



## **Newsflash: Changes in Regulatory Provisions related to Independent Directors**

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### Changes in Regulatory Provisions related to Independent Directors

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#### **1.0 BRIEF BACKGROUND:**

- 1.1 The concept of Independent Directors (IDs) emerged from the need to have a certain number of directors on the Board who would think and act independently to bring about a healthy balance between the interests of the promoters and other stakeholders including minority and small shareholders. IDs are an important component in the overall framework of Corporate Governance.
- 1.2 SEBI has over the years, strengthened the institution of IDs through the recommendations of various committees. The Ministry of Corporate Affairs (MCA) has also introduced the requirement of Independent Directors in the Companies Act of 2013 ("Companies Act") and even laid down a Code of Conduct for IDs.
- 1.3 As per the Code of Conduct, IDs are expected to pay specific attention on the integrity of financial information and on related party transactions along-with safeguarding the interests of the minority shareholders. Accordingly, the Audit Committee of the board which is responsible for approving related party transactions and for oversight of the financial reporting process and the sanctity of financial information is mandated to have at least two-third of Independent Directors. Besides, IDs are also expected to bring in independent judgment on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct; as well as bring an objective view in the evaluation of the performance of board and management.
- 1.4 Despite the above provisions and various measures taken, concerns around the efficacy of independent directors as a part of corporate governance framework continue. SEBI therefore felt a need to further strengthen the independence of IDs and enhance their effectiveness in protection of the interest of the minority shareholders, and other functions.
- 1.5 Accordingly, SEBI has at its meeting held on 29th June, 2021, has approved certain amendments to Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations) pertaining to regulatory provisions related to Independent Directors (IDs). These amendments shall be made applicable with effect from Jan 01, 2022.
- 1.6 The Board also agreed to make a reference to the Ministry of Corporate Affairs (MCA), for giving greater flexibility to companies while deciding the remuneration for all directors (including IDs), which may include profit linked commissions, sitting fees, ESOPs, etc., within the overall prescribed limit specified under Companies Act, 2013.

## **2.0 MAJOR CHANGES / SALIENT FEATURES (APPLICABLE W.E.F. JAN 01, 2022):**

Some of the key highlights of certain important changes approved by SEBI are as follows:

### **2.1 Definition of Independent Directors:**

A cooling off period of three years has been introduced for Key Managerial Personnel (and their relatives) or employees of the promoter group companies, for appointment as an ID.

Relatives of employees of the company, its holding, subsidiary or associate company have been permitted to become IDs, without the requirement of a cooling off period, in line with Companies Act, 2013.

### **2.2 Appointment / re-appointment and removal of Independent Directors**

Appointment/Re-appointment and Removal of IDs shall be through a special resolution of shareholders for all listed entities.

The process to be followed by Nomination and Remuneration Committee (NRC), while selecting candidates for appointment as IDs, has been elaborated and made more transparent including enhanced disclosures regarding the skills required for appointment as an ID and how the proposed candidate fits into that skillset.

The composition of NRC has been modified to include 2/3rd IDs instead of existing requirement of majority of IDs.

Shareholder approval for appointment of all directors including IDs shall be taken at the next general meeting, or within three months of the appointment on the Board, whichever is earlier.

### **2.3 Change in composition of NRC**

Composition of NRC is modified to include 2/3rd IDs instead of majority of IDs.

### **2.4 Resignation of Independent Directors**

The entire resignation letter of an ID shall be disclosed along with a list of his/her present directorships and membership in board committees.

A cooling-off period of one year has been introduced for an ID transitioning to a whole-time director in the same company/ holding/ subsidiary/ associate company or any company belonging to the promoter group.

### **2.5 Composition of the Audit Committee**

At least 2/3rd of the members of the audit committee shall be independent directors and all related party transactions shall be approved by only Independent Directors on the Audit Committee.

## 2.6 Directors and Officers insurance

The requirement of undertaking Directors and Officers insurance has been extended to the top 1000 companies (by market capitalization).

## 3.0 COMPARATIVE ANALYSIS OF OLD V/S NEW REGIME, AT A GLANCE:

Change	Old regime	New regime (applicable w.e.f. 01/01/2022)
<b>Definition of Independent Directors</b>	<p>Currently, as per SEBI LODR Regulations, a cooling-off period has been prescribed for the person to be eligible for acting as an ID, inter-alia as follows:</p> <ol style="list-style-type: none"> <li>Cooling-off period of 3 years in case 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.</li> <li>Cooling-off period of 2 years in case of a material pecuniary relationship between person or his / her relative and the listed entity / its holding company / subsidiary / associate company.</li> </ol>	<p>Since, the cooling off period in condition a &amp; b was not uniform; there was a need to harmonize the same.</p> <p>Accordingly, the cooling off period for Key Managerial Personnel (and their relatives) or employees of the promoter group companies, for appointment as an ID has been harmonized to 3 years.</p> <p>Further, in line with the provisions of the Companies Act, 2013, relatives of employees of the company, its holding, subsidiary or associate company have been permitted to become IDs, without the requirement of a cooling off period.</p>
<b>Appointment and re-appointment process of Independent Directors</b>	<p>As per the extant regulatory norms for appointment of IDs, the Nomination and Remuneration Committee ("NRC") proposes a person as ID, who is then appointed by the Board.</p> <p>Subsequently, shareholders approve the appointment through an ordinary resolution (special resolution in case of re-appointment).</p>	<p>Appointment/Re-appointment of IDs shall be now done only through a special resolution of shareholders for all listed entities.</p> <p>Shareholder approval for appointment of all directors including IDs shall be taken at the next general meeting, or within three months of the appointment on the Board, whichever is earlier.</p> <p>The process to be followed by Nomination and Remuneration</p>

Change	Old regime	New regime (applicable w.e.f. 01/01/2022)
		Committee (NRC), while selecting candidates for appointment as IDs, has been elaborated and made more transparent including enhanced disclosures regarding the skills required for appointment as an ID and how the proposed candidate fits into that skillset.
<b>Removal of Independent Directors</b>	<p>At present, an ID can be removed through a simple majority in the first term and through a special resolution in case of second term, after giving him a reasonable opportunity to be heard.</p> <p>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>	Removal of IDs shall also be through a special resolution of shareholders for all listed entities.
<b>Change in composition of NRC</b>	At present, all members of the NRC should be non-executive, with a majority of independent directors.	Composition of NRC is now modified to include 2/3rd IDs instead of majority of IDs.
<b>Resignation of Independent Directors</b>	<p>As per current provisions of LODR, 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 material reason for resignation other than those already provided.</p> <p>It was observed that IDs often resign for reasons such as pre-occupation, other commitments or personal reasons and then join the boards of other companies. There was, therefore, a need to further strengthen the disclosures around resignation of Independent Directors.</p> <p>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</p>	<p>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>Further, a cooling-off period of one year has been introduced for an ID transitioning to a whole-time director in the same company/ holding/ subsidiary/ associate company or any company belonging to the promoter group.</p>

Change	Old regime	New regime (applicable w.e.f. 01/01/2022)
	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.	
<b>Composition of the Audit Committee</b>	The LODR Regulations cast specific responsibilities on the Audit Committee (two-thirds of its members are independent directors), to review financial statements, scrutinize inter- corporate loans & investments and valuation of undertakings and assets of the listed entity, wherever applicable. In case of related party transactions, prior approval of the Audit Committee is mandatory.	Considering the importance of the Audit Committee, at least 2/3rd of the members of the audit committee shall now be independent directors and all related party transactions shall be approved by only Independent Directors on the Audit Committee.
<b>Directors and Officers insurance</b>	With effect from October 1, 2018, the top 500 listed entities by market capitalization calculated as on March 31 of the preceding financial year, shall undertake Directors and Officers insurance ('D and O insurance') for all their independent directors of such quantum and for such risks as may be determined by its board of directors	The requirement of undertaking Directors and Officers insurance has been extended to the top 1000 companies (by market capitalization).

**Click here for complete text of SEBI circular:**

[https://www.sebi.gov.in/media/press-releases/jun-2021/sebi-board-meeting\\_50771.html](https://www.sebi.gov.in/media/press-releases/jun-2021/sebi-board-meeting_50771.html)



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This newsflash summarizes certain important changes in regulatory provisions related to Independent Directors as approved by SEBI at its meeting held on 29th June, 2021. It may be noted that nothing contained in this newsflash should be regarded as our opinion and facts of each case will need to be analyzed to ascertain applicability or otherwise of the said judgement and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this newsflash.

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