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## Decoding Impact of Corporate Governance Committee's recommendations on 'Managerial Remuneration'

November 1, 2017 3:20 pm | By : Gaurav N. Pingle



Apart from how the company complies (and deals) with Related Party Transactions (RPTs), another critical test of good Corporate Governance is the modes and manner in which a company remunerates its directors for their services. Section 197 and Section I of Part II of Schedule V to the Companies Act, 2013 provides remuneration payable to its directors (executive directors and non-executive directors) by companies having

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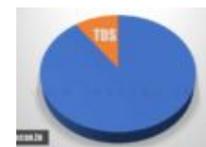
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profits. Section II of Part II of Schedule V to the Companies Act, 2013 provides for remuneration payable by the companies to its directors having no profit or inadequate profit.

SEBI's Listing Regulations also covers provisions relating to compliances and disclosures w.r.t. remuneration to directors. The Kotak Committee has made certain recommendations relating to remuneration to directors. This article is an analysis of the recommendations relating to remuneration vis-à-vis the extant provisions of the Companies Act, 2013.

**Remuneration to Executive Promoter Directors:** Kotak Committee noted various cases of disproportionate payments made to executive promoter directors as compared to other executive directors. Considering this, the Committee recommended that shareholder approval by Special Resolution should be required if total remuneration paid: To a single executive promoter-director exceeds Rs. 5 crore or 2.5% of the net profit, whichever is higher; or

To all executive promoter-directors exceeds 5% of the net profits.

Presently, there is no specific provision in SEBI's Listing Regulations on maximum remuneration payable to executive promoter directors. However, there are detailed provisions in Companies Act, 2013 w.r.t. the remuneration to executive directors. But, the Companies Act, does not distinguish between 'executive promoter director' and 'executive non-promoter director'. Under the Companies Act, 2013, except with the approval of the company in general meeting, remuneration payable to any one Managing Director or Whole-Time Director or Manager shall not exceed 5% of the net profits of the company and if there is more than one such director remuneration shall not exceed 10% of net profits to all such directors and manager taken together. The Committee recommends internal bifurcation between executive directors – promoters / non-promoters. In my view, this recommendation is in shareholders' interest and other directors, whereby promoter executive director may either accept limit on its remuneration (as suggested) or the proposal would be sanctioned by shareholders. In conflict with the Companies Act, 2013 (which permits 10%, in aggregate), the Committee suggests remuneration of up to 5% of the net profits to executive promoter-directors. Also, it is interesting to note that the remuneration to such promoter executive directors, as per Kotak Committee Recommendation, is valid only till the expiry of the term of the director.



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**Remuneration to Non-Executive Directors:** Pursuant to the extant provisions of Companies Act, 2013, subject to the shareholders' approval in general meeting, the remuneration payable to non-executive directors shall not exceed: (i) 1% of the net profits of the company, if company has appointed Managing Director or Whole-time Director or Manager, (ii) 3% of the net profits, if company has not appointed Managing Director or Whole-time Director or Manager. Committee recommended that in case the remuneration of a single non-executive director exceeds 50% of the pool being distributed to the non-executive directors as a whole, shareholder approval should be required. However, in such cases Promoter should also be allowed to vote on such resolutions. Based on the existing practices and statistics, the Committee observed that certain promoter non-executive directors were receiving disproportionate remuneration from the total pool available vis-à-vis all other non-executive directors. It is interesting to note that the remuneration to such promoter non-executive directors, as per Kotak Committee Recommendation, is valid for only one financial year. Though not explicitly mentioned in the Report, but the phrase "Pool being distributed to the non-executive directors" would mean either 3% or 1% of the net profits, as provided in Section 197 of the Companies Act, 2013. If the recommendation is accepted by the SEBI, then it is desirable that such clarification is provided in the SEBI's Listing Regulation.

- **Minimum Compensation to Independent Directors ('IDs'):** In order to attract competent IDs on the boards of the listed entities, Kotak Panel recommended that a listed entity may be required to pay certain minimum compensation to IDs as under:
  - Minimum total remuneration for an ID per year shall be Rs. 5,00,000/- for top 500 companies by market capitalisation (subject to approvals as required under Companies Act). In case of inadequacy of profits, the minimum requirement of Rs. 5,00,000/- shall not apply. However, under the Companies Act, 2013 there is no provisions of payment of minimum remuneration to independent directors (or non-executive directors) in case of loss or inadequacy of profits. Section II of Part II of Schedule V to Companies Act, 2013 relates to remuneration payable to managerial persons by companies having no profit or inadequate profits. In my view, there seems to be a conflict in the recommendation of Kotak Panel and provisions of Companies Act, 2013.
  - Kotak Panel has recommended minimum sitting fees to be paid to ID for Board Meetings, Audit Committee Meetings and every other Board



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Committee Meeting (mandatory under SEBI Listing Regulations). The minimum sitting fees to be paid to IDs for every board meeting shall be:

- 50,000 for top 100 companies by market capitalization,
- 25,000 for next 400 companies by market capitalisation.
- The minimum sitting fees to be paid to IDs for every audit committee meeting shall be:
  - 40,000 for top 100 companies by market capitalisation;
  - 20,000 for next 400 companies by market capitalisation.
- The minimum sitting fees to be paid to IDs for every other board committee meeting (*only for those committees which are mandatory under SEBI LODR Regulations*) shall be:
  - 20,000 for top 100 companies by market capitalisation;
  - 10,000 for next 400 companies by market capitalisation.

While the Panel acknowledged the importance of all board committees, it observed that the workload and obligations on Audit Committee are significantly higher and therefore merit higher sitting fees.

**Conclusion:** Taking into consideration the recommendations, in my view, there are now four types of directors for the purpose of managerial remuneration, i.e. Promoter Executive Director, Non-Promoter Executive Director, Promoter Non-Executive Director, Non-Promoter non-Executive Director. If the recommendations are accepted by SEBI, the monitoring, compliance and disclosures of the managerial remuneration will significantly increase. Also, if the recommendations are accepted, then SEBI ought to provide transition time to comply with the proposed amendments. It is also noteworthy that Kotak Panel has not made any recommendation on the payment of remuneration to directors in 'any other capacity' [Proviso to Section 197(4) of Companies Act, 2013].



**Gaurav N. Pingle** is a Practising Company Secretary from Pune. He handles various assignments of Secretarial Audits, Due Diligence, Quarterly compliance audit of listed companies, routine compliance (under Companies Act & FEMA) for private companies, wholly owned subsidiaries, joint venture companies. As an Author, he religiously writes articles and columns on the current case laws, latest

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