

INDIA'S SEBI AMENDS LODR TO INTRODUCE TIGHTER CORPORATE GOVERNANCE NORMS

By: Rukshad Davar, Partner and Head of M&A | Co-authored by: Yashaswee Sarkhel, Senior Associate and Anshul Isaac, Associate

Background

Last month, India's Securities and Exchange Board of India (the "SEBI") amended the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the "LODR") by way of the SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023 (the "Amendment Regulations"). The key changes introduced by the Amendment Regulations are highlighted in greater detail below.

Timely Filling up of Key Managerial Vacancies: The Amendment Regulations provide that vacancies arising in the following offices must be filled up within a period of **three (3) months** from the date of the vacancy:

- (i) Compliance Officer;
- (ii) Chief Executive Officer (CEO);
- (iii) Managing Director (MD);
- (iv) Whole Time Director;
- (v) Manager;
- (vi) Chief Financial Officer (CFO); and
- (vii) Director (however, any vacancy due to expiration of the term of office of any director must be filled not later than the date such office is vacated).

Interim appointments to these offices are expressly prohibited unless such appointments are made in compliance with all laws applicable to fresh appointments to such offices. Further, any such interim appointee will have the same obligations as a full-time appointee under all applicable laws.

Often listed companies fail to fill key managerial vacancies in a timely fashion, which has the potential of affecting a company's operations adversely. A definite timeline for appointment will ensure that adequate succession planning is put in place by listed companies (especially those that are family controlled) and will, thereby, improve the functioning of such companies. That said, listed companies need to avoid situations where replacements are rushed and the quality of the candidate is compromised.

Periodic Shareholder Approval for Certain Matters: Under the Amendment Regulations,

periodic shareholder approval will be necessary for the matters listed below.

(i) Continuity of a Director

Newly introduced Regulation 17(1D) of the LODR provides that the continuation of a director serving on the board of directors of a listed company will be subject to shareholder approval in a general meeting at least **once every five (5) years** from the date of appointment or reappointment (as the case may be). This requirement will be implemented from April 1, 2024 but will not apply to certain directors.¹

This step is expected to reduce or at least keep in check the practice of having a 'director for life' in many family-controlled listed companies. However, given that only an ordinary shareholder approval (i.e., a 50% + 1 resolution) is required to confirm the continuity of a director, this will be of little concern to any promoter group holding majority shareholding (more than 50%) of a listed company.

(ii) Continuity of Special Rights

Under the newly introduced Regulation 31B of the LODR, any special right granted to most shareholders² of a listed company will be subject to shareholder approval through a special resolution **once every five (5) years** starting from the date when such special right is granted. Any special right available to any shareholder of a listed company as on the date of introduction of this requirement will have to be re-confirmed after five (5) years from the date of the amendment and every five (5) years thereafter.

The SEBI has always been wary of special rights being made available to a small, sophisticated group of shareholders in listed companies, especially from the point of view of protecting the interest of public shareholders. This amendment is an effective tool to ensure that a few sophisticated shareholders of a listed company do not enjoy special rights on a permanent basis. A key point to note is that the special rights must be re-confirmed each time by way of a special resolution (requiring the approval of at least 75% of the voting shareholders). In our view, however, the five (5) year period may prove too long, considering that business dynamics are fast moving, and a shorter period of three (3) years may have served the purpose better.

New Materiality Thresholds and New Material Events: Regulation 30 of the LODR mandates the disclosure of certain “material” events and information by listed companies to stock

¹ **Note:** This requirement will not apply to whole time directors, managing directors, managers, independent directors, directors retiring by rotation as per the Companies Act, 2013, or directors nominated by a regulator, any court, tribunal, debenture trustee or lender.

² **Note:** This requirement will not apply to special rights granted to the following shareholders (if applicable): (i) regulated financial institution pursuant to a lending arrangement; or (ii) debenture trustee under a subscription agreement for the debentures.

exchanges. Regulation 30(2) read with paragraph A of Part A of Schedule III sets out a list of events which are deemed to be material and must be disclosed. Regulation 30(3) requires that any event listed in paragraph B of Part A of Schedule III, which is determined by the board to meet any of the materiality thresholds set out in Regulation 30(4), must be disclosed. The Amendment Regulations have supplemented both: (a) the list of material events set out in paragraph A of Part A of Schedule III (the “**Additional Events**”); and (b) the materiality thresholds set out in Regulation 30(4) that should be used by a listed company to determine whether an event set out in paragraph B of Part A of Schedule III must be disclosed (the “**Additional Thresholds**”).

- (i) Additional Events: Some of the key Additional Events are:
- (a) Any acquisitions made by a listed entity (including agreements to acquire) must be disclosed, subject to the cost of acquisition or the price of acquisition of shares meeting the materiality thresholds set out in Regulation 30(4)(i)(c) (*see below*).
 - (b) Any sale or disposal of: (A) whole or substantially the whole of any undertaking or subsidiary of a listed entity; or (B) a stake in an “associate company,”³ such that: (I) the company ceases to be a wholly owned subsidiary, subsidiary or an associate company of the listed entity; or (II) the sale value meets the materiality threshold set out in Regulation 30(4)(i)(c) (*see below*), must be disclosed.
 - (c) Any fraud or financial defaults by the listed entity or its subsidiaries, or arrests whether in India or abroad, of: (A) promoter(s); (B) director(s); (C) key managerial personnel; or (D) senior management, must be disclosed.
 - (d) Any resignation of the following officers of a listed entity along with the letter of resignation giving detailed reasons for the resignation, must be disclosed within seven (7) days from the resignation coming into effect: (A) key managerial personnel; (B) senior management; (C) compliance officer; and (D) director⁴.
 - (e) Any indisposition or unavailability for a period exceeding forty-five (45) days within any rolling period of ninety (90) days of the MD or CEO of the listed company must be disclosed along with reasons.
 - (f) Any announcement or communication made on social media or in mainstream media in relation to a material event or information that was not previously made available in the public domain by: (A) directors; (B) promoters; (C) key managerial personnel; or (D) senior management of a listed entity, must be disclosed.
 - (g) Any action initiated or orders passed by any governmental or regulatory authority against: (A) the listed entity; (B) its directors, key managerial personnel, senior management, or promoter; or (C) its subsidiary, in respect of: (I) search or seizure;

³ **Note:** This includes agreements to sell shares or voting rights in a company.

⁴ **Note:** This does not apply to an independent director.

(II) re-opening of accounts and investigation under the Companies Act, 2013; (III) suspension; (IV) imposition of fine or penalty; (V) settlement of proceedings; (VI) debarment; (VII) disqualification; (VIII) closure of operations; (IX) sanctions imposed; (X) warning or caution; or (XI) any other similar actions, along with the requisite details, must be disclosed.

(h) Any voluntary revision of financial statements or board report of the listed entity must be disclosed.

(ii) Additional Thresholds:

Prior to the introduction of the Amendment Regulations, the materiality thresholds existing under Regulation 30(4) were not precise and gave a large degree of subjectivity to the board of directors of a listed company in determining whether an event is material. While the Amendment Regulations have not reduced any of the already existing subjective materiality thresholds, it has added the Additional Thresholds (in Regulation 30(4)(i)(c)) which are significantly more objective in nature. Listed companies will now also be required to consider the following additional materiality thresholds while determining whether an event is material:

If the value or expected impact in terms of value of any event or information exceeds any of the following thresholds, it will now have to be disclosed:

- (a) 2% of turnover, as per the last audited consolidated financial statements of the listed company; or
- (b) 2% of net worth, as per the last audited consolidated financial statements of the listed company, except in the case the arithmetic value of the net worth is negative; or
- (c) 5% of the average of the absolute value of profit or loss after tax, as per the last three audited consolidated financial statements of the listed company.

Any continuing event that becomes material due to the above thresholds being crossed pursuant to the Amendment Regulations must be disclosed to stock exchanges within thirty (30) days of the date of the amendment.

The SEBI's move has essentially increased the extent of mandatory disclosures and, more importantly, reduced the subjectivity of the board's opinion in determining which events are material. As a result, a higher number of events will now have to be disclosed by listed companies, and the risk of important events not being disclosed due to board's discretion will be lower.

Further Disclosures: The following additional disclosure requirements have been introduced by the Amendment Regulations:

- (i) Certain Agreements: As per Regulation 30A, any agreement made by:
- (a) shareholders (including promoters and entities related to the promoter group);
 - (b) related parties;
 - (c) directors;
 - (d) Key Management Personnel (KMPs); and
 - (e) employees,

(each an “**Executing Party**”)

of a listed company, its holding company, subsidiary, or associate company that, directly or indirectly:

- (a) impacts the management or control of the listed company;
- (b) imposes restrictions on the listed company; or
- (c) creates liabilities for the listed company,

must be disclosed by the Executing Party to the listed company within two (2) working days of the execution. The listed company is then required to disclose such event to the relevant stock exchange(s). It is important to note that the execution of the aforesaid agreements have also been included paragraph A of Part A of Schedule III as a deemed material event, thereby creating a direct obligation on the listed company to disclose such agreements under Regulation 30(2) (*see above under New Materiality Thresholds and New Material Events*).

This is a broad disclosure requirement and is aimed at giving more visibility to public shareholders and the SEBI of the affairs of a listed company. Often a subsidiary or an associate of a listed company (which does not meet the thresholds of a ‘material subsidiary’ and related disclosure requirements under the LODR) undertakes obligations to ensure certain actions by the listed company (e.g., discharge of a payment obligation by the listed entity in case of a default by the subsidiary or associate). Such obligations will now have to be disclosed to the stock exchange(s).

- (ii) Cybersecurity Breaches: The Amendment Regulations require that details of cyber security incidents or breaches or loss of data or documents faced by listed companies must be disclosed as part of the quarterly compliance report on corporate governance submitted to stock exchanges.

Timelines: Prior to the Amendment Regulations, the LODR prescribed a uniform timeline of twenty-four (24) hours for the disclosure of material events or information under Regulation 30, save for those disclosures for which specific timelines were provided elsewhere in the LODR. The Amendment Regulations have introduced greater clarity and prescribe specific timelines within which disclosures are to be made under Regulation 30. These timelines are listed below:

- (i) thirty (30) minutes from the closure of the meeting of the board of directors in which the decision pertaining to the event or information has been taken;
- (ii) twelve (12) hours from the occurrence of the event or information, in case the event or information is emanating from within the listed company; or
- (iii) twenty-four (24) hours from the occurrence of the event or information, in case the event or information is not emanating from within the listed company.

It is important to note that, notwithstanding the aforesaid timelines, any timeline already specifically prescribed under Part A of Schedule III with respect to a particular event will continue to apply.

Sale, Lease or Disposal of an Undertaking outside a Scheme of Arrangement: Regulation 37A has been introduced, which provides that the prior approval of shareholders by way of a special resolution is required in the event of the sale, lease, or disposal of the whole or substantial whole of any undertaking of the listed company other than through a scheme of arrangement under the Companies Act, 2013.

Further, votes cast by the public shareholders in favor of the resolution must exceed the votes cast by such public shareholders against the resolution. In other words, any sale, lease or disposal must have the approval of the majority of the minority public shareholders. This requirement is not applicable if the sale, lease or disposal is to a wholly owned subsidiary of the listed company.

Business Responsibility and Sustainability Report: The Amendment Regulations replace the Business Responsibility Report under Regulation 34 of the LODR with a Business Responsibility and Sustainability Report. India's top one thousand (1000) listed companies by market capitalization will be required to submit a report containing disclosures on environmental, social, and governance aspects. The format and specifications of this report will be provided by the SEBI.

Responses to Reporting on Rumors: Regulation 30(11) of the LODR permitted listed companies to confirm or deny any information being reported on their own initiative. However, with effect from October 1, 2023, the top one hundred (100) listed companies (by market capitalization) will be obligated to confirm, deny or clarify any event or information indicating rumours of any impending material event within twenty-four (24) hours of such event or information being reported in the mainstream media. This obligation to respond to rumours is set to be extended to the top two hundred and fifty (250) listed companies with effect from April 1, 2024.

If the listed company confirms the reported event or information, it must also provide the current stage of such event or information. Previously, a mandatory requirement to clarify market rumours applied only if a clarification was sought by stock exchanges. Listed companies were not otherwise mandated to clarify market rumours.

In this regard, the Amendment Regulations has also defined the term “mainstream media”, inclusively, to mean:

- (i) newspapers registered with the Registrar of Newspapers for India;
- (ii) news channels permitted by the Ministry of Information and Broadcasting, Government of India; and
- (iii) content published by the publisher of news and current affairs content as defined under the Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021.

The definition also includes newspapers or news channels, or news and current affairs content providers similarly registered or permitted or regulated in jurisdictions outside India.

At first sight, this is a welcome change that may go some distance in quelling investor speculations and short-term volatility in share prices of large, listed companies solely based on rumors. However, the obligation to confirm, deny or clarify every single event or information (which indicates a rumour) reported in the mainstream media may be counterproductive in certain cases, as the act of confirmation, denial or clarification itself may lead to more speculation and price volatility.