CHAPTER 4

# Directors and Key Managerial Personnel

**This article aims to:**

Provide an overview of additional requirements applicable to directors under the SBR.

## Background

Directors play a critical role in the operations and management of a company and are empowered by shareholders to take pivotal decisions for the company. Various regulations including the 2013 Act, the Listing Regulations and the RBI provisions cover a number of aspects regarding directors such as those pertaining to appointment, remuneration, number of directorships, resignation, compensation, transactions with directors, etc.

The SBR framework prescribes certain additional provisions pertaining to the directors (including Independent Directors (IDs), Key Managerial Personnel (KMP) and senior managers of NBFCs. These additional provisions have been given in figure 1 below:


(Source: KPMG in India's analysis, 2022 read with RBI circular, 'Scale Based Regulation (BSR): A Revised Regulatory Framework for NBFCs, issued on 22 October 2021)

In this article, we aim to provide an overview of the provisions issued by SBR pertaining to directors and KMP and expound the existing regulations prescribed in the 2013 Act and the Listing Regulations pertaining to those provisions.

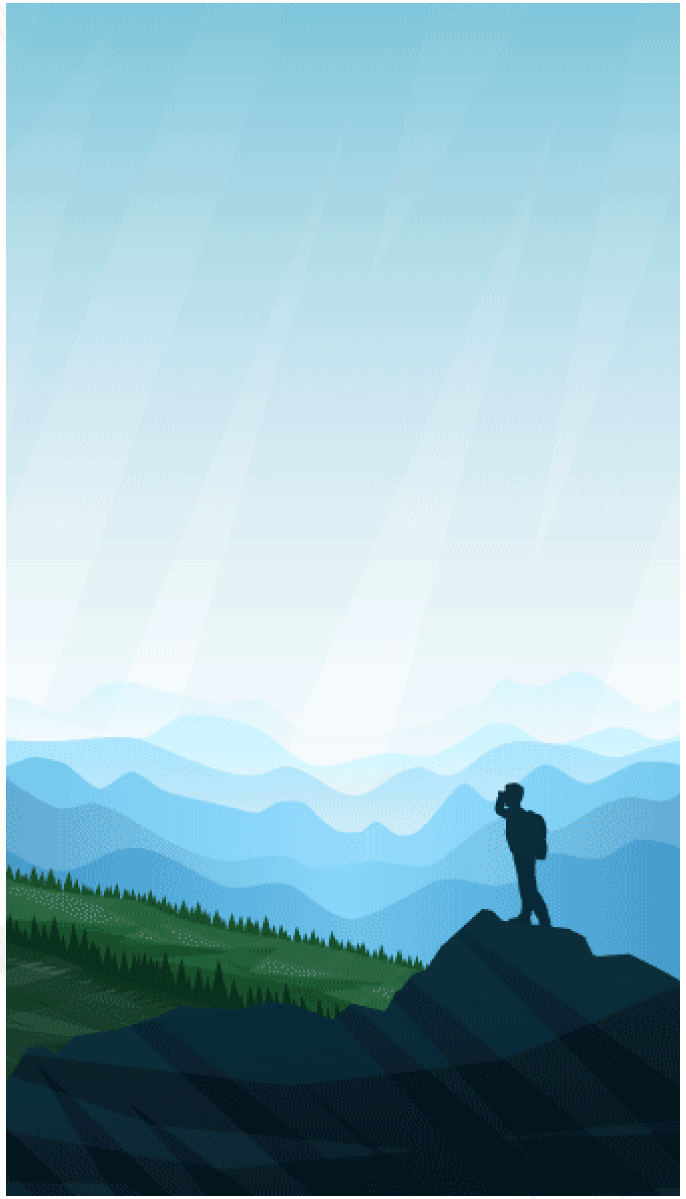
## Overview of additional provisions

The BoD have to exercise strategic oversight over business operations of the NBFC, ensure compliance with legal framework and financial accounting and reporting systems. Hence, it is essential for the BoD to ensure that the board has directors with relevant qualifications, adequate compliance and control over their transactions with the entity, number of directorships are within the maximum threshold, etc. These requirements are further discussed below:

### Qualification and experience of BoD

In order to consider the need for professional experience in managing the affairs of NBFCs, the SBR framework requires NBFCs in all layers to ensure that at least one of the directors has relevant experience of having worked in a bank or NBFC.

Additionally, considering that NBFCs in the upper layer pose higher systemic risk and need to maintain highest corporate governance standards, they need to ensure that composition of BoD has relevant educational qualification and experience. Specific expertise of board members would be a prerequisite for appointment of directors depending on the type of business pursued by the NBFC-UL.



### Current provisions of the 2013 Act and Listing Regulations

The Companies (Appointment and Qualification of Directors) Rules, 2014 require independent directors to possess appropriate skills, experience, and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations, or other disciplines related to the company's business.

Certain independent directors are also required to undertake an online proficiency self-assessment test in accordance with Rule 6 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

Under the Listing Regulations, Part D of Schedule II of the Listing Regulations[1], requires the Nomination and Remuneration Committee (NRC) to formulate the criteria for determining qualifications, positive attributes, and criteria to evaluate independence of a director, identify persons who are qualified to become directors in accordance with the criteria laid down, and recommend to the BoD for their appointment.

1. Roles of committees (other than audit committees)

## Restriction on directorships of KMP and ID

Both, the 2013 Act and the Listing Regulations prohibit a person from holding the office of a director in more than prescribed number of companies. This helps ensure that directors spend adequate time in considering the issues and efficiently discharge their functions as directors in the companies they have been appointed The RBI guidelines were silent on the number of directorships and did not prescribe such restrictions.

The SBR has now advocated the maximum number of directorships that a KMP or ID in an NBFC in the middle or upper layer can undertake. A comparison of the provisions pertaining to maximum number of directorships under the 2013 Act, Listing Regulations and SBR framework is given in the table below:

| Director/KMP | Maximum number of directorships[2] as prescribed under | | |
|---|---|---|---|
| | 2013 Act | Listing Regulations | SBR Framework |
| Executive directors (including Whole-Time Director (WTD)) | 20 companies in total (10 public companies) | Seven listed entities. ID in not more than seven listed entities. If person is a MD[3]/WTD, then ID in not more than three listed entities. | Executive director cannot hold any office (including directorship) in any other NBFC-ML or NBFC-UL[4] However, directorship in a subsidiary of the company in which he/she is an Executive director is permitted |
| KMP[5] (excluding whole-time directors, covered above) | No restriction | No restriction | KMP cannot hold any office (including directorship) in any other NBFC-ML or NBFC-UL.[4] However, directorship in a subsidiary of the company in which he/she is a KMP is permitted |
| Independent director | 20 companies in total (10 public companies) | In not more than seven listed entities | ID cannot be a director in more than three NBFCs (NBFC-ML and NBFC-UL)[4] at the same time |

Source: KPMG in India's analysis, 2022

**Effective date:** The above restrictions are applicable to NBFC-ML and NBFC-UL. Time of two years is provided with effect from 1 October 2022 to NBFCs to ensure compliance with these norms (i.e. amendment is applicable from 1 October 2024).

## Loans to directors, senior officers, and relatives of directors

The SBR framework prescribes certain restrictions on loans to directors and senior officers. This will help bring about transparency and to strengthen the disclosures around loans and advances provided by the NBFCs to directors, senior officers, and relatives of directors,

**a. Board approved policy on loans and advances to directors, senior officers, and relatives of directors (for NBFCs in the base layer)**

NBFCs in the base layer are required to prepare Board approved policies on grant of loans to directors, senior officers, and relatives of directors and to entities where directors or their relatives have major shareholding. The BoD approved policy should include a threshold beyond which loans to above mentioned persons shall be reported to the BoD. Additional disclosures of loans and advances sanctioned to directors, senior officers and relatives of directors and senior officers would be required (in the format given in the next page).

**b. Restrictions on loans and advances to directors and relatives of directors (for NBFCs in the middle and upper layer)**

As per the SBR framework, NBFCs (ML and UL) can grant loans and advances to (subject to certain conditions):

- Their directors (including Chairman and Managing director) or relatives[6] of directors
- Any firm in which any of their directors or their relatives are interested as a partner, manager, employee, or guarantor.
- Any company in which any of their directors, or their relatives are interested as a major shareholder[7], director, manager, employee, or guarantor.

These loans can be granted after obtaining a sanction from BoD/Committee of Directors if the loan and the advance amount is equal to or more than INR5 crores. If the amount is less than INR5 crores, then it may be sanctioned by the appropriate authority in the NBFC under powers vested in such authority, but the matter is required to be reported to the BoD.

---

2. Including alternate directorships
3. Managing Director
4. Directorship in NBFC-BL is permitted
5. Key managerial personnel in relation to a company, means the Chief Executive Officer or the managing director or the manager; the company secretary; the whole-time director; the Chief Financial Officer; such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the BoD; and such other officer as may be prescribed.
7. The term 'relative' includes members of a Hindu Undivided Family, spouse, mother, father, son, son's wife, daughter, daughter's husband, brother, or sister
8. A director or his/her relatives would be deemed to be interested in a company being a subsidiary or holding company if he/she is a major shareholder or is in control of the respective holding or subsidiary company.

**c. Loans and advances to senior officers[8] (for NBFC ML and UL)**

While sanctioning loans and advances to a senior officer, NBFCs in the middle and upper layer need to consider the following:

- Loans and advances sanctioned should be reported to the BoD.
- No senior officer or any committee which *inter alia* includes a senior officer as member, can sanction any credit facility to a relative of that senior officer. The next higher sanctioning authority would be empowered for sanctioning such a credit facility.

**Provisions under the 2013 Act and the Listing Regulations**

NBFCs are currently exempted[9] under the provisions of the Section 185 of the 2013 Act from obtaining a special resolution for advancing loans to directors, provided the loans granted to directors are at interest rates prescribed. However, these loans need to be approved by the audit committee of the company, under the provisions of Section 177[10] of the 2013 Act and under the provisions of Regulation 23(2) of the Listing Regulations.

8. The term 'Senior Officer' has the same meaning as assigned to 'Senior Management' under Section 178 of the 2013 Act. 'Senior management' means personnel of the company who are members of its core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads.
9. This is because NBFCs advance loans in the ordinary course of their business.
10. Approval of audit committee is required for NBFCs which are mandated to constitute an audit committee under Section 177 of the 2013 Act.

**d. Compliance by NBFCs for loans and advances to directors, senior officers, and relatives of directors**

While granting loans and advances mentioned in (b) and (c) above, NBFCs should:

- **Obtain declaration from borrower (NBFC-ML and UL):** The borrower is required to provide declaration of their relationship with the directors/senior officers for loans and advances aggregating to INR5 crore and above. NBFC shall recall a loan if it comes to their knowledge that the borrower has given a false declaration.
- **Communicate guidelines to directors:** The SBR guidelines are required to be placed before the NBFC's BoD.
- **Specific disclosure format in annual financial statements (ML, UL, and BL):** NBFCs shall disclose in their annual financial statements, aggregate amount of such sanctioned loans and advances as per the template provided below:

| Particulars | Current Year | Previous Year |
|---|---|---|
| Directors and their relatives | | |
| Entities associated with directors and their relatives | | |
| Senior Officers and their relatives | | |

**Disclosure requirements pertaining to loans to directors under Listing Regulations**

***In the annual report***

Schedule V of the Listing Regulations requires entities that have listed their non-convertible securities on a recognised stock exchange to provide certain disclosures on related party transactions in their annual reports. These disclosures *inter alia* include the amount at the year end and the maximum amount of loans/ advances/investments outstanding during the year for loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount both in the holding and subsidiary companies.

***In the compliance report on corporate governance***

Listed entities are also required to *inter alia* disclose loans or any other form of debt advanced to promoters, promoter group, directors or KMPs or any of the entities controlled by them in their compliance report on Corporate Governance[11].

***As part of related party disclosures to stock exchange***

Loans to directors will form part of related party disclosures required to be submitted to the stock exchange in the format prescribed by SEBI. This disclosure is required to be made by entities that have listed their specified securities on a recognised stock exchange and by high value debt listed entities within the time prescribed.

11. As prescribed by circular SEBI/HO/CFD/CMD-2/P/CIR/2021/567 dated 31 May 2021

### Disclosure requirements pertaining to loans to directors under Schedule III of the 2013 Act

Currently, Division III of the Schedule III to the 2013 Act requires NBFCs to provide certain disclosures with regard to loans or advances in the nature of loans granted to promoters, directors, KMPs and related parties that are repayable on demand or without specifying any terms or period of repayment. The disclosures pertain to:

- Total amount of loan or advance in the nature of loan outstanding
- Percentage of such loans granted to the total loans or advances in the nature of loan.

Further, debts due by directors or other officers of the NBFC or any of them either severally or jointly with any other person or debts due by firms including Limited Liability Partnerships (LLPs), private companies respectively in which any director is a partner or a director or a member are required to be disclosed as a separate note to the balance sheet caption 'receivables'.

Section 186(4) of the 2013 Act also requires companies to give full particulars of loans given, investment made or guarantee given or security provided and purpose for which the loan or guarantee or security is proposed to be utilised by the recipient.

## Compensation guidelines of KMP and senior management in NBFCs

The SBR required NBFCs classified in the middle and upper layer of the SBR framework to put in place a compensation policy that is approved by the BoD. This will help address issues arising out of excessive risk taking caused by misaligned compensation packages.

In this regard, RBI (vide a notification dated 29 April 2022) has issued broad guidelines for formulating compensation policies of KMP and members of senior management. As per the guidelines, the compensation policy of an NBFC should at the minimum include the following provisions:

- **Constitution of Nomination and Remuneration Committee (NRC):** NBFC-ML and NBFC-UL should constitute an NRC, which will have the constitution, powers, functions, and duties as laid down in the 2013 Act. The NRC may work in close coordination with the Risk Management Committee of the NBFC to achieve effective alignment between compensation and risks. The NRC may also ensure 'fit and proper' status of proposed/ existing directors and that there is no conflict of interest in appointment of directors in the BoD of the NBFC.
- **Principles for fixed/variable pay structures:** The proportion of variable pay in total compensation of a director or KMP should be commensurate with the role and prudent risk-taking profile of KMPs/senior management.
- **Malus[12]/claw back[13] provisions:** The deferred compensation to directors/KMP/members of senior management may be subject to malus/claw back arrangements in the event of subdued or negative financial performance of the company and/or the relevant line of business or employee misconduct in any year.

**Effective date:** These guidelines will come into effect from 1 April 2023.

---

12. A malus arrnagement permits the NBFC to prevent vesting of all or part of the amount of a deferred remuneration. Malus arrangement does not reverse vesting after it has already occurred.
13. A clawback arrangement is a contractual agreement between the employees and the NBFC in which the employee agrees to retrun previously paid or vested remuneration to the NBFC under certain circumstances.

### Provisions under the 2013 Act and the Listing regulations

Currently, under the 2013 Act, all listed companies and certain public companies are required to constitute an NRC. The NRC is required to *inter alia* ensure that remuneration of directors, KMP and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals. As per the Listing Regulations, the NRC is required to recommend to the BoD all the remuneration that is payable to senior management.

Additionally, NBFCs are required to compute managerial remuneration in accordance with the provisions of Sections 197[14] and 198[15] of the 2013 Act and the rules made thereunder.

14. Overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits. This section is applicable to public companies.
15. Calculation of profits (for computing managerial remuneration)

## Independent directors - intimation on resignation/removal

The SBR requires all NBFCs in the upper layer to report to the RBI in case any ID is removed/resigns before completion of his/her normal tenure.

### Provisions under the 2013 Act and Listing Regulations

As per Section 169 of the 2013 Act, a company may remove an ID before the expiry of his/her term, by passing an ordinary resolution in his/her first term and by passing a special resolution in his/her second term after giving him/her a reasonable opportunity of being heard.

As per the Listing Regulations the appointment, re-appointment, or removal of IDs of a listed entity would be subject to the approval of shareholders by way of special resolution.

### Next Steps

Considering the systemic importance of NBFCs, there is a need to regulate the provisions pertaining to directors as they have a key role to manage and provide an oversight on all aspects of the NBFC. NBFCs would need to consider the provisions of the 2013 Act, the Listing Regulations, and the RBI regulations (including the SBR framework) while implementing these requirements.