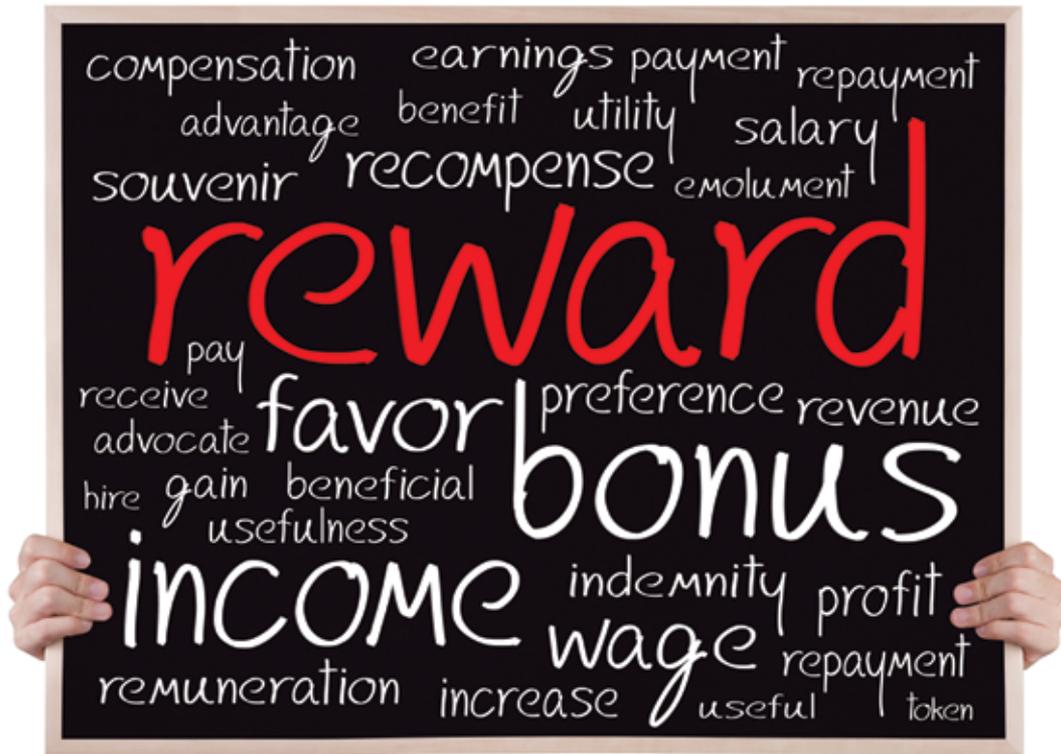


## Insight on Provisions of Managerial Remuneration in Companies Act, 2013



*Director's remuneration had been a tricky issue in the Companies Act, 1956. Despite a presence of many provisions to deal with this issue, some loopholes continued to persuade the Ministry to issue various circulars and notification for more clarity and more transparency on this aspect. But now the Companies Act, 2013 throws a clear light on this complex issue, while entrusting to provide more and more transparency on this issue, so that no one from management could extract funds that belong to shareholders and stakeholders. This transparency is moreover linked with the term Shareholder Democracy, as shareholders are the true owners of a company. Again, shareholders can hardly affect the remuneration of Directors in the present scenario, as most of the remuneration structures are designed by Remuneration Committees comprising a team of Directors. The author in this article tries to explore the scope and issues in the provisions of managerial remuneration under the new Companies Act, 2013. Read on...*



**Ms. Reena Kewat**

(The author is a Company Secretary who may be reached at reenakewat@gmail.com.)

Director's remuneration has always been a tricky part of the Companies Act, 1956. Although the Companies Act, 1956 has provided many provisions for dealing with this issue. But some of the loopholes of the previous act continuously persuaded the Ministry to issue various circulars and notifications for more clarity and transparency on this aspect.

**Corresponding to the Section 309 of the Companies Act, 1956, Clause 197 deals with the demarcation line for payment of remuneration to Whole-time Director and Non-whole-time Director. Proviso (i) of Sub-clause (1) of clause 197 retains the ceiling limit of 5% of net profit to Director in whole-time employment, if there is a Managing or Whole-time Director, or else, it would be 10% if more such Directors are there.**

But now the Companies Act, 2013 throws a clear light on this complex issue. The new Act entrusts to provide more and more transparency on this issue, so that no one from the management can extract funds, which belongs to not only shareholders but all stakeholders.

This transparency is linked with the term *shareholder democracy*. It has been an established concept that *shareholders* are the exact owners of a company. But it is also true that they can hardly affect the Director's remuneration, since in present scenario, most of the remuneration structures are designed by *remuneration committees*, which are almost a team of Directors, and shareholders have no control over those committees. Therefore, it seems that, on behalf of *stakeholders*, the law itself takes on the responsibility to control the Directors' remuneration so that no one can take additional advantage through the outflow of funds.

### Categories of Managerial Person Covered

- a) Managing Director (MD)
- b) Whole-time Director (WTD)
- c) Non-whole time/Part-time Director
- d) Manager

### A Snapshot of Provisions of Companies Act, 2013

- (a) *Under the Companies Act 2013, Clause 197 would correspond with the existing Section 198 of the Companies Act, 1956 as main charging Section. It deals with the overall ceiling limit of managerial remuneration. As per the charging Section of the Companies Act, 1956, 11% of the net profit is the maximum ceiling limit of managerial remuneration.*
- (b) *One of the most important features of the new Companies Act is that it tries to put all the relevant provisions regarding*

*managerial remuneration at a single point. Whereas the Companies Act, 1956 provides various provisions regarding managerial remuneration in a different Section and one has to very carefully reassemble all the provisions to solve an issue, the Companies Act, 2013 has wonderfully consolidated all provisions through a single clause 197.*

- (c) *Corresponding to the Section 309 of the Companies Act, 1956, Clause 197 deals with the demarcation line for payment of remuneration to Whole-time Director and Non-whole-time Director. Proviso (i) of Sub-clause (1) of clause 197 retains the ceiling limit of 5% of net profit to Director in whole-time employment, if there is a Managing or Whole-time Director, or, else it would be 10% if more such Directors are there. Further again, Proviso (i) of Sub-clause (1) of clause 197 retains the existing ceiling limit of 1% for Non-whole-time Directors. However, one interesting and vital point is to be noted here that the ceiling limit of Non-whole time Directors depends on the factor whether the Company has a Managing Director/Whole-time Directors/Manager. If there is a Managing Director/Whole-time Director/Manager, only 1 % of net profit would be distributed, but if there is no such designation, 3% (higher limit) of net profit can be distributed. A sharp study of this clause reveals that the new-born Act equips to provide a balance between remuneration of whole-time and Non-whole time Director. The prime focus is that Managing/Whole-time Director should get proper remuneration for their whole-time liability as well as no extra or unregulated outflow of fund be there by way of Directors' remuneration.*
- (d) *Clause 197 of the Companies Act, 2013 deals with the increase in remuneration of Managing or Whole-time Directors. This issue has been dealt with via exercising shareholders right. It specifically indicates that any type of increase in managerial remuneration must be done through approval by the shareholders in general meeting.*
- (e) *Under the new Act, Schedule V corresponds with the Schedule XIII of the Companies*

# Corporate Governance

*Act, 1956, which exercises controlling power regarding criteria to be fulfilled for the appointment of Managing or Whole-time Director as well as the age of the person to be appointed as Managing or Whole-time Director. The schedule deals in 3 parts. Part I deals with the conditions to be fulfilled for appointment as Managing or Whole-Time Director. Part II deals with the remuneration. Again, Section I of Part II deals with remuneration to be payable by companies having profits. Further, Section II of Part II deals with providing guidance for remuneration payable by companies having no profits or inadequate profit which inter-alia contains Part A and Part B. Part A prescribes payment of yearly remuneration depending on the effective capital, and Part B prescribes for the payment of fixed 2.5% of the current relevant profit to a managerial person, who is not a shareholder, employee or a director of the company at any time during the two years prior to his appointment as a managerial person.*

## Applicability of Managerial Provisions to Public Limited Companies Only

It is very strange to note that all managerial provisions are applied to public companies. Therefore, private companies are still free of stringent regulations in terms of managerial remuneration. However, one thing has to be noted as per the Act, that a company which is a subsidiary of a company, not being a private company, *i.e.* public company, shall be deemed to be a public company for the purpose of this Act even where such subsidiary company continues to be a private company in its articles. Thus, all stringent provisions would be applicable to a company which is a subsidiary of a company, not being a private company.

**With a view to maintain uniformity in the remuneration of Directors, it has been prescribed by the Act that the remuneration shall include all remuneration to be payable to the Director for any kind of service in other capacity. But if a person has a professional qualification beside directorship, he/she also provides services in his/her professional capacity.**

## Sitting Fees to be Paid to Managerial Personnel is outside the Limit of 11%

One should note that sitting fees for attending board or committee meetings would be outside the purview of the ceiling limit of 11%. Even in case of having no profit or having inadequate profit, sitting fees can be paid regardless of the fact that the usual remuneration cannot be paid in case of loss. In case of loss for paying remuneration to directors, central government approval is required but there is no such requirement for payment of sitting fees. Companies Act, 2013 provides power to the Board for deciding the purpose for which sitting fees may be paid. It may be paid for attending a Board meeting or for attending committee meeting or any other purpose. Compared to the erstwhile provision for payment of sitting fees depending upon the criteria of paid-up capital, the new Act does not prescribe any such kind of slab. The Ministry will prescribe such amount in due course. However, it has been mentioned that different fees for different classes of companies and fees in respect of independent director may be prescribed.

## Mode for Payment of Remuneration to MD, WTD and Manager

With the enactment of new law, shareholders will have the right to approve or not, the terms and condition for appointment of MD, WTD and Manager and the remuneration payable to them. The approval should be in the form of special resolution preceded by the formal approval of the Board of Directors, subject to the condition of the appointment and terms. The remuneration has to be determined in accordance with and subject to the provisions of this Section, either by the articles of the company, or by a resolution or, if the articles so require, by a special resolution, passed by the company in the general meeting. Therefore, the prescribed mode may be either of the following:

- (a) Articles of Association
- (b) By a Resolution
- (c) By a Special Resolution.

Articles of Association are to be treated as the main document for determination of managerial remuneration, which provides the manner for determination of managerial remuneration. In case of absence of any provision, it may be determined by a resolution or by a special resolution if required by the articles.

## Remuneration of Directors having Professional Qualifications

*With a view to maintain uniformity in the remuneration of Directors, it has been prescribed by the Act that the remuneration shall include all remuneration to be payable to the Director for any kind of service in other capacity. But if a person has a professional qualification besides directorship, he/she also provides services in his/her professional capacity. That means extra remuneration can be paid to professionally qualified Directors. But one has to take approval of the nomination and remuneration committee, if the company is a listed company or the Board of Directors if company is not a listed one that the director possesses the requisite qualification for the practice of the profession, and that the intended person is having requisite professional qualification for the practice of the profession. The erstwhile provision for taking the approval of Central Government has been withdrawn.*

## Modes of Payment of Remuneration

Whereas the Companies Act, 1956 prescribes a separate manner for payment of remuneration to Managing Director, Whole-time Director, Non-whole-time Director and Manager, sub-clause 6 of Clause 197 prescribes a single manner for payment of remuneration to all Directors. Now, all Directors and Managers may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other.

## Separate Provision for Independent Directors

The Companies Act has put its best efforts to exercise governance at every level. Independent Directors are an integral part of such governance. Independent Directors' duties are always focused on ensuring practice of corporate governance at Board level. In view of this, the new Act has prescribed various provisions to maintain their *independent identity*. As regards the remuneration payable to Independent Directors, the government has tried to maintain a check from all sides, so that *independent identity* should not get divulged. Some of the important provisions regarding remuneration to be paid to Independent Directors are:

- (a) Different sitting fees are proposed to be prescribed for Independent Directors

**Remuneration committee has a responsibility of drawing a suitable package for Directors keeping in view the regulatory financial position, industry trend, qualification, experience, past performance and past remuneration, and above all the stakeholder's interest. The committee has to approve the remuneration structure in case of loss. The committee owns primary responsibility for remuneration to be paid under Schedule V.**

- (b) Independent Directors are not allowed to receive stock options.
- (c) Reimbursement of expenses for participation in the Board and other meetings are allowed.
- (d) Profit-based commissions are allowed to Independent Directors subject to the condition that the same has to be approved by the shareholders at a general meeting.

## Payment of Remuneration at Exceeding Rate

- (a) In contrast to the Companies Act, 1956, the new law provides a way for payment of managerial remuneration at a rate exceeding 11% of net profit provided the same has to be approved by members at a general meeting coupled with the approval of the Central Government.
- (b) Payment of remuneration to Managing Director and Whole-time Directors may be made at a rate exceeding 5% or 10% as the case may be, subject to the approval of members at a general meeting.
- (c) Payment of remuneration to Directors who are not Managing Directors or Whole-time Directors may be made at a rate exceeding 1% or 3% as the case may be, subject to the approval of members at a general meeting.

The law seems to be very strict regarding the outflow of fund by way of remuneration of Directors. At the same time, it allows flexibility to change the percentage of Directors' remuneration.

*(Note: The law prescribes extensive power to members of a Company to decide the issues of managerial remuneration.)*

## Waiver of Refundable Remuneration

The excess remuneration drawn by any Director is strictly refundable to the company. No waiver of

# Corporate Governance

remuneration is allowed except with the approval of Central Government.

## Increase in Managerial Remuneration

- a) **For companies having adequate profit:** Increase in managerial remuneration has to be read combined with Clause 197 along with Schedule V. As the Act suggests that, for increase of managerial remuneration to Managing or Whole-time Director or even Non Whole-time Director within the limit of 5% and 10% or 1% and 3% as the case may be, no CG approval is required. The company is free to draw a suitable package within the prescribed limit. For increase above the limit, approval of members would be required. One should keep in mind that only for raising the overall limit exceeding 11%, CG approval will be required coupled with members approval.
- b) **For companies having no profit or inadequate profit:** For companies having no profit, remuneration will automatically become non-payable except certain conditions of Schedule V are fulfilled and the slabs of Schedule V are being adopted. Same rule is also applied in case of companies having inadequate profit. The prescribed slab is:

(A)

Sl no	Where the effective capital is	Limit of yearly remuneration payable shall not exceed (Rs)
1	Negative or less than 5 crore	30 lakh
2	5 crore and above but less than 42 lakh 100 crore	42 lakh
3	100 crore and above but less than 60 lakh 250 crore	60 lakh
4	250 crore and above	60 lakh plus 0.01% of the effective capital in excess of ₹ 250 crore

(B)

In case of a managerial person who was not a shareholder, employee, or, a director of the company at any time during the two years prior to his appointment as a managerial person, — 2.5% of the current relevant profit.

Compared to the provisions of the Companies Act, 1956, the limit for effective capital and yearly remuneration has been raised to a great extent. Further, no-fixed highest limit is prescribed, as for the companies having effective capital of more than 250 crore, 60 lakh plus 0.01% of the effective capital in excess of 250 crore has been prescribed. With a view to provide more option, it has been prescribed that the limits mentioned in the slab shall be doubled if the resolution passed by the Shareholders is a special resolution. Further, it has been prescribed that limits shall be adjusted on *pro-rata* basis for a year. Further, it has been provided that the limits raised on double-scale basis shall be approved by the Board of Directors, if the company is not a listed one and, in case of a listed company, it has to be approved by the nomination committee.

## Increase in Remuneration on Appointment or Re-Appointment

Clause 200 corresponding to the Section 311 deals with the increase in remuneration of Managing or Whole-time Director only. It states that normally company itself and Central Government in cases where appointment is made with Government's approval, shall be empowered to fix a limit with regard to remuneration after keeping in view the various matters including the financial position of the company as well.

## More Disclosure by Listed Companies

Under the new Companies Act, 2013, Sub-clause (12) of Clause 197 prescribed to disclose the ratio of the remuneration of each Director to the median employee's remuneration. This provision treats Directors and Managing Director as an employee of the company.

**In order to provide more and more flexibility and to ensure better corporate governance, it has been prescribed that a Managing Director, Whole-time Director or Manager shall be appointed and the terms and conditions of such appointment and remuneration payable be approved by the Board of Directors at a meeting which shall be subject to approval by a special resolution at the next general meeting of the company and by the Central Government, in case such appointment is at a variance to the conditions specified in that Schedule.**

## Role of Remuneration Committee under Schedule XII

Remuneration committee has a responsibility of drawing a suitable package for Directors keeping in view of the regulatory financial position, industry trend, qualification, experience, past performance and past remuneration, and above all the stakeholder's interest. The committee has to approve the remuneration structure in case of loss. The committee owns primary responsibility for remuneration to be paid under Schedule V.

## Comparison of Present Provisions with New Companies Bill, 2012

The new Companies Bill, 2012 has brought more transparency and flexibility in terms of managerial remuneration. Some of the important provisions describing the major change in the area of managerial personnel and their remuneration are:

- (a) No Managing Director or Whole-time Director or Manager shall be appointed for a term exceeding 5 years. However, no reappointment shall be made earlier than one year before the expiry of his term.
- (b) Minimum age limit required for appointment as Managing or Whole-time Director or Manager has been reduced to 21 years against the present age limit of 25 years. Maximum age limit of 70 years will also apply to existing Whole-time Director, Managing Director and Manager. And the post will automatically vacate on the attainment of age of 70 years. However, in case of a new appointment, the maximum age limit of 70 years can be relaxed if approved by a special resolution.

In order to provide more and more flexibility and to ensure better corporate governance, it has been prescribed that a Managing Director, Whole-time Director or Manager shall be appointed and the terms and conditions of such appointment and remuneration payable be approved by the Board of Directors at a meeting which shall be subject to approval by a special resolution at the next general meeting of the company and by the Central Government, in case such appointment is at a variance to the conditions specified in that Schedule.

- (c) Prescribed time limit for filing return of appointment has been reduced to 60 days against the present time limit of 90 days.
- (d) In order to have a tight vigil on the corporate decisions, the Act suggests that where an appointment of a Managing Director, Whole-time Director or Manager is not approved by the company at a general meeting, any act done by him before such approval shall not be deemed to be invalid. Therefore, a Managing Director or Whole-time Director cannot disown its liability on the ground that their appointment has not been approved by the shareholders at the next general meeting.
- (e) Overall ceiling limit of managerial remuneration has not been changed. It remains at 11% of the net profit. However, the biggest change is that, subject to certain conditions, the company in a general meeting may, with approval of the Central Government, authorise the payment of remuneration exceeding 11% of the net profits of the company.
- (f) In view of more empowerment of shareholders, it has been decided that an approval of shareholders would be required *for payment of remuneration to any one Managing Director or Whole-time Director* at a rate exceeding 5% or if there is more than one such director, remuneration shall not exceed 10 % of the net profits to all such Directors and Manager taken together.
- (g) As the role of Independent Directors is continuously expanding in maintenance of corporate governance, the law proposes to limit the interest of Independent Directors and as such it proposes that Independent Directors shall not be entitled to any stock option and may receive remuneration only by way of commission or fees payable for attending Board or Committee meetings.
- (h) A new provision regarding insurance on professional liability has been inserted which states that where any insurance is taken by a company on behalf of its Managing Director, Whole-time Director, Manager, Chief Executive Officer, Chief Financial Officer or Company Secretary

# Corporate Governance

for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel:

Provided that if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration.

(i) With a view to have better compliance system in a company, it has been decided that, where a company is required to restate its financial statement due to fraud or noncompliance with any requirement under this Act and the rules made there under, the company shall recover from any past or present Managing Director or Whole-time Director or Manager who, during the period for which the financial statements are required to be restated, the remuneration received (including stock option) arisen due to such statement or noncompliance in excess of what would have been paid to the Managing Director, Whole-time Director or Manager under such restated financial statements.

(j) A provision has been inserted for payment as consideration for retirement or as compensation for loss of office to Managing Director or Whole-time Director or Manager. This facility will not be available to any other Director. Again, this facility would not be available in the following cases:

- Where Directors resign from their office as a result of reconstruction of the company, or of its amalgamation with any other body corporate or bodies corporate and is appointed as the Managing or Whole-Time Director, Manager or other Officer of the reconstructed company or of the body corporate resulting from the amalgamation;
- where Directors resign from their office other than on the reconstruction of the company or its amalgamation;
- where the vacation is under sub-section



(1) of Section 167 which corresponds present section 283 of the Companies Act, 1956;

- where the company is being wound up, whether by an order of the Tribunal or voluntarily, provided the winding up was due to the negligence or default of the director;
- where Directors have been guilty of fraud or breach of trust;
- where Directors have instigated, or taken part directly or indirectly in bringing about the termination of their office;
- where individuals shall not be chairperson of a company as well as the Managing Director or Chief Executive Officer of the company at the same time unless provided in the Articles.

## Summary

Maintenance of corporate governance at all levels is the main focus area of the law. Whereas the Companies Act, 1956 is trying to regulate more and more managerial remuneration through various checks and limits, the new Companies Act provides more and more flexibility to companies, to draw a suitable remuneration package as well as regulate the same with more transparency and Shareholders empowerment. ■