
Compliance – Risks and mitigation measures for your Indian entity

Context

This note is being prepared in the context of the following trends in the Indian legal system –

1. Laws relating to company operations, labour, corporate social responsibility, insolvency, taxes and foreign investments are being overhauled and new laws are being introduced that have different and sometimes higher compliance standards.
2. Laws relating to bribery, environment protection, health and safety are being enforced more rigorously.
3. German companies have to now, more than ever before, focus on compliance status of their Indian entities and ensure that they are compliant with applicable rules and regulations as both their Indian management and directors (who are often German management) will be held liable for non compliance.

It is difficult and even counter productive for HQ in Germany to micromanage compliance in India. That should be left to capable Indian qualified professionals. However, it is important for HQ to understand the key compliance risks, obtain comfort that these key risks have been addressed and ensure that the risk mitigation measures are in line with the group policies as well as the local legal requirements in India, which is very important to ensure that the Indian management are well protected.

This note flags (at a high level) some key compliance risks and suggests mitigation measures that can be considered and those found suitable may be implemented.

Corporate Compliance

The Companies Act, 2013 is a basic statute governing the method and manner of corporate functioning of an Indian company – private or public. The statute contains numerous sections on all aspects of the operations of an Indian company starting from incorporation to mergers and amalgamations. Non compliances can lead to potential fines, Indian company being struck off and liability being attached to directors and management of the Indian company.

Red Flag: Although very basic, most foreign HQs don't appreciate the complex and paper heavy compliance requirements of share issuances, board meetings, appointments of auditors, shareholders meetings, maintenance of various registers etc. The list of compliances is a very a long list and most foreign HQs are not capable of handling this on their own.

Mitigation: Appoint qualified Indian professionals (internal or external) for all compliance matters and maintain an annual audit checklist. Directors on the board of the Indian company should ensure that they are completely aware of all the operations of the Indian company. It is no defense for a director to say that he or she wasn't aware of a non compliance if he or she had an opportunity to become aware and did not use it.

Bribery and Corruption

Corruption risks in India are generally perceived to be high due to its administrative and bureaucratic environment. Businesses identify government procurement as a process particularly vulnerable to corruption. While this is changing at a fast pace,

criminal liability can be imposed under the Prevention of Corruption Act, if –

- an officer/agent of a company commits the offence of bribery while exercising the powers given to him by the company;
- the directors, employees or agents of a company commit an act of fraud, wilful misconduct or gross negligence.

Red Flag: Relying on third parties such as agents/brokers etc. in dealing with government entities is often very risky, as it provides greater opportunity for bribery. Further, if no enforcement action is being taken by a regulator despite non compliance, there is a greater need to obtain comfort that enforcement is not being avoided via undue influence.

Mitigation: HQ should play a very strong role in communicating (top down approach) a zero tolerance policy on corruption and provide training to all employees and consultants on these policies. An India specific policy should be implemented for use in the Indian operations. Companies should evaluate the effectiveness of its policies by undertaking regular internal and external audits of the policies and material transactions and monitoring of third party relationships.

Related Party Transaction

Under the Indian Companies Act, transactions between closely-held group private companies have become smoother without the requirement for cumbersome approval process. However, criminal liability can be imposed if: any director/employee of a company has entered into or authorized a related party contract without obtaining consent of the board of directors and the shareholders. A person can also be disqualified to be appointed as a director if he has been convicted of the offence dealing with related party transactions. Contravention of the provision of the law may attract heavy fines.

Red Flag: If your Indian subsidiary is an intra group service provider or part of your supply chain, you should be extra cautious and authorize all intra group

transactions via the special procedure specified under law.

Mitigation: Companies must have a set of guiding principles which will help their boards segregate ordinary activities from ones with other group companies. Documentation should be maintained to justify related party transactions on arms length basis.

Health and Safety

Health and safety at work place is governed by a number of labour legislations but the key one is the Factories Act. Each state has its own department that administers this Act. While the Factories Act sets minimum health and safety standards, these are seen (in the market) as the bare minimum and the market (and regulators) appreciate and expect global health and safety standards to be applied in India. Criminal liability can be imposed if: a company/manufacturing unit – engages in unfair labour practices and fails to comply with the provisions of law with respect to health, safety and welfare of the employees. Violations may also result in fine/imprisonment.

Red Flag: Genuine complaints from employees of lack of health and safety measures and increased incidence of accidents, mishaps or health issues may be an indication of lax compliance.

Mitigation: Conduct a regular risk assessment to determine which parts of the business and supply chains are at risk of safety violations.

Sexual Harassment

The statute seeks to provide every woman a safe and secure working environment free from any form of sexual harassment. Criminal liability can be imposed: if the employer fails to – form the Internal Committee, take action against the act of sexual harassment or contravenes the provisions of law. Non – Compliance may result in fine or cancellation or non-renewal or non-approval of license required for carrying out business activity. Offence of sexual harassment is also

punishable with rigorous imprisonment under the Indian Penal Code.

Red Flag: An increased incidence of well performing women workforce leaving or a dominant patriarchal HR approach may be an indication of the existence and tacit forbearance of harassment.

Mitigation: HQ should play a very strong role in communicating (top down approach) a zero tolerance policy on anti sexual harassment and provide training to all employees and consultants on these policies. An India specific policy (including setting up the committee) should be implemented for use in the Indian operations. Companies should evaluate the effectiveness of its policies by undertaking regular internal and external audits of the policies and direct interaction with women workforce.

Corporate Social Responsibility (CSR)

The Companies Act, 2013 mandates a minimum level of CSR spending by every Indian company (over a certain threshold) under the CSR scheme. Each company must form a CSR committee headed by the company's board of directors. The law applies both to domestic enterprises and subsidiaries of multinational companies with offices in India. Companies must issue a public report of their CSR spending or provide an explanation of why they failed to meet the minimums. Liability can be imposed: if the company breaches regulations relating to CSR expenditure and reporting.

Red Flag: Absence of a CSR policy or committee is a clear indication that management does not have a structured approach to this issue.

Mitigation: CSR should be sustainable – involving activities that are approved under the Companies Act. The Indian company should appoint a specialist CSR resource (internal or external) to implement and oversee all CSR activities.

Environment Protection

Environmental and pollution control matters are governed by various statutes and each state has a department to monitor the implementation of these statutes. Enforcement has become stricter over the course of the last 5 years. A company is required to comply with the provisions of the environmental laws to the extent specifically applicable to the business operations of the company. Criminal liability can be imposed if: the company fails to comply with provisions of law with respect to standards prescribed for prevention/control and abatement of environmental pollution. Non-compliance may attract fine/imprisonment.

Red Flag: Each state has its own policies on special kinds of waste (for example e-waste), which need to be complied with. Further, any manufacturing process involving effluent generation should adopt specific treatment plans and these should be regularly audited by HQ technical team.

Mitigation: Technical audits on suitability and sufficiency of the treatment plants should be conducted. Legal departments should follow up on any notices received from authorities and track responses and mitigation measures.

Human Rights Violations

Although the possibility of human rights violations in a well run and organized group is very low, even a single case of such violation may attract liability under various statutes apart from the very negative publicity that it may generate. Direct criminal liability may attach to directors and management under various statutes for such violations.

Red Flag: High number of contract workers (as opposed to permanent employees), migrant labour, young workers and lack of freedom to leave employment easily (via loans and other financial fetters) are indicators of possible human rights violations.

Mitigation: HQ should play a very strong role in communicating (top down approach) a zero tolerance policy on human rights violations. A thorough and regular audit should be conducted to obtain comfort that all labour management practices are fair and well documented.

In conclusion, it would be a fair summary to say that HQ should play the role of a mentor and auditor while allowing the Indian management to deal with the specific compliance aspects. HQ should also be sensitive to the cultural differences in approach to compliance in India. However, this does not and should not mean compromising on compliance. A number of Indian companies are well run with robust compliance

programs already in place and the culture of compliance is well and truly being recognized as being extremely critical for the corporate culture and risk management of a company.

Authors:



Prashant Mara

Partner

BTG Legal, Mumbai

Email: prashant@btg-legal.com



Priyanka Chandran

BTG Legal, Mumbai

Email: research@btg-legal.com



Ulrich Bäumer

Partner

Osborne Clarke, Köln

Email: ulrich.baeumer@osborneclarke.com



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