

Conversations on Corporate Governance

Dialogue 4: Conflict of Interest



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Dialogue 4: Conflict of Interest

Conflict of Interest (COI) arises when an individual's personal interest conflicts with her/his professional interest, or when an individual mixes or misuses her/his position for personal gains, above duty. One of the responsibilities of the Board is to identify existing and potential COI, and build adequate systemic safeguards for building integrity, and accountability having regard to Corporate Governance standards.

COI can exist in different situations, and at different levels, within an organisation. It can be caused by an association with more than one organisation, because of directorships, relationships, family businesses or liabilities. COI arises when an individual, with competing interests with the company, occupies a position by which any decision made promotes one such interest, at the cost of endangering the other interest. When such a situation emerges, propriety demands that one should recuse oneself from participating in the decision-making process. Encouraging competing interests may at times end up compromising organisational goals for personal gains.

The fiduciary responsibilities of the corporate Board are to make decisions that are in the best interest of the organisation and its stakeholders, including minority shareholders. COI therefore cannot be ignored, and should be disclosed promptly and adequately. It enables the Board to distance the conflicted individual or institution from the decision or transaction, in the interest of good Corporate Governance standards.

Related Party Transactions (RPT) norms in India provide corporates with guidance on dealing with such situations. In November, 2019, SEBI constituted a Working Group to extend the norms pertaining to RPTs. The Working Group in its report, submitted in January, 2020, has provided several recommendations to strengthen the monitoring and enforcement of norms of RPTs. The key recommendations include widening of the definitions of Related Parties and RPTs, lowering the materiality threshold of transactions requiring approval of shareholders, and enhanced responsibility of Audit Committee for the approval of RPTs.

In this context, NSE, jointly with Excellence Enablers - a corporate governance advisory firm, had organized a **webinar on “Conflict of Interest”** – the first dialogue in the second series of Corporate Governance Webinars on December 16th, 2020.¹ The panel discussion focused on how corporates should deal with situations of conflicting interests. The panel comprised very eminent and highly regarded speakers from the legal and corporate governance fraternity – Ms. Zia Mody, Founder and Managing Partner, AZB & Partners, Prof. Umakanth Varottil, Associate Professor, Faculty of Law at the National University Singapore (NUS) and Mr. M. Damodaran, Former SEBI Chairman and Founder, Excellence Enablers. This report provides a summary of the deliberations.

- COI is all pervasive: It exists everywhere and cannot be wished away. Putting in place fail-safe systems is not possible. COI must be addressed as and when they manifest themselves. COI is an absolute concept, and not a relative concept. One is either conflicted or is not conflicted. If conflicts are not confronted at the first opportunity, additional problems will get created. There are several situations in which COI might exist. A few of the examples are:
 - A Director, while dealing with a proposal in a boardroom, acting in a manner that is against the interest of the company, and furthers her/his interest.
 - Regulators sitting on the Boards of regulated entities is a major conflict. RBI, while having a majority shareholding in State Bank of India, had a very senior functionary on the Board.

Please click [here](#) to listen to the recording of the webinar.

¹ The first series comprised: First dialogue on August 19th, 2020 on the topic “Crisis Management: The Lessons Learnt. Please click on the link to watch the recording of the first dialogue on [YouTube](#) and read the summary report on [NSE's website](#). Second dialogue held on September 22nd, 2020 on the topic “Corporate Governance and Financial Sector Regulations”, Please click on the link to watch the recording of the second dialogue on [YouTube](#) and read the summary report on [NSE's website](#). Third dialogue on October 21st, 2020 on the topic “Instruments of Corporate Governance”. Please click on the link to watch the recording of the third dialogue on [YouTube](#) and read the summary report on [NSE's website](#).

- Trying to further the promoter's interest because the promoter brought the Director concerned on the Board.
- Independent Directors sitting on the Boards of competitors who are in the same sector/ market, and have similar products.

COI could go against the interest of all stakeholders, and not just minority shareholders.

- Recusal from decision-making: One of the ways in which a conflicted Director deals with a situation of conflict is by recusing herself/himself from the discussions. Recusal from decision-making can take several forms. There are instances in which the conflicted Director continues to sit in the boardroom, and only the minutes of the meeting mention that she/he had recused from discussions, and decision-making in the matter involving COI.

This approach has its own problems, since discussions, taking place in the presence of the conflicted Director, often shy away from addressing the seriousness of the problem. Even a silent presence can be persuasive when it comes to decision-making. While conflicts cannot always be anticipated, it is important to deal with them as soon as they are noticed. There are of course cases of individuals who are in a situation of conflict, but either do not recognise it or, what is worse, refuse to act on it.

- Doing what is right: Simply stated, conflicts are best avoided by doing what is right. This is a commonsensical approach, without technicalities clouding the concept. Avoidance of COI is a key concept of Corporate Governance. It is sometimes possible that there are doubts about whether a particular situation presents a COI. In the event of doubt, disclosure is the best option, since no person can level any allegations later if some conflict is noticed.
- COI should be disclosed promptly and adequately: The promptness with which the conflict is dealt with is important. One should not wait for it to be discovered by someone else, or for it to fester. It sometimes happens that the problem involving COI is noticed on the first day of a due diligence exercise. If it is not disclosed at the first opportunity, and is subsequently disclosed, it remains the problem of the person who delayed the disclosure.

It is useful to remember that third parties often look at possible COI, with the benefit of hindsight, after a long period has elapsed. Sometimes, it attracts the suspicions of Regulators, media, and also of some colleagues in the organisation.

One of the tests when dealing with COI is to look at how it would be seen and dealt with by different stakeholders. Dealing with COI is a duty of loyalty, both to the people you are working with, and the entity that you represent or are a part of. Diversion of corporate opportunity is a relatively common example of COI.

- Conflicts could be at different levels: There are conflicts at an individual/personal level. As a Board member, one could be in conflict with larger stakeholders. There could also be situations of conflict among different stakeholders. Viewed through the ESG lens, there could be a conflict perceived between the company and society at large.

There is no one-size-fits-all solution that can be followed in situations of COI. Continuous improvement should be attempted, remembering that, like Corporate Governance, avoidance of/ dealing with COI will always be work-in-progress. The

business of business is much more than business. It is necessary to have trust so that the company's performance is not impeded, but at the same time, questions should be asked to ensure that the trust is not misplaced.

- Conflict recognition should lie in the eyes of the beholder: COI seems theoretical, but it has a lot of practical elements. In the context of a fiduciary, there could be an actual conflict which is easy to identify. There are perceived conflicts, and it is important to ensure that the world should not perceive that there is a conflict, where none exists. Then there are potential conflicts which could arise in the future because of some change that has occurred. Detailed explanations often do not help the cause. The simple test to follow when addressing COI is "I know it when I see it".
- How and where does COI manifest itself? Firstly, it could be at the Board level. Secondly, it could percolate to other levels of stakeholders such as shareholders. RPTs are also indicative of possible COI, and at AGMs interested parties will have to recuse themselves from voting. There is no clarity in India on whether institutional investors, having significant shareholding in competitor companies, are in a situation of conflict. Elsewhere, Anti-Trust Regulators and Securities Regulators have started looking at these as possible indications of the existence of conflict. Intermediaries, such as auditors, credit rating agencies and investment advisors, should also be considered for assessing potential COI.
- How to deal with COI? Disclosure is the low hanging fruit to deal with COI. Fiduciaries should err on the side of caution. In some cases, such as material RPTs, there is the possibility of moving the decision-making to another body, namely the shareholders. This is an internationally accepted practice. In the case of M&As, a substantive review of a decision could also be outsourced. In India, this concept is at a nascent stage. Institutions, such as ombudsman and a whistleblower mechanism, often help in dealing with COI. However, a check the box approach is never the answer. Form over substance is never the best approach.

RPTs constitute the best example of COI. Abolishing them is hardly a solution since there could be transactions which are beneficial to the company. Prescribing majority of minority voting could sometimes lead to playing into the hands of an influenceable minority.

Stringent regulations do not necessarily translate to the best way of addressing an issue of this nature. Contextually, it is relevant to examine whether Proxy Advisors are also sometimes in situations of COI. While SEBI is seeking to regulate them through the SEBI (Research Analysts) Regulations, 2014, elsewhere, Proxy Advisors remain unregulated on the plea that freedom of expression should not be curtailed.

- Premature disclosures could be detrimental: When it comes to whistle-blowing, India has the maximum number of complaints. Resultantly, there is a need to be extraordinarily vigilant both as a Board and as individuals, and to nip in the bud any situation which is likely to result in a COI. At the same time, there exists the possibility of premature disclosures that can cause harm to corporate entities and to the individuals concerned.

SEBI's recent directive that as soon as a company commences a forensic audit, it should be reported, and brought into the public domain, would appear to be creating a situation of premature disclosures in some cases. While news regarding the starting of a forensic audit will necessarily give rise to doubts and suspicion, and could possibly impact on share prices, it is possible that on conclusion of the audit, the allegation is found to be baseless. The damage done from the time it was disclosed, to the time when the complaint was found to be baseless, cannot be repaired. It is also possible that as soon as there is information in the public domain, regarding a forensic audit, some shareholders could get together and opt to file a class action suit, especially if any security of that entity is listed abroad. The damage having been done, a subsequent finding that the complaint is not established, might not attract any attention in the media or elsewhere.

Fortunately, Regulators have been responsive and should be expected to put in place a procedure that balances the consideration of disclosure, while avoiding unintended damage to the reputation of a company or an individual. It must be recognised that no one can stop persons from filing complaints. Therefore, Directors, who are likely to be adversely affected, should continuously seek to place themselves in a position which is better than what is normally possible.

- Every entity should have a policy on COI: What should be the components of a policy on COI, and what can make it actionable? One way would be to identify, based on past experiences, situations where things have gone wrong, and to make a list of dos and don'ts for the company. SEBI has a policy on COI, which requires its Board members to indicate issues in regard to which they may have conflicts, as soon as the agenda for the meeting is received by them. One way to look at conflicts is to follow the three colour codes used in arbitration cases, which will give a fair indication of what should be done and what should not be done.

While policies can be very detailed and formal, they could be counterproductive. Having the right balance is important. The policy can contain incentives and disincentives. However, it should be recognised that while financial disincentives can be dealt with, the adverse impact on reputation is the major problem that needs to be anticipated and addressed.

- Reputational damage resulting from COI can be high...: This is something that should always remain in the minds of Independent Directors and members of senior management. It is universally recognised that sunlight (disclosure and transparency) is the best disinfectant. A simple test is to adopt the position "if it does not feel right, drop it". Ultimately it boils down to individual character and conscience. In a business environment, there should be a balance between being sensible and being too good. Behavioural aspects are critical when it comes to identifying conflict of interest, disclosing it, and mitigating it.
- ...but all conflicts are not necessarily bad: The differentiation between confluence of interest and COI must be clear. Simply stated, a COI is an existence of an interest that should not adversely impact on the interest of the company.

One question that has been raised is whether a COI policy can be sufficiently anticipatory. This is a very big ask. It is adequate if a potential conflict or a possible conflict, when first identified, is appropriately dealt with.

Avoidance of COI is inherent to Corporate Governance. It either protects or destroys your reputation, depending on how you handle it. The acid test is whether a fiduciary is ultimately acting in the interest of the company.

Key speakers

Welcome address

Mr. Vikram Limaye, *MD and CEO, NSE*

Introductory remarks

Dr. Tirthankar Patnaik, *Chief Economist, NSE*

Panel Discussion

Zia Mody

Founder and Managing Partner, AZB & Partners



Ms. Zia Mody is the Founder and Managing Partner of AZB & Partners, and one of India's foremost corporate attorneys. She has advised clients across the world on marquee deals. Ms. Mody has served as Vice President and member of London Court of International Arbitration from 2009 to 2013, and member of the World Bank Administrative Tribunal from 2008 to 2013. She has served as the Vice Chairperson and Non-Executive Director of HSBC Asia Pacific Board. She has served, and continues to serve, on several government committees on financial reforms and Corporate Governance, including the Kotak Committee on Corporate Governance and Godrej Committee on Corporate Governance. She has worked with Baker & McKenzie in New York, before moving to India to set up practice, establishing the Chambers of Zia Mody in 1984, which then became AZB & Partners in 2004. She has won several awards and recognitions, and has earned tremendous appreciation as a role model for women in business.

Dr. Umakanth Varottil

Associate Professor, Faculty of Law at the National University Singapore (NUS)



Dr. Umakanth Varottil is the Associate Professor at Faculty of Law, National University Singapore (NUS). He is the Director of Graduate Coursework Studies and NUS Law Academy. He specialises in corporate law and governance, mergers and acquisitions, and corporate finance. His specific focus is on India and Singapore. He started his career with Amarchand & Mangaldas & Suresh A. Shroff & Co., where he was promoted to the post of a Partner. He was ranked as a leading corporate/mergers and acquisitions lawyer in India. He has taught as a visiting faculty at law schools in Australia, India, Italy, New Zealand and USA. He has co-authored/ co-edited four books, published several articles in international journals and founded the Indian Corporate Law Blog. He is recipient of several academic medals and honours.

M Damodaran

Chairperson, Excellence Enablers and Former Chairman, SEBI, UTI and IDBI



Mr. M. Damodaran is Chairperson, Excellence Enablers Private Limited and Former Chairman of SEBI, UTI and IDBI. He serves on Boards of Directors, including as Non-Executive Chairperson of InterGlobe Aviation, and on Advisory Boards of several companies. He successfully led the revival efforts of UTI and IDBI. He created the unique Stressed Assets Stabilisation Fund (SASF) which helped clean IDBI's books. He was also the Former elected Chairman of the International Organization of Securities Commissions (IOSCO)'s 80-member Emerging Markets Committee for two years. He has chaired several committees of the Government of India, RBI and some chambers of commerce. He was Former Chief Secretary of the Government of Tripura. He is a recipient of several awards and recognitions.

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Given that our founder, Mr. M. Damodaran, introduced Clause 49 of the Listing Agreement, dealing with corporate governance in India, and has been a part of both public sector and private sector Boards, as well as performing and underperforming Boards, we offer experience based consultancy and courses on the journey from compliance through governance to performance. Further, given his success in turning around organisations that had been written off, we are uniquely positioned to offer courses on leadership, organisational transformation, and building winning teams.

EEPL has a number of highly experienced and renowned consultants and faculty members who have helped, and continue to help, us deliver programmes that have been well received.

For more information, please visit: www.excellenceenablers.com

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