



# Regulatory Update - Approval of Certain Recommendations Contained in the Report of the Committee on Corporate Governance by the Securities and Exchange Board of India

Regulatory Update  
March 30, 2018

In light of various developments in the realm of corporate governance across the globe and in continuation of its role as a proactive regulator, the Securities and Exchange Board of India (“SEBI”) constituted a committee under the Chairmanship of Mr. Uday Kotak in June 2017 to suggest suitable policy and regulatory changes required to be carried out in order to enhance the efficiency of corporate governance norms for Indian listed entities (“**Kotak Committee**”). The Kotak Committee, submitted its report (“**Report**” or “**Kotak Committee Report**”) on October 5, 2017 after detailed deliberation with various experts and stakeholders. The Report contained recommendations pertaining to a plethora of regulatory changes to align Indian corporate governance norms with global best practices, while being premised on local business realities unique to India, such as the prevalence of large, concentrated shareholding blocks (as opposed to a dispersed shareholding pattern observed in few developed markets such as the United States of America), family run businesses and “promoter – raj”.

It is pertinent to note, that the board of SEBI, has inherent powers to either accept/reject/ partially accept recommendations given by an expert committee set up by it. SEBI, in its board meeting held on March 28, 2018, approved the adoption of some important recommendations of the Kotak Committee (some with modifications as to time-lines, applicability ), and referred certain others, including those pertaining to strengthening the role of Institute of Chartered Accountants of India (ICAI), internal financial controls, adoption of Ind-AS accounting standards by listed banks, NBFCs and insurance companies sans any extension on the timelines, restriction on exercise of voting rights on treasury stock and governance aspects of Public Sector Enterprises to various agencies such as the government, other regulators, and professional bodies.

Some of the key recommendations that have been approved by SEBI, and are proposed to be carried out primarily vide amendment to the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements), 2015 (“**LODR Regulations**”) are as follows –

- a) **Capping the Maximum Number of Directorships** –No person will be allowed to hold the office of director in more than eight listed entities at the same time (of which independent directorships are capped at seven) with effect from April 1, 2019. Further, with effect from April 1, 2020, such number is to be capped at seven.
- b) **Expanded Eligibility Criteria for Independent Directors** –No person who is a part of the promoter group can be appointed as an Independent Director. Further, to avoid the problem of ‘board interlocks’, a person who is a non-independent director of another company on the board of which any non-independent director of the listed entity is an independent director, will not be eligible to be an independent director in the listed entity.
- c) **Enhanced Role of the Audit Committee, Nomination and Remuneration Committee and Risk Management Committee** –
  - ♦ **Audit Committee** - The Audit Committee will have to review the utilization of loans and/or advances from/investment by the holding company in the subsidiary exceeding rupees100 crore or 10% of the asset size of the subsidiary, whichever is lower.
  - ♦ **Nomination and Remuneration Committee** – The Nomination and Remuneration Committee, which is currently mandated by the LODR Regulations to recommend to the board of directors the appointment and removal of the senior management of the listed entity, shall now have to identify and recommend to the board, the appointment and removal of persons for the positions/offices one level below the chief executive officer/managing director/whole time director/manager (including chief executive officer/manager, in case chief executive officer/manager is not a part of the board), specifically including the position of the company secretary and the chief financial officer: Such positions/offices will now be considered to be a part of the ‘senior management’. Further, it shall now be the duty of the Nomination and Remuneration Committee specifically to recommend to the board, all remuneration, in whatever form, payable to members of the senior management.
  - ♦ **Risk Management Committee** - The functions of the Risk Management Committee shall now specifically cover cyber security.
- d) **Disclosure of Utilization of Funds from Qualified Institutional Placement (“QIP”) /Preferential Issues** – Full disclosure of utilization of funds raised through Preferential Allotment and QIPs undertaken in the relevant financial year have to be made

in the Annual Report of the listed company until such funds are fully utilized.

- e) **Disclosures of Auditor Credentials, Audit Fee, Reasons for Resignation of Auditors** – A listed entity has to disclose in its Annual Report, the details of all fees paid by the listed entity and its subsidiaries (on a consolidated basis) to the statutory auditor and to all other entities in the network firm/network entity of which the auditor is a part. Further, the notice being sent to shareholders for an Annual General Meeting (“AGM”) where the statutory auditor(s) is/are proposed to be appointed/re-appointed will have to include the following disclosures as a part of the explanatory statement to the notice:-
- ♦ (a) Proposed fees payable to the statutory auditor(s) along with terms of appointment and in case of a new auditor, any material change in the fee payable to such auditor from that paid to the outgoing auditor along with the rationale for such change;
  - ♦ (b) Basis of recommendation for appointment, including the details in relation to and credentials of the statutory auditor(s) proposed to be appointed.

Apart from the above, detailed reasons for resignation of an auditor as given by the said auditor has to now be disclosed to the stock exchanges.

- f) **Disclosure of Expertise/Skills of Directors** – The listed entity is required to disclose a chart or a matrix setting out the skills/expertise/competence of the board of directors in its Annual Report containing a 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 in the Financial Year -2018-2019.

Further, detailed disclosures of competencies of every board member, along with their names have to be disclosed in the Annual Report for the Financial Year 2019-2020.

- g) **Enhanced Disclosure of Related Party Transactions (“RPT”) and Permitting Related Parties to vote against RPTs** - A listed entity has to submit within 30 days of publication of its standalone and consolidated financial results for the half year, disclosures of RPTs on a consolidated basis, in the format prescribed in the relevant accounting standards for annual results, to the stock exchanges and to publish the same on its website. Further, listed entities will now have to include disclosures of transactions of the listed entity with any person or entity belonging to the promoter/promoter group which hold(s)10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results in its Annual Report.

Apart from the above, related parties will now be permitted to vote ‘against’ a material RPT as opposed to the extant position, whereby there is a blanket ban on voting in the proposal to accept a material RPT by shareholders.

- h) **Mandatory Disclosure of Consolidated Quarterly Results with effect from Financial Year 2019-2020** –A listed entity has to mandatorily disclose consolidated quarterly results with effect from Financial Year 2019-2020.
- i) **Enhanced Obligations on Listed Entities with Respect to Subsidiaries** –One independent director on the board of directors of a listed entity should also be a director on the board of a directors of its unlisted foreign material subsidiary (as opposed to the extant requirement pertaining to an unlisted material subsidiary incorporated in India). In addition, the board of all listed entities will have to be appraised of significant transactions involving all unlisted subsidiaries (as opposed to the extant requirement of significant transactions of only unlisted material subsidiaries).

Apart from the above, a material subsidiary will now be defined as a subsidiary, whose income or net worth exceeds ten (as opposed to twenty) percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

- j) **Secretarial Audit to be Mandatory for Listed Entities and their Material Unlisted Subsidiaries** –All listed companies and their material subsidiaries incorporated in India will have to undertake secretarial audit and annex a secretarial audit report given by a practicing company secretary with their Annual Reports.
- k) SEBI has approved the following recommendations of the Kotak Committee with certain modifications as to timelines and/or applicability threshold (by market capitalization):
- ♦ SEBI has approved the recommendation of the Kotak Committee pertaining to the requirement of a minimum of six directors on the board of a listed entity. However, the said requirement shall apply to the top 1000 listed entities (by market capitalization) by April 01, 2019 and to the top 2000 listed entities by April 01, 2020 (as opposed to the recommended timeline of implementation of October 1, 2018).
  - ♦ The Kotak Committee had recommended that at least one woman director on the board of a listed entity had to be independent. SEBI has accepted the said recommendation. However, the said requirement is to apply to only the top 500 listed entities (by market capitalization) by April 1, 2019 and to the top 1000 listed entities by April 1, 2020 (as opposed to the recommended timeline for implementation of October 1, 2018).

- ◆ The recommendation of the Kotak Committee pertaining to quorum requirements for every meeting of the board of directors of a listed entity, mandating such quorum to be one-third of the total strength of the board of directors or three directors, whichever being higher, was accepted by SEBI for the top 1000 listed entities (by market capitalization) to be adopted from April 1, 2019, and for the top 2000 listed entities to be adopted from April 1, 2020 (as opposed to the recommended timeline for implementation of October 1, 2018).
  - ◆ The top 100 listed entities by market capitalization have to hold their AGM within a period of five months from the date of closing of the Financial Year 2018-2019 i.e. by August 31, 2019 (instead of the proposed date of August 31, 2020).
  - ◆ The Kotak Committee strongly recommended the separation of powers of the chairperson (i.e. the leader of the board) and CEO/MD (i.e. the leader of the management) for listed entities having a public shareholding of 40% or more. Keeping in view the merits of the proposal, SEBI approved separation of CEO/MD and Chairperson, but made such requirement applicable to the top 500 listed entities (by market capitalization) with effect from April 1, 2020.
- l) SEBI has approved the following recommendations of the Kotak Committee with other modifications:
- ◆ SEBI approved the mandatory webcast of AGMs (instead of the proposed webcast of all shareholder meetings) for top 100 entities by market capitalization with effect from Financial Year 2018-19.
  - ◆ SEBI approved the mandating of shareholder approval (majority of minority) for royalty/brand payments to a related party exceeding 2% of consolidated turnover (instead of the proposed 5%).

*Disclaimer: The information provided in this update is intended for informational purposes only and does not constitute legal opinion or advice. Readers are requested to seek formal legal advice prior to acting upon any of the information provided herein. This update is not intended to address the circumstances of any particular individual or corporate body. There can be no assurance that the judicial/ quasi judicial authorities may not take a position contrary to the views mentioned herein.*



**ECONOMIC  
LAWS  
PRACTICE**  
ADVOCATES & SOLICITORS

**MUMBAI**  
[mumbai@elp-in.com](mailto:mumbai@elp-in.com)

**AHMEDABAD**  
[ahmedabad@elp-in.com](mailto:ahmedabad@elp-in.com)

**NEW DELHI**  
[delhi@elp-in.com](mailto:delhi@elp-in.com)

**PUNE**  
[pune@elp-in.com](mailto:pune@elp-in.com)

**BENGALURU**  
[bengaluru@elp-in.com](mailto:bengaluru@elp-in.com)

**CHENNAI**  
[chennai@elp-in.com](mailto:chennai@elp-in.com)

© Economic Laws Practice 2018