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Analysing developments impacting business

EASING OF COMPLIANCES FOR INDEPENDENT DIRECTORS: ADDITIONAL BUFFER PERIOD AND RESTORED CATEGORY

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INTRODUCTION

The role of an independent director (**ID**), amongst others, is to uphold ethical standards of integrity and probity, act objectively while exercising his / her fiduciary duties, and exercise responsibilities in a *bona fide* manner in the interests of the company. Under the Companies Act, 2013 (**Act**), IDs are required to possess appropriate skills, experience, and knowledge in one or more fields of finance, law, management, corporate governance, or other disciplines related to the company's business.

With the intention to bring the right balance of independence and competence and to facilitate companies in their search for the 'right fit' ID, the Ministry of Corporate Affairs (**MCA**) on 22 October 2019 notified the Companies (Appointment and Qualification of Directors) Fifth Amendment Rules, 2019 (**Appointment Rules**) and the Companies (Creation and Maintenance of databank of Independent Directors) Rules, 2019 (**Databank Rules**). The Appointment Rules and the Databank Rules, *inter alia*, were aimed to facilitate setting up of an online database of skilled IDs (presently known as the Independent Director's Databank) who are eligible and willing to be appointed as IDs.

The Independent Director's Databank is managed by the Indian Institute of Corporate Affairs (**IICA**) under the aegis of the MCA. An important criterion for inclusion in the Independent Director's Databank is the requirement for every ID to have appeared for and passed an online proficiency self-assessment test (**Proficiency Test**) by securing at least in aggregate 50% of the marks, within a period of 2 years from the date of on which the ID has registered with the Independent Director's Databank.

Further, per Rule 6(1) of the Appointment Rules, IDs (whether already elected or aspiring) are required to apply (along with the prescribed fee) to the IICA for inclusion of their names in the Independent Director's Databank maintained by IICA for a period of 1 year, 5 years, or lifetime. As such, inclusion of the ID's name in the Independent Director's Databank is a pre-requisite for appointment as an ID and appropriate declarations are required to be given by every ID each financial year affirming adherence to the Appointment Rules.

Subsequently, by way of amendments to the Appointment Rules, the MCA has been progressively easing the applicability of the Proficiency Test to several categories of individuals. For example, persons who have served as a director or key managerial person for at least 3 years in a listed company, or in an unlisted public company having a paid-up share capital of INR 10 crore or more, or a body corporate incorporated outside India and having a paid-up share capital of USD 2 million or more are specifically exempted from taking the Proficiency Test. Additionally, advocates, chartered accountants, cost

accountants, and company secretaries having at least 10 years of practice are exempted from appearing for the Proficiency Test.

In furtherance of providing relief to aspiring IDs, the MCA has, on 10 June 2022, notified amendments to Rule 6 of the Appointment Rules vide the Companies (Appointment and Qualification of Directors) Second Amendment, Rules, 2022 (**Amendment**). The Amendment allows an opportunity for name restoration to those IDs who are unable to clear the Proficiency Test within the specified time of 2 years and, are consequently removed from the databank.

ANALYSIS

The Amendment inserts a new sub-rule (5) to Rule 6 of the Appointment Rules which allows any ID whose name has been removed from the Independent Director's Databank to apply for restoration of his / her name on payment of INR 1,000 and the IICA shall allow for such restoration, subject to conditions discussed below.

The conditions include moving the ID's name in a separate restored category for 1 year from the date of restoration within which, the ID would be required to pass the Proficiency Test with at least 50% of the marks in aggregate. Thereafter, upon clearing the Proficiency Test, the name of such ID will be included in the Independent Director's Databank and the fees paid by the ID at the time of initial registration shall continue to be valid for the period for which it was initially paid.

In the event such ID fails to pass the Proficiency Test within 1 year from the date of restoration, his / her name will be removed from the Independent Director's Databank, and he / she would be required to apply afresh for inclusion of his / her name in accordance with Rule 6(1) of the Appointment Rules.

COMMENTS

The additional timeline for clearing the Proficiency Test will largely benefit those IDs who are not able to clear the Proficiency Test within the specified timeline of 2 years for various reasons (including general lapse of time). The Amendment is a welcome move as it provides relief to IDs allowing them an additional year to prepare and qualify the Proficiency Test.

However, similar to the move of progressively exempting categories of persons for appearing for such Proficiency Test, this exemption may also be subject to industry critique. Given the critical role of IDs in steering and monitoring companies in an objective and transparent manner, it is imperative that IDs possess requisite skills and competencies that would enable them to fulfil their fiduciary duties. Qualifying as an ID by passing the Proficiency Test therefore, generally speaking, acts as a minimum benchmark allowing companies to exercise due diligence while selecting IDs and in assessing basic skills and knowledge.

Aspiring IDs should accordingly, view this as an additional relaxation and a welcome step that will allow them to upskill and in turn, create a larger pool of capable individuals and contribute to board effectiveness.

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