareholder meetings.
 - (iii) being informed of the rules, including voting procedures that govern general shareholder meetings.
 - (iv) opportunity to ask questions to the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.
 - (v) effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors.
 - (vi) exercise of ownership rights by all shareholders, including institutional investors.
 - (vii) adequate mechanism to address the grievances of the shareholders.
 - (viii) protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress.
- (b) Timely information- Regulation 4(2)(b) :** The listed entity shall provide adequate and timely information to shareholders, including but not limited to the following:
- (i) sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be discussed at the meeting.
 - (ii) Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership.
 - (iii) rights attached to all series and classes of shares, which shall be disclosed to investors before they acquire shares.
- (c) Equitable treatment- Regulation 4(2)(c):** The listed entity shall ensure equitable treatment of all shareholders, including minority and foreign shareholders, in the following manner:
- (i) All shareholders of the same series of a class shall be treated equally.
 - (ii) Effective share holder participation in key corporate governance decisions, such as the nomination and election of members of board of directors, shall be facilitated.
 - (iii) Exercise of voting rights by foreign shareholders shall be facilitated.
 - (iv) The listed entity shall devise a framework to avoid insider trading and abusive self-dealing.
 - (v) Processes and procedures for general shareholder meetings shall allow for equitable treatment of all shareholders.
 - (vi) Procedures of listed entity shall not make it unduly difficult or expensive to cast votes.
- (d) Role of stakeholders in corporate governance- Regulation 4(2)(d):** The listed entity shall recognise the rights of its stakeholders and encourage co-operation between listed entity and the stakeholders, in the following manner:
- (i) The listed entity shall respect the rights of stakeholders that are established by law or through mutual agreements.

- (ii) Stakeholders shall have the opportunity to obtain effective redress for violation of their rights.
 - (iii) Stakeholders shall have access to relevant, sufficient and reliable information on a timely and regular basis to enable them to participate in corporate governance process.
 - (iv) The listed entity shall devise an effective vigil mechanism/ whistle blower policy enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.
- (e) Disclosure and transparency– Regulation 4(2)(e):** The listed entity shall ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the listed entity, in the following manner:
- (i) Information shall be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.
 - (ii) Channels for disseminating information shall provide for equal, timely and cost-efficient access to relevant information by users.
 - (iii) Minutes of the meeting shall be maintained explicitly recording dissenting opinions, if any.
- (f) Responsibilities of the board of directors – Regulation 4(2)(f):** The board of directors of the listed entity shall have the following responsibilities:
- (i) Disclosure of information– Regulation 4(2)(f)(i):
 - (1) Members of board of directors and key managerial personnel shall disclose to the board of directors whether they, directly, indirectly, or on behalf of third parties, have a material interest in any transaction or matter directly affecting the listed entity.
 - (2) The board of directors and senior management shall conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture of good decision-making.
 - (ii) Key functions of the board of directors- Regulation 4(2)(f)(ii):
 - (1) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans, setting performance objectives, monitoring implementation and corporate performance, and overseeing major capital expenditures, acquisitions and divestments.
 - (2) Monitoring the effectiveness of the listed entity's governance practices and making changes as needed.
 - (3) Selecting, compensating, monitoring and, when necessary, replacing key managerial personnel and overseeing succession planning.
 - (4) Aligning key managerial personnel and remuneration of board of directors with the longer term interests of the listed entity and its shareholders.
 - (5) Ensuring a transparent nomination process to the board of directors with the diversity of thought, experience, knowledge, perspective and gender in the board of directors.
 - (6) Monitoring and managing potential conflicts of interest of management, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions.

- (7) Ensuring the integrity of the listed entity's accounting and financial reporting systems, including the independent audit, and those appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
 - (8) Overseeing the process of disclosure and communications.
 - (9) Monitoring and reviewing board of director's evaluation framework.
- (iii) Other responsibilities– Regulation 4(2)(f)(iii):
- (1) The board of directors shall provide strategic guidance to the listed entity, ensure effective monitoring of the management and shall be accountable to the listed entity and the shareholders.
 - (2) The board of directors shall set a corporate culture and the values by which executives throughout a group shall behave.
 - (3) Members of the board of directors shall act on a fully informed basis, in good faith, with Due diligence and care, and in the best interest of the listed entity and the shareholders.
 - (4) The board of directors shall encourage continuing directors training to ensure that the members of board of directors are kept up to date.
 - (5) Where decisions of the board of directors may affect different shareholder groups differently, the board of directors shall treat all shareholders fairly.
 - (6) The board of directors shall maintain high ethical standards and shall take in to account the interests of stakeholders.
 - (7) The board of directors shall exercise objective in dependent judgement on corporate affairs.
 - (8) The board of directors shall consider assigning a sufficient number of non-executive members of the board of directors capable of exercising independent judgement to tasks where there is a potential for conflict of interest.
 - (9) The board of directors shall ensure that, while rightly encouraging positive thinking, these do not result in over-optimism that either leads to significant risks not being recognised or exposes the listed entity to excessive risk.
 - (10) The board of directors shall have ability to 'step back' to assist executive management by challenging the assumptions underlying: strategy, strategic initiatives (such as acquisitions), risk appetite, exposures and the key areas of the listed entity's focus.
 - (11) When committees of the board of directors are established, their man date, composition and working procedures shall be well defined and disclosed by the board of directors.
 - (12) Members of the board of directors shall be able to commit themselves effectively to their responsibilities.
 - (13) In order to fulfil the irresponsibility, members of the board of directors shall have access to accurate, relevant and timely information.
 - (14) The board of directors and senior management shall facilitate the independent directors to perform their role effectively as a member of the board of directors and also a member of a committee of board of directors.

- (3) In case of any ambiguity or incongruity between the principles and relevant regulations, the principles specified in Chapter II shall prevail- Regulation 4(3) .

CORPORATE GOVERNANCE IN UNLISTED COMPANIES

1. Provisions under the Companies Act, 2013- A Bird's Eye view

i) Disclosure of Interest by Director – Section 184

a) Disclosure by new director in first meeting of board and thereafter at the first meeting in every financial year – Section 184(1).

Every director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change, disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in such manner as may be prescribed.

b) Disclosure of interest in a contract – Section 184(2)

Every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into—

- (a) with a body corporate in which such director or such director in association with any other director, holds more than two per cent. shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or
- (b) with a firm or other entity in which, such director is a partner, owner or member, as the case may be,

shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting:

Provided that where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

c) Participation in the meeting by interested director in the contract shall be voidable -Section 184 (3)

A contract or arrangement entered into by the company without disclosure under sub-section (2) or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company.

d) Penal Provision - Section 184(4)

If a director of the company contravenes the provisions of sub-section (1) or sub-section (2), such director shall be liable to a penalty of one lakh rupees.

e) No restriction in any contract by director, only disclosure to be made- Section 184(5)

Nothing in this section—

- (a) shall be taken to prejudice the operation of any rule of law restricting a director of a company from having any concern or interest in any contract or arrangement with the company;

- (b) shall apply to any contract or arrangement entered into or to be entered into between two companies where any of the Directors of the one company or two or more of them together holds or hold not more than two per cent. of the paid-up share capital in the other company or the body corporate.

f) Register of contracts or arrangements in which Directors are interested – Section 189

- i) Company to keep registers of contract – Section 189(1):** Every company shall keep one or more registers giving separately the particulars of all contracts or arrangements to which sub-section (2) of section 184 or section 188 applies, in such manner and containing such particulars as may be prescribed and after entering the particulars, such register or registers shall be placed before the next meeting of the Board and signed by all the Directors present at the meeting.
- ii) Director to disclose interest within 30 days of his appointment – Section 189(2):** Every director or key managerial personnel shall, within a period of thirty days of his appointment, or relinquishment of his office, as the case may be, disclose to the company the particulars specified in sub-section (1) of section 184 relating to his concern or interest in the other associations which are required to be included in the register under that sub-section or such other information relating to himself as may be prescribed.
- iii) Register of contracts to be kept at Registered Office – Section 189(3):** The register referred to in sub-section (1) shall be kept at the registered office of the company and it shall be open for inspection at such office during business hours and extracts may be taken therefrom, and copies thereof as may be required by any member of the company shall be furnished by the company to such extent, in such manner, and on payment of such fees as may be prescribed.
- iv) Register of contracts to be produced before AGM – Section 189(4):** The register to be kept under this section shall also be produced at the commencement of every annual general meeting of the company and shall remain open and accessible during the continuance of the meeting to any person having the right to attend the meeting.
- v) Contracts not exceeding Rs. Five lakh in year – Section 189(5):** Nothing contained in sub-section (1) shall apply to any contract or arrangement—
- (a) for the sale, purchase or supply of any goods, materials or services if the value of such goods and materials or the cost of such services does not exceed five lakh rupees in the aggregate in any year; or
 - (b) by a banking company for the collection of bills in the ordinary course of its business.
- vi) Penal Provisions – Section 189(6):** Every director who fails to comply with the provisions of this section and the rules made thereunder shall be liable to a penalty of twenty-five thousand rupees.

g) Duties of Directors – Section 166

- (1) Subject to the provisions of this Act, a director of a company shall act in accordance with the articles of the company.
- (2) A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

- (3) A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
- (4) A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
- (5) A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.
- (6) A director of a company shall not assign his office and any assignment so made shall be void.
- (7) If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

CORPORATE GOVERNANCE IN BANKS/ FINANCIAL INSTITUTIONS

Banking and financial institutions are the strong back bone of any economy. Functioning of banking and financial Institutions differs with other corporate entities in many ways which makes good corporate governance of banks very critical and important. RBI had under taken several measures to strengthen the corporate governance in the Indian banking sector. Various advisory groups and consultative groups were formed to deeply study banking sector in the light of effective corporate governance.

In March 2000, an advisory group on corporate governance was formed under the chairmanship of Dr. R. H. Patil.



Subsequently, another consultative group was formed in November 2001 under the Chairmanship of Dr. A.S. Ganguly, with an objective to strengthen the internal supervisory role of the Boards in banks. The Committee made several recommendations for effective functioning of banks which were circulated by RBI for adoption by all banks.



On 20th January, 2014, another Committee to Review Governance of Boards of Banks in India was constituted by the RBI Governor under the Chairmanship of Mr. P. J. Nayak. The Committee had submitted its report with various recommendations in May 2014.

Considering the recommendations of these advisory groups and the global corporate governance experiences, various areas of governance which were potentially important and needed attention, were emphasized. It included defined role of supervisors, ensuring an environment supportive to the sound corporate governance, effective organizational structure to have responsible board of directors, etc. Another global initiative in 1999 of the Basel Committee also brought important principles on corporate governance for banks.

Presently Indian banking sector comprises of Scheduled and Non-Scheduled banks, co-operative banks, commercial banks dominated by the government-managed banks including public sector banks, nationalized banks and rural banks, etc. These banks in our country have been established under the different statutes.

- ❖ Majorly banks are governed by the Banking Regulation Act, 1949.
- ❖ The State Bank of India is governed by the State Bank of India Act, 1955.
- ❖ Nationalized banks are governed by the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.
- ❖ The private sector banks came into being as company registered under the Companies Act (whether under the Companies Act, 2013/1956 or under the Indian Companies Act, 1913 or prior to that) and hence are regulated by the Companies Act also to the extent applicable.
- ❖ The banks listed with the stock exchange have to additionally adhere to the requirement of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Additionally Foreign Exchange Management Act (FEMA), 1999, Payment and Settlement Systems Act, 2007, and other directives/ regulations/ guidelines/ instructions issued by RBI and SEBI from time to time also need to be adhered.

Basel Committee on Corporate Governance

Growing size and complexity of India's financial system underscores the significance of strengthening governance standards in banks. Recent events in a dynamic and rapidly evolving financial landscape have led to increasing scrutiny of the role of promoters, major shareholders and senior management vis-a-vis the role of a board. In the context where management plays the role of an agent of a board and the board in turn plays the role of an agent of shareholders, governance failures have brought to fore the impact of quality of governance on efficiency in allocation of resources, protection of depositors' interest as well as maintaining financial stability.

Effective corporate governance is critical to the proper functioning of the banking sector and the economy as a whole. Banks perform a crucial role in the economy by intermediating funds from savers and depositors to activities that support enterprise and help drive economic growth. Banks' safety and soundness are key to financial stability, and the manner in which they conduct their business, therefore, is central to economic health. Governance weaknesses at banks that play a significant role in the financial system can result in the transmission of problems across the banking sector and the economy as a whole.

The Basel Committee's guidance draws from principles of corporate governance published by the Organisation for Economic Co-operation and Development (OECD). The OECD's widely accepted and long-established principles aim to assist governments in their efforts to evaluate and improve their frameworks for corporate governance and to provide guidance for participants and regulators of financial markets.

Basel Committee on Banking Supervision (BCBS) released Guidelines on Corporate Governance for banks were released by the Basel Committee on Banking Supervision in July 2015.

The principles of corporate governance of these guidelines are as under:

- **Principle 1: Board's overall responsibilities:** The board has overall responsibility for the bank, including approving and overseeing the implementation of the bank's strategic objectives, governance framework and corporate culture. The board is also responsible for providing oversight of senior management.

- **Principle 2: Board qualifications and composition:** Board members should be and remain qualified, individually and collectively, for their positions. They should understand their oversight and corporate governance role and be able to exercise sound, objective judgment about the affairs of the bank.
- **Principle 3: Board's own structure and practices:** The board should define appropriate governance structures and practices for its own work, and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness.
- **Principle 4: Senior management:** Under the direction and oversight of the board, senior management should carry out and manage the bank's activities in a manner consistent with the business strategy, risk appetite, remuneration and other policies approved by the board.
- **Principle 5: Governance of group structures:** In a group structure, the board of the parent company has the overall responsibility for the group and for ensuring the establishment and operation of a clear governance framework appropriate to the structure, business and risks of the group and its entities. The board and senior management should know and understand the bank group's operational structure and the risks that it poses.
- **Principle 6: Risk management function:** Banks should have an effective independent risk management function, under the direction of a chief risk officer (CRO), with sufficient stature, independence, resources and access to the board.
- **Principle 7: Risk identification, monitoring and controlling:** Risks should be identified, monitored and controlled on an ongoing bank-wide and individual entity basis. The sophistication of the bank's risk management and internal control infrastructure should keep pace with changes to the bank's risk profile, to the external risk landscape and in industry practice.
- **Principle 8: Risk communication:** An effective risk governance framework requires robust communication within the bank about risk, both across the organisation and through reporting to the board and senior management.
- **Principle 9: Compliance:** The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should approve the bank's compliance approach and policies, including the establishment of a permanent compliance function.
- **Principle 10: Internal Audit:** The internal audit function provides independent assurance to the board and supports board and senior management in promoting an effective governance process and the long-term soundness of the bank. The internal audit function should have a clear mandate, be accountable to the board, be independent of the audited activities and have sufficient standing, skills, resources and authority within the bank.
- **Principle 11: Compensation:** The bank's compensation structure should be effectively aligned with sound risk management and should promote long term health of the organisation and appropriate risk-taking behavior.
- **Principle 12: Disclosure and transparency:** The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.
- **Principle 13: The role of supervisors:** Supervisors should provide guidance for and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management, should require improvement and remedial action as necessary, and should share information on corporate governance with other supervisors.

The Reserve Bank of India plans to overhaul the corporate governance structure of Indian banking system, limiting the terms of directors and chief executive officers and placing more responsibility on the board of directors for a bank's culture and compensation. Board of directors would be responsible for the remuneration and the outcome or performance and would be accountable for the risk a bank takes. Related party transactions and conflict of interest between various entities of a group to which the bank belongs also dominate the latest set of governance rules that the regulator is proposing. Among other things, the new guidelines put the burden of outcomes vis-a-vis the compensation on the board.

Master Direction - Reserve Bank of India ('Fit and Proper' Criteria for Elected Directors on the Boards of PSBs) Directions, 2019

The RBI vide its Master Direction No. RBI/DBR/ 2019-20 / 71 .DBR. Appt. No. 9/29.67.001./ 2019-20 dated 2nd August, 2019 (Updated as on 3rd June, 2020) issued the Master Direction – RBI 'Fit and Proper' Criteria for Elected Directors on the Boards of PSBs) Directions, 2019.

These Directions shall be applicable to Public Sector Banks.

'Fit and Proper' Criteria for Elected Directors on the Boards of State Bank of India and Nationalised Banks:

Authority

All the banks are required to constitute a Nomination and Remuneration Committee consisting of a minimum of three non-executive directors from amongst the Board of Directors, out of which not less than one-half shall be independent directors and should include at least one member from Risk Management Committee of the Board, for undertaking a process of due diligence to determine the 'fit and proper' status of the persons to be elected as directors under sub-section (c) of Section 19 of the SBI Act/clause (i) of sub-section (3) of Section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980. The Government of India nominee director and the director nominated under section 19(f) of the SBI Act/section 9(3)(c) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980 shall not be part of the Committee. The non-executive Chairperson of the bank may be appointed as a member of the Committee but shall not chair such Committee. The Board should also nominate one among them as Chairman of the Committee. The quorum required is three, including the Chairman. In case the absence of any nominated member results in want of quorum, the Board may nominate any other non- executive director in his place for the meeting. At the time of constituting the Committee, the Board can decide on its tenure.

Manner and procedure

The banks shall obtain necessary information, and a declaration & undertaking, in the prescribed form, from the persons who file their nominations for election. The Committee shall meet after the last date prescribed for acceptance of nominations and determine whether or not the person's candidature should be accepted, based on the criteria mentioned below. The Committee's discussions shall be properly recorded as formal minutes of the meeting and the voting, if done, shall also be noted. Based on the information provided in the signed declaration, the Committee shall decide on the acceptance or otherwise of the candidature and shall make references, where considered necessary, to the appropriate authority / persons, to ensure that the candidate conforms to the requirements indicated.

Criteria

The Committee shall determine the 'fit and proper' status of the proposed candidates based on the broad criteria mentioned hereunder:

- **Age** – The candidate's age should be between 35 to 67 years as on the cut-off date fixed for submission of nominations for election.

- **Educational qualification** – The candidate should at least be a graduate.
- **Experience and field of expertise** – The candidate shall have special knowledge or practical experience in respect of one or more of the matters enumerated in section 19A(a) of the SBI Act / section 9(3A)(A) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980, as the case may be, read with RBI Circular DBR .Appt .BC No 39/29.39.001/2016-17 dated November 24, 2016.
- **Disqualifications** - In addition to 'Disqualifications of Directors' as prescribed in Section 22 of the SBI Act, 1955 / Clause 10 of Nationalised Banks (Management and Miscellaneous Provisions) Scheme, 1970/80:
 - a. The candidate should not be a member of the Board of any bank or the Reserve Bank or a Financial Institution (FI) or an Insurance Company or a Non-operative Financial Holding Company (NOFHC) holding any other bank.
Explanation: For the purpose of this sub-para and sub-para (c), the expression “bank” shall include a banking company, a corresponding new bank, State Bank of India, a co-operative bank and a regional rural bank.
 - b. A person connected with hire purchase, financing, money lending, investment, leasing and other para banking activities shall not be considered for appointment as elected director on the board of a PSB. However, investors of such entities would not be disqualified for appointment as directors if they do not enjoy any managerial control in them.
 - c. No person may be elected/ re-elected on the Board of a bank if he/she has served as director in the past on the board of any bank/FI/RBI/Insurance Company under any category for six years, whether continuously or intermittently.
 - d. The candidate should not be engaging in the business of stock broking.
 - e. The candidate should not be holding the position of a Member of Parliament or State Legislature or Municipal Corporation or Municipality or other local bodies.
 - f. The candidate should not be acting as a partner of a Chartered Accountant firm which is currently engaged as a Statutory Central Auditor of any nationalised bank or State Bank of India.
 - g. The candidate should not be acting as a partner of a Chartered Accountant firm which is currently engaged as Statutory Branch Auditor or Concurrent Auditor of the bank in which nomination for election is filed.
- **Tenure** – An elected director shall hold office for three years and shall be eligible for re-election: Provided that no such director shall hold office for a period exceeding six years, whether served continuously or intermittently.
- **Professional Restrictions** –
 - (a) The candidate should neither have any business connection (including legal services, advisory services etc.) with the concerned bank nor should be engaged in activities which might result in a conflict of business interests with that bank.
 - (b) The candidate should not be having any professional relationship with a bank or any NOFHC holding any other bank.

Provided that a candidate having any such relationship with a bank at the time of filing nomination for election shall be deemed to be meeting the requirement under item (b), the candidate shall submit a declaration to the Committee that such relationship with the bank shall be severed if he is elected as a director, and upon being elected, severs such relationship before appointment as a director of the bank.

- **Track record and integrity** - The candidate should not be under adverse notice of any regulatory or supervisory authority/agency, or law enforcement agency and should not be a defaulter of any lending institution.

The banks shall obtain from the elected director:

- a Deed of Covenant executed in the prescribed format before such person assumes office of director;
- a simple declaration every year as on 31st March to the effect that the information already provided by such person has not undergone any change;
- Where the elected director informs that there is change in the information provided earlier, the bank shall obtain from such director a fresh Annex 1 incorporating the changes.

The banks shall also:

Ensure compliance to Section 20 of the Banking Regulation Act, 1949. In addition,

- Put in place a system of safeguards, including proper disclosure of the elected CA director's/his firm's clients, and not participating in bank's credit/investment decisions involving his/firm's clients. The elected CA director should be required to compulsorily dissociate himself from the entire process and sign a covenant to this effect.
- Require the elected director to make a full and proper disclosure of his interests and directorships in business entities, with the director personally distancing himself from and not participating in the bank's credit/ investment decisions involving entities in which he is interested.
- Not allot any professional work to a person who was an elected director of that bank, for a period of two years after demitting office as such director.

Where the elected director:

- fails to
 - submit the Deed of Covenant or declaration; or
 - make proper disclosures; or
 - refrain from participating in credit/investment decisions, where he is interested; or
- makes incomplete or incorrect disclosures, or
- involves in such activities that render him/her 'not fit and proper' as per the criteria mentioned above, such director shall be deemed to be not fulfilling the requirements of sub-section (2) of section 19A of the SBI Act/ sub-section (3AA) of section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980 and shall be liable for the consequences thereof.

The Committee shall adopt the revised criteria stated above while scrutinizing the nomination of candidates seeking election as new directors (appointment/re-appointment). However, existing elected directors may be allowed to complete their current terms as per the pre-revised criteria.

GUIDELINES ON CORPORATE GOVERNANCE FOR NBFCs

In order to enable NBFCs to adopt best practices and greater transparency in their operations the RBI vide its Master Direction No. RBI/DNBR/ 2016-17/45. DNBR.PD.008/03.10.119/2016-17 dated 1st September, 2016 (updated as on 17th February, 2020 issued the guidelines. These guidelines are applicable for NBFC-Systematically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

The provisions of these directions shall apply to the following:

- i. every Systemically Important Non-Deposit taking Non-Banking Financial Company (NBFC-ND-SI) registered with the Bank under the provisions of RBI Act, 1934;
- ii. every Deposit taking Non-Banking Financial Company (NBFC-D) registered with the Bank under the provisions of RBI Act, 1934;
- iii. every NBFC-Factor registered with the Bank under section 3 of the Factoring Regulation Act, 2011 and having an asset size of Rs. 500 crore and above;
- iv. every Infrastructure Debt Fund – Non-Banking Finance Company (IDF-NBFC) registered with the Bank under the provisions of RBI Act, 1934;
- v. every Non-Banking Finance Company – Micro Finance Institutions (NBFC-MFIs) registered with the Bank under the provisions of RBI Act, 1934 and having an asset size of Rs. 500 crore and above;
- vi. every Non-Banking Finance Company - Infrastructure Finance Company (NBFCIFC) registered with the Bank under the provisions of RBI Act, 1934 and having an asset size of Rs. 500 crore and above.

The Category of NBFCs as mentioned at points (i) to (vi) above are hereafter referred to as ‘applicable NBFCs’, for the purpose of these Directions.

Chapter XI of the captioned Master Directions deals with the Corporate Governance and provides as under:

1. Audit Committee:

- i. All Applicable NBFCs shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors.

Explanation I: The Audit Committee constituted by an on-banking financial company as required under Section 177 of the Companies Act, 2013 shall be the Audit Committee for the purposes of this paragraph.

Explanation II: The Audit Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 177 of the Companies Act, 2013.

- ii. The Audit Committee must ensure that an Information System Audit of the internal systems and processes is conducted at least once in two years to assess operational risks faced by the NBFCs.

2. Nomination Committee: All Applicable NBFCs shall form a Nomination Committee to ensure ‘fit and proper’ status of proposed/ existing directors.

Explanation I: The Nomination Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 178 of the Companies Act, 2013.

3. Risk Management Committee: To manage the integrated risk, all Applicable NBFCs shall form a Risk Management Committee, besides the Asset Liability Management Committee.

Appointment of Chief Risk Officer

With the increasing role of NBFCs in direct credit intermediation, there is a need for NBFCs to augment risk management practices. While Boards of NBFCs should strive to follow best practices in risk management, NBFCs with asset size of more than Rs.50 billion in categories - Investment and Credit Companies, Infrastructure Finance Companies, Micro Finance Institutions, Factors and Infrastructure Debt Funds shall appoint a CRO with clearly specified role and responsibilities. The CRO is required to function independently so as to ensure highest standards of risk management.

The NBFCs shall strictly adhere to the following instructions in this regard:

- (a) The CRO shall be a senior official in the hierarchy of an NBFC and shall possess adequate professional qualification/ experience in the area of risk management.
- (b) The CRO shall be appointed for a fixed tenure with the approval of the Board. The CRO can be transferred/ removed from his post before completion of the tenure only with the approval of the Board and such premature transfer/ removal shall be reported to the Department of Non-Banking Supervision of the regional office of the Bank under whose jurisdiction the NBFC is registered. In case the NBFC is listed, any change in incumbency of the CRO shall also be reported to the stock exchanges.
- (c) The Board shall put in place policies to safeguard the independence of the CRO. In this regard, the CRO shall have direct reporting lines to the MD & CEO/ Risk Management Committee (RMC) of the Board. In case the CRO reports to the MD & CEO, the RMC/ Board shall meet the CRO without the presence of the MD & CEO, at least on a quarterly basis. The CRO shall not have any reporting relationship with the business verticals of the NBFC and shall not be given any business targets. Further, there shall not be any 'dual hatting' i.e. the CRO shall not be given any other responsibility.
- (d) The CRO shall be involved in the process of identification, measurement and mitigation of risks. All credit products (retail or wholesale) shall be vetted by the CRO from the angle of inherent and control risks. The CRO's role in deciding credit proposals shall be limited to being an advisor.
- (e) In NBFCs that follow committee approach in credit sanction process for high value proposals, if the CRO is one of the decision makers in the credit sanction process, the CRO shall have voting power and all members who are part of the credit sanction process, shall individually and severally be liable for all the aspects, including risk perspective related to the credit proposal.

Fit and Proper Criteria

All applicable NBFCs shall -

- (i) ensure that a policy is put in place with the approval of the Board of Directors for ascertaining the fit and proper criteria of the directors at the time of appointment, and on a continuing basis;
- (ii) obtain a declaration and undertaking from the directors giving additional information on the directors;
- (iii) obtain a Deed of Covenant signed by the directors;
- (iv) furnish to the Bank a quarterly statement on change of directors, and a certificate from the Managing Director of the applicable NBFC that fit and proper criteria in selection of the directors has been followed. The statement must reach the Regional Office of the Department of Non-Banking Supervision of the Bank where the company is registered, within 15 days of the close of the respective quarter. The statement submitted by applicable NBFC for the quarter ending March 31, shall be certified by the auditors.

Provided that the Bank, if it deems fit and in public interest, reserves the right to examine the fit and proper criteria of directors of any NBFC irrespective of the asset size of such NBFC.

Disclosure and transparency:

- (1) All Applicable NBFCs shall put upto the Board of Directors, at regular intervals, as may be prescribed by the Board in this regard, the following:
 - i. the progress made in putting in place a progressive risk management system and risk management policy and strategy followed by the NBFC;

- ii. conformity with corporate governance standards viz., in composition of various committees, their role and functions, periodicity of the meetings and compliance with coverage and review functions, etc.
- (2) All Applicable NBFCs shall also disclose the following in their Annual Financial Statements, with effect from March 31, 2015:
- i. registration/licence/authorisation, by whatever name called, obtained from other financial sector regulators;
 - ii. ratings assigned by credit rating agencies and migration of ratings during the year;
 - iii. penalties, if any, levied by any regulator;
 - iv. information namely, area, country of operation and joint venture partners with regard to Joint ventures and overseas subsidiaries; and
 - v. Asset-Liability profile, extent of financing of parent company products, NPAs and movement of NPAs, details of all off-balance sheet exposures, structured products issued by the mas also securitization/ assignment transactions and other disclosures.

Rotation of partners of the Statutory Auditors Audit Firm

All applicable NBFCs shall rotate the partner/s of the Chartered Accountant firm conducting the audit, every three years so that same partner shall not conduct audit of the company continuously for more than a period of three years. However, the partner so rotated shall be eligible for conducting the audit of the applicable NBFC after an interval of three years, if the applicable NBFC, so decides. The applicable NBFC shall incorporate appropriate terms in the letter of appointment of the firm of auditors and ensure its compliance.

Framing of Internal Guidelines:

All applicable NBFCs shall frame their internal guidelines on corporate governance with the approval of the Board of Directors, enhancing the scope of the guidelines without sacrificing the spirit underlying the above guidelines and it shall be published on the company's web-site, if any, for the information of various stakeholders.

CORPORATE GOVERNANCE GUIDELINES FOR INSURANCE COMPANIES

The Insurance Regulatory and Development Authority of India (IRDAI) issued Guidelines on Corporate Governance for insurance companies vide circular dated 5th August, 2009. The Authority had also issued separate guidelines for appointment/reappointment and remuneration of MD/CEO/WTD as well as other Key Management Persons (KMPs) and also the Appointment of statutory auditors of insurers through various circulars.

The IRDAI revised the existing Guidelines in the light of changes brought in by the Companies Act, 2013 vide Circular Dated 18th May 2016 to ensure that the structure, responsibilities and functions of Board of Directors and the management of the company recognize the expectations of all stakeholders as well as those of the regulator. These guidelines are applicable to all insurers granted registration by the Authority except:

- (i) reinsurance companies may not be required to have the Policy holders 'Protection Committee; and
- (ii) branches of foreigner insurers in India may not be required to constitute the Board and its mandatory committees as indicated herein.

The guidelines address the various requirements broadly covering the following major structural elements of Corporate Governance in insurance companies:-

1. General

- 1.1** Corporate Governance is understood as a system of financial and other controls in a corporate entity and broadly defines the relationship between the shareholders, Board of Directors and management. In case of the financial sector, where the entities accept public liabilities for fulfillment of certain contracts, the relationship is fiduciary with enhanced responsibility to protect the interests of all stakeholders. The Corporate Governance framework should clearly define the roles and responsibilities and accountability within an organization with built-in checks and balances. The importance of Corporate Governance has received emphasis in recent times since poor governance and weak internal controls have been associated with major corporate failures. It has also been appreciated that the financial sector needs to have a more intensive governance structure in view of its role in the economic development and since the safety and financial strength of the institutions are critical for the overall strength of the financial sector on which the economic growth is built upon. As regards the insurance sector, the regulatory responsibility to protect the interests of the policyholders demands that the insurers have in place, good governance practices for maintenance of solvency, sound long term investment policy and assumption of underwriting risks on a prudential basis. The emergence of insurance companies as a part of financial conglomerates has added a further dimension to sound Corporate Governance in the insurance sector with emphasis on overall risk management across the structure and to prevent any contagion and to ensure financial stability.
- 1.2** The Insurance Regulatory and Development Authority of India (IRDAI) has outlined in general terms, governance responsibilities of the Board in the management of the insurance functions under various Regulations notified by it covering different operational areas. It has now been decided to put them together and to issue the following comprehensive guidelines for adoption by an Insurer. In the light of changes brought in by the Companies Act, 2013, the existing guidelines on Corporate Governance practices of insurers are being revised as below. These revised Guidelines shall replace the existing guidelines on Corporate Governance issued by the Authority and shall take effect from FY 2016-17. These guidelines shall also supercede the Guidelines on Reporting of Key Persons dt. 9th October, 2013 and stipulations regarding appointment of Statutory Auditors issued *vide* Circulars dt.25.07.2005 and 22.04.2009.

2. Objectives

- 2.1** The objective of the guidelines is to ensure that the structure, responsibilities and functions of Board of Directors and the management of the company recognize the expectations of all stakeholders as well as those of the regulator. The structure should take steps required to adopt sound and prudent principles and practices for the governance of the company and should have the ability to quickly address issues of non-compliance or weak oversight and controls. These guidelines therefore amplify on certain issues which are covered in the Insurance Act, 1938 and the regulations framed thereunder and include measures which are additionally considered essential by IRDAI for adoption by insurers.
- 2.2** The guidelines accordingly address the various requirements broadly covering the following major structural elements of Corporate Governance in insurance companies:-
- Governance structure
 - Board of Directors
 - CEO
 - Key Management functions

- Role of Appointed Actuaries
- External audit – Appointment of Statutory Auditors
- Disclosures
- Relationship with stakeholders
- Interaction with the Supervisor
- Whistle blower policy

2.3 In these guidelines, the reference to the “Board” would apply to the “Board of Directors” and the term “Key Management Persons” shall be as defined in these guidelines.

3. Significant Owners, Controlling Shareholders – Role of Board

3.1 IRDAI prescribes a minimum lock-in period of 5 years from the date of certificate of commencement of business of an insurer (R3) for the promoters of the insurance company and no transfer of shares of the promoters is permitted within this period without the specific approval of the Authority.

3.2 Section 2 (7A) of the Insurance Act, 1938 has prescribed the ceiling of Foreign Investment in Indian Insurance Companies at 49%, subject to the Indian Insurance Company being Indian owned and controlled. The manner of computation of Foreign Investment to satisfy this requirement is specified in the Rules and Regulations issued by the Government and IRDAI from time to time.

Explanation to sub-clause (b) of clause 7A of Section 2 of the Insurance Act, 1938, which defines ‘Indian Insurance Company’ provides that the expression “control” shall include the right to appoint a majority of directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.

Therefore, it has to be demonstrated through express provisions in the agreements between the promoters/ shareholders and/ or the Articles of Association of the Insurance companies that the ownership as well as control does not lie with foreign entities but ultimately rests with resident Indian citizens at all times.

3.3 The Insurance Act, 1938 stipulates prior approval of the IRDAI for registration/transfer of shares, exceeding one per cent and /or which involve holding of share capital, after such transfer, in excess of 5 per cent of the paid-up capital of the company. The Board of Directors of the company shall ensure that the registration of shares is in compliance with the above provisions of the Act, Regulations and circulars issued by IRDAI from time to time.

3A. Conflict of Interest – Role of Board

1. Where it is proposed to enter into a contract or arrangement with Related parties as defined in Companies Act 2013, the disclosures by Directors and necessary approvals as required under Sections 184, 177(4)(iv) and 188 of Companies Act 2013, read with the relevant Rules thereunder, shall be obtained. Adequate systems, policies and procedures to address potential conflicts of interest and compliance with the provisions of Companies Act, 2013 need to be established by the insurers. These include Board level review of key transactions, disclosure of any conflicts of interest to manage and control such issues. Where the transactions with related parties are in the nature of transactions such as reinsurance arrangements or investment transactions or outsourcing to related parties, for which specific regulations or guidelines have been notified, compliance with the respective regulations or guidelines shall also be ensured.

The Board of Directors of an insurer shall formulate a Policy on Related Party Transactions laying down the following:

- (a) Definition of Transactions in the ordinary course of the insurance business giving examples specific to the insurance company.

- (b) Method of determination of arm's length pricing.
- (c) List of items requiring approvals from various authorities, Audit Committee, Board, Shareholders etc.
- (d) Any other matter relevant to the Related party transactions.

The Policy shall be reviewed by the Board on an yearly basis. In the case of insurance cover given by the insurance company to the group companies, price/ premium quoted by the companies under F&U guidelines should be considered as arm's length. The disclosures about payments made to group entities of the insurer out of the policyholders funds, shall be made as a part of the related party disclosures in terms of para 9 of these guidelines; and all such transactions may be grouped together under the related party transactions.

2. Auditors, Actuaries, Directors and Key Management Persons shall not simultaneously hold two positions in the insurance company that could lead to conflict or potential conflicts of interest.
3. The Board should ensure ongoing compliance with the statutory requirements on capital structure while planning or examining options for capital augmentation of the Company.

4. Governance Structure

The insurance companies presently could have different structures with the Board of Directors headed by a Executive or Non-executive Chairman with distinct oversight responsibilities over the other Directors and Key Management Persons. It is expected that whatever form is taken, the broader elements of good Corporate Governance are present.

The governance structure of the insurer could also be influenced by its association with an insurance group or a larger financial/ non-financial conglomerate. Insurers who are a part of a financial group could also be subject to the regulatory requirements on governance policies and practices established for the group level and implemented uniformly across the group.

However, these practices should be reoriented at the level of the insurer taking in to account its specific business and risk profile and sectoral regulatory requirements. Such insurers should nevertheless strive to maintain consistency in policies and practices in order to have in force controls across the group.

5. Board of Directors

5.1. Composition

- The Insurance Act stipulates that the insurance companies in India would be public companies and hence, would require a properly constituted Board.
- Insurance companies should ensure that the Board comprises of competent and qualified Directors to drive the strategies in a manner that would sustain growth and protect the interests of the stakeholders in general and policyholders in particular.
- The size of the Board in addition to being compliant with legal requirements (where applicable), should be consistent with scale, nature and complexity of business.
- It is expected that the shareholders of the companies elect or nominate Directors from various areas of financial and management expertise such as accountancy, law, insurance, pension, banking, securities, economics, etc., with qualifications and experience that is appropriate to the company.

- It is essential that the Directors possess the knowledge of group structure, organizational structure, process and products of the insurer and the Board generally complies with the following requirements-
 - The Board of Directors and Key Management Persons should understand the operational structure of the insurer and have a general understanding of the lines of business and products of the insurer, more particularly as the insurer grows in size and complexity.
 - The Board of Directors of an insurer belonging to a larger group structure/ conglomerate should understand the material risks and issues that could affect the group entities, with attendant implication on the insurer.
- The Board of Directors is required to have a minimum of three “Independent Directors”. However, this requirement is relaxed to ‘two’ independent directors, for the initial five years from grant of Certificate of Registration to insurers. An independent Directors shall fulfill all the conditions specified under Section 149 of the Companies Act, 2013.
- In case the number of independent directors falls below the required minimum laid down, such vacancy shall be filled up before the immediately following Board meeting or 3 months from the date of such vacancy, whichever is later, under intimation to the Authority.
- Where the Chairman of the Board is non-executive, the Chief Executive Officer should be a wholetime director of the Board.

As required under Section 149 of the Companies Act, 2013, there shall be at least one Woman Director on the Board of every Insurance company.

5.2. The Role and responsibility of the Board

The Role and Responsibilities of the Board of insurers are detailed as under:

Role and Responsibilities of the Board of Directors

- 1) The Board should ensure that the Governance principles set for the insurer comply with all relevant laws, regulations and other applicable codes of conduct.
- 2) The Board should set the following policies in consultation with the Management of the Company.
 - (a) Define and periodically review the business strategy.
 - (b) Define the underwriting policy of the insurer.
 - (c) Determine the retention and reinsurance policy and in particular, the levels of retentions of risk by the insurer and the nature and extent of reinsurance protection to be maintained by the insurer.
 - (d) Define the policy of the insurer as regards investment of its assets consistent with an appropriate asset liability management structure.
 - (e) Define the insurer’s policy on appointments and qualification requirements for human resources and ensure that the incentive structure does not encourage imprudent behaviour.

- 3) The Board should define and set the following standards:-
 - (a) Define the standards of business conduct and ethical behaviour for directors and senior management.
 - (b) Define the standards to be maintained in policyholder servicing and in redressal of grievances of policyholders.
- 4) The Board would be responsible to provide guidance for implementation of business strategy and review the same periodically.
- 5) As an integral part of proper implementation of the business strategy, the Board should take action as under:-
 - (a) Establish appropriate systems to regulate the risk appetite and risk profile of the Company. It will also enable identification and measurement of significant risks to which the company is exposed in order to develop an effective risk management system.
 - (b) Ensure that all directions of IRDAI are submitted to the Board and the recommendations are implemented as per the Board philosophy.
 - (c) Ensure that the IT systems in the company are appropriate and have built-in checks and balances to produce data with integrity and put in place a business continuity and disaster recovery plan.
 - (d) Ensure that the company has put in place a robust compliance system for all applicable laws and regulations.
 - (e) Prescribe requirements and frequency of reporting in respect of each of the above areas of responsibility as may be decided by the Board.
- 6) In discharge of the above and other Governance functions, the Board may delegate the responsibilities to mandated/ other recommended Empowered Committees of Directors while retaining its primary accountability.

The Board would primarily concentrate on the direction, control and governance of the insurer and in particular should articulate and commit to a corporate philosophy and governance that will shape the level of risk adoption, standards of business conduct and ethical behaviour of the company at the macro level. The Board should also set clear and transparent policy framework for translation of the corporate objectives. The Board can delegate its authority to the Board Committees in the discharge of this responsibility but such delegation does not absolve the Board from its primary responsibilities. In this regard, the Board should seek detailed and transparent information flow from the senior management (CEO and other KMPs) through well documented agenda notes and also devise appropriate systems to serve as effective monitoring arrangements. As the Boards generally do not meet at frequent intervals, it is imperative that the senior management is clearly made accountable for the two way information flow. The structure of the Board of Directors should be oriented to setting- up of objectives to meet the expectations of various stakeholders, strategies for their fulfillment and for monitoring the achievements. The Boards of insurance companies need to consider interests of all stakeholders, and especially their policyholders as a specific group. Further, since there could arise a conflict of interest amongst the various stakeholders, a key board function would be to establish strategies and policies that define ethical individual and corporate behaviour and ongoing, effective processes that ensure adherence to these strategies and policies.

Thus, with a view to being effective, the Board in active consultation with the Key Management Persons, should establish and evaluate strategies and policies to address, at the minimum, a

broad range of areas, as indicated below. There should concurrently be arrangements to review the policies from time to time to ensure that they are dynamic.

- Overall direction of the business of the insurance company, including policies, strategies and risk management across all the functions;
- Projections on the capital requirements, revenue streams, expenses and the profitability. While laying down the projections, the Board must address the expectations of the shareholders and the policyholders;
- Obligation to fully comply with the Insurance Act and the regulations framed thereunder, and other statutory requirements applicable to it;
- Addressing conflicts of interest;
- Ensuring fair treatment of policyholders and employees;
- Ensuring information sharing with and disclosures to stakeholders, including investors, policyholders, employees, the regulators, consumers, financial analysts and/or rating agencies.
- Establishing channels for encouraging and facilitating employees raising concerns or reporting a possible breach of law or regulations, with appropriate measures to protect whistle blowers;
- Developing a corporate culture that recognizes and rewards adherence to ethical standards.

5.3. Fit and Proper Criteria

In line with the international and domestic norms, the Directors of insurers have to meet the “fit and proper” criteria. The criteria to be satisfied, at a minimum, would relate to integrity demonstrated in personal behaviour and business conduct, soundness of judgment and financial soundness. The Insurance Act prohibits (i) an insurance intermediary/ agent to be the Director of an insurance company (except with prior approval of the Authority); and (ii) the common directorship among life insurance companies. Currently, the fit and proper requirements seek to ensure that the Director should not have been convicted or come under adverse notice of the laws and regulations involving moral turpitude or of any professional body. With a view to ensuring that the Directors comply with the above requirement, a due diligence enquiry should be undertaken on the person to be appointed as Director or for the continuance of the existing Directors only after obtaining a declaration from the proposed/existing Directors in the format given in Annexure 2, at the time of their appointment/re- appointment.

5.4. Disclosures about Meetings of the Board and its Committees

Insurers shall ensure compliance with the provisions of the Companies Act, 2013 and the Secretarial Standards issued by the ICSI from time to time as regards conduct of the meetings of the Board of Directors and their committees. In addition to the above, all insurers shall disclose the following in the Director’s Report:

- (a) Number of meetings of the Board of Directors and Committees mandated under these Guidelines, in the financial year
- (b) Details of the composition of the Board of Directors and Committees mandated, setting out name, qualification, field of specialization, status of directorship held etc.
- (c) Number of meetings attended by the Directors and members of the Committee

(d) Details of the remuneration paid, if any, to all directors (including Independent Directors)

6. Control Functions

Given the risks that an insurer takes in carrying out its operations, and the potential impact it has on its business, it is important that the Board lays down the policy framework to put in place:

- robust and efficient mechanisms for the identification, assessment, quantification, control, mitigation and monitoring of the risks;
- appropriate processes for ensuring compliance with the Board approved policy, and applicable laws and regulations;
- appropriate internal controls to ensure that the risk management and compliance policies are observed;
- an internal audit function capable of reviewing and assessing the adequacy and effectiveness of, and the insurer's adherence to its internal controls as well as reporting on its strategies, policies and procedures; and
- Independence of the control functions, including the risk management function, from business operations demonstrated by a credible reporting arrangement.

The Board shall be responsible for the oversight over the control functions of an Insurer.

For insurers within a group, appropriate and effective group-wide risk control systems should be in place in addition to the control systems at the level of the insurer. It is essential to manage risks appropriately on a group-wide basis as well as at the level of the insurer. The Boards of the respective insurers are required to lay down requisite policy framework to ensure that such risks are adequately addressed.

7. Delegation of Functions- Committees of the Board

With a view to providing adequate Board time for discharge of the significant corporate responsibilities, the Board can consider setting up of various Committees of Directors by delegating the overall monitoring responsibilities after laying down the roles and responsibilities of these Committees to the Board. In particular, the following aspects need to be defined in respect of the role and functions of the Committees:

- Constitution
- Objectives
- Responsibilities
- Frequency of meeting / quorum requirements
- Appointment and removal of members
- Reporting to the Board

Insurers may establish several Committees to undertake specific functions depending on the size and level of the complexity of the operations. Typically, the Committees that assist the Board are Audit Committee, Risk Management Committee, Nomination and Remuneration Committee, Investment Committee, Ethics Committee and Asset-Liability Management Committee.

However, the Authority advises all insurers that it is mandatory to establish Committees for Audit, Investment, Risk Management, Policyholder Protection, Nomination and Remuneration, Corporate Social Responsibility (only for insurers earning profits).

In addition, Regulation 45d of the IRDA (Non-linked Insurance Products) Regulations, 2013 requires constitution of a 'With Profits' Committee by Life Insurance Companies comprising of one Independent Director of the Board, the Chief Executive Officer, the Appointed Actuary of the Company and an Independent Actuary. Establishment of the other Committees is left to the option of the insurer. The role and responsibilities of the Committees would generally be as detailed below:-

7.1. Audit Committee (Mandatory)

- Every Insurer shall constitute an Audit Committee as per Section 177 of the Companies Act, 2013.
- The Audit Committee shall oversee the financial statements, financial reporting, statement of cash flow and disclosure processes both on an annual and quarterly basis. It shall set-up procedures and processes to address all concerns relating to adequacy of checks and control mechanisms.
- The Chairperson of the Audit Committee should be an Independent Director of the Board with an accounting/finance/audit experience and may be a Chartered Accountant or a person with a strong financial analysis background. The association of the CEO in the Audit Committee should be limited to occasions where the Audit Committee requires eliciting any specific information concerning audit findings. As required under Section 177 of the Companies Act, 2013, the Audit Committee shall comprise of a minimum of three directors, majority of whom shall be Independent Directors.
- The Audit Committee will oversee the efficient functioning of the internal audit department and review its reports. The Committee will additionally monitor the progress made in rectification of irregularities and changes in processes wherever deficiencies have come to notice.
- The Audit Committee shall be directly responsible for the recommendation of the appointment, remuneration, performance and oversight of the work of the auditors (internal/statutory/Concurrent). In case of statutory audit, the independence of the external auditors shall be ensured (although the approval of appointment, remuneration and removal of the statutory auditors shall be done by the shareholders at the general body meeting).
- The Audit Committee shall have the oversight on the procedures and processes established to attend to issues relating to maintenance of books of account, administration procedures, transactions and other matters having a bearing on the financial position of the insurer, whether raised by the auditors or by any other person.
- The Audit Committee shall discuss with the statutory auditors before the audit commences, about the nature and scope of audit as well as have post-audit discussions to address areas of concern.
- Act as a Compliance Committee to discuss the level of compliance in the Company and any associated risks and to monitor and report to the Board on any significant compliance breaches.
- Any additional work other than statutory/internal audit that is entrusted to the auditor or any of its associated persons or companies shall be specifically approved by the Board keeping in mind the necessity to maintain the independence and integrity of the audit relationship. All such other work entrusted to the auditor or its associates shall be specifically disclosed in the Notes to Accounts forming part of the annual accounts of the insurance companies. However, it may be ensured that insurance companies comply with Section 144 of the Companies Act, 2013 before deciding to provide any additional work to the Statutory Auditors.

7.2. Investment Committee (Mandatory)

The Board of every Insurer shall set up an Investment Committee comprising of at least two Non-Executive Directors, the Chief Executive Officer, Chief of Finance, Chief of Investment, Chief Risk Officer and, the Appointed Actuary.

The Committee shall be responsible to recommend investment policy and lay down the operational framework for the investment operations of the insurer. The policy should focus on a prudential Asset Liability Management (ALM) supported by robust internal control systems. The investment policy and operational framework should, inter alia, encompass aspects concerning liquidity for smooth operations, compliance with prudential regulatory norms on investments, risk management / mitigation strategies to ensure commensurate yield on investments and above all protection of policyholders' funds.

The Investment Committee shall be responsible for implementing the Investment Policy duly approved by the Board.

Members of the Committee should familiarize themselves and be conversant with the various Acts, Rules, Regulations, Guidelines, Circulars, etc., issued by the Authority as amended from-time-to-time.

For assessment of credit risk and market risk, the members of the Committee should not be influenced only by the credit rating. The committee should independently review their investment decisions and ensure that support by the internal due diligence process is an input in making appropriate investment decisions.

The Committee shall formulate an effective reporting system to ensure compliance with the policy set out by it apart from Internal /Concurrent Audit mechanisms for a sustained and on-going monitoring of Investment Operations.

The Committee shall meet at least once in a quarter to review investment operations and submit a report to the Board on the performance of the investment portfolio with regard to its safety and soundness.

7.3. Risk Management Committee (Mandatory)

It is now well recognized that the sound management of an insurance company, as in the case of other financial sector entities, is dependent on how well the various risks are managed across the organization. In pursuit of development of a strong risk management system and mitigation strategies, insurers shall set up a separate Risk Management Committee to implement the company's Risk Management Strategy. The risk management function should be under the overall guidance and supervision of the Chief Risk Officer (CRO) with a clearly defined role. It shall be organized in such a way that it is able to monitor all the risks across the various lines of business of the company and the operating head has direct access to the Board. It should not focus solely on compliance; it should focus on adding value to rest of the business. Risk management function should work in close co-ordination with the finance function, but independently assess and evaluate the capital, finance and other operating decisions. Broadly, the Risk Management Committee shall:

- Establish effective Risk Management framework and recommend to the Board the Risk Management policy and processes for the organization.
- Set the risk tolerance limits and assess the cost and benefits associated with risk exposure.
- Review the Company's risk- reward performance to align with overall policy objectives.

- Discuss and consider best practices in risk management in the market and advise the respective functions.
- Assist the Board in effective operation of the risk management system by performing specialized analyses and quality reviews.
- Maintain an aggregated view on the risk profile of the Company for all categories of risk including insurance risk, market risk, credit risk, liquidity risk, operational risk, compliance risk, legal risk, reputation risk, etc.
- Advise the Board with regard to risk management decisions in relation to strategic and operational matters such as corporate strategy, mergers and acquisitions and related matters.
- Report to the Board, details on the risk exposures and the actions taken to manage the exposures; review, monitor and challenge where necessary, risks undertaken by the Company.
- Review the solvency position of the Company on a regular basis.
- Monitor and review regular updates on business continuity.
- Formulation of a Fraud monitoring policy and framework for approval by the Board.
- Monitor implementation of Anti-fraud policy for effective deterrence, prevention, detection and mitigation of frauds.
- Review compliance with the guidelines on Insurance Fraud Monitoring Framework dt. 21st January, 2013, issued by the Authority.

7.4. Policy holder Protection Committee (Mandatory)

The Authority is mandated by statute to protect policy holders' interests and therefore adoption of sound and healthy market practices in terms of sales, marketing, advertisements, promotion, publicity, redressal of customer grievances, consumer awareness and education is essential. The Authority has, therefore, notified the following Regulations/Guidelines/Circulars:-

- i) Protection of Policyholders' Interests Regulations, 2002;
- ii) Insurance Advertisements and Disclosure Regulations, 2002;
- iii) Master Circular on Insurance Advertisements in August, 2015;
- iv) Guidelines on Public Disclosure for insurance companies;
- v) Guidelines on Advertisements, Promotion & Publicity of Insurance Companies and Insurance Intermediaries in May 2007;
- vi) Various Circulars on Handling and Disclosure of the Unclaimed Amounts pertaining to the Policyholders;
- vii) Guidelines on Grievance Redressal by Insurance Companies in July 2010 and Handling of Complaints/ Grievances from Policyholders in April 2015; and
- viii) Guidelines on Electronic Mode of Payments for Claims.

Indian Insurance companies are also required to report on the number and nature of complaints to the IRDAI at monthly intervals to enable IRDAI to assess the governance and market conduct issues with respect to each insurance company. With a view to addressing the various compliance

issues relating to protection of the interests of policyholders, as also relating to keeping the policyholders well informed of and educated about insurance products and complaint-handling procedures, each insurer shall set up a Policyholder Protection Committee.

Such Committee shall be headed by a Non-Executive Director and shall include an expert/representative of customers as an invitee to enable insurers to formulate policies and assess compliance thereof. The Committee shall recommend a policy on customer education for approval of the Board and ensure proper implementation of the same. The Committee should put in place systems to ensure that policyholders have access to redressal mechanisms and shall establish policies and procedures, for the creation of a dedicated unit to deal with customer complaints and resolve disputes expeditiously. The functions and responsibilities of the Policyholders' Protection Committee shall include:-

- Adopt standard operating procedures to treat the customer fairly including time-frames for policy and claims servicing parameters and monitoring implementation thereof.
- Establish effective mechanism to address complaints and grievances of policyholders including mis-selling by intermediaries.
- Put in place a framework for review of awards given by Insurance Ombudsman/Consumer Forums. Analyze the root cause of customer complaints, identify market conduct issues and advise the management appropriately about rectifying systemic issues, if any.
- Review all the awards given by Insurance Ombudsman/Consumer Forums remaining unimplemented for more than three (3) months with reasons therefor and report the same to the Board for initiating remedial action, where necessary.
- Review the measures and take steps to reduce customer complaints at periodic intervals.
- Ensure compliance with the statutory requirements as laid down in the regulatory framework.
- Ensure adequacy of disclosure of "material information" to the policyholders. These disclosures shall comply with the requirements laid down by the Authority both at the point of sale and at periodic intervals.
- Provide details of grievances at periodic intervals in such formats as may be prescribed by the Authority.
- Ensure that details of insurance ombudsmen are provided to the policyholders.
- Review of Claims Report, including status of Outstanding Claims with ageing of outstanding claims.
- Reviewing Repudiated claims with analysis of reasons.
- Status of settlement of other customer benefit payouts like Surrenders, Loan, Partial withdrawal requests etc.
- Review of unclaimed amounts of Policyholders, as required under the Circulars and guidelines issued by the Authority.

The Board shall review the status report on policyholders' protection issues, submitted by the Committee, in each of its meeting.

7.5. Nomination and Remuneration Committee (Mandatory)

The Nomination and Remuneration Committee shall be constituted in line with the provisions of Section 178 of the Companies Act, 2013. Indian Insurance Companies which have constituted

two independent committees for Nomination and Remuneration separately may merge these two Committees after seeking the Board approval, under intimation to the Authority, within a period of 180 days from the date of issue of these guidelines.

The Nomination and Remuneration Committee shall scrutinize the declarations of intending applicants before the appointment/reappointment/election of directors by the shareholders at the General Meetings. The Committee shall also scrutinize the applications and details submitted by the aspirants for appointment as the Key Management Persons. The Nomination and Remuneration Committee could also make independent/ discreet references, where necessary, well in time to verify the accuracy of the information furnished by the applicant. The insurance companies are further advised that they should obtain an annual declaration from the Directors/ KMPs that the information provided in the declaration at the time of appointment/ reappointment has not undergone any change subsequently and the changes, if any, are apprised by the concerned Director to the Board. The Directors are also required to enter into a Deed of Covenant. With the insurance company, duly approved by the Board, pursuant to their terms of appointment to ensure that there is a clear understanding of the mutual role of the company, the Directors and the Board in Corporate Governance.

It is pertinent to draw attention to the provisions of Section 34 (A) (1) of the Insurance Act, 1938 which stipulates that the remuneration of CEOs/Whole-time Directors of Indian insurance companies is subject to statutory approval of the IRDAI. Further, the overall management costs of the insurer are also additionally governed by the limits prescribed statutorily in the Insurance Act and Regulations framed there under in order to protect the interests of the policyholders. The setting up of a Nomination and Remuneration Committee should keep the above requirements in view. Further, the envisaged role of the Committee includes the following aspects:-

The Nomination and Remuneration Committee is required to determine on behalf of the Board and on behalf of the shareholders with agreed terms of reference, the insurance company's policy on remuneration packages and any compensation payment, for the CEO, the Executive Directors, Key management Persons of the company.

The remuneration package shall be aligned appropriately with the performance objectives laid down for the Key Management Persons.

In order to avoid conflict of interest, the Nomination and Remuneration Committee, may comprise of at least three non-executive directors, with the Chairman of the Committee being an independent director. At least one-half of the Committee shall comprise of Independent Directors.

The Nomination and Remuneration Committee shall ensure that the remuneration packages of the Key Management Persons of the company are as per the Remuneration Policy approved by the Board.

The Committee shall also ensure that the proposed appointments/ re-appointments of Key Management Persons or Directors are in conformity with the Board approved policy on retirement/ superannuation.

7.6. Corporate Social Responsibility Committee ('CSR Committee') (Mandatory)

Section 135 of the Companies Act, 2013 requires constitution of a CSR Committee if certain conditions as mentioned in the said Section are fulfilled. For Indian Insurance Companies, a CSR Committee is required to be set up if the insurance company earns a Net Profit of Rs. 5 Crores or more during the preceding financial year. Further the 'Net Profit' for this purpose shall be as under:-

“Net profit” means the “profit/(loss) before tax” as per its financial statements prepared in accordance with the applicable provisions of the Insurance Act, 1938 and the Regulations framed thereunder, but shall not include the following, namely

- (i) Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and
- (ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Companies Act.

Provided that net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Insurance Act, 1938, shall not be required to be re-calculated in accordance with the provisions of the Companies Act.

In line with Section 135(5) of Companies Act, 2013, the Board of Directors of the Company shall ensure that the Company spends not less than 2% of the three years' average Net Profits as defined above towards the CSR activities.

- (a) CSR will be based only on the average of the three years' profit as per the Statement of Profit and Loss Account as stated above.
- (b) The CSR Committee shall formulate a CSR policy and get it approved by the Board. Constitution of CSR Committee will be as per Companies Act, 2013.
- (c) The expense incurred on CSR shall not be included for the purpose of calculation of ceilings on Expenses of Management under Section 40B or Section 40C, as the case may be.
- (d) The expenses incurred on CSR activities should not be charged to the Policyholders' Account.

7.7. With Profits Committee

The Authority has issued IRDA (Non-Linked Insurance Products) Regulations 2013, which lay down the framework about the With Profit Fund Management and Asset sharing, among other things. In terms of these Regulations, every Insurer transacting life insurance business shall constitute a With Profits Committee comprising of an Independent Director, the CEO, The Appointed Actuary and an independent Actuary. The Committee shall meet as often as is required to transact the business and carry out the functions of determining the following:

- the share of assets attributable to the policyholders
- the investment income attributable to the participating fund of policyholders
- the expenses allocated to the policyholders.

The report of the With Profits Committee in respect of the above matters should be attached to the Actuarial Report and Abstract furnished by the insurers to the Authority. The Board of an insurer shall ensure that any other stipulations regarding the constitution and/ or functioning of the With Profits Committee as indicated in the Regulations made by the Authority from time to time shall be complied with at all times.

7.8. Other Committees

The other Committees which can be set up by the Board, include the Ethics Committee and ALM Committee (other than life insurers). In cases where Board decides not to constitute such Committees, their functions and responsibilities can be addressed in such manner as the Board may deem fit. However, once these Optional Committees are in place, the insurer is required to comply with the requirements on the “Role and Responsibilities” of such Committees as laid down under these Guidelines.

Wherever the functions of the mandatory committees are capable of being merged without affecting the independence and objectivity envisaged in the corporate governance structure, insurance companies may do so under specific approval of their Boards and intimation to the Authority. However, the Audit Committee and the Investment Committee shall not be merged with any other Committee of the Board under any circumstances.

7.8.1 Ethics Committee (not mandatory)

Functions and Responsibilities of the Ethics Committee shall include:

Monitoring the compliance function and the insurance company's risk profile in respect of compliance with external laws and regulations and internal policies, including its code of ethics or conduct.

Receiving reports on the above and on proactive compliance activities aimed at increasing the insurance company's ability to meet its legal and ethical obligations, on identified weaknesses, lapses, breaches or violations and the controls and other measures in place to help detect and address the same.

Supervising and monitoring matters reported using the insurer's whistle blowing or other confidential mechanisms for employees and others to report ethical and compliance concerns or potential breaches or violations.

Advising the board on the effect of the above on the insurer's conduct of business and helping the board set the correct "tone at the top" by communicating, or supporting the communication, at all levels of the insurer of the importance of ethics and compliance.

Approving compliance programmes, reviewing their effectiveness on a regular basis and signing off on any material compliance issues or matters.

7.8.2 Asset Liability Management (ALM) Committee

ALM is an ongoing process of formulating, implementing, monitoring and revising strategies related to assets and liabilities to achieve an organization's financial objectives, given the organization's risk appetite, risk tolerances and business profile. The need for ALM cannot be over-emphasized as it lays down the framework to ensure that the insurer invests in a manner which would enable it to meet its cash flow needs and capital requirements at a future date to mitigate liquidity risk and solvency stipulations.

The functions of the ALM Committee (wherever constituted) shall include:

- Setting the insurer's risk/reward objectives and assessing policyholder expectations.
- Quantifying the level of risk exposure (e.g. market, credit and liquidity) and assessing the expected rewards and costs associated with the risk exposure.
- Formulating and implementing optimal ALM strategies and meeting risk-reward objectives at both product and enterprise level.
- Ensuring that liabilities are backed by appropriate assets and manage mismatches between assets and liabilities to ensure they remain within acceptable monitored tolerances for liquidity, solvency and the risk profile of the entity.
- Monitoring risk exposures at periodic intervals and revising ALM strategies where required. Reviewing, approving and monitoring systems, controls and reporting used to manage balance sheet risks including any mitigation strategies.

- Regular review and monitoring of mismatch between assets and liabilities and the acceptable tolerance limits for mismatch, if any.
- Ensuring that management and valuation of all assets and liabilities comply with standards, prevailing legislation and internal and external reporting requirements.
- Submitting the ALM information before the Board at periodic intervals. Annual review of strategic asset allocation.
- Reviewing key methodologies and assumptions including actuarial assumptions, used to value assets and liabilities.
- Managing capital requirements at the company level using the regulatory solvency requirements.
- Reviewing, approving and monitoring capital plans and related decisions over capital transactions (e.g. dividend payments, acquisitions, disposals, etc).

Where an insurer does not constitute the Asset Liability Management (ALM) Committee, the functions of ALM shall form part of the Risk Management Committee.

- 7.9.** The mandatory committees, **except Nomination and Remuneration Committee, the Corporate Social Responsibility Committee and the With Profits Committee** shall meet at least four times in a year and not more than four months shall elapse between two successive meetings of such Committees. The quorum shall be two members or one-third of the members of the Committee, whichever is greater, however in case independent director(s) is/ are mandated to be in any of the Committees, **at least one such independent director or his alternate director**, should necessarily be present to form the quorum.

As specified in the proviso to Section 161(2) of the Companies Act, 2013, no person shall be appointed as an alternate director for an independent director unless he/she is qualified to be appointed as an independent director under the provisions of this Act. This condition shall be applicable even while appointing an alternate director to an Independent director in any of the Committees.

It is emphasized that the overall responsibility for directing the affairs of the insurers shall be with the Board and it shall continue to exercise its oversight directly on matters that are not specifically delegated to any of its Committees.

8. Key Managerial Persons

8.1 CEO/ Managing Director/ Whole-Time Director

The Chief Executive Officer / Whole Time Director/Managing Director of the company and other key functionaries are responsible for the operations and day to day management of the company in line with the directions of the Board and the Committees setup by the Board. Section 34A of the Insurance Act,1938 requires prior approval of the Authority for appointment, re-appointment or termination of the Chief Executive Officer and the Whole Time Directors. The Authority expects the CEO to be responsible for the conduct of the company's affairs in a manner which is not detrimental to the interests of the policyholders and which is consistent with the policies and directions of the Board. The Board should, therefore, carry out effective due diligence to establish that the new incumbent is 'fit and proper' before recommending the name for Authority's approval. In case the CEO resigns, the Authority should be kept informed of such resignation and the reasons therefor. The Insurance Act also prohibits the Managing Director or other Officer of a life insurance company from being a Managing Director or Other Officer of any other Life insurance

company or of a Banking company or an Investment Company. As the appointment of the CEO is made with the prior approval of the IRDAI the Board should take proactive steps to decide on the continuance of CEO well in time before the expiry of his tenure or to identify the new incumbent. The Authority requires the proposal to be submitted with the approval of the Board at least a month before the completion of the tenure of the incumbent. As a corollary, the insurers should also have practices in place for succession planning for the key senior functionaries through a process of proper identification and nurturing of individuals for taking over senior management positions.

8.2. Role of Appointed Actuaries

IRDAI has brought out detailed Regulations on Appointed Actuary *vide* IRDA (Appointed Actuary) Regulations, 2000, detailing the procedure for his appointment, qualifications, powers along with his duties and obligations. The Regulations also stipulate that prior approval of the Authority shall be taken for the appointment of the Appointed Actuary. The Board should ensure that the requirements are scrupulously complied with. In brief, it is reiterated that:

- The Appointed Actuary should qualify and satisfy the 'Fit & Proper' criteria and other eligibility conditions as mentioned in IRDA (Appointed Actuary) Regulations, 2000, as amended from time to time.
- The insurance companies shall clearly set forth the Appointed Actuary's responsibilities and any advisory role vis-à-vis the Board or the management as well as his/her rights and obligations. These Shall be in addition to the duties of the Appointed Actuaries as specified in the IRDA Regulations and any other directions of IRDA in the matter.
- As soon as the Appointed Actuary realizes that the entity does not comply or is likely to fail in complying with the requirements of solvency and other parameters of sound operations, he/she shall inform the Board of the insurer. If no viable/acceptable action is taken by the Board, then he/she has to inform the same to IRDAI.
- The Board shall interact directly with the Appointed Actuary wherever it considers it expedient to secure his advice, it may do so in such manner as it may deem fit. The Appointed Actuary shall provide professional advice or certification to the board with regard to:-
 - Estimation of technical provisions in accordance with the valuation framework setup by the insurer
 - Identification and estimation of material risks and appropriate management of the risks
 - Financial condition testing
 - Solvency margin requirements
 - Appropriateness of premiums (and surrender value)
 - Allocation of bonuses to with-profit insurance contracts
 - Management of participating funds (including analysis of material effects caused by strategies and policies)
 - Product design, risk mitigation (including reinsurance) and other related risk management roles.

While the areas of advice/certification listed above are with specific reference to life companies, the appointed actuaries in case of non-life insurance companies shall provide such advice/

certification to the extent applicable. In order to facilitate the Appointed Actuary in discharging his/her responsibilities, he/ she shall at all times be provided access to the information as required.

8A. External Audit – Appointment of Statutory Auditors

The IRDAI (Preparation of Financial Statements and Auditors 'Report of Insurance Companies) Regulations, 2002 empower the Authority to issue directions/guidelines on appointment, continuance or removal of auditors of an insurer. These guidelines/directions may include prescriptions on qualifications and experience of auditors, their rotation, period of appointment, etc. as may be deemed necessary by the Authority.

The detailed guidelines as regards appointment of auditors and the reporting about all the auditors appointed by insurers are given in Annexure 7 to these guidelines. The Board should therefore ensure that the statutory auditors are compliant with the regulatory requirements and there are no conflicts of interest in their appointment. The auditors should possess the competence and integrity to alert the appropriate authorities promptly of any event that could seriously affect the insurance company's financial position or the organization structure of its administration or accounting and of any criminal violations or material irregularities that come to his notice.

8A.1. Access to Board and Audit Committee

The Audit Committee should have discussions with the statutory auditors periodically about internal control systems, the scope of audit including the observations of the auditors (where applicable) and review the quarterly/half yearly and annual financial statements as the case may be before submission to the Board of Directors and also ensure compliance with the internal control systems. The statutory auditors should also have access to the Board of Directors through the Audit Committee.

9. Disclosure Requirements

The IRDAI (Preparation of Financial Statements and Auditors 'Report of Insurance Companies) Regulations, 2002, have prescribed certain disclosures in the financial statements and the Authority is in the process of finalizing additional disclosures to be made by insurers at periodical intervals. In the meantime, it may be ensured by the Board that the information on the following, including the basis, methods and assumptions on which the information is prepared and the impact of any changes therein are also disclosed in the annual accounts-

- Quantitative and qualitative information on the insurance company's financial and operating ratios, viz. incurred claim, commission and expenses ratios
- Actual solvency margin details vis-à-vis the required margin
- Insurers engaged in life insurance business shall disclose persistency ratio of policies sold by them
- Financial performance including growth rate and current financial position of the insurance company
- Description of the risk management architecture
- Details of number of claims intimated, disposed off and pending with details of duration
- All pecuniary relationships or transactions of the Non-Executive Directors vis-à-vis the insurance company shall be disclosed in the Annual Report
- Elements of remuneration package (including incentives) of MD & CEO and all other directors and Key Management Persons

- Payments made to group entities from the Policyholders Funds
- Any other matters, which have material impact on the insurer's financial position.

Where finalization of annual accounts extends beyond 90 days from the end of the Financial Year, the status on disclosure in the financial statements required under this clause may be made with in 15 days of adoption of annual accounts by the Board of Directors of the Insurers.

10. Outsourcing Arrangements

All out sourcing arrangements of an Insurer shall have the approval of a Committee of Key Management Persons and should meet the terms of the Board approved out sourcing policy. The Board or the Risk Management Committee should be periodically apprised about the outsourcing arrangements entered into by the insurer and also confirmation to the effect that they comply with the stipulations of the Authority as well as the internal policy be placed before them. An insurer shall not outsource any of the company's core functions other than those that have been specifically permitted by the Authority. Every outsourcing contract shall contain explicit safeguards regarding confidentiality of data and all outputs from the data, continuing ownership of the data with the insurer and orderly handing over of the data and all related software programs on termination of the outsourcing arrangement.

The management of the insurance company shall monitor and review the performance of agencies to whom operations have been outsourced at least annually and report findings to the Board.

The Authority reserves the right to access the operations of the outsourced entity to the extent these are relevant to the insurance company and for the protection of policyholder.

11. Interaction with the Regulator

Effective corporate governance practices in the office of the insurance company will enable IRDAI to have greater confidence in the work and judgment of its board, Key Management Persons and control functions.

In assessing the governance practices in place, the IRDAI would:

- Seek confirmation that the insurance company has adopted and effectively implemented sound corporate governance policies and practices;
- Assess the fitness and propriety of board members;
- Monitor the performance of boards;
- Assess the quality of insurance company's internal reporting, risk management, audit and control functions;
- Evaluate the effects of the insurance company's group structure on the governance strategies;
- Assess the adequacy of governance processes in the area of crisis management and business continuity.

The IRDAI would bring to the attention of the Board and senior management, concerns which have been detected by it through supervisory activities.

Reporting to IRDAI

Insurers should examine to what extent they are currently complying with these guidelines and initiate immediate action to achieve compliance (where not already in compliance) within a period of three months from the date of notification of these guidelines. It is expected that all the arrangements should be in place to ensure full compliance with the guidelines from the financial year 2016-2017. Where such

compliance is not possible for any specific reason, the insurance companies should write to the IRDAI for further guidance.

Each insurer should designate Company Secretary as the Compliance officer whose duty will be to monitor continuing compliance with these guidelines.

Annual Report of insurers shall have a separate certification from the Compliance Officer.

All insurers are required to file a report on status of compliance with the Corporate Governance guidelines on an annual basis. This report shall be filed within 3 months from the end of the financial year, i.e., before 30 June. The report shall be filed as per the format in the Annexure 9.

12. Whistle Blower Policy

Insurers are well advised to put in place a “whistle blower” policy, where-by mechanism exist for employees to raise concerns internally about possible irregularities, governance weaknesses, financial reporting issues or other such matters. These could include employee reporting in confidence directly to the Chairman of the Board or of a Committee of the Board or to the Statutory Auditor.

The Policy illustratively covers the following aspects:

- Awareness of the employees that such channels are available, how to use them and how their report will be handled.
- Handling of the reports received confidentially, for independent assessment, investigation and where necessary for taking appropriate follow-up actions.
- A robust anti-retaliation policy to protect employees who make reports in good faith.
- Briefing of the board of directors.

The appointed actuary and the statutory / internal auditors have the duty to ‘whistle blow’, i.e., to report in a timely manner to the IRDAI if they are aware that the insurance company has failed to take appropriate steps to rectify a matter which has a material adverse effect on its financial condition. This would enable the IRDAI to take prompt action before policy holders’ interests are undermined.

13. Evaluation of Board of Directors including Independent Directors

As required under Schedule IV of the Companies Act, 2013, the independent directors shall meet at least once in a year to evaluate the performance of other than independent Directors. Similarly, there shall be an evaluation of the Independent Directors by the other members of the Board of Directors as required in the Schedule.

14. Applicability

These guidelines shall be applicable to all insurers granted registration by the Authority except that:

- (i) reinsurance companies may not be required to have the Policyholders’ Protection Committee; and
- (ii) branches of foreign reinsurers in India may not be required to constitute the Board and its mandatory committees as indicated herein.

STEWARDSHIP CODE FOR INSURERS IN INDIA

Insurance companies are significant institutional investors in listed companies and the investments are held by them as custodians of policy holders. The state of governance of the investee companies is an important aspect and insurance companies must ensure that investee companies maintain corporate governance standards at

high level. Therefore, it is felt that insurance companies should play an active role in the general meetings of investee companies and engage with the managements at a greater level to improve their governance. This will result in informed decisions by the parties and ultimately improve the return on investments of insurers which will ultimately benefit the policyholders..

The IRDAI had issued a code for Stewardship for the Insurers in India in March 2017. The code was in the form of a set of principles, which the insurance companies needed to adopt and made applicable from FY 2017-18. As per the code, insurer should have a board approved stewardship policy which should identify and define the stewardship responsibilities that the insurer wishes to undertake and how the policy intends to fulfill the responsibilities to enhance the wealth of its policyholders who are ultimate beneficiaries.

The IRDAI *vide* its Circular No. IRDAI/ F&A/GDL/CPM/045/02/2020 dated 7th February, 2020 issued the Revised Guidelines on Stewardship Code for Insurers in India.

All the insurers need to review and update their existing stewardship policy based on the Revised Guidelines on Stewardship Code for Insurers in India within 3 months from the date of issue of the same and the updated stewardship policy needs to be approved by the Board of Directors. The updated policy should be disclosed on the website within 30 days of approval by the Board by all insurers, alongside the public disclosures. Any subsequent change / modification to the stewardship policy should be specifically disclosed at the time of updating the policy document on the website.

All insurers shall comply with all the principles given in the guidelines and submit an Annual Certificate of Compliance approved by the Board to the Authority as per Annexure B referred in the guidelines, duly certified by CEO and Compliance Officer on or before 30th June every year.

These guidelines are issued under the provisions of Section 34 (1) of the Insurance Act, 1938 for compliance by all insurers from FY 2020-21.

Revised Guidelines on Stewardship Code for Insurers in India

Insurers should formulate a policy for Stewardship based on the principles indicated in these guidelines and get the approval of their Boards for implementation of the same.

The principles and the guidance for the implementation are given below:

Stewardship Principles

Principle 1: Insurers should formulate a policy on the discharge of their stewardship responsibilities and publicly disclose it.

Principle 2: Insurers should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.

Principle 3: Insurers should monitor their investee companies.

Principle 4: Insurers should have a clear policy on intervention in their investee companies.

Principle 5: Insurers should have a clear policy for collaboration with other institutional investors, where required, to preserve the interest of the policyholder (ultimate investors), which should be disclosed.

Principle 6: Insurers should have clear policy on voting and disclosure of voting activity.

Principle 7: Insurers should report periodically on their stewardship activities.

Principle 1: Insurers should formulate a policy on the discharge of their stewardship responsibilities and publicly disclose it.

Guidance: Stewardship activities include monitoring and engaging with investee companies on matters such as strategy, performance of risk, capital structure, and corporate governance, including culture and remuneration. The Stewardship policy should identify and define the stewardship responsibilities that the insurer wishes to undertake and how it intends to fulfill the same to enhance the wealth of its clients. The policy should address all the aspects relating to stewardship activity like Managing conflict of interest Training of personnel, Monitoring of investee companies, Intervention in investee companies, Collaboration with other institutional investors and Voting activities. The policy should be approved by the Board of the insurer and should bring out how the insurer applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client. While the Boards of an insurer could decide to engage in all cases, it may also decide to selectively intervene based on its extent or level of investment. In such case, the policy should clearly identify the threshold (level of investment or any other criteria as may be determined by the Board) for intervention. The policy should clearly state whether the insurer intends to use the services of external service providers such as institutional advisors. In case services of any external service providers are used, the policy should provide for the mechanism to ensure that in such cases, stewardship responsibilities are exercised diligently. Though core function of investment cannot be outsourced, professional advices to arrive at voting decisions and research reports like Market survey data, Industry wide analysis, Business valuation, etc. may be sought from external agencies. The policy should clearly provide that the ultimate stewardship responsibilities shall be discharged by the insurer. The policy should be reviewed and updated periodically and the updated policy should be publicly disclosed on the insurer's website.

Principle 2: Insurers should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.

Guidance: The stewardship policy put in place by the insurers should also cover the aspects of identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first. The policy should identify scenarios of likely conflict of interest as envisaged by the Board and should also address how matters are handled when the interests of clients or beneficiaries diverge from each other. Aspects covered in the stewardship policy with regard to conflict of interest may, among other issues, address the following:

1. Identifying possible situations where conflict of interest may arise. If in case of investee companies being associates of the entity.
2. Procedures put in place by the entity in case such conflicts of interest situations arise which may, inter alia, include:
 - a. Blanket bans on investments in certain cases.
 - b. Referring such matters to Audit Committee.

- c. Clear segregation of voting function and client relations / sales functions.
- d. Policy for persons to recuse from decision making in case of the person having any actual / potential conflict of interest in the transaction.
- e. Maintenance of records of minutes of decisions taken to address such conflicts.

Principle 3: Insurers should monitor their investee companies.

Guidance: Insurers should have mechanisms for regular monitoring of their investee companies in respect of their performance, leadership effectiveness, succession planning, corporate governance, reporting and other parameters they consider important. Insurers may or may not wish to have more participation through nominations on the Board for active involvement with the investee companies. An insurer who may be willing to have nominations on the Board of an investee company should indicate in its stewardship statement the willingness to do so and the mechanism by which this could be done.

Aspects covered in the stewardship policy with regard to monitoring shall address the following:

1. Different levels of monitoring in different investee companies.
E.g. companies where larger investments are made may involve higher levels of monitoring vis-a-vis companies where amount invested is insignificant from the point of view of its assets under management (AUM).
2. Areas of monitoring which shall, inter-alia, include:
 - a. Company strategy and performance - operational and financial.
 - b. Industry level monitoring and possible impact on the investee companies.
 - c. Quality of company management and Board, leadership.
 - d. Corporate governance including remuneration, structure of the Board (including Board diversity and independent directors) and related party transactions.
 - e. Risks including Environmental, Social and Governance (ESG) risks.
 - f. Shareholder rights and their grievances.
3. Identification of situations which may trigger communication of insider information and the procedures adopted to ensure SEBI (Prohibition of Insider Trading) Regulation 2015 as amended time to time are complied with in such cases.

Principle 4: Insurers should have a clear policy on intervention in their investee companies.

Guidance: Insurers may decide their own engagement strategy and the stewardship policy should clearly set out the criteria/ circumstances in which they will actively intervene. The policy should provide for regular assessment of the outcomes of intervention by the insurer. Intervention should be considered regardless of whether an active or a passive investment policy is followed. Circumstances for intervention may, inter alia, include but not limited to, poor financial performance of the company, corporate governance related practices, remuneration, strategy, Environmental, Social and Governance (ESG) risks, leadership issues and litigations.

The mechanisms for intervention may include meetings / discussions with the management for constructive resolution of the issue and in case of escalation thereof, meetings with the Boards, collaboration with other investors and voting against decisions. Various levels of intervention and circumstances in which escalation is required may be identified and disclosed in the stewardship policy. This may also include interaction with the companies through the insurance councils in case of any industry level issues. Investment Committee of the insurer has to consider which mechanism to be opted and escalation of matters in specified cases.

Principle 5: Insurers should have a clear policy for collaboration with other institutional investors, where required, to preserve the interest of the policyholder (ultimate investors), which should be disclosed.

Guidance: For issues that require larger engagement with the investee company/ insurers may choose to act collectively with other institutional investors in order to safeguard the interests of their investors. In such situations, the stewardship policy should guide their actions and extent of engagement.

Principle 6: Insurers should have clear policy on voting and disclosure of voting activity.

Guidance: Insurers should exercise their own independent judgment as regards voting decisions on resolutions and should not automatically support the proposals of the Board of the investee company. The decisions should be aimed at promoting the overall growth of the investee companies and, in turn, enhance the value of their investors.

The stewardship policy should cover the aspects of voting activity. Audit Committee will monitor oversight on voting mechanism. Insurers should disclose their approach to stock lending and recalling lent stock in their stewardship policy.

Insurers should mandatorily undertake active participation and voting on resolutions/proposals of the investee companies under the following circumstances:

<i>Size of the AUM of the Insurers (Rs. in Crore)</i>	<i>Compulsory voting required, if the insurer's holding of the paid up capital of investee company (in %) is</i>
Up to 2,50,000	3% and above
Above 2,50,000	5% and above

In other cases, insurers may voluntarily participate and vote if such resolutions/proposals are considered significant and may have an impact on the value of investments of the insurer. Disclosures have to be made by the insurers regarding the voting activity in the investee companies in which the insurers have actively participated and voted on resolutions/proposals. The disclosures will form part of Public Disclosures on website and have to be made on quarterly basis as per the timelines prescribed for quarterly public disclosures on website, in the given format at Annexure A.

Principle 7: Insurers should report periodically on their stewardship activities.

Guidance: In addition to the regular fulfilment of their stewardship activities, insurers should also provide a periodic report to their ultimate beneficiaries (policyholders) of how they have discharged their responsibilities, in a format which is easy to understand, as a part of public disclosures.

Compliance and Reporting

The compliance with the aforesaid principles does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding when this is considered in the best interest of clients or beneficiaries, The Board shall ensure that there is effective oversight on the insurer's stewardship activities and the Audit Committee of the Board shall exercise the same. All insurers shall comply with all the principles given in the guidelines and submit an Annual Certificate of Compliance approved by the Board to the Authority as per Annexure B duly certified by CEO and compliance officer on or before 30th June every year.

CORPORATE GOVERNANCE IN CENTRAL PUBLIC SECTOR ENTERPRISES (CPSEs)

Corporate Governance involves a set of relationships between a company's management, its Board, its shareholders and other stakeholders. Corporate Governance provides a principled process and structure through which the objectives of the company, the means of attaining the objectives and systems of monitoring

performance are also set. Corporate Governance is a set of accepted principles by management of the inalienable rights of the shareholders as a true owner of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, ethical business conduct, transparency and makes a distinction between personal and corporate funds in the management of a company.

Department of Public Enterprises (DPE) is the nodal department for issuing the corporate governance guidelines for the Public Sector Enterprises for both at center and state level. Since Government is the major shareholder in Public Sector Undertakings (PSUs)/ Central Public Sector Enterprises (CPSEs), it is responsible to set the high standard of governance to be followed by these public sector enterprises. As the government's disinvestment strategy gathers momentum, there is a genuine need to improve the levels of transparency, and accountability within PSUs.

The guidelines on Corporate Governance are formulated with the objective that the CPSEs follow the guidelines in their functioning. Proper implementation of these guidelines would protect the interest of shareholders and relevant stakeholders.

The Department of Public Enterprises (DPE) had issued guidelines on composition of Board of Directors of Central Public Sector Enterprises (CPSEs) in 1992. According to these guidelines at least one-third of the Directors on the Board of a CPSE should be non-official Directors. The Maharatna, Navratna and Miniratna schemes provide that exercise of the enhanced powers delegated to these CPSEs is subject to the condition that their Boards are professionalised by inducting adequate number of non-official Directors, with minimum of four in case of Maharatna, Navratnas and minimum of three in case of Miniratnas. The schemes for Maharatna, Navratna and Miniratna CPSEs also provide for setting up of Audit Committees.

In November 2001, DPE issued further guidelines on the composition of Board of Directors of listed CPSEs. It provided that the number of Independent Directors should be at least one-third of the Board if the Chairman is non-executive, and not less than 50% if the Board has an executive Chairman.

To bring in more transparency and accountability in the functioning of CPSEs, the Government in June, 2007 introduced, for an experimental period of one year, the Guidelines on Corporate Governance for CPSEs. These Guidelines were of voluntary nature. Since the issue of these guidelines, the CPSEs have had the opportunity to implement them for the whole of the financial year 2008-09. These Guidelines have been modified and improved upon based on the experience gained during the experimental period of one year.

The Government have felt the need for continuing the adoption of good Corporate Governance Guidelines by CPSEs for ensuring higher level of transparency and decided to make these Guidelines mandatory and applicable to all CPSEs. Accordingly, revised Guidelines on Corporate Governance for Central Public Sector Enterprises was issued by DPE in 2010.

Apart from these instructions of DPE, the CPSEs are governed by the Companies Act, 2013 and regulations of various authorities like Comptroller and Auditor General of India (C&AG), Central Vigilance Commission (CVC), Administrative Ministries, other nodal Ministries, etc. The Right to Information Act 2005 is also applicable to the CPSEs. The CPSEs fall under the definition of 'State' as provided in Article 12 of the Constitution of India. Further, some principles of Corporate Governance are already in vogue in public sector because (a) the Chairman, Managing Director and Directors are appointed independently through a prescribed procedure; (b) Statutory auditors are appointed independently by the C&AG; (c) Arbitrary actions, if any, of the Management can be challenged through writ petitions; (d) Remuneration of Directors, employees, etc. are determined on the basis of recommendations of Pay Committees constituted for this purpose; etc.

In case of Listed CPSEs the Listing Regulations would also be applicable in addition to other applicable laws and DPE Guidelines. For the purpose of DPE Guidelines on Corporate Governance, CPSEs have been categorised into two groups, namely, (i) those listed on the Stock Exchanges; (ii) those not listed on the Stock Exchanges.

CPSEs listed on Stock Exchanges: In so far as listed CPSEs are concerned, they have to follow the SEBI (LODR) Regulations, 2015. In addition, they shall follow those provisions in these Guidelines which do not exist in the SEBI Guidelines and also do not contradict any of the provisions of the SEBI Guidelines.

Non-listed CPSEs: Each CPSE should strive to institutionalize good Corporate Governance practices broadly in conformity with the SEBI Guidelines. The listing of the non-listed CPSEs on the stock exchanges may also be considered within a reasonable time frame to beset by the Administrative Ministry concerned in consultation with the CPSEs concerned. The non-listed CPSEs shall follow the Guidelines on Corporate Governance on a mandatory basis.

DPE guidelines on Corporate Governance provide following governance parameters

- Board of Directors
- Audit Committee
- Remuneration Committee
- Subsidiary Companies
- Disclosures
- Report, Compliance and Schedule of Implementation.

Salient features of Guidelines on Corporate Governance for Central Public Sector Enterprises 2010

(a) Board of Directors

Composition of Board of Directors: The Board of Directors of the company shall have an optimum combination of Functional, Nominee and Independent Directors. The number of Functional Directors (including CMD/ MD) should not exceed 50% of the actual strength of the Board. The number of Nominee Directors appointed by Government/other CPSEs shall be restricted to a maximum of two. In case of a CPSE listed on the Stock Exchanges and whose Board of Directors is headed by an Executive Chairman, the number of Independent Directors shall be at least 50% of Board Members; and in case of all other CPSEs (i.e. listed on Stock Exchange but without an Executive Chairman, or not listed CPSEs), at least one-third of the Board Members should be Independent Directors.

Nominee Directors appointed by an institution which has invested in or lent to the company shall be deemed to be Independent Directors.

Part-time Directors' compensation and disclosures: All fees/compensation, if any, paid to part-time Directors, including Independent Directors, shall be fixed by the Board of Directors subject to the provisions in the DPE guidelines and the Companies Act, 2013.

Number of Board meetings: The Board shall meet at least once in every three months and at least four such meetings shall be held every year. Further, the time gap between any two meetings should not be more than three months. A Director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a Director. Furthermore it should be a mandatory annual requirement for every Director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

Compliance of Laws to be reviewed: The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.

Code of Conduct: The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be circulated and also posted on the website of the company. All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by its Chief Executive. Guidelines and policies evolved by the Central Government with respect to the structure, composition, selection, appointment and service conditions of Boards of Directors and senior management personnel shall be strictly followed. There shall be no extravagance in expenditure on the part of Board members and senior management personnel. CPSEs executives shall be accountable for their performance in conformity with established norms of conduct. Any external / internal changes made from time to time, due to addition of or amendment to laws/regulatory rules, applicable to CPSEs, need to be dealt with carefully by the respective Boards/senior management personnel.

Functional Role Clarity between Board of Directors and Management: A clear definition of the roles and the division of responsibilities between the Board and the Management is necessary to enable the Board to effectively perform its role. The Board should have a formal statement of Board Charter which clearly defines the roles and responsibilities of the Board and individual Directors. The Board of each CPSE may be courage to articulate its Corporate Governance objectives and approach (within the broad parameters of these guidelines and the general perception of business risk) to satisfy the expectations of its majority shareholders and other stakeholders.

Risk Management: Enterprise risk management helps management in achieving CPSE's performance and profitability targets. It helps to ensure effective reporting and compliance with laws and regulations, and helps avoid damage to the entity's reputation and associated consequences. Considering the significance of risk management in the scheme of corporate management strategies, its oversight should be one of the main responsibilities of the Board/Management. The Board should ensure the integration and alignment of the risk management system with the corporate and operational objectives and also that risk management is undertaken as a part of normal business practice and not as a separate task at set times.

Training of Directors: The company concerned shall undertake training programme for its new Board members (Functional, Government, Nominee and Independent) in the business model of the company including risk profile of the business of company, responsibility of respective Directors and the manner in which such responsibilities are to be discharged. They shall also be imparted training on Corporate Governance, model code of business ethics and conduct applicable for the respective Directors.

(b) Audit Committee

Qualified and Independent Audit Committee: A qualified and independent Audit Committee shall be set up, giving the terms of reference. The Audit Committee shall have minimum three Directors as members. Two-thirds of the members of audit committee shall be Independent Directors. The Chairman of the Audit Committee shall be an Independent Director .All members of Audit Committee shall have knowledge of financial matters of Company, and at least one member shall have good knowledge of accounting and related financial management expertise. The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries; provided that in case the Chairman is unable to attend due to unavoidable reasons, he may nominate any member of the Audit Committee.

The Audit Committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the Committee. The Audit Committee may also meet without the presence of any executives of the company. The Finance Director, Head of Internal Audit and a representative of the Statutory Auditor may be specifically invited to be present

as invitees for the meetings of the Audit Committee as may be decided by the Chairman of the Audit Committee. The Company Secretary shall act as the Secretary to the Audit Committee.

Role of Audit Committee: The role of the Audit Committee shall include the following:

- Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
- Recommending to the Board the fixation of audit fees.
- Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
- Reviewing, with the management, the annual financial statements before submission to the Board for approval, with particular reference to:(a) Matters required to be included in the Directors' Responsibility Statement to be included in the Board's report (b) Changes, if any, in accounting policies and practices and reasons for the same; (c) Major accounting entries involving estimates based on the exercise of judgment by management; (d) Significant adjustments made in the financial statements arising out of audit findings; (e) Compliance with legal requirements relating to financial statements; (f) Disclosure of any related party transactions; and (g) Qualifications in the draft audit report.
- Reviewing, with the management, the quarterly financial statements before submission to the Board for approval.
- Reviewing, with the management, performance of internal auditors and adequacy of the internal control systems.
- Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure, coverage and frequency of internal audit.
- Discussion with internal auditors and/or auditors any significant findings and follow up there on.
- Reviewing the findings of any internal investigations by the internal auditors / auditors / agencies into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board.
- Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
- To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors.
- To review the functioning of the Whistle Blower Mechanism.
- To review the follow up action on the audit observations of the C&AG audit.
- To review the follow up action taken on there commendations of Committee on Public Undertakings (COPU) of the Parliament.
- Provide an open avenue of communication between the independent auditor, internal auditor and the Board of Directors.
- Review all related party transactions in the company. For this purpose, the Audit Committee may designate a member who shall be responsible for reviewing related party transactions.
- Review with the independent auditor the co-ordination of audit efforts to assure completeness of coverage, reduction of redundant efforts, and the effective use of all audit resources.

- Consider and review the following with the independent auditor and the management: (i) The adequacy of internal controls including computerized information (ii) system controls and security, and -Related findings and recommendations of the independent auditor and internal auditor, together with the management responses.
- Consider and review the following with the management, internal auditor and the independent auditor:
 - (i) Significant findings during the year, including the status of previous audit recommendations
 - (ii) Any difficulties encountered during audit work including any restrictions on the scope of activities or access to required information.

Powers of Audit Committee: Commensurate with its role, the Audit Committee should be invested by the Board of Directors with sufficient powers, which should include the following:

- To investigate any activity within its terms of reference.
- To seek information on and from any employee.
- To obtain outside legal or other professional advice, subject to the approval of the Board of Directors.
- To secure attendance of outsiders with relevant expertise, if it considers necessary.
- To protect whistle blowers.

Meeting of Audit Committee: The Audit Committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the Audit Committee whichever is greater, but a minimum of two independent members must be present.

Review of information by Audit Committee: The Audit Committee shall review the following information:

- Management discussion and analysis of financial condition and results of operations;
- Statement of related party transactions submitted by management;
- Management letters/letters of internal control weaknesses issued by the statutory auditors;
- Internal audit reports relating to internal control weaknesses;
- The appointment and removal of the Chief Internal Auditor shall be placed before the Audit Committee; and Certification / declaration of financial statements by the Chief Executive/Chief Finance Officer.

(c) Remuneration Committee:

Each CPSE shall constitute a Remuneration Committee comprising of at least three Directors, all of whom should be part-time Directors (i.e. Nominee Directors or Independent Directors). The Committee should be headed by an Independent Director. CPSE will not be eligible for Performance Related Pay unless the Independent Directors are on its Board. Remuneration Committee will decide the annual bonus/ variable pay pool and policy for its distribution across the executives and non-unionized supervisors, within the prescribed limits.

(d) Subsidiary Companies:

At least one Independent Director on the Board of Directors of the holding company shall be a Director on the Board of Directors of its subsidiary company. The Audit Committee of the holding company shall also review the financial statements of its subsidiary company. The minutes of the Board meetings of the

subsidiary company shall be placed at the Board meeting of the holding company. The management should periodically bring to the attention of the Board of Directors of the holding company, a statement of all significant transactions and arrangements entered into by its subsidiary company.

Explanation: For the purpose of these guidelines, only those subsidiaries whose turnover or net worth is not less than 20% of the turnover or net-worth respectively of the Holding company in the immediate preceding accounting year may be treated as subsidiary companies.

(e) Disclosures:

Transactions: A statement in summary form of transactions with related parties in the normal and ordinary course of business shall be placed periodically before the Audit Committee. Details of material individual transactions with related parties, which are not in the normal and ordinary course of business, shall be placed before the Audit Committee. Details of material individual transactions with related parties or others, which are not on an arm's length basis should be placed before the Audit Committee, together with Management's justification for the same.

Accounting Standards: Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation in the Corporate Governance Report as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction.

Board Disclosures–Risk management:

- The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework. Procedure will be laid down for internal risk management also.
- The Board should implement policies and procedures which should include:(a) staff responsibilities in relation to fraud prevention and identification (b) responsibility of fraud investigation once a fraud has been identified (c) process of reporting on fraud related matters to management (d) reporting and recording processes to be followed to record allegations of fraud (e) requirements of training to be conducted on fraud prevention and identification.

Remuneration of Directors:

- All pecuniary relationship or transactions of the part-time Directors vis-à-vis the company shall be disclosed in the Annual Report.
- 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 all the directors i.e. salary, benefits, bonuses, stock options, pension, etc. (b) Details of fixed component and performance linked incentives, alongwith 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.

Management: As part of the Directors Report or as an addition thereto, a Management Discussion and Analysis Report should form part of the Annual Report. This Management Discussion and Analysis should include discussion on the following matters within the limits set by the company's competitive position: (a) Industry structure and developments, (b) Strength and weakness (c) Opportunities and Threats (d) Segment-wise or product-wise performance (e) Outlook (f) Risks and concerns (g) Internal control systems and their adequacy (h) Discussion on financial performance with respect to operational performance (i) Material developments

in Human Resources, Industrial Relations front, including number of people employed. (j) Environmental Protection and Conservation, Technological conservation, Renewable energy developments, Foreign Exchange conservation (k) Corporate social responsibility.

Senior management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest that may have a potential conflict with the interest of the company (e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives, etc.)

Explanation: For this purpose, the term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the Functional Directors, including all functional heads.

Report on Corporate Governance: There shall be a separate section on Corporate Governance in each Annual Report of company, with details of compliance on Corporate Governance.

Compliance: The company shall obtain a certificate from either the auditors or practicing Company Secretary regarding compliance of conditions of Corporate Governance as stipulated in these Guidelines and Annexes. The afore said certificate with the Directors’ Report, which is sent annually to all the shareholders of the company, should also be included in the Annual Report. Chairman’s speech in Annual General Meeting (AGM) should also carry a section on compliance with Corporate Governance guidelines / norms and should form part of the Annual Reports of the concerned CPSE. The grading of CPSEs may be done by DPE on the basis of the compliance with Corporate Governance guidelines/norms.

Schedule of implementation: These Guidelines on Corporate Governance are mandatory. The CPSEs shall submit quarterly progress reports, within 15 days from the close of each quarter, in the prescribed format to respective Administrative Ministries / Departments. The Administrative Ministries will consolidate the information obtained from the CPSEs and furnish a comprehensive report to the DPE by 31st May of every financial year on the status of compliance of Corporate Governance Guidelines during the previous financial year by the CPSEs under their jurisdiction. DPE will, from time to time, make suitable modifications to these Guidelines in order to bring the minline with prevailing laws, regulations, acts, etc., DPE may also issue clarifications to the concerned Administrative Ministries/CPSEs on issues relating to the implementation of these Guidelines.

GUIDELINES ON CORPORATE SOCIAL RESPONSIBILITY AND SUSTAINABILITY FOR CPSEs

Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises

Prior to the notification of CSR Rules under the Companies Act 2013, DPE Guidelines on CSR and Sustainability issued in December 2012, were applicable to all CPSEs w.e.f. 01.04.2013.

After the enactment of the Companies Act 2013, all CPSEs shall have to comply with the provisions of the Act and the CSR Rules. Any amendment notified by the Ministry of Corporate Affairs in the CSR Rules, or in Schedule VII of the Act will also be binding on the CPSEs. Along with these, Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises, 2014 have been notified by DPE which shall be applicable to all CPSEs.

In earlier DPE guidelines, CSR and sustainable development were treated as complementary and, therefore, were dealt with together. CSR was seen as an important constituent of the overarching framework of sustainability. The present guidelines of DPE are also intended to rein force the complementarity of CSR and sustainability and to advise the CPSEs not to overlook the larger objective of sustainable development in the conduct of business and in pursuit of CSR agenda.

Guidelines on Corporate Social Responsibility And Sustainability For Central Public Sector Enterprises w.e.f. 01.04.2014 (Issued by the Govt of India, Ministry of Heavy Industries and Public Enterprises, vide Circular No. F. No. 15(13)/ 2013-DPE(GM), dated 21st October, 2014)¹

Background

The Government of India enacted the Companies Act 2013 in August 2013. Section 135 of the Companies Act 2013 (hereinafter referred to as 'the Act') deals with the subject of Corporate Social Responsibility (CSR). It lays down the qualifying criteria based on net worth, turnover, and net profit for companies which are required to undertake CSR activities and, *inter alia*, specifies the broad modalities of selection, implementation and monitoring of the CSR activities by the Boards of Directors of companies. The activities which may be included by companies in their CSR policies are listed in Schedule VII of the Act. The provisions of Section 135 of the Act and Schedule VII of the Act apply to all companies, including CPSEs.

The Ministry of Corporate Affairs has formulated CSR Rules (hereinafter referred to as the 'CSR Rules'), under the provisions of the Act and issued the same on 27.2.2014. The CSR Rules are applicable to all companies, including CPSEs w.e.f. 1.4.2014.

All CPSEs shall have to comply with the provisions of the Act and the CSR Rules. Any amendment notified by the Ministry of Corporate Affairs in the CSR Rules, or in Schedule VII of the Act will also be binding on the CPSEs.

Prior to the notification of CSR Rules, DPE Guidelines on CSR and Sustainability issued in December 2012, were applicable to CPSEs w.e.f. 01.04.2013. In DPE guidelines, CSR and sustainable development were treated as complementary and, therefore, dealt with together. CSR was seen as an important constituent of the overarching framework of sustainability. The present guidelines of DPE are also intended to reinforce the complementarity of CSR and sustainability and to advise the CPSEs not to overlook the larger objective of sustainable development in the conduct of business and in pursuit of CSR agenda.

DPE Guidelines on CSR and Sustainability for CPSEs

The Department of Public Enterprises (DPE) has formulated Guidelines on CSR and Sustainability (hereinafter referred to as 'the Guidelines') which are applicable to CPSEs. These Guidelines do not supersede or override any provision of the Companies Act, or Schedule VII of the Act, or the CSR Rules, but will only supplement them. In case of any perceived conflict between the CSR Rules and the Guidelines, the former shall prevail in all circumstances.

In the Guidelines the need for taking sustainability initiatives is emphasised in addition to the requirement of mandatory compliance with the CSR Rules. The Guidelines are aimed at providing an over arching framework of Sustainability within which CSR is firmly embedded.

The CSR policy document of a CPSE should include a vision and mission statement of how the CPSE proposes to comply with the Guidelines. The broad sustainability initiatives which a CSPE intends to undertake should also find mention therein. Since CSR and Sustainability issues are complementary in nature, and both are to be mentioned in the policy document, it may be referred to as 'CSR and Sustainability' policy. The Revised Guidelines applicable to all CPSEs are generally in the nature of guiding principles. The guidelines contain certain additional requirements as mentioned below:

1. It is mandatory for all profit making CPSEs to undertake CSR activities as per the provisions of the Act and the CSR Rules. Even the CPSEs which are not covered under the eligibility criteria based on threshold limits of net-worth, turnover, or net profit as specified by Section 135(1) of the Act, but which made profit in the preceding year, would also be required to take up CSR activities as specified in the Act and the CSR Rules, and such CPSEs would be expected to spend at least 2% of the profit made in the preceding year on CSR activities.

¹ https://dpe.gov.in/sites/default/files/Guidelines_on_CSR_SUS_2014.pdf

2. All CPSEs must adopt a CSR and Sustainability Policy specific to their company with the approval of the Board of Directors. The philosophy and spirit of CSR and Sustainability must be firmly ingrained in the policy and it must be consistent with the CSR provisions of the Act, Schedule VII of the Act, CSR Rules, the Guidelines, and the policy directions issued by the Government from time to time. The CSR and Sustainability policy of a CPSE should serve as the referral document for planning its CSR activities in accordance with Schedule VII of the Act and give a road map for formulation of actionable plans.
3. If the CPSEs feel the necessity of taking up new CSR activities /projects during the course of a year, which are in addition to the CSR activities already incorporated in the CSR policy of the company, the Board's approval of such additional CSR activities would be treated as amendment to the policy.
4. It would be mandatory for all CPSEs which meet the criteria as laid down in Section 135(1) of the Act, to spend at least 2% of the average net profits of the three immediately preceding financial years in pursuance of their CSR activities as stipulated in the Act and the CSR Rules. This stipulated percentage of average net profits is to be spent every year in a manner specified in the Act and CSR Rules.

In case a company fails to spend such amount, it shall have to specify the reasons for not spending it. However, in case of CPSEs mere reporting and explaining the reasons for not spending this amount in a particular year would not suffice and the unspent CSR amount in a particular year would not lapse. It would instead be carried forward to the next year for utilisation for the purpose for which it was allocated.

5. While selecting CSR activities/projects from the activities listed in Schedule VII of the Act, CPSEs should give priority to the issues which are of foremost concern in the national development agenda, like safe drinking water for all, provision of toilets especially for girls, health and sanitation, education, etc. The main focus of CSR and Sustainability policy of CPSEs should be on sustainable development and inclusive growth, and to address the basic needs of the deprived, under privileged, neglected and weaker sections of the society which comprise of SC, ST, OBCs, minorities, BPL families, old and aged, women / girl child, physically challenged, etc.
6. For CPSEs to fully exploit their core competence and mobilize their resource capabilities in the implementation of CSR activities / projects, they are advised to align their CSR and Sustainability policy with their business policies and strategies to the extent possible, and select such CSR activities/ projects which can be better monitored through in-house expertise.
7. All CPSEs are expected to act in a socially, economically and environmentally sustainable manner at all times. Even in their normal business activities, public sector companies should try to promote sustainable development through sustainability initiatives by conducting business in a manner that is beneficial to both, business and society. They are advised not to lose sight of their social and environmental responsibility and commitment to sustainable development even in activities undertaken in pursuance of their normal course of business. National and global sustainability standards which promote ethical practices, transparency and accountability in business may be referred to as guiding frameworks to plan, implement, monitor and report sustainability initiatives. But the amount spent on sustainability initiatives in the pursuit of sustainable development while conducting normal business activities would not constitute a part of the CSR spend from 2% of profits as stipulated in the Act and the CSR Rules.
8. As a part of their sustainability initiatives CPSEs are expected to give importance to environmental sustainability even in their normal mainstream activities by ensuring that their internal operations and processes promote renewable sources of energy, reduce / re-use / recycle waste material, replenish ground water supply, protect/ conserve/restore the ecosystem, reduce carbon emissions and help in greening the supply chain. CPSEs are expected to do so in a responsible manner by producing

goods and services which are safe and healthy for the consumers and the environment, resource efficient, consumer friendly, and environmentally sustainable throughout their life cycles i.e. from the stage of raw material extraction to production, use / consumption, and final disposal. However, such sustainability initiatives will not be considered as CSR activities as specified in the CSR Rules, and the expenditure incurred there on would also not constitute a part of the CSR spend. Never the less, CPSEs are encouraged to take up such sustainability initiatives from their normal budgetary expenditure as it would demonstrate their commitment to sustainable development.

9. Sustainability initiatives would also include steps taken by CPSEs to promote welfare of employees, especially women, physically challenged, SC/ST/OBC categories, by addressing their concerns of safety, security, professional enrichment and healthy working conditions beyond what is mandated by law. However, expenditure on such sustainability initiatives would not qualify as CSR spend.
10. The philosophy and spirit of CSR and Sustainability should be understood and imbibed by the employees at all levels and get embedded in the core values of the company.
11. CPSEs should extend their reach and oversight to the entire supply chain network to ensure that as far as possible suppliers, vendors, service providers, clients, and partners are also committed to the same principles and standards of corporate social responsibility and sustainability as the company itself. CPSEs are encouraged to initiate and implement measures aimed at 'greening' the supply chain.
12. As mentioned in the Act, CPSEs should give preference the 'local area' in selecting the location of their CSR activities. It is desirable that the Board of Directors of CPSEs define the scope of the 'local area' of their commercial units/plants/projects, keeping in view the nature of their commercial operations, the extent of the impact of their operations on society and environment, and the suggestions/demands of the key stakeholders, especially those who are directly impacted by the company's commercial operations/activities. The definition of 'local area' may form part of the CSR policy of the CPSE.
13. After giving due preference to the local area, CPSEs may also under take CSR activities anywhere in the country. The Board of Directors of each CPSE may also decide on an indicative ratio of CSR spend between the local area and outside it, and this may be mentioned in the CSR policy of the CPSE. CPSEs, which by the very nature of their business have no specific geographical area of commercial operations, may take up CSR activities / projects at any location of their choice within the country.
14. As far as possible, CPSEs should take up the CSR activities in project, which entails planning the stages of execution in advance by fixing targets at different milestones, with pre-estimation of quantum of resources required within the allocated budget, and having a definite times pan for achieving desired outcomes.
15. CPSEs should devise a communication strategy for regular dialogue and consultation with key stakeholders to ascertain their views and suggestions regarding the CSR activities and sustainability initiatives undertaken by the company. However, the ultimate decision in the selection and implementation of CSR activities would be that of the Board of the CPSE.
16. As per the CSR Rules, all companies are required to include an annual report on CSR in their Board's Report. The template/format for reporting CSR activities as provided by CSR Rules Should be strictly adhered to. However, CPSEs shall also have to include in the Board's Report a brief narrative on the action taken for the implementation of the Guidelines so that the stakeholders are informed of not only the CSR activities but also of the sustainability initiatives taken by the CPSEs. CPSEs are further advised to prepare an Annual Sustainability Report, which would go a long way in imparting greater transparency and accountability to the company's operations, apart from improving the brand image.
17. It is desirable that CPSEs get a baseline/need assessment survey done prior to the selection of any CSR activity. It is also desirable that CPSEs should get an impact assessment study done by external

agencies of the CSR activities/ projects undertaken by them. Impact assessment is mandatory for mega projects, the threshold value of which can be determined by the Board of a CPSE and specified in its CSR and Sustainability policy. However, the expenditure incurred on base line survey and impact assessment study should be within the overall limit of 5% of administrative overheads of CSR spend as provided for under the CSR Rules.

18. Within the provisions of the Act, Schedule VII of the Act, and the CSR Rules, CPSEs are encouraged to take up CSR activities / projects in collaboration with other CPSEs for greater social, economic and environmental impact of their CSR activities/projects.
19. CPSEs which are statutory corporations should also comply with the provisions of the Companies Act, 2013, CSR Rules and the Guidelines.

Guidelines for CSR expenditure of CPSEs²

1. The Government of India, Ministry of Heavy Industries & Public Enterprises Department of Public Enterprises, vide its Circular No. CSR-08/0002/ 2018-Dir (CSR) dated 10th December, 2018. Issued the Guidelines for CSR expenditure of CPSES.
2. One of the recommendations which emerged from the CPSEs Conclave held in April 2018 was related to utilization of CSR funds in a focussed manner towards national priorities by adopting a theme based approach every year. Detailed deliberations on this recommendation were held subsequently by Department of Public Enterprises (DPE) with CPSEs, select Ministries/Departments, NITI Aayog and the Committee of Secretaries. Based on the deliberations, the Competent Authority has approved the following course of actions for undertaking CSR activities by Central Public Sector Enterprises (CPSES):
 - (i) A common theme may be identified for each year for undertaking CSR by CPSES.
 - (ii) For the current year 2018-19, school education and health care may be taken up as the theme for focussed intervention.
 - (iii) CSR expenditure for thematic programme should be around 60% of annual CSR expenditure of CPSES.
 - (iv) Aspirational Districts may be given preference.
 - (v) The annual theme for the future will be decided by the Competent Authority separately.
3. The Competent Authority has further entrusted to NITI Aayog the responsibility to pilot the programme.
4. Accordingly, the CPSE undertaking CSR activity in Aspirational districts would. (i) designate a senior level functionary as nodal officer to liaise closely with the District Administration of concerned Aspirational district (ii) furnish the details of nodal officer along with the name of selected aspirational district(s) to NITI Aayog, DPE and concerned administrative Ministry/Department of the CPSE (iii) furnish the details of projects funded by CPSE under CSR in an aspirational district to NITI Aayog, DPE and concerned administrative Ministry/Department of CPSE (iv) brief the concerned Central Prabhari Officer of Aspirational District (Joint Secretary/Additional Secretary nominated by GOI for aspirational district), about the CSR project being funded by CPSE.
5. It will be the responsibility of the concerned CPSE to ensure that all the CSR activities being undertaken are in accordance with the relevant provisions of the Companies Act 2013, its Schedules and Rules issued under the said Act and there is no deviation from statutory provisions.
6. These guidelines are in supersession of earlier advisory of DPE dated 1st August 2016 regarding utilisation of 33% of CSR funds by CPSEs towards Sanitation and SBM activities.

2. <https://dpe.gov.in/guidelines-csr-expenditure-cpses>.

7. All the administrative Ministries/Departments are requested to bring these guidelines to the notice of CPSEs under their jurisdiction for necessary action.

LESSON ROUND-UP

- Legal and regulatory framework of corporate governance in India is mainly covered under the Companies Act, 2013, Listing Regulations, 2015 and SEBI guidelines.
- The Securities and Exchange Board of India (SEBI) is the prime regulatory authority which regulates all aspects of securities market enforces the Securities Contracts (Regulation) Act including the stock exchanges. Companies that are listed on the stock exchanges are required to comply with the Listing Regulations, 2015.
- Corporate Governance' as the application of best management practices compliance of law in true Letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.
- The companies listed with Stock Exchanges have to adhere to the SEBI (LODR) Regulations, 2015 in addition to the provisions of the Companies Act or the Act under which they been formed. The banks under governed by the different statutes hence the respective Acts under which they have been incorporated have to comply with that requirement along with the directives of the Regulatory Authorities (like RBI for Banks and IRDA for Insurance).
- The inception of the Corporate Governance norms may for banks may firstly be treated when the RBI accepted and published the Ganguly Committee Recommendations. Since India is also following the best practices as enunciated by the Basel Committee and adopted by the banks in India as per the directions of the RBI, the Corporate Governance Norms as suggested in Basel I, II and III has also been elaborated in the chapter.
- The Corporate Governance norms for insurance companies are governed by the IRDA guidelines.

GLOSSARY

Insurance: A company that calculates the risk of occurrence then determines the cost to replace (pay for) the loss

Company: to determine the premium amount. A business that provides coverage, in the form of compensation resulting from loss, damages, injury, treatment or hardship in exchange for premium payments.

Banking: "banking company" means a banking company as defined in clause (c) of section 5 of the Banking

Company: Regulation Act, 1949.

NBFC's: A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/ debentures/ securities issued by Government or local authority or the marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lumpsum or in installments by way of contributions or in any other manner, is also a non-banking financial company and is known as Residuary non-banking company.

CPSEs: Central Public Sector Enterprises (CPSEs) are those companies in which the direct holding of the Central Government or other CPSEs is 51% or more.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What do you mean by the Corporate Governance? How the governance norms are applicable in the banks.
2. Discuss the salient features of the Ganguly Committee Report applicable to Private Sector Banks.
3. IRDA has issued the guidelines on Corporate Governance Norms for the Insurance Companies. Please mention the salient features of it.
4. Public Sector Under takings also have to adhere to the norms of the Corporate Governance. What guidelines have been issued by the Ministry in this regard?
5. Comment on Corporate Social Responsibility as a part of Corporate Government.
6. DPE has issued the guidelines on Corporate Governance for the CPSEs. Discuss in Brief.

LIST OF FURTHER READINGS

- D. P. Mittal's Corporate Governance Board of Directors, Duties and Functions, Publisher: Commercial Law Publishers
- Corporate Governance in Banking and Investor Protection by Belen Diaz Diaz, Samuel O. Idowu and Philip Molyneux
- Handbook on Corporate Governance in Financial Institutions by Collot, Solène
- Department of Public Enterprises, <https://dpe.gov.in/dpe-guidelines/corporate-governance>
- Corporate Governance For Insurance Companies by Dr.Rajkumar S. Adukia
- Non Banking Financial Companies By Indian Institute of Banking & Finance