

Business Standard

ICICI-Chanda clawback case is likely to end up being challenged in court

The provision isn't part of legal statute in India, making it vulnerable to legal challenge

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On January 30, the board of ICICI Bank stirred up a hornet's nest by

Illustration by Ajay Mohanty

announcing it would claw back all the bonuses and stock options given to former Chief Executive Officer (CEO) and Managing Director (MD) Chanda Kochhar between April 2009 and March 2018. This followed a report by a probe panel headed by former Supreme Court judge B N Srikrishna that indicted Kochhar for violation of the bank's Code of Conduct in the Videocon loan case.

The rarely used clause in the employment agreement has left legal experts and HR executives divided on whether the bank's board has gone overboard and on the challenges in the implementation of these provisions.

"This is probably one-of-a-kind or a unique situation," says K Sudarshan, managing partner, India, EMA Partners International. Till now, following a breach in the employment contract, there have been instances of companies claiming back joining bonus, or amounts spent on training and development of a senior executive, say HR experts.

Experts point out enforcing clawback provision in an employment contract is open to legal challenge once invoked. “The question will be whether it will pass legal scrutiny and the process of recovery itself,” says Sudarshan.

According to Vikram Shroff, partner at law firm Nishith Desai Associates, a clawback provision, similar to Section 304 of the Sarbanes-Oxley Act in the US, does not exist under Indian corporate or labour laws. “Accordingly, it is necessary for employers to include such provisions in the individual employment contract or in the bonus and incentive plans, as applicable,” he says.

Section 304 of the Sarbanes-Oxley Act — popularly known as the ‘clawback provision’ — allows the US Securities and Exchange Commission (SEC) to impose severe financial penalties on a CEO and a chief financial officer if the company’s financial statements have been materially inaccurate.

Though the provision does not exist under Indian statute, clawback clauses have been part of employment agreements in the banking and financial services sector for many years, say HR experts. Of late, these provisions have started appearing for sales functions in information technology companies, points out Atul Gupta, a partner at Trilegal, a law firm.

“In principle, clawback provisions should be extended to key managerial personnel,” says Shroff. HR experts agree that this will ensure better accountability among key management personnel (KMP) in any company. The Indian accounting standards define key managerial personnel as those who have the authority and the responsibility for planning, directing and controlling the activities of a company.

The Reserve Bank of India (RBI) guidelines say banks and financial institutions should put in place appropriate modalities to incorporate the clawback mechanism in respect of variable pay. These guidelines by the RBI were a “reaction to the global financial crisis and aimed at creating accountability amongst senior management for their decisions and to prevent excessive risk-taking and misconduct,” says Ronesh Puri, managing director at Executive Access.

Puri points out the time period for claiming the refund by an organisation has to be reasonable; otherwise, this could be challenged as a violation of the Indian Contract Act.

“From a legal standpoint, organisations are not permitted to make deductions from guaranteed components of 'wages' for lower paid employees, except in very limited circumstances,” says Gupta. However, in the case of C-suite executives, banks and other financial institutions can exercise greater control and flexibility when it comes to structuring the terms and conditions around discretionary incentives, conditional bonuses, and stock options, he adds.

For instance, in its compensation policy for board members, ICICI Bank has specified a clawback provision, which says that the employees covered under this “will agree to return the previously paid variable pay to the Bank, in event of an enquiry determining gross negligence or integrity breach”.

Most experts believe that the ICICI Bank-Chanda Kochhar clawback case is likely to end up being challenged in the court. “A lot depends on framing of the clause and whether a correlation is established and the proof of it,” says Puri.

“Given her senior position... her rights would largely depend on the policies and contractual terms that ICICI has in place with her, and the approach and findings of the report based on which this action was taken,” adds Gupta.

In the contract, but now in Law

- What does Section 304 of the Sarbanes-Oxley Act, a US law, say
- Authorises the SEC to seek clawback performance-based compensation paid to CEOs, CFOs
- The SEC can seek clawback if financial statements were a “result of misconduct”

The legal lacunae

- Vulnerable to legal challenge as clawback clause is not part of any legal statute in India

ICICI Banks's compensation policy on malus and clawback

- Compensation aligned to financial and non-financial indicators of performance
- Gross negligence and integrity breach are under the compensation policy. Errors of judgment aren't
- The bank will prevent vesting of all or part of variable pay in event of an enquiry
- If reasonable evidence of deterioration in financial performance found, the bank committee may decide on how to apply malus
- Employees will be required to sign clawback agreements for variable pay
- In clawback arrangement, the employee will return previously paid variable pay if enquiry determines integrity breach