

Independent Directors: Position, Role and Duties - A primer

DR. S K GUPTA, MD & CEO | IPA OF INSTITUTE OF COST ACCOUNTANTS OF INDIA

DR. NANDITA MISHRA, ASSOCIATE PROFESSOR | AMITY UNIVERSITY

Introduction:

Today, Indian corporate law seems to be clouded by corporate trust deficit due to preponderance of scandals and financial frauds across sectors and businesses. Post-Satyam, the Government of India attempted to build rigour into the corporate regulatory framework and enacted new legislation i.e. the Companies Act, 2013. The Parliamentary Standing Committee on the Companies Act, 2009 observed that the role of independent directors is very important when we contemplate about controlling the failures of major corporates.

Independent Directors are the first line of defense for the minority shareholders. They are an integral part of Corporate Governance. They build a crucial interface between promoters/ management on the one hand and Shareholders / stakeholders on the other.

Independent Directors can be divided into three categories:

- ◆ Who are nominees of the Chairman and who perform the role of “Nodders”. They nod whenever the Chairman says anything. They are technically independent, but they echo the sentiments of the Chairman.
- ◆ Directors who are truly independent and they express their views clearly, fearlessly and frankly regardless of what the Chairman thinks.
- ◆ The vast majority of independent Directors fall between these two extremes. These are people conditioned by culture of not expressing dissent forcefully and are therefore intimidated or unsure

how their criticism will be taken.

Therefore, one of the prominent features of the Companies Act, 2013 was that it brought clarity on the functions, liabilities and duties of independent directors. As Independence is a state of mind and cannot be codified through a statute. Prior thereto, there was uncertainty because neither the Companies Act, 1956 nor the Securities and Exchange Board of India (SEBI) Listing Agreement provided any guidance about the role of independent directors.

The prerequisites for good corporate governance and various other code of conducts has always emphasised that the Board of Directors should provide appropriate direction to the company, evaluate and decide the roadmap, appoint and give directions to various top level management of the company. But an Independent Director should focus on the effectiveness of internal control, should protect the interest of non- controlling stakeholders, should analyse the risk management system of the company and should be ever watchful towards company's vulnerabilities. After the Enron, Satyam, World com the challenges for Independent Directors are increasing manifold along with progressively increasing stakeholders' expectations. This paper is an attempt to highlight the roles, duties and responsibilities of the Independent Directors in these ever changing business synergies.

The Companies Act, 2013 has fine-tuned corporate governance and role of Independent directors and thereby removed the deficiencies of Companies Act of 1956. The duties and liabilities of the directors is both fortified and enhanced by the revised corporate

governance norms (Revised and New Clause 49 of the Listing Agreement) of SEBI [the Securities and Exchange Board of India.

Background and Conceptual framework:

An independent director is a non-executive director of a company who helps the company in improving corporate credibility and governance standards. It was in 1950s that the independent director was first introduced voluntarily in United States for better governance. After the Cadbury Committee Report (UK) in the year 2002, development with regard to Independent Director in US and UK witnessed propagation. In India, the concept of Independent Director was conceived in the later part of 1990s, when the Securities and Exchange Board of India (SEBI) mandated that all large public listed companies in India should have a minimum number of Independent Directors for the independence of the board and smooth Corporate Governance.

The provisions relating to appointment of Independent directors are contained in Section 149 of the Companies Act, 2013 which should be read along with Rule 4 and Rule 5 of the Companies (Appointment and Qualification of Directors) Rules, 2014

According to sub-section (6) of section 149 of the Companies Act, 2013 an independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director and According to SEBI (Regulation 16), an Independent director" means a non-executive director, other than a nominee director of the listed entity:

- (a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
- (b) who is or was not a promoter of the company or its holding, subsidiary or associate company;
 - (i) who is not related to promoters or directors in the company, its holding, subsidiary or

associate company;

- (c) who apart from receiving director's remuneration, has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;
- (d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
- (e) who, neither himself nor any of his relatives—
 - (i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;
 - (ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—
 - ◆ a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or
 - ◆ any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

- (iii) holds together with his relatives two per cent. or more of the total voting power of the company; or
- (iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent. or more of its inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. 1.10.2018.
- (v) is a material supplier, service provider or customer or a lessor or lessee of the company
 - ◆ who is not less than 21 years of age.
 - ◆ (ii) who is not a non-independent director of another company on the board of which any non-independent director of the listed entity is an independent director:
- (f) who possesses such other qualifications as may be prescribed i.e possesses appropriate skills, experience and knowledge in one or more fields of finance / law / management / sales / marketing / administration / research / corporate governance / technical operations/other disciplines related to company's business.

Independent Director and his Position

The number of Independent directors has been fixed as one third of the total strength of the directors in the company. SEBI has mandated that the Board of Directors of the top 500 listed entities shall have at least one independent woman director by 1-4-2019 and the Board of Directors of the top 1000 listed entities shall have at least one independent woman director by 1-4-2020. Unlisted Public Companies must appoint at least 2 independent directors if the paid up share capital exceeds Rs 10 Crores; if the turnover exceeds Rs.100

Crores; if the aggregate of all the outstanding loans, debentures and deposits exceeds Rs 50 Crores. The terms and conditions of appointment of independent directors shall also be posted on the company's website. Again, the independent directors are not permitted to hold office for more than two consecutive terms of five-year periods. Independent directors have to be selected from a data bank containing names, addresses and qualifications of persons eligible and willing to act as directors.

On 2nd Dec 2019, Ministry of Corporate Affairs (MCA) launched the Independent Directors database in accordance with Companies Act 2013. Its objective was to strengthen the institution of Independent directors. The database will be developed and maintained by Indian Institute for Corporate Affairs (IICA). Sec 150 of Companies Act 2013 provide that Independent Director should be selected from the Data Bank. Data Bank should contain names, address and qualifications of persons. As per the notification rules, all existing independent directors are required to register themselves in the database by 1st March 2020 and pass the online proficiency self- assessment test within 12 months thereafter. To register they must login into the website of the Ministry. The Indian Institute of Corporate Affairs (IICA) under the MCA will hold the exam and to make the process stringent, a score of 60 per cent marks will be mandatory criteria for qualification.

SEBI (Regulation 25):

Obligations with respect to independent directors:

- (1) The independent directors in the meeting referred in sub-regulation (3) shall, inter alia-
 - (a) review the performance of non-independent directors and the board of directors as a whole;
 - (b) review the performance of the chairperson of the listed entity, taking into account the views of executive directors and non-

executive directors;

- (c) assess the quality, quantity and timeliness of flow of information between the management of the listed entity and the board of directors that is necessary for the board of directors to effectively and reasonably perform their duties.
- (2) An independent director shall be held liable, only in respect of such acts of omission or commission by the listed entity which had occurred with his knowledge, attributable through processes of board of directors, and with his consent or connivance or where he had not acted diligently with respect to the provisions contained in these regulations.
- (3) An independent director who resigns or is removed from the board of directors of the listed entity shall be replaced by a new independent director by listed entity at the earliest but not later than the immediate next meeting of the board of directors or three months from the date of such vacancy, whichever is later:
- Provided that where the listed entity fulfils the requirement of independent directors in its board of directors without filling the vacancy created by such resignation or removal, the requirement of replacement by a new independent director shall not apply.
- (4) The listed entity shall familiarise the independent directors through various programmes about the listed entity, including the following:
- (a) nature of the industry in which the listed entity operates;
 - (b) business model of the listed entity;
 - (c) roles, rights, responsibilities of independent directors; and
 - (d) any other relevant

information.

- (5) Every independent director shall, at the first meeting of the board in which he participates as a director and thereafter at the first meeting of the board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, submit a declaration that he meets the criteria of independence as provided in clause (b) of sub-regulation (1) of regulation 16 and that he is not aware of any circumstance or situation, which exist or may be reasonably anticipated, that could impair or impact his ability to discharge his duties with an objective independent judgment and without any external influence.
- (6) The board of directors of the listed entity shall take on record the declaration and confirmation submitted by the independent director under sub-regulation (8) after undertaking due assessment of the veracity of the same.

Today the role of Independent Director has become more challenging due to:

- ◆ Intense Scrutiny from stakeholders.
- ◆ Greater demands imposed by regulatory authorities.
- ◆ Increase in overall complexity of business environment in which corporate India functions.

Guidelines for Professional Conduct (As per Schedule IV of Companies Act 2013)

The Code is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfilment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

An independent director shall:

- ◆ uphold ethical standards of integrity and probity;
- ◆ act objectively and constructively while exercising his duties;
- ◆ exercise his responsibilities in a bona fide manner in the interest of the company;
- ◆ devote sufficient time and attention to his professional obligations for informed and balanced decision making;
- ◆ not allow any extraneous considerations that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decision making; 6. not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;
- ◆ refrain from any action that would lead to loss of his independence;
- ◆ where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly;
- ◆ assist the company in implementing the best corporate governance practices.

Independent Directors & their Roles

Independent Directors act as mentor, coach and guide in a Company. They should work towards improving corporate creditability, governance standards, and their risk managing skills and should act as watchdog of the company.

Inclusion of Independent Directors is a check on the management of companies as an oversight mechanism. Their ability to contribute to the board's deliberations

is an added bonus to voice of the minority interests. On the other hand, Board expected Independence, Impartiality, wide experience, special knowledge and personal qualities from Independent Directors.

According to the Schedule IV of the Companies Act, 2013 the roles of Independent directors have been listed out as:

1. Facilitate withstanding and countering pressures from owners;
2. Fulfil a useful role in succession planning;
3. On issues such as strategy, performance, risk management, resources, key appointments and standards of conduct he must support in gaining independent judgment to bear on the board's deliberations.
4. Play the role of a facilitator outside the board room especially on contentious issues.
5. While evaluating the performance of board and management of the company bring an objective view.
6. Scrutinizing, monitoring and reporting management's performance regarding goals and objectives agreed in the board meetings.
7. Safeguard the interests of all stakeholders, particularly the minority shareholders;
8. Balance the conflicting interest of the stakeholders;
9. Satisfying themselves that financial controls and systems of risk management are in operation and check on the integrity of financial information.
10. In situations of conflict between management and shareholder's interest, aim towards the solutions which are in the best interest of the company.
11. Provide candid feedback to CEO, CFO post an executive session.

12. Establishing the suitable levels of remuneration of:

- ◆ executive directors,
- ◆ key managerial personnel
- ◆ senior management

Duties of an Independent Director

The Independent Directors shall:

1. Undertake appropriate induction and regularly update and refresh their skills, knowledge, and familiarity with the company
2. Attempt to attend company's general meetings
3. Attempt to attend BOD's meetings and board committees meeting being a member
4. Have adequate knowledge about the company and the external environment in which it operates
5. Report matters concerning the unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy
6. Acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees
7. Not to unfairly obstruct the functioning of the company or committee of the Board
8. Participate in the Board's committee being chairpersons or members of that committee
9. Not to disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law
10. Ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses

such mechanism are not prejudicially affected on account of such use.

Other Provisions related to Independent Directors under Companies Act, 2013:

1. In companies that trigger the conditions of Corporate Social Responsibility Committee of the Board to formulate and monitor the CSR policy of a Company, the Companies Act, 2013 requires the CSR Committee to consist of at least three directors, including at least one independent director.
 - Every independent director shall give a declaration that he meets the criteria of independence when :
 - he attends the first board meeting as a director;
 - in every financial year, at the first meeting of the board of directors
 - when a situation arises which affects his status of independence being an independent director
2. The independent director shall be appointed for a maximum term of 5 years. The term shall not be more than 2 consecutive terms. He shall be re-appointed only by special resolution by the company.
3. Any vacancy in the office of independent director shall be filled in the very next Board Meeting or within 3 months of such vacancy, whichever is later.
4. A person must be an independent director in not more than seven listed companies at a time
5. An independent director shall not retire by rotation and shall not be included in "total number of directors' for the purpose of computation of

rotational directors.

6. A person can be appointed as an alternate director. But he must be qualified to be appointed as an independent director.
7. A small shareholder director shall be considered as an independent director, if-
 - ◆ he is eligible for appointment as an independent director u/s 149 (6),
 - ◆ he gives a declaration of his independent u/s 149(7).
8. If the Board meeting is called at shorter notice so as to transact some urgent business, then the presence of at least 1 independent director is mandatory. In absence of any independent director, a decision shall be circulated to all the directors and later approved by at least 1 independent director.

Is Role of Independent Director Effective

In recent past we have witnessed many instances of financial frauds, corporate misconduct and lack of corporate governance even after boosting the compliance and rules in the companies Act. And the question therefore arises about the accountability of Independent Directors in Indian context. We have also witnessed independent directors quitting their position when the companies face problems. One of the case in point was the head of Jet Airways' Risk Management Committee and according to the Annual Report of Jet Airways; the Committee did not even meet once in 2017-2018. In Infrastructure Leasing and Financial Services (IL&FS) where many directors resigned when the company started facing problem, the survey revealed that the Risk Management Committee of IL&FS (Which included independent directors also) had not conducted any meeting in previous four years.

There have also been instances where the independent

directors have raised their voice against the corporate governance failure and faced the impact thereof. It is pertinent to note that not all independent directors perform their functions properly; but then there are some who are strong minded to work effectively and in compliance with their duties and expectations. Thus, the Government and the regulatory authorities like SEBI need to come up with solutions that ensure that not only are the independent directors incentivized and motivated to work, but they are also provided with adequate powers and protection to carry out their functions.

Independent Director Attributes	Company Attributes
Work well with others	Have a diversity policy
Possess the required business/industry knowledge	Appoint Directors through an independent and objective process
Should available when needed	Establish appropriate board committees
Prepares for and attend meetings	Share information especially with Independent Directors
Devotes quality time to oversee company affairs	Develop and follow a code of conduct
Alert and inquisitive	Adopt a consultative approach in setting meeting agendas
Challenges management assumptions	Record and share minutes of meeting

For making their roles effective, SEBI has mandated evaluation of the performance of Independent Directors: As per amended Regulation 17(10),

The evaluation of independent directors shall be done by the entire board of directors which shall include:

- (a) Performance of the directors; and

- (b) Fulfilment of the independence criteria as specified in these regulations and their independence from the management.

MCA has also suggested amendments to the Companies Act, 2013. CA 2013 initially barred a person from acting as an independent director of a company if such person had a 'pecuniary relationship' with that company. Subsequently, this provision was revised pursuant to the Amendment Act and it was clarified that an independent director cannot have any pecuniary relationship with the company other than (i) remuneration payable to such person, and (ii) transactions with the company, which do not exceed 10% of his total income. Under CA 2013, an independent director is entitled to receive remuneration in the form of sitting fees for attending board meetings and a profit-based commission. The Committee considered compensation received by an independent director from the company to rank as one of the most important factors that is likely to influence an individual's ability to exercise unbiased and independent judgement. Therefore, while the Amendment Act stopped at clarifying that receipt of remuneration was a permissible pecuniary relationship between the independent director and the company, the Notice now proposes a cap on the maximum remuneration payable.

Accordingly, to ensure that there is no material pecuniary relationship between an independent director and the promoter group that can impair his independence, the maximum remuneration of an independent director payable by a company (including its holding, subsidiary or associate company) or its promoters or directors is proposed to be capped at 25% of such independent director's total income. For computation of this cap on the maximum remuneration, the sitting fees payable to the independent directors would not be counted. Further, within the total cap on the maximum remuneration payable (i.e., 25% of the total income), fees payable for any professional or other services rendered

by the independent director (except those prescribed) cannot amount to more than 10% of his total income. It remains to be seen what kind of professional or other services will be excluded from this cap of 10%.

Such a move to cap remuneration of independent directors may further accentuate the problem of attracting the best talent. Further, since the caps are tied to the total income of a given independent director, the proposed amendment will result in several practical difficulties in assessing and monitoring the maximum fees and/or commissions payable to each independent director. Since the cap prescribed would be a percentage of the total income being earned by a given independent director, it may force companies to pay different amounts to independent directors on the same board even though they are performing more or less the same functions.

Conclusion:

Instances of financial frauds and lack of corporate governance are increasing but tightening the norms for selection and functioning of Independent Director are not the only solution to this. The Companies Act, 2013 provides clearer picture of the roles and responsibilities of the independent director and now the Government needs to balance the interests of the company and the independent directors.

Independent Directors need to set clear ground rules about their independence. Next, they need to understand that they are part of a process. They aren't going to change everything all at once. Instead, they will need to take things step-by-step, address some key issues today and then, at the next meeting, they can focus on moving something else forward. It takes time for boards and independent board members and owners to learn how to work together. Increasing the effectiveness of their role is significant to achieving high governance standards as independent directors are the backbone of corporate governance.