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PROVISIONS AND REVISIONS

As 2024 was winding to a close, came the news that new provisions of SEBI LODR Regulations, 2015 will come into effect. Change has its merits, but caution is advisable to ensure compliance.

Regulation is always work in progress. Therefore it comes as no surprise that on 12th December, 2024, SEBI has issued a notification detailing a number of changes in the SEBI (LODR) Regulations (LODR). Some of the more important changes made are proposed to be addressed in this newsletter. We will not comment on the changes in punctuation marks from comma to semi colon and the like, because as Mark Tully famously observed there are no full stops in India.

The first change suggested is that 2 categories of transactions will no longer be seen as Related Party Transactions (RPTs) indicative of conflict of interests. The first is the acceptance of current account deposits and savings account deposits by banks, and the second is retail purchases made by Directors or employees, without establishing a business relationship, and at the terms uniformly applicable to all Directors and employees. This is a long overdue amendment. There is no conflict that manifests itself in transactions of this nature, and to treat them as requiring a special dispensation would be contrary to common sense.

The second is a proviso which states that Key Managerial Personnel (KMPs), Directors, Promoters, Promoter group, or any other person, dealing with a listed entity shall disclose to the listed entity all information that is relevant and necessary for the listed entity to ensure compliance with applicable laws. In a regime premised on transparency and disclosures, there should never have been any choice for any of the persons referred to in this clause, to hold back information that is relevant and necessary to ensure compliance.

One major change that has been introduced is that the Compliance Officer shall be an officer who is in wholetime employment of the listed entity, and is not more than one level below the Board of Directors. He/She shall be designated as a KMP. There is no problem whatsoever with designating the Compliance Officer as a KMP. However, given that the CEO is also one level below the Board, having a Compliance Officer at the same level would dilute the overall control and position that goes with the designation of CEO. In many companies, the Company Secretary, who is two or three levels below the Board, functions as the Compliance Officer since there is some commonality between the duties discharged by holders of both these offices. It should have been possible for SEBI to notify that the Compliance Officer, notwithstanding at what level he/she is in the company, should report on compliance matters to the Board or the appropriate committee of the Board. This in no way would have prejudiced the integrity of compliance reporting. By having as Compliance Officer a person one level below the Board, there could be coordination issues between the Compliance Officer and the Company Secretary.

Regulation 17 of LODR, dealing with the appointment or reappointment of Non-Executive Directors (NEDs), on attaining the age of 75 years, also merits some comment. It has been made clear in the relevant proviso that the sub-regulation ought to be complied with at the time of appointment or reappointment or any time prior to the NED attaining the age of 75 years. This again follows logically from the stipulation that no person above the age of 75 shall be a member of the Board, unless his/her candidature has been approved by a 3/4th majority of shareholders. Therefore a Director above the age of 75 continuing on the Board, without appropriate shareholder approval, is an irregularity which should have been specifically addressed earlier.

The Regulation goes on to provide that the approval of shareholders for appointment or reappointment of a person on the Board of Directors or as a Manager is taken at the next general meeting or within a time period of 3 months from the date of appointment. The proviso goes on to state that if the appointment or reappointment of a person to the Board of Directors or as a Manager is subject to the approval of regulatory, government or statutory authorities, the time taken to receive such approvals shall be excluded for the purpose of this clause. This is a welcome move since the extraordinary period of time taken by some regulatory/ statutory authorities to accord clearance often defeated the purpose of appointing a Director without undue delay.

It is by now fairly clear that no amendment of LODR can take place without tinkering with the process of approval of RPTs. The present amendment provides for the Independent Directors (IDs) ratifying RPTs within 3 months from the date of the transaction or in the immediate next meeting of the Audit Committee (AC), whichever is earlier, subject to a few conditions.

The first condition is that the ratified transactions, whether entered into individually, or taken together during a FY, shall not exceed Rs 1 crore. This monetary limit seems unduly low and conservative, given that this provision is sought to be introduced to further the cause of improving the ease of doing business. If there is a failure to seek ratification of the AC within the prescribed period, the transaction shall be rendered voidable at the option of the AC. Considering that the transaction is with an external party, voiding the transaction is not going to be free from complications. Further, the amendment states that if the transaction is "with a related party to any Director, or is authorised by any other Director, the Director(s) concerned shall indemnify the listed entity against any loss incurred by it." Presumably, the reference is to a transaction with "a party related to any Director", and not with "a related party to any Director". Further, the causal relationship between the decision and the loss incurred by the entity would have to be established before a Director is called upon to make good the loss.

The present amendment devotes considerable attention to Secretarial Audit and to Secretarial Auditors. It provides in considerable detail the circumstances in which a company can appoint a Secretarial Auditor or a Secretarial Audit firm. The attention given to Secretarial Audit is timely since experience has shown that Secretarial Audit reports rarely point to any mistake or transgression, except when there is a penalty imposed on the company by the Stock Exchanges. Normally, such concerns as are noted by the Secretarial Auditor rarely find a mention in the report. It is perhaps uncharitably explained that with managements satisfaction necessary for the continuation of a Secretarial Auditor, peaceful coexistence is a preferable practice. There is also a provision that a person shall be eligible for appointment as a Secretarial Auditor only if such person is a peer reviewed Company Secretary. This will be an entry barrier for persons who have newly entered the profession, and are yet to get their peer reviewed certificate.

The oft repeated complaint that reclassification of Promoters is taking considerable time, and is very complex has been addressed by these Regulations. What is now required is a no objection from the Stock Exchanges of such reclassification, once it has considered the views of the Board of Directors. Thereafter, the reclassification request shall be placed before the shareholders in a general meeting for approval. Time limits have been prescribed for both the Stock Exchanges' no objection certificate, and for the approval by the shareholders. This will make life simpler for erstwhile Promoters who over time, on account of reduction of shares held, have lost control over the company, and are in no position to influence any decisions.

Schedule II Part E of LODR has also been amended to provide that listed entities ranked from 1001 to 2000 "shall endeavour" to have at least one woman ID on its Board of Directors. Similarly, it has been provided that the IDs of the top 2000 listed entities "shall endeavour" to hold at least 2 meetings in a FY without the presence of non-IDs and members of the management, and all IDs "shall endeavour" to be present at such meetings. "Shall endeavour" is neither here nor there. There is no clear reason why both the above provisions should not be made mandatory, and why they should figure in the list of non-mandatory provisions. Pleading with the IDs to endeavour to do what is in the interest of the company is not desirable. Such kid glove treatment will ensure that the smaller companies embrace well intended regulations at a leisurely pace. As for the meetings of IDs, Schedule IV of the Companies Act, 2013 presently contemplates at least 1 such meeting during a year. This has been found to be inadequate. Therefore, it would have been better to mandatorily move from 1 to at least 2 meetings of IDs in a year. The considered view of Excellence Enablers is that there should be one such meeting before every meeting of the Board of Directors, and in case there are more than 4 Board meetings in a year, the number of meetings could be limited to 4. Not to do so will be to not take advantage of a forum which should be able to deliver considerable value.

The explanation dealing with fraud has been amended to state that fraud by senior management, "other than by who is a Promoter, Director or Key Managerial Personnel" shall be required to be disclosed only if it is in relation to the listed entity. Stated simply, this would mean that a fraud committed by senior management, other than the excluded category, need not be listed if it is in relation to some other entity or in a non-corporate situation. Fraud, if established, indicates an unacceptable mental state of the senior functionary concerned, and non-disclosure of such frauds, irrespective of where they take place, goes against the grain of good corporate governance in a disclosure-based regime.

Forensic audit has also been explained in the new Regulations. The focus is on financial matters, and excludes matters such as product quality, control practices, manufacturing practices, recruitment practices, and the like. The differentiation is because it is felt that no revision to the financial statements would be required in the latter cases. To conclude that none of these practices will impact the financial statements directly or indirectly is to take a simplistic view.

The LODR (Third Amendment) Regulations, 2024 is a welcome move. Regrettably, like the curate's egg, it is good only in parts. In the interest of the ecosystem, and the ease of doing business, it might well be worth SEBI's while to address some of these concerns, and to retain what is necessary, without having the good provisions crowded out by those that either do not add value, or create confusion.

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