KPMG

First Notes

SEBI revises the regulatory framework for schemes of arrangements by listed entities

27 March 2017

First Notes on

Financial reporting

Corporate law updates

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Disclosures

Sector

All

Banking and insurance

Information, communication, entertainment

Consumer and industrial markets

Infrastructure and government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

Within the next 3 months

Post 3 months but within 6 months

Post 6 months

Background

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) provide the procedure (through a circular dated 30 November 2015)[1] to be followed by listed entities for undertaking schemes of arrangements such as amalgamations, mergers, reconstruction, etc.

The Ministry of Corporate Affairs (MCA) on 7 December 2016 notified certain sections of the Companies Act, 2013 (2013 Act) such as sections relating to compromises, arrangements, amalgamations (including fast track amalgamations and demergers), reduction of capital and variations of shareholders' rights. These sections became effective 16 December 2016 and the National Company Law Tribunal (NCLT) assumed jurisdiction of the High Courts as the sanctioning authority for certain sections such as compromises, arrangements, reduction of capital and variations of shareholders' rights.

In order to align SEBI requirements with the 2013 Act, SEBI in its board meeting held on 17 January 2017 had given an in-principle approval for the revised regulatory framework for the schemes of arrangements. Accordingly, it issued following circulars highlighting following important changes:

- The schemes of arrangement for merger of a wholly owned subsidiary with the parent entity would not be required to be filed with SEBI (under the Listing Regulations). Such schemes would be filed with stock exchanges for the purpose of disclosures (circular issued on 15 February 2017) [2]
- Where under a scheme of arrangement allotment of shares takes place only to a select group of shareholders or shareholders of unlisted companies then the pricing provisions of Chapter VII of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 would be applicable (circular issued on 15 February 2017)[3].

New developments

A. In line with the above two circulars issued on 15 February 2017, SEBI on 10 March 2017 revised[4] certain obligations in the Listing Regulations (given in circular dated 30 November 2015) in relation to the schemes of arrangements. The new circular issued on 10 March 2017 brings about certain important changes and carries forward many requirements of the SEBI circular dated 30 November 2015.

[1]SEBI circular no. CIR/CFD/CMD/16/2015 dated 30 November 2015 provides the detailed guidance to be complied with by the listed entities.

[2]SEBI circular no. SEBI/LAD-NRO/GN/2016-17/029 dated 15 February 2017.

[3]SEBI circular no. SEBI/LAD-NRO/GN/2016-17/030 dated 15 February 2017.

[4]SEBI circular no. CFD/DIL3/CIR/2017/21 dated 10 March 2017 revised the requirements of SEBI circular dated 30 November 2015.

B. Additionally, on 23 March 2017, SEBI has issued another clarification[5] with respect to the circular issued on 15 February 2017 regarding the scheme of arrangements where allotment of shares takes place only to a select group of shareholders or shareholders of unlisted companies. The 15 February 2017 circular (as explained in the background section above) requires such schemes to follow the pricing provisions of Chapter VII of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations). The recent circular on 23 March 2017 clarifies that the 'relevant date' for the purpose of computing pricing would be the date of board meeting in which such scheme is approved.

The key changes to the 10 March 2017 circular relate to the following topics:

1. Schemes of arrangement involving unlisted entities
2. E-voting instead of postal voting
3. Lock-in requirements for a scheme for hiving-off of a division from a listed entity to unlisted entity
4. Submission of a new report called 'compliance report'.

This issue of First Notes provides an overview of the key changes in the requirements to be followed by the listed entities involving the schemes of arrangements.

Overview of the key changes in the requirements for schemes of arrangements

1. **Schemes of arrangement involving unlisted entities:** In case of schemes of arrangement between a listed and an unlisted entity, SEBI has introduced following conditions that should be satisfied:
   - *Information as per abridged prospectus*: The listed entity would now have to include the applicable information pertaining to the unlisted entity involved in the scheme in the format specified for abridged prospectus (as provided in Part D of Schedule VIII of the ICDR Regulations, in the explanatory statement or notice or proposal accompanying resolution to be passed sent to the shareholders while seeking an approval of the scheme.
   - *Certificate from a SEBI registered merchant banker*: The accuracy and adequacy of the above disclosures as per the abridged prospectus would be required to be certified by a SEBI registered merchant banker (after following the due diligence process).
   - *Disclosures to be submitted to the stock exchanges*: Such disclosures should also be submitted to the stock exchanges for uploading on their websites.
   - *Shareholding pattern of public shareholders and Qualified Institutional Buyers (QIBs) in the merged entity*: The percentage of shareholding of pre-scheme public shareholders of the listed entity and the QIBs of the unlisted entity, in the post scheme shareholding pattern of the 'merged' entity should not be less than 25 per cent.
   - *Stock exchange with nationwide trading terminals*: Unlisted entities can be merged with a listed entity only if the listed entity is listed on a stock exchange having nationwide trading terminals.

2. **Approval of shareholders to a scheme of arrangements:** The process of approval of shareholders to a scheme of arrangement has following key changes:
   - *E-voting*: SEBI has removed the requirement of voting through postal ballot and voting for approval of the scheme will be only through e-voting. The listed entity would disclose all the material facts in the explanatory statement that would be sent to the shareholders in relation to the resolution for the scheme of arrangement.
   - *Approval by only public shareholders*: In certain cases, SEBI has mandated that a scheme of arrangement would be approved only if the votes cast by the public shareholders in favour of the proposal are more than the number of votes cast by the public shareholders against it. Such cases are as follows:
     - Where additional shares have been allotted to a promoter/promoter group and its related parties, related parities of associates and subsidiary/(s) of the promoter/promoter group of the listed entity
     - Where the scheme of arrangement involves the listed entity and any other entity involving promoter/promoter group and its related parties, related parties of associates and subsidiary/(s) of the promoter/promoter group
     - Where the parent listed entity has acquired, either directly or indirectly, the equity shares of the subsidiary from any of the shareholders of the subsidiary who may be promoter/promoter group and its related parties, related parties of associates of promoter/promoter group and subsidiary/(s) of promoter/promoter group of the parent listed entity, and if that subsidiary is being merged with the parent listed entity under the scheme
     - Where the scheme involving merger of an unlisted entity results in reduction in the voting share of pre-scheme public shareholders of a

[5]SEBI circular no. CFD/DIL3/CIR/2017/26 dated 23 March 2017.

listed entity in the transferee/resulting company by more than five per cent of the total capital of the merged entity.

In the cases other than those specified above, the approval 'only by public shareholders' would not be applicable. In such cases, the listed entities should furnish an undertaking certified by the auditor which has been approved by the board of directors of the entity. The undertaking should state clearly the reasons for non-applicability of the provisions relating to approval 'only by public shareholders'. The undertaking should be displayed on the websites of the stock exchange as well as the entity along with other documents as prescribed.

- Changes *to the scheme of arrangements*: After filing the draft scheme with SEBI, a listed entity needs specific written consent of SEBI to make changes to the draft scheme, except for the changes mandated by the regulators, authorities, or tribunal.

3. **Scheme involving hiving-off of a division from a listed entity into an unlisted entity:** In such a case, the pre-scheme share capital of the unlisted issuer would be locked-in in the following manner:
   - Shares held by promoters up to the extent of 20 per cent of the post-merger paid-up capital of the unlisted issuer, should be locked-in for a period of three years from the date of listing of the shares of the unlisted issuer.
   - The remaining shares should be locked-in for a period of one year from the date of listing of the shares of the unlisted issuer.
   - No additional lock-in should be applicable if the post scheme shareholding pattern of the unlisted entity is exactly similar to the shareholding pattern of the listed entity.
4. **Detailed compliance report:** The listed entities would be required to submit a compliance report as per the format prescribed in the circular, regulatory requirements and all accounting standards. The compliance report would be certified by the company secretary, chief financial officer and the managing director of the entity.

Applicability date and transition

- **Schemes post 10 March 2017**: The draft schemes of arrangements filed with the stock exchange after 10 March 2017 would be governed under the revised framework covered in the circular dated 10 March 2017.
- **Schemes pre 10 March 2017:** The draft schemes of arrangements already submitted to the stock exchange as per framework covered in the circular dated 30 November 2015, would be governed by the requirements given in the 30 November 2015 circular.
- **Merger of a wholly owned subsidiary:** The provisions of the 10 March 2017 circular would not apply to the schemes which solely provides for merger of a wholly owned subsidiary with the parent company. Such draft schemes should be filed with the stock exchanges for the purpose of disclosures and the stock exchanges should disseminate the scheme documents on their websites.
- **Allotment of shares to a select group of shareholders or shareholders of unlisted entities:** The issuance of shares under schemes in case of allotment of shares only to a select group of shareholders or shareholders of unlisted entities should follow the pricing provisions of Chapter VII of the ICDR Regulations relating to preferential issue. (As mentioned above, the 'relevant date' for the purpose of computing pricing would be the date of board meeting in which such scheme is approved.)

Our comments

SEBI has revised the regulations relating to the schemes of arrangements to prevent entities from seeking direct approval of NCLT and to help ensure compliance with the SEBI regulations. Some of the important revisions/relaxations in the revised framework are as follows:

- **Enhanced disclosures**: The amendments regarding merger of an unlisted entity with a listed entity have been made with a view to improve the disclosure standards and provide more information to shareholders of the listed entities, and is certainly a welcome move. These changes are directionally similar to the disclosure standards relating to material acquisitions in other major markets. However, from an Indian entity's standpoint, these changes could bring in a fair amount of additional work in preparing for these mergers, as the process to be followed by the unlisted entity in preparing its abridged prospectus could be in many respects similar to that followed for an IPO, including the due diligence by a SEBI registered merchant banker, preparation of restated financial statements for a five year period and the audit of those financial statements, etc. This activity of preparing the abridged prospectus could therefore be an elaborate and time consuming exercise and is likely to impact timelines involved in the preparation for merger filings and approvals.

  As per the ICDR requirements applicable to abridged prospectus, the unlisted entity is required to provide financial information (both stand-alone and consolidated) for five years' restated total income from operations, net profit or loss before tax and extraordinary items, equity share capital, reserves and surplus, net worth, basic earnings per share, diluted earnings per share, return on net worth and net asset value per share. In addition to financial information, an unlisted entity would have to provide information relating to the entity, its promoters, business model and strategy, the composition of its board, risk factors, summary of outstanding litigation, claims and regulatory actions, and any other important information as deemed relevant. The requirements relating to abridged prospectus are laid down in the SEBI circular no. CIR/CFD/DIL/7/2015 dated 30 October 2015.

  Additionally, the unlisted entity would also have to follow the SEBI circular regarding the manner of presenting Ind AS for the five years' financial information (SEBI circular SEBI/HO/CFD/DIL/GR/O/2016/47 dated 31 March 2016).

Our comments (cont.)

- **Increased filing requirements:** In addition to the enhanced disclosures, the revised requirements highlight additional filing requirements for a scheme of merger of listed and unlisted entity. As per clause 1.A.2.(f) of Annexure I, a listed entity is required to file 'audited financials of last three years (financials not being more than six months old) of the unlisted entity' with the stock exchange to obtain 'observation letter' or 'no-objection letter' subject to certain more criteria prescribed. While sending notice to the shareholders, clause 1.A.3.(a) is applicable. According to this clause, ICDR requirements in relation to abridged prospectus have to followed and unlisted entity, therefore, would be required to provide financial information (both stand-alone and consolidated) for the latest five years as well as latest stub period (if applicable).

- **Voting by public shareholders:** The revised circular (10 March 2017) seeks to widen the percentage of public shareholding and therefore, requires the shareholding of pre-scheme public shareholders of the listed entity and the QIBs of the unlisted company, in the post scheme shareholding pattern of the 'merged' entity to be not less than 25 per cent. This will also help prevent a very large unlisted entity to get listed by merging with a very small listed entity.

  Additionally, the requirement to obtain approval of public shareholders through e-voting has been extended to more situations:

  - The schemes involving merger of an unlisted entity resulting in reduction in the voting share percentage of pre-scheme public shareholders by more than five per cent of the total capital of merged entity
  - Schemes involving transfer of whole or substantially the whole of the undertaking of a listed entity and consideration of such transfer is not in the form of the listed equity shares
  - Schemes involving merger of unlisted subsidiary with listed holding entity where the share of the unlisted subsidiary have been acquired by the holding entity directly or indirectly from promoters/promoter group.

The bottom line

The amendments are expected to make the regulatory framework relating to the schemes of arrangements by listed entities more robust.

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The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

Amendment to the Finance Bill, 2017: Proposal for MAT-Ind AS compliant companies

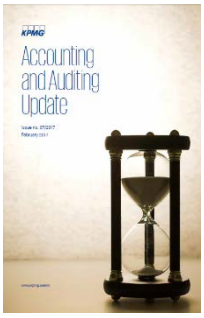
23 March 2017

The Finance Bill, 2017 (the Bill) dated 1 February 2017 included proposals on 'computation of book profit for Ind AS compliant companies for the purpose of levy of Minimum Alternate Tax (MAT) under Section 115JB of the Income Tax Act, 1961'.

The Bill defined a new term 'transition amount' which means the amount or aggregate of the amount adjusted in other equity (excluding equity component of compound financial instruments, capital reserve, and securities premium reserve) on the date of adoption of Ind AS but excluding certain exclusions specified.

The amendments to the Bill introduced in the Lok Sabha on 20 March 2017 have changed the definition of transition amount by omitting the term 'equity component of compound financial instruments'.

Missed an issue of Accounting and Auditing Update or First Notes



Issue no. 7/2017 – February 2017

The topics covered in this issue are:

- Insolvency and Bankruptcy Code, 2016
- Accounting for extinguishment of a financial liability with an equity instrument
- Consolidated financial statements – requirements of Companies Act, 2013
- Oil and gas producing activities – Guidance under Ind AS
- Tax effects of intra-group transactions in consolidated financial statements
- Regulatory updates.

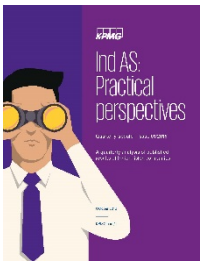
SEBI advises listed companies to adopt integrated reporting voluntarily

9 February 2017

On 2 September 2015, SEBI notified the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations). Clause 34(2)(f) of the Listing Regulations requires mandatory submission of Business Responsibility Report (BRR) for top 500 listed entities based on market capitalisation (calculated as on 31 March of every year).

On 7 February 2017, SEBI issued a circular advising top 500 listed companies which are required to prepare BRR to adopt Integrated Reporting (IR) on a voluntary basis from the financial year 2017-18.

Our issue of First Notes provide an overview of the requirements prescribed by SEBI with respect to IR.



Ind AS - Practical perspectives

KPMG in India's Ind AS - Practical perspectives through aims to put a finger on the pulse of India Inc's adoption of Ind AS and capture emerging trends and practices.

Our impact assessment is based on Nifty 50 companies which would be the first group of companies to report Ind AS results. The Nifty 50 companies have released their financial results for the quarter ended 31 December 2016.

Out of the companies comprising Nifty 50 index, eight companies are banks, one is Non-Banking Financial Company (NBFC) and two companies follow a different date of transition to Ind AS. Therefore, our analysis would comprise the remaining 39 companies.

This can be accessed on KPMG in India website - **'Ind AS- Practical perspectives' webpage**

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