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Strengthening Corporate Governance

Amendments to Clause 49 of the Equity Listing Agreement
[revised on 31 October 2014]

The Securities and Exchange Board of India (SEBI), vide its circulars dated 17 April 2014, had issued certain amendments to Clause 49 of the Listing Agreement. These amendments followed the overhaul in the corporate governance norms under the Companies Act, 2013 and the related rules notified on 27 March 2014 (together, the "2013 Act"). These amendments are aimed at aligning the SEBI requirements with the provisions of the 2013 Act and adopting best practices on corporate governance.

The SEBI, subsequently, vide its circular dated 15 September 2014, issued further amendments to Clause 49 to address the concerns and practical difficulties raised by market participants and to facilitate the listed companies to ensure compliance with the provisions of revised Clause 49 by also more closely aligning to the requirements of the 2013 Act.

To implement the corporate governance framework effectively, the SEBI has also provided that the monitoring cell of the stock exchanges shall also monitor as to whether all listed companies were complying with the the provisions of the revised Clause 49 on corporate governance. The monitoring cell shall ascertain the adequacy and accuracy of disclosures in the quarterly compliance reports received from the companies and shall submit a consolidated quarterly compliance report to the SEBI.

The revised Clause 49 is applicable to all listed companies with effect from 1 October, 2014. However, a temporary relaxation, for the time being, has been provided to the following class of companies:

- Companies with paid up equity capital not exceeding INR 10 crore and net worth not exceeding INR 25 crore as on the last day of the previous financial year.
  However, companies enjoying relaxation under this criteria, shall be required to comply with the provisions of the revised Clause 49 within six months from the date they cease to meet the aforesaid criteria.
- Companies whose equity shares capital is listed exclusively on the SME and SME-ITP platforms.

Further, for listed entities, which are not companies but body corporate, or are subject to regulations under other statutes (e.g. banks, financial institutions, insurance companies etc.), the revised Clause 49 shall apply only to the extent it does not violate the respective statutes and guidelines or directives issued by the relevant regulatory authorities. The revised Clause 49 is not applicable to Mutual Funds.

This publication summarises the key amendments to Clause 49 brought in by the aforesaid circulars dated 17 April 2014 and 15 September 2014, respectively.

Grant Thornton fully endorses the revisions to the listing agreement by the SEBI. We also appreciate the recent amendments and strongly believe that an inclusive legislation by the SEBI to address the concerns expressed by the industry would go a long way in facilitating compliance and promoting highest standard of corporate governance in India.

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Principles of Corporate Governance

True to its objective, the revised Clause 49, for the first time, has laid out the principles of corporate governance. It also expressly states that in case of any ambiguity, the provisions shall be interpreted and applied in conformity with the said principles. Following is a brief overview of the said principles:

1. The rights of shareholders
   a. The company should seek to protect and facilitate the exercise of shareholders' rights.
   b. The company should provide adequate and timely information to shareholders.
   c. The company should ensure equitable treatment of all shareholders, including minority and foreign shareholders.
2. Role of stakeholders in corporate governance
   a. The company should recognise the rights of stakeholders and encourage co-operation between company and the stakeholders.
3. Disclosure and transparency
   a. The company should ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company.
4. Responsibilities of the Board of Directors
   a. Disclosure of information
   b. Key functions of the Board of Directors
   c. Other responsibilities

Board of Directors

Composition of Board of Directors

Woman director

With effect from 1 April 2015, the Board of Directors of a listed company shall be required to have at least one woman director.

Minimum number of independent directors

The Clause 49 previously provided that if the chairman of the Board of Directors is a non-executive director, at least one-third of the Board should comprise independent directors, and if the chairman of the Board is an executive director, at least half of the Board should comprise independent directors. The revised Clause 49 has reworded the requirement to replace the reference to executive director with regular non-executive director.

The revised Clause 49 has further added that if the chairman of the Board is a regular non-executive director who is also a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least half of the Board should comprise of independent directors.

Independent Directors

Definition of independent director

The revised Clause 49 has expanded the disqualification criteria for independent directors, and thus, makes the definition more restrictive. Also, the definition specifically excludes a nominee director.

Limit on number of directorships

The revised Clause 49 has introduced the limit on number of directorships and now specifies that an individual shall not serve as an independent director in more than seven listed companies. Further, any individual who is also serving as a whole-time director in any listed company shall not serve as an independent director in more than three listed companies.

Maximum tenure of independent directors

The revised Clause 49 provides that the maximum tenure of an independent director shall be in accordance with the provisions of the 2013 Act and clarifications/ circulars issued by the Ministry of Corporate Affairs from time to time. Under the 2013 Act, the maximum tenure of an independent director in office is up to five consecutive years, followed by a reappointment for another term of up to five consecutive years on passing of a special resolution by the company. On completion of the said maximum tenure of 10 years, an individual shall be eligible for appointment again as an independent director in that company only after a cooling-off period of three years. Further, the tenure already served by an independent director in the past shall not be considered, and for the purpose of determining the maximum tenure, only future term shall be considered.

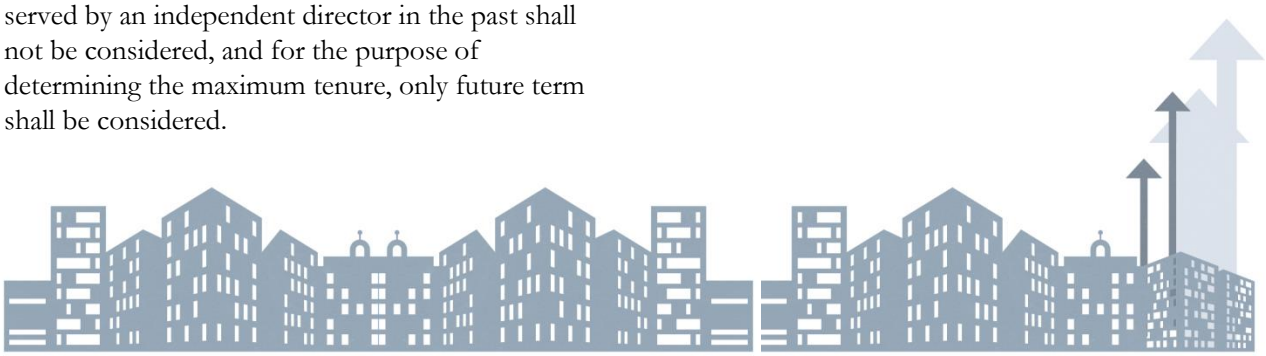
Performance evaluation of independent directors

The revised Clause 49 has formalised the performance evaluation of independent directors and specifies that the Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors. Such performance evaluation shall be done by the Board of Directors and shall form the basis for determination of reappointment of the independent director. The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its annual report.

Separate meetings of independent directors

The revised Clause 49 has added a new requirement that the independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting. The independent directors in the meeting shall:

a. review the performance of non-independent directors and the Board of Directors as a whole
b. review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors, and
c. assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform its duties.



Familiarization program for independent directors

The revised Clause 49 requires that the company shall familiarise the independent directors 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 programs.

The company shall disclose the details of such familiarisation programs on its website and also provide that web link in its annual report.

Non-executive Directors' compensation and disclosures

The revised Clause 49 has inserted a prohibition and specifically forbids the independent directors from being entitled to any stock option.

Code of Conduct

The revised Clause 49 has inserted the requirement that the code of conduct of the company shall incorporate the duties of independent directors as laid down in the Act. An independent director shall be held liable in respect of acts by a company that occur with his knowledge or if the independent director does not act diligently with respect to the requirements of the listing agreement.

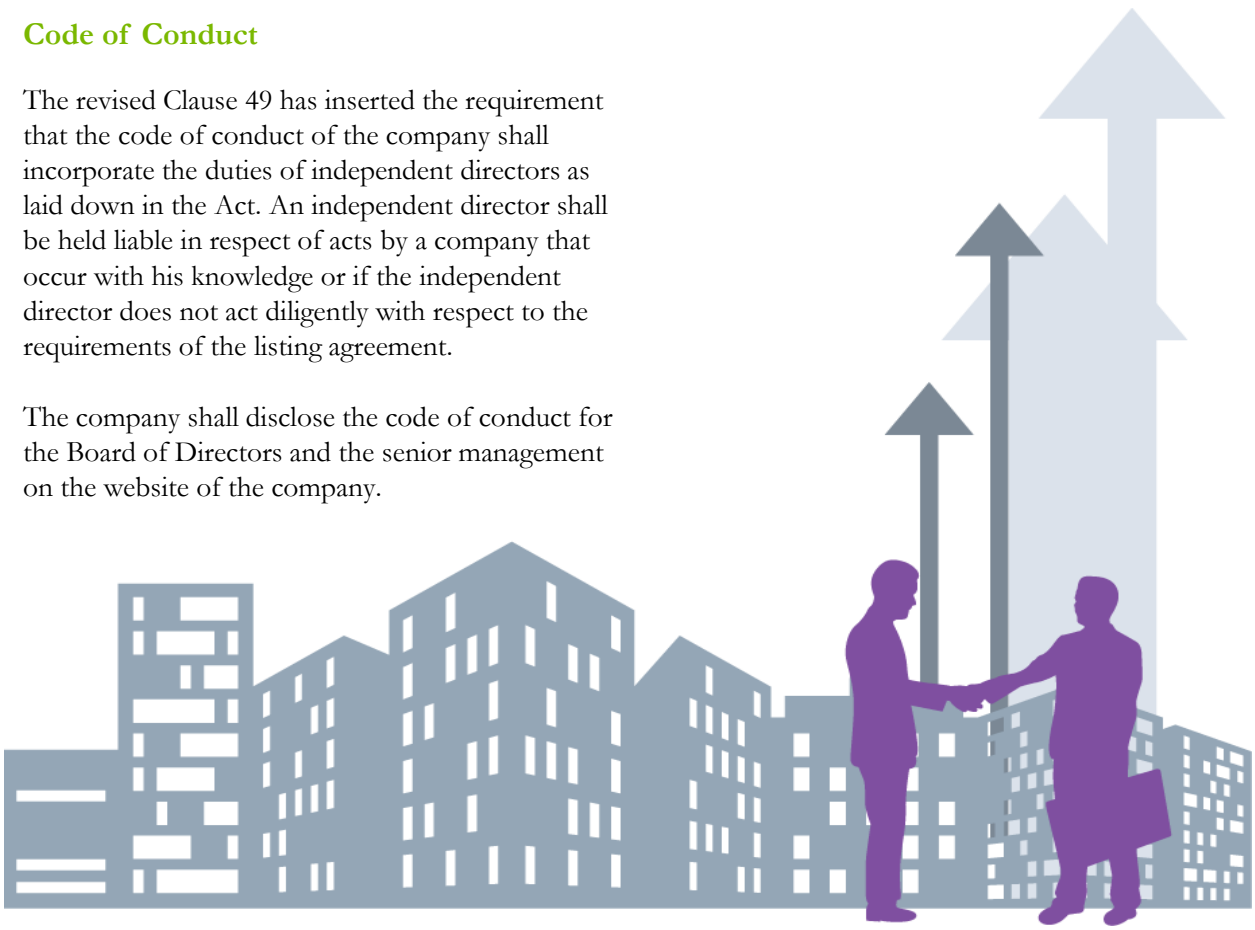
The company shall disclose the code of conduct for the Board of Directors and the senior management on the website of the company.

Whistle Blower Policy

The revised Clause 49 has formalised the whistle blower policy requirements and mandates that the company shall establish a vigil mechanism for directors and employees to report concerns about

- unethical behavior,
- actual or suspected fraud, or
- violation of the company's code of conduct or ethics policy.

This mechanism should also provide for adequate safeguards against victimisation of individuals who utilise such mechanism to report any concerns. The details of establishment of such mechanism shall be disclosed by the company on its website, and in the report of Board of Directors.



Audit Committee

Role of Audit Committee

The revised Clause 49 has enhanced the role of the audit committee to also include:

a. review and monitor the auditor's independence and performance, and effectiveness of audit process
b. approval or any subsequent modification of transactions of the company with related parties;
c. scrutiny of inter-corporate loans and investments
d. valuation of undertakings or assets of the company, wherever it is necessary, and
e. evaluation of internal financial controls and risk management systems

Also, the meaning of 'related party transactions' shall be determined by reference to the definitions given in the revised Clause 49 (see below), and not the definition contained in Accounting Standard 18.

Nomination and Remuneration Committee

The revised Clause 49 has formalised the remuneration committee and requires that a company through its Board of Directors shall constitute a 'Nomination and Remuneration' committee which shall comprise at least three non-executive directors, half of which should also be independent. The chairman of the committee shall be an independent director. The chairperson of the company, even if an executive, can be appointed as a member, but not as the chairman, of such committee. Such committee shall be responsible for:

a. formulation of the criteria for determining qualifications, positive attributes and independence of a director
b. formulation of criteria for evaluation of independent directors and the Board
c. identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend their appointment and removal
d. recommend to the Board of Directors, the policy for remuneration of the directors, key managerial personnel and other employees; and
e. devising a policy on Board diversity

The company shall disclose the remuneration policy and the evaluation criteria in its annual report.

Subsidiary Companies

The revised Clause 49 has expanded the requirements for subsidiary companies, and additionally requires that the company shall formulate a policy for determining 'material' subsidiaries, and the company shall disclose such policy on its website and also provide that web link in its annual report. The revised Clause 49 also prescribes that at a minimum, a subsidiary shall be considered as material if the investment of the company in the subsidiary exceeds 20% of its consolidated net worth as per the audited balance sheet of the previous financial year or if the subsidiary has generated 20% of the consolidated income of the company during the previous financial year.

The revised Clause 49 mandates a special resolution, except in cases where a scheme or arrangement has been duly approved by a court/ tribunal, to dispose of shares in its material subsidiary which would reduce the shareholding to less than 50% or result in loss of control over the subsidiary. Further, selling, disposing and leasing of assets amounting to more than 20% of the assets of the material subsidiary shall, except in cases where a scheme or arrangement has been duly approved by a court/ tribunal, also require prior approval of shareholders by way of special resolution.

The revised Clause 49 has also modified the definition of a 'material non-listed Indian subsidiary', and replaces the references to 'turnover' by 'income', thus expanding the applicability of provisions for material non-listed Indian subsidiary.

Risk Management

The revised Clause 49 has formalised the risk assessment and minimisation procedures and requires that the Board of Directors shall be responsible for framing, implementing and monitoring the risk management plan for the company.

The revised Clause 49 has also inserted a new requirement (for only top 100 listed companies by market capitalisation as at the end of the immediate previous financial year) that a company through its Board of Directors shall constitute a Risk Management Committee. The majority of the members, and the chairman, of such committee, shall comprise the members of the Board. The Board shall define the roles and responsibilities of the Risk Management Committee and may delegate its said responsibilities to such committee.

Related Party Transactions

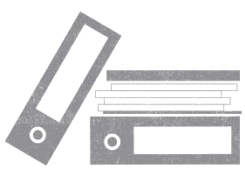
[These requirements are applicable to all prospective transactions. All existing material related party contracts or arrangements as on the date of the circular, which are likely to continue beyond 31 March 2015, shall be placed for approval of the shareholders in the first general meeting subsequent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

The revised Clause 49 has added a detailed new section on related party transactions. This section describes what related party transactions are, and also defines the term 'related party'. This definition of related party comprises the definition of related party provided in, both, the 2013 Act as well as the applicable accounting standards.

The revised Clause 49 also prescribes that a company shall formulate a policy on materiality of related party transactions, and also on dealing with related party transactions. The revised Clause 49 also prescribes that at a minimum, a transaction with a related party shall be considered material if the transaction(s), individually or taken together with previous transactions during a financial year, exceed 10% of the annual turnover of the company as per the last audited financial statements of the company.

The revised Clause 49 mandates that all related party transactions shall require prior approval of the audit committee. The audit committee may grant an omnibus approval subject to the following conditions:

a. the audit committee shall lay down the criteria for granting the omnibus approval in line with the policy on Related Party Transactions of the company and such approval shall be applicable in respect of transactions which are repetitive in nature
b. the audit committee shall satisfy itself about the need for such omnibus approval and that such approval is in the interest of the company
c. such omnibus approval shall specify (i) the name/s of the related party, nature of transaction, period of transaction, maximum amount of transaction that can be entered into, (ii) the indicative base price / current contracted price and the formula for variation in the price if any and (iii) such other conditions as the Audit Committee may deem fit. However, where the need for related party transaction cannot be foreseen and aforesaid details are not available,



Audit Committee may grant omnibus approval for such transactions subject to their value not exceeding INR 1 crore per transaction

d. audit committee shall review, at least on a quarterly basis, the details of related party transactions entered into by the company pursuant to each of the omnibus approval given
e. such omnibus approvals shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year.

Further, all material related party transactions shall require approval of the shareholders through a special resolution and all related parties shall abstain from voting on such resolutions.

Following transactions shall be exempt from the aforesaid approvals of the audit committee and the shareholders, respectively:

a. transactions entered into between two government companies, or
b. transactions 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

The details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance. The company shall also disclose the policy on dealing with related party transactions on its website and also provide that web link in the annual report.

Particulars	Revised Clause 49	2013 Act
Limit on number of directorships for independent directors	Revised Clause 49 is more restrictive on the limit on number of directorships for independent directors i.e. maximum seven listed companies. Also, the revised Clause 49 shall have to be complied with effect from 1 October 2014.	The 2013 Act provides overall limits on number of directorships by an individual i.e. maximum 20 companies (including 10 public companies). Further, the 2013 Act provides transition period of one year to comply with the requirements.
Definition of related party	Definition of related party in revised Clause 49 is broader than that under the 2013 Act and also includes definition under the applicable accounting standards.	-
Approval of related party transactions	The revised Clause 49 mandates that all related party transactions shall require prior approval of the audit committee. The audit committee may also grant an omnibus approval subject to the certain conditions. All material related party transactions shall require approval of the shareholders through special resolution and all related parties shall abstain from voting on such resolutions. The revised Clause 49 provides exemption from approval requirements for transactions entered into between two government companies, and transactions 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.	The 2013 Act also requires that all related party transactions shall require prior approval of audit committee. Additionally, all related party transactions, which are not in the ordinary course of business or not at arm's length basis, should also be approved by the Board and shareholders. However, shareholders' approval is required for only certain transactions with the criteria for such approval defined differently.

Particulars	Revised Clause 49	2013 Act
Risk Management Committee	The revised Clause 49 has inserted a new requirement (for only top 100 listed companies by market capitalisation as at the end of the immediate previous financial year) that a company shall also constitute a Risk Management Committee.	The 2013 Act does not contain similar requirements.
Sale of a material subsidiary	The revised Clause 49 mandates a special resolution to dispose of shares in its material subsidiary which would reduce the shareholding to less than 50% or result in loss of control over the subsidiary. Further, selling, disposing of and leasing of assets amounting to more than 20% of the assets of the material subsidiary shall also require prior approval of shareholders by way of special resolution. The meaning of the 'material subsidiary' is similar to the term 'undertaking' as defined under the 2013 Act. Cases where a scheme or arrangement has been duly approved by a court/ tribunal are exempt from aforesaid requirements.	The 2013 Act mandates a special resolution to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company. The term 'undertaking' means an undertaking in which the investment of the company exceeds 20% of its net worth as per previous audited balance sheet or an undertaking which generates 20% of the total income of the company during the previous financial year.

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