



The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018

Background and Purpose

The Securities and Exchange Board of India ("SEBI") published the Report of the Committee on Corporate Governance dated October 5, 2017, under the chairmanship of Mr. Uday Kotak ("Kotak Committee") comprising recommendations aimed at ensuring:

- independence in spirit of independent directors and their active participation in functioning of the company. improving safeguards and disclosures pertaining to related party transactions. addressing issues in accounting and auditing practices by listed companies. improving effectiveness of board evaluation practices. addressing issues faced by investors on voting and participation in general meetings. disclosure and transparency related issues.

At its board meeting held on March 28, 2018, SEBI accepted several recommendations of the Kotak Committee and subsequently amended the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the "**Listing Regulations**") by way of notification of the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018 (the "**Listing Amendment Regulations**") on May 9, 2018. While certain of these amendments have already come into force since October 1, 2018, a majority of these amendments will come into force with effect from April 1, 2019. Since these amendments will require substantial changes in the existing corporate governance mechanism of listed and to-be listed companies, we seek to

highlight some of the key amendments that need to be noted for future compliance.

Key amendments under the Listing Amendment Regulations

Enhanced monitoring of related party transactions (Compliance with effect from April 1, 2019)

In line with the key objective of introducing measures to improve safeguards and strengthen transparency in relation to disclosure of related party transactions:

- the definition of a "related party" under the Listing Amendment Regulations has been broadened to include any person or entity belonging to the promoter or promoter group of the listed entity and holding 20% or more (individually) of shareholding in the listed entity.
- certain additional disclosure requirements have also been added, including:
 - submission of the disclosures of related party transactions on a consolidated basis within 30 days of publication of standalone and consolidated financial results for the half year in the format prescribed in the relevant accounting standards for annual results, to the stock exchanges and publishing the same on its website. *(to be complied with for the half year ending March 31, 2019).*
 - the annual report should include disclosures of transactions of the listed entity with any person or entity belonging to the promoter/promoter

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- Board composition - split in position of Chairman and Managing Director (Compliance with effect from April 1, 2020)
- Regulation of remuneration payable to non-executive directors (Compliance with effect from April 1, 2019)
- Regulation of remuneration payable to senior management (Compliance with effect from April 1, 2019)
- Strengthening monitoring and improving compliance at a consolidated level (Compliance with effect from April 1, 2019)
- Independent Woman Director (Compliance with effect from April 1, 2019 and April 1, 2020)
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group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results.

- approval of the shareholders (majority of minority) is needed for royalty/brand payments to related parties where the payment exceeds 2% of the annual consolidated turnover. This amendment seeks to regulate one of the most characteristic related party transactions which are undertaken by majority of the companies, in particular, those forming part of a conglomerate which use common intellectual property rights for their business operations. Such companies will now have to get their existing arrangements ratified by their shareholders.

Board composition - split in position of Chairman and Managing Director

(Compliance with effect from April 1, 2020)

- for top 500 listed companies (based on market capitalisation), the chairman must not be a 'relative' (as defined in the Companies Act, 2013 (the "**Companies Act**")) of the managing director or the chief executive officer.
- the chairman must be a non-executive director.

These amendments are aimed at achieving a more balanced governance structure by reducing excessive concentration of authority in a single individual and enabling better and more effective supervision of the management. A number of companies, in particular, which are promoter owned and controlled, tend to appoint one of the promoters as the managing director and chairman. Pursuant to this amendment, such companies will now need to find a suitable replacement for either of the positions.

Regulation of remuneration payable to non-executive directors *(Compliance with effect from April 1, 2019)*

- a special resolution is now required to be obtained from the shareholders every year, in which the annual remuneration payable to a single non-executive director exceeds

50% of the total annual remuneration payable to all non-executive directors.

- the fees or compensation payable to executive directors who are promoters or members of the promoter group is required to be approved by way of a special resolution, if – (i) the annual remuneration payable exceeds ₹ 5 crore or 2.5% of the net profits of the listed entity, whichever is higher; or (ii) where there is more than one such director, the aggregate annual remuneration to such directors exceeds 5% of the net profits of the listed entity.

As a consequence of these amendments, greater checks and balances have been brought in on the remuneration payable to non-executive directors, in particular, companies which have appointed their promoters and members of the promoter group as non-executive directors.

Regulation of remuneration payable to senior management *(Compliance with effect from April 1, 2019)*

- the role of the Nomination and Remuneration Committee (the "**NRC**") will now include recommending to the Board, the remuneration, in whatever form, payable to senior management. Prior to this amendment, in terms of the Companies Act, while the role of the NRC included formulation of a policy to ensure, among others, that the remuneration paid to the directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals, the NRC was not given powers to "recommend" the remuneration.
- the Listing Regulations did not categorically identify the management personnel which were covered within the definition of "senior management". As a consequence, it was noted that compensation paid to certain key management personnel (who did not fall within the definition of Companies Act) were not covered within the scope of the policy framed by NRC in some companies.

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It has now been clarified that persons in senior management should include all members of management one level below the chief executive officer/managing director/whole time director/manager (including CEO/manager, in case CEO/manager is not part of the board) and shall specifically include the company secretary and the chief financial officer.

Strengthening monitoring and improving compliance at a consolidated level

(Compliance with effect from April 1, 2019)

The Kotak Committee noted that under the previously existing threshold for determining “material subsidiaries”, the proportion of the subsidiaries being classified as such was low compared to the total number of subsidiaries of the listed companies. Further, the disclosure obligations with respect to material subsidiaries did not extend to subsidiaries incorporated in foreign countries. Thus, in order to increase monitoring at a consolidated level:

- the threshold for identification of “material subsidiaries” has been modified to include a subsidiary, whose income or net worth exceeds 10% (from the erstwhile 20%), of the consolidated income or net worth, respectively, of the listed company and its subsidiaries in the immediately preceding accounting year. However, for the purposes of compliance with the requirement for appointment of an independent director of the listed entity on the board of a material subsidiary, whether incorporated in India or not, the threshold for determining the “material subsidiary” will continue to remain 20%.
- all material unlisted subsidiaries (whether incorporated in India or not) are now required to undertake secretarial audit and annex it with its annual report, with effect from the year ended March 31, 2019.
- the requirement to appoint at least one independent director on the Board of the listed entity on the Board of an unlisted material subsidiary has been extended to subsidiaries incorporated in foreign countries as well.
- separate audited financial statements of each subsidiary of the listed entity in respect of a relevant financial year, uploaded at least 21 days prior to the date

of the annual general meeting which has been called to inter alia consider accounts of that financial year.

Independent Woman Director *(Compliance with effect from April 1, 2019 and April 1, 2020)*

While the Companies Act and the Listing Regulations require atleast one woman director to be appointed on the Board of every listed entity, in the interest of furthering women participation on corporate boards, pursuant to the Listing Amendment Regulations, top 500 and 1,000 listed entities (based on market capitalization) are now required to have one independent woman director by April 1, 2019 and April 1, 2020, respectively.

Increased disclosure requirements in the quarterly financial results *(Compliance with effect from April 1, 2019)*

- the Companies Act and the Listing Regulations mandate the submission of consolidated financial statements by a listed entity every financial year. However, keeping with the objective of greater transparency at a consolidated level, listed entities are now required to submit consolidated financial results on a quarterly basis as well.
- as part of the standalone and consolidated financial results for the half year, by way of a note, the statement of cash flows for the half-year also needs to be included. This amendment will provide investors meaningful information regarding business development, directions and information on the seasonality of some activities, collection efficiency, quality of revenue or asset liquidation efforts, etc. which may not otherwise be available in the quarterly financial results.
- the Kotak Committee was of the view that the audit/limited review of a listed entity did not often take into account a substantial portion of the group business since the accounts of the underlying subsidiaries did not typically undergo limited review/audit. Thus, pursuant to the Listing Amendment Regulations, listed entities are now required to ensure that, for the purposes of quarterly consolidated financial results, at least 80% of each of

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the consolidated revenue, assets and profits, respectively, will be subject to audit or in case of unaudited results, subject to limited review.

- the Listing Regulations require submission of the audited financial results in respect of the last quarter along with the results for the entire financial year, with a note stating that the figures of the last quarter are the balancing figures between audited figures in respect of the full financial year and the published year-to date figures up to the third quarter of the current financial year. To add further clarity, listed entities are now required to disclose by way of a note, the aggregate effect of material adjustments made in the results of the last quarter which pertain to earlier periods.

Other amendments to note compliance:

Unless otherwise stated, the amendments set out below need to be complied with effect from April 1, 2019:

- reduction in the maximum number of listed entity directorships to 8 (by April 1, 2019) and to 7 (April 1, 2020)
- any person who is serving as a whole time director / managing director in any listed entity is not allowed to serve as an independent director in more than three listed entities. The count for the number of listed entities on which a person is a director / independent director will include only those whose equity shares are listed on a stock exchange.
- the Board of top 1,000 and 2,000 listed entities (based on market capitalisation) to comprise not less than six directors by April 1, 2019 and April 1, 2020, respectively.
- appointment or continuation of tenure of non-executive directors of 75 years and above is subject to a special resolution.
- the risk management committee to be constituted for top 500 (from the erstwhile 100) listed companies (based on market capitalisation) and their role should include cyber security.
- the stakeholders' relationship committee should comprise at least three directors of which one should be an independent director.

- the role of the audit committee will include reviewing the utilization of loans and/ or advances from/investment by the holding company in the subsidiary exceeding ₹1,000 million or 10% of the asset size of the subsidiary, whichever is lower.
- all the listed entities (in addition to material unlisted subsidiaries as set out above) to undertake secretarial audit and annex with its annual report, with effect from the year ended March 31, 2019.
- quorum for Board meetings will be one third of the size of the Board or three members, whichever is higher in the top 1,000* listed entities and in the top 2000 listed entities (based on market capitalisation).
- top 100 listed entities (based on market capitalisation) shall hold annual general meeting within 5 months after the end of Fiscal 2019, i.e. by 31 August 2019.
- webcast of annual general meetings will be compulsory for top 100 entities (based on market capitalisation).
- details of utilization of funds raised through preferential allotment or qualified institutions placement to be disclosed in the annual report.

Further, while certain key amendments became effective from October 1, 2018, and several companies are still in the process of ensuring compliance. Set out below is a ready reference to these amendments:

- no person can be appointed or continue as an alternate director for an independent director of a listed entity.
- an independent director cannot be a non-independent director of another company on the Board of which any non-independent director of the listed entity is an independent director.
- independent directors cannot be and should not have been members of the promoter group of the company.
- directors and officers' insurance mandatory for all the independent directors of top 500 listed entities (based on market capitalisation).

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Certain key recommendations of the Kotak Committee have not been included in the SEBI Amendment Regulations yet, including:

- **change in composition of the Board of all listed entities so as to comprise 50% of independent directors** - while this recommendation is in line with the general objective of ensuring “independence in spirit” of the independent directors, the practical ramifications are fairly significant because a majority of the listed companies will need to make substantial changes to the composition of their boards, which will be a challenging and time consuming task..
- **right of certain promoters and significant shareholders to access material information, including unpublished price sensitive information, subject to an**

agreement being entered into between the listed entity and the promoter/ shareholder - this recommendation is aimed towards providing a transparent framework which regulates the information rights of certain promoters (including promoters of the promoter) and significant shareholders by introducing appropriate and adequate checks and balances to prevent any abuse and unlawful exchange of unpublished price sensitive information.

- **minimum compensation to independent directors (based on market capitalisation of the listed company)** - this was recommended in order to provide a risk-reward balance in the compensation payable to independent directors and to incentivise competent people to accept appointment as independent directors.

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