

SEBI's recent amendments of clause 49

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First Notes on:

Financial Reporting
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Sector:

All
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Relevant to:

All
Audit committee
CFO
Others

Transition:

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

Background

Clause 49 of the Equity Listing Agreement (ELA) was amended by the Securities and Exchange Board of India (SEBI) in April 2014, and the revised requirements were to be applicable from 1 October 2014. Since then, the SEBI has received various representations from industry associations, companies and other market participants seeking clarifications and interpretation relating to certain of these amended provisions of clause 49. Additionally, SEBI recently sought feedback on the status of preparedness of the top 500 listed companies by market capitalisation for ensuring timely compliance with the clause 49.

To address the concerns and help the listed companies to ensure compliance with the revised provisions of the clause 49, the SEBI has made further amendments to some of the provisions of clause 49. This issue of First Notes summarises these amendments.

Significant amendments to the revised provisions of the clause 49 as released by the SEBI in April 2014

Applicability of clause 49

The clause 49 continues to be applicable to all listed companies with effect from 1 October 2014*. However, the SEBI has amended the applicability criteria to provide that the clause 49 is not mandatory, for the time being, to the following class of companies:

- a. Companies having paid up equity share capital not exceeding INR100 million and net worth not exceeding INR250 million, as on the last day of the previous financial year.
- b. Companies whose equity share capital is listed exclusively on the SME (small and medium enterprises) platforms and SME-ITP (Institutional Trading Platforms).

If the provisions of clause 49 become applicable to a company at a later date, such a company would comply with the requirements of the clause 49 within six months from the date on which the provisions became applicable to the company.

***Appointment of woman director**

Clause 49(II)(A)(1): The SEBI has amended the clause relating to 'composition of board' to provide that provisions regarding appointment of a woman director will be applicable with effect from 1 April 2015.

Independent directors

Pecuniary relationship (49(II)(B)(1)(c)): The SEBI has amended the clause to state that an independent director should not have any 'material' pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year apart from receiving director's remuneration. As per the earlier provisions, an independent director was prohibited from having any pecuniary relationship, even if it was not material, in the ordinary course of business and at an arm's length.

Maximum tenure of an independent director (clause 49(II)(B)(3)(a)): The SEBI has amended the clause and has aligned the maximum tenure of the independent directors as per the Companies Act, 2013 and related clarifications/circulars issued by the Ministry of Corporate Affairs (MCA) in this regard.

Letter of appointment to independent directors (clause 49(II)(B)(4)(b)): The SEBI has amended the clause to require disclosure of terms and conditions of appointment on the website of the company instead of the earlier requirement of disclosing the letter of appointment along with the detailed profile of the independent director.

Further the requirement to provide such a disclosure on the website of the stock exchanges within one working day from the date of such appointment has been removed.

Familiarisation programme for independent director (clause 49(II)(B)(7)): The SEBI has amended this clause to provide that independent directors should be familiarised with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc., through various programmes instead of the earlier requirement of a specific training to be provided to the independent directors.

Additionally, these details of the familiarisation programmes should be disclosed on the website of the company, and a web link to be mentioned in the annual report, instead of providing detailed disclosures in the annual report.

Nomination and remuneration committee (NRC)

Clause 49(IV)(A): This clause has been amended to require the board of directors to constitute NRC to comprise at least three directors, all of whom should be non-executive directors and at least half should be independent directors. The Chairman of the committee should be an independent director. The chairman of the company (whether executive or nonexecutive) may be appointed as a member of the NRC but he should not chair the NRC.

Material subsidiaries

Requirement for disclosure of policy to determine 'material subsidiaries' (clause 49(V)(D)): The clause 49 issued in April 2014 required disclosure of the policy relating to material subsidiaries as follows:

- to the stock exchanges
- in the annual report
- on the company's website.

SEBI has amended this clause and now requires such policy to be disclosed on the company's website and a web link to that to be provided in the annual report.

Disposal of shares in material subsidiary (clause 49(V)(F)): The clause 49 issued in April 2014 did not allow a company to dispose off shares in its material subsidiary which would reduce its shareholding (either on its own or together with other subsidiaries) to less than 50 per cent or cease the exercise of control over that subsidiary, without passing a special resolution in its general meeting.

SEBI has amended this clause to allow an exception to such cases where divestment is made under a scheme of arrangement duly approved by a court/tribunal.

Selling, disposing and leasing of assets of material subsidiaries (clause 49(V)(G)): The clause 49 issued in April 2014 required prior approval of shareholders by way of special resolution for selling, disposing and leasing the assets amounting to more than 20 per cent of the assets of the material subsidiary.

SEBI has amended this clause to allow an exception to such cases where the sale/disposal/lease, is made under a scheme of arrangement duly approved by a court/tribunal.

Risk and management committee (RMC)

Clause 49(VI): This clause has been amended and prescribes composition of the RMC as follows:

- majority of members of the RMC should consist of members of the board of directors
- senior executives of the company may become members of the RMC
- chairman of the RMC should be a member of the board of directors.

Related party transactions

Definition of a related party transaction (clause 49(VII)(A)): An explanation has been added to the clause to explain that a 'transaction' with a related party would be construed to include a single transaction or a group of transactions in a contract.

Definition of a related party (clause 49(VII)(B)): This clause has been substituted to revise the definition of a related party to refer to an entity related under section 2(76) of the Companies Act, 2013 or a related party as per Accounting Standards.

Meaning of material related party transaction (clause 49(VII)(C)): This clause has been amended to change the monetary limit for considering material related party transactions. Materiality in this regard is now defined as 10 per cent of the annual consolidated turnover of the company as per its last audited financial statements. The criteria of five per cent of turnover or 20 per cent of net worth, whichever is higher, has been removed.

Approval of related party transactions (clause 49(VII)(D)): The requirement for prior approval by an audit committee for the related party transactions has been amended to include that the audit committee may grant omnibus approval for related party transactions proposed to be entered into by the company subject to following conditions:

- a. The criteria for granting omnibus approval should be laid down by the audit committee in line with the policy on the related party transactions of the company and such approval will be applicable in respect of transactions which are repetitive in nature
- b. The audit committee should satisfy itself of the need for such omnibus approval and that such approval is in the interest of the company
- c. Such omnibus approval should specify
 - The name of the related party, nature of the transaction, period of the transaction, maximum amount of the transaction that can be entered into
 - The indicative base price/current contracted price and the formula for variation in the price, if any
 - Such other conditions as the audit committee may deem fit.

Additionally for situations where the need for a related party transaction can not be foreseen and aforesaid details are not available, the audit committee may grant omnibus approval for such transactions subject to their value not exceeding INR10 million per transaction.

- d. The details of a related party transaction entered into by the company pursuant to each of such omnibus approval given should be reviewed by the audit committee at least on a quarterly basis.
- e. Such omnibus approvals should be valid for a period not exceeding one year and will require fresh approvals after the expiry of one year.

Approval of related party transactions (clause 49(VII)(E)): The clause 49 issued in April 2014 requires approval of shareholders through a special resolution for all material related party transactions and that related parties should abstain from voting on such resolutions. This clause has been amended to provide that such shareholder approval and the approval of the audit committee as per clause 49(VII)(D) as mentioned above is not required in the following cases:

- a. where the transactions have been entered into between two government companies (government company to have the same meaning as per section 2(45) of the Companies Act, 2013)
- b. Where transactions are entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

However, the amendment additionally provides that all entities falling under the definition of related parties should abstain from voting irrespective of whether that entity is a party to the particular transaction or not. This is a stringent condition and

is not in line with the clarification provided by the MCA on 17 July 2014 which stated that a member would be considered as a related party only with reference to a contract or arrangement in which he is interested and thus, would not be barred from voting on every contract or arrangement entered into by the company.

Disclosure of related party transactions (clause 49(VIII)(A)(2)): The clause has been amended to provide that since these details are required to be disclosed on the website of the company, it is sufficient to provide such web link in the annual report, instead of providing detailed disclosures in the annual report as well.

Disclosures

Deletion of clauses 49(VIII)(F), (G), (H): The clause 49 issued in April 2014 required certain disclosures to be made relating to resignation of directors on the company's website and stock exchanges; disclosure of establishment of a vigil mechanism on the company's website and in the Board's report; disclosure of remuneration policy in the company's annual report. SEBI has now deleted these clauses.

Certification by the CEO

Clause 49(IX): Regarding certification to the board on financial statements and true and fair view of the company's affairs, this clause has been amended to provide that such certification should be given by 'the CEO or the managing director or manager or in their absence, a whole time director appointed in terms of the Companies Act, 2013 and the CFO'.

Our comments

The above amendments are a mixed bag of relaxations and clarifications to the clause 49 of the Equity Listing Agreement that were to become effective from 1 October 2014. It is encouraging to note that SEBI, through its outreach to large corporates has gauged their readiness and identified the areas with implementation challenges, and take into account practicality of implementation as well. These changes to some extent align the requirements of the clause 49 with those in the Companies Act, 2013, but in many other areas, still retain the more stringent requirements, although the SEBI has provided some clarifications.

In particular the alignment of the definition of related parties and the extension of timeline for appointment of a woman director are changes that corporates were looking forward to. The increase in threshold for determining materiality of related party transactions to 10 per cent of the annual consolidated turnover, and permitting omnibus approvals are also welcome changes. On the other hand, the restriction on all related parties voting on any related party transaction, whether they are a party or not, is an area where SEBI has not provided relaxations like the MCA has done under the Companies Act, 2013.

The bottom line

The amendments are a welcome step and are expected to help corporate India in a smooth transition to the revised clause 49. However, considering some of the significant differences between the Companies Act, 2013 and the revised clause 49, such as 'the restriction on all related parties to vote on any related party transaction, whether they are a party or not', it is expected to pose some hardship on the companies. In this light, we believe that the SEBI and the MCA should undertake a thorough review of various provisions of the Equity Listing Agreement and the Companies Act, 2013 to save companies from the hardship of having to apply and comply with conflicting requirements, and facilitate companies in adopting the revised norms smoothly.

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Introducing Voices on Reporting



KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 24 July 2014, the International Accounting Standards Board issued the completed version of IFRS 9, Financial Instruments (IFRS 9 (2014)), which substantially concluded the challenging project launched in 2008 to replace IAS 39, *Financial Instruments: Recognition and Measurement*.

The Companies Act, 2013 (the Act) was largely operationalised with effect from 1 April 2014. However, there are a number of implementation issues relating to related party transactions.

In our call we provided an overview on IFRS9 (2014) and discussed the approval process for related party transactions under the Act and the Securities and Exchange Board of India's Equity Listing Agreement guidelines, and highlighted the implementation challenges that corporate India is expected to face.

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