

**RESPONSE OF LEGAL & GOVERNANCE COMMITTEE OF BOMBAY
CHAMBERS ON SEBI'S CONSULTATION PAPER ON INDEPENDENT
DIRECTORS**

A. Introduction

Independent directors (IDs) are an integral part of a corporate governance framework. They balance the interests of promoters and other stakeholders including minority and other shareholders and bring an objective view in the evaluation of the performance of board and management. To strengthen the position of IDs in a company, both Companies act 2013 and SEBI regulations specify the number of IDs in a company and also prescribe their code of conduct. Despite the stringent norms and various measures taken, there are concerns regarding the functioning of IDs. Thus, it has become essential to review the existing provisions and enhance the effectiveness to ensure the governance of essential functions and protect the interest of minority shareholder.

The Securities and Exchange Board of India, on March 1, 2021 released a consultation paper on review of regulatory provisions related to independent directors (IDs) on the boards of listed entities. The paper notes that despite the provisions regulating IDs and governing their conduct, concerns around their efficacy as a part of the corporate governance framework still persist. Therefore, in a bid to strengthen the independence of IDs and enhance their effectiveness in protection of the interest of the minority shareholders, and other functions, the paper makes certain proposals and seeks to solicit public comments on such proposals made therein.

Highlights of the paper:

1. It is proposed that the criteria for appointing Independent directors, which was earlier restricting the Key Managerial Personnel's (KMPs) or his/her relatives that have been KMPs of the listed entity / its holding company / subsidiary / associate company in the past 3 years to be IDs in the listed entity, should be extended to the promoter group as well i.e the KMPs/relatives of such KMPs or employees of the promoter group companies cannot be appointed as IDs in the listed entity unless there has been a cooling of period of 3 years.
2. It is proposed that the appointment and reappointment of IDs shall be subject to dual approval. Presently, shareholders approve the appointment through ordinary resolution

and reappointment through special resolution. The proposed amendment requires that the appointment shall meet two thresholds -

- i. Approval of Shareholders
- ii. Approval by majority of the minority (simple majority) shareholders. 'Minority' shareholders would mean shareholders, other than the promoter and promoter group.

Removal of IDs shall also follow the abovementioned dual process.

3. It is proposed that the Nomination and Remuneration committee (NRC) shall evaluate the balance of skills, knowledge and experience on the board. For purpose of identifying suitable candidates, NRC can use services of external agencies as well. Further the composition of NRC shall be modified to include 2/3rd of the members as ID as opposed to the present requirement i.e majority of the members. The proposed amendment of requiring 2/3rd IDs as members, shall also be extended to the composition of Audit Committee as well.
4. It is proposed that prior approval of shareholders should be taken in case of appointment of IDs. In case, a casual vacancy arises due to resignation / removal / death / failure to get re-appointed etc., the approval of shareholders should be taken within a time period of 3 months.
5. SEBI has further invited views on reviewing the remuneration structure for IDs. Further it has mooted that, whether ESOPs with a long vesting period of 5 years, be permitted for IDs, in place of profit linked commission and what should be the maximum limit of remuneration through ESOPs.

B. Detailed Outline and Discussion Points of Consultation Paper vis-à-vis Current Regime

Sr. No.	Current Regime / Need for Change	Proposed Change
1.	Definition of Independent Directors a. The present regulatory framework sets out the condition for determining the independence of IDs that persons	Definition of Independent Directors a. It has been proposed that Key Managerial Personnel's (KMPs) or employees of promoter group

	<p>who have been employees/ KMPs or his/her relatives have been KMPs of the listed entity/ its holding company/ subsidiary/ associate company in the past 3 years, cannot be appointed as IDs under Regulation 16(1)(b) of SEBI LODR Regulations.</p> <p>b. However, the paper noted that in order to establish the independence of the person it is important that KMPs or employees of companies forming part of the promoter group and relatives of such KMPs should also be excluded from acting as independent directors.</p> <p>c. The paper also noted the non-uniformity of cooling-off periods provided i.e. cooling-off period of 3 years if the person has been an employee/ KMP or his/ her relative has been a KMP of the listed entity/ its holding company/ subsidiary/ associate company and of 2 years if a material pecuniary relationship between them and therefore the need to harmonize the cooling-off periods.</p>	<p>companies, cannot be appointed as IDs in the company, unless there has been a cooling-off period of 3 years.</p> <p>b. The above stated restriction is also proposed to be applicable to relatives of such KMPs for the same period.</p> <p>c. The cooling-off period for eligibility condition was 3 years in case the person had been an employee/KMP or his/ her relative had been a KMP of the listed entity/ its holding company/ subsidiary/ associate company and 2 years in case of a material pecuniary relationship between person or his/her relative and the listed entity etc. has been proposed to be harmonized to 3 years.</p>
2.	<p>Appointment and re-appointment process of Independent Directors</p> <p>a. The present system of appointment of the IDs entails a proposal by the Nomination and Remuneration Committee (NRC) who is then appointed by the Board as under Part D (A) of Schedule II of SEBI LODR</p>	<p>Appointment and re-appointment process of Independent Directors</p> <p>a. The present process of appointment and re-appointment is fraught by the influence of the promoters in recommending the name of ID and in the approval process by virtue of shareholding, which may undermine</p>

	<p>Regulations. The shareholders may approve the appointment through an ordinary resolution or special resolution in case of re-appointment, subsequently.</p> <p>b. Accordingly, this appointment may be influenced by the promoters in recommending the name of the ID and in the approval process by virtue of shareholding which may hinder the independence of IDs by undermining their ability to differ from the promoter, especially in cases where the interests of promoter and of minority shareholders are not aligned.</p> <p>c. The paper recognised the need for minority shareholders to have greater say in the appointment/ re-appointment process of IDs considering that their primary duty is to protect the interest of minority shareholders.</p>	<p>their ability to differ from the promoter and protect the interests of minority shareholders.</p> <p>b. Recognising the need for minority shareholders to have greater say in the appointment/ re-appointment process of IDs and taking guidance from the practices in Israel and the UK, it has been proposed that the appointment and re-appointment of IDs shall be subject to “dual approval”, taken through a single voting process and meeting following two thresholds:</p> <p>i. Approval of shareholders through ordinary resolution in case of appointment and special resolution in case of re-appointment.</p> <p>ii. Approval by ‘majority of the minority’ (simple majority) shareholders. ‘Minority’ shareholders would mean shareholders, other than the promoter and promoter group. It has been further proposed that if either of the approval thresholds are not met, the person would have failed to get appointed / re-appointed as ID and then listed entity may either:</p>
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<p>3.</p>	<p>Removal of Independent Directors</p> <p>a. The current framework for the removal of ID entails their removal through a simple majority in the first term and through a special resolution in case of second term, after giving them a reasonable opportunity to be heard.</p> <p>b. The consultation paper noted that since the ID may be removed through a simple majority, the promoter may have significant influence in the removal process by virtue of shareholding.</p>	<p>Removal of Independent Directors</p> <p>a. The proposed process of appointment and re-appointment of IDs as has been set out above has been recommended mutatis mutandis for the process of removal of IDs.</p>

	<p>c. Secondly, minority shareholders should also be given a say in the removal process of IDs following the same rationale as with respect to their greater say in case of the appointment of an ID.</p>	
4.	<p>Enhancing and bringing in more transparency in the role of Nomination and Remuneration Committee</p> <p>a. The extant regulatory norms dictate that all members of the NRC should be non-executive, with a majority of independent directors under Regulation 19(1) of SEBI LODR Regulations.</p> <p>b. The LODR Regulations under Part D (A) of Schedule II prescribe the role of the NRC in the matter of appointment of IDs which includes formulation of the criteria for determining qualifications, positive attributes and independence of a director, identifying persons who are qualified to become directors in accordance with the criteria laid down, and recommend to the board of directors for their appointment and removal and deciding whether to extend or continue the term of appointment of the independent director, on the basis of the report of performance evaluation of independent directors.</p>	<p>Enhancing and bringing in more transparency in the role of Nomination and Remuneration Committee</p> <p>a. Recognising the lack of transparency in the process followed by the Nomination and Remuneration Committee (NRC) while laying down detailed criteria of qualifications and attributes for directors, certain disclosures have been proposed regarding the process to be followed by NRC.</p> <p>b. It has been recommended that for the process of short-listing candidate, for each appointment, the NRC shall evaluate the balance of skills, knowledge and experience on the board and accordingly, prepare a description of the role and capabilities required for a particular appointment.</p> <p>c. The person who is recommended to the Board for appointment as ID should have the capabilities identified in this description.</p> <p>d. For the purpose of identifying suitable candidates, the committee</p>

	<p>c. The consultation paper noted the lack of transparency in the process followed by the NRC while laying down detailed criteria of qualifications and attributes for directors and the consequent need of prescribing disclosures regarding the process to be followed by NRC in respect of the appointment.</p>	<p>may use services of external agencies, consider candidates from a wide range of backgrounds, having due regard to diversity and consider the time commitments of the appointees.</p> <p>e. The notice for appointment of director shall include the following disclosures:</p> <ul style="list-style-type: none"> i. Skills and capabilities required for the appointment of the ID and how the proposed individual meets the requirement of the role. ii. Channels used for searching appropriate candidates. In case, one of the channels is 'recommendation from a person', the category of such person (viz. promoters, institutional shareholders, directors (non-executive, executive, ID) etc) shall be disclosed. <p>f. Composition of NRC may be modified to include 2/3rd IDs instead of majority of IDs.</p>
5.	<p>Prior approval of shareholders for appointment of IDs</p> <p>a. The paper remarked that a person may get appointed as an additional ID just after an AGM and then serve on the Board without shareholder</p>	<p>Prior approval of shareholders for appointment of IDs</p> <p>1. Recognising the possibility of a significant time gap between the appointment of an independent director and approval of</p>

	<p>approval, till the next AGM as the present regime provides for the appointment of IDs as additional directors, subject to approval of the shareholders at the next general meeting.</p> <p>b. Secondly, in case of a vacancy due to resignation or removal of an ID, existing provisions provide a time-period of up to 3 months to appoint another director. However, the approval of shareholders would be taken at the next AGM, which could potentially be up to another 9 months away.</p> <p>c. The paper noted this significant time gap between the appointment of an independent director and approval of shareholders, which not being in the best interest of especially the minority shareholders, the need for reduction/ elimination of this gap giving more say to shareholders in the appointment process was stated.</p>	<p>shareholders, which is not in the best interest of especially the minority shareholders, it has been proposed that IDs shall be appointed on the board only with prior approval of the shareholders at a general meeting.</p> <p>2. Furthermore, if a casual vacancy arises due to resignation / removal / death / failure to get re-appointed etc., the approval of shareholders should be taken within a time period of 3 months.</p>
<p>6.</p>	<p>Resignation of Independent Directors</p> <p>a. The LODR Regulations under clause 7B Part A (A) of Schedule III provide that the resigning ID within 7 days of his resignation, has to disclose to stock exchanges, detailed reasons for the resignation along-with a confirmation that there is no other</p>	<p>Resignation of Independent Directors</p> <p>a. The paper noted that IDs often resign for reasons such as pre-occupation, other commitments or personal reasons and then join the boards of other companies or that they resign and then join the same company as an executive director.</p>

	<p>material reason for resignation other than those already provided.</p> <p>b. However, IDs often resign for reasons such as pre-occupation, other commitments or personal reasons and then join the boards of other companies, thereby creating a need to further strengthen the disclosures around resignation of IDs.</p> <p>c. Moreover, the paper noted that cases have also been observed where IDs have resigned and then joined the same company as an executive director. While there may be valid reasons for transition from an ID to executive director, such instances where an ID knows that he/she may move to a larger role in the company in the near future, may practically lead to a compromise in independence</p>	<p>Such instances where an ID knows that he/she may move to a larger role in the company in the near future has been noted to practically lead to a compromise in independence.</p> <p>b. Accordingly, it has been suggested that the entire resignation letter of an ID shall be disclosed along with a list of his/her present directorships and membership in board committees.</p> <p>c. If an ID resigns from the board of a company stating reasons such as pre-occupation, other commitments or personal reasons, there will be a mandatory cooling-off period of 1 year before the ID can join another board.</p> <p>d. It is proposed that there should be a cooling-off period of 1 year before a director can transition from an ID to a whole-time director.</p>
7.	<p>Composition of the Audit Committee</p> <p>a. Regulation 18(1) of SEBI LODR Regulations prescribe that the audit committee shall have minimum three directors as members and two-thirds of its members are to be IDs.</p> <p>b. The LODR Regulations under Part C (A) of Schedule II cast specific responsibilities on the Audit Committee to review financial statements, scrutinize inter-corporate loans & investments and valuation of</p>	<p>Composition of the Audit Committee</p> <p>a. It has been proposed that the audit committee shall comprise of 2/3rd IDs and 1/3rd Non-Executive Directors (NEDs) who are not related to the promoter, including nominee directors, if any, considering the importance of the Audit Committee with regard to related party transactions and financial matters.</p>

	<p>undertakings and assets of the listed entity, wherever applicable.</p> <p>c. In case of related party transactions, prior approval of the Audit Committee is mandatory and SEBI has mandated that a committee of Independent directors should give their recommendations on open offers and schemes of arrangements.</p> <p>d. In light of the importance of the Audit Committee with regard to related party transactions and financial matters, changes to the composition of the audit committee have been proposed.</p>	
8.	<p>Review of remuneration</p> <p>a. The IDs are permitted to be paid sitting fees of maximum 1 lakh and profit linked commission within an overall limit apart from reimbursement of expenses under the Companies Act, 2013. Further, in terms of both Companies Act and LODR Regulations under Regulation 17(6)(d), IDs cannot be given stock options.</p> <p>b. Accordingly, the paper noted that while there are concerns that a large remuneration may compromise the independence of ID, lesser compensation may also not attract competent IDs on the boards of the listed entities.</p>	<p>Review of remuneration</p> <p>a. While no proposals have been set out in the consultation paper for the review of remuneration of the IDs, it has been stated that since any modification in the existing remuneration structure of IDs will require changes to the Companies Act, based on the comments received and further analysis of the same, appropriate recommendations will be sent to the Ministry of Corporate Affairs (MCA) for their consideration.</p> <p>b. The views are sought through three questions:</p> <p>i. Whether there is a need for reviewing the remuneration structure for IDs.</p>

<p>c. In this regard, two options were recognised i.e. either removal of profit linked commission and increase in sitting fees paid to IDs leading to IDs getting a fixed fee, without having any stake in the long-term growth of the company, or linking remuneration to profit or performance linked commission ensuring that IDs have “skin-in-the-game”. The concern with the latter approach that short-termism may be encouraged leading to conflicts, may be addressed by permitting ESOPs to IDs (instead of profit linked commission) with a long vesting period of say, 5 years.</p> <p>d. Since any modification in the existing remuneration structure of IDs would require changes to the Companies Act the paper stated that appropriate recommendations would be sent to the Ministry of Corporate Affairs (MCA) for their consideration.</p>	<p>ii. If so, whether ESOPs with a long vesting period of 5 years, be permitted for IDs, in place of profit linked commission and</p> <p>iii. What should be the maximum limit of remuneration through ESOPs.¹</p>
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C. Suggestions and Recommendations.

A Joint meeting of the Legal & Governance Committee of Bombay Chambers was convened in order to discuss SEBI's paper on ID's on 6th March 2021. The following are the points of concerns and solutions to it as proposed by the committee.

¹ Available at: https://www.sebi.gov.in/reports-and-statistics/reports/mar-2021/consultation-paper-on-review-of-regulatory-provisions-related-to-independent-directors_49336.html

Discussion 1. Definition of Independent Directors: SEBI frowns upon appointment of persons familiar to the organization. KMP (key managerial personnel) and their relatives should not be appointed as ID's.

Comments – A) There are already pre-existing provisions that require KMP's to undergo a 3-year cool-off period before being appointed as an ID, given that KMP's are employees. The same is applicable to the relatives of KMP's as well. (This provision is applicable to Holding, Subsidiary and Associate Companies). As per the proposal, the KMPs and employees of promoter group companies shall also have to undergo a cooling off period of 3 years. The Committee welcomes this amendment.

Discussion 2. Material Pecuniary Relationship: SEBI proposes cool off period to be increased from 2 years to 3 years to make it uniform to the cool-off period of 3 years for employees.

Comments- Committee agrees to the proposed increase in cool off period from 2 years to 3 years to make it uniform to the cool-off period of 3 years for employees.

Discussion 3. The process of Appointment, Re-appointment of ID's, and Prior Appointment of ID's: Process of dual voting (1. Ordinary Resolution for appointment passed by shareholders, 2. Majority of Minority)

Concerns: Committee also opines that no tangible benefit could be observed as the process is too bureaucratic and would not actually work in a corporate setting. Also, Once an ID meets their qualification, there is no requirement for a dual voting process.

Committee shares its concerns seeking the need for corporate democracy as some promoters out of fear due to the process may become inclined to have benami holding to control minority voting.

Committee is also concerned with the quality of ID because as soon as an ID is dismissed due to dual voting process, another ID cannot be made ready in such short span as it requires prior preparedness. The rejection of a candidate shall lead to additional difficulties, as another candidate may be reluctant to go through the same dual voting process. The presence of a dual voting process shall accordingly affect the availability of competent IDs.

Committee is also concerned with deprivation of rights of the majority shareholders.

Comments – The Committee understands that SEBI wants to safeguard the interests of the minority shareholders, however, committee is of the opinion that this proviso works only from the optics angle and is not practical hence toothless.

The committee also believes that the SEBI should take practical suggestions from Chambers of Commerce or adopt a more facilitating approach such as Majority of minority “present & voting”, which is a more feasible and realistic option.

The committee is of the opinion that Minority shareholders may not be equipped to appoint an ID, as they do not think about the company in the long run. The minority shareholders may also not have a long-term stake in the business, and hence should not be granted a separate/independent vote. The Committee was also of the view that the 90/120 day time-period in case the proposal is defeated is not workable.

Discussion 4. Removal of ID: Dual voting

Comments – The committee believes that simple voting is more feasible as removal of ID is similar to a vote of no-confidence. A simple removal procedure of ineffective ID should be quick and un-complicated. As a landmark Tata Case and their dismissal of an ID in 2016 must be considered where in case if an ID turns hostile to the board, his removal should be smooth rather than having the board divided. Committee in furtherance of the above stated comments also believes that the Board should possess the highest standards of governance and thus it is important that the board is cohesive rather than fighting over a majority of minority voting system.

The Committee is of the view that a dual voting process for removal of an ID shall only lead to more conflict within the Board, and shall be counter-productive. Further, uncertainty in management will cause more harm than good, especially considering the shareholding structure of companies in India. As dual voting may lead to additional complications, the existing process for removal may be continued.

Discussion 5. Prior Approval for Appointment of ID

Comments- Committee is of the opinion that the concerned proposal aims to develop a good governance practice. Although there can be various perspectives to look at the same, for example, SEBI is adding onto compliance cost as there is no requirement for prior approval.

Committee’s general view is that SEBI has drafted policies for ID with a perspective that ID’s sole responsibility is to protect interest of minority shareholders, however that is just one of the many

responsibilities that come up. Thus, certain aspects of paper need to be altered and role of ID must be considered holistically, and not only from the perspective of minority shareholders.

The Committee felt that there is no need to alter the existing process, where an ID is appointed as an additional director, subject to shareholder approval. This proposal effectively abridges the right of the Board and the NRC to appoint an ID of their choice. This proposal may also lead to practical concerns, as it may not be feasible to complete the entire appointment process within 3 months.

As an alternative, an amendment can be made prescribing that the IDs appointment should be placed before the shareholders within 6 months from the date on which he/she was appointed.

Discussion 6. Enhancing Role of NRC as well as bringing transparency in appointment of ID's: NRC shall carry out a set of competence and skill-based evaluations of a set of shortlisted candidates for selection to the post of an ID. NRC is bound to evaluate, prepare a description of the roles and capabilities required to be possessed by the ID such that the person recommended should have the said skill set. NRC can also use external agencies for the same.

Comments – Committee is of the opinion that the concerned proposal aims to develop good methods to maintain transparency and shows the right intent; In addition to the aforementioned there was an opinion that the method is too prescriptive, and that company may lose out on talented IDs as no senior ranking person would be willing to undergo a series of competitive tests by NRC. Secondly, disclosing the channels used for searching candidates and the individual who recommended a particular candidate may also not be feasible, and may compromise on the appointment process.

Lastly, the committee is of the opinion that the discretion of selecting a method for appointment should be left to company rather than SEBI mandating it. Flexibility should be granted for formulating methods/criteria of appointment that is feasible for the company.

Discussion 7: Review of the Remuneration Framework for IDs.

The members of the Committee noted that any change to the remuneration framework shall also require amendments to the Companies Act, 2013.

The Committee was also of the view that allowing IDs to avail ESOPs shall lead to a conflict of interest, and shall compromise the independence of the ID. Hence, allowing IDs to avail ESOPs

(even with a long vesting period of 5 years) may be counter-productive, and may compromise the role played by the ID on the Board. Further, ESOPs may be considered only in case of start-ups, and distressed companies under the IBC, 2016.

The members also took the view that there is currently no need for a reduction of the thresholds for payment of sitting fees and profit-based commissions to IDs. A reduction in the remuneration thresholds may hamper the pool of available IDs, and shall make it difficult for the company to avail the services of competent IDs.

The proposal to provide ESOPs with a long vesting period of 5 years to IDs, should be permitted as an additional option of remuneration and not in place of profit linked commission. The current practice of remuneration to IDs basis the commission should not be disturbed. Many companies may not have ESOP and MNC may have ESOP of their Global Company at Global level and there may be inherent legal and policy related restriction to include India Company IDs for the ESOPs. It is suggested to have ESOP as an additional option of remuneration and SEBI and MCA should remove the curb in this regard and let the NRC & Board decide the way and means to remunerate the IDs.