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Decoding Impact of Corporate Governance Committee's recommendations on "Independent Directors"

October 10, 2017 12:34 pm | By : Gaurav N. Pingle



The [earlier article](#), we discussed the SEBI's Corporate Governance Committee's ('Kotak Committee') recommendation on "Composition & Role of Board of Directors". The article covered the analysis of recommendations relating to minimum number of directors, attendance in board meetings, approval of shareholders for appointment of non-executive directors on attaining certain age, updation of knowledge of the

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board members, separation of the roles of non-executive directors and maximum directors. This article is an analysis of recommendations on the "Institution of Independent Directors" referred to in SEBI's Corporate Governance Committee Report.

- **Minimum Number of Independent Directors:** Kotak Committee has recommended that every listed entity, irrespective of whether the Chairperson is executive or non-executive, may be required to have at least half its total number of directors as Independent Directors ('IDs'). The Committee suggested that the recommendation would be applicable to Top 500 listed companies (by market capitalization) by April 1, 2019 and to the rest of listed companies by April 1, 2020. As per the provisions of Section 149(4) of the Companies Act, 2013, every listed public company shall have at least one-third of the total number of directors as IDs and the Central Government may prescribe, the minimum number of IDs in case of any class or classes of public companies. There is an apparent conflict in the provisions of Companies Act, 2013 and the recommendation by the Kotak Committee. Either the provisions of the Companies Act, 2013 would be required to be amended to that effect or SEBI may have to reject the suggestion. SEBI may partially consider the suggestion, whereby every listed entity, irrespective of whether the Chairperson is executive or non-executive, may be required to have at one-third (instead of atleast half) its total number of directors as IDs.

- **Eligibility Criteria for IDs:** In addition to the eligibility criteria prescribed in Section 149(6) of Companies Act, 2013, Kotak Committee recommends few more criteria for IDs of listed companies, which includes:

- Specifically exclude persons who constitute 'promoter group' of a listed entity;
- Requirement of an undertaking from the ID that such a director is not aware of any circumstance or situation, which exists or may be reasonably anticipated, that could impair or impact his/her ability to discharge his/her duties with objective independent judgements and without any external influence;
- Board to take on record the said undertaking after due assessment of veracity of such undertaking;
- Exclude "board inter-locks" arising due to common Non-Independent Directors on boards of listed entities.



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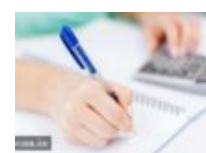
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With an intention to protect the IDs from being genuinely unaware of some pecuniary interest, the Committee has introduced a proposal of including such undertaking from the ID. Considering the proposed amendments through Companies (Amendment) Bill, 2017 (relating to 'pecuniary interest' u/s 149(6) of Cos. Act, 2013), the undertaking will further protect IDs. The Committee also recommends that the board of directors, as a part of the board evaluation process, may be required to certify every year that each of its IDs fulfils the conditions specified in the SEBI LODR Regulations and is independent of the management. This certification shifts the burden on the board of directors, in addition to IDs, w.r.t. 'independence' of IDs.

- **Minimum Compensation to IDs:** Committee suggests that, depending on the market capitalization, minimum total remuneration for IDs. The recommendation relates to the IDs remuneration where the listed entity has profits or has inadequate profits. The committee has recommended minimum sitting fees for IDs for the Board Meetings or Audit Committee Meetings or every other Board Committee Meeting. The Committee has made this suggestion with an objective to ensure that the risk-reward balance in compensation payable to IDs, would make it attractive for competent people to accept appointment as IDs. The Committee made this recommendation to ensure that the compensation paid should be commensurate to the value that the IDs deliver. However, in my view, the minimum total compensation should be linked to the profits of the listed company and not market capitalization as one of the factors of market capitalization is stock market price. The stock market price is subject to volatility and may not always justify the listed company's fundamentals. In the Kotak Committee Report, there is no reference of payment of remuneration in any other capacity (as prescribed under the proviso to Section 197(4) of the Cos. Act, 2013) to the IDs. However, the concept of linking the minimum total remuneration to the IDs with the risk involved in listed entity definitely deserves an appreciation.
- **Disclosures on Resignation of IDs:** Kotak Committee recommends that listed entities should be required to disclose detailed reasons for resignation of IDs (as provided by such IDs) along with the Notification of their resignation to the stock exchanges, as well as subsequently as part of the Corporate Governance Report. As part of such disclosure, the Listed Entity should include a confirmation as received from the director that there are no other material reasons other than those set out therein. In my view, the Committee is expecting a lot of disclosures and accountability on the resignation of IDs. Pursuant to the extant



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provisions of Section 168 of the Companies Act, 2013 (relating to 'resignation of directors'), a director shall also forward a copy of his resignation along with detailed reasons for the resignation to the Registrar of Companies within 30 days of resignation in prescribed manner. The Companies (Amendment) Bill, 2017 proposes to make this provision optional for all directors (not just IDs). However, the Kotak Committee Report makes it mandatory in case of resignation of IDs. In my view, the provisions ought to be more stringent for removal of IDs than resignation of IDs.

- **Directors & Officers ('D&O') Insurance for IDs:** Considering the risks involved in business and the liability of the IDs being at par with non-IDs, the Kotak Committee proposes mandatory D&O Insurance Policy for Top 500 Cos. (by Market Capitalization) for its IDs. The Committee suggests that the listed entity's board of directors may determine the quantum and type of risks covered under such insurance.
- **Induction & Training of IDs:** Kotak Committee proposes: (i) Mandatory formal induction for every new ID appointed to the board; and (ii) Formal training, whether external/internal, especially w.r.t. Governance aspects, for every ID once every 5 years. Considering the passing reference of training and induction to IDs in Companies Act, 2013 and SEBI's Listing Regulation, the Kotak Committee has rightly codified the induction and training for IDs. However, considering the cost involved, the proposal may affect listed companies that are loss making or companies with less profit margins. Such companies may consider it as a 'compliance cost' and not 'value addition'.
- **Alternate Directors for IDs:** Considering the fact that IDs are elected to the board for their skills, experience, acumen, network and objectivity and the presence of such IDs via video conferencing, Kotak Committee recommended that appointment of Alternate Director for ID should not be permitted. But the Companies Act, 2013, which is the primary legislation, does not make any such exception for alternate director. In fact, Section 161(2) of the Companies Act, 2013 provides that no person shall be appointed as an alternate director for an ID unless he is qualified to be appointed as an ID. If the recommendation is accepted, there would be an apparent conflict in the provisions of Cos. Act, 2013 and the SEBI Regulations.
- **Lead ID in Cos. with Non-independent Chairperson:** Taking into consideration the globally recognized practice of appointing a Lead ID in the cos., Kotak Committee has proposed the concept of 'Lead ID'. As per the recommendation, the Lead ID is expected to assist in co-ordinating

the activities and decisions of the other non-executive and/or IDs to chair the meetings of the IDs. The position of Lead ID becomes crucial where the Chairperson is non-independent. It will be interesting to see the codification of the recommendations and then its implementation. However, the accountability and answerability of that Lead ID will be quite high, as compared to the other IDs.

- **IDs' Exclusive Meeting & Casual vacancy of IDs:** Kotak Committee has recommended that exclusive meetings of IDs may be held more than once at the discretion of the IDs. W.r.t. filling up of casual vacancy of any ID, the Committee recommends that such appointment shall be approved by the shareholders at the next general meeting.

Conclusion: Considering the extant provisions of the Companies Act and SEBI's Listing Regulations, the Kotak Committee has made some exceptional recommendations w.r.t. the Independent Directors for listed entity. Taking into consideration the above discussion, there would be an apparent conflict of the provisions in the Companies Act, 2013 and codification of Committee's recommendation. In such a case, the Ministry of Corporate Affairs would be required to make corresponding amendments in the Companies Act, 2013 or the Rules framed there under.

Gaurav N. Pingle is a Practising Company Secretary from Pune. He handles various assignments of Secretarial Audits, Due Diligence, Quarterly compliance audit of listed companies, routine compliance (under Companies Act & FEMA) for private companies, wholly owned subsidiaries, joint venture companies. As an Author, he religiously writes articles

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