February, 2024

DIRECTIVES AND THEIR DIRECTION

M. Damodaran
Chairperson, Excellence Enablers
Former Chairman, SEBI, UTI and IDBI

Regulators have got off to an early start this year by putting out a plethora of consultation papers. Regrettably, one cannot say 'Amen' to all the proposed amendments.

The Budget Speech (2023-24) of the Finance Minister exactly a year ago, contained 2 paragraphs of significant import in the context of promoting the ease of doing business. The relevant paragraphs are reproduced below for reference and recall.

"Financial Sector Regulations
99. To meet the needs of Amrit Kaal and to facilitate optimum regulation in the financial sector, public consultation, as necessary and feasible, will be brought to the process of regulation-making and issuing subsidiary directions.
100. To simplify, ease and reduce cost of compliance, financial sector regulators will be requested to carry out a comprehensive review of existing regulations. For this, they will consider suggestions from public and regulated entities. Time limits to decide the applications under various regulations will also be laid down."

The stated objectives are unquestionable and cannot be quarrelled with. Reduction of complexity and cost constitute major steps to facilitate business activities. However, there are some important aspects that should not be lost sight of.

The Policy of the Ministry of Corporate Affairs (MCA) for pre-legislative consultations and comprehensive review of existing rules and regulations addresses two related problem areas that financial sector regulators are obliged to grapple with. As far as pre-legislative consultation is concerned, it is necessary to not merely go through a well laid down process, but to bring to bear an open mind that is willing to carefully consider the suggestions that are received, and to accept and incorporate them, wherever considered appropriate. This concern is being expressed since it is often heard that even though a detailed consultative process has been gone through, there appears to be no change in the content of the original proposal, prompting the question whether suggestions were received, and if so, whether they were carefully considered. At the same time, many of the critics of the present pattern of consultation should bear in mind that consultation is not concurrence. There is no requirement for every suggestion, major or minor, to be accepted, following a detailed analysis. What can be quarrelled with is clearly the very short

time period made available to stakeholders to study the proposals, consider their implications, and to articulate the alternatives that they wish to suggest.

Having taken the trouble to lay down the detailed guidelines, the MCA has gone on to state that the Policy is advisory in nature, and should not be construed as a policy directive. This position has been taken since there are specific statutory provisions in some statutes on the manner of consultation. It would be useful to reconcile the differences, if any, and to formulate one common policy for consultations, without diluting its force, by stating that it is mandatory in nature.

The second aspect which the Policy paper addresses is the need for a comprehensive review of existing regulations. This is an area in which it is not necessary to reinvent the wheel. The RBI had several years ago put in place a regulatory review mechanism, by constituting a Regulatory Review Authority, which would look at existing regulations, retain what is relevant, restate what needs to be refined, and retire the irrelevant regulations. Separately, Excellence Enablers has for years been articulating the need for every authority that writes out regulations, to examine the stock element, and to weed out all regulations guidelines and the like that are past their sell by date. To ensure that this is done on an ongoing basis, the possibility of introducing sunset clauses, so as to compel a review, had also been suggested. This is an area where the prescription is available, and only the treatment needs to be commenced. What could be more value-adding in a consultative process is to state clearly the present position, the need for change, the manner and extent of change, and the alternatives that could be considered. It is equally important to give adequate time for the consultees to express their views. This could lead to lesser regulations, that are better crafted, and are easy to understand and comply with. The avoidable adversarial nature of the relationship between the Regulator and the regulated should not influence the process of consultation. This alone will give rise to regulations that are pragmatic and practicable.

Consistent with the announcement in the Union Budget for FY 23-24, SEBI has floated a consultation paper to harmonise the provisions of ICDR and LODR Regulations, with a view to facilitating the ease of doing business. SEBI's consultation paper contains the recommendations of a 21-member Expert Committee, that was constituted to make appropriate recommendations. At first sight, it would seem that the Expert Committee should have had more representation from promoters and senior management, and a few well informed and experienced Independent Directors (IDs). The Expert Committee has stated in its report that while the process of deliberating on the suggestions received, and finalising its recommendations, is ongoing, some recommendations pertaining to the ease of doing business under LODR and ICDR Regulations have been set out in the Report. One wonders whether this is the right approach considering that some of the other regulations that the Expert Committee is presently looking at would have to be harmoniously constructed with the LODR and the ICDR.

The number of interim recommendations will by themselves merit a very detailed paper. Therefore, for our present purpose, some of the issues given rise to by some interim recommendations are proposed to be addressed.

The first set of recommendations relates to applicability of regulations on the basis of market capitalisation. The problem sought to be addressed is the treatment to be accorded to companies which fall below the applicability threshold, and then cross the applicability threshold. Without getting into avoidable details, it would be better to state simply that when a company falls below the applicability threshold, the provisions shall cease to be applicable until such time as the company reaches a position above the applicability threshold. A period of 3 months could be prescribed to determine eligibility.

The next recommendation relates to the limit of membership and chairmanship of committees for a Director. The suggestion is that while operationalising the limit for the maximum number of committee positions, the Stakeholders Relationship Committee (SRC) should be excluded, and only the Audit Committee (AC) should be included. The Expert Committee seems to be of the view that in order not to breach the limits laid down, IDs prefer not to take up membership of the SRC. It would appear that the membership of a committee is by choice, and not by a considered decision of the Nomination and Remuneration Committee (NRC)/ Board, after taking into account the experience and the aptitude of the members concerned. The Expert Committee should have proceeded in the opposite direction, and stated that membership of the NRC and the Risk Management Committee (RMC), a non-statutory committee mandated by SEBI, should be taken into account, having regard to the increased importance of these committees, and the consequent time commitments that members of these committees will have to make. The underlying logic seems to be that there would not be enough persons to take up Board positions when a big churn takes place a few months from now. To put it mildly, this perceived supply constraint of candidates is an imaginary problem created by the unwillingness of Boards and managements to look beyond familiar territories and comfort zones while scouting for worthwhile candidates. This recommendation by the Expert Committee should be junked. What is immediately necessary is to reduce the number of directorships to a maximum of 5 in listed entities, and to

ensure that each such Director is a member of at least 2 committees of the Board. Omitting certain categories of companies, and limiting the regulatory maximum to only equity listed entities, is a move in the wrong direction.

The timeline for filling up vacancies of KMPs has also led to a questionable recommendation. The Expert Committee has recommended that the time limit for filling up of the vacancy should be increased from 3 months, to a maximum of 6 months, in cases involving approvals of regulatory, Government or statutory authorities. Firstly, except in a few sectors, that have security implications, approvals of statutory authorities should be dispensed with. Further, the need for approval of the Regulators or the Government is inconsistent with the role and responsibilities of the Board, which should alone be tasked to identify and appoint KMPs. Prior clearance by Regulators or Government authorities translates to micro management, and disempowers the Board from discharging one of its primary responsibilities, which is to select the right persons as KMPs. What superior wisdom Regulators or Governments can bring to bear on the process is not at all clear.

The gap between meetings of the RMC is presently 180 days. It has been recommended that this gap should be increased to 210 days. This is also a step in the wrong direction. Considering that the number, nature and dimensions of risks have considerably expanded in recent times, the RMC should be required to meet at least 4 times in a year. Resultantly, this counterproductive proposal to increase the maximum gap between the meetings of RMCs should be abandoned.

Yet another consultation paper which has been around for a while is the one detailing the proposals to amend SEBI Regulations with respect to verification of market rumours. This paper, and subsequent observations by the NFRA, have led to Boards and managements grappling with the problem of defining materiality in the context of the reporting requirements. There is no clarity yet on how materiality is to be defined. At the same time, putting in place the right structure to ensure reporting of rumours that have a bearing on share prices is also a continuing challenge. Mercifully, SEBI has postponed the last date for giving effect to these proposals. In a lighter vain, corporates have been heard to ask whether the postponement is a fact or a rumour that they need to deal with.

There have also been increasing noises on the setting up of Self Regulatory Organisations (SROs). While it is fashionable to talk in terms of setting up SROs, it is necessary to ask the question whether the existing SROs have been discharging their responsibilities adequately. There are regulatory bodies comprising professional members of industry or trade bodies, with the business versus regulation conflict not being adequately addressed. In most of these organisations, the committee that has been seen to underperform is the Disciplinary Committee, which flies the flag of self regulation. Whether we should act in haste by setting up SROs, only to repent at leisure, is a thought that should worry the policymakers, having regard to the experience across sectors and professions.

As this newsletter was being put to bed, came SEBI's addendum to the consultation paper recommending that "the provision of 1% security deposit in public/ rights issue of equity shares, as prescribed under the ICDR Regulations" should be done away with. Can it be hoped that such recommendations are not put out, in driblets, for comments?

The facilitation of the ease of doing business is an objective which has universal endorsement. It is however necessary to ensure that the instrumentalities and procedures being put in place to facilitate the ease of doing business do not in themselves become obstacles or hurdles in the process. "Less regulations, more regulation" is what we should be looking for".

Follow us :

Read our Chairperson, Mr. M. Damodaran's views on the Supreme Court judgment on the Adani matter here