SEBI REVAMPS GOVERNANCE AND DISCLOSURE REGIME FOR LISTED ENTITIES

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The Securities and Exchange Board of India (SEBI) plays a crucial role in regulating and developing the securities market in India. One of SEBI's key responsibilities is ensuring fair and transparent practices in securities listing and trading. To fulfil this objective, SEBI periodically updates and strengthens its regulations.

SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2015 (LODR), initially introduced in 2015, set forth various obligations for listed entities to ensure transparency and investor protection. The Securities and Exchange Board of India (SEBI) vide its notification dated 14 June 2023 has notified SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023 (LODR Amendment) which seeks to further strengthen the regulatory framework and address emerging challenges in the market.

The LODR Amendment is largely in furtherance of the consultation papers issued by SEBI on LODR earlier in February 2023 in respect of 'streamlining disclosures by listed entities and strengthening compliance with LODR' (CP on Disclosures) and 'strengthening corporate governance at listed entities by empowering shareholders' (CP on Corporate Governance) and also the consultation paper issued in November 2022 in respect of 'review of disclosure requirements for material events or information' (CP on Regulation 30) (collectively SEBI LODR CPs). Worthwhile to note that the recommendations in the SEBI LODR CPs among other amendments to LODR were discussed in the SEBI board meeting on 29 March 2023 and approved for carrying out certain amendments to the LODR, resulting in the LODR Amendment.

Worthwhile to note that the LODR Amendment is the 38th amendment to the LODR ever since it was notified in 2015. On one hand it shows SEBI's response to the rapidly changing circumstances, while on the other hand it shows the regulator's trust deficit towards corporate governance and compliance practices adopted by listed entities. It would have been reasonable to expect that the listed companies will have enough reasons not to emulate the mischievous conduct observed by SEBI in a few cases.

While the efforts to empower public shareholders of the listed companies is a welcome move, some of the amendments appear to ideologically negate the globally accepted 'majority rule' in the management of affairs of a company. Since the public shareholding in many Indian listed companies is fragmented or widely scattered, the public shareholders seem to have 'control' over microscopic commercial decisions. The approach of the proxy advisory firms as fiduciaries to the stock market to the proposals requiring majority of public shareholders votes is likely to determine the success of the empowerment philosophy.

This update deals with the LODR amendment by thematically breaking down the key amendments brought about by the LODR Amendment into two categories: (a) amendments enhancing disclosure; and (b) amendments strengthening governance.

As a thumb rule, the LODR Amendment shall be effective from the thirtieth day from date of publication of the notification, i.e., 14 July 2023, subject to certain exceptions (some of which are effective immediately from the date of publication of the notification, i.e., 14 June 2023) which have been dealt with in the course of the update.

A. AMENDMENTS ENHANCING DISCLOSURE

With respect to the disclosure regime, the LODR Amendment has: (a) enhanced the disclosure requirements; (b) included new items as disclosable events/information; (c) shortened the timelines for disclosure; and (d) introduced objective quantitative thresholds for determining materiality of events/transactions for stock exchange intimations. All these will bring will eliminate subjectivity in ascertaining the materiality of events/information and ensure much needed uniformity of disclosures by listed entities.

The key changes in the LODR disclosure regime have been summed up below:

1. Streamlined timelines for disclosure

a. Stock exchange intimation timelines: By way of regulation 30(6), SEBI has

attempted to consolidate the timelines for stock exchange intimation in one clause, which was otherwise scattered between regulation 30(6) and Schedule III.

Under the new regime, listed entities are required to continue making disclosure to stock exchange 'as soon as reasonably possible', but not later than:

i. 30 minutes from closure of the board meeting, in which decisions pertaining to the event/information has been taken;

ii. 12 hours from the occurrence of the event/information, in case the event/information is emanating from within the listed entity; and

iii. 24 hours from the occurrence of the event/information, in case the event/information is not emanating from within the listed entity.

The listed entities (particularly those with pan-India presence) will have to review and ensure time-sensitivity of the internal communications and protocols to ensure compliance with the shortened disclosure requirements. The difference in time window for disclosure based on the origin of event/information is likely to be a bone of contention for listed entities to follow through with. Factors like availability of tools for tracking such event/information, knowledge of event/information are few of the practical difficulties that listed entities would face which could impact the disclosure of such events/information within the aforesaid timelines.

b. Advance notice for investor meet: In terms of regulation 46(2)(o), the listed entity is required to disseminate, on its website, schedule of analysts or institutional investors' meet and presentations made by the listed entity to analysts or institutional investors. Under the new regime, the requirement is to publish such information (akin to the disclosure requirements under Regulations 29 (2)) at least 2 working days in advance (excluding the date of the intimation and the date of the meet).

c. Publication of first financial result post initial public offer: In terms of regulation 33(3)(i), a newly listed entity post the initial public offer has to submit its first financial results (for the quarter or the financial year last quarter and annual immediately succeeding the period for which the financial statements have been disclosed in the offer document for the initial public offer) post listing within 21 days from the date of listing. This addresses the crunch in timeline a newly listed entity is likely to face on account of time gap between date of listing and statutory reporting deadline under 33(3), on a case to case basis. This amendment was publicly floated in the CP on Disclosures on the basis of representations received by SEBI from newly listed entities. While this regulation shall take effect from the thirtieth day from date of publication, please note that it has been clarified that it shall be applicable to the issuers whose public issues open on or after these regulations come into effect.

The timeline for submission of first financial results, by newly listed entities, post the initial public offer, has been streamlined in order to overcome the challenges in immediate submission of financial results post listing and to ensure that there is no omission in submission of financial results.

2. Prescribed quantitative materiality thresholds for disclosure

a. Quantitative materiality thresholds: Schedule III has 4 categories of lists of events/information, which triggers stock exchange intimation under regulation 30, being event/information to be reported regardless of materiality (paragraph A), material event/information (paragraph B), event/information likely to affect the business of the listed entity or exclusively known to listed entity and required to be disclosure for symmetry of public information (paragraph C) and residuary category for voluntary disclosure (paragraph D). As is evident from the plain reading, reporting of event/information listed in paragraph B hinges on assessment of whether such event/information is material, and to this end listed entities are required to formulate and adopt a policy for determination materiality (Materiality Policy).

By way of the LODR Amendment, SEBI has brought in the recommendation of CP on Regulation 30 to institutionalise and standardise quantitative thresholds for

assessing materiality of event/information. Under the new regime the additional requirement to consider event/information material has been quantified, such that disclosure is warranted, if the value or expected value impact exceeds:

i. 2% of turnover (as per the last audited consolidated financial statements of the listed entity);

ii. 2% of net worth (as per the last audited consolidated financial statements of the listed entity, except in case the arithmetic value of the net worth is negative); or

iii. 5% of the average of absolute value of profit or loss after tax (as per the last three audited consolidated financial statements of the listed entity).

b. Application of quantitative materiality thresholds to continuing event/information: Another critical item is that any continuing event/information becoming material as per the above threshold shall be required to be disclosed by listed entity within 30 days from effective date of LODR Amendment. In this context, it would be relevant to note that the effective date of LODR Amendment ranges event specific date to date of publication of the notification (i.e., 14 June 2023) and thirtieth day from the date of publication of the notification (i.e., 14 July 2023). That being the case clarity on the effective date for the purpose of reporting of continuous material event/information would be key.

c. Pointers to bear in mind for amending/updating Materiality Policy: The LODR Amendment has also specifically prohibited the listed entities from diluting the prescribed quantitative thresholds in listed entities' Materiality Policy. An action item for listed entities to specifically bear in mind in respect of this change is the need to update the Materiality Policy, bearing the foregoing in mind and ensuring that the prescribed quantitative thresholds are not diluted, directly or indirectly, in listed entities' Materiality Policy.

d. Emphasis on role of employees for assistance in determining materiality: The LODR Amendment has recognised the role of employees in identifying any potential material event/information and reporting to the key managerial personnel(s) (KMP), authorised by the board of directors of the listed entity to determine materiality. Given that the new quantitative thresholds provide for both actual impact and also expected impact, the listed entities and especially the KMP(s) charged with the responsibility of determining materiality shall have added responsibility to shoulder, while taking the call on reportable event/information under paragraph B of Part A of Schedule III. To assist and enable the authorised KMPs to effectively undertake this responsibility, it would be worthwhile for the listed entities, to (i) publicise their Materiality Policy among the employees so that employees are aware of their own onus of responsibility and are able to act accordingly and (ii) build reporting infrastructure in place, so that the employees may highlight the reportable events to the KMPs.

3. Top listed entities to address market rumours

In terms of regulation 30(11), the top 100 listed entities (with effect from 1 October 2023) and top 250 listed entities (with effect from 1 April 2024) are required to confirm, deny or clarify along with current status of rumoured event/information reported on the mainstream media, which is not general but indicative of impending event/information, within 24 hours of such media reporting. Mainstream media has an inclusive definition under regulation 2(ra) comprising of print or electronic modes of newspapers and news channels (being registered/permitted by relevant authority in India or any other jurisdictions), and content published by publisher of news and current affairs content as defined under Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021.

While this development is a step towards transparency, it can dampen the commercial vigour of listed entity (as tracking such rumours is likely to be a time consuming and tedious process), as the listed entity is now under obligation to not only comment on a market rumour but also provide its status. To ensure compliance, the listed entity would be required to keep pace with the media developments, effectively track such media

developments to be able to timely verify and respond to the market rumour.

Lastly, although mainstream media has been defined, the interpretational developments thereof would be interesting to watch out vis-à-vis finfluencers.

4. Changes in reporting and disclosure requirement

A listed entity is now required to make disclosure in respect of the following items as well:

a. Cybersecurity and data privacy incidents: Listed entities are required to compile and disclose details of cyber security incidents or breaches or loss of data/documents in the quarterly compliance report on corporate governance.

b. Regulation communication/action: Listed entities are required to disclose communication from any regulatory, statutory, enforcement or judicial authority, unless such disclosure is prohibited by the authority.

c. Agreement binding listed entity: Listed entities are required to disclosure requirement for certain types of agreements binding listed entities like shareholder agreements, joint venture agreements, family settlement agreements (to the extent that it impacts management and control of the listed entity), agreements with media companies etc. This amendment comes riding on the back of Part A of CP on Corporate Governance. Further, the agreements that are subsisting as on the date of notification of the LODR Amendment, the parties to the agreements shall inform the listed entity, about the agreement to which such a listed entity is not a party and the listed entity shall in turn disclose all such subsisting agreements to the stock exchanges and on its website within the timelines as specified by the Board. Revisions or amendments and termination of such agreements too have to be disclosed.

Also, the listed entity shall disclose the number of agreements that subsist as on the date of notification of the LODR Amendment, their salient features, including the link to the webpage where the complete details of such agreements are available, in the Annual Report for the financial year 2022-23 or for the financial year 2023-24.

d. ESG based disclosures: Regulation 34(f) has been updated to provide for business responsibility and sustainability report (BRSR) and remove the obsolete reference to BRSR's predecessor, business responsibility report. Further, the ESG related compliance has been amped up to require reporting entities to provide assurance of certain key performance indicators specified by SEBI under BRSR Core in furtherance of SEBI's consultation paper on 'ESG disclosures, ratings and investing' (CP on ESG). CP on ESG had discussed the importance of assurance in terms of attributing credibility and maintaining investor confidence. This regulation, in relation to the ESG based disclosures, has come into effect from date of publication, i.e., 14 June 2023.

e. Sale, lease or disposal of an undertaking outside scheme of arrangement: The listed entities are required to take prior approval of shareholders and also disclose object and commercial rationale for carrying out any sale, lease or disposal of an undertaking outside scheme of arrangement. This amendment was browsed in the CP on Corporate Governance and caters to the circumstance where transaction pertaining to undertaking takes place through a mechanism like slump sale, not approved by the National Company Law Tribunal, in an attempt to safeguard the interest of minority shareholders.

   This regulation has come into effect from date of publication, i.e., 14 June 2023, however the new regime shall not be applicable to such sale, lease or disposal of undertakings of a listed entity where the notice has already been dispatched to the shareholders of the listed entity.

f. Update in events triggering stock exchange intimation regarding non-convertible securities:

   Under the new regime, SEBI has brought down the disclosure compliances in respect of NCS down to submission of certificate, to stock exchange by listed entity, regarding status of payment of interest or dividend or repayment or redemption

of principal of NCS, within 1 working day of it becoming due. This regulation has come into effect from date of publication, i.e., 14 June 2023.

g. Fraud/default linked disclosure enhanced: Fraud/default linked disclosure have been enhanced to include:

   i. fraud/defaults by director, senior management (SM) or subsidiary of the listed entity, or

   ii. arrest of KMP, SM, director of the listed entity, whether occurred within India or abroad.

   In this respect, it is worthwhile to note that fraud by director is now mandatorily disclosable irrespective of breach of materiality thresholds.

   Further, as far as reporting of fraud/default by SM is concerned, it is relevant to bear in mind that SM is defined under regulation 16(d) and means: (a) officers and personnel of the listed entity who are members of its core management team, excluding directors, (b) all the members of the management one level below the chief executive officer (CEO)/managing director (MD)/whole time director (WTD)/manager, including CEO/manager who are not directors of the listed entity, (c) functional heads, by whatever name called, and (d) company secretary and chief financial officer (CFO). Given the wide net of cast by the definition of SM, it would be prudent for listed entities to maintain a list of persons eligible for classification as SM. In order to ensure compliance with this disclosure requirement, the listed entity may also consider revisiting its agreements with its SM to contractually obligate the SM to bring fraud/default by SM to listed entity.

   Additionally, clarity has been brought in by way of definitions of fraud and default:

   i. definition of fraud has been aligned with Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, and

   ii. definition of default has been inserted to mean non-payment of the interest or principal amount in full on the date when the debt has become due and payable.

h. Changes in mandatory disclosure items under Schedule III: There are couple of changes in paragraph A of Part A of Schedule III, the same have been summarised below:

   i. Acquisition and restructuring related entry amended to include sale or disposal of whole or substantially the whole of the undertaking and sale of stake in associate company of the listed entity.

   ii. New ratings disclosable, in addition to revision of ratings.

   iii. Insertion of disclosure of agreements entered into by the shareholders, promoters, promoter group entities, related parties, directors, key managerial personnel, employees of the listed entity or of its holding, subsidiary or associate company, among themselves or with the listed entity or with a third party, solely or jointly, which, either directly or indirectly or potentially or whose purpose and effect is to, impact the management or control of the listed entity or impose any restriction or create any liability upon the listed entity. An exception to the foregoing is such agreement being entered into by the listed entity in the normal course of business.

   In respect of this inclusion, worthwhile to note the use of phrases 'impact the management' and 'impose any restriction' or 'create any liability' as qualifiers triggering disclosure of aforementioned agreements even if the listed entity is not a transaction party to the agreement, all of which read with 'directly or indirectly' increase the net cast by this disclosure item.

   iv. Change in SM inserted as a disclosable item. Relevant to note that this is also required to be disclosed in the section on corporate governance of the annual report.

v. Resignation of KMP, SM, compliance officer (CO), director (other than independent director (ID)) disclosable along with letter of resignation which should have detailed reasons for resignation.

vi. Indisposition or unavailability of MD or CEO for more than 45 days in any rolling period of 90 days is another disclosable item.

vii. Announcement or communication through social media intermediaries or mainstream media by directors, promoters, KMP or SM of a listed entity, in relation to any event/information reportable under LODR and not already available in the public domain is required to be disclosed by the listed entity under regulation 30 on such announcement or communication.

viii. Actions initiated or order passed by any regulatory, statutory, enforcement authority or judicial body against the listed entity or its directors, KMP, SM, promoter or subsidiary, in respect of 3 events: (a) search and seizure, (b) reopening of accounts under section 130 of the Companies Act, 2013 (Companies Act), or (c) investigation under the provisions of Chapter XIV of the Companies Act, is required to be disclosed by listed entity with the information detailed in the LODR Amendment like name of authority, date of receipt of direction/order, details of allegations and impact on financial operations of the listed entity.

ix. Action(s) taken or orders passed by any regulatory, statutory, enforcement authority or judicial body against the listed entity or its directors, KMP, SM, promoter or subsidiary, in relation to the listed entity, in respect of certain identified events is also considered disclosable.

x. Voluntary revision of financial statements or report of board of directors of the listed entity.

i. <u>Changes in material event/information based disclosure items under Schedule III</u>: The LODR Amendment has also tweaked certain event/information reportable in case of breach of materiality, the changes have been summarised below:

i. Instead of disclosure of mere litigation/dispute/regulatory action with impact, the listed entity is now required to disclose, based on materiality breach, pending of such proceedings.

ii. Emphasis on nomenclature has been diluted for disclosure of instance when listed entity gives guarantee or indemnity or becomes a surety for any third party by expressly qualifying the disclosure item to state 'by whatever name called'.

iii. Insertion of delay or default in the payment of fines, penalties, dues, etc. to any regulatory, statutory, enforcement or judicial authority as a disclosable item.

B. AMENDMENTS STRENGTHENING GOVERNANCE

The LODR Amendment has also brought in a slew of corporate governance based amendments focused on KMPs, board permanency, management of vacant offices and promotion of equitability among shareholders.

1. Vacancy in the office of certain personnel

Any vacancy in the office of CO and certain identified KMPs, i.e., CEO, MD, WTD, manager and CFO shall be filled by the listed entity at the earliest, and not later than 3 months from the date of vacancy, squeezing out the 6 months window available for appointment under the Companies Act. Further, it has been provided that for appointing any person in such offices for the interim period shall require compliance with the applicable laws. Therefore, with respect to KMP appointments, especially interim appointments, it shall be necessary to bear in mind section 203 of the Companies Act, which prohibits *inter alia* dual employment of person in KMP positions.

While this amendment means well, attributing high value to the role of KMPs and CO (as should be) and nudging listed entities to adopt succession planning especially of KMPs, listed entities might struggle in practical implementation.

2. Addressing board permanency

SEBI recognising the issue of board permanency, which essentially refers to a situation where a director is appointed either without any defined end date/ tenure or with the aid of provisions in the articles of association, permitted permanent director. To address this issue in the light of the requirement of director retirement under the Companies Act, SEBI pondered on the requirement to mandate shareholder approval for all categories of directors of a listed entity, in the CP on Corporate Governance.

Accordingly, by way of regulation 17(1D), with effect from April 1, 2024, the continuation of a director serving on the board of directors of a listed entity shall be subject to the approval by the shareholders in a general meeting at least once in every 5 years from the date of their appointment or reappointment, with exceptions for:

a. WTD/MD/manager/ID/director retiring as per section 152(6) of Companies Act, if the shareholder approval for continuation or reappointment has otherwise been obtained;

b. Court or tribunal appointed director;

c. Nominee director of the Government on the board of listed entity (other than public sector company);

d. Nominee director a financial sector regulator on the board of a listed entity;

e. Director nominated by a financial institution registered with or regulated by the Reserve Bank of India (RBI) under a lending arrangement in its normal course of business; and

f. Director nominated by a debenture trustee registered with the board under a subscription agreement for the debentures issued by the listed entity.

Further, any person continuing as director as on 31 March 2024, without the shareholder approval for 5 or more years shall be required to be approved by the shareholders in the first general meeting post 31 March 2024.

As a necessary implication of this amendment, all persons having permanent directorship status in the listed entity, which are typically promoter directors, shall now be required to seek shareholder approval for continuation as director on the board. The requirement of obtaining shareholder approval also exposes such directors to proxy advisory scrutiny. It would be interesting to see what parameters (legal and higher than law standards) are adopted by proxy advisors for evaluation of such resolution for providing voting recommendation.

3. Vacancy in the office of director

Similar to provision for managing vacancy in office of KMPs and CO under regulation 26A, regulation 17(1E) has been inserted to provide the same timeline of 3 months from the date of vacancy for the listed entity to fill the vacant office of a director. This action requirement is relaxed and not applicable to a situation where the board of a listed entity is compliant with the board composition as set out under the LODR, which *inter alia* requires of appointment of at least 1 woman director (or 1 woman ID for top 1000 listed entities), at least 50% of the board comprising of non-executive directors (NED) and similar ratio of ID depending on the chairperson.

There is further emphasis placed on maintaining board composition as prescribed under LODR, and accordingly, in the instance the vacancy disturbs such statutory board composition making the listed entity non-compliant, in such case the requirement is for the listed entity to fill the vacant office on the date such office is vacated.

Listed entities without board planning are likely to have a tough time implementing this amendment real time, especially with the limited pool of talent pool having the skillset to take charge as director on the board of a listed entity and more importantly, having values that resonate with other members of the board. It would be unfortunate for a listed entity to appoint a director in a hurry to fill vacancy and end up in board partisan and conflict.

4. Approval of special rights to shareholders

Regulation 31A requires that any special right granted to shareholder(s) of listed entity shall be subject to shareholder approval once in every 5 years starting from the date of grant of such special right. Some of common

illustrations of special rights contemplated to be approval driven are rights like nomination rights, veto rights / affirmative voting, information rights, anti-dilution rights, right of first refusal, tag along rights and divestment rights.

This approval requirement was recommended in Part B of the CP on Corporate Governance, with the agenda of ensuring equitable treatment of all shareholders, especially for listed companies with investor/shareholder(s) having negotiated commercial rights which continue despite listing and dilution of such shareholder(s)' stake.

A recognised exception to the approval requirement are special rights made available by a listed entity:

a. to a financial institution registered with or regulated by the RBI under a lending arrangement in the normal course of business, if such financial institution becomes a shareholder of the listed entity as a consequence of such lending arrangement, or

b. to a debenture trustee registered with the Board under a subscription agreement for the debentures issued by the listed entity, if such debenture trustee becomes a shareholder of the listed entity as a consequence of such subscription agreement for the debentures.

5. Deferring strict application to high value debt listed entities

By way of amendment to LODR in 2021, LODR was made applicable to high value debt listed entities (HVDLE), and the HVDLE were provided a window till 31 March 2023 to ensure compliance to the tee, and until then having the benefit of 'comply or explain' regime for adherence to LODR. By way of the LODR Amendment, the strict application of LODR, being the otherwise 'comply or be penalised' regime, has been deferred until 31 March 2024, which in effect allows a year more of 'comply or explain' regime vis-à-vis LODR for HVDLE. Please note that this regulation has come into effect from date of publication, i.e., 14 June 2023.

CONCLUSION

The LODR Amendment represents a significant step towards enhancing corporate governance, transparency, accountability, disclosure standards, and investor protection in the Indian securities market. The amendments reinforce board composition and independence, streamline definitions, strengthen the role of audit committees, and introduce stringent disclosure requirements. Through the amendment, SEBI aims to bring greater transparency, accountability, inclusivity in the functioning of listed entities, protect investor interests, promote fair practices, and maintain the integrity and stability of the market. While the LODR Amendments borrow heavily from the SEBI LODR CPs, a recommendation from the consultation papers which have been given a miss in this round of amendment was the recommendation to freeze demat accounts of the MD, WTD and CEO for continuing non-compliance with LODR/non-payment of fines by listed entity, which goes a long way to reinforce SEBI's commitment to regulate and not run a restrictive/prohibitive regime. SEBI's proactive role in addressing any challenges that arise on implementation of the LODR Amendment will be crucial for the successful execution of the LODR Amendment. While most of the LODR amendments are underscoring the need for listed entities to introspect the spirit of compliance, it is clear that the compliance and governance costs of listed entities will continue to grow substantially.

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AMBITION STATEMENT

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