

The IDentity Crisis
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Mumbai

SUMMARY OF DISCUSSIONS

Backgrounder

In recent times, there has been no bigger mismatch between expectations and reality as in the case of Independent Directors (IDs) on Corporate Boards. The statute and the stakeholders alike, seem to pin considerable faith on IDs to guide the corporate entity to perform in a manner consistent with the interest of all stakeholders. Lacking in domain familiarity and in legal and accounting knowledge, many IDs are ill-equipped to do any justice to their role. The law does not provide adequate protection to this category of persons who are part-time non-executive presences in Boardrooms, and have very little interaction with management outside of Boardrooms. The figleaf of protection, that Section 149(12) of the Companies Act, 2013 (the Act) appears to provide, is considerably diluted, both by being limited to alleged offences under the Companies Act, 2013 and even more by the words “where he had not acted diligently”. In an atmosphere, in which failures are treated as akin to misdeeds, even a whisper that a person had not acted diligently could help to build up the case against him. When bonafide errors in decision-making are treated as ab initio mala fide decisions, an ID cannot be blamed for seeking to protect himself/ herself by not associating with any management decision. The logical outcome of such a safety-first approach by IDs would be that management proposals would get blocked or at least dissented from. There is no doubt that such a situation would harm the corporate entity considerably.

IDs need to be enabled, encouraged and empowered to match upto the expectations of the stakeholders. At same time there must be a mechanism which protects honest decision-making in Boardrooms and does not expose such Directors, in the winter of their lives, to investigations and prosecution.

Objective of Discussions

1. Need to strengthen the institution of IDs –
 - How can IDs be made more relevant to Boardrooms? There is a lot of criticism of IDs. There is a need to improve their performance as also the perception of their performance.
2. Protection of IDs from baseless charges -
 - What should IDs do when they are held responsible for executive action without being a part of it? Increasingly, IDs are being thought of guilty until proven otherwise.

DISCUSSIONS

- Governance is not the remit of the Board alone.
 - However, in case of an adverse development, the Board, especially IDs, are among the first to be questioned.
- Good quality IDs join only the Boards of companies that they are comfortable with. Their diligence before joining a Board includes considering the governance standard of the company.
 - However, governance standard of most companies in India is poor. While good IDs may be reluctant to join such Boards, these are the companies that require good quality IDs. As a result, majority of the Boards in India have sub-optimal quality of IDs.
- There are enough laws for companies and IDs. However, the effectiveness of an ID ultimately depends on her taking ownership of her role.
 - The level of preparedness of an ID for a meeting and the quality of deliberations cannot be legislated for. They flow from the commitment of the ID.

- With IDs getting legal notices (including for criminal charges) for companies on whose Boards they are or have been, it is tough for them to fight legal cases. This could *inter alia* be because
 - The process of law is very time-taking.
 - With a legal notice becoming public knowledge, the reputation gets adversely impacted immediately.
 - Cost of legal battles is prohibitive, and some IDs do not have the resources to meet them in their individual capacity.
- While some IDs feel that legal notices etc. are occupational hazards, and law will be fair in the end, not all IDs agree.
- Going forward, in an environment of distrust of IDs, it may be difficult for companies to get good IDs.

Role of IDs

- There is no clarity on role of IDs, and different stakeholders and regulators interpret the role differently.
- With continuous evolution of the institution of IDs, the role too seems to be a moving target.
- While Executive Directors (EDs) have a clearly defined role, role of IDs is often vague. However, the accountability of IDs often seems to be higher than that of EDs.
 - This is despite the fact that there is asymmetry of information between EDs and Non-Executive Directors (NEDs), wherein lesser information reaches NEDs, and often they are expected to take a decision quickly on the basis of the limited and last-minute information that they receive.
- Directors are an interface between the owners (including shareholders) and the management, with the management acting on the behalf of the owners. However, it may not always be possible for IDs to perform their role to the satisfaction of all the stakeholders (and not just the owners).
 - Due importance however should be given to their intent and objective.
- IDs should definitely not get into operational details which is under the ambit of the management.
 - It would be helpful if there is role clarity for IDs so that every stakeholder, including IDs themselves, are aware of the expectation from them.
 - Even though promoters get diluted in the business, it is not always backed by emotional dilution from the business. This may sometimes result in them trying to take decisions through management. On such occasions, the role of IDs definitely includes protecting the interest of minority shareholders.
- At present, the understanding of the role of IDs by different stakeholders, including judiciary and media, is very little. Different regulators too interpret their role differently.
 - This is primarily because they do not understand what happens in Boardrooms.
 - There is an urgent need to educate media, especially on the role of IDs, since they play an important role in forming public perception of a company and/or its Directors and management.
 - The judiciary too needs to be made aware of the role of IDs.
- IDs should ensure that there is a proper process, which is objective, for each decision.
 - While there would be some discretion while arriving at a decision, a wrong decision is often not taken as a bad business decision, but one with a negative intent, and hence it is important to have a proper objective process in place.
- Decisions of the Board/ IDs should be based on the information provided to them by the management. In the process, IDs should exercise due diligence.
- IDs are thought to be investigative agents in the Boardroom, which is far from the truth.
 - If things are running smoothly in a company, they are not to assume a problem. Unnecessary or incessant questions from IDs can stall the work of management.
- One of the questions that is often asked in Board evaluation is whether there is sufficient/ adequate distance between the IDs and management, to check the independence of the IDs from the management.

- However, in case of legal action against a company, judiciary and investigative agencies assume that IDs are aware of all executive actions etc., which is often untrue.
- At times, law, however, makes IDs responsible for executive action, which is not correct.
 - Audit committees have to approve related party transactions (RPTs). This is an executive action.
 - In banking sector, IDs form a part of the committee that sanctions loans, which is an executive action.
 - Even though there would be notes for each case by the management, the final decision to grant a loan has some degree of discretion. Among factors to be considered include outlook of the industry etc. which is subjective.
 - Post the granting of the loan, the decision of granting the loan comes to the Board for noting.
 - In case a loan converts into a non-performing asset (NPA), the ID, and in turn the Board (at times), is held responsible, even if she followed the proper process that has been laid down.
- In the US, large institutional investors have got together and listed some principles and rules on governance, and in turn the role of IDs and the Board, that they want the companies to follow.

Information to Directors

- There is asymmetry of information to IDs. However, IDs should not either ask for no information or too much information. They should not stall the work of management.
- If agenda notes for important decisions are tabled, IDs should not blindly agree with management. They have the right to postpone the item so that they can read the notes, seek clarifications, if any, before discussing it in the Boardroom.
 - IDs should push back if agenda notes are not circulated in time, especially where important decisions are sought.
 - For circular resolutions too they can push back and ask for them to be included in the agenda for the meeting, unless they are non-postponable items.
 - Some companies also seek the permission of the Chairperson before sending an item for approval by circular resolution or for tabled items.
- While IDs should not enter into executive action, at times it could be tough to determine to what extent they should deep dive.
 - If management has followed due process and procedure before preparing agenda notes, IDs should not seek to second guess them by revisiting the procedure already followed by the management.
- In some cases, management may not always be happy to provide additional information.
- IDs should ensure that the information given to them is correct and truthful. If the information itself is not truthful, then no matter how good the processes are, they would yield sub-optimal or even wrong results.
- IDs should also interact with management in between meetings to keep themselves upto date about the company.

Law – The Companies Act, 2013

- The Act has attempted to incorporate a number of provisions relating to Boards and IDs through defining the role of IDs in Schedule IV of the Act and providing them protection through Section 149(12) of the Act. But a number of provisions are kneejerk responses and subjective in their interpretation.
- The Act is relatively new, and subject to continuing changes, and hence is still being interpreted.
 - The interpretation of the Act is different across the Tribunal, the Courts, different regulators etc. since each of them sees it from their lens, thereby causing uncertainty.

- There has been a lot of transmission loss between the writing, interpreting and implementing of some of the provisions of the Act.
- India does not have good case laws on Corporate Governance on the basis of which judges can base their decisions.
 - Internationally, an ID is assumed to have acted diligently and with care, and this assumption is rebuttable. However, in India, increasingly, an ID is assumed to be guilty and not diligent, unless proven otherwise.
 - There is little understanding of what happens inside a Boardroom, and therefore those outside seem to think that those inside are having a good time.

Section 149(12) of the Act

- Protection under Section 149(12) of the Act is limited as
 - It provides limited protection and that too for offences under the Companies Act, 2013 alone.
 - It is hugely subjective and relies on the interpretation of the officer dealing with the case.
- According to this section, an ID can be held guilty if she has not acted diligently.
 - However, it is for the investigative officer to decide, in hindsight, whether the ID was diligent or not.
 - Further, IDs can act diligently only if correct and complete facts are provided to them. However, on several occasions, managements may not provide complete facts to the IDs. IDs do however have a right to ask for additional information.
- According to this section, IDs are held responsible for what they get to know through Board processes.
 - In case an ID is held responsible for what she “ought to know”, and not what she “gets to know”, the scope will be very wide and can result in varied interpretations.
 - If the law, as currently stated, limits it to gets to know, an ID will be responsible for all the information that she “gets to know”, even if she does not attend a meeting of the Board and/or committee(s).

Screening of cases against IDs

- There should be a mechanism through which, before an ID gets a legal notice, the case should be screened to assess the role of ID, if any.
 - This will prevent unnecessary harassment of IDs.
- This should preferably be done by some senior person(s).

Directors & Officers Liability Insurance Policy (D&O Policy)

- While a number of companies have taken D&O policies, the quantum, scope and exclusions of the policy are important.
 - It should specifically cover the cost of litigation(s).
 - As the quality of governance in a company improves, the premium goes down.
- Fraud is one of the major exclusions in most policies.
 - However, post the Satyam scam, some companies have negotiated with insurance providers to include any cases that are ongoing, and the policy covers the expense, including litigation, on the assumption that the alleged fraud did not happen.
 - In case, the ruling is against the company, the policy then provides for the cost to be recovered from the company and/or directors.
- Some policies now make Directors co-insured. By paying a part of the premium, Directors too are specifically covered under the policy.
- Some bodies like Indian Banks’ Association (IBA) too are coming up with possible inclusions to such a policy which are focussing on sector specific requirements.

Agenda of Meeting

- There is a need to improve the quality of agenda and agenda notes.

- Increasingly, Directors too are suggesting agenda items.
- IDs should push back on tabled items/ agenda notes.
- At the end of each meeting, there is a need to ensure that the final set of agenda, along with agenda notes, updated in all respect, is stored in a format (such as in digi-locker) that does not allow it to be tampered with and assures retention for a long period.
 - The access to such folders should be restricted, to avoid tampering, but should be provided to Board members.
 - This is currently not done by a number of companies, and hence records may not always be updated, or be possible to retrieve.
 - Internal Audit could add this to their scope at least once in 2 years. Alternatively, if the quality of secretarial audit improves, they could probably add this to their scope.
 - Technology can be used to ensure that documents are saved properly, with access control, and can be easily retrieved when required.

Minutes of Meeting

- Many Company Secretaries do not know how to write proper minutes. They should capture the flavour of the discussions. Minutes should neither just be a record of decisions nor a complete transcript of the meeting. The focus of the minutes should be on transparency in recording.
- With draft minutes being circulated within 15 days of a meeting, IDs should send their comments, to *inter alia* show that they exercised their mind.
 - A number of IDs, citing limitation of time, do not send their comments on draft minutes. However, they need not send their comments on each item, but may confine their comments to specific points in the minutes.
- In case an ID feels strongly about an item, she should ensure that her dissent is recorded in the minutes. It does not make her an enemy of the Board.
 - At the same time, an ID should not dissent on every agenda item, thereby making it impossible for business to be conducted. A Board should function as a functional collective unit. Dissent should be used sparingly, and as a last resort.
 - The Act gives the powers to the Chairperson of the Board to decide the final contents of the minutes. In case she chooses to ignore the dissent, the ID has the right to write to the Chairperson about her dissent, or mention the same in a mail to the Company Secretary, so that she has a record of the dissent.
 - A dissent should not necessarily imply an intention to resign. Directors are expected to deliberate on agenda items, and it is natural for different points of view to emerge. The difference could be a difference in judgement, and not backed by wrong intention.
- While minutes are a record of what transpired in a meeting, it can never capture all the aspects of a meeting. There have been instances when IDs, several years after a meeting, have been questioned by investigating officers, on some comment of theirs on an agenda item, and it is impossible for the ID to recollect what was discussed.
- Documentation and retrievability of the documents is very important.

Induction/ Orientation/ Familiarisation Programmes

- There is a need for a planned induction and/or training programmes for IDs.
 - These should not focus on the business alone.
- Such programmes should include
 - Details about the company, and its business
 - Role as NEDs – After superannuating from executive roles, most persons become NEDs. They need to be reoriented towards the change in the role.
 - Basic information on common topics such as finances, law etc. which will help them perform better as NEDs.

- These programmes should not be one time, and could be a pre-condition for a Director's continuing on a Board.
- However, these should preferably be provided by the company and not an agency which does not understand the role of the Board and the Directors.

Role of Chairperson

- The Chairperson of the Board plays a very important role.
- The deliberations of the Board, involvement of IDs etc depends on her leadership style.

Role of Nomination and Remuneration Committee (NRC)

- NRC has a very important role in the selection of Directors and the composition of the Board and the committees.
 - To make a Board/ IDs more relevant to the needs of a company, the starting point is the composition of the Board.
- At the time of induction, it is important to specify the expectation of the Board to the ID.
 - In case an ID brings a certain functional expertise to the Board, she should be made a member of the relevant committee of the Board so that the Board can benefit from her expertise.
- NRC also has a big role in succession planning.
 - This role however is currently being performed sub-optimally in most companies.

Resignation of IDs

- Dissent in a Boardroom is natural, but a dissent need not make an ID quit.
- Resigning from the position of an ID should be the last option that an ID should exercise only if she is not comfortable with the processes being followed, or with the intention of the promoter or the senior management.

Forum for IDs

- IDs need a forum which can serve as an advocacy forum for their common concerns since a collective voice is always better than an individual voice.
- It could also be a forum where IDs can help one another, especially, if the ID is facing a legal problem.

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Given that our founder, Mr. M. Damodaran, introduced Clause 49 of the Listing Agreement, dealing with corporate governance in India, and has been a part of both public sector and private sector Boards, as well as performing and underperforming Boards, we offer experience based consultancy and courses on the journey from compliance through governance to performance. Further, given his success in turning around organisations that had been written off, we are uniquely positioned to offer courses on leadership, organisational transformation, and building winning teams.

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