Companies and banks see laws change with the times

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December 2012 witnessed progress for key reform legislation aimed at changing the business landscape of India. After hanging in limbo for a long time, the lower house of the parliament cleared the revised draft of the Companies Bill, 2011.

Two other reform bills – the Banking Laws (Amendment) Bill, 2011, and the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Bill, 2011 – recently received the nod of the upper house. The former paves the way for issuance of new bank licences and consolidation in the sector, while the latter is an attempt to strengthen the regulatory framework for recovery of debts.

Companies Bill

The changes in the Companies Bill aim at improving corporate governance, increasing transparency, making independent directors more accountable and strengthening regulations for companies and auditing firms. The bill makes it mandatory for profit-making companies to spend on activities relating to corporate social responsibility; allows only two layers of subsidiaries for investment in companies; requires approvals from shareholders and board of directors for appointment of auditors; and provides for class action suits. The bill also gives more statutory powers to the Serious Fraud Investigation Office to better tackle corporate fraud.

Also noteworthy is the introduction of the concept of "one person company", which means a company that has only one person as a shareholder and where, despite this, legal and financial liability is limited to the company alone.

The purpose behind this provision is to end the hypocrisy of the provision in the existing Companies Act, 1956, which requires a company to have a minimum of two members to distinguish it from a sole proprietorship. This requirement encouraged people to register companies by adding a nominal member/director and allotting them a single share, which is the minimum requirement for a director under the act, while retaining the rest of the shares for themselves.

Further, in an effort to address the concern that issuing stock options to independent directors might be causing conflicts of interest and casting a cloud over their independence, the bill proposes to end this practice by categorically providing that an independent director will not be entitled to stock options.

The Companies Bill, 2008, was introduced in the lower house to replace the existing Companies Act. However, due to dissolution of the 14th Lok Sabha, that bill lapsed. What was the Companies Bill, 2008, became, with minor modifications, the Companies Bill, 2009. It was reintroduced in the Lok Sabha in August 2009 and then referred to the Standing Committee of Finance for its examination and report.

The final draft of the Companies Bill, 2011, which was prepared after considering the recommendations of the standing committee and after obtaining input from the finance and law ministries as well as the Planning Commission, received the much awaited approval of the Lok Sabha on 18 December 2012.

Banking and debt recovery

The key feature of the Banking Laws (Amendment) Bill, which has now been cleared by both houses of parliament, is to increase voting rights of investors in private-sector banks to 26% from the existing 10%. The bill gives power to the Reserve Bank of India to issue new bank licences. This will make the Indian banking sector attractive for overseas investors and is expected to lead to consolidation in the industry.

The Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Bill seeks to amend the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act and the Recovery of Debts Due to Banks and Financial Institutions Act so as to strengthen the regulatory and institutional framework related to recovery of debts due to banks and financial institutions. It was felt that amendments in the law were needed to further strengthen the rights of secured creditors.

The amendments would strengthen the ability of banks to recover debts due from borrowers, enhance the ability of banks to extend credit to both corporate and retail borrowers, reduce the cost of funds for banks and their customers and reduce the level of non-performing assets.

Conclusion

India's growth in recent years reached 7.5%, which would double its average income in a decade. The amendments to the companies and banking laws have been brought in to keep pace with the development and growth in India. The objective is to create a business-friendly environment in the country, while keeping in place a well formulated and well equipped regulatory framework to secure the interests of a fast growing economy along with necessary checks and balances to minimize the possibility of abuse and foul play.

Ranjana Roy Gawai, the managing partner at RRG & Associates, was among those involved with the Indian Institute of Corporate Affairs, Ministry of Corporate Affairs, in recommending amendments to the Companies Bill, 2011. Vasudha Sen is a team leader at RRG & Associates.