

CHAPTER 4

# Regulatory updates



## SEBI approves certain proposals through its board meeting

On 30 September 2022, the Securities Exchange Board of India (SEBI) conducted a board meeting to approve proposals on certain significant matters pertaining to the SEBI Regulations. Following are the key takeaways from the board meeting:

### a. Flexibility in approval process for appointment and/or removal of Independent Directors (IDs)

Currently under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations), appointment, re-appointment or removal of IDs is to be made through a special resolution.

The SEBI in its board meeting approved an alternative method under the LODR Regulation for appointment and removal of IDs appointed for the first term in listed entities. As per the alternate method, if a special resolution for appointment/removal of an ID does not attain the requisite majority, then following thresholds would be tested:

- i. Threshold for an ordinary resolution
- ii. Threshold for majority of minority shareholders.

If the resolution crosses the above two thresholds, in the same voting process, then such a resolution for appointment of an independent director would be deemed to be approved by the shareholders.

The same threshold would also be applicable for removal of an independent director appointed under this alternate mechanism.

### b. Amendment regarding schemes of arrangements in the LODR Regulations

The SEBI has approved to introduce provisions pertaining to following:

- Schemes of arrangement for debt listed entities,
- Handling of unclaimed amounts pertaining to non-convertible securities of listed entities which do not fall within the definition of a 'company' under the Companies Act, 2013 (2013 Act) and the Rules made thereunder, and
- Continuous disclosure norms for entities with listed non-convertible securities, pertaining to financial results and related requirements.

The key amendments are explained below:

- i. Introduction of provisions pertaining to schemes of arrangement for entities which have listed non-convertible debt securities/non-convertible redeemable preference shares. The new provisions approved are related to filing of draft schemes of arrangement/schemes of arrangement with stock exchange(s) for obtaining the no-objection letter, the process to

be followed by the stock exchange(s) including forwarding the draft schemes to SEBI and consequential fee payments.

- ii. Any unclaimed amount lying in the escrow account for more than seven years pertaining to non-convertible securities issued by listed entities which do not fall within the definition of a 'company' under the 2013 Act and the rules made thereunder and are governed by separate statutes, should be transferred to the Investor Protection and Education Fund (IPEF) created by SEBI in accordance with Section 11 of the SEBI Act, 1992.
- iii. Uniformity in the disclosure requirements for entities with listed non-convertible securities, pertaining to financial results and related requirements has been introduced.

### c. New disclosures

Issuers proposing Initial Public Offer (IPO) would be required to make certain disclosure of the Key Performance Indicators (KPIs) and price per share of issuer based on past transactions and past fund raising undertaken by the issuer from the investors. These disclosures will be given in the 'Basis for Issue Price' section of the offer document and in price band advertisement under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations).

### d. Introduction of pre-filing of offer document

SEBI has approved the proposal of a pre-filing mechanism of offer documents as an alternative to the existing mechanism of filing offer documents, in relation to initial public offers on the main board of the stock exchanges.

The pre-filing mechanism would allow issuers to carry out limited interaction without having to make any sensitive information public. Further, the document which incorporates SEBI's initial observations would be available to investors for a period of at least 21 days, thereby, assisting them better in their investment decision making process. The existing mechanism of processing offer document shall continue in addition to this alternative mechanism of pre-filing.

### e. Review of the existing framework for Offer for Sale (OFS) of shares

The SEBI approved certain modifications to the framework for OFS of shares through stock exchange in order to provide more flexibility and efficiency to the framework. The key modifications are as follows:

- i. Currently, non-promoter shareholders holding at least 10 per cent of the share capital of an eligible company and who are willing to offer shares of at least INR25 crore would be eligible to offer their shares through OFS mechanism. However, it has now been decided to do away with minimum 10 per cent shareholding requirement for the non-promoter shareholders for offering shares through OFS mechanism.
- ii. The existing cooling off period of +12 weeks for OFS has been reduced to a range of + 2 weeks to +12 weeks, based on the liquidity of securities of such eligible companies.
- iii. Retail investors have been allowed to bid for the unsubscribed portion of non-retail segment.
- iv. OFS mechanism would be available to unit holders/sellers of listed Real Estate Investment Trust (REITs)/Infrastructure Investment Trust (InvITs) to offer their holdings.

### f. Inclusion of units of Mutual Funds under the SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations)

The proposal to cover dealings in mutual funds under the PIT Regulations in order to harmonise the regulations governing the trading in securities, while in possession of Unpublished Price Sensitive Information (UPSI) has been approved.

(Source: SEBI press release no. PR No.29/2022 on board meeting dated 30 September 2022)

## SEBI prescribes regulations for Social Stock Exchange Governing Council

On 25 July 2022, SEBI amended the ICDR Regulations and inserted a Chapter X-A on Social Stock Exchange (SSE). As per Regulation 29D of the ICDR Regulations, every SSE shall constitute a Social Stock Exchange Governing Council (SGC) to supervise the functioning of the SSE.

Considering this, SEBI through its circular dated 13 October 2022 has prescribed specific requirements relating to composition and terms of reference of SGC. The SGC is expected to provide an oversight and guidance to facilitate the smooth functioning of the operations of the SSE, with regard to registration, fund raising and disclosures by Social Enterprises (SEs).

(Source: SEBI circular no. SEBI/HO/MRD/MRD-RAC-2/P/ CIR/2022/141 dated 13 October 2022)



## Clarification on disclosure of absolute figures in e-forms

As per Schedule III to the 2013 Act, companies are mandatorily required to round off the figures appearing in the financial statements depending upon their total income. In this regard, the Ministry of Corporate Affairs (MCA) has issued a clarification on 26 September 2022, that, if the companies provide absolute figures in e-forms for filing of the financial statements i.e. Form AOC-4, the same would not be treated as incorrect certification by the professionals.

(Source: MCA clarification dated 26 September 2022)



## RBI issues revised guidelines on unhedged foreign currency exposure

On 11 October 2022, the Reserve Bank of India (RBI) issued the Unhedged Foreign Currency Exposure (UFCE) Directions, 2022 (UFCE Directions 2022) after receiving references from banks seeking clarification on various aspects pertaining to UFCE. These revised guidelines are a consolidation of all the existing instructions, and also include revisions and clarifications<sup>1</sup> on certain matters.

The UFCE Directions, 2022 are applicable from 1 January 2023 to all commercial banks (excluding payments banks and regional rural banks). The UFCE Directions, 2022 are also applicable to overseas branches/subsidiaries of banks incorporated in India.

The key amendments are as follows:

**i. Modification in the definition of 'entities':**

Banks are required to assess UFCE of all entities. Presently, the term 'entities' is defined as those entities which have borrowed from banks including borrowing in Indian Rupee (INR) and other currencies irrespective of the size of exposure/entity. As per the revised definition, an entity means a counterparty to which the bank has an exposure in any currency.

**ii. Extension of exemption category:** Currently, the exposures arising from derivative transactions are excluded from the purview of

extant UFCE guidelines. This UFCE Directions, 2022 have expanded the exemption category to factoring transactions. Accordingly, banks' exposures to an entity arising from derivative transactions and/or factoring transactions shall be excluded from the purview of UFCE guidelines.

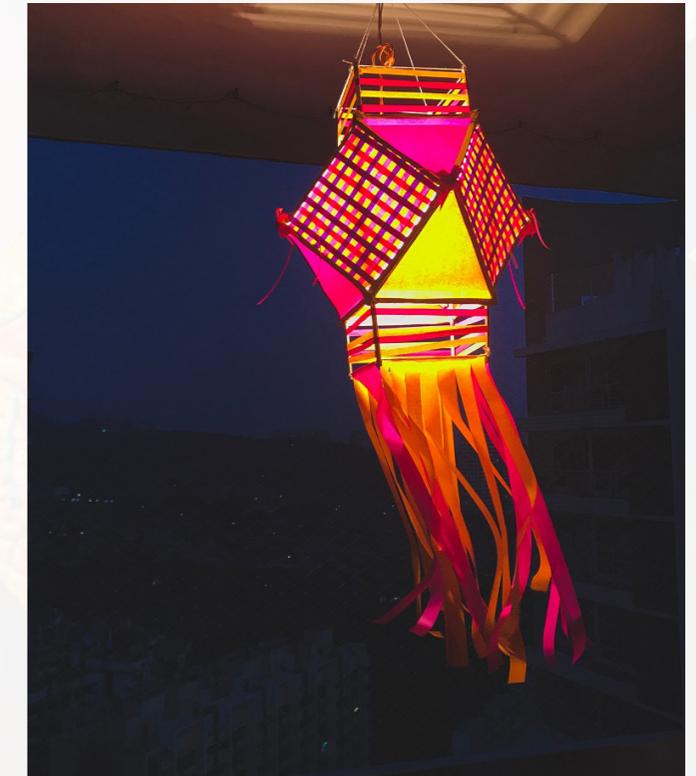
**iii. Assessment for smaller entities:** At present, banks have an option to follow an alternative method for computing exposures to 'smaller entities' which have:

- a. UFCE; and
- b. Are not in a position to provide information on their UFCE to the bank.

The UFCE Directions, 2022 have now made the alternative method applicable for exposure to 'smaller entities' which have:

- a. Foreign Currency Exposure (FCE), instead of UFCE, and
- b. Are not in a position to provide information on their UFCE to the bank.

Further, the definition of 'smaller entities' has also been amended. As per the revised guidelines, smaller entities are those entities on which total exposure of the banking system is INR50 crore or less (earlier INR25 crore or less).



1. RBI circular DBOD.BPBC.37/21.04.048/2001-2002, 27 October 2001, DBOD.BPBC.51/21.04.103/2003-2004, 5 December 2003, DBOD.BPBC.96/21.04.103/2008-09, 10 December 2008, DBOD.BPBC.No.76/21.04.103/2011-12, 2 February 2012, DBOD.BPBC.No.61/21.04.103/2012-13, 21 November 2012, DBOD.No.BP.BC.85/21.06.200/2013-14, 15 January 2014, DBOD.No.BP.BC.116/21.06.200/2013-14, 3 June 2014, Mailbox Clarification dated 8 July 2016 and DOR.No.MRG.BC.41/21.06.200/2020-21, 17 February 2021

**iv. Explanation for incremental capital requirement:** Banks are required to apply incremental capital and provisioning requirements as follows:

Potential Loss / EBID (%) <sup>2</sup>	Incremental provisioning requirement	Incremental capital requirement
Upto 15 per cent	0	0
More than 15 per cent and upto 30 per cent	20bps	0
More than 30 per cent and upto 50 per cent	40bps	0
More than 50 per cent and upto 75 per cent	60bps	0
More than 75 per cent	80 bps	25 per cent increase in the risk weight

The UFCE Directions, 2022 clarified that, the incremental capital requirement for exposures falling in the last bucket is provided as 25 per cent point increase in risk weight. For example, if an entity which otherwise attracts a risk weight of 50 per cent falls in the last bucket, the applicable risk weight would be 75 per cent (i.e. 50 per cent +25 per cent). This is because the exposures falling in the same bucket will have equal increase in their riskiness irrespective of the original risk weight applicable.

(Source: RBI notification no. RBI/2022-23/131 DOR.MRG.REC.76/00-00-007/2022-23 dated 11 October 2022)

2. Earnings Before Interest and Depreciation – EBID is computed as Profit after tax + Interest on debt + Depreciation + Lease rentals (if any)

## Amendments to the directions on presentation and disclosures of financial statements by banks

The RBI (Financial Statements-Presentation and Disclosures) Directions, 2021 (Master Directions) incorporates all the guidelines, instructions and directives issued by RBI to banks. The guidelines require commercial banks (excluding Regional Rural Banks (RRBs)) to disclose details of divergence in asset classification and provisioning if such divergence exceeds certain specified thresholds.

In order to strengthen the compliance with income recognition, asset classification and provisioning norms, RBI through its notification dated 11 October 2022, introduced similar disclosure requirements for primary (urban) co-operative banks and revised the specified thresholds for commercial banks which are as follows:

- The additional provisioning for Non-Performing Assets (NPAs) assessed by the RBI exceeds 5 per cent (earlier 10 per cent) of the reported profit before provisions and contingencies for the reference period; and
- The additional Gross NPAs identified by the RBI exceeds 5 per cent (earlier 10 per cent) of the reported incremental Gross NPAs for the reference period.

Provided further that in the case of urban co-operative banks the threshold for reported incremental Gross NPAs specified in paragraph (b) above shall be 15 per cent, which would be reduced progressively in a phased manner, after review.

The thresholds specified above would be applicable for disclosures in the notes to the annual financial statements for the year ending 31 March 2024 and onwards.

(Source: RBI notification no. RBI/2022-23/130 DOR.ACC.REC.No.74/21.04.018/2022-23 dated 11 October 2022)



## Aggregation of group NBFC's assets for middle layer classification

As per the master direction on Non-Banking Financial Company-Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions 2016, all applicable Non-Banking Financial Companies (NBFCs) that are part of a common group or are floated by a common set of promoters should be assessed at a consolidated level.

In this regard, RBI through its circular dated 11 October 2022, provided that, the total assets of all the NBFCs (including NBFCs are classified as Base Layer – NBFC-Peer to Peer Lending Platform, NBFC-Account Aggregator, Non-Operative Financial Holding Company and NBFC without public funds and customer interface) forming part of the same group<sup>3</sup> should be consolidated to determine the middle layer classification status of NBFCs and all the regulations applicable to the middle layer category of NBFCs would be applicable to them.

Therefore, if the consolidated asset size of the group is INR1,000 crore and above, then each of the NBFCs classified as NBFC-Investment and Credit Company (NBFC-ICC), NBFC-Micro Finance Institution (NBFC-MFI), NBFC-Factor and NBFC-Mortgage Guarantee Company (NBFC-MGC), forming part of the group should be considered as an NBFC in the middle layer.

The circular further provides that, the statutory auditors are required to certify the asset size of all the NBFCs in the group as on 31 March of every year. The certificate would be submitted to the Department of Supervision of the RBI under the jurisdiction in which the NBFCs are registered.

The provisions of the circular are effective from 1 October 2022 and would not be applicable for NBFCs classified in the upper layer.

(Source: RBI notification no. RBI/2022-23/129 DOR.CRE.REC.No.78/03.10.001/2022-23 dated 11 October 2022)

## RBI issued concept note on Central Bank Digital Currency (CBDC)

RBI through its press release on 7 October 2022, has issued a concept paper on CBDC which is a digital form of currency notes issued by the Central Bank. The concept note explains the objectives, choices, benefits and risks of issuing a CBDC in India and it would be termed as e₹ (digital Rupee). The purpose for the issuing the concept note is to create awareness about CBDCs and discuss the planned features of the digital rupee.

The concept note provides insights on the key considerations relating to CBDC such as technology and design choices, possible uses of digital rupee, issuance mechanisms, etc. It also discusses the implications of introduction of CBDC on the banking system, monetary policy, financial stability, and analyses privacy issues.

The concept paper provides that RBI would soon commence the limited pilot launches of e₹ for specific use cases and RBI would communicate about the specific features and benefits of e₹, from time to time.

(Source: RBI press release no. 2022-2023/1012 dated 7 October 2022)



3. Paragraph 3(vi) of the Master Direction – Non-Banking Financial Company-Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions 2016 defines 'companies in group'.

## Narrow scope amendments to IFRS 16, Leases for sale and leaseback transactions

Amendments to IFRS 16, *Leases* impact how a seller-lessee accounts for variable lease payments that arise in a sale-and-leaseback transaction. The amendments introduce a new accounting model for variable payments and will require seller-lessees to reassess and potentially restate sale-and-leaseback transactions entered into since 2019.

The amendments confirm the following.

- On initial recognition, the seller-lessee includes variable lease payments when it measures a lease liability arising from a sale-and-leaseback transaction.
- After initial recognition, the seller-lessee applies the general requirements for subsequent accounting of the lease liability such that it recognises no gain or loss relating to the right of use it retains.

A seller-lessee may adopt different approaches that satisfy the new requirements on subsequent measurement.

### Example

A seller-lessee enters into a sale-and-leaseback transaction in which the carrying amount of the underlying asset immediately before the sale is 80. The present value of the expected lease payments (all variable) is 50 and the fair value of the underlying asset is 100, which equals the consideration received.

### *At the date of the transaction*

The seller-lessee would measure the right-of-use asset at 40 ( $80 \times (50/100)$ ) and the gain to be recognised in profit or loss at 10 ( $((100 - 80) \times (50/100))$ ). Therefore, it would measure the lease liability at 50, even though all of the lease payments are variable.

### *Subsequent accounting for the lease liability*

The seller-lessee would reduce the lease liability as if the 'lease payments' estimated at the date of the transaction had been paid. It would recognise any difference between those lease payments and the amounts actually paid in profit or loss.

It could determine the lease payments to be deducted from the lease liability in a number of ways – e.g. as 'expected lease payments' or as 'equal periodic payments' over the lease term.

Effective date: The amendments are effective for annual reporting periods beginning on or after 1 January 2024, with earlier application permitted.

Under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, a seller-lessee will need to apply the amendments retrospectively to sale-and-leaseback transactions entered into or after the date of initial application of IFRS 16. This means that it will need to identify and re-examine sale-and-leaseback transactions entered into since implementation of IFRS 16 in 2019, and

potentially restate those that included variable lease payments.

(Source: IAASB announcement dated 22 September 2022 and KPMG IFRG Ltd's web article on Lease liability in a sale-and-leaseback dated 26 September 2022)

