KNOWLEDGEWARE JANUARY 2016

REGULATORY

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Editorial:

Dear Esteemed Readers,

We are pleased to share with you our January 2016 Regulatory Newsletter covering regulatory updates in India.

After a flurry of new regulations coming in, over the last couple of years (the new Companies Act, the Rules there under, IND AS accounting standards, and the Income Computation and Disclosure Standards) the month of January has been a little quiet.

One can say that besides the normal updates that SEBI and RBI issue, the focus is to refine and/or clarify some existing requirements (eg introducing omnibus approval of related party transactions in companies' law generally aligned to SEBI regulations, introducing a limit for reporting fraud by auditors).

The introduction of the limit on fraud reporting by auditors is a welcome clarification and the introduction of the omnibus approval also eases greatly the compliance burden on corporates. However, there are still certain important differences in the Companies' Act omnibus approval requirements vis a vis SEBI which need to be kept in mind by listed corporates:

- Validity of approval for financial year in companies act v/s 1 year in SEBI
- SEBI omnibus approval for only repetitive transactions
- All related parties (and not just the interested related parties) prohibited from voting under SEBI regulations

While generally the objective is to align different sets of rules, as always the fine print would be important.

Among other updates, the RBI clarification that borrowings of a company would not be classified as non-performing even if preference shares of that company are classified as such due to non-payment of dividend on such shares is welcome, as non-payment of dividend does not expose the borrower to bankruptcy proceedings by preference shareholders.

The year has just commenced and all of us look forward to updates which clarify/simplify/align regulations and that important much needed changes are also implemented over time

We hope you find this a good read and we continue to look forward to communicate to you about changes in the coming months as they occur.

Yours Sincerely,

Knowledgeware Team

B. K. Khare & Co.

Reserve Bank of India (RBI)

Amendment in the Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by FIs

To align the asset classification norms of banks and all India Financial Institutions, the Paragraph No.2.5.3.4 (iii) of the Master Circular DBR.No.FID.FIC.3 /01.02.00 /2015-16 dated July 01, 2015 has been amended as under:-

Existing Paragraph No.2.5.3.4 (iii)	Revised Paragraph No.2.5.3.4 (iii)
If any credit facility availed by the issuer of the security is classified as NPA in the books of the FI, investment in any of the securities issued by the same issuer would also be treated as NPI (Non Performing Investment).	If any credit facility availed of by the issuer is classified as NPA in the books of the FI, investment in any of the securities, ***including preference shares*** issued by the same issuer would also be treated as NPI and vice versa. ***However, if only the preference shares are classified as NPI, investment in any of the other performing securities issued by the same issuer may not be classified as NPI and any performing credit facilities granted to that borrower need not be treated as NPA.***

The amendment has been made considering the fact that preference shares are subordinate to bank loans wherein the borrowing company could have enough surplus to service the bank loan, but not to pay dividend on the preference shares.

Considering that non-payment of dividend on preference shares does not expose the borrowing entity to the risk of initiation of bankruptcy proceedings by the preference holders, it is not necessary to downgrade loans in a situation where investments in the preference shares have become non-performing investments.

However, if a loan becomes non-performing, investment in preference shares being subordinate to bank loans will certainly become non-performing.

Circular No. RBI/2015-16/283 DBR.No.FID.FIC 5/01.02.00/2015-16 dated 07th January 2016

Amendment to Permissible activities of IFSC Banking Units (IBUs)

RBI had issued circular no.DBR.IBD.BC.14570/23.13.004/2014-15 dated April 01, 2015 setting out directions relating to financial institutions set up in the International Financial Services Centers (IFSC).

Certain provisions in the Annexure I & II in respect of the scheme for setting up IBU by Indian Banks & Foreign Banks already having a presence in India have been amended as under:

Existing	Amendment / Clarification
Para No.2.6 (v) IBUs are not allowed to open any current or savings accounts. They cannot issue bearer instruments or cheques. All payment transactions must be undertaken via bank transfers	IBUs can ***open foreign currency current accounts*** of units operating in IFSCs and of non-resident institutional investors to facilitate their investment transactions. IBUs ***cannot raise liabilities from retail customers*** including high net worth individuals (HNIs). All other terms of para 2.6 V in respect of cheque facility & transactions through bank transfers shall remain the same.
Paragraph No. 2.6 (iv) IBUs can raise short term liabilities from banks subject to limits as may be prescribed by the Reserve Bank.	***RBI will not prescribe any limit for raising short-term liabilities from banks.*** However, IBUs are ***required to maintain LCR (Liquidity Coverage Ratio)*** as applicable to Indian banks on a standalone basis and strictly follow the liquidity risk management guidelines issued by RBI to banks. It is also clarified that NSFR (Net Stable Funding Ratio) will be applicable to the IBUs as and when it is applied to Indian banks.
Paragraph No.2.7 on Prudential Regulations The bank's board may set out appropriate credit risk management policy and exposure limits for their IBUs consistent with the regulatory prescriptions of the RBI.	With a view to provide a greater flexibility to the IBUs in their business transactions, ***exposure ceiling has been set to*** : • ***Single borrower- 5 %*** of Parent bank's Tier-I capital • ***Borrower group- 10 %*** of Parent bank's Tier-1 capital

RBI/2015-16/282 DBR.IBD.BC. 8536/23.13.004/2015-16 dated 07th January 2016

Reserve Bank of India (RBI) circular: Clarification on the "Criteria for Inclusion of Perpetual Debt instrument (PDI) in Additional Tier 1 Capital" of Master Circular

As per the Master Circular released by RBI dated 1 July 2015,the banking regulator, is planning to implement the Basel III Capital Regulations in India in a phased manner. Annexure 4 of the Master Circular lays down the 'Criteria for inclusion of Perpetual Debt instrument (PDI) in Additional Tier 1 capital' i.e. to the core capital base.

The condition prescribed in para 1.8(e) of the Annexure states in case of insufficiency of current year profits for payment of coupons, balance can be paid out of revenue reserves (reserves which are not created for specific purpose). However, there were negative views from the industry/stakeholders as to why the said para did not mention any testing for the sufficiency of revenue reserves.

The purpose of current Circular is to remove any potential ambiguity and to reflect the intent of the amendment in para 1.8(e) on Coupon discretion.

Other conditions remaining the same, the said para has been re-worded with the highlighted changes as under and is applicable with immediate effect i.e. January 14. 2016:

,……..

"Coupons must be paid out of distributable items. In this context, coupon may be paid out of current year profits. ***However, if current year profits are not sufficient, coupon may be paid subject to availability of sufficient revenue reserves (those which are not created for specific purposes by a bank) and / or credit balance in profit and loss account, if any****.*

………..'

RBI Circular no.RBI/2015-16/285 DBR.No.BP.BC.71/21.06.201/2015-16

RBI intimates about commencement of operations of Central Fraud Registry (CFR)

RBI has announced in para 22 of its Fourth Bi-monthly monetary policy statement creation of CFR for a searchable database usable by banks. RBI through this circular dated January 21, 2016 has intimated the operationalisation of CFR.

Highlights of the circular and CFR are as follows:

1. Revision of limits in reporting of Fraud Cases:

    - Frauds of Rs. 0.1 million and above but below Rs. 50 million will be monitored by the respective Regional Office of RBI under whose jurisdiction the Head Office of the bank is situated.
    - Frauds of Rs. 50 million and above will be monitored by Central Fraud Monitoring Cell (CFMC), Bengaluru, and
    - Flash reports are to be sent in fraud cases of Rs. 50 million and above to the concerned RBI authority with a copy to CFMC at Bengaluru as against the present limit of Rs. 10 million and above.
2. The hardcopy filing requirement in form FMR-1 (Fraud Monitoring Return) is now discontinued. From this date, frauds involving amount Rs. 0.1 million and above should be sent to RBI on a monthly basis through an email.

The format for reporting has been annexed to the circular.

Circular Reference:RBI/2015-16/295

Reserve Bank of India modifies the RBI (Gold Monetization Scheme, 2015) Master Direction on January 21st, 2016

The understated modifications replace the erstwhile directions issued for administration of the gold given as deposit to the banks.

The principal and interest on Short Term Bank Deposits (STBD) would be denominated in gold however for Medium and Long Term Deposits (MLTGD) only the interest would be denominated in gold. Further Proprietorship & Partnership firms can now also make deposits under the scheme.

All deposits under the scheme should be made at the CPTC which includes designated branches of banks. Banks at their discretion may allow depositors to deposit their gold with refiners issuing deposit receipts of the standard gold of 995 fineness. Designated banks shall inform the RBI of their decision to participate in the Scheme as soon as the policy to implement the Scheme is approved by their Board. A report of the gold mobilized under the Scheme by all branches of the banks should be sent to the RBI on a monthly basis in the prescribed format. The CG has decided that for initial period of one year from the date of launch of the Scheme, designated banks will be paid handling charges and commission on the amount of gold mobilized.

The Medium Term Government Deposit & Long Term Government Deposit can be made for 5-7 years and 12-15 years and the interest rate would be decided by the CG from time to time. The designated banks may allow whole or part premature withdrawal of the deposit subject to minimum lock-in period and penalties.

Circular Reference:RBI/2015-2016/300

Securities and Exchange Board of India (SEBI)

Outsourcing by Depositories

SEBI vide circular CIR/MIRSD/24/2011 dated December 15, 2011 had prescribed Guidelines on Outsourcing of Activities by Intermediaries. A committee formed by SEBI, Depository System Review Committee examined the outsourcing practice followed by depositories and recommended the following:

- Depositories to formulate and document a policy on outsourcing which is to be approved by the Board.
- Core activities of the depository are not permitted to be outsourced. The circular defines twelve activities such as Compliance, processing applications of depository participants, execution of transfer of securities etc.
- Further, core IT support for running core activities shall not be outsourced to the extent possible.

Depositories should also perform a due diligence on third parties to whom outsourcing is proposed and perform risk analysis and monitoring of the outsourced third parties including sufficient audit of outsourced activities.

The above are to be implemented within three months of the date of the current circular i.e. within three months of 9 December 2015.

CIR/MRD/DP/19/2015

Introduction of system-driven disclosures in securities market

SEBI had specified disclosure requirements for acquisition, sale and pledge of securities under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (hereinafter referred to as "SAST Regulations") and SEBI (Prohibition of Insider Trading) Regulations, 2015 (hereinafter referred to as "PIT Regulations") in order to bring in transparency in the market.

SEBI vide this circular is exploring the possibility of disclosing such relevant information based on the information systems developed by market participants.
Applicable date: 1 January 2016.

The proposed system-driven disclosures are to be implemented in two phases:

Phase 1: Disclosure of the changes in equity shareholding of promoter/promoter group of the listed entities. The circular prescribes *six steps* involved for implementing system-driven disclosures throughcompilation of database of promoter holdings.

The steps involve building an accurate database of the existing holdings at ISIN level of all the promoters / promoter group, tagging of demat accounts based on PAN/account numbers by depositaries in their depository systems at ISIN level of respective promoter/promoters group, notifications of any change in promoter/promoter group by respective Registrar & Transfer Agents (RTAs), monitoring by RTAs for the disclosures made by promoter/promoter group under current regulatory framework with those generated by the systems.

Phase 2: Based on experience gained in the first phase, subsequent phase would be implemented regarding disclosure of information on non-promoters and instruments other than equity shares.

CIR/CFD/DCR/17/2015

Monthly Development Report for Commodity Derivative Exchanges

Subsequent to the merger of the Forward Markets Commission with SEBI, the SEBI has oversight over the activities of Commodity Derivatives Exchanges in the country. Accordingly, the SEBI has asked Commodity Derivatives Exchanges to submit monthly reports on trading activities and volumes on the Exchange, traded values of commodities, movement of indices developed by the Exchange, number of trading terminals, quantum of specific purpose funds and clearing and settlement values in the format prescribed.

The information is to be provided from April 2015 onwards on a monthly basis by the 7 th of each succeeding month.

CIR/CDMRD/DEA/4/2015

Ministry of Company Affairs (MCA)

Reporting on fraud by Auditors:

The Companies Act, 2013 had introduced provisions requiring auditors to report frauds to the Central Government. Considering operating difficulties in ensuring compliance with these requirements, the Institute of Chartered Accountants of India (ICAI) had issued a guidance note specifying the reporting mechanism to be followed by auditors in case of frauds on the Company by its officers or employees.

The MCA vide circular dated 14 December 2015 which amends the Companies (Audit and Auditors) Rules, 2014 has provided a monetary limit on reporting of frauds on companies by its officers or employees by the auditors. The circular also prescribes timing and format of such reporting.

Monetary limits for reporting:

- Frauds of Rs. One Crore or more – reporting to Central Government.
- Frauds lower than Rs. One Crore – reporting to the Audit Committee/Board.

An interesting point regarding the proposed amendment is that in the determination of the above threshold the amount involved in the fraud includes amount expected to be involved.This would place onus on the auditors and also the management in estimating accurately the full extent of amounts involved in the fraud which may not always be possible in the early stages of detection. The mechanism and onus of reporting in such instances may result in difficulties in compliance for both auditors and companies. Further use of a numerical threshold for reporting as opposed to a threshold based on size of the Company (for example revenue of profitability) is likely to increase the burden of compliance on large companies and auditors of such companies.

Timing and manner of reporting:

Reporting to	Matter of reporting	Timing
Board or Audit Committee	Report on Fraud noted and seeking reply thereon	Within 2 days of knowledge of fraud
Board or Audit Committee to reply to the auditor with their observations on the Fraud within period of 45 days		
If reply received from the Board or Audit Committee within 45 days		

Central Government	Report on Fraud noted, reply received from the Board and comments thereon	Within 15 days of receipt of reply
If reply notreceived from the Board or Audit Committee within 45 days		
Central Government	Report on Fraud noted, and auditor comments thereon	Not specified, however would be immediately after expiry of 45 days period

Format for reporting:
The auditors' report is to be submitted in the format prescribed in the circular and is to be addressed to the Secretary, Ministry of Corporate Affairs.

The provisions of this amendment would also apply to Cost Auditors and Secretarial Auditors during performance of their duties under Section 148 and Section 204 of the Companies Act, 2013.
It is also pertinent to note that the Guidance Note on fraud reporting issued by the ICAI requires auditors to report frauds noted to the Central Government only if such frauds were first detectedby the auditors. Therefore in the case where the management has brought the fraud to the attention of the auditors, the same is not required to be reported to the Central Government by the Auditor.

Companies (Audit and Auditors) Amendment Rules, 2015

Companies (Meetings of Board and its Powers) Second Amendment Rules, 2015

The MCA has amended Companies (Meetings of Board and its Powers) Rules, 2O14 in order to prescribe conditions on which omnibus approval can be given by the audit committee for related party transactions. The conditions have been specified as follows:

1. Audit Committee (after Board approval), shall specify criteria for granting omnibus approval which shall include maximum value of transactions under the omnibus route, the maximum value per transaction, extent of disclosures to the audit committee at the time of seeking omnibus approval, frequency of review of such transactions and also the transactions which cannot be subject to omnibus approval.
2. Audit Committee to consider factors such as repetitiveness of transactions and justification of the need for omnibus approval.
3. Audit Committee to satisfy itself on need for omnibus approval.
4. The omnibus approval shall contain details of proposed transactions such as name of related party, maximum amount of transaction, indicative pricing, nature and duration of the transaction.

5. Validity of omnibus approval would be one financial year.
6. Also, omnibus approval cannot be granted for transactions in respect of selling or disposing off the undertaking of the company.

Further, Rule 15 (3) of the Companies (Meetings of Board and its Powers) Rules, 2O14, required special resolution of the company in respect of related party transactions by companies with paid up capital of Rs. 10 crore or more or for entering into specified transactions(such as selling or disposing off or buying any property, availing or rendering of services, etc.) under Section 188 (1) of the Companies Act, 2013. The same has now been amended to remove the requirement of special resolution, a general resolution would suffice.
The MCA vide current circular has providedclarity on the process of providing omnibus approval of related party transactions by Audit Committees which would facilitate compliance by companies and Audit Committees in respect of such transactions.
Further, the relaxation of requirement of special resolution for specified related party transactions per the Companies (Meetings of Board and its Powers) Rules, 2O14 is a significant step in easing of compliance requirements on companies.

Companies (Meetings of board and its powers) second amendment rules, 2015

MCA clarifies certain Frequently Asked Questions (FAQs) with regard to Corporate Social Responsibility under section 135 of the Companies Act, 2013

The Ministry of Corporate Affairs has received several references and representations from stakeholders seeking clarifications on the provisions under Section 135 of the Companies Act, 2013, Schedule VII of the Companies CSR Policy Rules, 2014 read with General Circular dated June 18, 2014 issued by Ministry of Corporate Affairs.

In this connection the Ministry has issued Circular No. 05/19/2015-CSR dated 12th January, 2016.
Vide this circular, in continuation of the Ministry's General Circular dated 18th June, 2014 and 17th September, 2014, a set of FAQs along with response is provided for facilitating effective implementation of CSR. Following are some issues on which the Clarifications have beengiven in the Circular/FAQ:

1) Amount spent on CSR cannot be claimed as business expenditure under Income Tax Act, 1961.
2) CSR Amount can be spent on Activities beyond Schedule VII. The items enlisted in Schedule VII are broad based and can cover a wide range of things. It is for the board of the company to take a call on this.

3) There are no specific exemptions to CSR expenditure although there are some expenditures included in Schedule VII which enjoy exemptions under different Sections of Income Tax act, 1961.
4) Holding or subsidiary of a company does not have to comply with Sec 135(1) unless the holding or subsidiary itself fulfils the criteria.
5) Even section 8 companies have to comply with CSR.
6) The CSR policy of the company should be disclosed on its Website.
7) Reporting of CSR is mandatory in Board Report.
8) Any excess amount paid cannot be carry forward or adjusted.
9) All CSR programmes / projects should be approved by the Boards on recommendations of their CSR committees.
10) Companies with small CSR funds can combine their CSR programs with other similar companies (Refer rule 4 in companies (CSR Policy) Rules, 2014).

Circular Reference:No. 05/19/2015-CSR