

Continuing Disclosures: The Emerging Challenges



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Disclosure of high quality information to the markets on an ongoing basis is crucial after a security has been listed. In recognition of the importance of ongoing disclosure, IOSCO published Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities (Principles for Ongoing Disclosure) in 2002¹. This guidance established

a set of common, high-level principles for jurisdictions reviewing and/or developing an ongoing disclosure and material development reporting regime for listed entities.

Consistent with the use of the term in the Principles for Ongoing Disclosure, ongoing disclosure includes current disclosure that must be provided on an as needs and immediate basis, as well as periodic reports that are provided according to set timeframes².

The information disclosed in periodic reports should be fairly presented, not be misleading or deceptive and should not contain any material omission of information. Moreover, information disclosed in a periodic report should be presented in a clear and concise manner without reliance on boilerplate language³.

Companies often make voluntary disclosures that go beyond minimum disclosure requirements in response to the market demand. A strong disclosure regime that promotes genuine transparency is pivotal for market-based monitoring of companies and central to shareholders' ability to exercise judgement.

The Kotak Committee, set up with the aim of improving standards of Corporate Governance of listed companies in India was inter alia tasked with improving safeguards and disclosures pertaining to Related Party Transactions and to make recommendations to disclosure and transparency related issues, if any; high-grade information represents the basic input for governance because it reduces the twin problems of reliability and asymmetric information, which refer to the fact that professional managers, board members and auditors possess significantly greater information than the average investor in these companies.

While a good alternative or pathway could have been a "comply or explain" approach on some of the recommendations⁴, by accepting most of the recommendations of the Kotak Committee report,

regulators have paved a way for aligning with some of the best practices followed globally and bringing in a renewed focus on improved corporate governance by way of better structure, more rigorous checks and balances and greater independence of all key gate-keepers including boards and auditors.

Transparency is of critical importance where companies operate through a complex set of Indian and cross border subsidiaries, associates, affiliates, joint ventures and the like, with cross-border flow of capital. However, disclosure requirements are not expected to place unreasonable administrative or cost burdens on companies, though in practice they have a potential to do so.

There though remain practical challenges in meeting disclosure standards. Companies, stock exchanges and regulators each face their unique challenges. Some of these are enumerated below -

Companies

1. Plethora of rules and sometimes contrary regulation: Companies whether listed or unlisted have to reconcile to an increasing array of complex and sometimes seemingly contrary rules. Companies Act, SEBI Regulations, Exchange Regulations, Prohibition of Insider Trading, Takeover Rules, ICDR, LODR, Depositories Regulations, RBI Guidelines are just some of the regulations applicable to a financial sector company. Further, examples of companies abound that are unable to comply / or comply with a delay with rules as government and regulatory pre-approvals are required.
2. Immediate reaction from markets: Recent trends point to increasingly immediate and at times disproportionate reaction to some of the disclosures.
3. Cost burden: Amount and frequency of disclosures is uniform for all companies (with few exceptions), irrespective of size or complexity of operations. Penalties for non-compliances are high and more often than not, do not take into account individual circumstances. Standard Operating Procedures (SOP) undoubtedly bring consistency and uniformity to disclosures and consequently raise investor confidence, however the flip side is the cost of compliance. As an example, companies are required to make the following disclosures and commit to undertaking certain audits:
 - Half yearly disclosure on RPTs required to be made on consolidated basis.
 - Disclosure consolidated quarterly results with effect from financial year 2019 -2020.
 - Disclosure of details of transactions entered into with any person which holds 10% or more shares as per the annual report.

- Disclosure of details of auditor credentials, audit fee and reasons for resignation of auditors.
- Corporate Governance report and shareholding report.
- Utilization of funds raised through preferential allotment or qualified institutional placements undertaken in the relevant financial year, until such funds are fully utilized.
- Secretarial audit to be performed for every listed entity and its material unlisted Indian subsidiary.
- Financial statement should include a statement of cash flows for the half-year as part of its standalone and consolidated financial results for the half-year.

Stock Exchanges

1. Stock Exchanges where companies' shares are listed and traded are considered a link between the investors and listed companies and are also a frontline regulator. While exchanges routinely create awareness about various regulations and submission of disclosures through conduct of seminars/workshops and issue circulars, notices and guidance notes, the scale and range of monitoring puts pressure on their resources. Further, companies at times face practical difficulties in complying with prescribed regulations. For instance, companies facing financial stress are unable to appoint independent directors within a set time frame. Since

suspension and delisting of companies lead to poor investor outcomes, exchange employees' need to explain and persuade companies to comply and to collect penalties for non-compliance, a tough task.

2. Technology changes: Given the vast amount of information that filters through a stock exchange, huge investments in technology to facilitate data collection, retrieval and analysis are becoming par for the course.

Regulators

Rising disclosure of corporate frauds and a steady stream of whistle blower complaints have been putting pressure on the regulators to find an appropriate enforcement and policy response. Regulators also face the unenviable task of striking the right balance between the type, frequency and quality of disclosure and cost of such compliance.

As corporate governance gains credence, a way forward could be an alternative approach to corporate governance i.e. a comply or explain regime⁵. In the comply or explain regime, issuers are frequently required to disclose the issuer's current level of compliance with the relevant code, as well as the issuer's anticipated level of compliance in the future and explanations for deviations⁶. This will allow flexibility to overcome temporary impediments while also maintaining investor trust.

¹ Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities, Statement of the Technical Committee of IOSCO, October 2002, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD132.pdf>.

² Principles for periodic disclosure- Final Report of Technical Committee of IOSCO, February 2010 available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD317.pdf>

³ Principles for periodic disclosure- Final Report of Technical Committee of IOSCO, February 2010 available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD317.pdf>

⁴ <https://economictimes.indiatimes.com/blogs/finreg/the-kotak-panel-on-corporate-governance-should-separate-best-practices-from-mandatory-provisions/>

⁵ COMPLY OR EXPLAIN - AN ALTERNATE APPROACH TO CORPORATE GOVERNANCE https://www.nseindia.com/research/content/res_QB4.pdf

⁶ Principles for periodic disclosure- Final Report of Technical Committee of IOSCO, February 2010 available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD317.pdf>