



NSE-IGIDR Conference on Corporate Governance

Edited Transcript of
Keynote Speech and Panel Discussion

Mumbai
June 21, 2018



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Mr. Nawshir Mirza, Professional Independent Director
Mr. Sumit Rai, Managing Director and Chief Executive Officer – Designate,
Edelweiss Tokio Life Insurance Company Limited
Moderator: *Mr. Suneet Weling, Managing Director, Head of Advisory,*
Capital Raising and Financing, India, BNP Paribas

Preface

While the onus of maintaining and raising governance standards of corporates in any jurisdiction lies with all the stakeholders, stock exchanges worldwide play a particularly key role in this, given their traditional mandate to monitor their listed companies' compliance with listing and disclosure requirements. In this respect, NSE has been no exception. Indeed, to improve governance standards, NSE has gone beyond these regular channels and taken initiatives to influence policy debates by involving regulators, practitioners and academics. Toward this end, NSE jointly with the Indira Gandhi Institute of Development Research (IGIDR) has taken a research initiative, whose aim is to provide a platform for industry and academia to complement each other and to give research support for effective policy making. As part of this initiative, a conference on corporate governance was held on June 21-22, 2018 in Mumbai. The conference *inter alia* involved a keynote speech by Dr. Jayant R. Kale (Professor of Finance, D'Amore McKim School of Business, Northeastern University) and a panel discussion.

Dr. Kale delivered his speech on the topic "Corporate Boards: Loyal to whom?" While pointing out that the corporate boards' objectives vary across different jurisdictions, he stated that in UK and many western European countries the directors' objective function is to maximize corporate wealth. This approach lies somewhere in between two extreme approaches: one that aims at 'shareholders wealth maximization' (followed in the United States), and the other that pursues 'stakeholders wealth maximization' (followed in India). While discussing about these objective functions of boards in different jurisdictions, he highlighted both pros and cons of each approach. He emphasized that trust plays a key role in all circumstances and hence, it is imperative that the policy makers and regulators enforce policies to preserve and promote trust in corporate bodies.

Subsequently, a panel discussion was held on "Indian Stewardship Code: Imperatives and Challenges". The panelists were from diverse backgrounds and included Mr. Amarjeet Singh (Executive Director, SEBI), Mr. Chris Hodge (Director, Governance Perspectives, UK), Mr. Leo Puri (Managing Director, UTI Asset Management Co. Ltd.), Mr. Nawshir Mirza (Professional Independent Director), Mr. Sumit Rai (Managing Director and Chief Executive Officer – Designate, Edelweiss Tokio Life Insurance Co. Ltd.) and Mr. Suneet Weling (Managing Director, BNP Paribas). The discussion started with an overview of the Stewardship Code that exists in UK and other countries. The discussion revolved around the challenges that a country could experience in the process of formulation of the code and its implementation. The panel also explored the scope of having a single code in India across all sectors.

I would like to thank Dr. Kale for the keynote speech and all the panelists for their valuable contribution to the discussion. I am also grateful to Mr. Weling for playing a wonderful role as moderator in the panel discussion. The deliberations of the conference has been captured in this edited transcript and we believe that the transcript would be useful for industry participants, academics and policy makers.

Nirmal Mohanty

Head, Department of Economic Policy and Research

National Stock Exchange of India Ltd.

Welcome remarks

Mr. Vikram Limaye, MD & CEO, NSE

Nirmal Mohanty: Good evening, Ladies and Gentlemen. A warm welcome to all of you for the NSE-IGIDR International Conference on Corporate Governance, 2018. May I now request Mr. Vikram Limaye, the MD and CEO of NSE, to deliver the welcome address and start the NSE-IGIDR Conference.

Vikram Limaye: Good evening, everyone. A warm welcome to all of you for the 4th NSE-IGIDR Conference on Corporate Governance. We have amongst us many distinguish professionals, academics, guests from Regulatory Bodies and of course from the NSE. It is indeed a matter of great pleasure and honour for NSE to interact with the gathering of highly regarded academics, experts and practitioners in the Corporate Governance domain. For those who are attending the conference for the first time, this is a result of a research collaboration between NSE and the Indira Gandhi Institute of Developmental Research, which is a prestigious academic institute set up by the Reserve Bank of India. This conference is held annually under this collaboration. There is one aspect of this conference which many of you may not be aware of, which is that this evening's program is only a part of the conference. The Conference also involves presentation of research papers selected by a team of eminent academics which will take place tomorrow. Tomorrow, the authors of these papers will present their research findings. For this, we typically invite academics and researchers because the papers are actually quite technical in nature. But the part of the conference that you are going to attend this evening has been deliberately kept nontechnical to the extent possible, keeping in view the fact that academics are in a minority in the audience and most of us present here are professionals from markets and from corporates.

Over the years the proceedings of the conference have been standardized. It covers the panel discussion on a topical issue and a keynote speech. The keynote speaker for this year is Prof. Jayant Kale. Thank you very much Prof. Kale for coming. Prof. Kale is the Professor of Finance at D'Amore-McKim School of Business at Northeastern University in Boston and he is going to talk about "Corporate Boards: Loyal to Whom?" He is a distinguished professor and has done extensive research on Corporate Finance. We all look forward to your talk, Prof. Kale.

I shall now talk a little bit about the Corporate Governance initiatives in India. Recognizing that good corporate governance is key to the integrity of corporations and even central to the health of any economy and its stability, the regulators have taken several initiatives over the years to improve corporate governance standards in India, the most recent one being the constitution by the SEBI of a Committee under the chairmanship of Mr. Uday Kotak in June 2017. I am sure all of you are aware of this Committee and that its report was submitted to SEBI on October 5, 2017. After consideration and

deliberation, SEBI in its board meeting in March 2018, has accepted several recommendations of the Kotak Committee. I consider it most pertinent to add here that a part of the recommendations of the Kotak Committee relate to the stewardship code, which will be the subject of the discussion today by an excellent panel of experts.

The results of the policy initiatives taken by the authorities in the last two decades have been encouraging. According to the Doing Business Report 2018 published by the World Bank, India has made substantial improvements in the realm of corporate governance over the years. For example, India is now ranked 4th in the world in protecting minority investors, as compared to 13th in 2017, which helped significantly in raising India's overall rank to 100th among 190 countries, from a rank of 130th in 2017. Further, the 'Corporate Governance Watch 2016' published by CLSA and ACGA ranked India 7th among Asian countries in terms of overall corporate governance score.

On its part, NSE has been persistently endeavouring to improve the governance standards of listed companies, driven by the conviction that such efforts would lead to fairer and more efficient securities market. Towards this end, we have gone beyond the traditional mandate for exchanges to monitor the compliance by listed companies with the governance norms. A number of initiatives have been taken. The annual conference that we organize with IGIDR for which we have all gathered here today is one such initiative. We also hold seminars and round-tables from time to time where we try and generate debate on topical issues, the most recent being a round-table we held in collaboration with the European Corporate Governance Institute. The aim in both cases is to bring together academics, practitioners and policy makers to debate on the existing and emerging corporate governance issues and generate useful insights.

Further, we have constituted the 'NSE Centre for Excellence in Corporate Governance', an independent expert advisory body. Some of you may be aware of the Quarterly Briefing that this Centre brings out, which is circulated amongst various NSE listed companies. Furthermore, we are in the process of creating incentives for listed corporates to voluntarily adopt corporate governance norms to be defined by NSE that are stricter than those defined by existing laws and regulations, and actually even go beyond what the Kotak Committee recommended. Companies are expected to sign up for these norms voluntarily in return for improved visibility, higher liquidity and better quality investors. This initiative has been inspired by an initiative in Brazil called Novo Mercado, which has been highly successful. The aim of this initiative is to drive corporate governance by incentives rather than a legal mandate.

Again, on behalf of NSE, I welcome all of you to this conference. I am sure that the deliberations of this conference would be useful for all stakeholders and contribute to the current debate on corporate governance. I wish the conference the very best. Thank you very much.

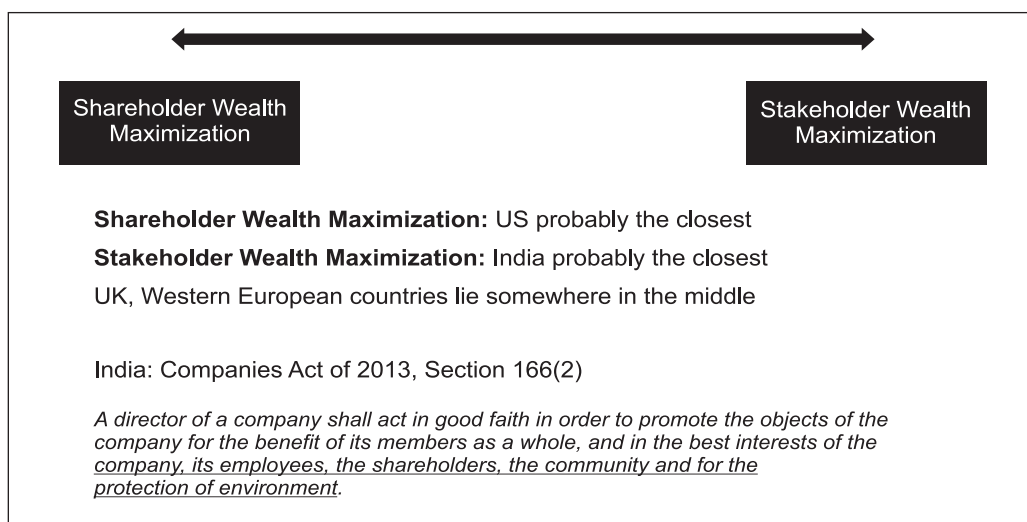
Corporate Boards: Loyal to Whom?

Professor Jayant R. Kale

Ashiana Salian: Thank you, Sir. Next program on the agenda is the keynote speech by Prof. Jayant Kale. He is the Professor of Finance at D'Amore-McKim School of Business at Northeastern University in Boston, where he also holds the Philip R. McDonald Chair. Before joining Northeastern, Prof. Kale held the Talmadge Dobbs Chair at Georgia State University with a joint appointment as Prof. at IIM Bangalore. He also taught at the Indian School of Business and Nanyang Technological University in Singapore. Prof. Kale's research interests are primarily in corporate finance and institutional investment. He has published several articles in premier academic journals including Journal of Finance, Journal of Financial Economics, Review of Financial Studies and the RAND Journal of Economics. I now invite Prof. Kale to please come on stage and deliver the keynote speech.

Jayant Kale: Thank you. I am very happy to be here. I have been involved with the NSE-IGIDR Conference right since the beginning and as Vikram said, tomorrow is the reason I got involved in this when there is a completely different part of this conference. Today I am going to talk about directors' loyalties and just to put the things in perspective, here is the picture (Chart 1).

Chart 1: Where does director loyalty lie?



As you can see here, at one extreme, you have loyalty to shareholder which is 'shareholder wealth maximization' and at the other extreme, you have 'stakeholder wealth maximization'. This is a continuum that I have drawn because those are the two extremes that I am going to look at.

If you look at shareholder wealth maximization, the country that probably comes closest to it is the US, i.e. the firms and public corporations in the US. As far as stakeholder wealth maximization is concerned, the country that comes closest, in my opinion, is now India, especially after the Amendment of the Companies Act in 2013. The other countries such as the UK and other countries in Western Europe lie in the middle of this spectrum. In India, according to the Companies Act of 2013, Section 166(2), the Board of Directors shall act in the best interests of the company, its employees, shareholders, community and the protection of environment (Chart 1). These are all stakeholders. In the case of the US, it would simply be the company and its shareholders, which means 'shareholder wealth maximization'.

Here is the roadmap of what I am going to talk about. I am going to spend some time talking about 'shareholder wealth maximization'. I will talk about its pros and cons. Then I will talk about what's going on in the US with 'shareholder wealth maximization' as an objective. Clearly all of you are aware that there are some problems with this. I will tell you a slightly augmented version of 'shareholder wealth maximization' that addresses some of these problems. I will discuss the same for 'stakeholder wealth maximization' and also for the third objective of 'corporate wealth maximization'. After discussing all that, and I might as well tell you the bottom-line now, it turns out that all three have problems. Then I am going to take a few steps back to see, if there is an optimal solution possible? Can we come up with a social rule which actually is the best? I will spend some time talking about that, and then talk about some takeaways of what we can go away with. So that's the roadmap, hopefully I will get through it.

Why did I choose this topic? Before answering this, let me tell you that I have been coming to this conference every time and know that there are many in the audience who actually live this dilemma because they serve on corporate boards or are trustees, etc. I am an academic, so I am going to look at it from academic's point of view. Please feel free at the end to share your views as to whatever I said makes sense or not.

So, why did I choose this topic? First of all, it had to be related to governance. It also had to be of interest to this audience, and most importantly, I should know something about it. Alright, so given these three requirements, I started figuring out, why am I doing this? I am aware of what this conference is about. It is about Corporate Governance and I think in the last year or the one before that, there was a lot of time spent on CSR and there was a panel discussion on representation of minorities in the board, etc. And then I also found out about this amendment to the Companies Act where India has now codified that the job of the director is to maximize stakeholders' wealth or welfare. Most importantly, I work on Corporate Governance but mostly from the point of view of incentives primarily in incentives that are present in remuneration scheme and how they affect behaviour. I have also done work on non-financial shareholders such as suppliers and customers under the objective of shareholders wealth maximization. If the firm wanted to take into account the concerns of these non-financial stakeholders,

how corporate financial decisions like capital structure, structuring of compensation schemes should be affected. In my research, I have pretty much always use shareholder wealth maximization as the objective function. While doing that, a couple of times when building a theoretical model, I came across a logical difficulty in using shareholder wealth maximization. So I said okay, I know little bit about governance, I know little bit about non-financial stakeholders. I know some problems, which is why I thought I will make this choice and speak about this subject.

It is something that sounded so straightforward. The more I started thinking about it, I figured that this is actually a very complex problem, and it's not clear to me, and I don't think it's clear to the profession, that there is an optimal solution possible. Apparently there isn't. The other thing I found out was that in order to understand the nuances of this issue, while I knew a little bit about what is there in Finance, I had to go and read articles in Economics, Accounting, Law, and you are not going to believe this, but also in political philosophy in order to understand what exactly is going on.

The bottom line is that I am still very unsure, and I will tell you over the next half an hour or so, as to why I am still unsure. I do recognize that many of you are policy makers, some are in regulatory bodies and many of you serve on boards, etc. As I said in the beginning, this is something you live. For me, this is an abstract exercise or it was an abstract exercise. I am not saying that one is better than the other. I am very agnostic about this. I am sure that you have some thoughts on some of these issues I will bring up and hopefully you will share them with the audience towards the end.

Let's talk about shareholder wealth maximization very quickly. When I talk about 'shareholder wealth maximization', I am talking about maximizing stock price because that's how we measure shareholders wealth. The fact that shareholder wealth maximization is about maximizing stock price the biggest advantage is that it's very well defined. It's very easily observable because I am talking about public corporations and it is a market determined benchmark. You have this benchmark which allows you to measure performance of the firm as well as performance of the management and so on. It gives a very good benchmark, so that's a pro. The second thing is that it works pretty well 'IF', and this is a very big 'IF', there are no imperfections, I will talk about these imperfections shortly, such as agency/information problems or institutional constraints. Once you bring those in, then things start falling apart. These are the pros of shareholder wealth maximization.

If you go to the cons, the first one people always talk about is 'Managerial Myopia'. Let me clarify one thing - I am using the word managers and directors interchangeably. Shareholder wealth maximization forces the managers to look at stock price and myopia refers to the criticism that managers tend to maximize shareholder wealth in the short term. Now if you look at the stock price, it should reflect not just cash flows from the short term but also from the long term. So where does this myopia come from? It comes because of imperfections such as agency issues where managers have their own interests and so on. I am not going to spend too much time on this myopia. If you look at all these issues related to earnings management, etc., Jeremy Stein has a very nice article where he shows that there is a bad

equilibrium outcome which you can't get out of. Everyone is acting rationally but is also behaving myopically. So that is the problem that occurs with shareholder wealth maximization.

The second problem with shareholder wealth maximization is that when managers act in the interest of shareholders, there is always the possibility that they can transfer wealth from creditors to shareholders. Let me explain it with a numerical example as given below.

Example 1: Shareholder Wealth Maximization

	Option A		Option B	
Up Prob.	0.50	\$1,500,000	1.00	\$1,200,000
Down Prob.	0.50	\$300,000	0.00	0
Debt Claim	\$1,000,000		\$1,000,000	
Net Present Value	-\$100,000		\$200,000	
Exp. Payoff to SH	\$250,000		\$200,000	
Exp. Payoff to Debt	\$650,000		\$1,000,000	

Let's suppose you have two choices A and B. For option A, the cash flows are: there is a 50% probability that you will get \$1.5 million and a 50% probability that you will get \$300,000. So, the expected value is \$900,000 for this one. Under option B, on the other hand, you are guaranteed a \$1.2 million cash flow. So, the expected value is \$1.2 million. Let's also assume that the cost of each option is one million dollars which is financed through debt. The expected value under option A was \$900,000 but the cost is \$1,000,000. So, the net value is negative, i.e. -\$100,000, whereas in the case of Option B, there is a net gain of \$200,000. So, B is a better option.

But because of limited liability, what should be the expected pay off to shareholders? When the cash flow here is \$1.5 million, they pay the million dollars owed to creditors and are left with \$500,000. When firm cash flow is \$300,000, they just walk away because of limited liability. Thus, their expected cash flow in Option A is 0.5 times \$500,000 i.e. \$250,000, whereas in Option B their expected cash flow is \$200,000. If you are a shareholder or someone acting in the interest of shareholder, even though A is not a good project, you will end up choosing A.

Who loses in the process? The people who gave this firm credit. If you look at the value of the creditors' claims, in Option B it's a million dollar; they will all definitely get their million back. But in Option A, if there is the upside, they will get a million dollars. If it's a downside, they will get only \$300,000. So their expected value is \$650,000. Thus there is a transfer of wealth from creditors to shareholders. In case of shareholder wealth maximization, such perverse behaviour is always possible. This is a very

simplified example and there are solutions to this problem; but I just wanted to point out the problem of this wealth transfer.

Another con is that shareholder wealth maximization may not be complementary with employee welfare. In the previous example, just substitute debt claim with employee pay or pensions or whatever, and you will get the same kind of solution. Similarly, under shareholder wealth maximization, there is potentially less concern for community welfare, environment, etc. Shareholders are going to maximize what they get and let everyone else lose.

That being the case, what do academics say? There are some well-known textbooks written by Van Horne, Brealey & Myers, Copeland & Weston, etc. which basically say, we assume that the objective of the firm is to maximize its value to shareholders or the most important theme is that the objective of the firm is to maximize the value of its stockholders. This is the academic's viewpoint and this is what got me in trouble and got me to choose this topic.

Then I started thinking, why do academics want shareholder wealth maximization as the objective? The reason is actually a manifestation of an agency problem. We like to build models, mathematical models that are clean, elegant. If I had a complicated objective function like stakeholder wealth maximization, then I won't be able to build these nice models. And I think that is the reason why academics have chosen shareholder wealth maximization as an objective function. Now there are some who are trying to work on models using stakeholder wealth maximization and to the best of my knowledge, there is no theoretical model yet which actually solves this problem.

Lynn Stout is a professor of Corporate Law at Cornell. Very sadly, she passed away in April. She is, in someone's words, a rock star in this campaign against shareholder wealth maximization. These are some of the quotes from her talks and if you ever get a chance, just see her talks on YouTube, they are really fun to watch. This is the state of the US Law, "*there is no legal duty to maximize shareholder value... (w)on't find it in the law*" that the job of a director is to maximize shareholder wealth. We made up this objective because it made our life easier. The academics have a mistaken idea that the purpose of the corporation is to maximize shareholder value. Nowhere it said so, and one of the reasons which is kind of similar to what I said is, if we have such a nice well defined objective function, it makes economics or financial economics more like a pure science, something like Physics where we can actually build models and do comparative statics and so on.

If you want to see the duties of directors, you have to go in the US State Laws. Majority of states in the US have passed what we call Constituency Statutes. They vary from state to state. You have a state like Delaware where the Constituency Statutes are more in favour of shareholder wealth maximization. At other end, you have states like Pennsylvania and Indiana which are more in favour of stakeholder welfare maximization. However, it is very important to note that the states' Statutes in the US do not mandate boards to consider other stakeholders. According to legal scholars, this is being done

because in case of the legal lawsuit, it may protect directors against claims of breach of duty. It is not clear whether this defence will hold if shareholders are negatively affected and, even if it did, it is not at all clear whether these Constituency Statutes will save them. These Statutes came about in the 1980s because there were lots of corporate control contests. If I have to put everything in one sentence about the US State Laws:- “directors can take into account interests of non-financial stakeholders only to the extent that they are acting in the short and long term interests of the shareholders”. It is still shareholder wealth maximization.

US is evolving. I wanted to present this one example which came out recently (Boston Globe, March 23, 2017). It is a judgment by the Supreme Court of State of Massachusetts. In 2015 EMC sold itself to Dell for a whopping \$67 billion. The CEO of EMC was Joe Tucci. Some investors felt that the management should have sold the firm in parts rather than just selling the entire firm to Dell. They filed a class action suit against Tucci and the Board, saying that they were delinquent in their duties, etc. The Supreme Judicial Court of Massachusetts ruled that Tucci and its crew were not obligated to focus only on shareholder interest. Instead, they should have focused on the company’s broader goals and objectives. This is actually a very clear statement, much clearer than the past, as to how the US Courts are also coming towards stakeholders wealth maximization. But it is still decided by the courts.

Now the question is, are there any other features that we can add to this framework which will make it better. That is what I am going to spend a couple of minutes now - which I call the augmented model. The problem with shareholder wealth maximization is that it gives rise to certain negative externalities such as transferring wealth from creditors to shareholders, not taking the interest of labor into account, not worrying about the environment and so on. Are there some ways in which we can control or mitigate these negative externalities? Let us look at each stakeholder separately.

First, let’s look at bond holders. My claim is that bond holders are protected pretty close to 100% from these negative externalities because of two main reasons: (i) They are able to price these negative externalities into the price through the bond market and therefore the cost is ultimately borne by shareholders. The existence of well-functioning markets protects bond holders from these negative externalities. (ii) There are debt covenants. We are in the realm of incomplete contracting but to the extent that you can foresee the future possibilities, debt contracts contain a number of covenants which protect debt holders. So, debt holders are almost fully protected.

How about other creditors, like bank loans, etc.? These are not well traded claims but they are governed by comprehensive contracts and there is a competitive loan market. So, they too have a fair amount of protection from negative externalities May be not as much as bond holders, but they do have pretty high level of protection even under shareholder wealth maximization.

Next, we come to workers. Workers’ protection is less. There is no market where they can trade their risks. Labor is also not as mobile as, let’s say, the management. At the same time, the sharing rule

with labor is also governed by contracts which may not be as complete or comprehensive as the debt contracts. There are also laws guaranteeing their pensions, the Pension Guarantee Trust, etc. that protects them to some extent from these negative externalities. In the case of pension, the firm may just eat away the money that is saved for pension, but there is a Pension Guarantee Trust which gives them something. Again, the Trust doesn't give them the entire pension that they were due. So, there is partial protection. Hence, workers are not as well protected as the creditors or bond holders, but there is still some protection.

But how about this guy who lives in a house by the river downstream from this firm's chemical plant? First, there is no market for this guy's risk. Second, this person is not protected by any explicit contract, and third, there is no insurance. The only recourse to this person is through regulation or legal recourse.

In summary, shareholder wealth maximization framework with markets, contracting, insurance and regulation does offer some protections, but it's definitely not a first best solution because the person living downstream and the workers are not really that well protected.

Let us now discuss stakeholders wealth maximization. When I say stakeholders wealth maximization, I am talking about an objective function which is a weighted average of the wealth of all the various stakeholders. As soon as you see this definition, you immediately see what the problem is. What are the pros? Well in principle at least, it addresses all the cons that I talked about before, because now you are maximizing stakeholders' wealth. That is, you are going to take everyone into account in the way the corporation does business.

What are the cons? How much weight do we give to each stakeholder class? Do we give equal weight to everyone, or do we give more to workers and less to suppliers? There is no clear guidance about what weight to give to each stakeholder. Some economists may disagree with me, but there is a basic problem in economics. For a given objective function, economists will give you very clear cut mechanisms on "how to do things?" Let's say the objective is profit maximization. We will tell you this fantastic model which maximizes profits. But once you get this profit, how do you share it? Economists are terrible at the welfare aspect and this is the problem. You give us the objective function and we will come up with the perfect decision rules. But we can't answer the question; how much weight or who should decide the weight?

Many people will say the Board of Directors can decide. For example there is this professor at Harvard, Eccles, who says that the Board should come out with one page document which describes how the company is going to take into account the various stakeholders in what order of priority. This sounds very good but think about it, who are these directors? They were elected by shareholders. If you take a step back, it's not clear to me that the first best solution is that they will take everybody's interest into account.

Unlike stock price there is now no well-defined metric to assess anyone's performance. You can say

that once you have this objective, managers can do pretty much what they want. If shareholders get upset, they can say that they were trying to help some other stakeholder. There is no metric.

To the best of my knowledge, the 2013 Companies Act doesn't tell clearly what way the objective function should be designed. It just says the Board should consider all stakeholders. It becomes difficult to determine whether they are doing their job or not. The last thing is legal recourse. In the case of shareholder wealth maximization, aggrieved shareholders can file class action or derivative suits. But non-financial stakeholders cannot file such suits themselves. If a suit has to be filed, they have to work through a shareholder to file that suit. When, most likely, the conflict of interest is with shareholders, why would a shareholder agree to file a class action suit on behalf of, say, some environmental group?

There are no easy answers that I can discover to these difficulties. Here is an example from mechanism design, which actually illustrates this problem. This is a quiz for you guys now. Here is the problem. You have a cake and you have to divide it among six people. The number doesn't really matter but let say six people. There is only one knife and only one person can use it. How do you design a social rule which results in a fair outcome? This is a classic problem in mechanism design.

I will tell you the solution. The best way to do this is the following. The rule is that the person who cuts the cake will get the last piece. By doing that what are you ensuring? How will that person do it? That person will make six equal pieces. Thus, as great economists, we have designed this perfect rule which yields the desired outcome, namely, six equal pieces.

The question then arises, is this really the best outcome? Remember that we are great at figuring out the rules but we don't know whether that outcome is the best. If you think about this outcome a little bit, it has two assumptions that are implicit in it. One assumption here is that every person is maximizing his or her self-interest. In other words, everyone wants as bigger share of the cake as they can get. If there is someone who says I am on a diet and I don't want to eat cake, that rule is no longer optimal. So everyone has to be maximizing their self-interest. The second assumption is that the outcome where everyone gets the equal share is the best outcome. Really, is that the best outcome? Maybe there is some person who is hungrier, someone who hasn't eaten for two days; or maybe one of the six is a person who has two cakes at home. Then is it a fair outcome giving each of them equal shares? It's not clear, so that is the problem with the stakeholders, you don't know what a fair sharing rule should be. There is this paper by Rochet and his co-authors which comes up with a highly complicated model and under lots of assumption shows that the optimum is that there should be equal shares. But we have already seen that this is not necessarily the best outcome. This is the best outcome in the paper because of the assumption they have made.

One way to resolve this problem would be to allow or enable people to trade their cakes. Then even if you give equal shares to everyone, those who have too much can sell the excess to those who have less. That may make it a little bit better. However, we are assuming here that the people don't have a

budget constraint, which is not really true. That poor guy living down the river may not have enough money. So this is just a suggestion, markets may solve this problem to some extent.

Given these two alternatives, is there a third alternative? It turns out that there has always been one which people really haven't talked about too much. If you look at the law in any economy, the one thing it does say about director's duties is that their duty is to maximize corporate welfare and to maximize the corporation's life as long as possible. That is stated in the US Law too. Even in the Indian Companies Act 2013, the first stakeholder mentioned is the company. So the question becomes: Is corporate wealth maximization a better objective than the first two that we talked about? Many academics, more recently even in textbooks, say that maximizing the value of firm is probably better than maximizing shareholders wealth. Legal scholars claim that maximizing corporate welfare along with the Business Judgment Rule that requires manager to act wisely is the best way. However it is not clear to me that it is. First I tell you why they think this is the best. So here is another example as shown in Example 2.

Example 2: Maximizing Corporate Welfare

	Project C		Project D	
Up Probability	0.50	\$ 5,000,000	1.00	\$ 3,500,000
Down Probability	0.50	\$ 3,000,000	0.00	0
Fixed Claims (Employees)	\$ 1,000,000		\$ 1,000,000	
Value	\$ 4,000,000		\$ 3,500,000	
Exp. Payoff to SH	\$ 3,000,000		\$ 2,500,000	
Exp. Payoff to Employees	\$ 1,000,000		\$ 1,000,000	

Now you have project C and D. Project C has an up probability of cash flow of \$ 5.0 million and a low probability of cash flow of \$ 3.0 million, so expected value is \$ 4.0 million, whereas D offers \$ 3.5 million and so the expected value is also \$ 3.5 million. Again, we have fixed claims of employees for a million dollars. The first thing I want to make clear is that employees are getting one million dollar in both these projects. However, shareholders get more from project C than from Project D. So, shareholders will clearly prefer Project C. What the corporate wealth maximization people claim is that even employees will also prefer Project C, even though they get the same under two projects. The reason is that, employees will realize that accepting Project C gives them a cushion of an extra half a million dollars, which can be used to protect them against future negative shocks. So they say corporate wealth maximization takes everyone's interest into account.

However, here is another example.

Example 3: Maximizing Corporate Welfare

	Project X		Project Y	
Up Prob.	1.00	\$ 4,000,000	1.00	\$ 2,000,000
Down Prob.	0.00	0	0.00	0
Addition to value	\$ 4,000,000		\$ 2,000,000	

Let us suppose, we have two projects X and Y. Option X is shutting down a factory and firing all 100 employees. Option Y is to continue the factory’s operations but not in an optimal manner. Now let us look at some cash flows. These are both certain cash flows because I want to focus on the numbers. If you shut down the plant, you can sell equipment etc. and get \$ 4.0 million. But if you keep the factory running sub-optimally, you will get \$ 2.0 million. So the value is \$ 4.0 million under X and \$ 2.0 million under project Y. Under corporate value maximization, we will choose project X because corporate value is \$ 4.0 million. Under stakeholder value maximization, we will choose Y because employees get something here, they don’t get fired. Which project would you choose? It’s a question. Yes.

Participant: Project Y seems a good choice but you know the problem with project Y is that in long term the moral hazard problem comes, that management becomes more and more inclined to externalize their loses.

I will respond to that in the next slide or maybe in the next couple of slides. All I want to say is that some of you prefer X and some prefer Y. We still don’t know which is better because there is no clear choice. That’s my whole point.

This is when I went to political philosophy to see whether they can answer this question. In order to answer this question, we need to place ourselves at the beginning of time, when we are trying to devise perfect laws for the future. How are you going to do that? The generally accepted first principle in this process of designing a fair law is something called the Concept of Original Position proposed by the very famous economist John Rawls. According to some, he was the most important economist of the last century because of his thesis “Theory of Justice”. What it says is very simple. What are the best social rules of people regardless of who they turn out to be? This is how this principle works. This is what Rawls suggests: Imagine yourself in the Original Position and this is why it is called the Original Position. It is also called the Whale of Ignorance. At that time of the Original Position, you don’t know anything about yourself. You don’t know your natural abilities. You don’t know your position in the society. You don’t know your sex. You don’t know your race. You don’t know your nationality. You don’t know your individual tastes. You don’t know anything about yourself and when I say ‘you’, I am talking about the collective you. And you are designing the laws and you don’t know what your type is going to be in the future. Then you will be the one who designs the fairest laws because you don’t know which group you are going to fall in.

In other words, in order to make a good rule, we must forget our type. Let's see, if you apply this concept to X and Y, how it works. Now you don't know whether you will be a shareholder, a worker, a manager or a customer. You don't know which stakeholder you will be. Now look at the example again. Which project will you choose now? In the past if you are a shareholder, you would have clearly chosen X. If you are a worker, you would have clearly chosen Y? But now you don't know who you will be? So, which project will you choose?

Unfortunately, even now it really hasn't solved our problem. Basically the choice of the project depends on what you think is the best and fairest thing to do. I am going to put some jargon here because this has been a common distinction drawn in political philosophy. On one side, you have the Utilitarians who would choose Project X because they believe in maximizing total wealth. They don't care about the redistribution of wealth among stakeholders. According to Utilitarians, it is okay if some stakeholders lose and some stakeholders gain as long as the total welfare goes up. Thus, Utilitarians will still choose project X.

This is what Rawls argued against. If you were a Rawlsian, you would choose project Y because Rawls proposes using the "maximin" criteria. It professes that we should maximize the gain to the most disadvantaged stakeholder. So, who is the most disadvantaged stakeholder in our example? The employees because they are going to lose their livelihood if you choose Project X. A Rawlsian will choose something which will maximize the benefit to the most disadvantaged, which are the employees in this case. Therefore if you follow the Rawls criteria, you will choose Y. There is no agreement here and they are still writing papers about one or the other.

The bottom line is that political philosophy also didn't help much. Thus far, we have looked at law, we have looked at accounting, now political philosophy and found no solution. And that's what I said in the beginning - I think this is a very difficult problem. I thought it was going to be easy to talk about but really there is no clear first best solution. What is the best objective for the board of directors to have? It depends on your point of view and what should the regulator codify as the objective, it depends on the regulators' point of view.

I think I have gone over time, let me just go over the takeaways quickly. I don't want to spend too much time because there is no clear winner in any of these three. So, things like markets, regulations, insurance programs, etc. may have reduced those problems to a certain extent, but not completely.

However, I don't want to you go home thinking that I wasted 45 minutes of your time. I have a solution for this problem. It is called Trust and there is a whole branch of economics dealing with issues of Trust. My proposal is the following. We don't have enough laws and we don't have complete contracting, but as long as we trust that the person in charge or the CEO of the firm will always do the right thing, then we really don't have a problem. Say you have a CEO, you don't care what objective function he or she uses but as long as that person thinks about workers, environment and everything, that person will do the right thing. If you can do that, that is the solution.

So, that is my solution for you, and here is how it translates operationally. Ensure that regulators and policy makers are persons that can be “trusted” to do the “right thing” even when there are no guiding laws. In case the regulators fail our trust, and this is very important, we implement an ex post system which will codify rules to ensure that such failures of trust are not repeated. For example, if you look at US presidents. Bill Clinton and Obama were from same political party but were very different. On the other side, we have George Bush and Donald Trump, both Republicans and supposedly conservative, but they are very different, right. Some believe that the current occupant of the White House has violated trust. If what I propose is correct, then in the post Trump world, there will likely be regulations passed which limit the power of the President. That would be an implementation of the rule that I am talking about.

For any system to work, we have to have regulators who are going to do the right things. We want to have Board of Directors who are going to do the right things regardless of whether the firm is following shareholder wealth maximization. As long as they do that, I don’t think this is such a big issue. So that’s the solution I want you to take away. Thank you.

Did I address your point?

Participant: Yes.

Participant: Actually, it is more complicated than what you have said it is, because the Companies Act is not only about maximizing stakeholders wealth; in other parts of the Act, it is even more explicit about the directors objectives; and I quote, “balance the conflicting interests of all stakeholders”. I emphasize two words in this, *balance* and the second is *interests*. A lot of what you said flowed from the classical belief that stakeholders as long as if they are contractual, you respect the contract or if your relationship is pituitary, you respect the law. You have fulfilled your obligations to your stakeholders. You talked of stakeholders interests, interests could be well beyond their contractual and/or legal rights. You think of something well beyond the interests and then it says to put them to balance, we suppose, as common unit of measurement. If you use wealth as a common unit of measurement like any economist would, but when we talk of the environment, you are really talking of future generations. So, your stakeholder is nothing for the substitution of future generations. How do you measure wealth of future generations? And today, if you look at corporation, what’s the one mantra of success, not survival? You said survival, but one mantra is growth, and all the growth you do, it has negative impact on future generations. Constant brainwashing is, grow your business. You can’t put on the television without being brainwashed and helping someone to grow his business. So, the negative impact is on future generation, so the unit of measurement would be able to strike this balance that doesn’t exist. So I agree

entirely to your conclusion, ultimately you are valuing the trust and you are 100 % right for that. But I say it is even more complicated than this. I think if you look at what Jeremy Bentham says I am sure it helps. He said the maximization of happiness, something which is jovial I mean I don't know who measured gross happiness in his country. But I think French had done some study on, maximization of happiness of the French People or something. God knows where that landed!

Jayant Kale: No, they have this happiness index.

Participant: Yes, happiness index. So, I just made my statement.

Jayant Kale: I agree with everything you are saying, I accept that there is unlikely to be a first-best solution because we can't measure them. But, we can monetize some of these things to some extent. The model is talking about an economic data where they have actually come up with an optimal sharing rule, etc. They talked about worker's rights, consumer rights and they say there should be a market for those rights. It is easy to say there should be a market, I don't know what that means. I am sure there are many innovators sitting here. We thought there couldn't be a market on environment, but we can come up with something, whether it works well or not, we don't know. So, my only thing is if we want to solve these problems by themselves, they will not. We have to have these other things like market contracts, and most importantly regulators and policy makers, so that is my point. So you came straight to the point and I went this way.

Participant: You said two things, one that Indian Law is the best that include stakeholders maximization, but theory and practice are two different things. In theory, the complete norm would be the best but how well it is being followed is another thing. There are two extremes; the shareholder maximization and the stakeholder maximization. So don't you think that if you concentrate on shareholder maximization, you are postponing the cost for future because you do not take care of all other stakeholders today. Ultimately after some time, they are going to pay the cost and you are going to reduce shareholders wealth.

Jayant Kale: First of all, I am not proposing shareholder wealth maximization. So, that's the first thing.

Participant: I am saying that they are two extremes.

Jayant Kale: Correct. As far as the first question is concerned, let me respond by asking everyone a question. See the way this Companies Act is amended and they brought about this codification of directors' duties. India is a "case law" country except for Goa. This is something that the courts will have to decide. But I could not find any court

decisions which are actually on this issue. I do not know, maybe some of you are more familiar with the legal rulings, how have the court implemented this or if there have been any court cases of Class Action Suits which have taken any decisions. That's the only way the implementation will come.

Participant: The laws by themselves will not make the society good.

Jayant Kale: Correct.

Participant: It has to be implemented and that is where it happens.

Jayant Kale: I agree with you. I don't know if there is any court case because I couldn't find any.

Participant: Well I suggested it to bring peace. Why don't they take any action against all these nasty companies? They haven't yet.

Jayant Kale: We can't file a Class Action.

Participant: No, you can just file an action for violating the law and to balance the interests. How do you look at the interests?

Jayant Kale: It's surprising that such suits are not there.

Participant: Yes. They were reluctant too. Any reason for the reluctance?

Jayant Kale: I don't think if they can associate the cost to this law, but if the governance is improving around, it isn't lacting.

Participant: I think one area where I believe you would be working or others would be working, is the Original Concept of Trust by Mahatma Gandhi. He encountered a lot of criticism that you are only favouring landlords, capitalists and we have some poster boys who are following Mahatma Gandhi, Jawaharlal Nehru. Over time this falls in disrepute. Maybe we can look at that dimension of Gandhiji's Trust Concept. This is one aspect of that trust. Other parties, if you see the whole world of corporate governance, it's completely lack of trust. All the poster boys of corporate governance, I don't want to take the names of there companies, that have absolutely breakdown of trust. CEO versus Chairman, CEO versus Promoter, the regulator versus the CEO, the Board versus rest of the people. Suppose some CEO is asked to go on guardian leave or something, people down below in some organization are very happy. So this is a lack of trust. How do you connect with what is happening now in the Indian context and what Gandhiji said. Is there any way we can connect this because at the end of it all are your formulas, it ends up with what you said trust. So do you have to enact some laws to bring the trust that is ensured or is there some continuous monitoring of trust level in each organization? How do you proceed on that?

Jayant Kale: First of all, you cannot, you know, just make a good plan. Earlier I used to work for the Thapar Group. If you looked at Karam Chand Thapar who had started the Group, he was someone who in my mind is the model of this trust. Why? Because there was a case when a paper godown was on fire and the workers doused themselves with blankets and moved the paper out. It was all because of the loyalty they felt for the company because Karam Chand Thapar always looked after them. But down the road, when Karam Chand Thapar was no more and then others were in charge, the company changed. So, it is very dependent on the person who is on the top. That's where the ex post codification is very important. Based on the experiences that we had, see what are the problems? Then you actually regulate what you can or cannot do. So it is a process; in cases the trust is broken, those actions need to be analysed and then the rules need to be changed. That only a process can do because you can't really do this by law.

Participant: Just an observation which is that, at times shareholder maximization or share price maximization does turn out to be the easiest option to pursue. Particularly, let say, you are selling the business but then if you are worried about the employees, what the government usually does to save the employees is ensuring that you will not late go the employees and instead continue with the existing employees for 3 years or 5 years. They might even say that you are not going to shut down business or sell the business, so that's how they achieve the objectives. Having said so, my sense is when you look at the Companies Act, notwithstanding the comments of my friend here. It's been a global replace. They have just said replace shareholders by stakeholders and let's get on with it and let people figure it out for themselves. I think that's what my observation from this whole thing is. So while it is good to see that India is thinking a lot more about it, we don't have regulations or rules and so on and so forth. We kind of left it a little bit too fuzzy to be able to kind of do just about anything you want on the basis that it's going to be good for one stakeholder or other rather than for the system as a whole. It is just an observation.

Jayant Kale: I agree with you completely, that's why I said the only solution finally is getting the right people at the end and regulating those who break the trust. Although you have regulations, policy making, and then you have all these effects of money, lobby, etc., I don't know whether that is a solution or whether it will work.

Participant: I am just quite happy in terms of the thought you have put into it. But I would be surprised if anyone in Delhi kind of thought about it as deeply as you have.

Jayant Kale: I had to speak in front of so many people, so that is what I had to do. Maybe we should make all directors talk to a hundred people.

Participant: I have one comment for this regulation problem. Regulation is the challenge where you have 10 good directors or 10 good CEOs or one bad CEO. The bad CEO will lead to regulation and that affects all 10 and will often cause the remaining 9 to become distrusted, which is often happening. For instance, let say scrutiny, you know one bad Chairman of a public sector company often causes increase in scrutiny for every chairman of the public sector company to the point where he starts getting afraid of making any decision. It's been a problem especially in India and that's been quite commonly quoted.

Jayant Kale: I mean this is the problem with any regulation. I mean this is the cost of regulation that it makes the people who are actually the good guys become less good. To give an example from the US, we have millions of people who are on social welfare. Some of them abuse it. To control that abuse, they are passing all these restrictions which actually make life miserable for those people who are honest, so that is the cost of regulation. Regulation is always this trade-off. That's something you cannot avoid and that's why designing regulation is an art. I agree that's a real problem, but that is a cost.

Participant: But what you are recommending seems to lead straight down to this.

Jayant Kale: Yes. That's the process unless you can create good guys.

Participant: In more of a solution, you mentioned the ex post analysis of any cost or whatever, now the Achilles heel of corporate governance in the recent times is the CEO compensation. There are figures ranged from anywhere from 100 times to the medium or average salary of an employee in a company. Now you said that you are also concerned on incentives and basically incentive options are the biggest part of a CEO's compensation. Why it is not that there are some clawback provisions included in CEO compensation. Now that's an expert analysis, specially when this is made on the board and by the CEO who takes time to evolve and if the CEO leaves prior to the fructification of their decisions and the stock price moves against, then the CEO is still compensated but the decision taken may not be in the right faith of what is termed as shareholder maximization. So why is clawback provisioning not prominent in CEO compensations worldwide?

Jayant Kale: If I understand your question correctly which I am not so sure because I didn't hear too well, even though I am wearing both of my hearing aids, but anyway. There are two things. One is, in order to have proper things built into the compensation scheme or remuneration scheme, you have to have clear metrics. So clearly one of

the benefits of shareholder wealth maximization is you have a metric whereas in case of the stakeholder maximisation you don't. But I will tell you a more logical problem. So, what happens when you design an optimal compensation scheme? It doesn't matter what you take into account. It is optimal only at that point in time. As soon as that point of time has passed, behaviour of the manager has changed, this environment has changed, and the solution is no longer optimal. So for example, when the manager is, let us say younger, you design that person's compensation as a combination of some fixed salary and some high power stuff like options and stocks, etc. But as this person gets older, now because of having being paid a lot, this person is also gathering his or her own wealth. So at every moment actually you should be changing this person's compensation scheme because this person's incentives are changing. If I understand your question correctly, I don't think it is possible to design compensation schemes which will remain optimal dynamically. However to talk about the example I was giving, one solution to this age problem would be that for younger CEOs, you give more fixed salaries and as they get older and start collecting their own wealth, you reduce the fixed salary and give more of what they do in terms of stocks, that would be one solution but it requires continuous updating. I think that answers your question.

Participant: My viewpoint is coming from an outstate CEO, and the person has already collected compensation till he was the CEO. Now decisions he has made are not panned out for the company and post his exit, the share price has taken a hit. Now the CEO is not going to be affected because he is no longer there. So why don't we have clawback provisioning in the CEO compensation that after his exit, 4 to 5 years down the road, if the share price is not where it was, then he should be held responsible to pay back the compensation he has collected.

Jayant Kale: But, then you are suggesting the solution, i.e. clawback.

Participant: No, that's why I am saying. But why is this not prevalent? Is there any kind of reason behind it?

Jayant Kale: It is definitely a mechanism that would work. Why it is not there, I can't say.

Participant: Okay.

Jayant Kale Okay, thank you.

Panel discussion: Indian Stewardship Code: Imperatives and Challenges

- Panellists:** **Mr. Amarjeet Singh**, Executive Director, SEBI
Mr. Chris Hodge, Director, Governance Perspectives, UK
Mr. Leo Puri, Managing Director, UTI Asset Management Co. Ltd.
Mr. Nawshir Mirza, Professional Independent Director
Mr. Sumit Rai, Managing Director and Chief Executive Officer – Designate, Edelweiss Tokio Life Insurance Company Limited
- Moderator:** **Mr. Suneet Weling**, Managing Director, Head of Advisory, Capital Raising and Financing, India, BNP Paribas

Ashiana Salian: The next event for today is the panel discussion. The topic of the discussion is *'The Indian Stewardship Code: Imperatives and Challenges'*. The moderator of the discussion is Mr. Suneet Weling. He is Managing Director and Head of Advisory, Capital Raising and Financing for India at BNP Paribas. Prior to joining BNP Paribas, he has worked with Kotak Mahindra Bank in Mumbai, Deutsche Bank in Singapore, UBS and Merrill Lynch in New York. He has significant experience across India, South East Asia and the US, and has advised several major corporations on M&A Transactions and Debt and Equity Capital Raisings. He was also responsible for working with Mr. Kotak on various policy initiatives, including the India-UK Financial Partnership and is a member of several CII committees including the CII Corporate Governance Committee. May I now request Mr. Weling to start the panel discussion.

Suneet Weling: Thank you NSE and IGIDR for inviting me and more importantly for putting together this panel which is really unique because it has panellists from an insurance company, an asset management company, SEBI an independent director and an international expert. So, I don't think it is possible to get a broader set of perspectives on this particular topic which is *'The Stewardship Code'*. For those of you who may not be familiar with what a stewardship code is, it is viewed as a next step of evolution of investor engagement with companies. So, while we may reach a point where investors vote 'yes' or 'no' on certain resolutions, the next step is where in addition to voting, they start engaging with companies on a variety of topics, including succession planning, risk management and strategy. It is a much broader engagement which also requires investors to disclose when they will vote collectively,

when they will be activists and how they will manage conflict of interests. So, it is viewed as a next step in the evolution of corporate governance from an investor perspective. The Indian private sector engagement on this meaningfully started in November 2016 when as part of the India-UK Financial Partnership, Chris, Leo and I were on a committee that prepared a paper on an Indian Stewardship Code. At that point of time it seemed like a fairly esoteric idea. As the UK had a Stewardship Code and we were wondering if it would be relevant for India. The idea has now gained a lot of momentum and in March 2017, IRDA came out with a code which is largely similar to the UK Code. I think one of the challenges is that to date, this code has been a document that has been complied with but not a lot of activities have followed. The other issue has been that it is only applicable to insurance companies. If you look at most countries they have a common stewardship code across all types of investors and we would be perhaps one of the few countries to have a different one for each asset class. In terms of agenda, what I was planning to do is have five minutes for each participant to talk about how the Stewardship Code looks like from their perspective, after which we can have a free flowing discussion and then open it up to the audience for about 15 minutes of Q&A.

I would like to introduce the panellists. Sumit Rai, he is the MD and CEO at Edelweiss Tokio Life Insurance Company Limited and he will represent the view of insurance companies. Leo Puri is the Managing Director of the UTI Asset Management Company Limited, representing one of the leading mutual funds in India. Amarjeet Singh is Executive Director at SEBI, and has been involved in SEBI's efforts on the Stewardship Code in addition to other initiatives. Nawshir Mirza is one of the leading independent directors in India, on the boards of Exide, Tata Power and Thermax. Chris is an international expert on corporate governance and has been involved in the UK Stewardship Code right from its early days. I think we have a very diverse and interesting set of panellists. To start with I would like to invite Amarjeet to talk a little bit about SEBI's perspectives on this particular initiative and broadly about the current status of corporate governance.

Amarjeet Singh:

First of all, thanks to NSE for having me in this interesting panel. Suneet has already introduced the topic. Since I come from SEBI, it is appropriate that I give you more of a regulatory perspective on the subject. Firstly, the context Corporate Governance norms have seen lot of traction in India as we

all know. Corporate Governance code in India has evolved very dynamically over time. The latest reforms which have been recommended, mostly by the Kotak Committee, are already implemented by SEBI. What we have today is a very strong framework by any comparable international standards. So, we have two major pieces, one is the Companies Act, 2013 and the other is SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR), which is a SEBI instrument, which governs various aspects of the corporate world. The stewardship code, the way I see it, is an integral part of the overall corporate governance framework. According to the recent Kotak Committee recommendations on the stewardship code, the institutional investors are expected to shoulder greater responsibility towards their clients and beneficiaries by enhancing their engagement with their investee companies.¹ The committee also recommended that a common stewardship code should be developed in India. They entrusted this task to SEBI, and SEBI already is working in that direction. That is the context from my perspective, from the regulatory perspective. Let me briefly touch upon why stewardship obligations are becoming more important today globally as well as here in India. There are two reasons, I would say. One is the increase in the institutional investors' ownership of various companies both globally and in India in terms of their assets under management. Secondly, more important from the regulatory perspective is that a large portion of such institutional investors represent, directly or indirectly, public money and that is why we are more concerned. In this backdrop, let me now spend a couple of minutes on the evolving regulatory landscape with respect to stewardship.

First, let me touch upon the global side. As you all know, and I think Chris would be the right person to talk in more detail about that, the UK was the first country to recognize the importance of the stewardship obligations. They brought out the first detailed stewardship code in 2010. They laid down seven principles which have been more or less replicated worldwide, more or less in the similar fashion. What is of greater interest is, what have been the domestic developments in the regulatory space in this area in India around the same time as UK got its code. I beg to differ slightly from Suneet when he said that it started in 2016; actually we started in 2010, to my mind. Although we did not call it the stewardship code then, but we started by issuing a circular to mutual funds way back in 2010, around the same time

¹ https://www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html

the Stewardship Code came in UK. We asked them to disclose periodically how they vote on various resolutions. This requirement has been streamlined, over time. We came up with another circular in 2014 and followed it with another one in 2016. We strengthened that space in terms of mutual funds participation in the companies. As a result, I think mutual funds are probably the most active, among all the domestic institutional investors in India in terms of a specific aspect of voting in the investee companies. Post SEBI's efforts in strengthening this space through requirement of mandatory disclosure, the number of 'Abstain Votes' by mutual funds have significantly reduced. I have some numbers, I am not sure if they are updated ones, but the numbers which I have here is the number of abstain votes, which used to be 40% or near about that in 2012-13 that has come down to 8% as per the last reckoning. Based on this experience that we had with mutual funds, and that also coincides with the efforts in enhancing India-UK collaboration, we took the initiative of working towards developing a common stewardship code. Since this is an inter-regulatory issue; we took this to the sub-committee of the Financial Stability and Development Council (FSDC). There it was agreed that SEBI would take the lead and work with the Insurance Regulatory and Development Authority (IRDA) and the Pension Fund Regulatory and Development Authority (PFRDA) to develop a common code. The code has since been developed. While we were developing the code, IRDA, I think in March 2017, came out with their guidelines, but their code is more on 'comply or explain' basis. Very recently, last month, PFRDA has followed through, and they have come out with their code for pension funds regulated by them, but that is on mandatory basis and more in-tune with the proposed common principles. What I would like to place here is that, we have already taken steps in the Financial Sector, where we have gone beyond just the voting requirement. We are touching the voting plus space when it comes to the requirement on institutional investors.

Finally, I would like to briefly touch upon how the current regulatory trends are also empowering the institutional investors apart from putting obligations on them. Two important features which I would like to mention here: one is technology. Technology plus also the regulatory enablement, which is the e-voting. The e-voting has been a game changer; it has strengthened institutional investor's ability to vote, to participate in voting without being physically there. I must mention that e-voting is now based on one share-one vote as against the earlier practice of voting on a show of hands irrespective

of share holdings. I think this is one important enabler which we need to recognize. Secondly, I feel from the regulatory side, and I end with this point, is the increasing use of majority of minority. As we all know, in order to prevent the views by dominant share holders, SEBI has particularly come out with a number of shareholders resolution which are mandated to be passed on the majority of minority basis, especially in the area of Related Party Transactions (RPT). So, with the promoter not being able to vote, the proportionate voting power of institutional investors goes up exponentially high, and empowers them more in terms of their play in voting company resolutions. Maybe I will just stop here, but I would probably like to know how effectively the scene is playing out on the ground. Thank you.

Suneet Weling:

Mr. Mirza, would you like to comment from an independent director's perspective?

Nawshir Mirza:

It prompted me to say that how an independent director views a code like this. I think it is an excellent thing if it happens because it will put some spine into independent directors, only a little, but it will at least put some strength into their system, because if nothing else, the threat of having to deal with institutional investors and to engage with institutional investors will make independent directors focus more on their jobs and their responsibilities. We know about the clamour that was set-up when SEBI tried to reduce the number of boards on which an independent director can sit. It has now been brought down to seven, which I think is still perhaps 2-3 times what it ought to be. But I can well understand how these things should be done gently. I cannot imagine people with full-time other occupations being ready to sit on more than seven listed company boards. It is mind boggling to me, because I see a lot of independent directors defending themselves by saying, what we can do, we go for 5-6 half-day meetings a year, how much can we know about the company and influence it. So we are all babes in the wood, and if the management tells us something, we just go and agree with that. Well I can tell from my own experiences. I am deeply engaged with whatever board I sit on. Indeed there are some boards where I engage at least once a week with the CEO. Certainly when Tata group went through this traumatic time, for a year I was engaged every day with the CEO of the board I sat on. So you have to be engaged. There is no way you can do that if you are sitting on 7-9 or whatever number of boards. So, I think it is a very good thing, and I would certainly be supportive of a stewardship code which would bring

in institutional investors for us to also deal with. However, independent directors are like the canine species, not likely to bite the hand that feeds them; they are not supposed to at least. The hand that feeds them is the hand that votes for them, which is the guy with maximum number of votes in the AGM when their names come up for election. Unless there is a system by which independent directors can be, as it were, protected from the capitalist system, and I don't see the capitalist system which is on the right side of this panel, being very supportive of any such proposal, I am afraid we will still wag our tails when we are thrown a few morsels off the high table of the promoter or the controlling shareholder. Unless the system enables, things that make the controlling shareholder infirm, unless there are, for example, an enabling of hostile takeovers.

Today hostile takeovers are still almost impossible in our country because of so many impediments to aspirants wanting to take over a company with hostility, unless institutions are willing to support. We saw what happened in Alembic. What happened in Alembic, some of you may know, one year ago, where one of the institutions Unifi rattled their sword, but when finally they were asked to draw the sword, we discovered that the sword had no blade. They only had a handle which they held up and put back in the scabbard. Unless institutional investors are prepared to carry forward their threats and do something about what is happening, I don't see the independent directors necessarily being emboldened in the boardroom, express their views with greater candour than they are currently doing.

The good news however is the Fortis experience which we have just had, where the foreign institutions have been able to displace the board and put in place their own people. We have to see how this whole thing plays out. But a little late in the day when much of the company's money may have been sucked out. But, better late than never as they say.

My last comment is, when we do have this code what happens about non-compliance, because in our country, 'comply or explain' just does not work. We have seen what happened in CSR, where a lot of companies are still ducking their 2% obligation because it is not obligatory and the government has no power to do anything except to ask 'why did you not spend it?' There is enough ingenuity to come up with a reason to explain why we did not spend the recommendatory 2%. Unless we know that there is a strong enforcement mechanism to act against the institutions that take advantage of the code or

the corporations that refuse to engage as the stewardship code expects them to engage, we may not see a great advantage flowing from this. This will be one more rule we will have on the statute books. We have already got a large statute book; there will be another 40 pages of code which will fill that. That is all I have to say at this point in my five minutes.

Suneet Weling:

Thank you, Mr. Mirza. You have put the onus clearly on institutional investors. Two of whom we have right next to us. We can now turn to Leo from a mutual fund's CEO's perspective. What role do you think a stewardship code can play and talk a little bit about the fact that we have very few independent asset managers in India and what are the conflicts of interest that one sees?

Leo Puri:

Sure. I think Amarjeet has provided an excellent summary of all the good work that has been done. Before I discuss some of the challenges, I want to underline that, I genuinely think that our industry has made tremendous strides in the last few years. It has gone beyond just voting; there is plenty of engagement as evidenced from the collective participation through the AMFI CIO panels. There is a consultation process that happens. So, we are evolving quite rapidly and I think we are starting to show the way. I fully endorse everything what Amarjeet has said and think that this is a positive development that has happened. What we need to do is to move on from here, and get better. Maybe, I should pick up on the point you made. Stewardship obviously has to start, based on the context, reality of the institutions you have in a given market. We are not a market that has the Blackrocks, Nomuras and Standard Life of this world operating as 800 pound Gorillas. What you have is a market that is constituted on the one hand by the insurance companies, occupying a large space, probably equivalent to the rest of the mutual fund industry put together on the other hand. In fact in terms of equity ownership, you have a number of mutual funds all of whom, despite good years we have had, are still relatively small on an individual basis and have odd ownership structures themselves. In the Indian asset management industry, many asset managers are either owned by banks, and banks do not always think like equity holders or owned by corporates, which are conglomerates. Indeed, they may have a number of issues as lenders which conflict with the interest of equity holders. There is a historical reason for this because at one point those were the brands, where the capital lay, that is where the network and ecosystem is. There is nothing wrong with that, but what that means is that the willingness to stand up and be counted in situations which are controversial

or to pull your full weight when it comes to discussions around things like strategies, succession planning, compensation, mergers, changes in capital structure, etc. These are big issues which you should be engaging on, not routine issues of, is it alright to reappoint the director for three years and so on. When you look at our voting records, we are voting, but more often we are voting on routine issues quite peacefully, and on really controversial stuff we are not actually engaging. We need to think about the times, when we are actually engaging on major decisions, on strategy or succession planning or compensation. To me, that is the next step that we have to get to, having proven that we can do other things that Amarjeet talked about. I think that is genuine progress. The day that you actually see us standing up in the way the global managers do; part of this will come with more independent asset managers because the ability to exercise calls on corporate governance, ultimately is rooted on being an independent institution yourself. The other thing that has happened in the west which has not yet happened here is that, one of the reasons people give you money there, if you are a large insurer or asset manager or pension fund manager, is because they actually value the role you will play in stewardship and governance. It is a conscious part of the evaluation, not just you need to be a good fund manager, that is given, that is hygiene; but they will also examine your track record and your philosophy in terms of saying, what are you doing, do you have a governance mechanism, do you have people in your company who understand this, do your mechanisms engage? Show us your track record, because you are going to be a fiduciary as far as we are concerned, and have you actually demonstrated that. Now in reality the people who give us money are either retail households who don't ask such questions or to be honest, relatively passive trustees of large pension funds. Actually there is also a cultural bias against anything understandably here that could be seen as activism. I try and draw the distinction between engagement and activism. There are many advocates we have in India who say in fact what is missing is actually shareholder activism which is a step even further than engagement. My own sense at this point, I would rather like to learn to walk before running. I think there will be people who will also push, and it is not a bad thing for the development of an activist group of shareholders, by and large they fail, essentially there are, I struggle to think, I know people who have tried to be activist, I probably should not name, and usually people who have tried to undertake the hostile takeover. Some of them come from overseas; some of them are home grown entrepreneurs. But they

rarely succeed, but they have occasionally changed their direction of events even if they have not got what they wanted. I think even that is healthy. For our part, even the engagement process is still maturing. I am not pessimistic about it; I think part of it will happen as industry strives to change. The rest of us in the meanwhile are showing the way and hopefully being a catalyst for this process. Overall actually, reasonably optimistic picture, things are evolving well and I think we know what we need to do over the next few years.

Suneet Weling:

Great. Thank you, Leo. Sumit, you are in one of the industries that actually has a stewardship code guideline prepared by IRDA. My understanding is that it is currently largely a code that most insurance companies have put on their website but there has not been much activity, which comes back to the point of 'comply and explain' versus mandatory regulation. Then of course there is the question of if LIC is covered by this code, because we have not really seen much activity. But as a representative from an industry that is guided by a stewardship code, we would love to hear your experiences and how you have seen it evolve.

Sumit Rai:

Thanks Suneet. Interesting question. We have been under this IRDA guideline of stewardship code since March last year. What are the requirements? The requirement is to first have a board approved policy of stewardship at every company level following the 5-6 principles that IRDA has laid out. Then you have to follow that and at the end of the year, in June this year, the first submissions will be made. That will be part of the public disclosure, about what are the actions that you have taken under the code itself. Now, the sector itself comprises of almost 50 companies. So, there are now about 50 odd different codes that the board has approved for various companies. When you look at those codes you will be amazed by the remarkable variants that exist. So, while there is a guiding code at the helm by IRDA which is a fairly broad guideline if I may call it that, different companies have interpreted it differently. There are some which are fairly descriptive to the extent of saying that if I have a stake of this extent in the company, I will be active in these areas with the company versus some which are probably left it all to the management to decide as to how they want to be active. So I think it is a journey of learning. We are all ahead of coming to terms with what this means. The first filings that will happen under the public disclosure will be interesting to see as to what happened. But I think June will be interesting. June 30th will be interesting when companies will file under this and then

will also be interesting to see 'comply or explain', what does IRDA do with what happens there. I think those are interesting things, like I said, we are an industry that is very unevenly balanced. There are 4-5 large players and there are lots of smaller players. I think the lead, in a lot of ways, will have to be taken, as Leo mentioned, by LIC, because that is the 1,000 pound gorilla in one corner. Once I think LIC moves, a lot of others will be forced to move, but even if that does not happen, I think some of the larger players have enough heft now to count for a substantial voice of boardroom. It is a question of when we will be able to utilize that heft. When I meet people informally and we discuss this kind of stuff, there is a recognition of something that needs to be done; I don't think the whole road map ahead is very clear.

I think the other challenge that we are all facing is, there are different institutions governed by different kind of codes. And then how do you come together and have a common view as institutional investors rather than an insurance company is having a different view because I am a long-term investor versus an AMC or some other financial institution. I think that is the other important thing that we will have to answer at some point of time as to how that will work. But as you said, on the whole if you ask me, I am optimistic. I believe that at least we have made a start. In that sense, well started is half done. So we have made a start and we will get there. It is probably a journey like so many other things that we do in this country. But it will become better. I know corporate governance is a hot item these days. As I was talking to Nawshir and he was mentioning that there is a lot on the corporate governance agenda that will be played out right now. So, I think that is an item on which there is lot of focus and I don't think it is an item that will get ignored or be swept under the carpet after few years. I think we are walking a certain path and there is no turning back. That is the way I see.

Leo Puri:

A quick point before you turn. Chris has said a point on the insurers as a manager. Actually the common stewardship code at a very basic level is what is missing at the practical level. I think that should clearly be on the agenda from Monday morning because I do think it is important for insurers, asset managers, pension and so on. I think we need to find the mechanism to put that in place. That single event will itself lend much more weight to what our collective efforts are, and push the bar up for all of us.

Sumit Rai:

Just to add to the question that you asked, yes LIC is covered by the code and it has a policy. A published policy which you can access on the website.

- Suneet Weling:** But not active in terms of activity?
- Sumit Rai:** The LIC is in a better position to answer that.
- Suneet Weling:** So, Chris you have heard the background of how the Indian stewardship code evolved. I think we may risk becoming one of the few countries in the world with multiple codes. It would be great to hear your experience on the UK code, different countries you have seen adopting a code and how you think India can benefit from international standards and experience.
- Chris Hodge:** Thank you very much. Before I start, the last point was an interesting one because there is a debate going on in a moment in the UK about the stewardship code and how it should change. One of the questions being asked is, would it be better to have a series of codes acting underneath a set of common principles for each part of the investment chain. It is not a view that I necessarily agree with this, but some people argue that by having a common code for asset owners, asset managers and intermediaries, it has been too easy for people to say, that is somebody else's responsibility and to pass the liability and not to carry out their own duties. My background briefly is that I was a regulator in the UK at the time the code was introduced in 2010. Since leaving that job, I now chair an informal network of bodies responsible for the institutional investor codes in about 15 countries. I am not an expert in this market, but I have seen little bit of the variety of approaches in different markets. The first and probably only thing I can say is what that UK's direct experience is, we developed the UK stewardship code as a local solution to a local problem. It was not our expectation that what we were doing will work anywhere else, so I think that is one bit of advice I would give is to please treat this as a local issue that you need to resolve and design an approach that will work best in local circumstances. Some of the issues that have been raised here are common I think in all markets, but some of the others – for example, controlling shareholders and the lack of a culture of engagement, those are not the things that we have in the UK. What prompted us to act in the UK was that we already had some traditional engagement that used to be carried out mainly by pension firms and insurance companies. At the time we introduced the 'comply or explain' concept in 1992, they owned 50% of the UK market. By the time of the financial crisis in 2008, they owned only 10%, and what happened as a result was that the level of engagement and oversight we had started with had gone away. The UK stewardship code was an attempt to rebuild that by engaging asset managers, overseas investors and so on, and

getting them to pick up some of the weight of stewardship. What we now have seen is similar codes in many of the other countries and frankly I was very surprised to see that this stewardship is becoming as popular as it has. The reasons behind the codes in each of these countries are very different. For example, Japan was mentioned. There was no tradition at all of engagement there. It was a very conscious effort by the Japanese government to try and jumpstart engagement by introducing the stewardship code and it has started happening for the first time. As was mentioned, I think by Amarjeet, the content of the code is fairly similar. But I don't think that is in any way copying the UK model. I think that is because if you look at the code it focuses primarily on the sort of activities that you will have to undertake in order to be a steward, I understand that from Prof. Kale's reference earlier that it is almost irrelevant to the market you are in or the structure you are in, you still need as an investor to set your investment criteria, select your investee companies, select which ones you can monitor, work out the circumstances in which you think is worth engaging, and how you wish to do that, and set all that out in your policies. These are common to almost all the markets. The content is fairly similar. What is very different I think, and the key to making it work or not work, is how you implement the code. This raises questions like, are they mandatory, are they voluntary, what expectations do you place on investors, and are they equivalent to the codes for companies for example. I think there are two tests which slightly overlap that I would draw out from looking at how the codes have been implemented. One is how well does it fit with what you already have in place, such as whether there is existing regulation, whether that is the culture of engagement or not. And you talked about walking before running, I think that is a very sensible way to go about it. You need to think about what sorts of institutions you are relying on to undertake the engagement, do you have large bodies who have influence even as a minority shareholder simply by the weight of their overall assets under management or not. Do you have a controlling shareholder? All of these things determine how you have to go about implementing the code. The other issue which overlaps is, what is realistic and what are your objectives. One of the things that we found as a big issue first in the UK was the resources, because there are many small asset managers. When we first went to the security regulator in the UK, when we were introducing the code, we were trying to decide whether to make it a mandatory requirement for all asset managers. Even they did not know how many asset managers they had,

and they had to register them all. To for a lot of very small managers, they did not have the resources to adopt an elaborate system of stewardship. The UK is a highly dispersed market in terms of ownership structures of most companies. They would come to us and say, well only own a fraction of a percent of any of the companies in which we invest and it is not rational for us to put a lot of resources into engagement and monitoring. We can be as active as we like, we will have absolutely no impact on the company because we are irrelevant as far as the board is concerned. For some of the larger investment funds such as BlackRock, they put a lot of resource into it but globally they invest in 10,000 or so companies, so again they have to be very selective when choosing to engage. But the other point that I would highlight is the impact for the regulator is an issue as well. If you introduce a mandatory system that creates additional responsibilities for the regulator, if it is to be anything other than a piece of show that exists in law but not in the reality. One other thing that we got wrong in the UK was thinking that when we had written the code we had completed our work, as we had an advantage in being in a market where there was natural appetite for engagement and interest in the subject. What we found was, a few years later we had 300 investors signed up to this code which made it seem a success but probably 200 of them were doing absolutely nothing. They signed up because they will be asked by the advisors to their potential clients to be a signatory to the stewardship code in order to get on to the short list for mandates. Nothing then happened, so there were lot of people using the badge of stewardship but not doing any actual engagement, which did not help the clients to decide who they should put the money with. In UK most of the focus is on asset managers, as there are few remaining pension funds in UK who are still directly investing and engaging. But not only did this situation not help the clients, it did not help those managers who were genuinely exercising stewardship and being very good owners. So this is why last year the UK introduced what they call a tiering system which is an attempt to distinguish between those investors who are genuine stewards and those who only signed up because it was expected of them. I think I will finish on that one word of caution, that if you go for the mandatory approach you may find that a lot of investors sign up, and it becomes quite hard to distinguish on the basis of well-crafted boiler plate writing who are the active stewards and who are not.

Suneet Weling:

We have about 15-20 minutes more. I will ask a couple of questions for the panel in general. When we were preparing for this discussion, one of the

topics that came up is that there have been a lot of whistle blowers who are going to the regulators and complaining about companies and boards. They are doing this as opposed to going to the independent directors of companies that they are investors in. Is this an acknowledgement that independent directors of the boards are not being responsive to individual shareholders and not being stewards? Why do they feel the need to go to the regulator directly? Mr. Mirza may be we will start with you.

Nawshir Mirza:

I think certainly it is that, otherwise why would they not? They should be engaging with the company. But this is a strange thing, even internal whistle blowing, I am the person to whom whistles should be blown, on the three boards I sit on as the chair of the audit committee. Almost never have the whistles gotten blown to me, they get blown to the promoter; they get blown to the CEO. It sort of irritates me that they got no confidence in me. There was only one company where I used to get a lot of whistles; coincidentally the then company secretary is in the audience today. But most of those were the kind of whistles that should not have gotten blown to me. Because that company was in the IT sector with a lot of young people and the whistles came out of intrapersonal relationships of young men and young women. So there was nothing, as the chair of the audit committee that I could do about somebody's love affair having gone sour. You are absolutely right that there is a belief that nothing will happen, there is that perception. In fact when the Tata affair happened I got a whistle blown by an institutional investor in Hong Kong. It had some excellent suggestions. I discussed the suggestions with the company secretary, who said that they are not the shareholders, so I wrote back and said can you prove that you are a shareholder. After several weeks of struggle they could not prove that they were shareholders. Anyway, I thanked the person for his suggestions. But that is where the thing went to sleep. Indeed we were doing several of the things that he had recommended. But otherwise I have not had experience myself of whistles blown. But then, I sit on the kind of companies where nobody has complained to the regulator. So, I sit on the wrong companies to answer your question.

Suneet Weling:

Amarjeet, what is your view as a regulator. You are the recipient of lot of these whistle blower complaints.

Amarjeet Singh:

Yes, just to pick the thread from what Mr. Mirza mentioned. I believe that it is also a communication issue. If you just check the developments in the corporate governance requirements, earlier the need to have a whistle

blowing mechanism or the policy at the corporate level was voluntary. So few years back we said that it is mandatory, every company must have a policy. Now you have to have a policy but are you communicating it well to your shareholders and to your investors? Are you telling them that there is an audit committee chair who can listen to you if you have any grievance? So, I think there is a need to have a discourse on this at the corporate level with their shareholders. On the regulatory side, of course, we are seeing a rise in number of references made to us making all sorts of allegations against the promoters or against the company. We are seeing a rise definitely but again why we are getting more complaints is probably people know that there is SEBI and there is even an online platform. We created a lot of awareness around how you can lodge your complaints with us. So, I guess at the corporate level, you need more proactive steps in communicating these issues.

Suneet Weling:

Leo and Sumit, it seems that individual investors don't know that you can go to your institutions as stewards and prefer to go to SEBI's website and lodge complains in their system. Why is that happening? What needs to happen?

Leo Puri:

I think the situations are very different. I think if you take apart all the factors, we are a very complaining society first of all. I just would like to emphasize by saying that a lot of whistleblowing may be without sense to begin with, but if you take the complaints which are actually serious, and which are serving the purpose, which it was designed for as opposed to becoming a method for settling scores for all the other nonsense which happens. The issue is partly to do with composition of boards and the whole issue of trust that Prof. Kale was talking about. If you look at the way many boards are composed that is where the problem starts. When you look for adjudication, you measure the people you are looking to, and often what you will see is a bunch of people who are being packed into that boardroom to serve a particular purpose. So, you can quickly reach a conclusion that, what is the point of going to that lot, because they are all there to serve a purpose, which is unlikely to be sympathetic to the issue I am about to raise. So there is a filtering out that happens simply based on the composition of boards, which unfortunately is despite the tremendous progress made in the Companies Act. The actual number of Boards whose composition is truly in compliance with the spirit of the code of conduct of independent directors, is very limited. So that is where the initial problem starts. So there is no point going to a group of people who are unlikely to have, frankly, the perspective, the independence

and the sympathy to actually listen, to meet and likely to close. Nawshir is probably an exception, I can think of examples where the typical response is stonewalling. So, it is not that they have always chosen to go to the regulator in the first instance. I am talking about genuine and not the score settling whistleblowing. They go there because indeed they have been stonewalled. I do know such cases as well. That is an issue.

Suneet Weling: Sumit, do you have any comments?

Sumit Rai: I would tend to agree with you. I think the first problem is, do the shareholders really see the board as being independent from the promoters or the management difference. I think that is the real issue, most people don't have trust in it and therefore if you don't have the trust you will revoke. Your only other option is law enforcement or the regulator, one of the two. That is I think a big part of the problem. Coming back to the second question you have asked me, why do investors not come to institutional investors and partner? I think you have to look at the problem in two ways. My average investor, probably 99% of the average investor probably does not know where I have invested. He trusts me as an institution to say that I will do the right thing in terms of my investment policies, I am providing the return. As long as he is getting the return, he is happy. He is not the variety who would say why this company is not doing well or whatever. As far as the independent investor is concerned who is really worried by all this, he is again taking the same repose, why will I go to an investor, they are probably so close to the management, large investors tend to be better known to the management than we are and they will probably not listen to us. As you go back to the same route of saying, let me go to the regulator and I think, till the time we really fix this issue of boards being seen as independent of management and owners, and truly taking the right steps to preserve. I don't think, you will struggle to give a single example in this country where the board has taken a stand which is against management or the ownership. They have to search for examples. So if you don't have those examples then from where will you get conviction that something like this will happen.

Suneet Weling: Chris, any concluding comments on this point, because we are clearly a unique market.

Chris Hodge: It is difficult for me to comment other than to make the general point that, if you don't expect anything to happen why would you go to the board. I think it is one of the issues in a lot of stewardship codes. As I said about small

investors in the UK, they feel they are unable to do that. I have spoken to investors who invest in some countries that have introduced codes, and they have said we don't have any expectation that if we try to engage with other boards in this particular country, they will have any interest in talking to us. In some countries we may get to talk to the investor relations department, or possibly one of the senior management people, but we have no way of knowing whether these issues which we have raised about whatever strategy, performance, or governance will ever get raised with the board. As a result, they said, there is no incentive to make an effort. As far as international investors, some of the names you have already mentioned, they said that we don't bother putting resources into some countries - you can work out what the countries are from the share of the investors' overall asset allocation - because they don't believe either the board will be responsive or they don't think that there are good shareholders rights. And we talked about the importance of encouraging and incentivising investors to take an interest. If they feel those conditions are in place they will make an effort.

Nawshir Mirza: As he mentioned, if I can quote an example; a CEO, he was obsessed with automating everything. One of his projects was to automate investor relations. So, "if you have a complain about strategy then press 2". We had to tell him that you have got to draw a line at something.

Leo Puri: He was ahead of his time. Artificial Intelligence then it could happen.

Chris Hodge: I think we should share that example, it is a good idea.

Nawshir Mirza: No, no. Not a good idea.

Suneet Weling: One last question from my side and then we will turn it over to the audience. When we were discussing the 'comply or explain' requirement of the UK Code, there was an emerging view that in India 'comply or explain' may not work as effectively and you may need stronger regulation to actually to have an impact. Amarjeet, you have seen regulation in India for 20 years, where does light touch and stronger regulation have a role?

Amarjeet Singh: Responding more directly to your question especially in the context of stewardship code, let me first give an example. We tried some voluntary steps, let's say, on the constitution of the board of directors, having a women director on the board, the moment we make it mandatory we saw very good results. I am kind of conscious of the fact that in most jurisdictions, it is 'comply or explain' when it comes to stewardship code, however each jurisdiction

has its own unique characteristics and you have to adapt accordingly. So my personal view is 'comply or explain' does not take you very far. If I have read it correctly, even in UK, the latest review which is being done, it notes somewhere that there again it is 'comply or explain' and, wherever there is non-compliance of a principle, mere reporting of the same is disappointing. That is what the report says. When an institutional investor is not complying, the reporting he makes on 'comply or explain' basis is disappointing. My personal view would be is that firstly you need to have uniformity, for example SEBI's requirements for mutual funds are mandatory, the PFRDA's prescription which came last month is mandatory. whereas it is not the same with IRDA. This is a point of discussion and point of evolution also, as to how the regulations evolve.

Suneet Weling:

Chris do you have a view on this?

Chris Hodge:

As I said in the beginning of my remarks, it is a case of working out which is most effective in India. What is the objective here? It is certainly far from being the only country where people are very sceptical about whether the 'comply or explain' approach will work. Some of the countries in eastern European countries we were talking about, if you speak to the regulators they will say that they struggle to get companies to obey the law, let alone follow the corporate governance code. If the view is that a 'comply or explain' approach will not work in India then, to get movement, it probably has to be mandatory. However, I am not in a position to second guess that judgement or say whether it is right. The only thing I would say is that if you do make the code mandatory, it is important then to be careful what the mandatory obligations. For example, will it be a mandatory obligation to explain what your policies are. That is essentially what is coming in Europe. There is a piece of European legislation which will require mandatory reporting on investing policies and voting policies for asset managers, insurance companies and pension firms in the European Union. So that is a fairly standard way of dealing with this issue. I think it is more difficult to tell investors how they have to behave or what they have to take interest in when they are engaging. There are couple of stewardship codes in Malaysia, for example, and South Africa which say these are the particular issues that we think you should take about, but they are comply or explain. If you are required to care about these things or if you are required to engage with all companies in which you invest then I think that is where you perhaps have the risk of unintended

consequences if there is lack of interest or a lack of resolve to enable those things to happen. You could see investors handing over their engagement and voting to third parties, or some fairly or meaningless boiler-plate disclosure which is certainly one of the things we have had in the UK. I would not say that the stewardship code there has been a 100% success at all. I think it has been generally positive, but there have been a lot of shortcomings. That is a long way of saying, it depends on what you think the reaction will be from investors here. If you are going down the mandatory route just be clear about what you mandate as opposed to what you leave to the judgement and the discussion of the individual investors.

Amarjeet Singh: I think it is also important to think how effective it is, whether you have mandatory or whether you have 'comply or explain', what is the test of effectiveness? How is the code playing out? Some sort of study would be helpful there. I mean, is it achieving the desired outcome? That is the way to test.

Suneet Weling: We have few minutes for questions from the audience. We request you keep it to questions and address one of the members of the panel.

Participant: Good evening everybody. You talked about asset managers being measured on the returns that they have generated because that is what is easily available, the track record of the return that they have generated. But you also mentioned that there should be some mechanism by which he is assessed also on the governance track. So, is there some sort of a score or some sort of a score card which can be developed on the governance front as to how the asset manager has fared on the governance front?

Leo Puri: Yes, whether you call it a score card or assessment, it depends on what methodologies you like. But could there be an evaluation? Yes, it has to be partly subjective, because it has to start with understanding the principles of the philosophy, if you like, that particular asset management follows. The big fund houses around the world do this. They have a conscious policy in place which lays out, here is how we are going to run our engagement with companies, these are the issues we are going to raise, these are the resources we are going to put into it, this is our monitoring process, this is the frequency, and we are happy to be evaluated on the outcome as well as the process. Good process is a good beginning, but then outcomes can also be evaluated. Typically you get tested at points of extremes. Routine cases do not matter. Simply saying the score card that says how many resolutions you have abstained or voted on or voted against. Is it necessary to vote against

good things for the sake of it. I actually think that this is dangerous, but it fits the Indian mind-set, because I think we invented zero and so we like binary outcomes. But actually I prefer the shades of grey in this area because it is actually an area that requires evaluation more than scoring. But we can hold ourselves accountable; we can explain how we acted when under pressure. Those are the moments that actually count. There are plenty of moments I can think of, as investors ultimately we are not always driven by what the regulator wants us to do, to be honest, our fundamental aim is to make sure that the company's shareholder value creation gains, But we have a philosophy, that if we take care of the shareholder; everything else will be taken care of, because society will act in a way that shareholders will eventually have to take account of the environment, of moral standards and so on. That is a debate. For example, on something like succession planning, if at the end of the day, there is a person who is continuing to deliver value, even though they may be in their third term or their fourth term or maybe past the age when most of us are still active. We might still support them if we think they are the best people to bring value to that company even though it may be countered by regulatory nudges or perhaps nudges from many of the proxy advisors and so on, who by the way have been a great asset to the development of the code of conduct. Sometimes, we will take views which are fundamentally driven by value creation, because that is our Dharma in a way, which is what we are led to do. So, why are we even doing this, at the moment we are doing it because the regulator has asked us to, I am honest. When was the impulse for this? As Amarjeet said, in 2010, when it was put in place. So essentially, until then, did any of our clients care? Absolutely not. The people who give us money, did they care, did they ask us those questions, absolutely not. So it is the impetus, that came in a way from there and today we are saying, now that we are getting good at this or some of us are saying that we are getting good at this, we liked to be acknowledged for this. That would be a best catalyst and the best way of accelerating. We would welcome an evaluation if it could be a mature evaluation; I would personally oppose simple minded scoring because that will take us in the wrong direction.

Participant:

It is a supplement to what Leo said, maybe he can add or the others can add in the panel. We don't have a formalized institutional investor's engagement but we know that there is an institutional investor's expectation. Even if there is no formal engagement, all the companies know what the expectation is. That expectation drives them to certain things to do. He says that the simple

way is to raise top line or bottom line, and that could possibly lead to of course shareholder value increases, but that could lead to for example a micro finance entity creating ghost borrowers, that could lead to a big motor vehicle company doing emission test cheating. When you say that my first principle is to have a publicly disclosed policy of engagement, should we not identify the elements or we should constitute a matrix that I will judge, not only on ROI. Should we not think of that? Maybe, as we are evolving, maybe this is the time that we put those dimensions of evaluations and monitoring by institutional industries.

Suneet Weling:

Thank you. That is a good comment. Prof. Kale, you had a question?

Jayant Kale:

My question is actually a little along the line of what Leo was saying. Generally when you think about these institutional investors as monitors, they have the problem of analysing cost on monitoring over return. Suppose, I spend 100 rupees on monitoring, and the value of the share goes up by 200, but I own only one per cent of that firm. So, I am spending 100 but I am getting only 2 rupees. Why would I want to get engaged? However in addition to this, instead of this explicit engagement most of the monitoring done by institutions, according to research I have seen is what they would say passive monitoring. All institutional investors are very powerful too, they can sell the shares if they are not happy. So, why is it so essential to kind of force institutions to become "activist"? Most institutions are not, they are passive monitors; they just have the shares. And the price pressure, we put on the management, whatever is the situation.

Leo Puri:

I will tell you in reality, how we actually behave. Where you have very small positions, you sell and go away; absolutely that is how you maintain the discipline. But when you know that you are going to maintain long term positions that are going to be relevant to your future performance, you tend to get engaged. The segmentation that happens is the larger funds with the larger positions, logically are the ones who lead the engagement exactly as it should be for that practical reason. In most other cases the people will sell. The regulator sometimes expects you, obviously, as you were saying in a mandatory system, not to work to that principle. That is when it becomes a little difficult. That is the source of tension where you may have preferred to just sell and go away but you may get held to an account as to why did you not take a particular view or sometimes you may take a legitimately different view from the regulator. The shareholders also sometimes on the same issue

may not always have the same point of view. They may take a different view on strategy; their own interest may be lying differently depending on how they have come to become investors and so on. Typically selling and going away is not to be sniffed at, even though regulators don't like that as a strategy.

Jayant Kale: I am saying that it is a very powerful mechanism.

Leo Puri: I agree with you.

Suneet Weling: Amarjeet, as a regulator what is your view on "selling and going away".

Amarjeet Singh: My quick reaction would be, we would be agnostic in the first place. Behaviour in the market can be short term or long term. If it is short term behaviour, then there will perhaps be less incentive to engage with the investee company. You know that you are not there for long, but as Mr. Puri said, if you are a long term investor and you are representing public money, the regulators would be more concerned about your behaviour and would probably keep a watch. A short term investor would just buy and sell.

Nawshir Mirza: You said that it is a powerful tool, perhaps not so powerful, because as far as the principle shareholder or promoter is concerned, he has got a long life ahead of him in that company. He is not too bothered with the share price going down or up because he is hanging in there, unless he is about to go to the market to raise some more money. Otherwise they are pretty blasé, if the price went down, He says to himself, "I know what the value of my business is. One day when I want to exit, I know I will collect it."

Participant: One quick point. If I am an investor and invested money with you, I want him to be well diversified. So they have invested in 200 odd firms. I would think that someone like a hedge fund which is invested in these five companies, they are more likely to be engaged there.

Participant: I just wanted to react to something about investors selling, which they do, but the consequence of that is that, we have recently witnessed a case where just to put some numbers, the share price was 100 and the company decided something, and the price came down to 80. The new investor said that at 80, we are not happy about it, but it is already priced still, and therefore we will go with it. If at 100, we would have taken a different view. So you have to recognise that behaviour which also comes into play with investors.

Participant: Nowadays, lots of auditors are resigning from their assignments. It is a major problem, but nobody owns the whether it is the promoter problem or the board problem or audit committee problem or institutional investors' problem

or regulators' problem. There is some element of information asymmetry. Somebody should own the responsibility.

Suneet Weling: Sorry, what was the question?

Participant: The auditors are resigning without even telling the reasons. So the investor should know why they are resigning, what is the reason, who audited last year? The investors are off-guard, what do they do? This we have seen a lot in the last 2-3 months.

Suneet Weling: I think Amarjeet, as a stock market regulator, when you see auditors resigning, is that an onus on SEBI or somebody else?

Amarjeet Singh: It is a complex situation, but let me put it this way, what Kotak Committee has recommended and we have already agreed and accepted that, whenever an auditor resigns, the company has to disclose the reasons for resignation to stock exchanges. This will become the practice from 1st April 2019. The problem is well recognised and the recommendation has been made and also implemented, of course prospectively.

Participant: I just want your views or comments on these. One is about the material related party transactions, of the board of directors of a holding companies or independent directors of the holding companies, are on the board of their subsidiaries, and second is about the variable compensation where, I just want a comment on this, can we link the variable compensation weightage, maybe a shared based compensation of a promoter against the performance of the company. Can we have more weightage towards the share based compensation in their salary?

Suneet Weling: Your second question is more stock compensation as opposed to cash. What is the first question?

Participant: The first question is about the BOD of the holding company being the BOD of their subsidiaries or key parties.

Suneet Weling: So, stock versus cash. Do you have a view on that?

Chris Hodge: I think this is a debate that goes round and round overtime whichever way you do it, someone will be unhappy about the outcome, whether it be the investors or sometimes the regulators or sometimes the public. What we have seen in the UK over the last 15 years, this has been a top political issue as well as a governance issue. Previously, the problem was that there was too much fixed pay, meaning there was no incentive to improve performance, so they

moved to more variable pay based on their performance. That is now seen as being too easy to get those bonuses and variable pay, and there is now a trend to move back to fixed pay. I think it is one of those issues that depending on what you see as a problem of that time, the opposite always seems more attractive. As I explained in the UK, you just go round and round.

Suneet Weling: Mr. Gupta, do you have a question?

Mr. Gupta: I just wanted to add that it is not a new thing that the auditors are resigning, but the only change is that the impact of Kotak committee recommendation is being felt, and many auditors who have resigned now, they have been giving reasons. Whether the reasons are right or wrong, we do not know, but they have got detailed reasons, and couple of instances that has happened. But the negative part of this is that there are rumours in the market of auditor resignation, and the investors are losing or making money because of those rumours.

Amarjeet Singh: Plus if I can also quickly add, media reports attribute to regulatory action taken by SEBI and the solicitors also.

Suneet Weling: Thank you for this very interesting panel discussion. There is clearly a lot of work that needs to happen on the creating a common stewardship code and I don't think anyone would debate that India needs one uniform code. The other question is about 'comply or explain' versus mandatory regulation, and to Chris's point that if SEBI makes its mandatory, it should be something that is enforceable and reasonable. Also from an investment managers' perspective clearly there is some work to do on educating your ultimate investors, providing disclosure and getting them to value the stewardship that you would be take up. Mr. Mirza as an independent director, it is wonderful to hear that you are welcoming more engagement and stewardship but I wonder how many other independent directors would do that. Chris, thank you for your comments and for sharing the experience of the UK Code and to Amarjeet's point, it would be good to see evidence of the outcomes of the UK experience. Thank you all once again.

Ashiana Salian: Thank you everybody. We come to the end of this event today. First of all, we are extremely grateful to the IGIDR for collaborating with us for this event. I thank Prof. Subrata Sarkar and Prof. Jayati Sarkar for their immense contribution in organizing the event. I would like to express our sincere

gratitude to Prof. Jayant Kale for graciously accepting our invitation to deliver the keynote address today. My sincere thanks to our esteem panellists, Mr. Singh, Mr. Hodge, Mr. Puri, Mr. Rai, Mr. Mirza and Mr. Weling. Their incisive views and comments made this discussion truly engaging and stimulating. A special thanks to all the participants for accepting our invitation to attend the conference today. It has been our pleasure to host you as our guest. I thank the media for the efforts they are taking for the coverage of today's event. Lastly, I thank our colleagues at NSE for all their immense support and cooperation in organizing today's event. We truly appreciate it. With this we come to the end of this event. Thank you all once again for joining us today for the event.



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