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(AN M. DAMODARAN INITIATIVE)

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M. Damodaran
Chairperson, Excellence Enablers
Former Chairman, SEBI, UTI, IDBI

THE ROAD TO THE CODE

If codes alone could lead to ideal conduct and behaviour, the world would be a better place. That said, orderly conduct needs law, rules and codes. SEBI's attempt to put in place an appropriate code of conduct has not come a day too soon.

In the list of major obstacles to corporate governance, conflict of interest and asymmetry of information are joint winners. Our focus in this newsletter is on conflict of interest.

Those that follow the developments relating to SEBI are aware that conflict of interest has been centre stage in most conversations in the last few months. The perception, and also the allegations, that the Chairperson of SEBI placed herself in avoidable situations of conflict have done very little to provide a sense of comfort to the stakeholders of the corporate governance ecosystem. It is not for us to determine, in the context of inadequate evidence, whether there has been any serious omission or wrongdoing.

Given that allegations of conflict of interest have adversely impacted the reputation of SEBI, it was only to be expected that the new Chairperson would take this up as a high priority item. Consistent with that expectation, SEBI has appointed a 6 member committee, comprising very senior and very experienced persons, to put in place a comprehensive code to grapple with the various manifestations of conflict of interest, and the possible solutions thereto.

Following the setting up of this high-powered committee, a view has been expressed that this being a relatively simple and direct matter, there was no need to appoint such a high-powered expert committee. Some have even said that this amounted to a sledge hammer approach to kill a fly. Nothing could be further from the truth. The reputation of the organisation will depend significantly on issues of conflict of interest being dealt with comprehensively and conclusively.

There are a few aspects that need to be addressed. The first of these is a clear appreciation of when conflict of interest exists or might exist. The code will be required to address existing conflicts, and possible future conflicts, so that the latter can be prevented.

One problem which needs to be tackled is the manner in which the shareholding or the ownership of properties by persons appointed as Members of the SEBI Board needs to be handled. It is reasonable to presume that whether a person is from the Government/ public sector or from the private sector, he/she could be expected to have some shares in his/her name or in the names of immediate family members. This situation would also arise in regard to properties owned by Members of the SEBI Board, and the manner in which they are dealt with subsequently.

It cannot be anyone's case that a person appointed to the SEBI Board cannot have, as on the date of appointment, any financial or physical asset. In a disclosure-based regime, the logical

expectation is that both at the time of appointment, and every year thereafter, the person concerned has to disclose the nature and extent of his/her interest in different asset classes, which could possibly place him/her in a situation of conflict. Existing conduct rules in the Government, and in SEBI itself, provide for both initial disclosure and periodic disclosures.

The related question is to which authority such disclosures should be made. All Members of the Board, whether they are Whole-time Members or Part-time Members are appointees of the Union Government, such appointments being made in accordance with the provisions of the SEBI Act. The logical corollary is that such disclosures for Whole-time and Part-time Members of the Board should be made to the appropriate Ministry or department in the Government of India. Making these disclosures to SEBI, as is understood to be the present practice, does not seem appropriate. This is so because there is no authority within SEBI which is superior to, or at the same level of, the Chairperson and the Whole-time Members, and therefore to presume that such disclosures would be objectively analysed and acted upon, rather than filed routinely, is a big ask. Also, since such disclosures are not in the public domain, there will always be questions of whether a disclosure was made, and if so, what that disclosure revealed regarding possible conflicts of interest. In parallel, with the disclosure to the Government of India, there could be for purposes of record, disclosures being made to SEBI, so that these can be easily accessed should any controversy arise in future.

There is also the related matter of how these assets should be dealt with when a person continues to occupy the office of Member of the SEBI Board. One approach which has been tried in some other jurisdictions, and has been found to be satisfactory, is for the shareholding to be parked in a blind Trust, with the person concerned having no authority to take buy or sell decisions regarding those shares. A blind Trust is a convenient instrument to house the shares of the persons who are likely to be in conflict should they choose to exercise buy or sell decisions.

As far as immovable property is concerned, the sale or lease of such property should be after a person has obtained the requisite approval from within the organisation for such sale or lease. Absent this safety mechanism, nothing would prevent a Member on the Board from leasing his/her property to a person who is active in the securities market, and is likely to offer a favourable price. However, there cannot be a negative conclusion necessarily drawn if a Member had leased out a property prior to his/her appointment, whether to a securities market participant or otherwise. All that is required is for an appropriate disclosure to be made at the time of appointment.

Recusal is a mechanism often used by persons in authority to address existing or potential conflict. There have been several instances of Judges who have recused themselves from dealing with cases on account of having dealt with matters earlier, before appointment as a Judge, or having found himself/herself conflicted because of subsequent developments. That said, recusal is not a device to be resorted to in a casual manner, in order to avoid being placed in a situation of having to decide a particular matter.

Given the nature of the organisation, and the expertise required, it is fair to expect that there would be, at any point of time, one to two members from the banking community who have handled credit decisions relating to entities which are also listed on the exchanges. Having dealt with the entities by way of grant of credit facilities, while the person was in his/her earlier position, it is not unnatural to expect persons to point a finger at such Members stating that they were *ab initio* conflicted, while dealing with the matter. One approach, which might not

satisfy everyone, is for prescribing a certain time period during which the Member concerned should not, in a previous avatar, have dealt with that entity. Much the better option would be for the Member concerned to recuse himself/herself, notwithstanding the period of time which has elapsed, so that no finger can be pointed at the Member concerned, and resultantly at SEBI. Since there are 4 Whole-time Members in SEBI, it is possible to find 1-2 of them who would not have dealt with the entity earlier, and therefore will be clearly seen to be free from any previous or continuing conflict. What is important in such matters is to communicate to the larger ecosystem that every iota of doubt has been addressed by putting in place a watertight mechanism to ensure the absence of conflict.

The question also arises whether the code of conduct should be so detailed as to provide for every possible contingency. Alternatively should the principles contained therein be such as to lead to the right conclusion regarding the avoidance of conflict? Overprescription is never an ideal situation. If there are far too many procedural elements in the code of conduct, it is possible to conclude that the interpretation and the application of such provisions would themselves lead to doubts. Alternatively, some provisions might be missed by persons who are tasked to ensure that there is no conflict of interest attached to any Member of the Board. The length of the code is no guarantee of its provisions being observed in practice. It is useful to remember that Enron's code of conduct ran to 64 pages.

The 6 member committee is understood to have commenced its deliberations, and its interactions with persons, who in the opinion of the committee, could enrich the process of putting in place a satisfactory code of conduct. The committee would be well advised not to get into avoidable details, and to lay down the principles and the practices and procedures that must be followed while addressing possible conflicts of interests. What is equally important is for every disclosure being made to be properly documented, and to be preserved for a sufficiently long period, say 8-10 years. The fact that there is an appropriate mechanism to deal with conflicts of interest would dissuade those who often make allegations, without having any shred of evidence in their possession. The credibility of the organisation is equally contingent on its ability to decide matters quickly and effectively. A code of conduct that is unduly prescriptive could adversely impact the process of expeditious decision-making. We should not lose sight of the fact that SEBI is tasked not only to protect the interests of investors, but also to ensure the development of the markets, which can happen only if business can be conducted without too many procedural obstacles. If ease of doing business is a stated objective, there cannot be a regulatory framework which, on account of excessive prescription, stands in the way of expeditious decision-making. Motivation levels in the organisation would also suffer. The possibility of attracting talent from outside will also be adversely impacted if the perception is that there are far too many compliances and procedures to be handled while one is on the Board of a regulatory organisation.

Very recently, the Chairperson of SEBI is quoted as having said that there were no disclosures of any kind in the past. This is disquieting to say the least. Perhaps what was intended to be stated was that there was no information adequately shared with the outside universe on whether appropriate disclosures had been made, and if so, by whom, and to which authority. The fact that when allegations were made, there was no serious effort from the organisation to dispel the doubts and suspicions, also did not help in the cause of preserving and protecting SEBI's reputation.

It is understood that the proposed code of conduct will also seek to address aspects of conflict of interest relating to persons below the Board level. Since these are SEBI appointees, and not

Government appointees, the procedure to be followed need not be identical. It would be preferable to have 2 separate codes of conduct, one for SEBI employees, and one for Government appointees on the Board of SEBI. This will, besides avoiding a sense of clutter, and giving rise to one voluminous document, ensure that the focus is on what needs to be done, by whom, at what time, and in what manner.

SEBI is the Regulator of the securities market in India. With the economy growing at a significant pace, the Indian markets will also reach levels that have not been seen before. In the circumstances, it is of paramount importance to ensure that the credibility of the securities market Regulator is preserved and protected. The consultative exercise, which is presently on, should hopefully lead to the framing of a code of conduct which ensures proper behaviour, while not standing in the way of decision-making, leading to development.

Post script *- Even as this newsletter was being put to bed, came the news of the Lokpal having held that the allegations made before it against the previous Chairperson have not been established.*