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Confederation of Indian Industry

# Global Trends in Corporate Governance

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# Foreword



Today, Corporate Governance is an inevitable topic of discussion in corporate boardrooms, academic roundtables, and for policy makers worldwide. Several events are responsible for the heightened interest in corporate governance. Corporate implosions over the last ten years and the subsequent increased demand for continuous improvement and transparency in the boardroom have heightened the pace of change for boards worldwide. 2016 is expected to continue this trend. The wave of financial crises of 1998 in Russia, Asia and Brazil, affected their entire economies and deficiencies in corporate governance endangered the stability of the global financial system. Corporate governance failures in United States and Europe caused some of the largest insolvencies in history. In the aftermath of these events, economists, the corporate sector and the policy makers worldwide recognized the potential long term consequences of weak corporate governance systems.

In an analysis of corporate governance from cross-country perspective, the question arises whether a common, global framework is optimal for all? With emergence of China, India and Brazil among others as global economic powers, the traditional model for corporate governance – monitoring and supervision through active investors, free and informed financial media is not necessarily the framework that works. Because corporate governance is primarily about management decision making, it is inevitable that social norms, national culture and structures play a pivotal role, which varies from country to country.

When a country's overall corporate governance is weak, voluntary and market corporate governance mechanisms have more limited effectiveness. Some of the key corporate governance frameworks published across various countries have been responsible for improving the global consciousness on the subject, which include; The Company Law in the EU, The latest G20/ OECD (Organisation for Economic Cooperation and Development) principles, Committee of the Sponsoring Organisations of the Treadway Commission (COSO Framework), the revised Clause 49 of the Listing Agreement, Securities and Exchange Board of India (SEBI) and The Companies Act, 2013 in India.

This paper benchmarks the corporate governance norms across geographies against Indian regulatory requirements and concludes by highlighting the key issues which Boards will need to address in time to come. It highlights some of the important mandates from the world of corporate governance that should continue to make the news and be the subject of debate and speculation. This paper includes research on important issues including, gender diversity, board evaluation and CSR (Corporate Social Responsibility) which are novel with little precedent by bringing global patterns to the foreground and encourage corporate preparedness and precaution.



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# Corporate Governance – Tracking International Developments

The Companies Act, 2013 has raised the bar for the Boards in India. The new concepts introduced in the Act suchlike - women directors on the Boards to bring in gender diversity, enhanced disclosure norms, small shareholder director, performance evaluation of Boards and directors, mandating corporate social responsibility, introducing the possibility of class actions; including internal financial controls and risk management as a part of oversight of the Boards and enhancing the role of the Independent Directors - aim at enhancing the protection for minority shareholders, provide for investor protection and activism, a better framework for insolvency regulation and thus strengthen the foundations of good governance in Indian companies.



Globally, there is an increased realization and an acceptability that good corporate governance is a means to create a business environment of trust, transparency and accountability in order to support investment, financial stability and sustainable economic growth. In the global and highly interconnected world of business and finance where money and corporate operations constantly cross borders, creating trust is something that we need to do together.

The following table identifies some of the key global trends in the landscape of Corporate Governance and benchmark these against the Indian Companies Act 2013 and Clause 49 requirements.

#### Key Global Trends in Corporate Governance and Indian Regulatory Initiatives\*

International Trends	Corporate Governance Requirements in India
<ul style="list-style-type: none"> <li>• <b>Asia:</b> Independent Directors are a requirement for listed companies in all Asian economies, where most require at least 1/3rd of the Board to be independent. The 2012 Singapore corporate governance code recommends a majority of Independent Directors when the chairman of the Board is not independent.</li> <li>• <b>US:</b> The Council of Institutional Investors (CII), Corporate Governance Policies state that at least 2/3rd of the directors should be independent.</li> <li>• <b>Europe:</b> European commission urges member states to have sufficient number of independent non-executive or supervisory directors on Board.</li> </ul> <p>G20/ OECD: The latest principles encourage the prominent role of independent Board members. It states that, it is a good practice where remuneration policy and contracts for Board members and key executives is handled by a special committee of the Board comprising either wholly or a majority of Independent Directors.</p>	<p><b>Independent Directors</b></p> <p>Board to have specific proportion of Independent Directors</p>
<p>Although, there is no specific law to enforce number of women directors on the Board, following countries have taken steps to maintain the ratio of female Board representation (source: www.cfainstitute.org):</p> <ul style="list-style-type: none"> <li>• <b>Japan:</b> In early 2014, Japanese Prime Minister announced the goal of increasing the percentage of women in executive positions at Japanese companies to 30% by 2020.</li> <li>• <b>UK:</b> UK businesses had voluntary targets first set in 2011 i.e. to have 25% women on FTSE100 (The Financial Times Stock Exchange) Boards by 2015.</li> <li>• <b>Canada:</b> At the Federal level, two bills are currently being tabled which will impose a 40% quota for female Board members of public companies and other regulated entities such as banks and insurance companies.</li> <li>• <b>Brazil:</b> A bill pending in the Brazilian Senate would impose a 40% female quota on the Boards of state-owned enterprises by 2022.</li> <li>• <b>France:</b> French parliament adopted a bill that requires public companies making at least 50 million euros in turnover and employing more than 500 workers to have 40% female Board representation by 2017.</li> <li>• <b>Europe:</b> The European Commission has proposed legislation that would require nonexecutive directors to be 40% women by 2020, up from 16.6% in 2013.</li> <li>• <b>Germany:</b> In November 2013, Germany’s Christian Democrats and Social Democrats agreed on a gender quota on supervisory Boards where, issuers would be required to have women comprise 30% of nonexecutive directors by 2016. The planned legislation would require firms that don’t meet the 30% mark to leave those seats vacant.</li> </ul> <p>The latest G20/ OECD principles encourages measures such as voluntary targets, disclosure requirements, Boardroom quotas, and private initiatives that enhance gender diversity on Boards and in senior management.</p>	<p><b>Woman Director</b></p> <p>Requirement of at least 1 woman director on the Board for listed companies and public companies</p>

International Trends	Corporate Governance Requirements in India
<ul style="list-style-type: none"> <li>• <b>Asia:</b> Committees of Boards such as audit, remuneration and Board nomination are required in all Asian economies except Vietnam. In China, the Audit Committee is to be composed of Independent Directors only.</li> <li>• <b>Europe:</b> European Commission in 2005 recommended that companies set up committees on the (supervisory) Board to deal with nomination, remuneration and audit issues.</li> <li>• <b>US:</b> The Nominating and Corporate Governance Committee is one of the three standing committees, along with Audit Committee and Compensation Committee, required by NYSE, to be composed entirely of Independent Directors.</li> </ul> <p>G20/ OECD principles encourages formulation of Nomination Committee to ensure proper compliance with established nomination procedures and to facilitate and co-ordinate the search for a balanced and qualified Board.</p>	<p><b>Formulation of various Committees</b></p> <ul style="list-style-type: none"> <li>• Audit Committee,</li> <li>• Advisory Committee,</li> <li>• Nomination and Remuneration Committee,</li> <li>• Stakeholder Relationship Committee</li> </ul>
<ul style="list-style-type: none"> <li>• <b>US:</b> The U.S. National Association of Corporate Directors (NACD), recommends that the Governance Committee should be responsible for ensuring that a process exists for the Board to routinely assess its own performance, the performance of its Committees as well as individual directors to conduct self- assessment.</li> <li>• <b>Europe:</b> The Commission of the European Communities in 2009 recommended that director’s remuneration should be based on performance. Variable components of remuneration should be linked to predetermined and measurable performance criteria, including criteria of a non-financial nature. The UK Corporate Governance Code recommends evaluation of the Board of FTSE 350 companies to be externally facilitated at least every three years (on a comply-or-explain basis)</li> <li>• <b>Brazil:</b> IBGC Code of Best Practices (Brazilian Institute of Corporate Governance) recommends: <ul style="list-style-type: none"> <li>– A formal evaluation process of the performance of the Board, of individual directors and of the CEO</li> <li>– The process to be conducted by the Chair</li> <li>– Participation of the outsider to make the process more effective</li> <li>– Evaluation system adapted to each organisation</li> <li>– Disclosure of the process of evaluation to the shareholders</li> </ul> </li> <li>• <b>Mexico:</b> Mexican Corporate Governance code recommends performance evaluation of the Board and its members as fiduciary duties.</li> </ul> <p>The revised G20/ OECD principles on corporate governance recommends that Boards should regularly carry out evaluations to appraise their performance and assess whether they possess the right mix of background and competences.</p>	<p><b>Performance Evaluations of the Board, Committees and Directors</b></p> <p>Independent Director’s and Committee’s performance evaluation by the Board is mandatory</p>

International Trends	Corporate Governance Requirements in India
<ul style="list-style-type: none"> <li>• <b>US:</b> The U.S. National Association of Corporate Directors (NACD) identifies Board’s role in risk oversight. Responsibilities of the Board include, establishing company’s risk management policy, risk appetite, regular review of risks in relation to the risk appetite and evaluation of management response to the significant risks. Board is expected to disclose sufficient information to shareholders at least annually to enable them to assess whether the Board is functioning effectively.</li> <li>• <b>UK:</b> The UK Corporate Governance Code 2014 states that Board should monitor company’s risk management and internal financial control systems at least annually carry out a review of their effectiveness and report on the same in the annual report. The Board should also state the methodology followed for conducting performance evaluation of the Board, its committees and individual directors.</li> <li>• Corporate governance code for most of the countries in Europe (Italy, France, Germany), UK, APAC (China, Japan, India) state requirements of Board oversight on IFC, risk management, related party transactions and other disclosures in their annual report.</li> </ul> <p>G20/ OECD principles state that, the corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. It says, that disclosure should include, but not be limited to, material information on:</p> <ol style="list-style-type: none"> <li>1. The financial and operating results of the company.</li> <li>2. Company objectives and non-financial information.</li> <li>3. Major share ownership, including beneficial owners, and voting rights.</li> <li>4. Remuneration of members of the Board and key executives</li> <li>5. Information about Board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the Board</li> <li>6. Related Party Transactions</li> <li>7. Foreseeable risk factors</li> <li>8. Issues regarding employees and other stakeholders.</li> <li>9. Governance structures and policies, including the content of any corporate governance code or policy and the process by which it is implemented</li> </ol>	<p><b>Board’s Report and its inclusions</b></p> <p>Directors’ Responsibility Statement (DRS)</p> <p>Additional requirement on Internal Financial Controls (IFC) and legal compliance.</p> <p>Inclusions of Board’s Report: Risk management policy, Loans, guarantees and investments, Contracts or arrangements with related parties, formal annual evaluation of its own performance, committees and individual directors, detailed disclosures related to directors’ remuneration, details of significant and material orders passed by the regulators or courts or tribunals.</p>
<ul style="list-style-type: none"> <li>• <b>Australia:</b> ASX Corporate Governance Council has recommended that the Board of the listed entity, before its approval of the entity’s financial statements, should receive a declaration from the CEO and CFO that the financial records are properly maintained, financial statements comply with appropriate accounting standards and give a true and fair view of the financial position and performance of the entity and their opinion is based on the sound risk management and effective internal controls.</li> <li>• <b>UK:</b> The UK Corporate Governance Code 2014 states that the CEO, jointly with management and other oversight bodies linked with Board of directors is responsible for developing and submitting internal control systems for the Board’s approval. The internal controls are subject to annual review.</li> <li>• <b>China:</b> Provisional code of CSRC (Corporate Governance for Securities Companies) in its general provisions state that the securities companies should establish a complete risk management and internal control systems in accordance with relevant laws, administrative rules and regulations in compliance with requirements of CSRC (Corporate Governance for Securities Companies).</li> <li>• Corporate Governance code for most of the countries in US, Europe and APAC state a requirements of an effective internal control system and disclosure of its adequacy in the company’s annual report.</li> </ul>	<p><b>Internal Financial Controls Disclosures:</b></p> <ul style="list-style-type: none"> <li>• Disclosure on adequacy and operating effectiveness in DRS</li> <li>• Adequacy of IFC and operating effectiveness in Auditor’s report</li> </ul>

International Trends	Corporate Governance Requirements in India
<p><b>Brazil:</b> IBGC Corporate Governance Code states that directors should ensure that the RPTs are conducted according to the market practices in terms of deadlines and rates and are clearly reflected in the organisation reports. There is a prohibition on the loans in favour of the controlling partner and the administrators. The operations should be based on the independent appraisal reports and information endorsed by third parties. Loans between related parties should be avoided.</p> <p>G20/ OECD: RPTs should be approved and conducted in a manner that ensures proper management of conflict of interest and protects the interest of the company and its shareholders. Conflicts of interest inherent RPTs should be addressed through proper monitoring and disclosure.</p> <p>In most jurisdictions, great emphasis is placed on the Board approval, often with prominent role for independent Board members or requirements for the Board to justify the interest of transaction for the company. Shareholders are also given a say in approving certain transactions, excluding the interested shareholders.</p>	<p><b>Related Party Transactions (RPTs)</b></p> <ul style="list-style-type: none"> <li>• Formulation of RPT policy</li> <li>• Prior Board Resolution at a meeting required for specified transactions with related parties.</li> <li>• Exemption for transactions in ordinary course of business and an arm's length basis</li> <li>• Prior approval of Audit Committee required for all RPTs</li> </ul>
<p><b>Canada:</b> In 2013, Canada launches SVX, the Social Venture Exchange, one of the first social stock exchanges. It self-describes as a private investment platform made to connect impact ventures funds and investors.</p> <p><b>Brazil:</b> In 2012, Bovespa releases 'comply or explain' recommendations for all listed companies, encouraging them to state whether they publish a regular sustainability report and where it is available, or explain why not.</p> <p><b>Australia:</b> In 2014, The Australian Securities Exchange (ASX) updated their non-financial disclosure requirements, now requiring companies to disclose if they have material exposure to 'environmental and social sustainability risks' and how they plan to manage and mitigate this risk.</p> <p>2010 Companies listed on ASX must disclose if they have developed a code of conduct on environmental risks and controls.</p> <p><b>China:</b> In 2008, China's State-owned Assets Supervision and Administration Commission (SASAC) releases a directive strongly encouraging state-owned enterprises to follow sound CSR practices and report on CSR activities. While this directive is not binding, SASAC holds a lot of influence in the business community, and such a directive demonstrates serious commitment to corporate social responsibility.</p> <p><b>UK:</b> In 2013, The Financial Reporting Council (FRC) in the UK announces that it is finalizing guidance on companies' disclosures on environmental, social, and diversity issues. The new strategic report requires companies to provide a complete picture of their business activity, including social effects, calling into question what is material in business reporting.</p> <p><b>Germany:</b> In 2011, The German Council for Sustainable Development (GCSDD) develops a German Sustainability Code. It includes 20 criteria and 27 GRI Performance Indicators that describe what should be taken into account in sustainability and reporting analysis.</p> <p><b>France:</b> In 2012, The Grenelle II Act is passed, requiring companies to include ESG (Environmental, Social and Governance) information in their annual report. Large companies are to comply in their 2012 reports, and smaller companies (defined as having fewer than 500 employees and total assets or net annual sales of €100 million) are to comply by 2014.</p>	<p><b>Corporate Social Responsibility</b></p> <ul style="list-style-type: none"> <li>• <b>CSR Committee:</b> &gt;=3 directors, 1 Independent Director (ID)ID</li> <li>• <b>CSR Policy:</b> To formulate the policy by CSR Committee</li> <li>• <b>CSR Projects:</b> Schedule VII of The Companies Act, 2013 prescribes the CSR projects</li> <li>• <b>CSR Report:</b> Disclose and report CSR policy and activities undertaken by the Company</li> <li>• <b>CSR spend:</b> At least 2% of the average net profit of the Company in the immediately 3 preceding years</li> </ul>

\*Source: European Corporate Governance Institute: <http://www.ecgi.org/codes>



# The Emerging Issues in Corporate Governance

2015 has shaped up to be a year where Boards, once again, are under intense pressure and scrutiny to get it right. The Board is not only accountable to the company and its shareholders but also has a duty to act in their best interests. In addition, Boards are expected to take due regard of, and deal fairly with, other stakeholder interests including those of employees, creditors, customers, suppliers and local communities.

Following are the key issues which the Boards will have to address themselves to, in the year ahead

1.

## Greater attention towards director independence

A director can be formally independent, and yet feel caught inside the boardroom. This can be because of his or her social relationships, donations, jobs or contracts for friends, perks, vacations, office use, director interlocks, supplier or customer relations, and excessive tenure and compensation.

2.

## Shareholder democracy vs stakeholder democracy

The appeal of "shareholder democracy" has dominated most changes in corporate governance over the past few years and has helped strengthen the shareholder franchise. However, maximizing enterprise value and a move from shareholder democracy to stakeholder view of governance is a tendency towards which academic literature is veering to.

3.

## Better Boards and diversity

Regulators are moving towards prescribed competency matrices. Production of detailed selection criteria, job descriptions, curriculum vitae and interviews with directors and oversight functions to determine whether these individuals are fit for purpose can be challenging in this changing landscape.

4.

## Risk governance and risk management

Directors are at risk for oversight failure. Regulators are imposing onerous risk coverage requirements on directors that require oversight of internal controls and risk management.





## 5.

### Compensation governance

Media and public consciousness about the quantum and alignment of executive pay have resulted in regulation over: compensation committee, adviser independence, and pay ratios.

## 6.

### Increased shareholder accountability

Greater control to shareholders over director selection and removal.

## 7.

### Increased focus on strategy and value creation

Good Board focus is on the value creation plan, monitoring, and hold management responsible for its achievement. Complacent or inexperienced Boards incapable of directing an under-performing, ineffective, or inefficient management team are being questioned. Excessive or non-performance-based compensation is a red flag for governance intervention.

## 8.

### Information Technology governance

Rapid technology advancement has created opportunity and risk. There is profound technological ignorance by many or most Boards that is creating an inability to direct and oversee management. Cyber security, BYOD (Bring Your Own Device), and social media are just three IT risks that have deficient or non-existent internal controls, which in turn can cause privacy breaches, reputational damage, and significant investor loss.

9.

### Board performance evaluations

Regulation, activist, technical, and public pressures are augmenting the objective standard of care for directors. Director action (or inaction) will be more and more visible.

10.

### Tone at the top, now in the middle

Boards vicariously responsible in acts of fraud, bribery, and other forms of corruption are being held by regulators at profound degrees within and outside their organization. "Tone in the middle" culture, and injudicious risk-taking are the new warning signs on which prudent boards are seeking substantial assurance, to ensure that the directors do not remain the last link in the information chain.

11.

### Boardroom

Board should work as one team with a common goal. Any behavior gap, undue influence, reliance, dislike, dysfunction, or even contempt — by one or more directors or managers, introduces information and oversight asymmetry that can lead to governance failure.

To conclude, there have been more governance changes occurring in the last five years than in a generation. Enron, WorldCom, and other implosions in 2001-2002 are different from the global financial crisis of 2008-2009. There are regulatory and investor pressures for broad and deep governance changes. The above 11 issues are the touch points where governance changes are expected to happen the most as we approach 2016. The Boards and management teams would do well to take on board these emerging issues.

# About CII



## Confederation of Indian Industry

The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the development of India, partnering industry, Government, and civil society, through advisory and consultative processes.

CII is a non-government, not-for-profit, industry-led and industry-managed organization, playing a proactive role in India's development process. Founded in 1895, India's premier business association has over 7600 members, from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 100,000 enterprises from around 250 national and regional sectoral industry bodies.

CII charts change by working closely with Government on policy issues, interfacing with thought leaders, and enhancing efficiency, competitiveness and business opportunities for industry through a range of specialized services and strategic global linkages. It also provides a platform for consensus-building and networking on key issues. Extending its agenda beyond business, CII assists industry to identify and execute corporate citizenship programmes/programs. Partnerships with civil society organizations carry forward corporate initiatives for integrated and inclusive development across diverse domains including affirmative action, healthcare, education, livelihood, diversity management, skill development, empowerment of women, and water, to name a few.

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With 66 offices, including 9 Centres of Excellence, in India, and 7 overseas offices in Australia, China, Egypt, France, Singapore, UK, and USA, as well as institutional partnerships with 300 counterpart organizations in 106 countries, CII serves as a reference point for Indian industry and the international business community.

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