

Sebi to make frauds disclosures a must; may unveil norms today to improve transparency

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MUMBAI: India's capital market regulator plans to announce stringent rules that will make it incumbent upon companies to make disclosures relating to fraud, litigation against senior executives and their financial implications. These are among a series of changes that will help improve transparency and corporate governance standards.



According to the guidelines likely to be announced by the Securities and Exchange Board of India (Sebi) on Monday, companies will have to make public any fraud committed by directors and employees, litigation against them and the impact of this on financials, reveal details about shareholders and loan agreements besides providing estimates of losses caused by natural calamities.

Sebi also intends to tighten rules on disclosures related to the filing of shareholding patterns and financial results by listed companies, said an official familiar with the matter.

This is the first time Sebi is considering that declarations of any fraud by employees, directors and agents of the listed entity be made mandatory.

Any litigation that could hurt the company financially also has to be made public. Sebi is of the view that fraud and defaults by persons related to the company can have a material impact on its working, especially in cases where such persons have significant control or influence in decision making.

The move is part of Sebi's ongoing push to bring regulatory norms in line with best practices elsewhere and strengthen investor protection. It also plans to introduce disclosure requirements with regard to shareholding and loan agreements. It wants companies to spell out terms and conditions of shareholding agreements, including special voting rights, the first right to share subscription in case of fresh equity issues and the right to restrict any change in capital structure that could have a bearing on the rights of public shareholders.

In case of a loan agreement, firms will have to reveal details about the nature of the debt, total outstanding amount and security provided and the impact of any default on financial performance. Companies will also have to spell out details of loan realignment under corporate debt restructuring, or CDR. "The costs and benefits of any additional disclosures should be thoughtfully considered, particularly in areas such as frauds and contingencies, which have inherent complexity and uncertainty, and consequently involve significant management judgment," said N Venkatram, managing partner, audit, at Deloitte Haskins & Sells.

"The time period for quarterly reporting may be insufficient for detailed disclosure in these areas... regulatory corporate disclosures are not always comprehensive, and require to be supplemented by management reports in order to tell the whole story."

Mehul Savla of **RippleWave Equity**, a boutique investment bank, said, "Shareholder agreements which create distortion in shareholder rights usually need a change in the articles of association that anyway require shareholder approval. Any other arrangements to which a company is not a party can be difficult to bring into the fold."

Legal disputes have become a sticky issue with companies getting mired in controversies. Corporate India has been paying millions of dollars in legal fees to fight various cases related

to wrongdoing and regulatory issues. Perhaps taking a cue from this, the regulator wants listed companies to immediately make public any litigation that's significant as against the current practice of informing the bourses after the event.

Moreover, firms may also have to say whether there will be any financial implications due to penalties or compensation as a result of this. "The test of materiality should be left to companies to bring to the shareholders' attention," said Sudhir Bassi, executive director, capital markets, Khaitan & Co., a leading law firm. "Litigation may or may not go against the company and any disclosure of maximum possible penalty could result in material impact on stock price.

However, if the claim is quantified in the litigation and it is material, then the same should be disclosed." Companies will also need to provide estimates of losses from natural calamities such as floods, fire and earthquakes, besides lockouts and strikes and whether these were covered by insurance.

