SEBI proposes revised norms relating to buy-back of securities

11 June 2019

First Notes on

Financial reporting

Corporate law updates

Regulatory and other information

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 three months

Post three months but within six months

Post six months

Forthcoming requirement

Background

The Companies Act, 2013 (2013 Act) (Sections 68 to 70) and the Securities and Exchange Board of India (SEBI) (Buy-back of Securities) Regulations 2018 (Buy-back Regulations) prescribe certain conditions subject to which a company can purchase its own shares or other specified securities.

The conditions, *inter alia*, include the following:

a) The buy-back should be authorised by the articles of the company and a special resolution should be passed at its general meeting[1].

b) The buy-back should not exceed 25 per cent of the aggregate of paid-up capital and free reserves of the company[2].

c) The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back should not be more than twice the paid-up capital and its free reserves. A higher ratio could be prescribed by the Central Government (CG)[3].

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[1]The condition is not applicable if the buy-back is less than 10 per cent of the total paid-up equity capital and free reserves of the company and an ordinary resolution has been passed at its meeting.

[2]In case of buy-back of equity shares by a company in any financial year, limit of 25 per cent will be construed with respect to its total paid-up equity capital in that financial year.

[3]The Ministry of Corporate Affairs (MCA) through its notification dated 10 March 2016 permitted government companies that carry on non-banking finance institution activities and housing finance activities proposing buy-back to have a debt to capital and free reserves ratio after buy-back of not more than 6:1.

The provisions, however, do not prescribe which financial statements (i.e. stand-alone or consolidated) are to be considered for the purpose of meeting the above mentioned conditions of buy-back.

New development

On 22 May 2019, SEBI issued a Discussion Paper (DP) proposing revised norms with respect to meeting the conditions for buy-back by companies. These are as follows:

Listed company with Non-Banking Financial Company (NBFC) and Housing Finance Company (HFC) as subsidiaries

a) The post buy-back debt to capital and free reserves ratio of 2:1 (except for companies for which higher ratio of the debt to capital and free reserves has been notified under the 2013 Act)[3] should be considered on a consolidated basis. The subsidiaries (i.e. NBFC and HFC) should be excluded only if they are regulated and have issuances with AAA ratings.

The SEBI's Primary Markets Advisory Committee (PMAC) suggested that infrastructure companies should not be excluded for the purpose of computation of the ratios.

b) The subsidiaries (i.e. NBFC and HFC) should have debt to equity ratio of not more than 5:1 on a stand-alone basis.

Other listed companies

SEBI proposed that the financial statements would be considered on a conservative basis (i.e. both stand-alone and consolidated basis) for evaluating various thresholds/conditions specified for buy-back of securities.

The reason to consider both stand-alone and Consolidated Financial Statements (CFS) are as follows:

a) CFS are intended to present financial information about a parent and its subsidiaries as a single economic entity to show the economic resources controlled by the group, the obligations of the group and results the group achieves with its resources.

b) The activities of the subsidiaries are not available in the public domain. For instance, subsidiaries of a listed company could have large amount of debts. Therefore, CFS allows the investors to get a complete overview of the parent company.

c) The subsidiaries could either be listed or unlisted. SEBI would have a very limited role in case of unlisted subsidiaries.

d) In case of Initial Public Offers (IPOs), the profitability and other financial statements are also considered on a consolidated basis as per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations, 2018).

e) All listed companies with subsidiaries are mandatorily required to submit quarterly/year-to-date consolidated financial results with effect from 1 April 2019 as per the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations).

The comments on the above proposals can be submitted up to 12 June 2019.

Our comments

The proposals are intended to bring clarity and uniformity in practice with respect to consideration of financial statements for ensuring compliance with the conditions stipulated for buy-back of securities by the companies.

As per the proposals:

- **Listed company with NBFCs and HFCs as subsidiaries (that are regulated and have issuances with AAA ratings):** The listed company has to consider CFS excluding NBFCs and HFCs to determine post buy-back debt-to-capital and free reserves ratio of 2:1. Additionally, it has to consider stand-alone financial statements of its subsidiaries (i.e. NBFCs and HFCs) to determine debt-to-capital and free reserves ratio for the purpose of buy-back. This is because, NBFCs and HFCs, generally, have higher debts and considering CFS (which includes such subsidiaries) could distort the ratios.

  A higher debt-to-equity ratio of 5:1 has been proposed for subsidiaries that are NBFCs and HFCs as per their stand-alone financial statements. However, the proposed ratio is not at par with the ratio prescribed by the Reserve Bank of India (RBI) for non-deposit taking NBFCs with assets less than INR500 crore which is 7:1. Similarly, MCA has prescribed a post buy-back ratio of 6:1 for government companies carrying on non-banking finance institution activities and housing finance activities. Therefore, SEBI should consider harmonising the proposed ratio with the ratios prescribed by other regulators e.g., MCA and RBI.

- **Other listed companies:** Other listed companies have to consider both stand-alone and CFS for meeting the conditions specified for buy-back of securities.

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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.

Missed an issue of Accounting and Auditing Update or First Notes

Issue no. 34 – May 2019

The topics covered in this issue are:

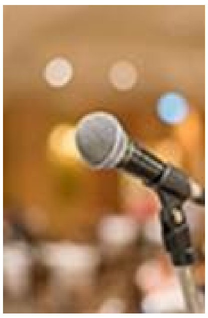
- Ind AS 116, *Leases* – Transition options
- Clarity on reflecting tax uncertainty
- Impact of IBOR reforms
- Regulatory updates

ITFG clarifications' bulletin 19

4 June 2019

The Ind AS Technical Facilitation Group (ITFG) of the Institute of Chartered Accountants of India (ICAI) issued its ITFG clarifications’ bulletin 19 on 10 May 2018. It provides clarifications on six issues relating to various Ind AS.

This edition of First Notes provides an overview of the issues clarified by the ITFG.



Voices on Reporting

KPMG in India is pleased to present Voices on Reporting (VOR) – a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 22 May 2019, KPMG in India organised a special session of VOR webinar to discuss significant impact areas of Ind AS 116, *Leases* on life sciences sector.

Also we discussed other important updates e.g. Appendix C, *Uncertainty over Income Tax Treatments* of Ind AS 12, *Income Taxes*. The new guidance seeks to bring clarity to the accounting for income tax treatments that are yet to be accepted by tax authorities. The appendix is effective for accounting periods beginning on or after 1 April 2019.

Click here to access the audio recording (mp3) and presentation (pdf).

Feedback/queries can be sent to aaupdate@kpmg.com

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