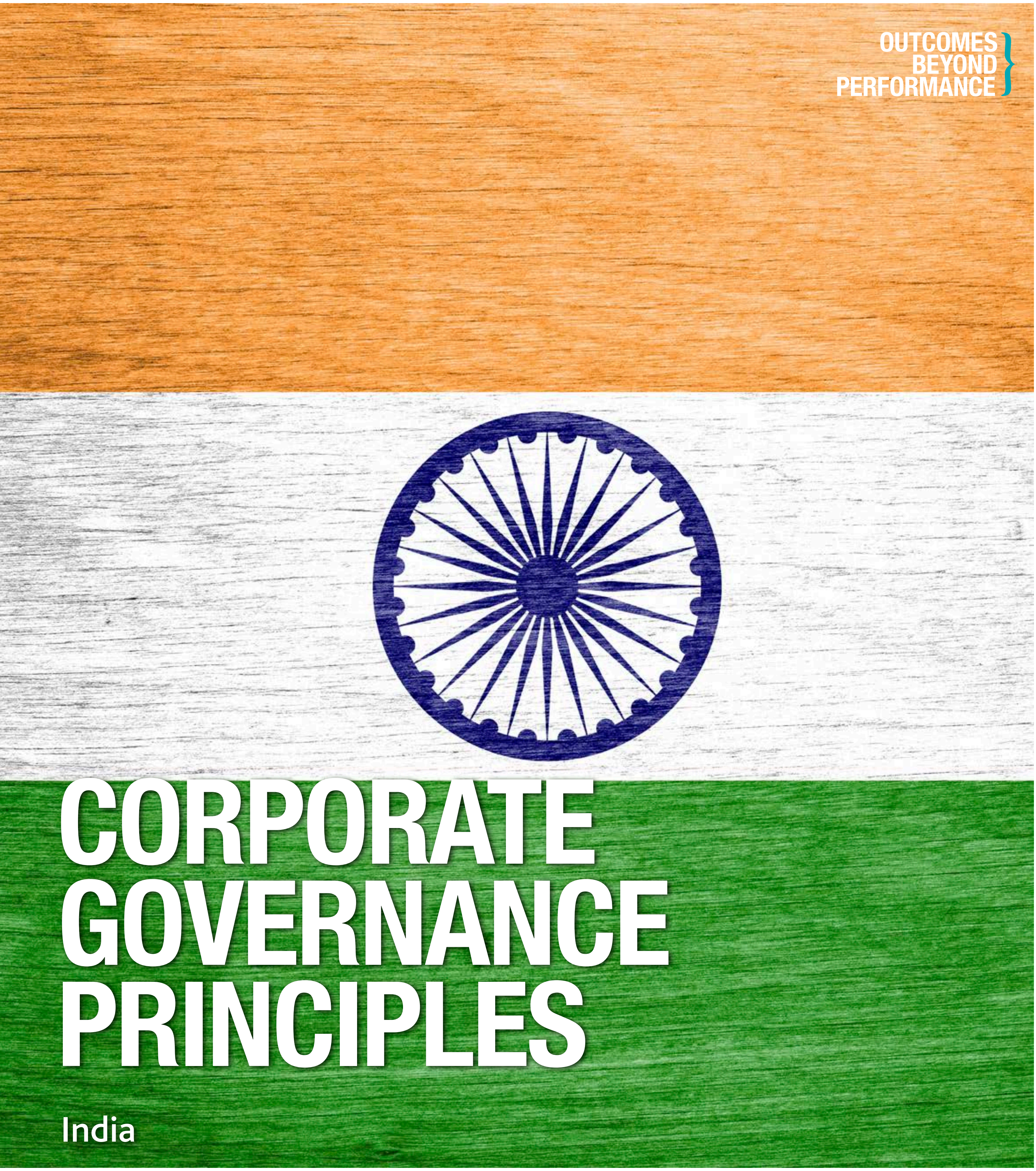

CORPORATE GOVERNANCE PRINCIPLES

India

2019

For professional investors only

www.hermes-investment.com

HERMES
EOS

CORPORATE PURPOSE AND RESPONSIBLE OWNERSHIP PRINCIPLES

Companies aim to provide goods and services for customers and society at a competitive quality and price. This can only be achieved sustainably if they create and preserve value over time, not only for their shareholders but also for other stakeholders, society and the environment. This document should be read in conjunction with the Hermes Responsible Ownership Principles[1] which provide our views on corporate purpose and other issues that we believe are important for companies globally.

CORPORATE GOVERNANCE IN INDIA

India has no corporate governance code. The country's corporate governance framework is based on the 2013 Companies Act (the 2013 Act)[2], which provides the legislative foundation, and the 2015 Listing Obligations and Disclosure Requirements (the Regulations) of the Securities Exchange Board of India (SEBI), which is responsible for the regulatory requirements of companies.

Our corporate governance principles for India acknowledge characteristics specific to the Indian market. In 2017 SEBI formed a committee on corporate governance (sometimes referred to as the Kotak committee) to make recommendations on how to improve corporate governance standards of listed companies in India. In March 2018, SEBI accepted many of the recommendations, including on the eligibility criteria for independent directors and the separation of the CEO/MD and chair roles. The majority of these requirements were applicable from April 2018 but others will come into force in April 2019 and April 2020[3].

We welcome these important developments in strengthening corporate governance standards, as well as SEBI's broadening of its enforcement framework for non-compliant companies[4]. However, on occasion our principles go further than SEBI's requirements and we encourage companies to take a proactive approach to all of these new requirements, including those due to be introduced in 2019 and 2020.

BOARD OF DIRECTORS

Promoter and promoter groups

The 2013 Act and SEBI regulations have defined the term 'promoter' as persons having control over a company. They include persons who have enabled the flotation of the company or promote investment into the company. Promoters can be natural or legal persons. They are often, but not necessarily, the drivers behind the formation of a company, commonly known as the founders.

Promoters have certain obligations and rights. Importantly, they have a fiduciary duty to the company and to minority shareholders. They have the right to remuneration from the company, provided there is an agreement in place, which must be disclosed. The 2013 Act strengthened governance in relation to promoters. For instance, independent directors can no longer be related to any of the promoters or directors in the company or its subsidiaries. Promoters and their relatives are not permitted to have any transactions with the company. When we have doubts about the independence of the parties involved in what may be connected party transactions, we will challenge companies through engagement.

Composition and independence

Boards should ensure that they comprise members with diverse skills, knowledge and experience, including: leadership skills; technical expertise; and sufficient independence and strength of character to challenge promoters and executive management and hold them to account, including appointing and removing executive directors.

Indian companies tend to have a single board structure, although some may set up a supervisory board. We support SEBI's requirements for a listed entity's board to comprise no less than six directors and for the board to issue detailed disclosures of competencies of every board member (by 31 March 2020 at the latest). The 2013 Act mandated that the tenure of independent directors be limited to two consecutive terms, with a maximum of five years for each term.

We consider a director non-independent if the individual has been serving on the board for more than 10 years, consistent with the legal cut-off based on two maximum five-year terms. We retain discretion to decide whether to support the re-election of these directors is warranted on a case–by-case basis. We support restrictions on the issuance of stock options and fees for directors attending board meetings.

We recommend that boards be at least 50% independent, irrespective of whether the chair of the board is non-executive or not. In addition to not considering as independent anyone who constitutes the promoter group of a listed entity, listed companies must avoid board 'interlocks' arising from the common practice of reciprocal directors on boards of each other's entities as this impairs their independence. We support SEBI's requirement that independent directors must carry out a self-assessment of their independence as well as a declaration that he or she is not aware of any circumstance which could impair or impact his or her ability to function as independent. This must be confirmed and continuously assessed by the board.

SEBI now requires the separation of CEO and chair roles for the top 500 listed entities by market capitalisation by 1 April 2020. The separation of these roles has been our strong preference for some time for all listed companies. We will now consider recommending a vote against the combined chair and CEO (or managing director) of a listed company even if the company is managed by a promoter. We would also encourage the appointment of an independent chair even if the company is managed by a promoter.

In addition, we recommend voting against any non-independent director, in line with global best practice, when they also sit on the audit or remuneration committees.

[1] https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/final-responsible-ownership-principles-2018.pdf
[2] http://www.mca.gov.in/MCASearch/search_table.html
[3] https://www.sebi.gov.in/media/press-releases/mar-2018/sebi-board-meeting_38473.html
[4] https://www.sebi.gov.in/legal/circulars/may-2018/non-compliance-with-provisions-of-sebi-listing-obligations-and-disclosure-requirements-regulations-2015-and-standard-operating procedure-for-suspension-and-revocation-of-trading-of-specified-securi-_38841.html

Director commitment

Board directors should avoid being over-committed such that he or she is not able to fully discharge their duties. Whether a director may be over-committed depends on a range of factors beyond the number of other roles he or she has. These include the size and complexity of a company, travel requirements and any responsibilities, such as committee chair.

We welcome as a step in the right direction SEBI's requirement to reduce the maximum number of directorships in listed entities from ten to seven (by April 2020) and for any executive director in any listed entity to no more than three independent directorships.

However, as a guideline, we regard a director as possibly over-committed if he or she has more than five directorships of public companies. We consider a chair to be probably over-committed if he or she has another chair or executive role or three other directorships, particularly at large, complex companies. Any executive should only have one non-executive role at another public company. For directors sitting on multiple boards, we expect a credible explanation for how they can devote sufficient time to their duties, particularly if they are committee members or on the boards of complex companies or those with difficult issues to address. We take into account directors sitting on boards of a group's subsidiaries when assessing their commitments before making voting recommendations.

When appointing directors, the company should disclose clearly to shareholders the director's other commitments. Directors must obtain prior approval before undertaking additional external appointments, providing reasons for permitting significant appointments in the annual report.

Board diversity

The 2013 Act mandates that listed companies have at least one female director, which has resulted in India having a high percentage of companies with at least one woman director. However, we encourage companies to approach diversity beyond gender to include nationality, ethnicity, skill set and socio-economic background.

We are pleased that at companies listed in India, most female directors are not linked to promoters. We support the election of independent female directors in line with SEBI recommendations and our wider voting policy. We also expect companies to go beyond the modest legal requirements and expect companies to have at least two female directors, at least one of whom should be independent. Where boards lack independent female directors, we recommend voting against all members of the nomination committee standing for election.

Board committees

We expect nomination and remuneration committees to comprise only independent directors. We support SEBI's requirement that the top 500 listed companies in India establish a risk management committee and that cyber security specifically is covered by that committee.

We welcome SEBI's requirements that the audit committee has oversight of loans and advances to subsidiaries exceeding 100 crore INR (approximately £11.5 million) or 10% of the asset size of the subsidiary, whichever is lower. However the committee should also ensure that it reviews series of investments that reach this sum.

According to the 2013 Act, large companies must establish a corporate social responsibility (CSR) committee with a minimum of three directors, of which at least 50% are independent. The 2013 Act defines CSR as activities that contribute towards a reduction in poverty and promote education, health, environmental sustainability, gender equality and the development of vocational skills. In evaluating the performance of the CSR committee, we expect companies to enact and report on CSR activities that relate to its environmental and social performance and the wider sustainability of its business activities, beyond philanthropy.

We expect all board directors to attend at least 75% of board and committee meetings. The core committees include audit, nomination, remuneration and CSR committees. If a director attends all board committees related to business functions but falls short on attendance at board meetings, we retain the discretion to oppose his or her election. This is to ensure that directors fulfil all their governance-monitoring roles.

Importance of board and shareholder engagement

We support India's Stewardship Code for Insurers and expect a wider adoption of stewardship by other asset owners. Dialogue between boards and serious, committed long-term shareholders on strategy, finance, corporate governance and risk management – including the management of risks and opportunities stemming from environmental and social issues – is essential.

Through this exchange of views, shareholders can better comprehend, and if necessary, attempt to influence the boards of companies in which they invest, developing relationships of trust based on an improved mutual understanding. Our experience has shown that constructive engagement between shareholders and directors in these areas can lead to improvements in the governance, performance and value of companies. Conversely, lack of engagement can lead to increased risk.

Chairs and other non-executive directors, in particular board committee chairs, should make themselves available for meetings and teleconferences with minority shareholders, as an essential part of their responsibilities. Developing relationships of trust with long-term shareholders can be invaluable for boards. We therefore expect boards to welcome more and better quality engagement between long-term investors and directors and for independent directors to participate in engagement.

Board effectiveness and evaluation

We expect boards to continually assess their effectiveness to ensure that they are operating optimally, with the right governance structures, processes and behaviour in place. We expect a formal board evaluation to occur annually. The evaluation should review the composition of the board and assess the way in which the board operates and the contribution of each director to the board and the company. We prefer evaluations to be conducted by third parties at least every three years. Nevertheless, we believe that in-house evaluations and the self-assessments of directors provide important information for third parties to conduct their impartial assessment. A description of the evaluation and a summary of the resulting findings with planned actions should be included in annual reports.

Board directors should be subject to training on, and regular exposure to, various topics that are material to the company, so that they are capable of challenging management on these issues.

Succession planning

A change in leadership is inevitable for all organisations and can be a challenging time. A company ought to develop and maintain succession plans for its chair, CEO and other key executives, as well as for its board directors. This is to ensure regular refreshment of the skills, experience and independence of its directors, as well as a variety in tenure among its board members. The succession process should also involve contingency planning for the sudden loss of key personnel.

We encourage companies to make their senior management and executive directors available to serve as non-executive directors at other, unconnected companies as part of their development. This helps to develop a deep pool of suitable talent for companies to draw from when selecting candidates for board positions. However, we do not encourage an excessive number of outside directorships or cross-directorships.

The process behind the nomination and appointment of independent directors can determine the quality and integrity of independent directors. We expect a company to disclose the process and criteria used for the appointment of new directors. This should cover the identification and evaluation of candidates, as well as the appointment and subsequent assessment as a director. We expect the company to evaluate the candidate in the context of the board as a whole, with the objective of having a board that can best serve the interests of the company's business and represent the interests of stakeholders through sound judgement, experience and skills.

In the annual report, boards should provide evidence to their shareholders that they have good quality succession plans in place.

BUNDLED RESOLUTIONS

We do not support bundled proposals. Resolutions should be separated to make it possible to vote for each one, rather than bundling different proposals so that shareholders cannot accurately express their views through voting.

RELATED PARTY TRANSACTIONS

Concentrated ownership and company group structures are common features of listed companies in India as most companies are held by families or the state. This allows for more opportunities for related party transactions (RPTs) involving controlling or other large shareholders to occur and increases the probability of abuse if they are not conducted at arm's length.

We expect companies to follow Section 188 of the 2013 Act, which prohibits interested shareholders from voting for transactions with related parties. If RPTs are conducted on a continuous basis, such as continuous financial services arrangements, there should be an annual shareholder vote to ratify them. If a majority of minority shareholders have voted against them, the company should engage with minority shareholders to understand and act on their concerns. We welcome SEBI's requirement that any royalty payment to a related party which exceeds 2% of consolidated turnover be approved by shareholders.

We encourage companies to provide disclosure of RPTs in advance of the minimum required notice period ahead of a vote on them to ensure that any questions from shareholders can be adequately answered before they are voted on. We expect to receive detailed disclosure on the rationale for the use of the RPTs, the terms of the agreement and the audit and assurance mechanisms put in place to ensure that any RPTs are conducted in a fair and transparent manner.

All material transactions, be they ordinary business or mergers and acquisitions, should be put to shareholders for a vote. Financing arrangements must be related to the business of the company and be justified. For transactions involving a promoter or members of the promoter group, the transaction should be related to or necessary for the ordinary day-to-day operations of the company. Where the transaction is between a parent company and one of its subsidiaries, we generally support the transaction unless we are concerned about the possible effects on minority shareholders.

If the transaction(s) between entities have overlapping directors, we expect further information on how the directors have managed these conflicts of interests. This information is crucial to our voting recommendations. If there is no disclosure on how any apparent or possible conflicts are managed, we are unlikely to support the RPT.

EXECUTIVE REMUNERATION

We are increasingly concerned that executive remuneration structures and practices around the world are not fit for purpose, neither serving long-term investors nor, in many cases, aligning properly with the core long-term objectives of companies.

Therefore we continue to hold many discussions on reforming pay with remuneration committee members, executives, human resource professionals, remuneration consultants and other investors around the world. We are often encouraged by their response to our views. However, pay practice within companies rarely reflects our discussions on our pay principles[5]. Our current thinking on executive pay can be summarised as follows:

[5] https://www.hermes-investment.com/wp-content/uploads/2018/10/remuneration-principles-clarifying-expectations.pdf

- Simplicity: pay schemes should be clear and understandable for investors as well as executives. Pay structures should be much simpler and less leveraged than they are at present, for example taking the form of a single incentive scheme and lower variable and total possible pay. Remuneration reports must explain how alignment with long-term shareholders is achieved.
- Shareholding: the executive management team should make material investments in the company's shares and become long-term stakeholders in the company's success. Significant shareholding requirements for directors should remain in place for a specific period of time following departure from the company, with no share sales allowed for at least one year.
- Alignment and quantum: pay should be aligned to the long-term success of the company and the desired corporate culture, and is likely to be best achieved through long-term share ownership. Pay is often too high and pay schemes often seem to pay out significant sums which conflict with many shareholders' and other stakeholders' views of performance. Boards should be able to justify to investors, the workforce and the public the rationale for the CEO's and the most senior management's pay, taking account of the pay of the wider workforce. If they are not able to do so, directors should use their discretion to adjust actual or potential pay downwards. The rules of pay schemes should support this.
- Accountability: remuneration committees should use discretion to ensure that pay properly reflects business performance. Pay should reflect outcomes for long-term investors and take account of any decrease in the value of, or drop in the reputation of the company. Remuneration committees should take a more robust view on pay, using their judgement and being accountable for their decisions. They should avoid paying more than is necessary and not place too much reliance on existing practice and benchmarking which help to perpetuate many of the problems that we seek to address. The potential outcomes of a pay policy should be rigorously scenario tested with a cap on the total possible pay published in advance, to help reduce the risk of unintended consequences.
- Stewardship: companies and investors should regularly discuss strategy, long-term performance and the link to executive remuneration. Executives should be encouraged to achieve strategic goals, rather than focus attention on total shareholder return or stock price appreciation. They should take account of the company's effect on key stakeholders.

We expect senior executives to willingly embrace these principles and, if they do not, for boards to consider the implications. Remuneration committees must take responsibility for the design, disclosure and dialogue on executive pay and we will hold them accountable for this.

SOCIAL, ETHICAL AND ENVIRONMENTAL RESPONSIBILITY

Companies should effectively manage environmental and social factors that are relevant to their business, with a view to enhancing long-term sustainability. They should also disclose to shareholders on a regular basis how they identify and manage the relevant risks and provide evidence that these structures are effective. In addition, companies should clearly define board and senior management responsibilities for environmental and social issues. We believe that directors of companies are accountable to shareholders for the management of social, ethical and environmental risks and opportunities in the same way that they are accountable for the company's financial performance.

Ethical leadership

We expect companies to have best practice anti-corruption and anti-bribery policies and processes in place and robust compliance mechanisms to enforce them. However, these are not enough on their own. We expect the board to oversee the anti-bribery and corruption controls and – just as importantly – to set the tone from the top, to encourage the highest ethical standards, to drive the expectations and values of the organisation. This is to ensure that the culture is one in which corruption cannot thrive, and that the necessary organisational measures exist to provide the best possible defence against corruption. We therefore seek to engage with companies where we judge the culture and values to be lacking or the effective oversight, management of, or reporting on anti-bribery and corruption to be insufficient.

Human capital management

Employees are a company's most valuable asset. Businesses should therefore develop human capital management strategies and accompanying objectives that seek to develop the potential of their employees in support of maximising long-term value through a positively engaged, committed and talented workforce. We encourage companies to provide qualitative contextual information describing their approach, as well as annual disclosure of the key performance indicators they use to manage human capital.

Human rights

Licences to operate are increasingly affected by the reputation of companies, including their performance on human rights. We support the UN Guiding Principles on Business and Human Rights and the UN Global Compact. We expect companies to use the reporting framework of the Guiding Principles to disclose how they manage human rights issues that are salient to their business.

Climate change

Climate change is a systemic risk to the value of the portfolios of our clients because of its economic and geopolitical consequences. We therefore support the goal of the 2015 Paris Agreement, which 195 countries signed up to, to limit global warming as a result of climate change to well below 2°C above preindustrial levels. This historic commitment was helped by the intervention of companies globally, which publicly encouraged political action in the run-up to the Agreement.

Because of the systemic risk to the global economy, we expect every company to publicly support the Paris Agreement and to make this commitment a central tenet of its public policy and sustainability activity. In particular for companies whose value chain relies on significant energy usage or is exposed to the effects of climate change, the board should ensure that support for the Paris Agreement underpins the company's strategy. Every board should ensure that it has climate change on its board meeting schedules at least annually, and that it and senior management engage with experts who can advise them on the strategic risks and opportunities that climate change represents, and challenge the company's approach, if necessary.

We understand that companies may have different views on climate change from organisations of which they are members or from other organisations which they may be able to influence. Every board should make sure that the company uses all available avenues to influence these third parties, to encourage effective action on climate change in line with the Paris Agreement. Where a company and one of these third parties disagree on climate change, the company should explain publicly the action it has taken to argue for effective advocacy or action on climate change by that third party. It should also explain its reasons for continued participation in, funding or membership of the organisation despite this disagreement.

Task force on Climate-related Financial Disclosures

We welcome the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures. We expect companies to adopt the recommendations in full. Companies should conduct scenario analysis to assess future transition and physical risks which will be brought about by climate change. As part of this scenario analysis, they should also identify and discuss their strategic options for a net zero emission world. In addition, we expect companies, especially those in sectors where climate risks are most material, to demonstrate clearly that they are managing both their current and possible future risks effectively. Furthermore, we expect companies to report on the opportunities presented by climate change. For instance, companies in the financial sector should report how they will help to finance the energy transition.

UN Sustainable Development Goals

We expect companies to assess the relevance of each UN Sustainable Development Goal (SDG) to their business and to consider how best to incorporate those which may be material into their business models and strategies. We urge companies to report on how they are responding to the SDGs and encourage them to participate with civil society on how best to support them.

Tax

We expect companies to:

- comply with all tax laws and regulations in all countries of operation;
- recognise the importance of taxation to the funding of good public services on which they and their stakeholders rely, and their commitment to pay their fair contribution;
- ensure that their tax policies and practices do not damage their social licence to operate in all jurisdictions in which they have a presence; and
- disclose the taxes paid by or collected by them in each country.

HERMES INVESTMENT MANAGEMENT

OUTCOMES BEYOND PERFORMANCE

HERMES INVESTMENT MANAGEMENT

We are an asset manager with a difference. We believe that, while our primary purpose is to help savers and beneficiaries by providing world class active investment management and stewardship services, our role goes further. We believe we have a duty to deliver holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world.

Our goal is to help people invest better, retire better and create a better society for all.

Our investment solutions include:

Private markets
Infrastructure, private debt, private equity, commercial and residential real estate

High active share equities
Asia, global emerging markets, Europe, US, global, small and mid-cap and impact

Credit
Absolute return, global high yield, multi strategy, global investment grade, unconstrained, real estate debt and direct lending

Stewardship
Active engagement, advocacy, intelligent voting and sustainable development

Offices

London | Denmark | Dublin | Frankfurt | New York | Singapore

Why Hermes EOS?

Hermes EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. Hermes EOS is based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

Contact information

Hermes EOS

Hannah Shoesmith +44 (0)20 7680 4693 hannah.shoesmith@hermes-investment.com

For more information, visit **www.hermes-investment.com** or connect with us on social media:

EOS00367 0005963 Global 03/19