



NEWSLETTER

Legal, Compliance and ESG

05 August 2020

Dear Readers,

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A) LEGAL AND REGULATORY UPDATES:

I. Special liquidity scheme for NBFCs/HFCs¹

RBI vide its circular dated July 01, 2020 has laid down guidelines for NBFCs, HFCs under special liquidity schemes to improve the liquidity position of NBFCs/HFCs through a Special Purpose Vehicle (SPV) to avoid any potential systemic risks to the financial sector.

To be eligible under the scheme, the following conditions should be met:

- NBFCs including Microfinance Institutions that are registered with the RBI under the Reserve Bank of India Act, 1934, excluding those registered as Core Investment Companies;
- Housing Finance Companies that are registered under the National Housing Bank Act, 1987;
- CRAR/CAR of NBFCs/HFCs should not be below the regulatory minimum, i.e., 15% and 12% respectively as on March 31, 2019;
- The net non-performing assets should not be more than 6% as on March 31, 2019;
- They should have made net profit in at least one of the last two preceding financial years (i.e. 2017-18 and 2018-19);
- They should not have been reported under SMA-1 or SMA-2 category by any bank for their borrowings during last one year prior to August 01, 2018;
- They should be rated investment grade by a SEBI registered rating agency;
- They should comply with the requirement of the SPV for an appropriate level of collateral from the entity, which, however, would be optional and to be decided by the SPV.

As per the Government decision, SBICAP which is a subsidiary of the State Bank of India has set up a SPV (SLS Trust) to manage this operation. The SPV will purchase the short-term papers from eligible NBFCs/HFCs, who shall utilise the proceeds under this scheme solely for the purpose of extinguishing existing liabilities. The instruments will be CPs and NCDs with a residual maturity of not more than three

¹ <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT013D1A96E8D0D94579A656351B41E6FB5B.PDF>

months and rated as investment grade. The facility will not be available for any paper issued after September 30, 2020 and the SPV would cease to make fresh purchases after September 30, 2020 and would recover all dues by December 31, 2020; or as may be modified subsequently under the scheme.

II. Practical aspects of UDYAM registration w.e.f. 01.07.2020²

Following the Atmanirbhar scheme and for facilitating ease of doing business, Union Ministry of Micro, Small and Medium Enterprises (MSME), vide its Notification Dated 26.06.2020, notifies the new definition of MSME and new registration process known as - “Udyam Registration” In that context, a new portal is introduced known as “UDYAM REGISTRATION PORTAL” which becomes effective from 01.07.2020.

Key points of difference between new and old registration process:

Particulars	Udyog Aadhar memorandum	Udyam Registration
Aadhar Number	Earlier we can take multiple registrations while using one Aadhar	Now one Aadhar one Udyam registration One enterprise shall only have on Udyam registration
PAN validation	No PAN validation	Now PAN validation is mandatory and all the enterprises registering with portal must have PAN and GSTIN.
Number of employees	Earlier only the number of employees is to be entered.	Now segregation must be given as per Gender.
Linkage with Income tax, PAN and GST department	Earlier all figures are to be entered manually on a self-declaration basis.	Now, the Udyam portal is lined up with other departments and all the details should be as per ITR (last year filed) and GST.
Composite criteria for the classification of MSMEs	Earlier enterprises were classified into two sectors manufacturing and service sector, and there are separate limits for both the sectors for classification of the same.	Now there are the composite criteria for both the manufacturing and service sector. There is the same limit of Investment and annual turnover for both the sectors for classification.
Composite criteria for the classification of MSMEs	Amounts of investment had been manually entered.	Investment gets auto filled based on last year's filed ITR. And in case of the new enterprise, must be filled on a self-declaration basis and this relaxation is available till 31st March after that updation is required, else certificate gets suspended.
Registration Certificate	Udyog Aadhar Memorandum (UAM) is issued instantly at the time of registration only.	After applying an Udyam Registration Number is issued and Udyam Registration Certificate shall be issued only after verification.

New things introduced through Udyam registration w.e.f. 01.07.2020:

1. Udyam Registration Certificate will have a dynamic QR Code from which the web page of Portal and details about the enterprise can be accessed.
2. Income tax, GST and PAN department are linked with the portal for verification of all the information.

² Source: Whitespan Advisory newsletter Issue No. 040/2020

3. The criteria of the classification i.e., investment and turnover of enterprises are now composite for both the manufacturing and service sector.
4. Existing registered enterprises have to re-register with the new portal before 31.03.2021.
5. PAN and GSTIN are mandatory for registration:
 - In the case of a Company, LLP, Cooperative Society, Trust, Society, GSTIN and PAN along with its Aadhaar number are mandatory
 - In the case of the proprietor, he/she can continue with Aadhar only on a self-disclosure basis but before 31.03.2021 he/she must apply for PAN & GST number and must update the same on the portal.
6. PAN and GSTIN are mandatory for registration on or after 01.04.2021.
7. The registration of the following two portals are also integrated with Udyam Registration Portal for the facilitation of MSME and ease of doing business:
 - Government e-Market (GeM) portal, and
 - TReDS portal
8. Re-classification of the existing registered enterprises following the new definition:
 - For ascertaining an enterprise as micro, small or medium, an enterprise must fulfill both the criteria i.e., investment and turnover. If the enterprise crosses the ceiling limit of even one criterion, then it will cease to exist in that category and be placed in the next higher category.
 - But the enterprise cannot be placed in the lower category unless it goes below the ceiling limits specified for its present category in both the criteria of investment as well as turnover.
 - In case of an upward change (from a lower to a higher category i.e. Micro to small), an enterprise will maintain its prevailing status till the expiry of one year from the close of the year of registration.
 - In case of reverse-graduation (sliding down to lower category i.e. Small to Micro) of an enterprise, the enterprise will continue in its present category till the closure of the financial year and it will be given the benefit of the changed status only with effect from 1st April of the financial year following the year in which such change took place.

B) Case-Study: K. Virupaksha & Anr. Vs. The State of Karnataka & Anr. [Appeal (Crl.) 377 of 2020, Judgment Date: Mar 03, 2020]

Brief Facts: K. Virupaksha (“Complainant”) had availed credit facilities from Canara Bank (“Bank”). Due to various defaults, the Complainant’s account was eventually classified as ‘NPA’ and the Bank invoked the power under Section 13(2) of The SARFAESI Act, 2002 (“Act”) for possession of the secured asset.

The secured asset was evaluated and brought to auction. The reserve price was fixed at Rs.2,28,51,000/-. Though no bids were received in the auction and the auction was postponed. Even on the next date no bids were received. The Bank revised the valuation to Rs.1.10 Crore and issued auction. The Complainant claiming to be aggrieved by such action, assailed the auction notice in a Writ Petition filed, the high court Judge having considered the matter, dismissed the writ petition. The Complainant assailed the said order by filing a Writ Appeal before the Division Bench, which was also dismissed. Complainant thereafter filed a complaint under Section 200 of the Cr.P.C alleging that the officers of the Bank in connivance with the auction purchaser had caused wrongful loss to the Complainant. In said complaint, highly placed officials, appellants, valuers and auction purchaser were shown as the accused. Court has referred the same for investigation. Based on such direction a FIR was registered.

Investigating Officer had concluded that as per the investigation it is found that all the accused persons with conspiracy and in collusion with each other have cheated the Complainant by releasing only Rs.90 Lakhs out of the sanctioned amount of Rs.2.68 Crores and by later not releasing the remaining amount had caused economic stumbling block and sold the property mortgaged to one of the accused.

Issue: Whether criminal action can be initiated against authorised officials acting under SARFAESI Act.

Held: While quashing a case of fraud, the Supreme Court of India (SC) has observed that action taken by the banks under the SARFAESI Act is neither unquestionable nor treated as sacrosanct.

The Apex Court held that the sanction of loan, creation of mortgage and the manner in which the sanctioned loan was to be released are all contractual matters between the parties. At that stage if any amount was withheld, the Complainant was required to take appropriate action at that point in time and avail his remedy. The SARFAESI Act provides the procedure to be followed by the secured creditor and also the remedy to the aggrieved parties including the borrower.

Section 32 of the SARFAESI Act provides for the immunity from prosecution since protection is provided thereunder for the action taken in good faith. In a circumstance where we have already indicated that a criminal proceeding would not be sustainable in a matter of the present nature, exposing the appellants even on that count to the proceedings before the Investigating Officer or the criminal court would not be justified.

C) ESG: Role of Independent Directors - Corporate Governance³

Despite strong legal framework, corporate frauds and mis-governance continue to happen - the recent ones being the PNB banking fraud case, IL&FS, DHFL, PMC Bank, CG power, and sudden collapse of Jet Airways.

In this context, here is an overview on the current mechanisms and the reforms needed, especially as to the role of independent directors.

What is the 'independent directors' provision?

An Independent director is a non-executive director who does not have any kind of relationship, material or financial, with the company. Independent directors are to ensure the independence of decisions taken in matters related with the board. A larger say for independent directors was believed to have an effective deterrent to fraud, mismanagement, and mis-governance.

What is the case with India?

In India, the Companies Act, 2013 defines 'independent directors' and codifies their duties and responsibilities. Schedule IV of the Act lays down the guidelines for professional conduct, role, functions, and duties of independent directors.

The Directors' Responsibility Statement under Section 135 requires an affirmation by directors on the adherence to: (i) accounting standards, accounting policies; (ii) maintenance of adequate accounting records for safeguarding of a company's assets and prevention of frauds; (iii) adequacy of internal financial controls, and their effectiveness and compliance with applicable laws. The Listing Regulations exhaustively list out the specific responsibilities of the directors.

³ Source : Business Line

What does this demand from the independent directors?

The law casts onerous duties, obligations, and responsibilities on directors and collectively on the board. So, a thorough understanding of the legal provisions and the various regulations is crucial to ensure compliance and discharge the responsibilities. These can be acquired only by a combination of formal training, experience, and knowledge sharing.

What are the common challenges?

Directors face difficulty when a company has conflicts with society or the public at large. This happens when their working or the company's products/services create an issue with the interests of the public. Promoter-shareholders have a strong say on the selection of independent directors. So, it is challenging for the independent directors to function with independence and effectiveness at the board. Access to information remains in the hands of the promoters and the KMP (Key Managerial Personnel) reporting to them. This again makes it hard for independent directors to exercise independent judgment.

What are the key problems?

Despite the exhaustive duties and regulations, the difficulties in implementation, adoption and compliance have led to many gaps. The evident factors across these cases are lack of integrity and fraudulent practices. Again, majority of the cases are in the financial sector. These are, in fact, regulated and classified as systemically important companies.

Naturally, the question arises as how they escape the several layers of checks and balances some of which include: (i) the professionals or the management running the company independent of the promoters; (ii) the audit and risk committees; (iii) the internal auditors; (iv) the statutory auditors; (v) the board; (vi) the regulators, wherever applicable

Certainly, there have been shortfalls in terms of regulations and supervision.

What are the possible measures at this end?

The recent regulation calling for mandatory registration of independent directors and prescribing a qualifying examination for them are in the right direction. Besides this, meanwhile, many other things may have to be put in place.

- If audit committee, risk committee and the nomination and remuneration committee are to be strengthened, the independent directors chairing/manning them have to be strengthened.
- The eligibility, role responsibility, and the authority of the independent director need to be reformed/ strengthened.
- There need to be separate regulations governing the entire functioning of independent director.
- Currently, the rules/regulations relating to the eligibility and appointment of independent director are the same for all applicable companies. This will have to change.
- Companies in the financial sector need to have a stronger criterion.
- Systemically important companies need to have a different set of independent directors.
- Also, larger companies in terms of size, complexities need to have different criteria for choosing and appointing independent directors.
- These will have to cover key managerial personnel as well.
- Independent directors, to be effective, should possess knowledge of the regulations, working of the company and the ability to speak out.
- Training to acquire the skills shall be made compulsory.

- The remuneration structure for independent director needs to be overhauled.
- It should provide for differential remuneration as per grade in the regulations.
- Remuneration shall be commensurate with the responsibility and liability to which independent director are exposed.
- A separate body needs to be constituted under the Ministry of Corporate Affairs to oversee the functioning of independent directors.
- The funding required can be collected as an annual cess and subscription from the corporate sector.

So, at least till the system gets fully established and starts functioning as intended, micromanagement appears to be the need of the hour.