Issue 7

NEWSLETTER

Legal, Compliance and ESG

5 November 2019

Dear Readers,

We bring to your reading and attention following topics:

A) LEGAL AND REGULATORY UPDATES:

I. Expansion of the scope of corporate spend under the Corporate Social Responsibility (CSR) norms[1]

- Till date companies were allowed to provide CSR funds to technology incubators located within Centre-approved academic institutions.
- The amendment has widened scope of CSR activities and companies can now contribute towards research across various fields such as science, technology, medicine. Besides, CSR fund can be spent on incubators funded by the Centre or state or any state-owned companies.

II. Shifting of Registered Office within same State2

- The application for shifting of registered office shall be examined by Regional Director and order there on shall be passed within 15 days of the receipt of application.

[1] For further details, please refer the following link: http://egazette.nic.in/WriteReadData/2019/213151.pdf

[2] For further details, please refer the following link: http://www.mca.gov.in/Ministry/pdf/CompIncEighthAmndtRules_18102019.pdf

- The certified copy of the order received from Regional director shall be filed in Form INC-28 within 30 days from the date of receipt of certified order copy.

III. Inactive Companies permitted to file Form –DIR-12 in exceptional cases3

- The companies which are inactive as on date, due to non-filing of e-Form ACTIVE (Form INC22-A), are now permitted to file Form DIR-12 for change in Directors, in following exceptional cases:
  - Cessation of any director;
  - Appointment of directors, where total number of directors are less than minimum number required, on account of disqualification of all/any of director;
  - Appointment of director, where DINs of all or any director(s) have been deactivated; or
  - Appointment of director(s) for implementation of the order passed by Court or Tribunal or Appellate Tribunal under Companies Act, 2013 or under the Insolvency and Bankruptcy Code, 2016.

IV. Last date for filing DIR-3 KYC expired

- The last date for filing DIR-3 KYC for the financial year ended 31st March 2019 has expired on 14th October 2019.
- The DINs of Directors which have not complied with the requirements of filing DIR-3 KYC, have been marked as 'Deactivated due to non-filing of DIR-3 KYC' and are not allowed for filing any e- forms on MCA 21 portal.
- In order to re-activate deactivated DIN, DIN holder shall file 'KYC' using e-form DIR-3 KYC or DIR-3-KYC-WEB service as applicable with prescribed fee of Rs.5000/-

V. Reserve Bank of India Reorganises its Regulation and Supervision Departments4

Currently, the supervision of financial sector entities is undertaken through three separate departments, viz., Department of Banking Supervision, Department of Non-Banking Supervision and Department of Co-operative Bank Supervision.

Similarly, the regulatory functions relating to financial sector entities are carried out through three separate departments, viz., Department of Banking Regulation, Department of Non-Banking Regulation and Department of Cooperative Banking Regulation.

With a view to having a holistic approach to supervision and regulation of the regulated entities so as to address growing complexities, size and inter-connectedness as also to deal more effectively with potential systemic risk that could arise due to possible supervisory arbitrage and information asymmetry, it has been decided to integrate the supervision function into a unified Department of Supervision and regulatory functions into a unified Department of Regulation with effect from November 1, 2019.

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[3] For further details, please refer the following link: http://www.mca.gov.in/Ministry/pdf/CompIncEighthAmndtRules_18102019.pdf

[4] For further details, please refer the following link: https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=48529

VI. Disclosure of divergence in the asset classification and provisioning by banks[5]

The Securities and Exchange Board of India vide its circular dated 31.10.2019 bearing reference number CIR/CFD/CMD1/120/2019, Under regulation 30 of SEBI (LODR Regulations) has mandated a listed entity to disclose to Stock Exchange(s), all events or information, which are material, as soon as reasonably possible, not later than twenty four hours from occurrence of such event or information. SEBI (Prohibition of Insider Trading) further mandates prompt disclosure of unpublished price sensitive information that would impact price discovery no sooner than credible and concrete information comes into being.

VII. Guidelines on Liquidity Risk Management Framework for NBFC and Core Investment Companies[6]

The Reserve Bank of India (RBI) has made changes in the extant guidelines pertaining to liquidity risk management for non-banking finance companies (NBFCs) in a bid to level-up and raise the standard of asset liability management (ALM) framework applicable to them.

All the non-deposit taking NBFCs with an asset size of Rs 100 crore and higher, systemically important core investment companies and all deposit accepting NBFCs irrespective of their asset size will segregate the 1-30 day timeline in the statement of structural liquidity into granular buckets of 1-7 days, 8-14 days, and 15-30 days.

The net cumulative negative discrepancies in the maturity buckets of 1-7 days, 8-14 days, and 15-30 days shall not inflate 10 percent, 10 percent and 20 percent of the cumulative cash outflows in the respective time buckets.

The NBFCs should inculcate liquidity risk monitoring tools/metrics in a bid to capture strains in liquidity position, if any. Such monitoring mechanisms shall cover a) concentration of funding by counterparty/ instrument/ currency, b) availability of unencumbered assets that can be used as collateral for raising funds; and, c) certain early warning market-based indicators, namely, book-to-equity ratio, coupon on debts raised, breaches and regulatory penalties for breaches in regulatory liquidity requirements.

Further, the measurement of structural and dynamic liquidity, NBFCs are also directed to keep an eye on the liquidity risk based on a "stock" approach to liquidity. The monitoring shall be predefined internal limits as framed by the board for various critical ratios pertaining to liquidity risk.

[5] For further details, please refer the following link https://www.sebi.gov.in/legal/circulars/oct-2019/disclosure-of-divergence-in-the-asset-classification-and-provisioning-by-banks_44830.html

[6] For further details, please refer the following link: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT88CF9DC47368A842CEB727122B1F5DC383.PDF

B) ESG: 6 Myths of Sustainable Investing

What are sustainable funds?

Sustainable funds are those that use environmental, social, and corporate governance (ESG) criteria to evaluate investments or assess their societal impact. They may pursue a sustainability-related theme or explicitly aim to create measurable social impact.

Myth No. 1 – ESG is just negative screening.

ESG is being conflated with ethical investing. The latter have a list of no-go areas which are excluded from their portfolios. Some common businesses or industries would be Alcohol, tobacco, gambling or adult entertainment. It could be an exclusion based on human rights. Certain investors boycotted South Africa and divested from the country in the 1980s to protest against apartheid. In the early 2000s, some investors stayed away from companies doing business in the Sudan because of the Darfur genocide. One of the oldest players in sustainable investing in the U.S. market is Pax World Funds. It was founded during the Vietnam war and was inspired by investors who wanted to stay away from weapons manufacturers. There might even be an environmental exclusion, such as a coal company. All this negative screening is just a part of sustainable investing. Sustainable investing has evolved to be a much more holistic and inclusive investing opportunity, much more positive screening in nature then just exclusionary.

Myth No. 2 – Sustainable investing is myopic.

Far from it. It is living in a way that meets the present needs, while not compromising the ability of future generations to meet their needs. Sustainable investing is a long-term investing approach that incorporates ESG criteria. So along the typical income statement and balance sheet analysis, other factors come into play with regards to environment (greenhouse gas emissions, water usage, pollution mitigation), social (workforce policies, labour standards, data privacy, product safety) and governance (independence of the board, auditing, business ethics, anti-corruption policies). All these factors are integrated into the investment process and considered them along with traditional financial analysis.

Myth No. 3 – Sustainable investing is all about values.

There is definitely some truth to the fact that investors want to align their values with their portfolio. After all, the roots of sustainable investing can be found in religion. Christianity (morality and money, the prohibition on usury), Islam (Sharia law, Islamic finance) and Hinduism (Jain style of investing that might be exclusionary in nature). But today, a lot of investors incorporate ESG criteria for risk mitigation. The CFA Institute put out a great report on sustainability a couple of years ago where they focused on this concept of materiality. Most companies that experienced major debacles that have had a huge impact to their bottom line financial distress had issues related to ESG considerations. Corporate governance issues were evident in some of the banks in India. Some sustainable funds always avoided investing in Facebook due to data privacy issues. Exxon Mobil is one of the largest integrated energy companies in the world, very involved in fossil fuel related energy sources. There was a shareholder resolution, passed with 62% of the vote, asking Exxon to produce an annual report on how the company contributing to climate change and how climate change is affecting it. This same shareholder resolution had been floated for several years running but never exceeded the 50%

threshold until 2017. Norwegian Sovereign Wealth Fund, California Teacher Retirement System, Vanguard, BlackRock, State Street Global Investors, are some that decided to vote in favor of this shareholder resolution. All saw climate change as a major financial risk to Exxon. How can you analyze Exxon from an investment standpoint if you don’t consider how it's business model might be impacted by climate change? A utility company that’s reliant on fossil fuels - investment analysis must consider climate change and how the transition away from fossil fuels towards lower carbon intensive energy sources might impact it. Insurance companies are recognizing that the impact from climate change is going to be more eminent and more severe than previously anticipated. Huge natural disasters will be more frequent, which in turn will have major implications for the insurance industry. Evaluate a company taking into account its labour standards and what it does to attract and retain top level talent. In the knowledge economy this is crucial and can give you a competitive advantage over the competition. On the governance side, an independent auditor and an independent board provide important checks and balances on corporate managers. These things are material. So much of corporate value these days is in intangible assets - people, intellectual property, brand, reputation.

Myth No. 4 – Only rich countries can afford to worry about sustainability.

There is a perception that when Western developed markets were at earlier stages of development, they polluted the environment, exploited their workers, and greased the wheels with corrupt business practices. Now that they have reached certain living standards, they have the luxury of being concerned with ESG issues. There is some truth to this, but not the complete picture. We can evaluate sustainability by looking at how these country indexes score by company level sustainability. Europe is the leader when it comes to sustainability; in fact, European companies were pioneers when it came to ESG practices. Australia scores very well too. Turkey has some pretty sustainable companies. Taiwan is a narrow market dominated by Taiwan Semiconductor, a global leader when it comes to semiconductor space in terms of ESG. South Africa scores pretty well; Naspers, which has a huge percentage of market capitalization, has pretty good ESG practices. Russia and China score poorly. India is below the global midpoint, but actually scores better than the U.S. and about the same as Brazil. Companies like Infosys, Wipro, M&M and L&T score pretty well when it comes to ESG.

Myth No. 5 - Sustainability gets a lot of talk, not assets.

According to the Global Sustainable Investment Alliance, assets in sustainable investments globally have multiplied by factor of 6 over the decade spanning 2006 to 2016. While retail is growing, it's mostly an institutional phenomenon - pension funds, sovereign wealth funds, endowments have the bulk of the sustainable assets. The number of funds is steadily increasing as well. Individuals are getting conscious of climate change and gender diversity.

Myth No. 6 - Sustainable investing is a detractor to performance.

Would you have to sacrifice returns if you invest sustainably? Based on various research and academic literature, the consensus seems to be that exclusionary screening is sort of about even with the market; the kinds of funds that exclude perform about the same as the market. And there is some evidence the companies that score well on sustainability actually slightly outperform the market.