



SEBI streamlines the framework for schemes of arrangement for listed companies

19 November 2020

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Background

Companies with listed specified securities (i.e. equity shares and convertible securities) are required to comply with the provisions of the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR) and the Companies Act, 2013 (2013 Act) while undertaking any scheme of arrangement including amalgamation, merger, reconstruction and reduction of capital.

The key provisions governing schemes of arrangement for listed companies are:

1 Filing of a draft scheme of arrangement with the stock exchange: A listed company that desires to undertake a scheme of arrangement (including with an unlisted company) under the requirements of the 2013 Act is required to obtain a no-objection letter or an observation letter from the stock exchange. A scheme of arrangement cannot be filed with the court or the National Company Law Tribunal (NCLT) unless the listed company has obtained an observation/no-objection letter from the stock exchange.

2 Regulatory framework for schemes of arrangement: SEBI through its circular dated 10 March 2017 has laid down detailed requirements to be complied with by listed companies while undertaking schemes of arrangements. Those, *inter alia*, includes:

- Mandatory submission of certain documents to the stock exchange including audit committee report recommending the draft scheme and valuation report.
- Disclosure of draft scheme of arrangement and the observation letter from the stock exchange on the website of the listed company.
- Scheme of arrangement submitted with the NCLT for sanction should provide for voting by public shareholders through e-voting.

The framework is not applicable to schemes which solely relate to merger of a wholly-owned subsidiary with the parent company. However, such draft schemes should be filed with the stock exchanges for the purpose of disclosures¹.

3 No violation of securities law or requirements of the stock exchange: A listed company is required to ensure that any scheme of arrangement/amalgamation/merger/reconstruction/reduction of capital, etc. presented to any court or NCLT should not violate, override or limit the provisions of securities law or requirements of the stock exchange.

1. LODR requires listed companies with specified securities to disclose information about the scheme of arrangement to the stock exchange(s) as a deemed material event. (Para A of Part A of Schedule III of LODR)

Recent development

On 3 November 2020, SEBI has made certain amendments to the regulatory framework for schemes of arrangements by listed companies (laid down in its circular dated 10 March 2017). The amendments relate to the following areas:



Documents to be submitted by the listed company to the stock exchanges before the scheme is submitted to the NCLT



Obligations of the stock exchange(s) and processing of the draft scheme by SEBI



Conditions for companies seeking relaxation under Rule 19(7) of the Securities Contracts (Regulation) Rules, 1957 (SCRR)

In this issue of First Notes, we provide an overview of these amendments.

Overview of the amendments



Documents to be submitted by the listed company to the stock exchanges before the scheme is submitted to the NCLT

Currently, listed companies are required to submit various documents to the stock exchange(s) before the scheme of arrangement is submitted for sanction to the NCLT. Those, *inter alia*, include report from the audit committee and valuation report. Following amendments have been made with respect to these documents:

- **Report from the audit committee:** The report should recommend the draft scheme, taking into consideration the valuation report. The valuation report is required to be placed before the audit committee of the listed company.

Amendment

The amendments require an audit committee to also comment on the following matters and include them in its report:

- Need for the merger/demerger/amalgamation/arrangement
 - Rationale of the scheme
 - Synergies of business of the entities involved in the scheme
 - Impact of the scheme on the shareholders
 - Cost benefit analysis of the scheme.
- **Valuation report:** All listed companies are required to submit a valuation report obtained from an **independent Chartered Accountant (CA)** except in cases where there is no change in the shareholding pattern of the listed company/resultant company.

Amendment

As per the amendments, the valuation report is to be obtained from a **registered valuer**. The registered valuer has been defined to mean a person, registered as a valuer, having such qualifications and experience and being a member of an organisation recognised, as specified in Section 247 of the 2013 Act read with the applicable rules issued thereunder.

(Emphasis added to highlight the change)

Overview of the amendments (cont.)



Documents to be submitted by the listed company to the stock exchanges before the scheme is submitted to the NCLT (cont.)

- **Report from committee of independent directors:** The amendments require a listed company to also submit a report from the committee of independent directors to the stock exchange(s). The report should recommend the draft scheme, taking into consideration, *inter alia*, that the scheme is not detrimental to the shareholders of the listed company. This is a new requirement and a listed company is required to submit this report to the stock exchange(s).



Effective date

The amendments are applicable to all the schemes filed with the stock exchanges after 17 November 2020.



Obligations of the stock exchange(s) and processing of the draft scheme by SEBI

Currently, on receipt of draft scheme of arrangement from a listed company, the stock exchange(s)² are required to provide an '**Observation Letter**' or 'No-Objection' letter to SEBI on the draft scheme.

Further, SEBI would issue a comment letter upon receipt of the '**Observation Letter**' or 'No-Objection' letter from the stock exchange(s).

Amendment

The amendments have removed the requirement of stock exchange(s) to provide an observation letter on the draft scheme to SEBI. Now, stock exchange(s) would provide a '**No-Objection**' letter to SEBI on the draft scheme **in coordination with each other**. Consequently, SEBI would issue a comment letter upon receipt of '**No-Objection**' letter from the stock exchange(s).

(Emphasis added to highlight the change)



Effective date

The amendments are applicable to all the schemes filed with the stock exchanges after 17 November 2020.



Conditions for seeking relaxation under Rule 19(7) of the SCRR

Currently, Rule 19(2)(b) of the SCRR lays down the minimum public shareholding requirements for a company seeking listing of its securities on a recognised stock exchange. Further, Rule 19(7) of the SCRR empowers SEBI to waive or relax the strict enforcement of any or all of the requirements of SCRR including Rule 19(2)(b)³.

- **Relaxation for listing equity shares (other than equity shares with differential voting rights):** The framework permits a listed company (including an unlisted company) to submit the draft scheme of arrangement and seek relaxation from the minimum public shareholding requirements for listing of its equity shares on a recognised stock exchange when it is not undertaking an Initial Public Offer (IPO). However, this is subject to specified conditions. The conditions, *inter alia*, include the following:
 - **Disclosures on website and advertisement:** Before commencement of trading, the transferee company should advertise in newspapers with prescribed details such as:
 - a. Shareholding pattern giving details of its promoter group shareholding, group companies
 - b. Financial statements for the previous three years prior to the date of listing
 - c. Any material development after the date of the balance sheet.

2. Designated stock exchange/stock exchange(s) with nationwide trading terminals.

3. On its own discretion or on the recommendation of a recognised stock exchange.

Overview of the amendments (cont.)



Conditions for seeking relaxation under Rule 19(7) of the SCRR (cont.)

Amendment

In addition to the advertisement in newspapers, the amendments require a transferee company to disclose the information in the form of an information document on the website of the stock exchange(s).

Both advertisement and information document would include certain additional disclosures. Those are as follows:

- a. Name and details of board of directors (experience including current/past position held in other firms)
 - b. Regulatory action, if any - disciplinary action taken by SEBI or stock exchanges against the promoters in last five financial years
 - c. Brief details of outstanding criminal proceedings against the promoters
 - d. Summary table of contingent liabilities as disclosed in the restated financial statements
 - e. Summary table of related party transactions in last three years as disclosed in the restated financial statements
 - f. Internal risk factors (minimum five and maximum 10).
- **Timeline for trading:** A listed company should also ensure that trading in securities commences within **45 days** of the order of the high court/NCLT.

Amendment

The amendments have modified the condition relating to trading by listed companies. As per the revised requirements, a listed company is required to ensure that the **steps for listing of specified securities are completed** and trading in securities commences within **60 days** of receipt of the order of the high court/NCLT, simultaneously on all the stock exchanges where the equity shares of the listed entity (or transferor entity) are/were listed.

- **Relaxation for listing equity shares with differential rights:** Currently, a listed company desirous of listing its equity shares with differential rights as to dividend, voting or otherwise, may also make an application to SEBI seeking relaxation from strict enforcement of minimum public shareholding requirements (as laid down in Rule 19(2)(b)) without making an IPO of such equity shares, subject to the specified conditions.

Amendment

The amendments have repealed the above-mentioned option given to a listed company seeking listing its equity shares with differential rights. This is in line with the amendments made to the SEBI (Issue of Capital and Disclosure Requirements) Regulations (ICDR Regulations)⁴ and SCRR relating to issuance of equity shares with superior voting rights (SR equity shares). As per the amendments to SCRR⁵, minimum offer and allotment requirements (as laid down in Rule 19(2)(b)) would not be applicable to the listing of equity shares with superior voting rights issued to the promoters or founders, as the case may be, in cases where the company is seeking listing of its ordinary shares for offering to the public.



Effective date

The amendments are applicable for all listed entities seeking listing and/or trading approval from the stock exchanges after 3 November 2020.

4. ICDR Regulations prescribe conditions for issuance of equity shares with superior voting rights.

5. Effective from 19 March 2020.

Our comments

The amendments to the framework aim to streamline the process of draft schemes of arrangement filed by the listed companies and to empower the stock exchanges with the decision making regarding such schemes. These amendments would help ensure that the recognised stock exchanges refer draft schemes to SEBI only upon being fully convinced that the listed company is in compliance with the SEBI Act, Rules, Regulations and circulars issued thereunder. Additionally, these amendments seek to strengthen the process relating to a scheme of arrangement within a company by adding responsibility on independent directors and audit committees to review these schemes. It also enhances the responsibility on the companies to include additional disclosures in their filing with the stock exchanges.

Some of the key areas to consider are as follows:

- **Additional comments by an audit committee:** The amendments put more onus on an audit committee to comment on certain additional matters in its report recommending the draft scheme of arrangement. For instance, need for the merger/demerger/amalgamation/arrangement, rationale of the scheme, synergies of business of the entities involved in the scheme, cost benefit analysis and impact of the scheme on the shareholders. This change is in line with the substance push that we are seeing across regulations and casts the onus on the audit committee to have specifically considered the scheme in detail. An audit committee would thus, need to form a holistic view on cost-benefit analysis of the scheme i.e. understand the direct costs, indirect costs and potential loss of benefits in relation to the overall benefits envisaged from such a scheme to the business and shareholders. Examples of costs that could be considered by an audit committee would include tax related costs, additional stamp duties, legal costs, integration impact, loss of benefits such as tax holidays, tax assets, etc. The analysis of the audit committee would help the stock exchanges as well as other stakeholders including investors understand various aspects of the scheme. However, the SEBI circular does not provide any specific guidance on how an audit committee would perform a cost-benefit analysis of the proposed scheme, therefore, with this specific governance requirement, it is expected that audit committees would use services of experts in the relevant matters.
- **Report by committee of independent directors:** Independent directors are expected to help in bringing an independent judgement to bear on the board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct. Also they are required to safeguard the interests of all stakeholders, particularly the minority shareholders. Therefore, the committee of independent directors is expected to review the scheme and help enhance the credibility of schemes of arrangement undertaken by the listed companies keeping interest of all stakeholders in mind including minority shareholders. However, it is unclear as to what would be the composition of the committee of independent directors i.e. whether committee would constitute of all the independent directors or it can be a smaller group of independent directors.
- **Observation letter by stock exchanges:** With the amendments, the requirement of stock exchanges to issue an observation letter to SEBI in respect of the draft scheme of arrangement filed by the listed company has also been removed. Instead, they are now required to provide a no-objection letter on the draft scheme to SEBI post which the scheme would be processed by SEBI. The amendment seems to indicate that a draft scheme would not be considered by SEBI unless the observations of stock exchanges, if any on the scheme have been resolved by the listed company.
- **Additional disclosures for seeking relaxation from minimum public shareholding:** In addition to disclosing the information in the form of an information document on the website of the stock exchanges, the transferee entity will have to advertise in newspapers giving information on various important areas such as:
 - a. Regulatory action taken by SEBI or stock exchanges against the promoters of the company in last five financial years
 - b. Brief details of outstanding criminal proceedings against the promoters and
 - c. Internal risk factors.

These enhanced disclosures are expected to facilitate greater transparency and better decision-making by stakeholders.
- **Revised timeline for commencement of trading:** For the purpose of seeking relaxation from the minimum public shareholding requirements, the transferee company is also required to ensure that the steps for listing of specified securities are completed and trading in securities commences within **60 days** (earlier within 45 days) of receipt of the order of the high court/NCLT, simultaneously on all the stock exchanges where the equity shares of the listed entity (or transferor entity) are/were listed.

The amendments relating to the schemes of arrangement under the framework have been made applicable with respect to all schemes filed with the stock exchanges after 17 November 2020. However, the requirement for additional disclosures for seeking relaxation from minimum public shareholding requirements and revised timeline for trading in securities are applicable to companies seeking listing and/or trading approval from the stock exchanges from 3 November 2020 onwards.

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Issue no. 51 – October 2020

The topics covered in this issue are:

- CARO 2020: Acceptance of deposits and payment of statutory dues
- Climate change: Potential financial impacts and related disclosures
- Clarifications on the Resolution Framework for COVID-19 related stressed assets
- Regulatory updates.



Revised norms relating to PF and gratuity under the Code on Social Security, 2020

29 October 2020

With an aim to rationalise labour laws prevalent in India, recently, following codes have been passed by the Parliament and have received assent of the President of India on 28 September 2020:

- The Occupational Health, Safety and Working Conditions Code, 2020
- The Industrial Relations Code, 2020
- The Code on Social Security, 2020.

The Codes will come into force on such date as the Central Government (CG) may, by notification in the Official Gazette, appoint. Different dates may be appointed for different provisions of the Code.

In this issue of First Notes, we aim to summarise key features of the Code on Social Security, 2020 along with highlighting the key changes introduced vis-à-vis existing provisions under various laws.



Voices on Reporting

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On 10 November 2020, KPMG in India held a special session of Voices on Reporting webinar on the technology sector and discussed some of the significant accounting issues arising due to recent developments in taxation matters, with the help of practical examples and case studies.

To access the presentation and recording, please click [here](#).

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