SEBI’s Announcement on Independent Directors

Why in news?

SEBI (Securities and Exchange Board of India) has backtracked on its earlier proposal of “dual approval” system in appointing independent directors.

Who are independent directors?

- Positions of independent directors were created in corporate boards to address corporate frauds and mis-governance issues.
- An Independent director is a non-executive director.
- S/he does not have any kind of relationship, material or financial, with the company.
- Independent directors are to ensure the independence of decisions taken in matters related with the board.
- A larger say for independent directors was believed to have an effective deterrent to fraud, mismanagement, and mis-governance.

How are independent directors appointed?

- An independent nomination and remuneration committee of the board screens candidates for independent directorships.
- But independent directors are appointed just like other directors through shareholder voting by a simple majority.
- In case of family-owned companies, it is common to appoint “friendly” independent directors.
- **Concerns** - The process for appointment and removal of independent directors is by far the most important determinant of allegiance.
- Shareholder voting by a simple majorityconfers significant power in the hands of significant shareholders to handpick the independents.
- So, independent directors owe their allegiance merely to the promoters and not to the shareholder body as a whole.
- As for public sector undertakings, a study reveals a demonstrable affiliation between independent directors and the ruling political power.

What was SEBI’s dual approval system in this regard?

- The SEBI, in March 2021, in its consultation paper,proposed a “dual approval” system.

- Under this, the appointment of an independent director required the satisfaction of two conditions:
    1. the approval by a majority of all shareholders
    2. the approval of a "majority of the minority", namely the approval of shareholders other than the promoters
- In case of a failure to satisfy the two-step test, the company would be free to propose the same candidate after a 90-day cooling off period.
- It should go for approval by a special resolution (75% majority) of all shareholders voting.
- SEBI recommended the same "dual approval" system for the removal of independent directors as well.
- The dual approval system draws inspiration from Israel and the premium-listed segment of the United Kingdom.
- They confer greater power to minority shareholders in installing or dethroning independent directors.

What is the recent announcement?

- SEBI announced that the appointment and removal of independent directors would be by way of a special resolution rather than a simple majority.
- It made no mention of the dual voting system.
- By this, SEBI has clearly backtracked from its earlier proposal.
- It deprived the minority shareholders of the level of say it had extended earlier.
- In all, the appointment and removal system continues to undermine the independence and efficacy of corporate boards.

Source: The Indian Express