

UPDATE

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SEBI REVAMPS REGULATIONS PERTAINING TO INDEPENDENT DIRECTORS OF LISTED ENTITIES

A. *Introduction*

In order to curtail the sway of promoters and boost the corporate governance framework in listed companies, the Securities and Exchange Board of India (“SEBI”) at its Board Meeting dated 29 June, 2021 approved amendments to the regulatory provisions governing the independent directors (“IDs”). It is however pertinent to note that these amendments will be made applicable with effect from 01 January, 2022. The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”) will have to be amended accordingly.

B. *Key amendments*

1. *Eligibility Requirement*

Currently, as per the LODR Regulations, a cooling-off period has been prescribed for the person to be eligible for acting as an ID, *inter-alia*, as follows:

- (i) Cooling-off period of 3 (three) years in case the person has been an employee/KMP or his/her relative has been a Key Managerial Personnel (“KMP”) of the listed entity/its holding company/ subsidiary/ associate company.
- (ii) Cooling-off period of 2 (two) years in case of a material pecuniary relationship between person or his/her relative of the listed entity/ its holding company/ subsidiary/associate company.

In order to harmonize the conditions pertaining to the cooling-off period, SEBI has introduced a cooling-off period of 3 (three) years for KMP (and their relatives) or employees of the promoter group companies, for appointment as an ID.

Further, in line with the provisions of the Companies Act, 2013, SEBI has approved the appointment of relatives of employees of the company, its holding, subsidiary or associate company as IDs, without the requirement of a cooling-off period.

2. *Appointment/Re-appointment of Independent Directors*

As per the new norms, the appointment/reappointment of IDs for all listed entities shall be through a ‘special resolution’ of the shareholders as opposed to the current requirement of just an ‘ordinary resolution’ of the shareholders. Further, such approval for appointment of IDs needs to be obtained at the next general meeting or within 3 (three) months of the appointment of the ID to the board of directors of the listed entity, whichever is earlier.

SEBI has also mandated a transparent and structured selection process of IDs. While selecting candidates for appointment as IDs, the NRC is required to disclose skills needed for being an ID and how the proposed candidate possesses that skill set.

3. ***Removal of Independent Directors***

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 the ID a reasonable opportunity to be heard. To reduce the significant influence of the promoter (by virtue of their shareholding) in the removal process, SEBI has mandated removal of IDs to be done through a special resolution of shareholders for all listed entities.

4. ***Resignation of Independent Director***

As per the current LODR Regulations, the detailed reasons for resignation of an ID has to be disclosed by the listed entity to the stock exchanges within 7 (seven) days of the resignation. In an attempt to further strengthen the disclosures around resignation, SEBI has mandated that the entire resignation letter of an ID be disclosed along with a list of his/her present directorships and membership in board committees of the listed entity.

Further, a 1 (one) year cooling-off period must be observed before an ID who resigns can transition to a whole-time director in the same company/holding/subsidiary/associate company or any company belonging to the promoter group.

5. ***Composition of Nomination and Remuneration Committee***

At present, all members of the NRC should be non-executive, with a majority of IDs. The composition of the NRC has been modified to include 2/3rd (two-thirds) of its total members to be IDs instead of the existing requirement of majority of IDs.

6. ***Composition of Audit Committee***

At least (2/3rd) (two-thirds) of the members of an audit committee of a listed company are required to be IDs. Under the present regime, in case of related party transactions, prior approval of the audit committee is mandatory. As per the new regime, it has been mandated that all related party transactions shall be approved by only IDs on the audit committee.

7. ***Directors and Officers Insurance***

The requirement of undertaking directors' and officers' insurance cover has been extended from top 500 (five hundred) companies to the top 1000 (one thousand) companies (by market capitalization).

8. ***Compensation Structure***

SEBI has agreed to consult the Ministry of Corporate Affairs, to relook at the remuneration of IDs, by providing flexible compensation structure, which may include sitting fees, ESOPs, profit-linked commissions etc. within the overall prescribed limits under Companies Act, 2013.

C. Implication of the amendments

IDs are considered to be an important part of the overall framework of corporate governance. Over the years, SEBI has attempted to strengthen the institution of IDs through various measures. Despite these measures, concerns around the efficiency and abilities of the IDs have continued. The proposed amendments will hopefully address these concerns and have a significant positive impact on the corporate governance of listed entities. These amendments may result in greater efficiency, transparency and accountability of IDs leading to better corporate discipline.

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