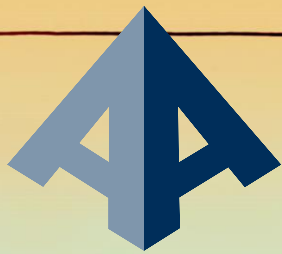

CG WATCH 2023

INDIA

Sustainability is key

Decoding ambiguity and non-transparency

Special report - October 2024

Founding Sponsor of ACGA

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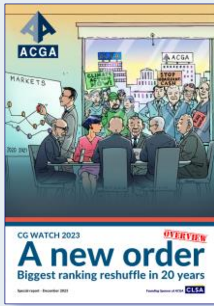

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All prices quoted herein are as at close of business 30 September 2024, unless otherwise stated

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Great
Solid
Meh

Regional review

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Sustainability is key

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India moves up one to joint sixth with Hong Kong in 2023

Over the past two years, India has focused heavily on sustainability and renewable energy, driven by government initiatives to promote green practices. Key among these is the National Green Hydrogen Mission, which aims for a green hydrogen capacity of at least 5 million metric tonnes (MMT) per annum, a goal of 500 GW of non-fossil fuel capacity by 2030, and achieving net zero emissions by 2070. These efforts are supported by the Environmental, Social, and Governance (ESG) disclosure frameworks implemented by the securities regulator and the central bank. As a result, India's score in the CG Watch improved from 58% to 59%, moving up from seventh place in 2020 to a joint sixth place with Hong Kong in 2023.

Audit regulator finds its feet sanctioning auditors and audit firms

Governance rules saw a notable improvement, with scores rising from 69% in 2020 to 73% in 2023. Investor performance also showed modest gains, increasing from 44% to 46%. The most significant progress, however, was observed in the auditors and audit regulators sector. The National Financial Reporting Authority (NFRA), established in 2018, has become increasingly influential, sanctioning auditors and audit firms and conducting audit quality reviews. Additionally, the NFRA's membership in the International Forum of Independent Audit Regulators (IFIAR) in November 2023, a recommendation from our 2020 report, has further strengthened its impact.

Listed companies, media, government and public governance have all lost ground

Despite these advancements, several areas have lagged. Listed companies and civil society have lost ground, and government and public governance, along with regulators, have remained stagnant. Persistent, long-term issues such as corruption, an understaffed judiciary, regulatory loopholes, and a lack of transparency within the government continue to challenge the country.

Bottom-up, CLSA analysts see a 6.0pt improvement in companies' CG scores

CLSA's bottom-up CG scoring of companies under our coverage suggest a 6.0pt improvement in Indian companies' governance compared with 2020, driven by the Independence and Discipline pillars. Relative to the Asia average, our CG scores for Indian businesses are 3.5pts higher, thanks to better performance in timeliness of financial reporting and board diversity (talent, background etc), though our analysts find interest alignment between ordinary and controlling shareholders concerning.

India's ACGA market ranking edged up in 2023

CG Watch 2023 market rankings and scores

Market	Previous ranking	2023 (%)	2020 (%)	Change vs 2020 (ppt)
1. Australia	1	75.2	74.7	+0.5
2. Japan	=5	64.6	59.3	+5.3
=3. Singapore	=2	62.9	63.2	-0.3
=3. Taiwan	4	62.8	62.2	+0.6
5. Malaysia	=5	61.5	59.5	+2.0
=6. Hong Kong	=2	59.3	63.5	-4.2
=6. India	7	59.4	58.2	+1.2
8. Korea	9	57.1	52.9	+4.2
9. Thailand	8	53.9	56.6	-2.7
10. China	10	43.7	43.0	+0.7
11. Philippines	11	37.6	39.0	-1.4
12. Indonesia	12	35.7	33.6	+2.1

Source: ACGA

CG Watch through the years

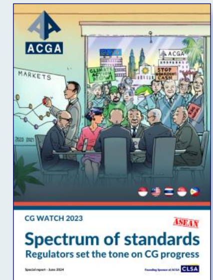
Saints & sinners
April 2001

The holy grail
October 2005

Dark shades of grey
September 2014

A new order
December 2023

Spectrum of standards
June 2024



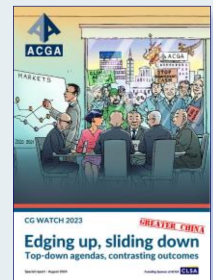
Make me holy . . .
February 2002

On a wing and a prayer
September 2007

Ecosystems matter
September 2016

Ramping up CG reform
May 2024

Edging up, sliding down
August 2024



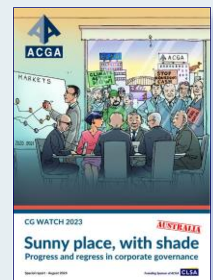
Fakin' it
April 2003

Stray not into perdition
September 2010

Hard decisions
December 2018

Dismantling the discount
June 2024

Sunny place, with shade
August 2024



Spreading the word
September 2004

Tremors and cracks
September 2012

Future promise
May 2021

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Great

Solid

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India - two steps forward, one step back

- The market moves up one place to rank equal sixth on a score of 59.4%, a 1.2 percentage point gain on its 2020 performance
- Green ambitions and pledges are high on the policy agenda and the Reserve Bank of India (RBI) consults on a climate risk and sustainable finance framework
- Regulators upgrade rules on corporate disclosure, related party transactions and ESG disclosures
- Corruption remains a concern and Comptroller and Auditor General (CAG) audit report highlights graft and mismanagement in government projects
- A shortage of judges leads to delays and backlogs
- Independent audit body, the National Financial Reporting Authority (NFRA) joins the International Forum of Independent Audit Regulators (IFIAR)

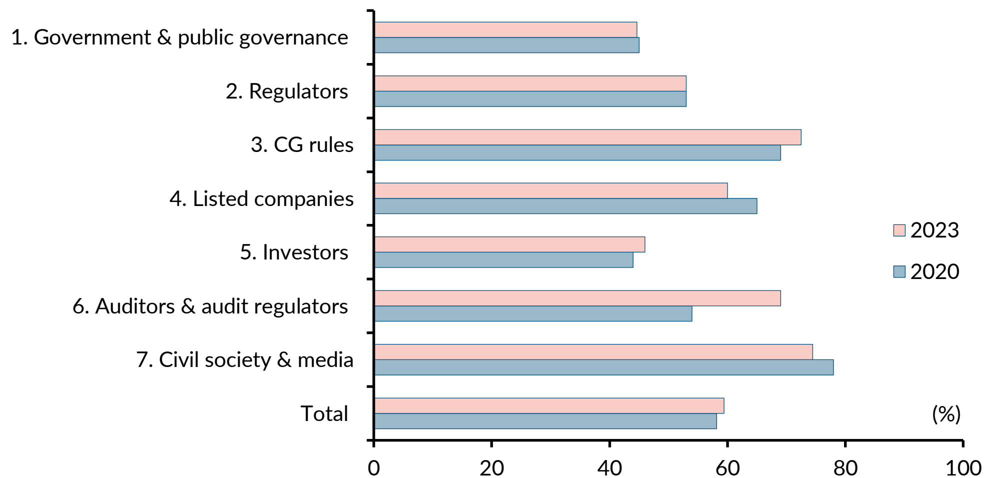
Click to rate this research

Great

Solid

Meh

Figure 1
India CG macro category scores: 2023 vs 2020



Source: ACGA

Introduction

India ranks equal sixth on a score of 59.4%

India saw a modest improvement in 2023, moving up one place to rank joint sixth with Hong Kong on a score of 59.4%, a 1.2 percentage point increase on its 2020 performance. Economically, India has made significant strides, becoming the fifth largest economy in the world by December 2021. Infrastructure projects are booming with public-private partnerships, and the government is pushing the country to embrace green initiatives. However, longstanding issues such as the politicisation of government departments, lack of transparency, and harassment of media, activists and opposition politicians persisted in 2023.

A report by Hindenburg Research highlights many CG issues

In January 2023, a report by Hindenburg Research on the Adani Group highlighted several of these issues, shining a harsh spotlight on regulatory loopholes, apparent political and capital cronyism, and gaps in the accounting and auditing space, issues that the Supreme Court appointed committee that looked into the accusations and regulatory failure on the part of the securities regulator did address despite clearing the regulator of any wrongdoing. Hindenburg, a US-based activist short-seller, published a report on 24 January 2023, accusing the conglomerate of engaging in decades-long practices of stock manipulation, accounting fraud, and improper use

of offshore tax havens. The report also pointed out deficiencies in financial controls, such as high turnover in CFO roles and suspicious related-party transactions involving offshore entities, which regulators had yet to adequately address.

There was a political dimension to the scandal

The report also became a political hot potato for Prime Minister Narendra Modi, especially as 2023 was the lead-up to the 2024 election year. The founder of Adani Group, Gautam Adani, is well-known for his close ties to Modi and has been a supporter, and in various ways had benefited from policies and projects, of the Modi government[1].

Transparency and press freedom are under threat

These issues compounded the broader erosion of democratic functions and lack of government transparency, which we raised in our 2020 CG Watch. Since 2014, under the current government's leadership, there has been a marked decline in civil liberties and freedom of expression. The use of colonial-era sedition laws and the Unlawful Activities (Prevention) Act (UAPA) to silence critics has increased significantly. Journalists and activists continue to face harassment and intimidation, leading to a climate of self-censorship. Reports also indicate a substantial decline in press freedom, with India falling from 150 in 2022 to 161 out of 181 countries in the 2023 World Press Freedom Index.

Key institutions are compromised in their gatekeeper roles

Moreover, institutions intended to provide checks and balances, such as the judiciary, have faced allegations of interference and bias, raising concerns about the undermining of India's democratic principles and the rule of law. These developments highlight persistent gaps in India's corporate governance framework and underscore the need for more robust regulatory oversight and protection of democratic norms. The real or perceived politicisation of government departments influenced by political agendas has also become an increasing concern.

There have been regulatory upgrades to the CG ecosystem

Despite these manifold issues, regulators have stepped up to upgrade disclosure rules, enhance transparency in related-party transactions with subsidiary companies, and improve environmental, social and governance (ESG) disclosures. This proactive stance by regulators has contributed to the slight improvement in India's corporate governance score in our rankings. However, it is crucial that these improvements are not diluted in the name of "ease of doing business," as has been the case in the past.

Recapping CG Watch 2020

Some of our previous recommendations are taken on board

Has India implemented any of our recommendations from 2020? To some extent, yes. The National Financial Reporting Authority (NFRA) has become a member of the International Forum of Independent Audit Regulators (IFIAR), and the Reserve Bank of India (RBI) has provided guidance on climate-related disclosures, although a comprehensive framework has yet to be published. Additionally, while the RBI has allowed three months for its consultations, the Securities and Exchange Board of India (SEBI) has reversed course and shortened its feedback period.

Enforcement disclosure has room for improvement

However, several longstanding issues persist. Gaps in enforcement disclosure remain, state-owned enterprises continue to treat corporate governance (CG) rules as guidelines for other companies to follow, and the release of AGM notices 28 days before meetings is still often an aspiration rather than a reality.

[1] In 2019, the Adani Group won the bid to operate six airports despite objections by the Department of Economic Affairs that no group should be given more than two airports due to the huge financial risk, while the government think tank, Niti Aayog, wrote that "a bidder lacking sufficient technical capacity can well jeopardise the project and compromise the quality of services that the government is committed to provide." These objections were not taken into consideration.

Figure 2

India: recap of 2020

	Recommendations	Outcomes
1.	The NFRA should join IFIAR	NFRA became a member of IFIAR in November 2023
2.	Improve enforcement disclosure on regulatory websites and annual reports	No progress
3.	Ensure public sector units (state enterprises) comply with all CG rules	No progress
4.	Release AGM notices 28 days before date of meeting	No progress
5.	RBI to provide guidance on climate-related disclosure	Partial progress: a 2022 consultation was followed by a February 2024 draft framework consultation on what finance companies should incorporate
6.	Map BRSR standards to international ESG reporting standards	No progress to date, but SEBI has indicated it will do this
7.	Extend regulatory consultations to two to three months	Some progress: RBI gave three months for consultations on climate risk in 2022 and 2024 but other regulators have shortened consultation periods
8.	Review accounting and auditing standard-setting to reduce time cycle for adoption of new standards	No progress

Source: ACGA

1. Government & public governance

India remains in seventh place with a score of 45%

India comes seventh on this category of our market rankings with a score of 45%, the same as it did in 2020. Its performance places India just below Korea, with a score of 52%, and above Malaysia, which scores 37%. India's ranking highlights a lack of improvement in several critical areas. The government continues to lack a CG strategy as part of its long-term agenda. Despite public commitments to enhance ease of doing business, tangible support for regulatory enforcement remains inconsistent.

Policy measures to promote ease of business may hinder CG progress

Finance Minister Nirmala Sitharaman's 2023 Budget speech emphasised promoting ease of doing business, including requesting financial sector regulators to conduct comprehensive reviews of existing regulations and setting time limits for decisions. However, these measures, aimed at easing regulations, can potentially undermine CG at companies. The reliance on IT systems for data governance, often seen as a band-aid solution, does not effectively address the deeper issues, especially when dealing with middlemen on the ground.

U-turn on separating the chair and CEO roles raises concerns

Notably, the Securities and Exchange Board of India (SEBI)'s reversal on the rule for the separation of chairman and CEO roles in 2022, making it voluntary, reflects apparent inconsistency in political support for regulatory frameworks. This move has raised concerns about the government's commitment to stringent governance norms.

Persistent issues such as support for regulators and bank governance are reflected in India's score

The scores indicate persistent issues in areas such as government support for regulators, governance of banks and the effectiveness of anti-corruption efforts. The judiciary's independence and resources, along with civil service ethics and accountability, also remain problematic, reflecting the need for more robust governance mechanisms.

Room for improvement in the regulatory and enforcement space

Overall, while some areas maintained moderate scores, the unchanged performance between 2020 and 2023 signals that significant work remains to be done to enhance India's regulatory environment and enforcement capabilities.

Long-term CG reform is questionable

Prospects for long-term CG are unclear

Whether India possesses a credible long-term corporate governance strategy or not is nuanced, much like the man behind it, Prime Minister Narendra Modi. What is particularly noteworthy is that the vision of a "better" India appears to be singularly Modi's, rather than a collective view of the country and governance. His 2019 campaign slogan, "Phir Ek Baar, Modi Sarkar" (Modi government once more), while his 2024 slogan "Teesri Baar Modi Sarkar" (Modi government for the third time) encapsulates this sentiment, emphasising that the direction India takes is closely tied to his leadership.

Modi emphasises ease of doing business

The most compelling argument that Modi's focus is not long-term corporate governance restructuring is his emphasis on transforming India into a global economic powerhouse through structural reforms and initiatives that facilitate business operations under the slogan "ease of doing business." While reforms have lessened regulatory issues for companies and enhanced economic performance, several issues remain unaddressed. For example, the push to streamline business regulations and reduce compliance burdens has had mixed effects on CG. Positive impacts include regulatory simplification, making it easier for companies to comply with governance norms by reducing bureaucratic red tape. Initiatives like the introduction of goods and services tax (GST) and the MCA21 e-governance project that enables easy and secure access of ministry of corporate affairs (MCA) services have supposedly enhanced transparency and accountability in business operations and facilitated a more transparent business environment, thereby promoting better CG practices.

A focus on compliance burdens without adequate oversight may be detrimental to CG

There are still concerns that the focus on reducing compliance burdens weakens the enforcement of CG standards. For example, the decriminalisation of certain provisions under the Companies Act and the reduction of penalties for non-compliance with the Act in 2019 and 2020 have been criticised for potentially lowering deterrence against corporate malpractices. The ongoing automated and faceless processing of regulatory filings, while increasing efficiency, also poses potential risks of oversight lapses if not adequately monitored, leading to possible gaps in regulatory scrutiny and enforcement, thereby undermining corporate accountability.

An audit of public sector enterprises highlights CG shortcomings

While these issues highlight a broader problem in corporate governance, specific sectors such as public sector enterprises further illustrate the government's lack of commitment to genuine reform. The comptroller and auditor general (CAG) report on central public sector enterprises (CPSEs) tabled in Parliament in December 2022 suggests that CG is not high on the government's priority list. CAG audited 72 listed CPSEs for the report, including some of the largest ones such as NMDC, Coal India, Gail, Steel Authority of India and ONGC. It is well-known that many government companies have not adhered to corporate governance practices outlined in SEBI's listing rules, the Companies Act 2013, or the Department of Public Enterprises' CG guidelines. The report highlights a troubling array of corporate governance issues: 20 out of 72 companies, including NMDC, Bharat Dynamics and Coal India, have no independent directors on their boards. Some boards have fewer than six directors, fail to provide detailed information for reviewing operations, lack a skills matrix, and even fail to constitute an audit committee (three out of 72 companies) or a nomination and remuneration committee (12 out of 72). More concerning are the audit committees that do not perform their duties or are inadequately staffed with independent directors.

The stock exchanges are aware of the issues

These infractions, particularly the lack of independent directors, have been flagged by the exchanges. In November 2023, at least 15 non-compliant PSEs were fined up to Rs542,800 (US$6,400) by both exchanges for failing to appoint independent directors. However, some companies, including Hindustan Petroleum Corporation Ltd, wrote to the exchanges requesting fine waivers because "the power to appoint the directors, including the independent directors, on its board vests with the Government of India . . . GOI is seized of the matter." This raises the question: why haven't the relevant ministries formulated a solution, such as a databank of independent directors that companies can utilise, or allowing the company's nomination and remuneration committees to identify and appoint independent directors?

The case of LIC serves as an example of not prioritising CG

Furthermore, the government's approach to listing the Life Insurance Corporation of India (LIC) suggests corporate governance norms were not a priority. SEBI revised the IPO rules in 2021, reducing the minimum offer to the public for companies with a post-issue capital of Rs1trn (US$11.9bn) to five percent (down from 10%), and extending the timeframe to meet the 25% public float requirement to five years (up from three years for other companies). When LIC's IPO, India's largest, launched in May 2022, it offered only a 3.5% public float without apparent objection from SEBI. In December 2023, the ministry of finance granted LIC an exemption until 2032 to meet the 25% public float requirement.

Moving up globally

India is experiencing significant economic growth

To be fair, India has achieved significant milestones in recent years, one of which is positioning itself as the world's fifth-largest economy, which can be attributed to robust economic policies, structural reforms, and an expanding digital infrastructure. The International Monetary Fund (IMF) reported that India surpassed the United Kingdom to become the fifth-largest economy in 2022, with a nominal GDP of approximately US$3.53trn. The growth has been driven by a diverse economy, including the service and industrial sectors, as well as increases in consumer spending and investments. Its renewable energy programmes, which is a focal point of the government's infrastructure development strategy, have bolstered India's growth story.

India going green

Green pledges would see India ramp up its renewable capacity

At the 26th United Nations Climate Change Conference (COP26) in Glasgow in 2021, Modi announced an ambitious target to achieve net-zero carbon emissions by 2070. The government also pledged to increase its non-fossil energy capacity to 500 GW by 2030 and meet 50% of its energy requirements from renewable sources by the same year. By the end of 2022, India had installed 165 GW of renewable energy capacity, just shy of its 175 GW target, showcasing significant progress in green energy infrastructure. According to the Centre on Global Energy Policy at Columbia University, the government has also implemented policies to encourage the use of electric vehicles and promote energy efficiency across various sectors.

Green ambitions, rocky roads

A solar project in Ladakh suggest there are limits to green progress

India faces several significant challenges in its pursuit of green energy, including securing land for renewable energy infrastructure, acquiring technical and human expertise, and managing the logistics of transporting solar and wind power to power generation sites. One of the most notable projects is the plan to build large solar farms in Ladakh, which has faced multiple hurdles. The Ladakh solar project aims to set up a 13 GW renewable energy facility, combining solar and wind power, with a substantial battery energy storage system. The project is targeted for completion by FY2029-30, with a total estimated cost of Rs207.74bn (US$2.4bn). Central

Financial Assistance (CFA) will cover 40 percent of the project cost, amounting to Rs83.09bn. However, this initiative has been a source of geopolitical tensions with China due to the region's strategic location and ongoing border disputes, heightening security concerns.

There are environmental concerns over the project

Environmental concerns also play a critical role given the fragile ecosystem of Ladakh, characterised by its unique biodiversity and harsh climatic conditions. The construction and operation of large-scale renewable energy projects could disrupt local habitats and water resources. For instance, in the Puga Valley, a geothermal project faced significant environmental challenges when geothermal fluids unexpectedly leaked, raising fears of water contamination and habitat destruction, according to a report in Scroll.

The effect on local communities is also being considered

Moreover, there is the potential displacement of local communities. Ladakh is home to semi-nomadic tribes who rely on the land for grazing their livestock. Large-scale renewable energy projects could appropriate these lands, forcing communities to relocate and disrupting their traditional ways of life. In an interview with Renewable India, Lawmaker Jamyang Tsering Namgyal emphasised the need for conditions that prioritise local employment and land lease models to mitigate some of these impacts. These challenges highlight the complexities of implementing large-scale renewable energy projects in geopolitically sensitive and environmentally fragile regions. They underscore the need for careful planning, robust environmental safeguards, and sensitive handling of local community interests to ensure that the transition to green energy is both sustainable and equitable.

Green finance

RBI is promoting green sovereign bonds

The banking regulator has also been supportive of the government's green ambitions as it pushes sustainable finance. In the past two years, the Reserve Bank of India (RBI) has made significant strides in promoting green bonds and green finance. One major initiative was the issuance of sovereign green bonds in January 2023 to mobilise resources for green infrastructure projects. Additionally, the RBI introduced a framework for the acceptance of green deposits in April 2023, allowing regulated entities to raise interest-bearing deposits specifically earmarked for financing eligible green projects. This framework is a step towards encouraging banks to support environmentally sustainable initiatives.

Challenges are identified in moving toward net zero

Furthermore, RBI's report on currency and finance for 2022-23, themed "Towards a Greener Cleaner India," highlighted several critical challenges to achieving a net-zero economy. It emphasised the substantial financial resources required for climate adaptation, estimated to reach Rs85.6trn (US$1trn) by 2030. Key issues included the need for deep decarbonisation across sectors like power, transportation and agriculture, overcoming significant technological and cost barriers in hard-to-abate sectors such as heavy industries and agriculture, and the necessity for robust regulatory and policy support, including appropriate carbon pricing and the development of carbon markets or emissions trading systems (ETS). The financial sector must focus on financing renewable energy projects, electric vehicles and energy-efficient technologies, supporting research and development, advocating for regulatory frameworks and collaborating with stakeholders to drive the green transition.

A survey of bank suggests larger ones are better prepared on climate risks

RBI enters the climate arena

In July 2022, RBI released the results of its January 2022 survey, assessing banks' preparedness for climate-related financial risks. The survey included responses from 12 public sector banks, 16 private sector banks and six foreign banks. The results found that large banks demonstrated high awareness of climate risks, while smaller institutions were less prepared. Few banks had fully integrated climate risk into their existing risk management frameworks, and many acknowledged the need for substantial improvements.

RBI consults on measures to address climate risk

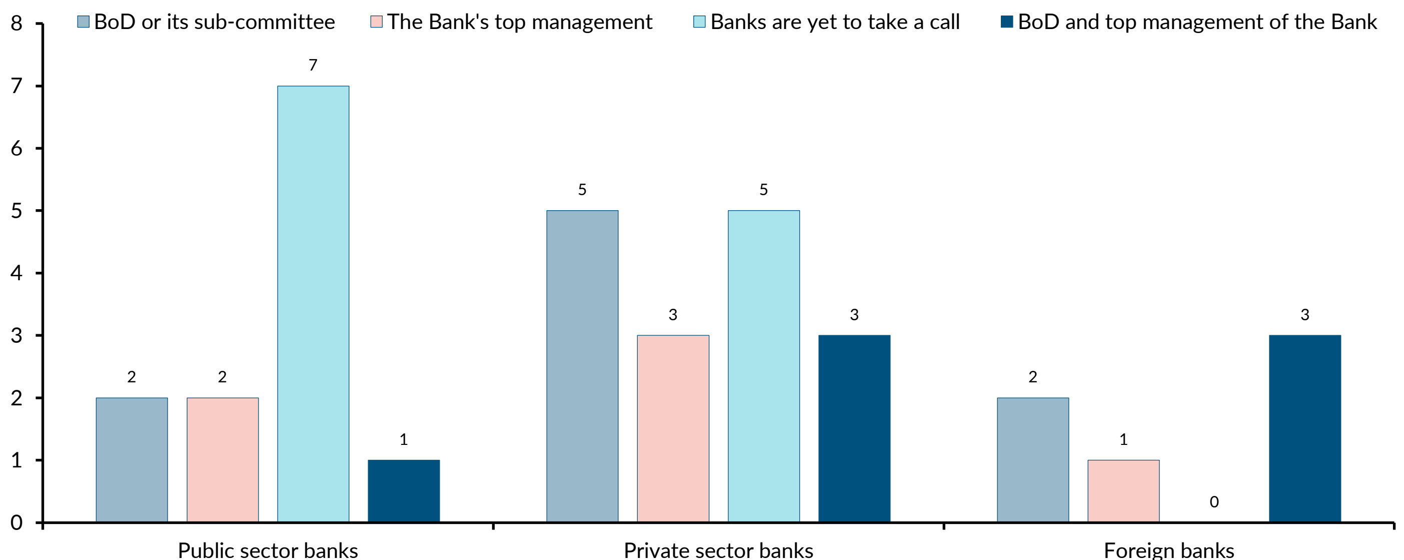
Simultaneously with the survey results, RBI issued a comprehensive discussion paper on climate risk and sustainable finance. The three-month consultation sought feedback from regulated entities (RE) and stakeholders on proposed measures to address climate-related risks and promote sustainable finance.

The paper also highlights the importance of strong governance

Key sections of the paper identified physical risks, such as extreme weather events and long-term shifts like rising sea levels, and transition risks from adjusting to a low-carbon economy. RBI emphasised strong governance frameworks, strategic planning, and the integration of climate-related risks into risk management frameworks. The paper also stressed the importance of consistent and comparable climate-related financial disclosures, aligned with the Task Force on Climate-related Financial Disclosures (TCFD). To support these initiatives, RBI recommended capacity-building efforts through training programs and international collaboration.

Figure 3

Oversight of climate and sustainability related initiatives



Source: Report of the Survey Climate Risk and Sustainable Finance, RBI

A draft framework on climate-related financial risks came out in February 2024

Draft framework

The draft Disclosure Framework on Climate-related Financial Risks was finally published in February 2024, proposing a comprehensive approach to managing and disclosing climate-related risks and opportunities based on International Financial Reporting Standards (IFRS). The extended consultation period is unprecedented among Indian regulators and much appreciated, as it provided ample time for stakeholders to respond and contribute. It is hoped that other regulators take note, RBI having set a benchmark for them to follow.

Four thematic pillars are identified

The framework encompassed four thematic pillars: governance, strategy, risk management, and metrics and targets. Under governance, REs were required to outline their processes for overseeing climate-related risks, detailing the roles of their boards and senior management. In terms of strategy, REs needed to disclose how climate-related risks and opportunities impacted their business models and financial planning over various time horizons. Risk management disclosures described the processes used to identify, assess and manage climate-related risks, ensuring these were integrated into overall risk management frameworks. The metrics and targets pillar required REs to report on their greenhouse gas emissions, aligned with global standard IFRS S2, and track progress towards climate-related targets.

Green finance is emphasised in the framework

Additionally, the draft framework emphasised the importance of green finance and its integration into the financial system. It called for REs to disclose their financing and investment activities related to climate-related opportunities, further promoting sustainable finance practices. The central bank's approach to climate-related financial risk disclosure, while later than many others, marked a significant step in enhancing the resilience of India's financial sector to climate change.

Stability in the banking sector

Indian banks remain solid during turbulence

Even as RBI takes positive steps towards green finance, it is noteworthy that the banking sector has maintained stability over the past two years; thankfully, the sector did not experience any major bank failures over the past two years, even as the global banking scene saw significant upheavals, particularly with the failures of Silicon Valley Bank and Signature Bank in the US and Credit Suisse in Switzerland. Indian banks remained relatively unaffected, having to weather significantly higher interest rate rises although not quite as sharp as in developed markets.

RBI strengthens governance structures in banks

RBI’s recent directive aimed to strengthen the governance structure of banks even further, building on the previous corporate governance guidelines issued in April 2021. As a follow-up to those guidelines, the circular issued on 25 October 2023 mandated that all private sector banks and wholly owned subsidiaries of foreign banks appoint at least two whole time directors (WTDs) on their boards, including the managing director and chief executive officer (MD&CEO). The initiative aimed to address the growing complexity in the banking sector and ensure that senior management could effectively navigate emerging challenges; it emphasised establishing a robust senior management team to facilitate succession planning, especially considering the regulatory stipulations regarding the tenure and upper age limit for MD&CEO positions. Banks that did not meet this requirement were required to submit their proposals for the appointment of WTDs within four months and make necessary amendments to their Articles of Association to comply with these new regulations.

Corruption is endemic

India has a low score in 2023 global corruption index

Corruption remains a pervasive issue in India, undermining effective governance and the implementation of policies. According to the Corruption Perceptions Index 2023 by Transparency International, India ranked 93 out of 180 countries with a score of 39/100, indicating significant corruption issues. While the central government touts the benefits of digitisation in reducing corruption, the reality at the local level tells a different story. Middlemen and local bureaucrats continue to exploit loopholes, and irregularities are frequently flagged by the Comptroller and Auditor General (CAG).

Probes by national auditor highlight governance issues

The 2023 CAG report highlighted several instances of corruption and mismanagement in government projects. Significant irregularities were found in the setting up of a Greenfield Airport in Pakyong, Sikkim, which began in the early 2000s, was deemed completed in 2018 but continues to face operational issues. The audit revealed that improper design adoption led to an avoidable expenditure of approximately $38m. In another example, efforts to modernise and improve NEPA Limited, known as the revival plan, were completed in August 2022 but showed undue favour to contractors, leading to cost overruns and delays. Meanwhile, the auditor also noted that Bokaro Power Supply Company failed to comply with environmental norms and procured substandard coal, causing operational inefficiencies. These examples underscore systemic issues in governance, emphasising the need for stricter oversight and accountability to mitigate corruption and inefficiencies.

Ethics . . . what ethics?

A code of ethics for civil servants is not enforced

How does one fight corruption in a country when the civil service has an ethics code that does not appear to be enforced and is rife with a lack of accountability among politicians? Despite efforts to establish high standards of both, these issues persist, undermining public trust and the effectiveness of government policies.

The standards date to 1964 and have not seen a major upgrade

The Civil Services (Conduct) Rules, 1964, set the ethical standards for civil servants, emphasising integrity, impartiality and dedication to duty. However, these standards have not been significantly updated to address modern challenges, and enforcement is inconsistent. The nexus between politicians and bureaucrats often leads to compromised integrity and accountability. Disciplinary actions against erring officials are rare, and the constitutional protection under Article 311, which protects civil service officers from dismissal, sometimes hinders swift action against misconduct.

Politicians or criminals

Many politicians are accused of criminal charges

Politicians in India are frequently implicated in corruption scandals, and many face criminal charges. According to a September 2023 report by the nonprofit Association for Democratic Reforms (ADR), 40% of all sitting MPs have criminal cases pending against them, including serious charges such as murder, attempted murder and crimes against women. Specifically, 139 out of 385 BJP MPs and 43 out of 81 Congress MPs face such charges. This high prevalence of criminal allegations among lawmakers poses a significant challenge to ethical governance and accountability.

Figure 4

MPs with criminal cases

Party	No. of MPs with declared cases related to murder	No. of MPs with declared cases related to attempt to murder	No. of MPs with declared cases related to crimes against women	No. of MPs with declared cases of rape
BJP	7	24	10	1
INC	1	1	5	2
YSRCP	1	1	3	1
BSP	1	1	0	0
IND	1	0	0	0
TRS	0	0	1	0
AITC	0	1	0	0
LIP	0	1	0	0
Viduthalai Chiruthaigal Katchi	0	1	0	0
BJD	0	1	1	0
Shiv Sena	0	0	1	0
Total	**11**	**32**	**21**	**4**

Source: ADR report

The Lokpal probes public corruption cases

Wither the corruption prosecutions?

The Lokpal of India, an ombudsman established in 2019 under the Lokpal and Lokayuktas Act of 2013, is tasked with investigating and prosecuting corruption cases against public officials, including the prime minister, ministers, members of parliament, and central government employees. Its mandate includes receiving complaints related to corruption, conducting preliminary inquiries, and, if warranted, ordering full investigations and prosecutions.

There have been thousands of complaints but no prosecutions

Despite its significant role, the Lokpal has faced criticism for its ineffectiveness. Since its inception, it has received over 8,700 complaints but has not prosecuted anyone. According to the Lokpal, many complaints were dismissed due to technicalities, such as improper format. In March 2023, a parliamentary panel recommended that the Lokpal should not reject genuine complaints on technical grounds and should streamline its complaint processing procedures to enhance effectiveness. This recommendation aims to restore public trust and ensure the Lokpal fulfils its role in combating corruption.

Judicial shortcomings impede checks on power

Wherefore art thou judiciary

Corruption in the civil service and political arena continues to undermine governance, but a functioning judiciary is supposed to be an independent check on the other branches of government. In India, though, the public lacks this avenue for relief for myriad reasons, including inertia and corruption.

There is still a significant backlog of cases

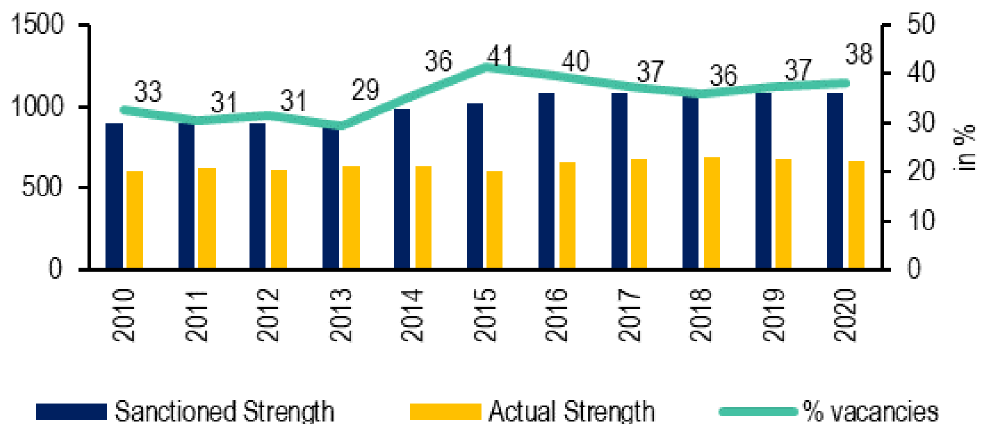
The Indian judiciary faces significant challenges that hinder its effectiveness and efficiency. One of the most pressing issues is the massive backlog of cases. As of June 2023, the National Judicial Data Grid (NJDG) reported over 50 million pending cases across various courts in India. This includes approximately 68,745 cases in the Supreme Court, 6.09 million in High Courts, and 43.8 million in District and Taluka Courts. This backlog has doubled over the past two decades, significantly delaying the delivery of justice.

Judges are in short supply

A critical factor exacerbating this backlog is the shortage of judges. High court vacancies average 30%, sometimes reaching nearly 50%, while subordinate court vacancies average 22%. As of September 2021, the Supreme Court had one vacancy out of the sanctioned strength of 34 judges, High Courts had 42% of sanctioned posts vacant (465 out of 1,098), and Subordinate Courts had 21% of posts vacant (5,146 out of 24,018), according to independent research organisation PRS Legislative Research. This shortage drastically reduces the judiciary's capacity to handle cases efficiently.

Figure 5

Vacancy of judges in high courts



Source: PRS Legislative Research

Corruption allegations damage the Judiciary's reputation

Corruption within the judiciary is another significant concern: allegations of bribery, favouritism and influence peddling have tarnished the judiciary's image. High-profile corruption cases and reports of judicial misconduct have highlighted the need for stringent anti-corruption measures over the years. In April 2018, three judges in Telangana were arrested for holding assets disproportionate to their income, and in Gujarat, two lower court judges were arrested in 2014 for allegedly accepting bribes to settle cases. Instances of judicial corruption continue to emerge, such as the suspension of a special CBI judge in Andhra Pradesh in 2022 for allegedly accepting a substantial bribe, and the arrest of former special CBI judge Sudhir Parmar in 2023 for money laundering. Meanwhile, earlier this year, former chief justice of Madras and Meghalaya, Sanjib Banerjee, who retired in November 2023, claimed that he was transferred in 2021 from Madras to the less prominent high court of Meghalaya after reporting corrupt judges to the Chief Justice of India, backed by evidence. Even previous chief justices of India have been the centre of allegations of corruption and misconduct in recent years.

Resource issues lead to delays and backlogs

Inadequate infrastructure further hampers the judiciary's efficiency. Many courts, especially at the lower levels, suffer from poor facilities, lack of technological resources and insufficient staff. This contributes to delays in case processing and resolution. Outdated procedures and lack of technology slow down case movement through the system, creating procedural bottlenecks and further exacerbating the backlog. Addressing these challenges requires comprehensive reforms, including filling judicial vacancies, enhancing infrastructure, tackling corruption and streamlining procedures.

Supreme Court slams pay-for-hire politics, nixes bonds

The top court rules against anonymous political donations

On 15 February 2024, the Supreme Court ruled that the Electoral Bonds Scheme, which allowed people to make anonymous donations to political parties, was unconstitutional. The court determined that the scheme violated the right to information under Article 19(1)(a) of the Constitution, emphasising the need for transparency in political funding. The scheme, introduced in 2018 to promote transparency, was criticised for allowing anonymous donations, which obscured the true sources of political funding, according to the *Supreme Court Observer*.

It upholds transparency as a cornerstone of an informed electorate

The Court emphasised that transparency in political funding is essential for an informed electorate, and donor anonymity undermines this principle. The ruling deemed amendments to various acts facilitating the scheme unconstitutional as they allowed unlimited corporate donations, potentially leading to quid pro quo arrangements.

The state bank ceases issuance of the bonds as a result

The State Bank of India (SBI), the only bank authorised to issue electoral bonds, was ordered to cease their issuance and disclose all transaction details to the Election Commission, which was instructed to publish this information by 15 March 2024 to enhance transparency and accountability in political financing.

High profile corruption cases emerged

Following the release of electoral bonds data, independent media investigations revealed significant corruption and apparent quid pro quo practices. Major donors to the BJP included companies under investigation by the Enforcement Directorate (ED) and the Income Tax Department (IT). For instance, Future Gaming and Hotels, Megha Engineering and Vedanta contributed substantial amounts shortly after facing federal probes. The data suggested a pattern where these companies purchased electoral bonds soon after being raided. According to media reports, civil society activists claimed these practices amounted to an extortion racket.

Probes suggest donors received lucrative contracts

Further, the investigations indicated that some of these companies received lucrative government contracts shortly after making large donations. Megha Engineering, for example, donated Rs1.4bn (US$16.7m) in electoral bonds in April 2023 and was awarded the Rs144bn Thane-Borivali twin tunnel project a month later. Similarly, Jindal Steel and Power received a coal mine contract just three days after a significant donation, according to unconfirmed reports in *India Today* and *Telegraph India*.

BJP is found to dominate political donations

An independent investigation by media outlets including *Newslaundry*, *Scroll*, and *The News Minute* revealed that the Bharatiya Janata Party (BJP) apparently dominated the share of electoral bonds and other forms of political finance, including contributions from electoral trusts and direct donations through cash and bank transfers. An analysis of the BJP's audited reports between 2018 and 2023 revealed that the party amassed Rs129.3bn (US$1.5bn) in funds from various sources. This sum represents approximately 60% of the total contributions received by all political parties during this period.

BJP received Rs60bn from the bond scheme

According to these reports, the BJP received more than Rs60bn (US$717m) or nearly half of all the funds donated through the electoral bonds scheme since its inception. The second-largest beneficiary was the Trinamool Congress (TMC), which received Rs16bn, followed by the Indian National Congress (INC), which received Rs14bn.

Two non-profits petitioned the Supreme Court for an investigation

On 24 April 2024, two non-profit groups, Common Cause and the Centre for Public Interest Litigation, filed a petition in the Supreme Court seeking an investigation into the alleged quid pro quo arrangements. The petition requested the formation of a Special Investigation Team, supervised by a retired Supreme Court judge, to probe the matter. The petitioners argued that the electoral bonds facilitated corruption, enabling corporations to secure government contracts, licenses and regulatory clearances in exchange for donations.

2. Regulators

India ranks ninth on a score of 53%

In our 2023 CG Watch survey, India ranked ninth in the regulators category with a score of 53%, reflecting both progress and ongoing challenges in the regulatory framework. In 2020, it ranked joint sixth place with the same score. The primary regulatory bodies, including the SEBI, the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE), play crucial roles in maintaining market integrity and investor confidence. Additionally, the Ministry of Corporate Affairs (MCA), through the Companies Act, 2013, and RBI, which oversees financial companies and non-banking financial companies (NBFCs), also significantly impact the regulatory environment of the capital markets.

Enforcement is a drag on the score . . .

While there has been a slight improvement in funding, capacity-building and regulatory reform, enforcement continues to be a significant challenge for the country. The allegations against Adani further highlighted regulatory weaknesses, including loopholes in regulations, potential failure to detect related-party transactions, and lapses in disclosure and compliance with the Listing Obligations and Disclosure Requirements (LODR). Despite the conclusions of a Supreme Court-appointed committee to consider potential regulatory failures by SEBI (see the box on page 23, "Court to SEBI: step up"), the issues underscored by a report by Hindenburg Research in January 2023 cannot be overlooked. Although reforms have been introduced, they may seem too little, too late.

. . . but a new SEBI chair is a breath of fresh air

One of the most significant changes in the regulatory landscape has been the appointment of Madhabi Puri Buch in as the chairperson of SEBI in March 2022. Her leadership brought a fresh perspective and new energy to the regulatory body.[2] Her term as chairperson expires in March 2025.

A new chapter for SEBI

Buch is the first female chair of SEBI

In March 2022, the government surprised the market by appointing Buch as the new chairperson of SEBI to a three-year term, ending in 2025. Buch is a trailblazer in many ways: she is the first woman, the youngest appointee, the first from the private sector, and only the second non-IAS (Indian Administrative Service) officer to hold this position. Her appointment followed a contentious period for the former chairman, Ajay Tyagi.

Her predecessor had a bumpy ride in the post

Tyagi's relationship with the government had been contentious, particularly since 2019, when he refused to transfer SEBI's surplus funds to the Consolidated Fund of India despite considerable governmental pressure - an issue that has never been resolved publicly. His six-month extension in February 2020 seemed almost grudgingly granted, and the subsequent 18-month extension in August 2020 was likely due to the need for stability in the market during the pandemic. Additionally, there was media speculation about dissatisfaction with SEBI's handling of NSE issues, notably the co-location scam and the discovery of governance lapses involving Chitra Ramakrishna, former NSE MD and CEO: enforcement challenges that Buch inherited. Regardless of the reasons, Tyagi was out, and Buch was in, marking a shift in leadership at SEBI.

2.1 Funding, capacity building, regulatory reform

India stays in seventh place with a score of 52%

India's regulatory environment saw a marginal improvement in our scoring, maintaining its seventh rank with a score of 52%, up one percentage point from 2020. Despite this incremental progress in funding and regulatory reforms, challenges remain.

SEBI invests more in technology

One area of improvement was SEBI's investment in technology. Buch's vision is for a data-driven and technologically advanced regulatory environment, and initiatives have included the implementation of AI-based surveillance systems, development of new data analytics projects, and plans to utilise artificial intelligence and machine learning for decision-making processes.

Securities law improves

The modernisation of company and securities laws also saw a positive change, with the score increasing by one point. Efforts by SEBI focused on enhancing transparency and accountability within the corporate sector.

India loses points on public consultations

However, the score for public and written market consultations by financial regulators before major rule changes dropped significantly. This decline reflects concerns about the lack of meaningful engagement with market participants during the regulatory change process. The reduction in consultation feedback periods and the perception that feedback is not adequately considered contributed to this negative assessment.

Funding twists and turns

In our last CG Watch, funding at SEBI was under scrutiny as the government announced plans to have financial regulators transfer their surplus funds to the Consolidated Fund of India (CFI). SEBI's primary source of income is through fees

[2] However, on 10 August, 2024, Hindenburg Research published a new report claiming that Buch was compromised because her husband and she had investments in the same 'obscure offshore funds' used by the Adani Group to siphon funds, leading to SEBI's lack of action against Adani Group companies. The report claims that her continued ownership in a consulting firm has compromised her position. These claims have been strongly refuted by Buch in two separate statements.

Surplus funds are a source of tension

and subscriptions, and the regulator has been obligated since 2002 to transfer all monies collected by way of penalties to the CFI. In 2019, however, the government proposed that SEBI park 75% of its surplus funds in the CFI, and the Finance Bill 2019 included proposed amendments to Section 14 of the SEBI Act, which regulates its funding.

SEBI chair cites independence concerns on moving surplus funds

Tyagi and the SEBI Employees Association opposed these moves, writing to the government and stating that such actions infringed on SEBI's financial independence, which is vital to its function as a regulator.

There is an impasse on the issue

The Bill passed, but the amendments to the SEBI Act have not been enacted, and neither the government nor SEBI has stated whether or how the matter was resolved. Other regulators, such as RBI, continue transferring their surplus to the government, with Rs874.16bn (US$10.44bn) transferred by RBI in 2022-23. Meanwhile, aside from a payment of Rs10bn in 2021-22 to the Government of India as a "one-time measure," with no further explanation given, SEBI's general fund continues to hold a substantial amount. Specifically, it maintained more than Rs45.08bn in FY 2022-23.

Funding at exchanges

Stock exchange funding is simpler

The funding at stock exchanges is more straightforward, they are self-funding through such means as listing fees, transaction charges, data services and technology services. NSE continues to be the largest exchange in India with the highest trading volume; in 2022-23, its total income soared to Rs127.65bn (US$1.5bn) from Rs88.74bn the previous year. This impressive growth was accompanied by a profit after tax of Rs73.56bn, up from Rs51.98bn.

BSE sees a rise in income . . .

Meanwhile, BSE is the only listed exchange and the oldest in Asia, and during FY2022-23, its total income was Rs9.54bn (US$114m), reflecting a 10% increase of Rs904.1m over the previous financial year. This growth was driven by higher income from securities services (up by 12%), data dissemination (up by 8%), and a remarkable 74% increase in income from the sale of software licenses and related services. Additionally, income from corporate services, training institutes and investments also saw notable increases.

. . . but expenses were also up

However, BSE's total expenses for the year rose by Rs1.05bn (up by 18%) to Rs7.06bn (US$83.4m). This increase was primarily due to higher costs related to employee benefits, computer technology, administration and other operational expenses. As a result, the net profit after tax was Rs2.06bn, down 16% from Rs2.45bn in the previous year.

Spending big, but where is the impact?

Despite reserves, regulators remain underfunded

Despite having substantial reserves, the regulators are woefully understaffed relative to the size of the Indian market. This issue was highlighted by the Kotak Committee on Corporate Governance in October 2017, which noted that the US Securities and Exchange Commission (SEC) had one employee per listed company, while SEBI had just one employee for every six listed firms. The committee also pointed out that SEBI's corporate finance department, responsible for assessing the quality of financial statements of listed entities, was particularly understaffed, with the SEC having 15 times more employees.

Growth without transparency

A breakdown on SEBI's budget is lacking

SEBI has grown - as of 31 March 2023, it had 1,073 employees, including 1,000 officers - but so has the number of listed companies. However, SEBI does not provide detailed budget allocations regarding enforcement, investigation and

surveillance. This lack of transparency makes it challenging to assess whether increased spending on human resources is effectively enhancing regulatory capabilities. Equally frustrating is SEBI's failure to provide data on manpower to the enforcement and investigation departments, despite providing detailed tables on grade-wise distribution of staff members, staff members-retired/resigned/deceased, and region-wise distribution of staff members.

Figure 6

SEBI's staff numbers

	2021-22	2022-23
Head office	**858** (87.6%)	**951** (89.5%)
Northern Regional Office	**41** (4.2%)	**36** (3.4%)
Eastern Regional Office	**28** (3.0%)	**26** (2.4%)
Southern Regional Office	**28** (2.9%)	**27** (2.5%)
Western Regional Office	**24** (2.5%)	**23** (2.2%)
Total	**979**	**1,063**[1]

[1] Excludes 10 Staff Members who are on deputation to other organisations as on 31 March 2023.
Source: SEBI Annual Report 2022-23

Internal audit shortcomings are highlighted

Transparency issues

The Principal Director of Audit (finance & communication) that signs off on SEBI's internal control system in the regulator's annual reports noted in the 2021-2022 and 2022-2023 reports that the regulator lacked an internal audit cell or audit manual, which, in our opinion, exacerbated transparency issues. She added that given the size and nature of the Board's activities, the Board should have its own Internal Audit Cell. This raises concerns about the efficient use of resources and the adequacy of internal controls within SEBI.

SEBI chair focusses on technology

Embracing technology

In her maiden chairperson statement in the 2021-22 annual report, Buch stressed that even as SEBI embraces data and technology, the regulator would need "data detectives" to identify misconduct in the markets. She emphasised SEBI's dedication to investing in personnel to develop this capability. A senior SEBI official confirmed that the regulator often hires people on short-term contracts, particularly for technology roles, adding that SEBI's committees are populated by industry experts, ensuring expertise is available when needed. These committees grew exponentially under Ajay Tyagi's leadership, a trend that has proliferated in Buch's tenure.

Exchanges are asked to make further disclosure

Regulatory expectations and disclosures

Ironically, former chairman Tyagi told the exchanges in 2019 that they need to enhance their capacity and manpower to manage and carry out their regulatory responsibilities. To further the irony, the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 mandate exchanges to disclose their spending on regulatory compliance. However, staffing information is not required, and exchanges seem to manage this aspect independently, lacking consistency and transparency.

Inconsistent reporting

Details on budget allocation are mixed

BSE reported spending Rs217.6m (US$2.5m) on regulatory compliance but did not detail staff strength in regulatory departments. NSE, meanwhile, disclosed that it had 631 employees in regulatory functions during FY23 and spent Rs8.35bn on human resources, Rs7.33bn on technology and Rs11.33bn on other financial resources. Despite this, detailed budget allocations and staff numbers in specific regulatory functions were still not provided. However, it was the first time NSE had provided such detail, indicating a step towards greater transparency.

SEBI's technological advancements

SEBI undertakes tech upgrades

SEBI has undertaken significant technological advancements to enhance its regulatory capabilities. These initiatives are aimed at improving efficiency, transparency and security. Some of the key advancements include:

- **Data warehouse and business intelligence system (DWBIS):** SEBI has upgraded its data warehouse and business intelligence systems to better handle market surveillance and investigation data from market infrastructure institutions (MIIs). This includes the migration to a Data Lake, which facilitates the generation of various reports and alerts.
- **Geotagging management solution:** The implementation of a geotagging solution via a mobile application enables SEBI to capture photos and videos with location, date and timestamp details during site visits, surveys and training programmes. This solution is expected to be fully operational in 2023-24.

AI and cybersecurity initiatives

AI is being used to improve market surveillance

SEBI, NSE and BSE have all placed significant emphasis on artificial intelligence (AI) and cybersecurity to safeguard the integrity of the financial markets and enhance their regulatory frameworks. SEBI has been leveraging AI to improve its market surveillance capabilities. AI-powered tools are being used to analyse large volumes of data for patterns indicative of market abuse and other irregularities. These tools help in proactively identifying potential issues before they escalate. SEBI has focused on strengthening its cybersecurity posture through regular threat hunting exercises and the development of a Cyber Capability Index (CCI) to evaluate the cybersecurity readiness of regulated entities and itself. Upgrades to the Security Information and Event Management (SIEM) system have improved attack detection rates and integration capabilities.

NSE leverages advanced tech to monitor disclosure

During our visit to the NSE during our Mumbai annual conference in November 2023, descriptions of their use of technology for parsing and surveilling listed companies and their disclosures was impressive. NSE employs advanced pattern recognition models and AI tools to monitor and analyse disclosures and trading patterns, ensuring compliance and identifying potential market abuses effectively. Furthermore, NSE has enhanced its disaster recovery capabilities significantly, reducing the Recovery Time Objective (RTO) for disaster recovery from 90 minutes to 17 minutes. This enhancement ensures rapid recovery and continuity of operations in the event of a disruption.

BSE beefs up cybersecurity

BSE has also made significant strides in enhancing its technological infrastructure, with a strong focus on cybersecurity. Implementation of various measures have strengthened its ability to detect, respond to, and mitigate cyber threats.

Some market participants feel infringements are selectively pursued

Despite this, market participants who research listed companies' disclosures believe that several disclosure infringements are ignored by the front-line regulators. According to one observer, the exchanges like to "go after big ticket items" like insider trading, which are then handed off to SEBI.

Consultation overload

SEBI shortens consultation periods

SEBI usually provided at least 28 days for a considered response and would take the feedback given into consideration before making any amendments to rules or regulations or in the formation of a regulation. That all seemed to go out the window in 2023 when consultation feedback was shortened to approximately two weeks. This significant reduction in time for feedback was perceived as a regression by many market participants.

The volume of consultations has gone up

Additionally, the number of consultations more than doubled, from approximately 20 in 2022 to more than 50 in 2023. This sudden increase, combined with the shorter feedback periods, overwhelmed many market participants and organisations. The rapid succession of consultations, sometimes multiple on the same day or within a few days of each other, left respondents struggling to provide well-considered, detailed responses.

Overloaded observers question SEBI's intentions

Some respondents argued that SEBI was not genuinely interested in meaningful feedback. Many believed that the outcomes of these consultations were predetermined, rendering the feedback process more of a formality than a genuine attempt to incorporate stakeholder input.

SEBI has responded with slightly longer periods

Following a discussion with SEBI, they have extended the consultation period to 21 days. While this falls short of the previously standard 28 days, it is an improvement over two weeks.

Regulatory reform

Reforms by SEBI have seen some improvements

SEBI has been overhauling the regulatory framework over the past two years and several concerns have been addressed:

- **Introduction of T+1 settlement cycle:** SEBI introduced the T+1 settlement cycle, reducing the settlement time for trades. This aims to improve liquidity and reduce settlement risk, benefiting the overall market efficiency.
- **Dual approval system:** SEBI introduced a dual approval system for the appointment, reappointment and removal of independent directors. Under this system, any resolution for the appointment, reappointment or removal of an independent director must receive approval through a majority of the total votes cast by all shareholders as well as a majority of the votes cast by public shareholders, excluding the votes of the promoter and promoter group. This method ensures that independent directors are not appointed, reappointed, or removed solely based on the will of the controlling shareholders, thereby providing a stronger voice to minority shareholders and enhancing the independence of the board.
- **Disclosure of material events or information:** Introduction of a quantitative threshold for determining the 'materiality' of events or information:
  - two percent of turnover, as per the last audited consolidated financial statements of the listed entity;

- two percent of net worth, as per the last audited consolidated financial statements of the listed entity, except in case the arithmetic value of the net worth is negative;
- five percent of the average of absolute value of profit or loss after tax, as per the last three audited consolidated financial statements of the listed entity.

Stricter timelines for disclosure have been set: within 30 minutes for decisions made in board meetings and within 12 hours for events originating within the listed entity. Market rumours must be verified and confirmed, denied, or clarified by the top 100 listed entities by market capitalisation effective from 1 June 2024, and by the top 250 listed entities from 1 December 2024.

- **Strengthening CG by empowering shareholders:** Shareholders' approval every five years is now required for any special rights granted to shareholders, addressing the perpetuity of special rights. Enhancements have been made to the mechanisms for the sale, lease, or disposal of an undertaking of a listed entity, and shareholders' approval every five years for any director serving on the board to prevent permanent board seats.

  However, ACGA believes this rule needs to be strengthened because approval is currently granted through an ordinary resolution rather than a special resolution. In cases where the individual is part of the promoter or promoter group, re-election is almost guaranteed due to the typically high promoter shareholding in family-owned businesses, ergo a permanent directorship.

- **Filling vacancies:** Listed entities are required to fill vacancies of directors, compliance officers, CEOs and CFOs within three months to ensure these critical positions are not left vacant.

- **Disclosure for certain types of agreements:** SEBI now mandates disclosure for certain types of agreements that are binding on listed entities. This change aims to enhance transparency regarding significant agreements that could impact the financial or operational aspects of listed companies.

Governance U-turn

SEBI backtracks on split roles of chair and CEO

In February 2022, SEBI did an about-face on mandating the separation of the roles of chairman and CEO for listed companies, making the separation of roles voluntary rather than mandatory. This rule, which was to have been effective in 2020, had been pushed back until April 2022. SEBI reversed the decision at Tyagi's last SEBI Board meeting in February 2022.

There had been significant industry pushback

This move came after considerable pushback from industry stakeholders, who argued that the mandatory separation imposed undue burden and was not suitable for all companies, particularly those with smaller boards or specific business structures. The SEBI Board acknowledged these concerns, noting that while the principle of segregating the roles of chairman and CEO was in the interest of better and more balanced governance structures, the one-size-fits-all approach may not be suitable given the varied business practices and sizes of companies listed in India.

Compliance had been an issue

Since the initial proposal in 2020, compliance levels showed minimal improvement. As of September 2019, 50.4% of the top 500 listed companies had adopted the separation, which only increased to 54% by December 31, 2021 - a mere 4% in more than two years. It indicated the significant resistance by many companies.

SEBI opts for a voluntary approach as a compromise

SEBI stated that the voluntary approach would allow companies to adapt the governance norms in a manner best suited to their individual circumstances. The decision was framed as a balanced compromise, aiming to promote good governance practices while also accommodating the practical challenges faced by companies.

Critics see it as a step backwards

Critics of the reversal, however, argued that the decision undermined the progress made in corporate governance reforms. It signalled inconsistent political support for stringent governance norms and potentially weakened the checks and balances within companies, making it easier for governance issues to arise.

The U-turn highlights wider CG challenges

The role reversal reflects broader challenges in India's regulatory environment, where efforts to ease business regulations and reduce compliance burdens can sometimes conflict with the goals of enhancing corporate governance standards.

Adani case triggers a probe into regulatory failures

Court to SEBI: step up

In March 2023, the Supreme Court appointed a six-member expert committee led by Justice AM Sapre to investigate potential regulatory failures by SEBI following significant investor losses due to allegations by Hindenburg Research against the Adani Group. The report accused the group of share price manipulation and accounting fraud, among other things. By May 2023, the committee had submitted its report, which cleared SEBI of wrongdoing but proposed several recommendations of reform for the regulator and to enhance the securities market framework.

Several recommendations are made

Key recommendations for SEBI

- **Structural reforms:**
  - SEBI should enhance transparency in law-making and include more societal participation to boost compliance.
  - Citing statistics that proceedings initiated by SEBI in 2021-22 skyrocketed to 7,195 cases from 562 in 2020-21 and 249 in 2019-20, it recommended enforcing strict timelines for investigations, proceedings and settlements.
- **Effective enforcement:**
  - Optimise resources with clear enforcement policies, aligning with legislative guidelines and being proactive.
  - Develop a robust settlement policy with objective criteria, ensuring settlements are appropriate and timely.
- **Judicial discipline:**
  - Maintain consistency in decisions by adjudicating officers and whole-time members, following precedents and higher authority decisions.
- **Surveillance and market administration:**
  - Reduce human discretion in surveillance, reserving it for exceptional circumstances only.
- **Transparency and real-time disclosures:**
  - Implement platforms for real-time company information disclosure to aid informed investor decisions.
  - Encourage companies to adopt International Financial Reporting Standards (IFRS) for consistent financial reporting.

Recommendations for the government

- ❑ **Regulatory independence:**
  - ■ Strengthen SEBI's independence from political and industrial pressures to ensure impartiality.
  - ■ Create independent review panels with legal and financial experts for objective oversight.
- ❑ **Legal and structural reforms:**
  - ■ Address overlapping corporate laws that complicate SEBI's regulatory role.
  - ■ Establish a Central Authority for Unclaimed Property to manage unclaimed private assets effectively.
- ❑ **Collaboration and knowledge exchange:**
  - ■ Formalise information sharing and joint investigations between SEBI and other regulatory bodies, such as central banks.
  - ■ Engage with international regulatory bodies to align India's market regulations with global best practices.

Broader regulatory framework enhancements

- ❑ **Investor protection:**
  - ■ Implement measures such as position disclosure thresholds and circuit breakers to curb manipulative short selling.
  - ■ Provide real-time alerts and simplify disclosures for stocks under additional surveillance measures.

The Supreme Court urges a coordinated response

However, SEBI expressed concerns about the feasibility of implementing a number of these recommendations on its own. The Supreme Court, however, emphasised the need for a constructive approach and encouraged collaboration between SEBI, the government and the expert committee to effectively implement these recommendations.

Changes to FPI disclosure

In light of the January Hindenburg report on the Adani Group and the subsequent findings by the Supreme Court appointed committee, SEBI issued a new circular on 24 August 2023, announcing additional disclosure requirements for certain foreign portfolio investors (FPIs). The committee recognised that SEBI had created a conundrum for itself by accepting the 2018 Working Group recommendations to remove provisions on "opaque structure," making it difficult to identify the ultimate beneficial owners.

The committee found that while SEBI's regulations conformed with the Prevention of Money Laundering Act (PMLA) requirements, there were still opaque structures in ownership of FPIs, making it difficult to identify “the last natural person above every person owning any economic interest in the FPI.” The new measures, which would come into effect on 1 November, 2023, aimed to increase transparency and prevent potential misuse of the FPI route to circumvent existing regulations.

SEBI's observations regarding FPIs holding large, concentrated equity positions and the associated concerns appear to be an ongoing issue highlighted by the recent investigations and findings of the Supreme Court appointed committee. Specifically, SEBI's investigation into the ownership of 13 overseas entities with "opaque" structures began in October 2020, which revealed difficulties in identifying the ultimate beneficial owners.

Key amendments

To address these concerns, SEBI amended the FPI Regulations, 2019. The new rules mandate that FPIs meeting certain criteria must disclose detailed information about entities holding any ownership, economic interest, or control, including:

- FPIs holding more than 50% of their Indian equity Assets Under Management (AUM) in a single Indian corporate group.
- FPIs, individually or as part of an investor group, holding more than Rs250bn (US$2.98bn) in equity AUM in the Indian markets.

Exemptions:

Certain FPIs are exempt from these disclosures, including:

- Government and government-related investors.
- Public retail funds (PRFs).
- Exchange-traded funds with less than 50% exposure to India.
- Diversified pooled investment vehicles.
- FPIs under statutory restrictions, newly registered FPIs and those winding down their investments.

Implementation and compliance

FPIs that exceed the specified thresholds must realign their holdings within designated timelines or provide the necessary disclosures. Non-compliance will result in the invalidation of their FPI registration, requiring them to exit the Indian market within 180 days. SEBI will enforce these regulations through mechanisms established by depositories and stock exchanges.

2.2 Enforcement

India drops one place to rank equal ninth on a score of 54%

India's enforcement score fell by two percentage points to 54% in 2023, causing it to drop one place to joint ninth with Thailand. It placed India below Malaysia, which scored 60%, but above the Philippines, with a score of 24%.

Insider trading

SEBI consults on changes to PSI definitions

Among the numerous consultations that SEBI put out in 2023, one in May was on amending the definition of unpublished price-sensitive information (UPSI) under the SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT). The aim was to enhance regulatory clarity and uniformity in compliance and proposed re-including "material events" as defined under Regulation 30 of the SEBI (listing obligations and disclosure requirements) Regulations, 2015, within the ambit of UPSI.

The term had been omitted in 2019 following recommendations from the committee on fair market conduct. At the time, "material events in accordance with the listing agreement" were considered UPSI, and the committee argued that not all material events were necessarily price sensitive. SEBI removed the term and expected companies to adhere to the regulations "in spirit," exercising sound

The omission of the phrase ‘material events’ had led to a loophole

judgement in categorising information as UPSI. However, this expectation proved to be a loophole that companies exploited, avoiding stringent scrutiny by not classifying critical information as UPSI.

SEBI looks to press releases to understand the repercussions

SEBI, along with the stock exchanges, studied 1,100 press releases from the top 100 listed companies between January 2021 and September 2022. Of the total press releases where price movement in the scrip of the companies, adjusted for movement in the Nifty/Sensex was more than 2%, only 8% of press releases leading to significant share price movements were categorised as UPSI. This selective disclosure indicated that companies often overlooked the broader implications on market prices and categorised only the items “explicitly mentioned” in the PIT regulations as UPSI.

Critique

Broadening the definition leads to compliance concerns

Despite the well-intentioned nature of these amendments, several lawyers and law firms have taken exception to the proposal, stating that they pose practical challenges. Regulation 30 of the listing regulations mandates the disclosure of various events, many of which may not always be price sensitive. For example, the resignation of an auditor or changes in senior management, while important for transparency, do not necessarily impact share prices. The broad classification of these events as UPSI could impose additional compliance burdens on companies, particularly in pre-clearance of trades and maintenance of trading windows.

Clarity on UPSI is sought from the regulator

Some lawyers suggest that SEBI, instead of rushing to change the rules, should focus on providing clearer guidelines and specific examples of what constitutes UPSI.

Governance lapses at NSE

A scandal at NSE unfolds

The governance of MIIs took a significant hit with the exposure of lapses at NSE, which was particularly shocking given its status as the premier exchange in India. The situation was exacerbated by SEBI's delayed response to a whistleblower complaint received in 2015, which market observers state sat unaddressed for a significant period. As the case unfolded, it was revealed that the MD and CEO, Chitra Ramkrishna, had been sharing sensitive information with a stranger and engaging in questionable hiring practices while other senior officials, including the compliance officer, covered up for her.

The case dates back to 2015

The NSE co-location case dates back to 2015 when a whistleblower filed a complaint with SEBI alleging irregularities in NSE's co-location facilities. Co-location allows traders to place their servers within the same premises as the stock exchange’s servers, providing them faster access to trading data and execution of trades due to reduced latency. The complaint alleged that certain traders, in collusion with NSE officials, were given preferential access to the exchange's systems, resulting in market manipulation and significant financial gains.

SEBI rebukes executives

In April 2019, SEBI imposed significant penalties on NSE and several of its top executives:

- **Fines and disgorgement:** NSE was ordered to return Rs6,248.9m (US$74.49m), which represented the profits earned from the co-location services, along with an additional 12% interest accruing from April 2014 onwards.
- **Prohibitions and directives:** NSE was barred from accessing the securities market directly or indirectly for a period of six months and required to conduct regular system audits and reconstitute its technology committee.

Several of SEBI's penalties were set aside on appeal

SAT reverses

The SEBI order was appealed and the Securities Appellate Tribunal (SAT) set aside several penalties imposed by SEBI in January 2023, including:

- **Reduction in penalties**: SAT directed SEBI to reassess the quantum of fines, considering them excessive. Specifically, SAT reduced the disgorgement amount from Rs6.2bn (US$74m) to Rs1bn (US$11.9m).
- **Re-evaluation of evidence**: SAT criticised SEBI for not providing sufficient evidence to justify the severity of some allegations. It called for a more evidence-based approach in reassessing penalties.
- **Proportionality of punishment**: SAT emphasised the need for penalties to be proportionate to the violations, ensuring they are justifiable and not unduly harsh.

SEBI is rebuked for being slow to act

SAT also highlighted SEBI's slow approach, stating, "We find that SEBI had adopted a slow approach and, in fact, was placing a protective cover over NSE's alleged misdeeds. It is only when questions were placed on the floor of the Parliament that SEBI woke up and instituted an investigation. Considering the gravity of the alleged charges, SEBI should have conducted the investigation itself instead of delegating it to NSE. It is strange and it does not stand to reason as to how SEBI directed NSE to conduct an investigation against itself. It is clear that a casual approach was adopted." SEBI has appealed the decision in the Supreme Court, which deferred the appeal in November 2023 to March 2024.

Other cases related to the co-location scam were also brought against NSE and its officials, including allegations of providing differential access to certain broking firms via dark fibre - an already laid but unused or passive optical fibre. The June 2022 SEBI order in that case was also overturned by SAT in December 2023.

The role of a mystery yogi is revealed

SEBI's order and the Himalayan yogi scandal

The governance issues at NSE were compounded by the revelations involving Chitra Ramkrishna, the MD and CEO at the time. During the co-location investigation, Ramkrishna was found to have been sharing sensitive company information with an individual she referred to as a "Himalayan Yogi." This was later revealed to be Anand Subramanian, Group Operating Officer at NSE. Ramkrishna had appointed Subramanian to this influential role without following proper hiring procedures bypassing the Nomination and Remuneration Committee.

SEBI acts on fiduciary breaches

SEBI's investigation and orders

SEBI's investigation uncovered that Ramkrishna shared confidential information, including NSE's financials and business plans, with Subramanian, who had no formal role that justified such access. This breach of fiduciary duty and corporate governance norms led to SEBI imposing the following sanctions in February 2022:

- **Fines:** Subramanian and Ramkrishna were fined Rs20m (US$239,000).
- **Prohibition:** Both individuals were barred from associating with any MII or listed company for a period of three years.

Critics see the penalties as lacking

Impact and critique

Despite these actions, the penalties were seen as insufficient by many in the market. Critics argued that SEBI's delayed response and the relatively lenient fines did not adequately address the severity of the governance failures at NSE. The scandal underscored significant lapses in corporate governance and regulatory oversight, raising questions about the effectiveness of SEBI's enforcement mechanisms and the overall integrity of India's financial markets.

A committee formed by SEBI looks at conflicting roles

In the wake of NSE's fall from grace, SEBI formed a committee in 2022 under the chairmanship of former Whole Time Member, G Mahalingam, to strengthen the governance of MIIs. SEBI noted that MIIs were unique institutions providing essential infrastructure for trading, settlement and record-keeping. They held regulatory responsibilities while also pursuing commercial interests like other profit-oriented entities. Due to the conflicting nature of their roles, the committee emphasised that their governance standards needed to be exceptionally robust.

Accepted and implemented

SEBI makes recommendations to improve governance

Based on the recommendations of the committee and public comments, SEBI board approved various amendments to the 2018 SECC regulations and 2018 depositories and participants (D&P) regulations to strengthen governance norms relating to MIIs. The major amendments include the following:

- **Categorisation of functions**: The functions of MIIs have been categorised into three verticals: Critical operations; regulatory, compliance, risk management and investor grievances; and other functions. MIIs are required to prioritise the functions under the first two verticals over other functions.
- **Appointment process**: The process for appointing public interest directors (PIDs), non-independent directors (NIDs), and the managing director (MD) has been rationalised. PIDs must now have skill sets in areas such as capital markets, finance and accountancy, legal and regulatory, and technology, while ensuring a balanced expertise on the governing board. Additionally, SEBI is empowered to suo-moto (on its own motion) appoint PIDs to the governing board of MIIs.
- **Transparency enhancements**: To enhance transparency, MIIs are required to disclose the agenda and minutes of governing board meetings related to regulatory, compliance, risk management and investor grievances on their websites.
- **Independent performance assessment**: An external agency will independently assess the performance of MIIs and their statutory committees.
- **Key managerial personnel (KMP) definition and compensation**: The definition of KMPs and their compensation policy related to variable pay has been revised to improve overall accountability.

These measures aim to align with global best practices and address the dynamic challenges of the securities market.

Are the figures meaningful?

SEBI takes up more investigations

SEBI took up a total of 144 new investigation cases in the fiscal year 2022-23. These cases covered various violations and complaints related to securities laws, including insider trading, market manipulation and financial statement fraud. During the same period, SEBI successfully disposed of 152 cases, which included the imposition of monetary penalties, issuance of directives for corrective actions, and, in some instances, suspension or cancellation of registrations of market intermediaries.

Here are the figures on cases

Figure 7

SEBI's investigation cases

Type	No. of Investigations taken up		No. of investigations completed	
	2021-22	2022-23	2021-22	2022-23
Insider trading	17	85	48	75
Market manipulation and price rigging	38	54	82	67
Takeovers	0	0	5	0
"Issue" related manipulation	0	0	1	0
Miscellaneous	4	5	33	10
Total	**59**	**144**	**169**	**152**

Source: SEBI Annual Report 2022-23

There were 127 prosecutions

SEBI's enforcement actions also extended to conducting 87 inspections of stockbrokers and 28 inspections of depository participants. The regulatory body issued prohibitive directions against 688 entities. Additionally, SEBI filed 127 prosecutions and disposed of 47 cases. Adjudication proceedings were initiated in 6,850 cases, with 11,824 cases disposed of during the year.

Caseload over time

Figure 8

Age-wise analysis of SEBI's enforcement actions - adjudication proceedings

Particulars	2021-22	2022-23
Cases pending at the beginning of the period	488	6,924
Cases added during the period	6,982	6,850
Cases disposed of during the year	546	11,824
Cases pending at the end of the period	6,924	1,950

Source: SEBI Annual Report 2022-23

The nature of cases is however unclear

While SEBI provides a lot of data, including age-wise analysis of enforcement actions and how long cases have been pending, the nature of these cases remains unclear. Although the regulator might argue that many cases involve multiple violations, SEBI also classifies cases by the main charge, and they should consider applying this classification for greater clarity. Furthermore, while SEBI's website is very informative and its members' or SAT's orders are complete, it is slow going if one is searching by the nature of a case.

Transparency in short supply

Enforcement data from exchanges is an issue

One of the significant concerns highlighted in the survey was the transparency and accessibility of enforcement data by the exchanges. Despite some improvements, enforcement data on the NSE is often challenging to access, and typically available only in downloadable format that is sometimes corrupted. It raises questions about the reliability of these disclosures.

Compliance data also poses challenges

Both the NSE and BSE face significant issues with how compliance data is reported. On the NSE, compliance data often comes in Excel formats that can be corrupted or contain embedded PDFs that cannot be opened, making it difficult for stakeholders to access and review the information efficiently. These technical and accessibility issues contribute to the perception that the transparency and effectiveness of disclosures are inadequate, leading to the belief that it is not a priority for the exchanges.

NSE enforcement disclosure improves

However, NSE has become better at reporting its enforcement activities in its annual report, including some of the technology enhancements it has made in surveillance and monitoring.

NSE surveillance and investigations

Figure 9

NSE's surveillance measures and investigation report 2022-23

Particulars	Count
Additional surveillance measure (ASM) - IBC[3]	74
ASM - long term	453
ASM - short term	581
High encumbrance (promoter pledge)	58
Graded surveillance measure (GSM)[4]	28
No. of investigation reports submitted to SEBI	**Unique scrips[5] covered in these investigation reports**
41	Scrips - 488, Contracts - 992

Source: NSE Annual Report 2022-23

NSE enforcement issued 119 show cause notices

The NSE has disciplinary jurisdiction over its trading members, which lies with the Member and Core Settlement Guarantee Fund Committee (MCSGFC). During the financial year 2022-23, the enforcement team issued 119 show cause notices and placed over 3500 cases before the MCSGFC. The committee imposed a monetary penalty of approximately Rs250m (US$2.9m), ordered the disablement/suspension of three members, and declared one member as a defaulter.

The exchange delisted four companies

In the financial year 2022-23, the NSE delisted four companies that had been suspended for more than six months due to non-compliance with the erstwhile Listing Agreement or SEBI (LODR) Regulations, 2015, and failed to complete the formalities for revocation within the stipulated timelines. Additionally, the exchange delisted one company that had been suspended for over six months due to liquidation.

BSE is disclosing less information on enforcement

Usually, BSE has been more thorough in previous years but like its website, it seems to be contracting in reporting in the annual reports as well. For the FY 2022-2023, BSE noted that it had generated 42,496 surveillance alerts, of which 872 were taken up for snap investigations. Subsequently, until 31 March 2023, 157 cases were taken up for preliminary or detailed investigations, of which 89 preliminary/ investigation reports were forwarded to SEBI.

3. CG rules

India stays in sixth place with an improved score of 73%

India remains in the sixth position compared to 2020 but has shown significant improvement in its overall score, which increased by four percentage points to 73% in 2023. While India has made strides, others have done more. India is just behind Hong Kong and Thailand, jointly ranked fourth with a score of 75%, and ahead of Taiwan, which stands at 71%. The improvement in India's ranking is largely attributed to its enhanced efforts in ESG reporting, reflecting the country's commitment to global best practices.

BRSR to BRSR Core

The BRSR framework posed challenges in comparing companies with global peers

SEBI introduced the Business Responsibility and Sustainability Reporting (BRSR), India's version of ESG reporting, to the market in 2021. The format was comprehensive, data-rich and specific to companies, requiring detailed statistics on various ESG matters, including energy and water consumption, emissions and employee metrics such as gender diversity, and became mandatory for the top 1,000 companies in FY 2022-23. However, an issue that international investors did

[3] ASM - IBC Additional Surveillance Measures (ASM) on companies under Insolvency and Bankruptcy Code (IBC).

[4] Graded surveillance measure (GSM): In continuation with various surveillance measures already in place, these are additional measures that SEBI and Exchanges have implemented on securities whose prices do not align with their financial health and fundamentals, such as earnings, book value, fixed assets, and net worth.

[5] Scrips are securities listed on the exchange.

raise was that it failed to align with global sustainability reporting standards like the Global Reporting Initiative (GRI), SASB and TCFD. If a company used such standards, the BRSR framework allowed it to state that, but then this made it difficult to compare companies within a sector in India.

BRSR Core aimed at improving comparability of ESG disclosures

Recognising the need for more rigorous and standardised reporting, SEBI introduced the BRSR Core in July 2023. The BRSR Core builds on the original BRSR, aiming to enhance the credibility and comparability of ESG disclosures. It emphasises nine critical ESG attributes, covering areas such as greenhouse gas emissions, water usage, waste management, employee well-being, gender diversity, and fairness in customer and supplier engagements.

The framework aimed to address several issues

The rationale for the BRSR Core framework addresses several key issues. Enhanced credibility is a primary goal, achieved by requiring reasonable assurance from independent agencies on ESG reports to minimise the risk of greenwashing and ensure the reliability of disclosed information. Increased transparency is also a critical aim, with detailed and standardised disclosures on essential ESG attributes providing a clearer picture of a company's sustainability practices. Aligning with international ESG standards, even while tailored to the Indian context, helps Indian companies meet global expectations and attract international investment. However, global institutional investors are asking SEBI to align the BRSR Core with IFRS S1 and S2 to allow for comparability across borders and in sectors. Finally, enhanced ESG reporting and independent assurance build investor confidence, making Indian companies more attractive to ESG-focused investors.

There are nine ESG attributes in the framework

The framework addresses nine ESG attributes, including:

- **Greenhouse gas emissions**:
  - Disclosure of Scope 1 and Scope 2 emissions.
  - Intensity ratios reflecting emissions per unit of revenue or production.
- **Water footprint reporting**:
  - Detailed disclosures on water usage, including sources and discharge practices.
  - Intensity ratios indicating water usage efficiency.
- **Investments in sustainable technologies**:
  - Disclosure of investments in R&D and capital expenditures aimed at improving environmental and social impacts.
- **Circularity and waste management**:
  - Metrics on waste generation, recycling and disposal.
  - Efficiency metrics in waste management.
- **Employee well-being and safety**:
  - Measures taken for employee well-being and safety.
  - Costs incurred as a percentage of total revenue.
  - Reporting on safety-related incidents.
- **Gender diversity**:
  - Gross wages paid to female employees as a percentage of total wages.

- Data on complaints filed under the Prevention of Sexual Harassment (POSH) Act.

- **Inclusive development**:
  - Sourcing from micro, small, and medium enterprises (MSMEs) and employment practices in smaller towns.
  - Disclosures on input materials sourced from MSMEs and wages paid in smaller towns.
- **Fairness in customer and supplier engagement**:
  - Reporting on media sentiment analysis.
  - Number of days of accounts payable, reflecting transparency in dealings.
- **Business openness**:
  - Concentration of transactions with related parties.
  - Details on loans, advances and investments involving related parties.

A phased adoption of BRSR Core is proposed

SEBI has proposed a phased implementation for reasonable assurance of BRSR Core disclosures. Starting with the top 150 listed entities in FY 2023-24, the requirement will expand to cover the top 250, 500, and 1,000 entities by FY 2026-27. This phased approach allows companies to gradually enhance their reporting capabilities and ensure compliance.

SEBI's ESG assurance mandate: seeking clarity and addressing concerns

An ESG assurance mandate is outlined

On 12 July 2023, SEBI's circular outlined the BRSR Core framework, but it also outlined the mandate for assurance providers, stating they must not have any conflicts of interest, including selling products or offering any non-audit services, such as consulting, to the listed entity or its group entities.

Concerns raised by assurance providers

Service providers voice concerns with the assurance rules

However, according to an article in the Economic Times, top professional services firms expressed concerns that SEBI's regulation was overly restrictive. They argued that the prohibition of offering non-audit services, even those permissible under Section 144 of the Companies Act, 2013, to their audit clients could create capacity and operational challenges. Section 144 allows auditors to provide certain non-conflicting services, such as tax compliance, with the approval of the audit committee or board of the company. However, SEBI's regulation disallowed these services for ESG assurance providers, which assurance firms argued would limit their ability to serve their clients effectively. A partner at BSR & Co highlighted that the SEBI regulation extended conflict assessment beyond the immediate subject matter within the company to its entire group, making it overly restrictive. This potentially excluded many large multinational professional services firms that operate through legally separate affiliate firms in India.

Concerns from other professional bodies

The guidelines also draw ire from professional groups

Beyond statutory auditors, other Indian professional bodies were also upset with SEBI's guidelines. They argued that statutory auditors should not be the sole providers of ESG assurance, as they may lack the necessary expertise in specific ESG-related areas. The Institute of Chartered Accountants of India (ICAI) released two standards for assurance engagements on sustainability information: SSAE 3000, Assurance Engagements on Sustainability Information, and SSAE 3410, Assurance Engagements on Greenhouse Gas Statements. However, these standards applied primarily to chartered accountants.

Internationally, standards such as ISAE 3000 (Revised) (International Standard on Assurance Engagements) and the upcoming ISSB 5000 (General Requirements for Sustainability Assurance Engagements) - expected to be issued at the end of 2024 - are both professionally agnostic. These standards allow for a broader range of professionals to conduct ESG assurance, not limiting it to statutory auditors. The professional bodies emphasised that other experts, such as cost accountants and company secretaries, should also be allowed to offer ESG assurance services, given their knowledge and frameworks in place. They believed that diversifying the pool of ESG assurance providers would ensure a more comprehensive and specialized approach to ESG reporting.

Need for clarification

Clarity from SEBI is sought

The ambiguity in SEBI's guidelines regarding who can provide ESG assurance need clarification. While SEBI has not explicitly stated that only statutory auditors could perform ESG assurance, the current interpretation of the regulation suggested a preference for auditors, which has led to confusion and concern among other professional service providers.

On May 22, 2024, SEBI released a consultation paper on the recommendations of the Expert Committee for Facilitating Ease of Doing Business with respect to BRSR. The paper aimed to address specific concerns, including a proposal to amend the term 'assurance' to either 'assessment' or 'assurance or assessment.' The expert committee suggested this change because the term "assurance" had been "inadvertently" aligned with the audit profession. Additionally, the committee referenced one of IOSCO's guiding principles, which states that "third-party assessment of sustainability-related corporate disclosures should remain independent of any specific profession," as another reason for proposing the change. However, the response from ACGA's India Working Group pointed out a significant difference between assurance and audit. They argued that any misalignment in understanding should not prevent SEBI from ensuring the quality of sustainability reporting validation, especially as non-audit firms are increasingly providing ESG assurance globally.

ESG ratings

Rules for ESG rating providers are introduced

SEBI has also introduced a regulatory framework for ESG Rating Providers (ERPs) in July 2023 to ensure the reliability of ESG ratings. This framework aims to mitigate greenwashing risks and enhance the credibility of ESG ratings used by investors. SEBI has identified 14 ESG parameters tailored to the Indian context, which must be integrated into at least one of the ESG ratings for Indian companies. These parameters cover critical areas such as energy efficiency, water management, waste management, job creation, gender diversity and corporate governance practices. ERPs are required to offer Core ESG Ratings based on assured or verified data, minimizing reliance on self-reported data and enhancing the reliability of ESG ratings. SEBI's regulatory framework mandates transparency in rating methodologies and requires ERPs to disclose the rationale behind their ratings, ensuring that investors have a clear understanding of how ESG ratings are determined and can make informed investment decisions.

Measures to improve transparency on ESG funds are introduced

In addition to enhancing ESG reporting and ratings, SEBI has introduced stringent measures to ensure higher transparency and accountability for ESG funds. These funds are required to invest at least 65% of their assets in companies that report comprehensive BRSR and provide assurance on BRSR Core disclosures. This requirement encourages companies to enhance their ESG reporting and obtain

third-party assurance. The remaining investments must be in companies reporting BRSR, ensuring a robust ESG focus across the portfolio. From FY 2024-25, ESG products must obtain independent assurance that their portfolios comply with their stated strategies and objectives. This assurance process, starting on a "comply or explain" basis, will become mandatory, ensuring that ESG funds adhere to their claimed ESG criteria. Additionally, fund managers or the board of Asset Management Companies (AMCs) must certify that their ESG schemes meet these standards based on a comprehensive internal ESG audit.

Enhanced stewardship

Voting decisions must be disclosed

To improve transparency, managers of ESG products must disclose their voting decisions, highlighting whether votes were influenced by environmental, social, or governance reasons. In instances where the voting approach for ESG and non-ESG schemes differs, AMCs must provide detailed rationales for the votes cast. This enhanced disclosure ensures that investors are aware of the stewardship activities and engagements undertaken by ESG funds. Fund managers are required to provide an annual commentary detailing how ESG strategies were applied, engagements with portfolio companies, and the outcomes of these engagements. This commentary must also include the percentage of AUM invested in companies without BRSR disclosures and its impact on the fund's ESG score. To avoid confusion and ensure clarity, SEBI has introduced standardised sub-categories for ESG schemes, including exclusions, integration, best-in-class & positive screening, impact investing and sustainable objectives. ESG schemes must include the specific ESG strategy in their names, such as "XYZ ESG Exclusionary Fund," to accurately reflect their investment approach. Spreading the stewardship net farther, in August 2023, the securities regulator amended both the real estate infrastructure trust and infrastructure investment trust (InvIT) regulations. These amendments require unitholders with at least 10% of the total outstanding units of a REIT or InvIT to comply with stewardship principles and accordingly formulate a comprehensive stewardship policy. This move is part of a broader effort to ensure that the principles of good governance are adhered to across various investment vehicles, collectively referred to as the 'Indian Codes'.

SEBI's balancing act on independent directors

Former insiders are subject to a three-year cooling off period . . .

Following a consultation in March 2021 on "Review of Regulatory Provisions Related to Independent Directors", SEBI announced amendments to the LODR in August 2021. One significant amendment was the introduction of a uniform three-year cooling-off period. This means that KMPs, employees of promoter group companies, and their relatives must observe a three-year gap before becoming eligible for appointment as independent directors. SEBI implemented this change to ensure a higher standard of independence and to harmonize the various cooling-off periods that previously existed for different eligibility conditions. The rationale was that a uniform three-year period would balance the need for independence while still allowing qualified individuals to serve as IDs.

. . . but the pool of potential candidates is widened

While this change is a positive step, it is not without its limitations. Previously, the cooling-off period was only two years, so the extension to three years is a modest improvement that acknowledges the need for a greater separation between potential conflicts of interest and independent oversight. However, SEBI's decision to allow relatives of employees who are not KMPs to be considered for independent directorship weakens this strengthened criterion. This provision means that while a more extended cooling-off period is in place, the eligibility criteria have been broadened in another respect, potentially diluting the intended independence of

IDs. This amendment appears to be a concession to the practical difficulties in finding sufficiently qualified IDs while maintaining a degree of familial separation from the company's operations. Overall, SEBI's amendments, which became effective on January 1, 2022, represent two steps forward and one step back in the pursuit of robust corporate governance. The introduction of a uniform three-year cooling-off period enhances the independence of IDs but is somewhat undermined by the relaxation of rules regarding the eligibility of relatives of non-KMP employees. Despite this, the changes reflect a commitment to incremental improvement and a response to stakeholder feedback, indicating a progressive, albeit cautious, approach to reform.

Amendments to RPT: Why so late?

In September 2021, the SEBI Board approved amendments proposed by the Working Group on Related Party Transactions (WG) in January 2020. The Group reviewed three key areas related to RPTs and made recommendations on the following:

i. Definitions;

ii. Approval requirements and materiality thresholds;

iii. Disclosure Requirements, including information to be provided to shareholders while seeking approval and periodic disclosure to the stock exchanges; and

iv. Strengthening the monitoring and enforcement of the regulatory norms related to RPTs.

In November 2021, SEBI published the SEBI (Listing Obligations And Disclosure Requirements) (Sixth Amendment) Regulations, 2021. Major amendments included:

- **Expanding the scope of related parties:**
  - **Inclusion of Promoters and Promoter Group Entities**: Any person or entity that is part of the promoter or promoter group of a listed entity is automatically considered a related party, ensuring transactions involving individuals or entities with a significant influence on the company are subject to related party regulations.
  - **Equity shareholders**: Up until March 31, 2023, Any person or entity holding 20% or more of the equity shares in a listed entity, either directly or indirectly, or on a beneficial interest basis is considered a related party. On 1 April, 2023, the threshold is further reduced to 10%, significantly broadening the number of stakeholders who are classified as related parties.
  - **Extended coverage**: The amendment also includes any entity that holds a significant stake in the listed entity at any point during the preceding financial year.
  - **Broadened definition of RPTs:** Significant amendments to the definition of RPTs in the LODR, effective April 2022, expanded the scope to include transactions not only between the listed entity and its related parties but also between the listed entity's subsidiaries and related parties. Additionally, transactions benefiting a related party, regardless of the intermediary party involved, are now considered RPTs. This change aims to close loopholes that previously allowed companies to bypass RPT regulations by channelling transactions through subsidiaries.

- **Audit Committee Approval:**
    - **Mandatory Approval**: All RPTs and any material modifications to those transactions must be approved by the audit committee. Crucially, only independent directors (IDs) on the audit committee are permitted to give this approval, placing a greater responsibility on them to ensure that transactions are in the best interest of the company and its shareholders.
    - **Subsidiary transactions**: This requirement extends to subsidiaries of listed entities involved in RPTs, particularly when the listed entity itself is not a party. Independent directors must approve these transactions if they exceed specific financial thresholds, thus extending the governance requirements across the entire corporate structure.
    - **Material Modifications**: This rule applies not only to initial approvals of RPTs but also to any significant changes or modifications to these transactions. Independent directors are required to define what constitutes a "material modification" and oversee any adjustments to RPTs, ensuring continued alignment with shareholders' interests.

Many of these amendments were long overdue. The WG, while reviewing recent issues related to RPTs, identified a recurring theme in major corporate misconducts: these wrongdoings were often orchestrated by individuals with significant influence over company decisions. These individuals allegedly used shell or seemingly unrelated companies, which they controlled either directly or indirectly, to siphon off large sums of money. This was accomplished through complex, innovative structures designed to bypass the existing regulatory framework governing RPTs. Moreover, companies reportedly engaged in circular transactions and diluted or bypassed their own RPT policies by obtaining approvals for continuous lending to affiliated group companies, further circumventing regulations.

However, despite these observations and various scams involving RPTs, including, but not limited to, Satyam, IL&FS, Jet Airways and DHFL, SEBI took nearly two years to amend the regulations. This proved to be an issue when reviewing RPTs of the Adani Group companies. The Expert Committee stated in its report that SEBI itself had been "probing the matter since October 23, 2020 after receipt of complaints in June 2020 and July 2020", long before Hindenburg published its report. But the amendments to related party and RPTs only occurred in November 2021 and took effect even later in 2022 and 2023. As the committee noted in its report, "it would be legally infeasible to attack past transactions on the standards that have later been made available with prospective effect."

Yet, at the same time, the Committee acknowledged that SEBI was continuing to review past transactions and, consequently, did not want to comment on the validity of any facts currently under investigation, choosing instead to focus solely on legal aspects and their application.

Materiality thresholds: raising the bar for transparency

Materiality thresholds for RPTs are tweaked

In 2020, the Working Group on Related Party Transactions recommended a dual threshold for classifying an RPT as material: an absolute threshold of Rs10 billion (US$119m) and a relative threshold of 5% of the annual total revenues, total assets, or net worth of the listed entity on a consolidated basis, whichever is lower. However, SEBI decided to maintain the existing threshold of 10% of the annual consolidated turnover and include an absolute threshold of Rs10 billion (US$135m), ensuring high-value transactions are scrutinized even if they do not meet the 10%

turnover criterion. Additionally, all material RPTs and subsequent modifications require prior approval from both the audit committee and shareholders, ensuring higher scrutiny and greater protection for minority shareholders.

The treatment of royalty payments becomes an issue

However, even these amendments failed to fully anticipate some unintended consequences, particularly regarding the treatment of royalty payments, which is a sub-clause under the materiality threshold for RPTs. LODR's Regulation 23 (1A) states that payments made to a related party for brand or royalty usage will be considered material, and thus require shareholder approval, only if such payments exceed 'five per cent of the annual consolidated turnover of the listed entity.' However, the amended quantitative threshold for material RPTs in Regulation 23 (1) does not apply to these royalty payments.

Shareholder approval can be avoided in practice

The stricter threshold for royalty payments in percentage terms was intended to ensure stronger scrutiny by shareholders. However, in practice, the lack of a specific monetary threshold means that shareholder approval can be avoided even when royalty payments exceed Rs10bn, as long as they remain below the five percent turnover limit. Furthermore, the markets interpret Regulation 23 (1A) as allowing companies to test the materiality of royalty payments separately from other related party transactions. Consequently, even if the aggregate sum of royalty payments and other RPTs exceeds the thresholds, shareholder approval can be avoided if these transactions individually stay within the stipulated limits. This relaxed framework potentially excludes minority shareholders from having a say in significant cash outflows to controlling shareholders, undermining the regulatory intent of tighter shareholder control over such payouts.

4. Listed companies

India ranks 3rd with a score of 60%

India remains in 3rd place in this category on a score of 60%, a five percentage point drop on 2020. This places it below Australia and Malaysia. Its lower score in part reflects changes in the evaluation criteria in this year's survey.

Where India does well

Banks perform well in the survey

The banking sector performed exceptionally well, driven by stringent regulatory mandates from both SEBI and the RBI. Banks excelled in providing comprehensive management discussions, timely financial disclosures, and more detailed remuneration reports than the average listed company, addressing a key concern for investors. This is because RBI demands more disclosure both in terms of remuneration policy as well as compensation disclosure.

The IT sector is strong on board diversity and independence

The IT sector also demonstrated strong governance practices, particularly in board diversity, independent leadership, and stakeholder engagement. In terms of ESG practices, this sector set a high standard in the industry.

Consumer goods issuers showed strong governance

The consumer goods sector showed strong governance practices, excelling in management discussions, financial disclosures, and adherence to best practices. However, there is room for improvement in expanding board diversity beyond gender and enhancing the quality of board evaluations.

Figure 10

India listed companies scores, CG Watch 2023

Question	Average score	Range of scores
1. Does the company's board governance reporting compare favourably against international best practice?	2.5	1.5-4
2. How would you rate the quality of the company's ESG/sustainability reporting?	3	0.5-5
3. Does the company provide comprehensive, timely and quick access to information for investors?	4	3-5
4. Does the company undertake annual board evaluations, either internally or using external consultants?	2.5	0-5
5. Does the company disclose and implement a credible board diversity policy?	1.5	1-3.5
6. Does the company provide induction and/or ongoing training to all directors?	4	2.5-5
7. Does the company have an independent chairman and/or a lead or senior independent director?	2	0-5
8. Does the company disclose total remuneration of each member of the board of directors?	4.5	3.5-5
9. Are the independent directors paid partly or wholly in stock options or restricted share awards? Do they share in a percentage of company earnings or other commissions in addition to their base fee?	1.5	1-5
10. Are audit committees (or an equivalent) independently led and competent in financial reporting/accounting matters?	4	3-5
11. Does the company have an internal audit department that reports to the audit committee?	4	2-5
12. Does the company provide a detailed explanation of its executive remuneration policies?	2.5	0-4
13. Does the company have a nomination committee and is it independently led?	4.5	3.5-5
14. Does the nomination committee have a female chair or at least one female director?	1.5	0-5

Note: Based on 15 large caps from a range of sectors. Source: ACGA research

Where India performs averagely

Public sector companies had lower scores

The automobile sector displayed mid-range performance, with significant gaps in governance practices. Improving financial disclosures, enhancing board diversity, and involving third-party assessors in board evaluations are critical areas for improvement.

Public sector enterprises scored lower, indicating substantial areas for improvement. These companies face challenges in board independence, financial disclosures, and stakeholder engagement. This is hardly surprising as the real estate sector also needs to enhance its governance standards, particularly in transparency and board diversity.

Key governance issues

Independent chairs are rare

A significant area of concern is the separation of Chairman and CEO roles. Companies we surveyed very rarely - two out of the 15 companies - had a separation of these roles. This is unsurprising considering that businesses lobbied against the SEBI mandate for the separation and succeeded in having it reversed. In a country with high promoter shareholding, this lack of separation impacts board independence and effectiveness. Furthermore, most companies did not appoint a lead independent director.

Clarity on the role of lead independent directors could help

During discussions with ACGA and investors in November 2023, several companies expressed the belief that the separation of Chairman/CEO roles was unnecessary. Additionally, some companies argued that having lead independent directors might not always be feasible, citing concerns that independent directors could inadvertently violate insider trading laws. This highlights the need for better training and clear guidelines to address such concerns.

Board diversity policies can have a narrow focus

Board diversity policies also require significant attention. They tend to focus narrowly on gender diversity without broader inclusion criteria or specific targets. Expanding these policies to include other aspects, such as skills and experience, would provide a more comprehensive approach to board composition. However, looking across the board, it is clear that women in the boardroom, and especially in chairperson position, is almost non-existent in Indian companies.

Audit committees fall short on expertise and autonomy

Another area of concern is audit committee competence. Ensuring that these committees are independently led and possess the necessary expertise in financial reporting is essential for maintaining robust governance standards. However, many companies fall short in this regard. There are times when looking at the chair of some of these audit committee, one wonders how are their qualifications making the person fit for the job. And no, the skills matrix does not provide an answer! And despite audit committees supposed to be comprised of independent directors, chairmen or MDs are permanent invitees and participate in all decisions.[6]

Details on board evaluations are scant

While board evaluations are mandated, they often lack the involvement of third-party assessors, and the disclosure of evaluation outcomes is frequently inadequate. Most companies have to let shareholders know that the evaluation has been done but there is no requirement to provide any details on the results. And of course, if it is not regulated, no one is going to do it.

Financial disclosure can be lacking

Financial disclosures in Indian companies also vary widely in quality. Issues such as aggregate reporting of trade receivables and payables without aging analyses, and limited transparency on loans and material acquisitions, remain prevalent. Enhancing the granularity of financial reports would improve transparency and investor confidence.

ESG reporting is mixed

The quality of stakeholder engagement and ESG reporting is mixed. While some companies provide detailed and specific information, others offer generic discussions lacking year-specific details. Companies listed abroad or with a significant foreign institutional presence tend to have better ESG disclosures. Large caps generally perform well in reporting on frameworks like SASB, addressing material issues such as climate change risks. There is room for improvement in utilizing materiality matrices, discussing the materiality process, and providing targets on material issues.

Gender Gap

A gender report sheds light on inequalities

The CFA Institute's report, "Mind the Gender Gap," released in March 2023, provides a detailed analysis of gender disparities in Indian public companies, focusing on women's participation, pay, and career progression. Despite regulatory efforts and increasing awareness, significant barriers to gender equality persist.

There is low female participation in the workforce

The report highlights the alarmingly low participation rates of women in the workforce, averaging just 12.7% across the companies studied. This issue is especially pronounced in industrial sectors, where participation is a mere 4.3%, compared to 30% in the information technology sector. Women's representation in key management personnel (KMP) positions is slightly lower, at 12.5%. This disparity indicates a "leaky pipeline," where women are less likely to advance to senior management roles, reflecting systemic issues in career progression for women.

[6] https://corporate.cyrilamarchandblogs.com/2022/06/regulatory-overload-on-audit-committees-is-there-a-need-to-have-a-fresh-look-at-its-role

Pay me the money

Women in senior roles earn less than men

Remuneration disparities are another critical concern. The report reveals that while the median remuneration ratio between women and men is near parity at the general employee level (0.97), it significantly drops for KMP roles (0.52) and directors (0.64). This stark difference suggests that women in senior positions are compensated significantly less than their male counterparts.

Turnover rates are higher among women

Turnover rates for women are higher than for men, standing at 18.3% compared to 16.1%. This trend is consistent across most sectors, suggesting potential dissatisfaction or increased care responsibilities that lead women to leave their jobs more frequently.

Sexual harassment is underreported

Sexual harassment is another pervasive issue, with significant underreporting noted in the report. Many companies reported no complaints, which contrasts sharply with survey data indicating that most women experience harassment but do not report it. This discrepancy suggests a lack of effective mechanisms to address and prevent sexual harassment, creating an unsafe work environment for women.

Be transparent

The CFA Institute recommends enhanced disclosure

To address these issues, the CFA Institute provides several key recommendations. First, there is a need for improved data granularity and transparency. Companies should offer more detailed disclosures regarding median remuneration and workforce composition, categorized by job roles and levels. Additionally, SEBI could enforce adherence to these regulatory formats and enhance oversight, potentially using technological tools to ensure the quality of disclosures improves over time.

Mandatory disclosure on women in executive roles would help

Another crucial recommendation is to increase diversity within senior management. While SEBI mandates at least one woman independent director on company boards, this requirement does little to address the lack of women in senior executive roles. Companies could provide qualitative disclosures on their efforts to improve women's career progression, and SEBI could make these disclosures mandatory for larger companies and those with no women among their KMP.

5. Investors

India ranks fourth with a score of 46%

India improved its score in this category by two percentage points to 46%, moving up one place to rank 4th behind Australia, Japan, and Korea.

Investors are more engaged at AGMs

The score increase is mainly due to retail investors being more engaged at AGMs, asking pertinent questions. Virtual meetings, which began during the pandemic and continued into 2023, changed how investors interact with senior management and the board. The Ministry of Corporate Affairs (MCA) allowed virtual AGMs for FY2023 and extended this provision in September 2023 for FY2024.

Institutional Investors

A divide between domestic and foreign investors persists

Institutional investors (IIs) are divided into domestic and foreign categories, with notable differences and a distinct lack of collaboration between the two. A prime example was the Adani stock crash in early 2023, where foreign IIs suffered significant losses, while domestic IIs were minimally affected or had exited beforehand. One foreign II had asked ACGA, "Why didn't they tell us?", and when ACGA inquired with a local II, they responded, "Would they have listened?"

Sub-divisions of domestic IIs

Regulatory oversight varies between funds

Even within the local fraternity, there are divisions; SEBI oversees mutual funds and alternative investment funds, the Insurance Regulatory and Development Authority of India (IRDAI) regulates the insurance sector, and the Pension Fund Regulatory and Development Authority (PFRDA) has oversight of pension funds. All have issued stewardship codes, but IRDAI's code historically diverged in not requiring voting across the board.

Voting

Voting regulations have a long history

Stewardship in India is recent, introduced in the last five to seven years, while voting regulations have a longer history. In 2011, SEBI mandated that mutual funds disclose voting policies and votes cast on resolutions at general meetings. But in 2014, the regulator expanded those rules requiring funds to disclose the rationale for their voting decisions and annually certify their voting reports by an auditor. Finally in March 2021, SEBI issued another set of amendments requiring mutual funds, including their passive funds such as index and exchange traded funds, to compulsorily vote on all resolutions as of 1 April 2022. Additionally, the regulator stated that while voting should be done at a fund level, if one fund manager of any scheme was in opposition with other scheme fund managers, scheme level voting would be allowed if detailed rationale for the votes were recorded.

Mutual fund disclosure levels are higher

The regulatory push ensures high disclosure levels from mutual funds on their votes and rationales, unlike the pension and insurance sectors, which lag despite recent improvements. To be fair, both came into the game much later, following the introduction of stewardship codes: in 2017 by IRDAI and 2018 by PFRDA. Initially, insurance companies were not obliged to publish voting data, arguing they lacked the bandwidth.

Insurers must disclose voting each quarter

In 2020, IRDAI amended its guidelines, making voting mandatory under certain conditions based on the insurer's AUM and holding percentage. Insurers must now disclose voting activities quarterly, aligning more closely with mutual fund standards, though still behind.

IRDAI guidelines explained

Figure 11

IRDAI's guidelines on mandatory voting

Size of the AUM of the insurer (10Rsm)	Compulsory voting is required if the insurer's holding of the paid-up capital of investee company is:
Up to 250,000	3% and above
Above 250,000	5% and above

Source: IRDAI

Stewardship

Details on stewardship often fall short

Stewardship reporting remains underdeveloped in India. SEBI introduced a code for mutual funds in 2019, but transparency and comprehension issues persist. Both insurance companies and mutual funds often provide minimal information, mainly compliance tables, with few offering detailed reports. The past three to four years have shown some improvement, but collaboration with other IIs on corporate governance or sustainability issues remains uncommon. There are occasional surprises, such as HDFC Life Insurance's FY2022 stewardship report. But finding current reports, like FY2023, remains challenging.

A few funds publish decent reports

Most mutual funds provide basic compliance tables, with few detailing engagements or collaborations with other investors. Notable exceptions include SBI Mutual Fund and Kotak Mahindra Asset Management, which have published more comprehensive stewardship reports. These reports provide detailed information on the number of companies they engaged with during the year and the nature of these engagements.

Foreign institutional investors

Foreign institutional investors are not required to provide stewardship reports

Tracking foreign institutional investors (FIIs) is challenging as they are not required to provide stewardship or voting reports. However, empirical evidence shows FIIs vote and engage with investee companies. Differences between domestic and foreign IIs were stark during the Adani stock meltdown, with foreign investors suffering significant losses compared to their domestic counterparts. Arguably, it was the passive investors, such as Vanguard and BlackRock, that suffered the most for their Indian portfolios, but other more active investors also found themselves out of pocket.

Foreign investors are more willing to engage

FIIs have been actively participating in the voting processes of Indian companies, as evidenced by data from Institutional Investor Advisory Services (IiAS) and company filings. These investors have shown a consistent trend of exercising their voting rights, as well as engaging with companies on a regular basis but also when the need arises. Hindustan Unilever (HUL) serves as a good example: in May 2023, one of ACGA's members, using the ACGA forum, tried to collectively engage with the company regarding its decision to increase royalty payments to Unilever without seeking shareholder approval. While HUL refused to have a call with the members, there is a growing appetite among ACGA's members to engage more deeply in India, both with regulators and companies.

Shareholder activism comes in all forms

A proxy advisor writes to a textile manufacturer

On 28 November 2023, proxy advisory firm Institutional Investor Advisory Services (IiAS) took the unprecedented step of writing an open letter to the independent directors of listed textile manufacturer Raymond where the managing director and chairperson, Gautam Singhania, and his wife, Nawaz Modi Singhania, a board member, were involved in a family feud. The feud, which included serious allegations by Modi against her husband of physical assault and the misuse of company funds for personal benefits, led to a decline in the company's market value by more Rs15bn (US$179m) in November 2023.

It was not the first family altercation involving the company

This is the second time the company was in the spotlight because of family issues. In 2017, an increasingly acrimonious altercation between Singhania and his father and chairman emeritus of Raymond at the time, Vijaypat Singhania, culminated in Singhania Sr. accusing his son of throwing him out of the family home, JK House.

But this time accusations of domestic violence prompted IiAS to write to independent directors expressing concern over their silence in the face of such "serious and heinous accusations", according to Hetal Dalal, IiAS's chief operating officer. The proxy advisory firm urged the independent directors to address investor concerns and initiate an independent investigation into the allegations. It recommended retaining independent legal counsel and ensuring the investigating firm had no prior affiliation with the Raymond group or the Singhania family. Additionally, the letter suggested temporarily relieving both parties of their board

The accusations prompted action by IiAS

responsibilities during the investigation and appointing an interim CEO from within the company's leadership team. IiAS closed the letter by posing a series of questions addressing potential breaches of conduct, criminal liabilities, brand alignment, controls against CEO excesses, and the impact of personal distractions on the Chairman and Managing Director. Based on answers to those questions, IiAS advised them to act in the company's long-term interests while maintaining objectivity and fortitude in handling challenging situations involving promoters.

The independent directors decided to take legal advice

IiAS won a small victory on 1 December when the independent directors announced that they had retained independent legal counsel, Berjis Desai, to advise them impartially. They, however, clarified that neither law nor any corporate governance standard mandates independent directors to investigate or delve into matrimonial disputes, as these matters are beyond the scope of their responsibilities. But they assured stakeholders of transparent communication regarding significant developments and affirmed their dedication to prioritizing the company's welfare and that of its non-promoter shareholders. The case is still ongoing.

Retail investors

Retail investors are becoming more relevant

Retail investors have increasingly become a significant force in the market, particularly through their investments in mutual funds.[7] This segment, having a lot of skin in the game, has shown substantial growth and influence. However, many retail investors have historically viewed stocks as a get-rich-quick scheme rather than long-term investments with governance and ethical considerations, but these considerations have changed with mutual funds.

A younger generation of retail investor is emerging

The landscape is gradually changing as the younger generation begins to invest. This new cohort of investors places more importance on ESG factors, recognizing the long-term value and impact of sustainable and ethical investing. Despite this shift, it remains challenging to determine the extent to which these retail investors are voting on shareholder issues, how they are voting, and what specific issues are driving their decisions.

Retail investors are willing to put board members on the spot

Sometimes, retail investors make their presence felt by holding company leaders accountable. For example, during the 2023 AGM of Tata Consultancy Services (TCS), retail shareholders asked the chairman, Natarajan Chandrasekaran, some difficult questions regarding a scandal that came to light on June 23, 2023. TCS subsequently announced that it had blacklisted staffing firms. Shareholders had questioned the chairman about the staff involved and how the company was handling the issue and its fallout.

6. Auditors & audit regulators

India jumps two places to rank 9th on score of 69%

Historically, India has always performed poorly in this area for various reasons, including not being fully convergent with IFRS - partly due to carve-outs - and the lack of an independent audit regulator. This section saw substantial improvement. In 2023, India's score reached 69%, a 15-percentage point increase from 2020. India's rank also improved from 11th in 2020 to 9th in 2023, placing it just below Korea, which scored 73%, and above Indonesia, which scored 65%.

[7] According to SEBI's 2023 annual report, 97.1% of mutual fund folios are held by individual investors, representing 55% of total net assets under management

Audit regulator finds its stride after Covid years

Although the establishment of an independent audit regulator became a reality in 2018, the pandemic years were not productive for the National Financial Reporting Authority (NFRA). Over the past few years, however, NFRA has begun to undertake more substantive work. While it was too late to make a difference in our scoring, NFRA became the 56th member of the International Forum of International Audit Regulators (IFIAR) in November 2023. These changes reflect a commitment to enhancing the quality of audits and increasing transparency in financial reporting.

Extended Auditor Reports and KAMs

Quality and depth of audit reports improves

The uptake of IFRS and ISA standards in India continues to be a long and gradual process. However, India has scored better on the quality of extended auditor reports, known as Key Audit Matters (KAMs), largely due to the guidance provided by the Institute of Chartered Accountants of India (ICAI). This requirement, in place since 2019, has significantly improved the quality and depth of auditor reports. KAMs offer deeper insights into the critical issues faced by companies, providing more information and transparency. This advancement in reporting ensures that stakeholders receive a comprehensive understanding of the financial health and challenges of companies, thereby enhancing the overall transparency and reliability of financial reporting in India.

NFRA

The audit regulator takes a more active role

The establishment of the National Financial Reporting Authority (NFRA) in 2018 marked a crucial development in the regulatory landscape of Indian auditing as an independent regulator but it failed to mark its presence during the pandemic years. In recent years, under the chairmanship of Dr Ajay Pandey in 2022, it has begun to actively fulfil its role. The regulator oversees and regulates audit practices, reviews and recommends accounting and auditing standards monitors and enforces compliance, investigates audit failures, and imposes sanctions where necessary.

NFRA website is a useful tool

Thankfully, the NFRA's website is user-friendly and ensures transparency, with orders, sanctions of audit firms and auditors, and annual reports and accounts easily accessible. It also issues guidelines for the audit industry, providing comprehensive resources for compliance and best practices, which for the past two years it has increasingly been doing.

Don’t ignore fraud

The auditor reinforces need to report fraud

On 26 June 2023, in response to auditors failing to report frauds at companies NFRA issued a circular, emphasizing the statutory responsibilities. The circular underscored the critical role auditors played in maintaining the integrity of financial reporting and emphasized strict compliance with fraud reporting obligations. It reiterated the following:

- **Mandatory Reporting:** Auditors must report any fraud or suspected fraud to the Central Government and the company's Board/Audit Committee as required by Section 143(12) of the Companies Act, 2013, and related rules.
- **Reporting Procedure:** If a fraud involving Rs10m ($119,000) or more is suspected, auditors must report it to the Board/Audit Committee within two days. If there is no response within 45 days, auditors must file a report to the Ministry of Corporate Affairs.
- **Resignation:** Resigning from an audit engagement would not absolve auditors of their responsibility to report fraud and they could still be held liable.
- **Professional Scepticism:** Auditors should maintain professional scepticism and not be influenced by legal opinions from the company's management.

Audit firms are required to file transparency reports each year

Annual Transparency Report
On 16 January 2023, NFRA announced the introduction of Annual Transparency Reports (ATRs) for audit firms. This initiative aims to enhance transparency regarding the management, governance, and internal policies of audit firms, aligning with international best practices. According to Rule 8(2) of the NFRA Rules 2018, ATRs will provide critical information on auditors' operational activities, governance, and quality control measures. Starting with the top 1000 listed companies by market capitalization, the ATRs would be required for the financial year ending March 31, 2023, and needed to be published within three months of the fiscal year's end. This move is expected to provide valuable insights to investors, audit committees, and the public, fostering greater accountability and transparency in auditing practices.

New guidelines on audit quality inspections are published

Audit Quality Inspection Guidelines
In November 2022, the regulator published guidelines for conducting audit quality inspections aligned with best practices followed by international audit regulators. An integral part of the functioning of independent audit regulators worldwide, recurring inspections of audit firms undertaking audits of public interest entities are conducted to assess compliance with applicable professional standards, independence requirements, and other rules, laws, and regulations. This practice is promoted by IFIAR. In the financial year 2022-23, NFRA completed ground inspections of the top five audit firms but only published the findings in December 2023.

Auditors face disciplinary sanctions

NFRA Enforcement Actions
NFRA has imposed several sanctions on auditors and audit firms to uphold the integrity of financial reporting. For example, in the case of Dewan Housing Finance Corporation Limited, the regulator fined two auditors Rs100,000 (US$1,200) each and debarred them for one year from being appointed as auditors due to professional misconduct. This misconduct included accepting an invalid audit engagement, improperly portraying themselves as "Branch Statutory Auditors," and issuing "Independent Branch Auditors' Reports" in violation of the Chartered Accountants Act, as well as failing to comply with auditing standards. In another case involving Vikas WSP Limited, the NFRA imposed a monetary penalty of Rs300,000 (US$3,750) on an auditor and debarred him for three years for failing to comply with Indian Accounting Standards (Ind AS) while auditing the financial statements. The auditor failed to verify or report the interest cost on loans declared as non-performing assets by the lending banks, which resulted in a significant overstatement of profit.

Punishments could be stronger

While we agree that these enforcement actions serve as a deterrent to non-compliance and emphasize the importance of adhering to high standards in auditing practices, ACGA believes the regulator should consider implementing more punitive measures.

NFRA gets greater financial autonomy

Free, free at last
NFRA was accorded grantee status by Parliament in the Supplementary Grants of 2022-23 and the first grants were released in March 2023, further strengthening the financial autonomy of NFRA. Prior to becoming a grantee organization, NFRA's receipts and disbursements were part of the accounts of the Ministry of Corporate Affairs (MCA). This financial independence ensured that NFRA operated separately from the MCA, reinforcing its autonomy and making its membership path to IFIAR clearer.

Going forward

Human resources are an issue

Despite its progress, NFRA faces several challenges in fulfilling its mandate effectively. Ensuring that NFRA is staffed with sufficiently qualified and experienced professionals remains a significant challenge. Attracting and retaining talent in a specialized field like auditing can be difficult, especially given the competition from private sector firms that often offer more lucrative compensation packages.

Is the NFRA sufficiently funded?

While the grants authorized by Parliament and released by the MCA provide a foundation, there are questions about whether these funds are sufficient to cover the extensive scope of NFRA's responsibilities. Adequate funding is crucial for conducting thorough inspections, enforcing regulations, and maintaining operational independence. Despite the sanctions imposed on auditors and audit firms throughout the year, there is a need for stronger measures to deter firms and individuals alike.

7. Civil society & media

India scores 74% and ranks 2nd

This is an area where India always performs well, though recent concerns have seen its score fall by four percentage points to 74% in 2023, while it remains in 2nd place behind Australia, which scored 82%. Japan is in 3rd place with a score of 66%.

Non-Profit Organizations

NGOs play a pivotal role in CG

Non-profit organizations continue to play a pivotal role, especially in India's ESG landscape, although several have faced government scrutiny and pressure. National and international associations, as well as regional grassroots organizations, are at the forefront improving governance and raising awareness of environmental, social, and governance (ESG) issues. These organizations provide a critical counterbalance to the concentrated media landscape.

Initiatives in education and research

Academia focus on ESG

The Thomas Schmidheiny Centre for Family Enterprise at the Indian School of Business conducts and publishes original research, contributing significantly to the field of corporate governance. But most academia is much more interested in ESG rather than just CG.

A sustainability school is established

In December 2023, for instance, the Kotak School of Sustainability was launched - a joint venture between Kotak Bank and IIT Kanpur to establish India's first fully integrated School of Sustainability. Kotak had earlier told ACGA that there is a lack of expertise in India to address sustainability issues, and this venture was aimed at developing solutions to combat global warming in the Indian context.

Media under pressure

India suffers in global press freedom rankings

India's media landscape is prolific, particularly when considering the numerous regional publications. However, the freedom once enjoyed by the press is under significant threat. Reporters Without Borders ranked India 161 out of 180 countries in 2023, indicating a severe decline in press freedom.

Journalists critical of government face reprisal

The Modi administration has been particularly challenging for the media. Journalists critical of the government face increased violence, harassment, and legal challenges, including charges of sedition. This hostile environment has led to self-censorship among journalists, impacting their ability to report freely and objectively on a variety of issues, including corporate governance. The complete lack of mainstream media coverage on the Adani controversy in 2023 is a prime example, with one journalist stating clearly that certain media houses will report on certain business groups.

Examples abound. For instance, in October 2020, Kerala journalist Siddique Kappan, along with three others, was arrested by the police while traveling to Hathras in BJP-controlled Uttar Pradesh (UP) to report on the rape and murder of a Dalit woman. Kappan was charged under the Unlawful Activities (Prevention) Act (UAPA) and the Information Technology (IT) Act. The Supreme Court (SC) granted him bail in September 2022, but Kappan remained in jail due to a Prevention of Money Laundering Act (PMLA) case brought against him by the Enforcement Directorate. Although the Allahabad High Court granted him bail on that charge in December 2022, he was not released until February 2023 due to procedural issues. During the SC hearing, Chief Justice of India U.U. Lalit asked the UP government's representative, advocate Mahesh Jethmalani, "Every person has the right to free expression. He is trying to show that the victim needs justice and raise a common voice. Is that a crime in the eyes of law?"

This was not the only instance where the Supreme Court pushed back against the government's high-handedness with the media. In January 2022, MediaOne, a Malayalam-language news channel, had its broadcast license revoked by the Ministry of Information & Broadcasting (I&B) following a Ministry of Home Affairs (MHA) order denying the channel security clearance. During an appeal in the Kerala High Court, the Assistant Solicitor General of India argued that the MHA could not disclose the reason for the denial "as a matter of policy and in the interest of 'national security'."

However, when the Supreme Court quashed the ban in April 2023, it criticized the government for the "cavalier manner" in which it invoked the claim of 'national security', despite the "reiterations by this Court that judicial review would not be excluded on a mere mention of the phrase 'national security'." The judgment further emphasized that "an independent press is vital for the robust functioning of a democratic republic" and made it clear that the channel's critical views on government policies could not be labelled as 'anti-establishment.' The Court concluded that using these views as a basis to deny the channel security clearance not only undermined free speech but also posed a significant threat to press freedom.

BBC offices in India face a tax raid

The raid on the BBC offices in India in February 2023 was seen as exemplifying the hostile environment for media. The Income Tax Department conducted raids on the BBC's offices in Delhi and Mumbai, seizing documents and phones from employees. This action was widely seen as a response to a BBC documentary critical of Prime Minister Modi's role in the 2002 Gujarat riots. For many observers, this incident highlights the government's efforts to intimidate and suppress media that it perceives as critical.

Other media have expressed concerns

Another foreign media group told ACGA that they are putting in place contingency plans in case they get raided, as they fear government reprisals due to their critical reporting. This pre-emptive measure indicates the level of concern among international media operating in India, reflecting the broader environment of media suppression and intimidation.

Concentrated media ownership

There is concentrated media ownership

The concentration of media ownership has further exacerbated these issues. Major media houses are owned by a few powerful entities with strong political and business ties. This structure allows owners to influence editorial decisions, often resulting in biased reporting and the suppression of critical stories. For example, Mukesh Ambani's Reliance Industries, perceived as an ally of the government, owns a significant number of media outlets followed by millions. This ownership concentration is seen as compromising the media's independence and objectivity.

A TV network is purchased by prominent tycoon

The December 2022 acquisition of NDTV by the Adani Group is another illustration of this trend. Gautam Adani, a prominent business tycoon also perceived as having close ties to the Modi administration, now controls one of India's most influential news networks. This acquisition has raised concerns about the further erosion of media independence and the potential for increased censorship of content critical of the government and its business allies.

Challenges in CG reporting

Journalists lack CG expertise

Despite these challenges, some print media manage to produce in-depth business reports. However, they often lack the expertise to handle complex corporate governance issues unless flagged by proxy advisors. A local journalist highlighted that while media outlets cover corporate abuses, they are generally not equipped to delve deeply into governance matters without external prompts. A pertinent example is the TVS Group agreement, where family members in March 2024 signed a non-compete pact over the use of the TVS brand. The issue gained media attention only after proxy advisors noted that it should have been put to a vote by minority shareholders, highlighting gaps in media coverage of critical governance issues.

Downgrade watchlist

What to avoid

Factors that could force India's score to fall in 2025:

- The government continuing to focus on "Ease of Doing Business" at the expense of improved governance practices.
- Any suggestion that RBI does not plan to establish a climate risk and sustainability finance framework based on IFRS standards by the end of 2024.
- Lokpal continues to fail to publish annual reports on its work.
- A lack of improvement in domestic institutional investors' stewardship reporting.
- Courts continue to work below capacity owing to a lack of judges at district courts and the high court.

Next Steps

Our recommendations for the next stage of CG reform in India include the following:

1. **Director training**

Ongoing director training could be mandatory and disclosure improved

In 2024, many companies will be refreshing their boards, yet there is a persistent complaint about the lack of qualified directors, especially in the banking and financial sectors. While there are a few associations, institutes, and companies offering training for independent directors, a more structured approach is required. This need is underscored by reports from regulators and other stakeholders indicating that many prospective directors failed the financial literacy module of the online independent director's proficiency test, leading to the test being downgraded instead of ensuring participants upskilled themselves. A programme could be provided by recognized institutes and mandated by the regulators, RBI and SEBI. Currently, listing rules merely state that "the board of directors shall encourage continuing directors training to ensure that the members of the board of directors are kept up to date," and disclosure of such training is mandatory. However, the quality of these disclosures is often inadequate. Ongoing training should be mandatory, and companies should be required to provide detailed information about the type of training, the number of hours dedicated to it, the providers of the training, and the specific board members who participated.

Regulatory websites could be overhauled

2. **Disclosure of enforcement work**
   SEBI's website provides access to a wealth of information but the presentation of enforcement data could be improved. The regulator could consider categorizing information under specific infractions, such as insider trading and market manipulation. If there are multiple violations, the case should be listed under the main infraction, similar to the presentation in SEBI's annual reports. And despite efforts by NSE over the years to improve its site, and BSE's history of presenting enforcement data in a user-friendly manner, both platforms are currently difficult to navigate for such data. Users often find that the data must be downloaded before it can be viewed, complicating the process and reducing accessibility.

More time to respond to consultations would be welcome

3. **Public consultations**
   The RBI set a strong precedent with its consultation periods, allowing three months for feedback on its climate risk and sustainable finance framework. But SEBI has shortened its feedback period from 28 days in 2020 to mostly 21 days in late 2023. By providing sufficient time for feedback, regulators can foster greater participation and enhance the quality of their regulatory frameworks. Additionally, consultations could be better spaced out.

Aligning with ISSB standards would ensure companies are benchmarked globally

4. **Alignment of BRSR and BRSR Core with IFRS**
   Aligning these two frameworks with IFRS S1 and S2 ensures global consistency and comparability, allows global investors to rely on these standards to assess a company's sustainability and financial health, and helps meet emerging global standards.

Domestic and foreign investors need to collaborate

5. **Collaboration between shareholders**
   Collective engagement between domestic and foreign institutional investors remains a distant goal. However, investors wield more influence when acting together and companies are more likely to heed concerns and recommendations when both domestic and global institutional investors present a united front on key issues.

An overhaul of campaign financing would help restore public trust

6. **Campaign financing**
   The government should find a viable solution to campaign financing, especially in light of the Supreme Court ruling on 15 February 2024 which struck down the Electoral Bond Scheme as unconstitutional by failing to disclose funding to political parties. Comprehensive campaign finance reforms could include strict disclosure requirements, caps on donations and spending, and robust monitoring and enforcement mechanisms. Transparency of this nature is especially important for corporate donations to allow investors and the public to know if and how companies are lobbying government.

Company checklist

Actions companies could take to enhance CG practice and disclosure immediately

Actions companies could take over the short to medium term to enhance their governance practices and disclosure include the following:

1. **Skills matrix:** SEBI since 2019 has mandated that companies provide a skills matrix and the following year companies were required to report which skills, expertise, and competencies each of the directors fulfilled. However, most companies currently provide generic skills that the company needs, with some not even providing that level of information. Companies should name the specific competencies needed for their business or sector, explain their relevance, and identify which directors fulfil those requirements. They should also provide this information for all new directors they plan to induct onto the board.

2. **Disclosure of compensation:** The level of disclosure around compensation in India falls short of global standards. To meet these standards, each component of compensation - such as bonuses, stocks, and other incentives - should be disclosed for all directors on the board as well as the top five key management personnel.

3. **Board diversity:** diversity policies would benefit from including specific targets and action plans.

4. **Board evaluations:** Companies should consider using an external consultant every two to three years, and disclose the results and any action points for improvement.

5. **Lead independent director:** Given the lack of independent chairs, appointing a Lead INED would be welcome.

6. **Director training:** Formal training programmes could cover topics such as leadership, cyber security, climate risk and insider trading regulations. Companies should disclose the types of training being undertaken and the number of hours involved.

7. **Audit committees:** Companies should cease allowing chairs or managing directors to be permanent invitees on audit committees, or take part in their decision-making.

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Bottom-up CG score improved on multiple fronts

CLSA's updated bottom-up CG scores indicate a 6.0pt improvement in India corporate governance compared with 2020, driven by the Independence and Discipline pillars. Relative to the Asia average, India's average CG score is higher by 3.5pts, thanks to better performance in timeliness of financial reporting and board diversity (talent, background etc), though our analysts find interest alignment between ordinary and controlling shareholders relatively concerning. Examining our CG scores by key thematic characteristics, small and midcap as well as private sector companies have the highest CG scores, whereas state-backed companies score the lowest on average. We provide the top 10 scorers and improvers within CLSA India coverage.

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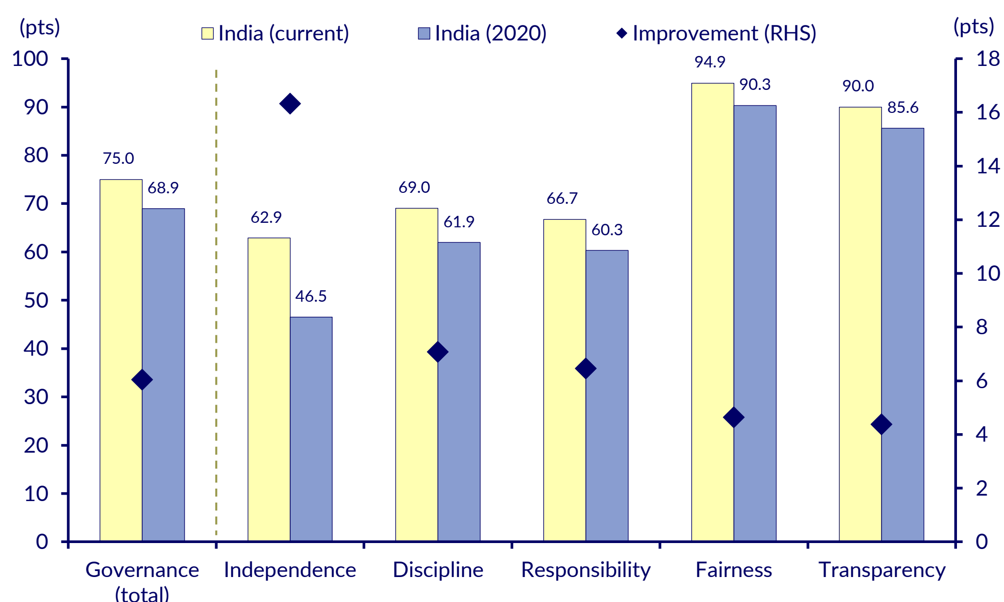
Independence and Discipline pillars drove improvement

CLSA's updated bottom-up CG scores indicate a 6.0pt improvement in India corporates' governance versus 2020, driven by the Independence and Discipline pillars. CLSA analysts are generally more confident in audit committee effectiveness and independence (CG13) and in management capital allocation decisions (CG02) across their 2024 coverage compared with 2020 on average. They also saw an improvement in the overall clarity and informativeness of financial reports (CG08).

Figure 12

Average CG score of India (current vs 2020)



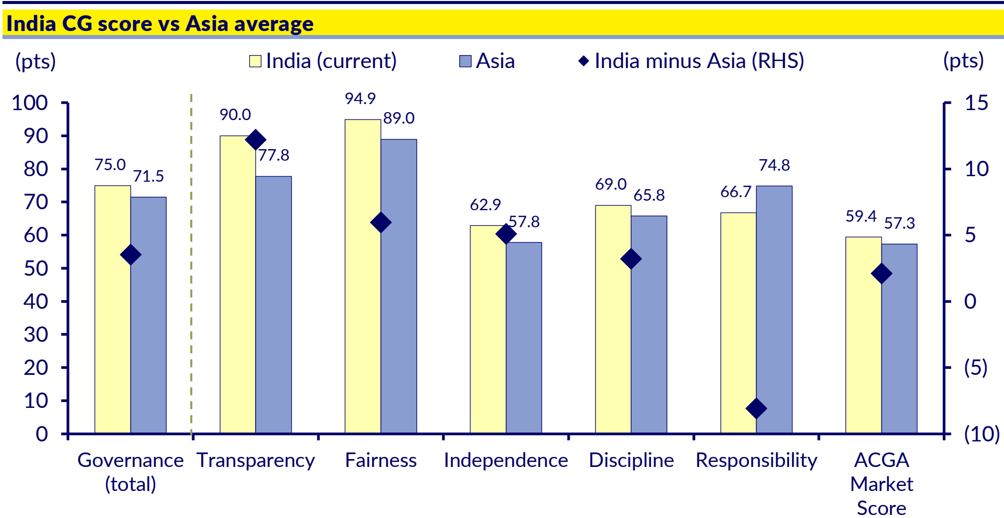
Source: CLSA

Relative to the Asia average, India's CG score is 3.5pts higher, mainly driven by the Transparency and Fairness pillars.

India CG outperforms Asia in Transparency and Fairness

Figure 13

India CG score vs Asia average



Source: CLSA

. . . particularly in CG question 05, 07. But underperform in CG question 20

In particular, our analysts think Indian companies tend to do better in terms of timeliness of releasing audited full-year results (CG07) and efforts to bring diversity (in terms of talent and backgrounds) to their boards (CG17). However, Indian companies lag the Asia average in the Responsibility pillar, as CLSA analysts have highlighted concerns around the primary financial interest alignment between controlling and ordinary shareholders (CG20).

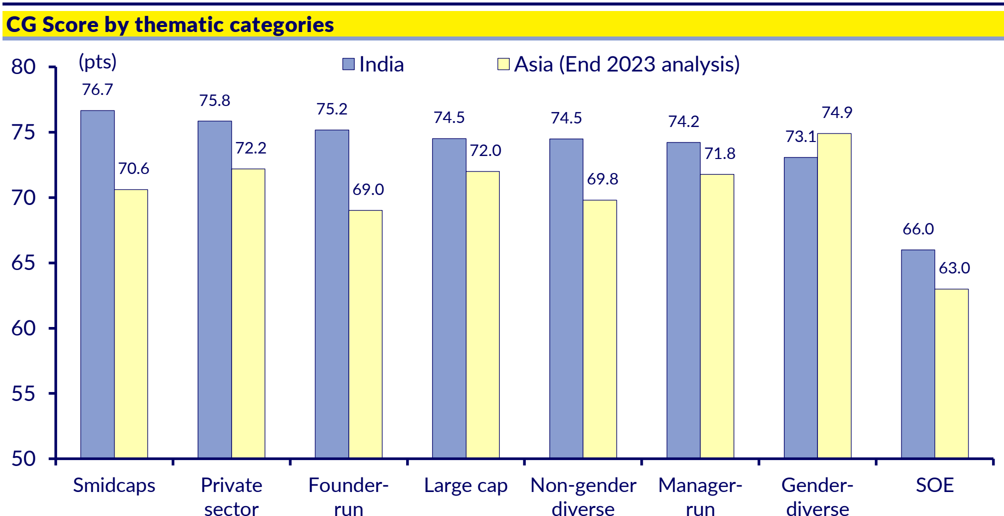
CG scores by thematic categories

What specific corporate characteristics contribute to better corporate governance in India? In this edition of CG Watch, we have cross-examined CG scores by the key thematic characteristics of ownership. We specifically break down the characteristics from four different angles: 1) government-owned (SOE) versus private-sector; 2) size (large- versus small/mid-cap); 3) gender diversity; and, 4) founder versus manager-run. Overall, Smidcaps and private-sector businesses have the highest CG scores, whereas SOEs score the lowest.

Smidcaps and private-sector company top CG score lists; SOEs score the lowest

Figure 14

CG Score by thematic categories



Source: CLSA

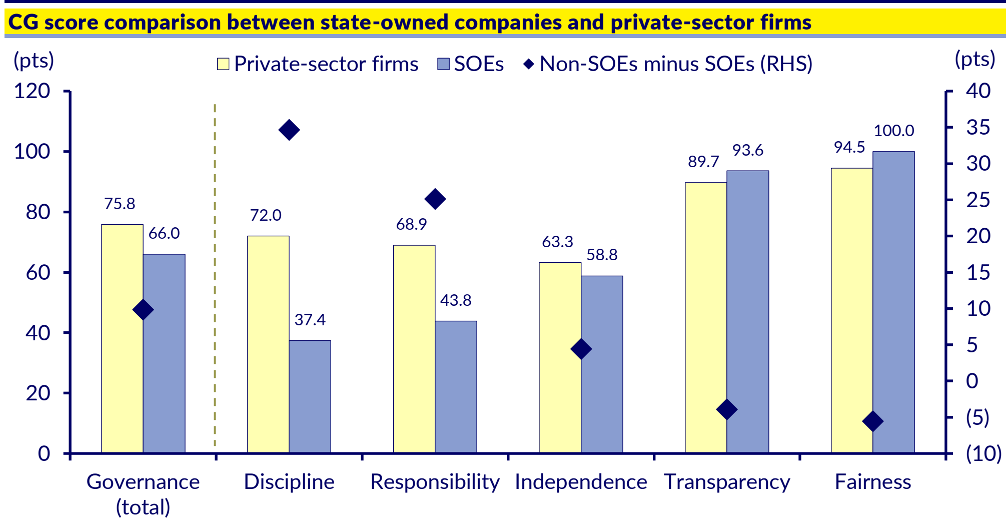
SOEs lag private sector firms on CG issues, particularly in the Responsibility and Discipline pillars

SOEs underperform in particular on CG questions 01,02,05,12 and 20

SOEs score lower than private-sector firms on shareholder interest concerns
Ownership and political intervention in corporate decision-making could affect corporate governance. Defining SOEs as those in which government holds 50% or more of shares outstanding, we observe that SOEs generally have lower governance scores than private-sector businesses and lag particularly in the responsibility and discipline pillar.

Figure 15

CG score comparison between state-owned companies and private-sector firms



Note: SOE=14, POE=147. Source: CLSA

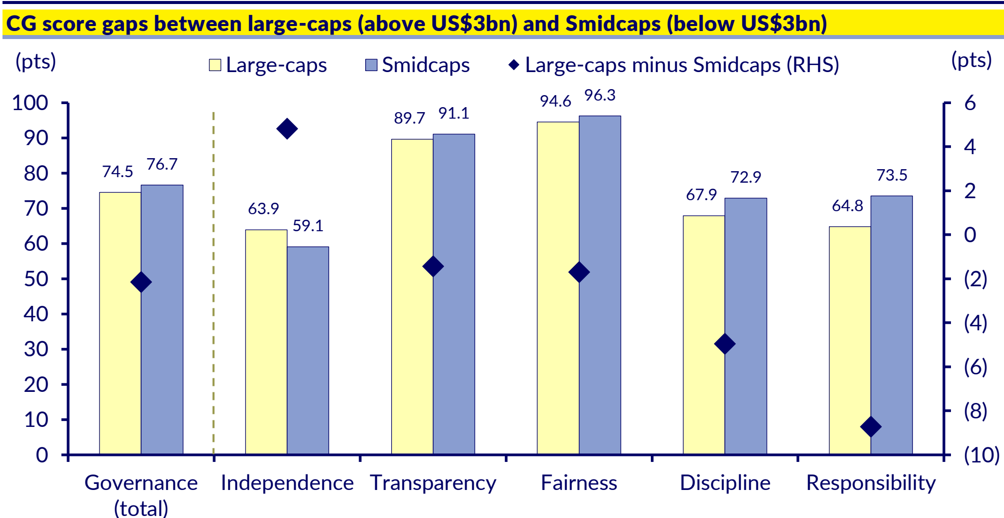
Apart from the obvious worry that SOEs are more likely to face government interference that could potentially hurt shareholder interests to support government goals (CGQ05), our analysts are generally more concerned about the interest alignment between controlling shareholders and ordinary shareholders (CG20), as well as chair independence (CG12). They are also generally more concerned around management adherence to clearly defined core businesses (CG01) and management capital allocation decisions (CG02).

Larger caps better on board diversity but shareholder interest not guaranteed
We also compare the CG score of large caps (>=US$3bn) against those of Smidcaps (<US$3bn). Overall, large caps score lower in the Responsibility and Discipline pillars while performing better in the Independence pillar. In particular, our analysts looking at large caps are, on average, slightly more concerned about financial interest alignment between controlling and ordinary shareholders (CG20), as well as government interference that may hurt shareholder interests (CG05). On the other hand, CLSA analysts think a large proportion of large caps have demonstrated efforts to bring a diversity of talent and backgrounds to the board (CG17).

Large caps score lower in Responsibility and Discipline pillars while being higher in Independence

Figure 16

CG score gaps between large-caps (above US$3bn) and Smidcaps (below US$3bn)



Note: SMID cap = 36, large cap = 125. Source: CLSA

1 in 7 companies in our sample qualifies as "gender-diverse"

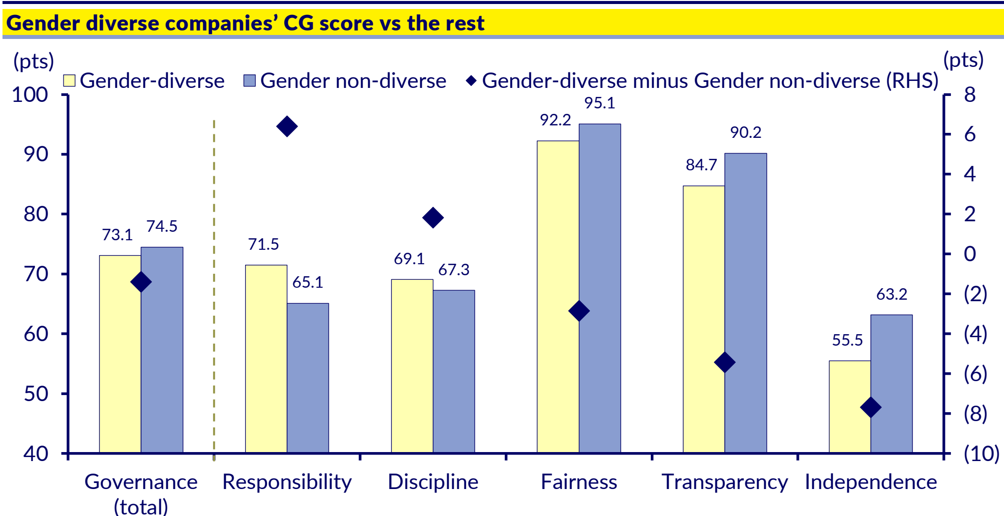
Gender diversity impact minimal

Companies with a fair share of women in management positions or on the board would tick the box for diversity, but do they differ meaningfully in terms of CG performance? We define gender-diverse companies as those that meet one of the following three criteria: 1) the CEO is female; 2) women account for more than 30% of board members; or, 3) women account for more than 30% of management. Among the 141 companies for which data is available from Bloomberg, 18 (13% of the total) meet our definition of being gender-diverse. Overall, we find that gender-diverse companies record similar scores on average to the overall universe of companies examined. In particular gender-diverse companies underperformed in the Independence pillar but outperformed in the Responsibility pillar.

Gender-diverse companies' CG scores are similar score to the overall market score

Figure 17

Gender diverse companies' CG score vs the rest



Note: Gender-diverse companies n=18. Others=123. Source: CLSA

. . . underperformance in particular in CG questions 11 and 13

Looking at individual questions, our analysts are relatively more concerned on the effectiveness and independence of the audit committee (CG13) and access to senior management (CG11) of gender-diverse companies. However, we also have to note the relatively small sample size of gender-diverse companies (18). That being said, on the positive side, our analysts are on average more confident in the primary financial interest alignment between controlling and ordinary shareholders (CG20) as well as in capital allocation decisions (CG02) at gender-diverse firms.

CLSA Thematic baskets

Introducing the Founders Portfolio

Read our report on how founder-run companies' stock performances differ from other businesses

Founder versus manager-run companies

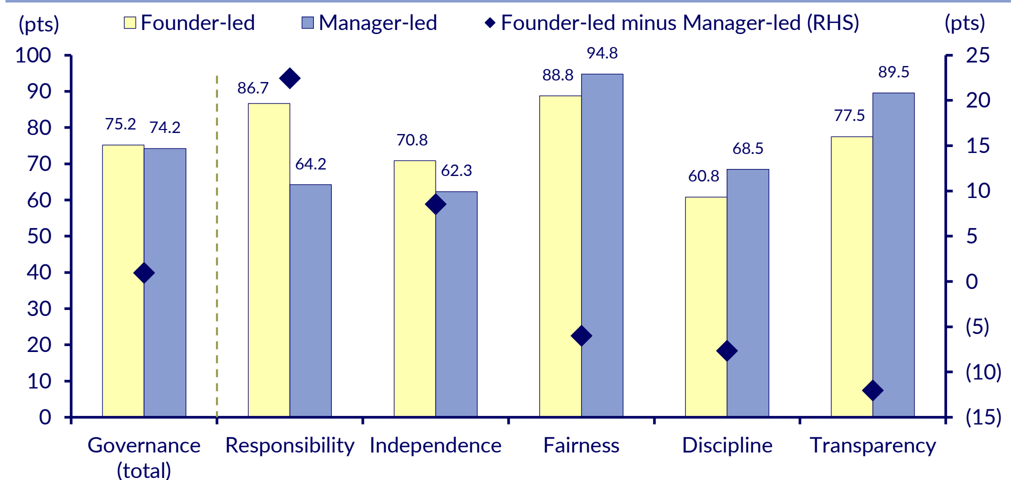
Some argue that founder-run companies could empower management to carry out a longer-term vision and with greater incentive for the company to succeed sustainably, but how would this affect corporate governance?

We define founder-run companies as those with founders undertaking CEO positions, which we sourced from Bloomberg. Admittedly, this definition is insufficient to identify the family influence over the management. Indeed, only four companies returned as founder-run, which limits us in drawing meaningful conclusions from this analysis. Overall, there isn't much difference in their CG scores. Founder-run companies on average score higher in the Responsibility pillar but lower in Transparency.

Founder-run companies generally score higher in the Responsibility pillar but lower in Transparency

Figure 18

Founder-run company CG scores versus manager-run company scores



Note: Founder-run=4. Manager-run=130. Source: CLSA

In particular, for founder-run companies, our analysts are more confident in the financial interest alignment between controlling and ordinary shareholders (CG20). However, access to senior management are on average not as good for founder-run companies (CG11).

Axis Bank appears on both top scorer and improvers list

Top scorers and improvers

We make use of CLSA's proprietary CG scores and list our top scorers and improvers in our India coverage, reflecting companies that have shown a willingness to improve corporate governance. Axis Bank appears on both lists.

A few financial companies are among the top scorers

Figure 19

Top CG scorers

Ticker	Company Name	Sector	Analyst	CG Score
DMART IS	DMart	Consumer	Aditya Soman	92.9
DIXON IN	Dixon	Technology	Indrajit Agarwal	90.5
AXSB IB	Axis Bank	Financial services	Piran Engineer	89.9
LT IB	Larsen & Toubro	Conglomerates	Bharat Parekh	89.9
BAF IN	Bajaj Finance	Financial services	Piran Engineer	86.9
ICICIBC IB	ICICI Bank	Financial services	Piran Engineer	86.9

Source: CLSA

DMart (DMART IS) - Aditya Soman

Uncomplicated governance strategy with clear accountability

We believe DMart scores highly on governance as it follows a very uncomplicated governance strategy with clear accountability towards each stakeholder - shareholders, employees, customers, suppliers and the community. It has very consistent disclosures and a relatively simple corporate structure for a large organisation with a global supply chain and stores spread across the country. The company's chairperson is non-executive with oversight over the board; the board is diverse with distinguished independent directors and a professional management team with clear accountability. The majority shareholder is neither the chairperson nor the CEO, who is a professional employee. DMart has very clear policies with suppliers and customers.

Dixon (DIXON IN) - Indrajit Agarwal

Diverse and independent board. Clear capital allocation policy

The board comprises seven members, with over half being independent directors and 15% being women. The company has expanded further in electronics manufacturing, which is its core competency. It has a well laid out capital allocation policy which focuses on a payback period of less than four years and ROCE of over 25%. This is the key business of the promoters and there have not been any unrelated / return dilutive acquisitions.

Axis Bank (AXSB IB) - Piran Engineer

Strong improvement, with efforts to improve diversity and independence, and raise transparency

Axis Bank is India's third largest private-sector bank and over the past decade, with its fast paced loan book growth, it has also levelled up its corporate governance practices. In line with its peers, it has eight independent directors out of a 13-strong board (compare FY20: 5/11). Its Audit, Risk and Remuneration committee is majority (60%+) independent and the company has made efforts to diversify the composition of its management team in terms of background and gender. Lastly, the IR team is also open to meet with analysts to disclose key developments and market updates, which is a leading indicator of good transparency of the business.

Larsen & Toubro (LT IB) - Bharat Parekh

While L&T's board is in line with the law of the land, it has addressed concerns by adding independent directors to over 50% of the board. It now has a professional board with no promoter and all key committees headed by independent directors. Further, the retirement of good independent directors, who are approaching or past 10-15-year tenures, should take care of concerns about an entrenched board. L&T has also taken measures to correct board compensation over the past seven years with it falling at a 1.3% Cagr over FY16-24, along with the CEO's compensation.

Experienced, independent board; commitment to ESG. Strong relationship with stakeholders

Bajaj Finance (BAF IN) - Piran Engineer

Bajaj Finance's board of directors and its management stand out compared to the rest because it is part of the esteemed Bajaj Group, has a well experienced and independent board (five out of nine independent directors), conducts regular policy assessments, and has effective communication mechanisms. It prioritises ethical dealings, transparency, fairness, and accountability. The company's commitment to ESG is evident through the executive-level cross-functional ESG committee, code of ethics training for over 47,000 employees (in FY24), and linking performance pay of senior management to critical initiatives and ESG goals. It also has a 'Know Your Customer' policy and maintains high governance standards, surpassing legal requirements. With good disclosures and strong communication with investors, it ensures transparency and maintains a strong relationship with stakeholders.

CG has been a top priority of the board for at least five years; best-in-class disclosures

ICICI Bank (ICICIBC IB) - Piran Engineer

ICICIB is India's second largest private-sector bank and at least since the past five years has been led by a board which has kept corporate governance as its top priority. In FY24, eight out of the 13-member board were independent, while in FY20 this number was seven (out of 12). Investor disclosures have also been one of the best-in-class through the years. Moreover, neither the nomination and remuneration nor the audit committees have any executive directors. On employee compensation, the cash component of the variable pay reflects its One Bank One Team philosophy (ie, is dependent on the bank's overall performance) while pay under the firm's employee stock ownership plan reflects individual performance, which we believe is a sign of corporate governance done right.

Figure 20

Top CG improvers

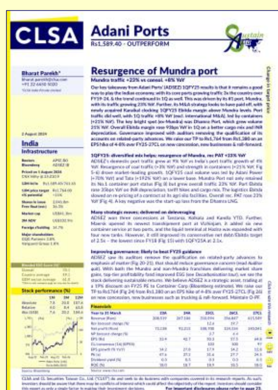
Ticker	Company name	Sector	Analyst	CG Score	CG Score 2020	Improvement (ppts)
TCOM IN	Tata Comm	Telecoms	Deepti Chaturvedi	77.0	57.7	19.4
ADSEZ IB	Adani Ports	Infrastructure	Bharat Parekh	77.3	62.7	14.7
IRB IB	IRB Infra	Infrastructure	Bharat Parekh	86.3	71.7	14.7
AXSB IB	Axis Bank	Financial services	Piran Engineer	89.9	76.0	13.9

Source: CLSA

Government stake sale drives CG score improvement

Tata Comm (TCOM IN) - Deepti Chaturvedi

As part of its divestment strategy the government sold its 26% stake in Tata Communications in March 2021, with 16% sold through an Offer for Sale and 10% sold to the Tata Group, raising Tata Group's holding to 59%. The government influence over the company ended with the stake sale, which resulted in the firm's CG score improvement.


CLSA Adani Ports
Rs1,589.40 - OUTPERFORM

Resurgence of Mundra port

Adani Ports (ADSEZ IB) - Bharat Parekh

Adani Ports saw its auditors removing the qualification on related-party advances to emphasis of matter which should reduce governance concerns. The company also provides investors with good transparency with clear management guidance. The proportion of independent directors has improved too.

IRB Infra (IRB IB) - Bharat Parekh

A strategic stake by Cintra and GIC has improved the growth and governance at IRB, with Cintra appointing two board members and GIC as an observer. There is also an equal representation of the firm's promoter and its strategic partner in the board.

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Companies mentioned

Adani Group (N-R)
Adani Ports (ADSEZ IB - RS1,472.2 - O-PF)
Axis Bank (AXSB IB - RS1,203.3 - O-PF)
Bajaj Group (N-R)
Beijing Jialin (N-R)
Bharat (N-R)
Bokaro Power Supply Company (N-R)
BSR & Co (N-R)
Cintra (N-R)
Coal India (COAL IS - RS495.6 - O-PF)
Dewan (N-R)
DHFL (N-R)
Future Gaming and Hotels (N-R)
Gail (GAIL IB - RS220.6 - U-PF)
GIC (N-R)
HDFC Life Insurance (HDFCLIFE IN - RS714.5 - O-PF)
Hindustan Unilever (HUVR IB - RS3,027.8 - U-PF)
IiAS (N-R)
IL&FS (N-R)
IRB Infra (IRB IB - RS60.0 - O-PF)
Jet Airways (N-R)
Jindal Steel & Power (JSP IN - RS1,004.6 - HLD)
Kotak Bank (KMB IB - RS1,938.6 - O-PF)
LIC Housing Finance (LICHF IB - RS704.0 - HLD)
MediaOne (N-R)
Megha Engineering (N-R)
NDTV (N-R)
Nestle India (NEST IB - RS2,527.8 - O-PF)
NMDC (N-R)
Oil & Natural Gas (ONGC IB - RS294.0 - O-PF)
Raymond (N-R)
Reliance Industries (RELIANCE IB - RS2,988.4 - O-PF)
SAIL (N-R)
Satyam Computer Services (N-R)
Signature Bank (N-R)
Silicon Valley Bank (N-R)
Tata Comm (TCOM IN - RS2,021.5 - O-PF)
Tata Consultancy (TCS IB - RS4,267.6 - HLD)
Tata Group (N-R)
TVS Group (N-R)
Unilever (N-R)
Vedanta (VEDL IS - RS453.1 - O-PF)
Vikas WSP (N-R)

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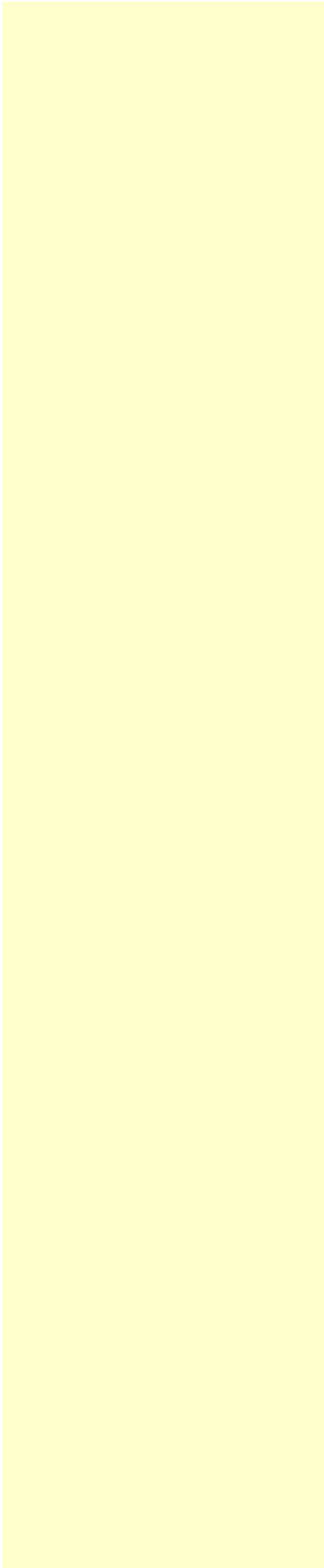

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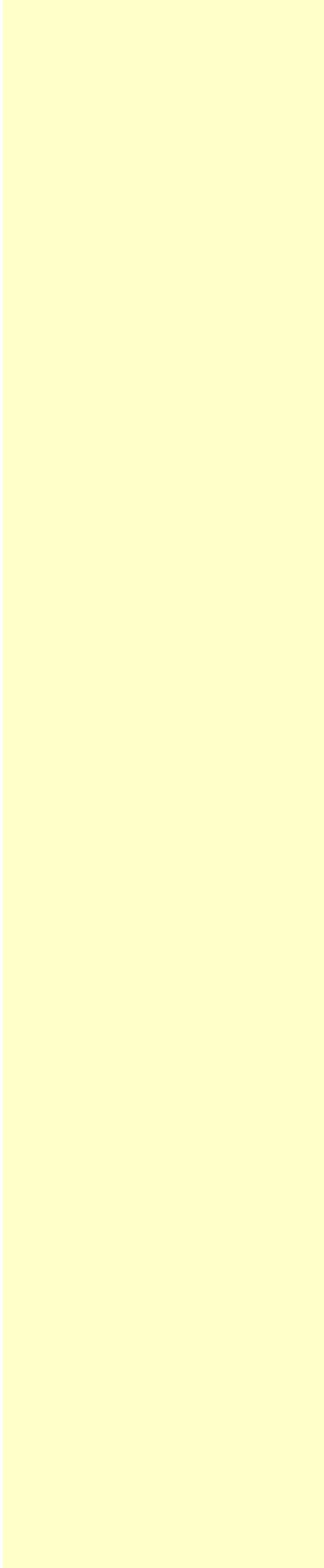

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