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THE SEBI BOARD MEETING ON THE ADOPTION OF THE KOTAK COMMITTEE'S RECOMMENDATIONS ON CORPORATE GOVERNANCE

9 April 2018

The Securities and Exchange Board of India (SEBI) in its board meeting dated 28 March 2018 (Board Meeting), accepted several recommendations (a few with modifications) of the Committee on Corporate Governance, headed by Mr. Uday Kotak (the Kotak Committee). The Kotak Committee was constituted in June 2017 to prepare recommendations for SEBI, in relation to improving the standards of corporate governance in Indian listed entities. In the Board Meeting, SEBI also decided on certain other changes to the legal regime regulating securities markets. This Ergo primarily presents a discussion on the aspects of the Board Meeting that are likely to have an impact on the disclosures in the offer and placement documents (Offer Documents) that are prepared for the purposes of undertaking public issues and private placements.

Maximum number of directorships

Presently, in terms of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended (SEBI Listing Regulations), a person cannot serve as an independent director in more than seven listed entities. However, if a person is a whole time director in one or more listed entities, then such a person cannot serve as an independent director in more than three listed entities.

The Kotak Committee believes that, if a person holds multiple directorships that is beyond a "reasonable limit", it may lead to a person being unable to allocate sufficient time to his duties towards a particular company, thereby hindering his ability to play an effective role as a director. The Kotak Committee's recommendation to bring down the maximum number of directorships held by a person in listed entities to eight by 1 April 2019, and to seven by 1 April 2020 (irrespective of whether the person holds positions as independent director or not) has been accepted by SEBI in the Board Meeting

Expanding the eligibility criteria for independent directors

The Kotak Committee has stated that independent directors play a critical role in a good governance framework, and that one of the most important elements of such a role is their "independence". The Kotak Committee felt that the evaluation of such "independence" should entail both objective and subjective assessments, and has accordingly recommended the following revisions to the eligibility criteria for a person to be appointed as an independent director – (i) to specifically exclude persons who constitute the 'promoter group' of a listed entity; and (ii) who is not a non-independent director of another company on the board of which, any non-independent director of the listed entity

is an independent director. This recommendation has been accepted by SEBI in its Board Meeting.

Disclosure of expertise/skills of directors

Currently, the Companies Act, 2013 provides certain expertise/skills related to the eligibility for the appointment of an independent director. Presently, in terms of the SEBI Listing Regulations, the nature of expertise/skill of a director must be intimated to the shareholders at the time of such director's appointment or re-appointment.

The Kotak Committee has recommended that every listed entity shall disclose in its annual report, a chart or a matrix setting out the skills/expertise/competence of the board of directors, specifying (i) list of core skills/expertise/competencies identified by the board of directors as required in the context of its business(es) and sector(s) for it to function effectively, and those actually available with the board, with effect from financial year ended March 31, 2019; and (ii) names of directors who have such skills/expertise/competence, with effect from financial year ended March 31, 2020. The recommendation of Kotak Committee in this regard is aimed at ensuring that the shareholders are fully apprised of the ability and capability of the board. Such recommendation has been accepted by SEBI in its Board Meeting.

Minimum number of directors, gender diversity and separation of roles of non-executive chairperson and managing director/ chief executive officer

In accordance with the Companies Act, 2013, a public limited company is required to have a minimum of three directors on its board. There is no similar requirement in the SEBI Listing Regulations. In the opinion of the Kotak Committee, the board of directors plays an important role in a company's governance and performance, and it is therefore essential that a company has sufficient number of directors on its board to ensure that it can carry out its functions effectively. The Kotak Committee has accordingly recommended that for any listed entity, a minimum of six directors should be required on the board of directors, which has been accepted by SEBI in its Board Meeting.

Further, both the Companies Act, 2013 and the SEBI Listing Regulations require at least one woman director on the board of directors of every listed entity. To further improve gender diversity on corporate boards, pursuant to the Kotak Committees' recommendation with modifications, SEBI in the Board Meeting has proposed that (i) the top 500 listed companies (by market capitalisation) shall have at least one woman independent director on their respective boards by 1 April 2019; and (ii) the top 1,000 listed companies (by market capitalisation) shall have at least one woman independent director on their respective boards by 1 April 2020.

Currently, in terms of the Companies Act, 2013, an individual shall not be appointed/ reappointed as the chairperson of a company as well as its managing director/ chief executive officer at the same time, unless the articles of such company provide otherwise, or the company does not undertake multiple businesses. SEBI Listing Regulations do not mandate a separation of the posts of chairperson and managing director/ chief executive officer of a listed entity, but state that it is a discretionary requirement for the listed entity. To provide a better and more balanced governance structure by enabling better and more effective supervision of the management, pursuant to the Kotak Committees' recommendation with modification, SEBI in the Board Meeting has proposed separation of the posts of chairperson and managing director/ chief executive officer of a listed entity (which is initially to be applicable to the top 500 listed companies by market capitalisation, with effect from 1 April 2010).

Going forward, the above mentioned compliances shall be required to be confirmed in Offer Documents and in other representations sought from the issuer company and/ or directors during the course of a transaction.

Enhanced role of the audit committee, nomination and remuneration committee and risk management committee

The Kotak Committee has made certain recommendations regarding the role of audit committees, nomination and remuneration committees, and risk management committees, which have been accepted by SEBI in its Board Meeting.

The role of the audit committee shall be enhanced to include the review of the utilization of loans and/or advances /investment by the holding company in the subsidiary (including foreign subsidiaries), which exceeds INR 100 crore, or 10% of the asset size of the subsidiary, whichever is lower.

Further, all payments made to senior management, in whatever form, shall be recommended by the nomination and remuneration committee to the board of the listed entity to ensure that the spirit of good governance is not undermined while remuneration is being paid to the senior management.

In relation to the role of the risk management committee, it has been recommended that cyber security be specifically covered as part of the function of monitoring and reviewing the risk management plan. Additionally, the provision of the risk management committee shall now be applicable to the top 500 listed entities, in comparison to the earlier requirement to the top 100 listed entities.

The terms of references and roles of the audit committee, nomination and remuneration committee, and risk management committee, are disclosed in Offer Documents of public issues. The enhanced role of the audit committee, nomination and remuneration committee, and risk management committee shall have to be approved by the board of listed companies, and accordingly the same shall be disclosed in such Offer Documents.

Disclosure of utilization of funds from QIP/preferential issue

SEBI in its Board Meeting has agreed to the recommendation of the Kotak Committee to disclose in its annual report, the utilization of funds raised through preferential allotments or QIPs undertaken in the relevant financial year, until such funds are fully utilized by the listed entity. The SEBI Listing Regulations impose certain periodic disclosures in relation to utilisation of proceeds from a public issue. The extension of such disclosure in respect of preferential allotments and QIPs in the annual report is a positive step towards greater transparency and accountability for shareholders. Going forward, an undertaking in relation to disclosure of utilisation of funds raised through a QIP in terms of the proposed amendment to the SEBI Listing Regulations, shall be included in Offer Documents of QIPs.

Disclosures of auditor credentials, audit fee, reasons for resignation of auditors, etc.

In terms of the Companies Act, 2013, the resigning statutory auditor is required to file form ADT-3 with the relevant Registrar of Companies along with the company of which he was statutory auditor, intimating the reasons for such resignation. The SEBI Listing Regulations require the company to inform the stock exchanges of a change in the auditor, without assigning any reasons for such resignation. The Kotak Committee has recommended disclosure of reasons of resignation of statutory auditor as given by such statutory auditor, to the stock exchanges, with effect from April 1, 2018, which has been accepted by SEBI. Henceforth, such reasons for resignation of statutory auditors shall also be disclosed in Offer Documents of QIPs.

Enhanced obligations on the listed companies with respect to subsidiaries

SEBI in its Board Meeting has agreed to the recommendation of the Kotak Committee to make it mandatory for a listed entity to appoint one independent director on its board of a foreign material subsidiary, in addition to the Indian material subsidiary, with effect from March 1, 2018. Further, it has recommended that the threshold for determining material subsidiaries should be 10% (instead of present threshold of 20%) of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year. Confirmation of compliance in relation to enhanced obligations on the listed companies with respect to their subsidiaries shall be disclosed in Offer Documents.

Secretarial Audit to be mandatory for listed entities and their material unlisted subsidiaries under SEBI LODR Regulations

Currently, the Companies Act, 2013 requires a secretarial audit only for listed entities and unlisted entities above a certain threshold. However, there is no specific provision for a secretarial audit under the SEBI Listing Regulations. The Kotak Committee has recommended to make secretarial audits mandatory for all listed entities and their material subsidiaries. The same has been agreed by SEBI in its Board Meeting. Confirmation of compliance of secretarial audit obligations by the listed companies shall be disclosed in the Offer Documents.

Transfer of securities

With the intention to curb fraud and risk of manipulation in physical transfer of securities by unscrupulous entities, SEBI has decided to amend Regulation 40 of the SEBI Listing Regulations to restrict effecting of transfer of securities of a listed entity unless it is in dematerialised form, even though Companies Act permits transfer of securities in physical form of any company (including listed companies). A disclosure in form of an undertaking and/ or in the terms of the issue, shall be included in the Offer Documents to state that the investors cannot transfer their shareholding in the issuer unless such shareholding is in dematerialised form.

The exact impact on disclosures in the Offer Documents could be better understood once the amendments to the SEBI Listing Regulations are notified pursuant to the decisions taken by SEBI in the Board Meeting.

Further, SEBI has approved certain other key changes to the legal regime of the securities market *vide* its Board Meeting. SEBI has decided to revise the existing enforcement framework for non-compliance of the SEBI Listing Regulations by listed companies, which includes – (i) comprehensive and wide regulations, non-compliances of which would lead to imposition of penalties by the stock exchanges; (ii) empowerment to the stock exchanges to freeze shareholding of the promoter and promoter group in such non-compliant entity, as well as their shareholding in other securities; and (iii) in case the non-compliance persists, suspension of listing of such listed companies.

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