

Request for comment: Additional criteria for (Re)Appointment of Independent Directors

In the annual review of its Voting Guidelines, IiAS is considering changing the way it will vote on the (re)appointments of Independent Directors. We propose to add three new elements to our criteria.

We believe Independent Directors perform a crucial role in setting the governance landscape for corporate India. Independent Directors provide the required guidance, help test the robustness of the business strategy, and when needed, push-back and set accountability for controlling shareholders, often protecting companies from their promoters. Because most of this happens behind closed doors, it is not sufficiently recognized. If one were to put it in context, most listed companies in India do not have governance failures, only a few do.

Recent corporate failures have had an underlying thread of board failures, especially in the context of monitoring and controlling related party transactions. Such corporate failures have resulted in significant wealth destruction for shareholders, and debt defaults for lenders.

In this context, IiAS is reviewing its criteria to (re)appoint independent directors. With increased market expectation from independent directors, IiAS proposes to add the following three elements to its assessment while recommending how shareholders must vote on independent director (re)appointments:

1. Past failures

We propose to vote against candidates who have been part of two or more board failures. Multiple failures in the past provide a reasonable trend for IiAS to conclude that the candidate is unable to discharge their fiduciary responsibility. Here, when we look at corporate failures, we assess only those failures where we believe corporate governance practices were weak – not failures on account of any business or operating risk.

There are several challenges in implementing this criterion. For one, there is no cogent database of board failures, therefore, to recall past performance will mean relying on our institutional memory. Second, whether the corporate failure is a function of poor corporate governance practices can be arguable – to this extent, IiAS will rely on what it considers corporate governance failures. Third, for a particular candidate, it may well be a series of unfortunate events (or board positions).

To this extent, it is likely that our implementation of this subjective criteria may not be consistent. Yet, we believe it is time for investors to provide push-back to independent directors with respect to performance and discharge of fiduciary responsibilities.

2. Past family relationships with the controlling shareholder

In limiting the tenure of independent directors to a maximum of 10 years (2 terms of five years each), the Companies Act 2013 has compelled board refreshment. Companies have begun doing this in a staggered manner, to ensure that by 2024, there are no tenured independent directors¹. Some companies, however, in the garb of rotating independent directors, have appointed family members (siblings or progeny) of the same tenured independent directors. We are sometimes hard-pressed to argue the competence and skills of such family relatives – they could well be equally, if not more, competent than the tenured independent director. It is also likely that the siblings or progeny may have an independent opinion on decisions that may not align with the previous tenured independent director. Even so, we raise concern over whether the board followed an objective process in appointing these family members. The act of appointing family members of tenured independent directors suggests that the board strives to maintain its cozy relationships, which is contrary to the rationale of board churn.

IiAS has been voting against independent directors that have had a long association (of over a decade) with companies within a group. We now propose to extend the association to family members of independent directors. Therefore, IiAS will recommend voting against family members of tenured independent directors, unless the board is able to provide cohesive disclosure on the process it followed (including – but not limited to – the number of candidates considered and the pool from which candidates were sourced), and the criteria used to select such candidates. Alternatively, IiAS may consider supporting the candidature of family members of tenured independent directors if there is at least a three-year cooling period between the retirement of the independent director and the appointment of another family member.

3. Over-boarding

At this stage, IiAS is following the regulatory thresholds for over-boarding: not more than 3 boards as independent directors for whole-time directors and not more than 7 for those that are not whole-time directors. Those holding

¹ Tenured Independent Directors are those with a tenure of over 10 years on the same board.

full time jobs (examples: partners in consulting firms, law firms, audit firms), who are not classified as whole-time directors under Companies Act 2013, however, continue to hold positions of an independent director in upto 7 boards. Although this is legally permissible, we believe it defeats the purpose of the regulation: where individuals have full-time jobs, they have a greater limitation on their ability to devote time to board directorships. To this extent, IiAS limits the number of boards that an individual holding a full-time role can hold to three.

IiAS recognizes that for those that are self-employed, the intensity of their individual businesses may differ – but this is difficult to gauge or assess. To this extent, if the board believes the director will be able to devote sufficient time, despite running a business, it must articulate this in the shareholder notice along with the basis of arriving at such a conclusion.

The changes highlighted above are being proposed considering the current trends visible in corporate India today. Our voting guidelines will continue to evolve as market practices change, and we will continue to raise the bar on expectations of corporate governance from Indian listed companies.

We welcome feedback on the proposed changes (on any or all of the three listed above) from all market participants. Please write to hetal.dalal@iias.in with your feedback on these proposed changes on or before 5 March 2021.