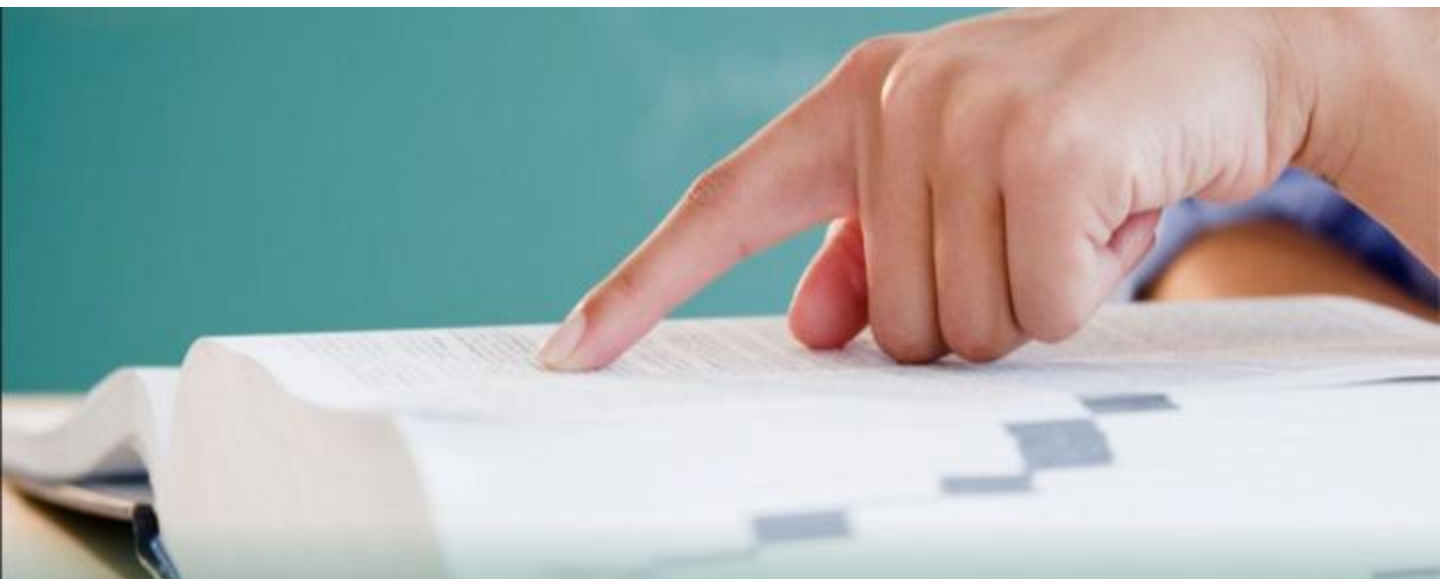


SEBI's amendments to corporate governance norms

22 April 2014



First Notes on:

Financial Reporting
Corporate law updates
Regulatory and Other Information
Disclosures

Sector:

All
Banking and Insurance
Information, Communication, Entertainment
Consumer and Industrial Markets
Infrastructure and Government

Relevant to:

All
Audit committee
CFO
Others

Transition:

Immediately
Within the next 3 months
Post 3 months but within 6 months
Post 6 months

The Securities and Exchange Board of India (SEBI) with the objective to align its provisions to the recently notified provisions of the Companies Act, 2013, ('the Act') has specifically reviewed clause 49 of the Listing Agreement, to adopt leading industry practices on corporate governance and to make the corporate governance framework more effective.

The revised clause 49 on corporate governance shall be applicable to all listed companies with effect from 1 October 2014, except for the clause relating to the constitution of a Risk Management Committee which shall apply to the top 100 listed companies by market capitalisation, as at the end of the immediate previous financial year.

The revised corporate governance norms make sweeping changes in the corporate governance environment in India. In this note, we focus on two aspects – differences between the revised norms and the existing norms and the differences compared to the Companies Act, 2013.

A. Significant differences between the revised norms and currently applicable norms

Clause 49(I) on Corporate Governance

This is a new clause which lays down the objectives of the principles sought to be achieved by the revised norms. It lays down the rights of the shareholders, role of other stakeholders, disclosure and transparency on all material matters and the responsibilities of the Board. The clause mentions that in case of any ambiguity in the provisions of the various clauses, they shall be interpreted and applied in alignment with the principles under aforementioned heads.

Clause 49(IIA) on Board Composition

There is no significant change in the requirement except for the requirement related to having at least one woman director on the Board, which has been included.

Clause 49(IIB) on Independent Directors

The expression 'Independent Director' has now been aligned with the Companies Act, 2013, and the current requirements relating to them not being a material supplier, service provider and former auditor, legal firm, company secretaries etc. has been retained.

In terms of limit on directorship, the new requirement states that a person cannot serve as an Independent Director in more than seven listed companies and if such person is a whole time director in any listed company, then the limit on independent directorships gets reduced to three listed companies.

The maximum tenure of Independent Directors is capped at two terms of five consecutive years. However, if a person who has already served as an Independent Director for five years or more on 1 October 2014, such person shall be eligible for appointment for a term of five years only. Cooling off period of three years has also been prescribed.

The requirements related to issuing a formal letter of appointment, performance evaluation, conducting at least one separate meeting of the Independent Directors each year and providing suitable training to them, arising from the requirements of the Act have now been included in the revised norms.

Clause 49(IIC) on Non-executive Directors Compensation

There is no significant change in the requirement except that the requirement relating to Independent Directors not being entitled to any stock option, as required under the Act, has been included.

Clause 49(IID) on Other Provisions as to Board and Committees

The Board shall meet at least four times a year, with a maximum time gap of 120 days between two meetings as compared to 90 days earlier. With respect to filling the position of an Independent Director who has been removed or has resigned, the time limit in the old corporate governance code as well as the Act was 180 days. This has now been truncated to either three months (90 days) or the immediate next Board meeting (maximum 120 days). However, this would not apply, if the Board already has the requisite number of Independent Directors.

The Board would need to satisfy themselves that plans are in place for orderly succession for appointments to the Board and senior management.

The other limits on the Committees and chairmanship continues in line with the existing norms.

Clause 49(IIE) on Code of Conduct

The revised corporate governance norms requires incorporation of duties of Independent Directors from schedule IV of the Act within

the overall code of conduct for Board members and senior management. There is no other significant change.

Clause 49(IIF) on Whistle Blower Policy

This is a new requirement under the revised corporate governance norms. It incorporates requirements for whistle blower policy from the Act.

Clause 49(III) on Audit Committee

The requirements in relation to constitution of the Committee, the meetings and powers of the Audit Committee are in line with the existing norms, except that the role of Audit Committee under the revised norms also incorporate additional matters from the Act such as reviewing and monitoring auditor independence etc., approval of transactions with related parties, scrutiny of inter corporate loans, valuations and evaluation of internal financial controls and risk management systems.

Clause 49(IV) on Nominations and Remuneration Committee (NRC)

The revised norms require listed companies to constitute a NRC. This is consistent with the requirements under the Act. It requires the chairman of the NRC to be independent.

The remit of the NRC is wider than stated in the Act.

Clause 49(V) on Subsidiary Companies

The revised norms also requires the Board of the listed company to exercise significant oversight over the activities being undertaken by material subsidiaries (i.e. a subsidiary whose income or net worth exceeds 20 per cent of the consolidated income or net worth respectively, of the listed holding company and its subsidiaries).

It also mentions that a company cannot dispose shares in a material subsidiary or cease to control it, without passing a special resolution in the general meeting. Further, prior approval by special resolution would be required to sell, dispose and lease more than twenty per cent of the assets of the material subsidiary.

Clause 49(VI) on Risk Management

The revised norms widen the requirements for risk management. It requires the Board to be responsible for framing, implementing and monitoring the risk management plan for the company.

Clause 49(VII) on Related Party Transactions

Under the revised norms, a related party transaction (RPT) includes transaction whether or not a price is charged. Related parties include, besides covering the requirements of the Companies Act 2013 and AS 18, additional relationships – for example, person that has a joint control or significant influence on the company and fellow joint ventures and associates.

The revised norms require all RPTs to be pre-approved by the Audit Committee. Also, it requires approval of all material RPTs by shareholders through special resolution with related parties abstaining from voting. A transaction is considered material if the transaction/transactions to be entered into individually or taken together with previous transactions during a financial year, exceeds five percent of the annual turnover or twenty percent of the net worth of the company as per the last audited financial statements of the company, whichever is higher.

This clause shall be applicable to all prospective transactions. All existing material related party contracts or arrangements which are likely to continue beyond 31 March 2015 shall be placed for approval of the shareholders in the first general meeting subsequent to 1 October 2014. However, a company may choose to get such contracts approved by the shareholders even before 1 October 2014.

Clause 49(VIII) on Disclosures

Most of the disclosures relating to

remuneration of directors, management, shareholders, disclosure of accounting treatment, proceeds from public issues, rights issue, preferential issues etc. are in line with the existing disclosures.

As regards RPTs, the revised norms require details of all material transactions with related parties to be disclosed quarterly along with the compliance report on corporate governance. Further, the company shall disclose its policy on dealing with RPTs on its website and also in the Annual Report.

In terms of new disclosures, disclosure on resignation of directors and disclosure of formal letter of appointment of Independent Directors has been added.

Further, disclosures in the Annual Report is required, relating to training imparted to the Independent Directors, establishment of vigil mechanism and the remuneration policy and the evaluation criteria.

Clause 49(IX) on CEO/ CFO Certification

There is no significant change in this requirement.

Clause 49(X) on Report on Corporate Governance

There is no significant change in this requirement.

Clause 49(XI) on Compliance

There is no significant change in this requirement.

B. Differences with the Companies Act, 2013

Sr No	SEBI Corporate Governance Norms	Companies Act 2013
Independent Directors related		
1	The maximum number of boards a person can serve as Independent Director is restricted to seven, and three in case the person is serving as a whole time director in any listed company.	The maximum number of directorships is capped at twenty, of which not more than ten can be public companies. However, no specific limit is prescribed for Independent Directors.
2	The maximum tenure of an Independent Director is capped at 10 years. However, if a person who has already served as an Independent Director for 5 years or more on 1 October 2014, will be eligible for appointment for a term of 5 years only.	The overall term of an Independent Director is ten years, except that under the 2013 Act, these requirements are applied prospectively.
3	Two-thirds of the members of the Audit Committee shall be Independent Directors. The Chairman of the Audit Committee is to be an Independent Director.	The Audit Committee is to be formed with majority being Independent Directors i.e. more than half of the board to be independent. No specific requirement for the Chairman to be an Independent Director.

B. Differences with the Companies Act, 2013

Sr No	SEBI Corporate Governance Norms	Companies Act 2013
Related Party Transactions		
4	<p>Approval of all material RPTs by shareholders through special resolution with related parties abstaining from voting.</p> <p>Material is defined to mean higher of 5% of annual turnover or 20% of net worth as per last audited financial statements. Transactions are to be considered taken together with previous transactions during a financial year.</p>	<p>The Act requires pre-approval of related party transactions which are not in the ordinary course of business or are not at arm's length, by the shareholders by a special resolution, with related parties abstaining from voting. The shareholder approval requirement applies to large companies (more than INR10 crore share capital) or material transactions.</p>
5	<p>Related parties include, besides covering the requirements of the Companies Act 2013 and AS 18, additional relationships – for example, person that has a joint control or significant influence on the company and fellow joint ventures and associates.</p>	<p>Related party covers those relationships which are defined in section 2(76) of the Act.</p>
Disclosures on websites		
6	<p>Requirement to disclose the letter of resignation along with detailed reasons for resignation, provided by the director of the company on the website immediately upon receipt. The copy of the resignation should also be forwarded to the stock exchanges and will be displayed on the website of the stock exchange.</p>	<p>The 2013 Act requires the resignation of a director to be intimated, along with detailed reasons provided to the Registrar, and in the report of directors laid in the immediately following general meeting by the company.</p>
7	<p>The letter of appointment of the Independent Director along with the detailed profile shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.</p>	<p>Schedule IV mentions that the terms and conditions of appointment of Independent Directors shall also be posted on the company's website.</p>

Sr No	SEBI Corporate Governance Norms	Companies Act 2013
Others		
8	The CEO/CFO certification on internal controls for financial reporting continues as per the earlier requirement.	There is no particular requirement of CEO/ CFO certification under the Act, however the requirement is for the board, Audit Committee and auditors to comment on 'internal financial control'.
9	Boards of companies to satisfy themselves that plans are in place for orderly succession for appointments to the Board and senior management.	No specific requirement.
10	Under the non-mandatory requirements: <ul style="list-style-type: none"> The internal auditor may report directly to the Audit Committee. the company may appoint separate persons to the post of chairman and MD/CEO. 	Under the Act: <ul style="list-style-type: none"> Section 138 suggests that the internal auditor report to the board. Section 203 makes it obligatory to appoint separate persons to the post of chairman and MD/ CEO unless the articles of the company provide otherwise or the company carries out multiple businesses.

Our comments

- Most of the revised norms to be effective from 1 October 2014, are in line with the requirements of the Companies Act, 2013. The new requirements rest on a principle-based framework and are significantly different from the current requirements.
- The new requirements broadly serve three objectives – alignment with the Companies Act 2013, adoption of leading industry practices on corporate governance and lastly, making the corporate governance framework more effective. As a result, while in most areas the clause 49 and Companies Act requirements are aligned, in certain areas like the tenure of an Independent Director, limits on independent directorships, approval of related party transactions etc., the SEBI requirements have been made more stringent.
- The new requirements seek to raise governance standards by bringing in greater transparency and reporting requirements. They require, in several places, the company to disclose its policies on compliance on its website and in the annual report. This can help in making the stakeholders fully aware of the significant matters on corporate governance.
- A monitoring cell set up by SEBI, will assess compliance by companies with the requirements of clause 49 and report non-compliances to SEBI within 60 days from the end of each quarter. This is a welcome move, and shows the strong intent of SEBI to not only bring in regulations, but also put in place a monitoring mechanism.

The bottom line

- SEBI has taken concrete steps to give effect to the provisions of the Companies Act, 2013, through the corporate governance norms for listed companies.
- Companies will need to assess the impact of those steps and move to implement changes swiftly.

KPMG in India

Ahmedabad

Commerce House V, 9th Floor 902
& 903, Near Vodafone House
Corporate Road, Prahaladnagar
Ahmedabad 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bengaluru 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi

4/F, Palal Towers
M. G. Road, Ravipuram,
Kochi 682 016
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604, 6th Floor, Tower - 1,
Godrej Waterside, Sector – V,
Salt Lake, Kolkata - 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Pune

703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3058 5764/65
Fax: +91 20 3058 5775

Useful Links



**Back issues are
available to
download from:
www.kpmg.com/in**

www.kpmg.com/in

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2014 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.

This document is means for ecommunication only.