



SEBI issues a consultative paper on revision of provisions relating to reclassification of promoters

17 August 2018

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Transition

Immediately
 Within the next three months
 Post three months but within six months
 Post six months

Forthcoming requirement

Introduction

Currently, Regulation 31A of the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) permits reclassification of promoters¹ of listed entities as public shareholders² in different scenarios, subject to the specified conditions. The reclassification scenarios, *inter alia*, include the following:

- When a promoter is replaced by a new promoter
- Where a company ceases to have any promoters (i.e. becomes professionally managed).

The Kotak Committee on Corporate Governance in its report to SEBI³ (Kotak Committee) provided certain recommendations which were aimed towards rationalising the existing norms pertaining to professionally managed entities and to introduce a new requirement which could enable one of the multiple promoters to get reclassified as a public shareholder. However, as several concerns were raised on the recommendations, SEBI decided to revamp the existing provisions governing reclassification of promoters/classification of entities as professionally managed⁴.

Accordingly, on 24 July 2018, SEBI issued a consultative paper and proposed revision to the existing provisions of Regulation 31A of the Listing Regulations (consultative paper).

This issue of First Notes provides an overview of the revisions made to the provisions relating to reclassification of promoters.

¹The term '*promoter*' includes:

- Person or persons who are in control of the issuer
- Person or persons who are instrumental in the formulation of a plan or programme pursuant to which specified securities are offered to public
- Person or persons named in the offer document as promoters.

However, following persons should not be deemed as a promoter:

- A director or officer of the issuer or a person, if acting as such merely in his professional capacity
- Financial institution, scheduled bank, foreign portfolio investor other than category III foreign portfolio investor and mutual fund merely by virtue of the fact that 10 per cent or more of the equity share capital of the issuer is held by such person. However, such financial institution, scheduled bank and foreign portfolio investor other than category III foreign portfolio investor should be treated as promoter for the subsidiaries or companies

promoted by them or for the mutual fund sponsored by them. (*Regulation 2(1)(za) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009*)

²The term '*public shareholding*' means 'equity shares of the company held by public including shares underlying the depository receipts if the holder of such depository receipts has the right to issue voting instruction and such depository receipts are listed on an international exchange in accordance with the Depository Receipts Scheme, 2014.'

However, the equity shares of the company held by the trust set up for implementing employee benefit schemes under the regulations framed by SEBI should be excluded from public shareholding. (*Regulation 2(e) of the Securities Contracts (Regulation) Rules, 1957*)

³Report of the Committee on Corporate Governance issued by SEBI on 5 October 2017.

⁴SEBI memorandum issued in April 2018.

The revisions can be categorised in the following areas:

1	Simplification of conditions for reclassification	
2	Uniform process to be followed for reclassification of promoters as public shareholders	
3	Listed entities with no promoters	
4	Others	

Overview of the proposed norms

1. Simplification of conditions for reclassification: Currently, Regulation 31A of the Listing Regulations specifies certain conditions for reclassification of promoters of a listed entity as public shareholders in different scenarios including:

- When a new promoter replaces the previous promoter subsequent to an open offer or in any other manner
- Where an entity becomes professionally managed and does not have any promoters.

SEBI proposal

It has been proposed that a single set of conditions should be applicable to all situations of reclassification of promoters as public shareholders.

The conditions applicable for promoters to be eligible for reclassification as public shareholders are as follows:

- **Voting power, control and special rights:** The specific promoter (seeking reclassification as public shareholder), its promoter group and the persons acting in concert should not:
 - Hold more than 10 per cent of the total voting power in the listed entity
 - Exercise control over the affairs of the listed entity directly or indirectly
 - Have any special rights with respect to the listed entity through formal or informal arrangements including through any shareholders' agreements
 - Be represented on the Board of Directors (BoD) (including by way of a nominee director) of the listed entity
 - Act as a key managerial person in the listed entity.
- **No wilful default:** The promoter seeking reclassification should not be a wilful defaulter (as per the guidelines issued by the Reserve Bank of India (RBI)) as on the date of the shareholders' meeting considering the request of the promoter.
- **Compliant listed entity:** A listed entity would be eligible to apply for reclassification, only if, as on the date of

the application, the listed entity complies with the following conditions:

- It is in compliance with the minimum public shareholding requirement
- Its shares have not been suspended from trading by the stock exchanges
- It does not have any outstanding dues to SEBI or the stock exchanges.

It is important to note that the above conditions would also be applicable in the following cases:

- There are more than one identified promoter and one/some of them are considering reclassification to public shareholders, and
- The continuing promoter(s) are not related to the outgoing promoter(s).

2. Uniform process to be followed for reclassification of promoters as public shareholders: Currently, the process to be followed for reclassification of promoters as public shareholders varies on a case to case basis and shareholders' approval is required in certain specified cases only.

The SEBI has proposed a uniform process containing clear stages to be followed by a listed entity and the promoters for all cases of promoter reclassification. These stages are as follows:

- **Stage I: Application by the promoter to a listed entity for reclassification as a public shareholder:** Currently, an application for reclassification of a promoter as a public shareholder could be filed either by the listed entity or concerned shareholder to the stock exchange. Also, there is no specific requirement for the promoter to apply for reclassification through the listed entity.

SEBI proposal

Reclassification of a promoter as a public shareholder would be permitted only upon the request of the promoter to the listed entity.

- **Stage II: Placing the request of the promoter before the BoD of the listed entity:** Currently, under the Listing Regulations, there is no clear role of the BoD of the listed entity in the matter of reclassification of a promoter into a public shareholder.

SEBI proposal

The listed entity would be required to place the request for reclassification from the promoter before its BoD. The resulting recommendations of the BoD (positive/negative) would be placed before the shareholders.

- **Stage III: Approval by the shareholders:** Currently, shareholders' approval is required only in certain specified cases. The profile of promoters/promoter group is an important criteria for investors to make their investment decisions.

SEBI proposal

All cases of reclassification of promoters (including the recommendation of the BoD) would be required to be placed by a listed entity before the shareholders in a general meeting and approved through an ordinary resolution. The promoter (who has requested such reclassification), its promoter group and persons acting in concert would not be permitted to vote on such a resolution.

Additionally, a listed entity would be required to ensure a time gap (a cooling off period) of at least six months between the date of board meeting and the shareholders' meeting that would consider the request of the promoter.

3. **Listed entities with no promoters:** Currently, Regulation 31A of the Listing Regulations specifies conditions to be complied by a listed entity to be classified as 'professionally managed'.

One of the conditions specifically requires that a person or group along with persons acting in concert taken together should not hold **more than one per cent paid-up equity capital** of the entity including any holding of convertibles/outstanding warrants/depository receipts⁵.

SEBI proposal

It has been proposed to replace the term 'professionally managed' with a new term 'listed entities having no promoter'.

A listed entity would be considered as 'the listed entities with no promoter' if due to reclassification or otherwise, the entity does not have any promoter.

Further, a listed entity with no promoter would also be required to comply with the proposed set of conditions (refer section 'simplification of conditions for reclassification' above). The conditions, *inter alia*, require that the specific promoter (seeking reclassification as public shareholder), its promoter group and the persons acting in concert should not hold **more than 10 per cent of the total voting power** in the listed entity.

4. Others

- **Disclosure of material events:** The SEBI has also proposed disclosure of certain events by a listed entity to the stock exchanges as *material* events not later than 24-hours from the occurrence of such event. These are as follows:
 - a) Receipt of application for reclassification from the promoter by the listed entity
 - b) With respect to disclosures pertaining to dispatch of notice to the shareholders on the agenda required under Regulation 30 read with Schedule III of the Listing Regulations (disclosures of events or information: specified securities), the recommendation of the BoD and rationale for such recommendation should also be included
 - c) Submission of application for reclassification to stock exchanges
 - d) Decision of the stock exchanges as communicated to the listed entity.
- **Applicability of reclassification provisions in case of transfer of shares by way of transmission/succession/inheritance/gift:** The SEBI has proposed to include the following clarifications in case of transfer of shares by way of transmission/succession/ inheritance/gift:
 - a) The inheritor should be classified as a promoter immediately on such transfer
 - b) In case the inheritor (currently classified as a promoter) subsequently proposes to seek reclassification of status as a public shareholder, it could do so, subject to compliance with the conditions specified above
 - c) In case of death of a promoter, such person would automatically cease to be included as a promoter subsequent to transmission of shares to an inheritor(s).
- **Other existing conditions:** It has been proposed that certain existing provisions of Regulation 31A of the Listing Regulations should continue. These provisions are as follows:
 - a) *Conditions for reclassification of public shareholders as promoters:* If any public shareholder seeks to reclassify itself as a promoter, it would be required to make an open offer in accordance with the provisions of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SEBI Takeover Regulations).
 - b) *Relaxations for listed entities where insolvency proceedings have been initiated:* The current relaxations applicable to the companies whose resolution plans have been approved under Section 31 of the Insolvency and Bankruptcy Code, 2016 would continue.

⁵Any mutual fund, bank, insurance company, financial institution, foreign portfolio investor could individually hold up to 10 per cent paid-up equity capital of the entity including any holding of convertibles/outstanding warrants/depository Receipts.

- c) *Power for relaxation of conditions:* SEBI could relax any condition for reclassification in specific cases, if it is satisfied about non-exercise of control by the outgoing promoter or its persons acting in concert.

Our comments

The Kotak Committee report expressed certain concerns and SEBI has been trying to address those concerns. Accordingly, most of the recommendations of the Kotak Committee relating to reclassification of promoters have been accepted by SEBI. Important points of the SEBI consultative paper are as follows:

- **One set of conditions for all scenarios of reclassification:** The SEBI has proposed a single set of conditions which would be applicable to all situations of reclassification of promoters as public shareholders including reclassification of a single promoter, where there are multiple/distinct promoters in a listed entity.
- **Total voting power:** For reclassification as a public shareholder, the specific promoter, promoter group and persons acting in concert of the listed entity should not hold more than 10 per cent of the **total voting power** of the listed entity as per the specified conditions. However, the Kotak Committee referred to 'paid-up equity capital' of the listed entity in the given condition.

It appears that SEBI has aligned this requirement with the Companies (Amendment) Act, 2017 which refers to 'total voting power' in the definition of a 'subsidiary' and an 'associate' under the Companies Act, 2013.

- **Control:** Another condition requires that a specific promoter, promoter group and persons acting in concert of the listed entity should not exercise control over the affairs of the listed entity directly or indirectly. As per Regulation 16(1)(a) of the Listing Regulations, the term 'control' would have the same meaning as defined in Regulation 2(e) of the SEBI Takeover Regulations.

As per the SEBI Takeover Regulations, 'control' includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner. Additionally, it provides that a director or officer of a target entity should not be considered to be in control over such target company, merely by virtue of holding such position.

The definition of control under Indian Accounting Standards (Ind AS) is different from SEBI's definition. However, the definition of control under the SEBI Takeover Regulations and Ind AS are both principle-based and not rule based. The Ind AS definition of control lays emphasis on exercising judgement while assessing the facts and circumstances to determine control. Accordingly, listed entities would be required to apply a holistic approach to analyse the facts and circumstances of each case to conclude whether the control principles are being met under Ind AS and the SEBI Takeover Regulations.

- **Restriction on voting:** SEBI has proposed that in all cases of reclassification of promoters (including the recommendation of the BoD) would be required to be placed by a listed entity before the shareholders in a general meeting and approved through an ordinary resolution. However, to avoid conflict of interest, it has been clarified that the specific promoter (who has requested such reclassification), its promoter group and persons acting in concert would not be permitted to vote on such resolution.

It is to be noted that SEBI in the recent amendments to the Listing Regulations (based on the Kotak Committee recommendations) have clarified that all entities falling within the definition of related parties can now vote to reject the relevant transactions irrespective of whether the entity is a related party to the particular transaction or not.

SEBI may also consider including similar provision in the norms relating to the reclassification of promoters.

- **Reclassification of a public shareholder as a promoter:** In case any public shareholder seeks to reclassify itself as a promoter, then, SEBI has mentioned that the existing requirement of making an open offer (by such shareholder) as per the provisions of the SEBI Takeover Regulations would continue.

The bottom line

The revised regulations are a step in the right direction as they seek to rationalise, update and codify the existing regulations.



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Financier Worldwide: A panel discussion on IFRS 16, Leases

4 June 2018

Recently, Financier Worldwide moderated a discussion on IFRS 16 between four experts of the Accounting Advisory Services (AAS) of the KPMG global network (Markus Kreher, Global Head of AAS, KPMG International; Sai Venkateshwaran, KPMG in India; Michelle Gibbs, KPMG in Australia; and Ruben Rog, KPMG in the Netherlands).

The insights of the discussion have been published in the form of an article in the June 2018 edition of Financier Worldwide. This issue provides the link to the article.

Missed an issue of Accounting and Auditing Update or First Notes



Issue no. 24 – July 2018

The topics covered in this issue are:

- The changing future of financial instruments accounting
- Change in ownership interests in investees
- Construction contracts - income from surplus funds
- Regulatory updates.



MCA notified certain provisions of the Companies (Amendment) Act, 2017 and modified certain rules under the Companies Act, 2013

2 August 2018

The Ministry of Corporate Affairs (MCA) through its notifications dated 5 July 2018 and 27 July 2018 notified certain sections of the Companies (Amendment) Act, 2017.

Additionally, MCA issued amendments to certain rules under the Companies Act, 2013 (2013 Act).

Certain provisions of the Companies (Amendment) Act, 2017 are effective from 5 July 2018, while others are effective from 10 July 2018, 27 July 2018 and 15 August 2018 respectively.

This issue of First Notes aims to provide an overview of the recently notified sections of the Companies (Amendment) Act, 2017 and the amendments issued to the rules under the 2013 Act.



Voices on Reporting – Quarterly update publication

Voices on Reporting – quarterly update publication (for the quarter ended 30 June 2018) provides summary of key updates from the Ministry of Corporate Affairs, the Securities and Exchange Board of India, the Reserve Bank of India and the Institute of Chartered Accountants of India.

Feedback/queries can be sent to aaupdate@kpmg.com

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