



**REPORT OF THE SUB-COMMITTEE**

**ON**

**INTEGRATED DISCLOSURES**

**21st January 2008**

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## **1. INTRODUCTION TO INTEGRATION OF INITIAL AND CONTINUOUS DISCLOSURES**

### **1.1 Disclosures**

When a company wishes to access the public for raising capital, it needs to go through a complex and long process. Much of the process relates to collecting, collating and presenting information about the company to the prospective investors. This philosophy of disclosure is premised on the simple idea that securities represent a bundle of rights which are not visible to an investor of securities and such investors must know about the underlying company and the nature of the bundle of rights before they take an investment decision. Disclosures also reduce the possibility of wrongdoing. Even if a disclosure is not read by anyone, the fact that something needs to be disclosed and is in public domain will provide a good prophylactic against wrongdoing. The idiom that 'sunlight is the best disinfectant' succinctly describes this philosophy in the securities market.

### **1.2 Efficient Capital Market Hypothesis**

The theory of integrated disclosure is premised on the efficient capital market hypothesis ("ECMH"). According to the ECMH, information put out in the public domain is promptly impounded in the price of a security. Thus, once information is already out in the public domain, no value addition will arise out of repeating the same information when capital is raised.

The goal of reduction of duplication and a holistic approach to disclosures can come about only when we are able to move from registration of issue of securities to a model where the company itself is registered. Under the proposed structure, there will be a need to strengthen the existing disclosure norms so that information which is sought only at the time of issue of capital becomes generally available not only to investors of new securities but to the existing shareholders as well. As a

result, full disclosures would be enjoyed by a larger class of investors and potential investors; at the same time, by avoiding duplication, issue costs would come down. Seasoned companies with a reliable track record would be able to raise capital easily and at a lower cost.

**1.3** A listed company is required to comply with the disclosure norms under the Companies Act 1956, SEBI Guidelines and Regulations and the Listing Agreement of Stock Exchanges. To the extent company related information of such companies is already out in the public domain, part of the disclosures made in tapping the capital markets again is repetitive and adds no value. It is important to distinguish between company information and transaction information. The former is already in the public domain, while the latter which relates to the particular issue of capital needs to be published in a prospectus. Such transactional details would include details of types of securities offered, underwriting commissions paid, intended proceeds of capital raised etc. On the other hand, company details would include the issuer's business, management compensation, capital structure, recent financial results etc. We have already witnessed an example of integrated disclosures in the form of "Shelf Registration" which provides for multiple issues of capital with a single prospectus. Each additional tranche of securities needs only incremental disclosures and transaction details. However, this provision is available only for raising debt by select financial institutions.

**1.4** The first step towards integrating initial and continuous disclosures is to divide company information and transaction information in the prospectus into two distinct parts. The second step is to make sure that the extent of disclosures made by the company at the time of IPO is replicated on a continuous basis also. The goal should be to make the company information in the continuous disclosures regime (annual report, quarterly reports and other disclosures) fungible with the company information in the prospectus. Currently, the initial disclosures viz. in the

prospectus provide superior information compared to the annual and continuous disclosures made by companies.

## **1.5 FORMATION OF THE SUB-COMMITTEE BY THE SEBI COMMITTEE ON DISCLOSURES**

The erstwhile **SEBI Committee on Disclosures (SCOD)** appointed, on February 01, 2005, the **Sub-Committee on Integration of Initial and Continuous Disclosures viz the Sub-Committee on Integrated Disclosures (SCID)** with the objective of standardizing and streamlining the corporate disclosures by integrating initial disclosures made under an offer document with the continuing disclosure requirements after a company gets listed. SCOD had also advised the Sub-Committee to confine itself to streamlining the existing initial and continuous disclosures only, and not make any recommendations regarding amending or addition of any disclosures.

The Sub-Committee was to focus on the existing set of disclosures, and suggest means of streamlining the same. The revised disclosures on one hand would bring more efficiency, economy and transparency at the issuers' end and on the other, improve access and usability of the information by the investors. Such a system would also highlight delinquencies in filing of information by corporates, enabling the regulator and the stock exchanges to take appropriate action, in a timely manner where adequate or appropriate disclosures have not been made. The reduced cost of compliance (which is indirectly paid by the investor) and ease of accessing information would ultimately help the market and the investors

### **1.5.1 The Sub-Committee was initially formed by the Chairman of the Committee Mr. Y.H. Malegam with the following members:**

- Mr. Sandeep Parekh (then an Advocate and presently Executive Director, Legal Affairs, SEBI), Chairman of the Sub-Committee

- Ms. Dipti Neelakantan (MD & Group COO, JM Financial Consultants Pvt. Ltd.), Member of SCOD
- Mr. Prithvi Haldea (Chairman & Managing Director, PRIME Database), Member of SCOD
- Mr. S. R. Mehta (Chartered Accountant, S.R. Mehta & Co.) - Nominee of FICCI, Member of SCOD
- Mr. P.S. Reddy – Nominee of BSE, Member of SCOD
- Mr. Uday Phadke – Nominee of CII, Member of SCOD
- Mr. Ranganath Char (presently Head, Capital Markets, JM Financial Consultants Pvt.Ltd.) - Nominee of Association of Merchant Bankers of India
- Mr. K. Hari (Asst. Vice President, National Stock Exchange of India Ltd.) - Nominee of NSE
- Ms. Neelam Bhardwaj (General Manager, SEBI)

**1.5.2** SCOD was reconstituted on September 12, 2006 and renamed as SEBI Committee on Disclosures and Accounting Standards (SCODA). As Mr. P.S. Reddy and Mr. Uday Phadke who were members of the erstwhile SCOD were not members of the reconstituted SCODA, they ceased to be associated with the Sub-Committee. On the other hand, Mr. Gopal Krishna Iyer from BSE was inducted into the Sub-Committee.

**1.5.2.1** The Sub-Committee presently has the following members:

- Mr. Sandeep Parekh (Executive Director, SEBI.), Chairman
- Ms. Dipti Neelakantan (MD & Group COO, JM Financial Consultants Pvt Ltd), Member of SCODA
- Mr. Prithvi Haldea (Managing Director, PRIME Database), Member of SCODA

- Mr. S. R. Mehta (Chartered Accountant, S.R. Mehta & Co.) - Nominee of FICCI, Member of SCODA.
- Mr. Ranganath Char (Head, Capital Markets, JM Financial Consultants Pvt.Ltd.) - Nominee of Association of Merchant Bankers of India
- Mr. K. Hari (Asst. Vice President, National Stock Exchange of India Ltd.) - Nominee of NSE
- Mr. Gopala Krishna Iyer (Deputy General Manager, Bombay Stock Exchange Ltdi) - Nominee of BSE
- Ms. Neelam Bhardwaj (General Manager, SEBI)

## **2. APPROACH**

Every disclosure made by a regulated entity has an effort and cost attached to it. To the extent disclosures are detailed at the time of an issue and become sketchy or inaccessible on a continuing basis after a company has got listed, the paradox is clearly a matter of concern. To the extent the disclosures are duplicative, the added cost of disclosures has no value addition and such duplication needs to be removed. To the extent the disclosures are made but are not fully or easily accessible by the public, there is a need to enable such disclosures to be available in the public domain in an easily accessible manner. To the extent disclosures are unnecessarily complex, lengthy and full of jargon, the disclosures can become a tool of defense for an issuer and not a means of dissemination of information, and such disclosures need to be simplified.

- 2.1** The pursuit of integrated disclosure refers to two objectives. First, to make disclosures meaningful, non-duplicative and non-burdensome to the extent possible. All disclosures must pass the test of relevance and non-duplication. Second, to make disclosures truly available and accessible; particularly when filings with a regulator makes a document theoretically public but the process of access is made so cumbersome that the information fails to effectively enter the

public domain. This is aggravated when an investor must go to more than one place to collate public information about a single company.

**2.2** Reduced duplication of disclosures would reduce wastage of time by companies which complain of being over-burdened with filling of huge amount of information, many times repetitive and to multiple organizations. To the extent there is unnecessary duplication, the company is distracted from its main economic purpose into paper pushing to dozens of authorities and running the risk of potential technical violations.

**2.3** The streamlined and reduced filing would enable the regulator to use its powers more effectively. The regulator would also be able to catch fraud and non-compliance more easily as it would need to tap only one source to check data. Fewer bottlenecks would also result in improved speed, reduced risk and more agile corporates with reference to raising capital.

### **3. SCOPE OF WORK**

**3.1.** The Sub-Committee is of the opinion that there is a need to examine the following minimum set of regulations: a) Companies Act, 1956; b) SEBI Guidelines and Regulations and c) Listing Agreement of the Stock Exchanges, with a focus on the latter two. At the same time, several reforms outside the direct scope of SEBI could be suggested. For instance, SEBI could mandate that a listed company need to put up its Articles of Association on its website, even though under the current law a company merely needs to file such information with the Registrar of Companies (RoC).

**3.2** Each of the three areas of disclosure i.e. by the issuer, intermediaries and investors needs to be threaded together – a role which a strengthened e-Corpfilling could possibly do. For instance, there is a disclosure mandated for all persons acquiring/selling their holdings of a listed company under insider trading regulation.

Simultaneously, an acquisition of a company's shares under takeover regulations by a person also needs to be disclosed. The information is submitted to the target company/Stock Exchanges/SEBI. If an integrated approach is taken, then the various disclosures could be consolidated and the information could be made available at a single reference point for investors and the regulator simultaneously.

**3.3** A major benefit of the proposed fungibility between initial disclosures (prospectus) and continuous disclosures (various disclosures like the annual report, quarterly reports, stock exchange notifications etc.) would be the reduced cost of compliance. Thus, if a company goes to the capital market for the first time in an IPO, it would find that because of the fungibility of company information, the cost and effort in continuing disclosures and in creating an annual report would get reduced drastically. Conversely, a seasoned listed company (which is listed for over 1 year and is in compliance with the various relevant enactments) already has the company information out in the public domain and thus could merely copy and paste the information along with any material updates and transaction based information, whenever it is required to prepare an offer document. An even more efficient means of integrating the information would be to incorporate the company information by reference into a prospectus. Such incorporation by reference exists in the US markets. Of course, any updates since the last annual/quarterly reports must be published as material updates in the prospectus along with the transaction based information about the securities on offer. Further, the integration will not dilute the liability of the issuer, directors, merchant bankers and others who must continue to carry out necessary due diligence before raising of capital by the company. Thus integration could reduce the cost of compliance while at the same time improve the disclosures being made to the investors.

**3.4** Even without incorporation by reference, there will be two benefits of the above exercise. One, the same set of information and the same format will be used for making public company information whether it is the primary market disclosures or



the secondary market disclosures. Conversely, even if a company is a first time issuer of equity capital, its continuous disclosures would be cast in the same die as the company information in the prospectus (as described in the previous paragraph) - thus making disclosures transferable and fungible. Second, continuous information will be substantially strengthened, eliminating the bias the current regulatory framework has towards protecting primary market investors over protecting secondary market investors. An efficient means of integrating could be by using a single set of regulations which gives a descriptive line item of company information. For instance there would be line items of: Description of Business, Description of Property, Legal Proceedings, Financial Data, MD&A (company information), Contents of First Page of Prospectus, Types of Securities Offered, Disclosure of Selling Commissions (transaction information). This master set of regulations can then be used with different forms. For instance, to draft a prospectus, one would use Company information and transaction information from the various line items. Similarly for a rights issue a simpler set of line items would be used from the same pool of items. A listed company which is coming to tap further capital thus can incorporate by reference the company information and use only the transaction information in its prospectus. For an annual report, one would tap the same pool and take only the company based information.

#### **4 PROCESS**

**4.1** The Sub-Committee identified the following broad categories in relation to which disclosures are presently required to be made:

- ❖ Promoters, Persons in Control and Promoter Group
- ❖ Capital Structure, Shareholding Pattern
- ❖ Board of Directors and Key Management.
- ❖ Industry, Project , Business and Business Strategy
- ❖ History of the Company, Change in name of the Company

- ❖ Guidance & Future Prospects
- ❖ Litigations, Defaults and Material Developments
- ❖ Miscellaneous Disclosures

Within each of these, the Sub-Committee then prepared an exhaustive list of all disclosure requirements referring to all relevant rules, regulations and guidelines. Each disclosure item was then deliberated extensively towards integration of the initial and continuous disclosures.

**4.2** The Sub-Committee then prepared the drafts of integrated disclosures for each of the above broad categories. This included several new formats of reporting, to make the information available in a database format, for easier access and search.. These drafts were discussed by SCODA in its various meetings. SCODA approved the same with certain changes, which were subsequently incorporated. The same are placed at **Annexure I to V**. The topic of Guidance and Future Prospects was not completed as SCODA needs to have elaborated discussion on the topic. As the work related to Litigations, defaults and material developments was predicated upon the views of the SEBI Board on what standard of materiality was to be used, the item was deferred till the views of the Board emerged. Subsequently, the Board has taken a view of the materiality of such events. The topic of miscellaneous disclosures was deleted as most of the disclosures amounted to additional disclosures which were not currently mandated.

As per the directive of SCODA, the Sub-Committee has confined itself to streamlining existing initial and continuous disclosures only, and has not made any recommendations regarding adding any new set of disclosures, This report proposes recommendations on bringing initial and continuous disclosures at one place, and under various logical headings. The Sub-Committee expects that this would enable investors to get a complete view of the company at one place, in a user-friendly manner.

**4.3** While the integrated disclosure requirements were being finalized, the Sub-Committee had informed SCODA that an expert team should be appointed to study the implementation of the recommendations of the sub-committee and the technology requirements for the revised disclosure formats. Accordingly, SCODA had formed a Sub-Committee under the Chairmanship of Mr. Mohandas Pai, a member of SCODA and authorized Mr. Pai to nominate any persons to this Sub-Committee as also invite outside experts for discussions.

## **5. CONCLUSION**

Relying on a regulatory framework based on the requirements of a different era may be a costly error which we might already be making. We can improve disclosure by strengthening continuous disclosures and reducing duplication for which there is substantial cost and no benefit. If we could do that with today's technology and thus improve the quality of information while reducing the quantity, information would become more readable, access to investors will be wider and an empty formality of registration could be translated into true 'on tap' disclosure available to all continuously. Data concerning business, property, management, financial condition, and results would be available at all times and updated in a single document whether there is an issue of capital or not. On the other hand a much lighter version of memorandum of transactional details could be made with each issue. Thus, making raising of capital cheaper and easier, information more accurate and more widely available - benefiting both issuer and investor. The intermediaries like investment bankers would have a leaner role in capital raising but a much more substantial role on a continuous basis.

The Sub-Committee would like to submit the contents of the finalized versions of the various areas of continuous disclosures which are attached hereto as **Annexures I to V**. In addition, in view of the SEBI Board decision on material litigation and defaults, the committee may take a view as to the form and

substance which the disclosures relating to material litigations, defaults and developments ought to take.

## **6. ACKNOWLEDGEMENTS**

The Sub-Committee would like to place on record its deep appreciation of the significant contribution made by Mr. P.S. Reddy and Mr. Uday Phadke. The Sub-Committee would also like to acknowledge the work done by the SEBI officers Mr. Santosh Shukla, Deputy Legal Adviser, Ms. Vidisha Krishan, Executive Assistant to ED and Ms. Rohini, Legal Officer. Last but not the least; the Sub-Committee would like to show its appreciation for the support lent by Mr M.K.Srikanth, Manager, Division of Issues and Listing, in compiling all relevant material to enable discussions by the Sub-Committee, co-ordinating with members for organizing meetings of the Sub-Committee and for his extensive help in the substantive work in preparation of this report .

**Date: 21<sup>st</sup> January 2008**

**Place: Mumbai**

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