‘Applicability and role of the Risk Management Committee’ - Amendments to the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015

1. Objective

1.1. This memorandum seeks approval of the Board to amend regulation 21 and schedule II of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations” or “LODR”) in relation to applicability and role of the Risk Management Committee (RMC) of listed entities.

2. Background

2.1. In June 2017, a committee on corporate governance headed by Shri Uday Kotak was constituted by SEBI with an aim to improve the standards of corporate governance of listed entities in India. Based on the recommendation of the committee, the requirement of constituting RMC was extended to the top 500 listed entities on the basis of the market capitalisation, from the top 100 listed entities. The committee further recommended that in view of the increasing relevance of cyber security and related risks, the role of RMC shall *inter-alia* cover this specific aspect. The LODR Regulations were amended, accordingly.

2.2. While LODR Regulations specify the role of various board committees such as audit committee, nomination and remuneration committee and stakeholder relationship committee; defining the role and responsibilities of the RMC (except for cyber-security risk) has been left to individual boards of listed entities.

2.3. Considering the multitude of risks faced by listed entities, risk management has emerged as a very important function of the board. The Covid-19 pandemic has also reinforced the need for a robust risk management framework. In view of the importance of the risk management function, it was felt necessary that RMC should have certain defined functions.

2.4. The issue was discussed by the Primary Market Advisory Committee (PMAC) of SEBI and subsequent to the discussions, it was decided to place a paper on extending the applicability and defining the role of the RMC for public consultation.

3. Public Consultation

3.1. As part of SEBI's consultative approach, public comments were sought on the proposed amendments to the LODR Regulations (regulation 21 and schedule II) by way of a consultation paper on 'Applicability and role of the Risk Management Committee' placed on the website of SEBI on November 10, 2020. A copy of the consultation paper is placed at **Annex – I** for reference.

3.2. Comments have been received from 28 entities/persons including listed companies, consultants, law firms, industry association and individuals, etc. Almost all the commentators are generally in agreement with majority of the proposed amendments to the LODR Regulations. Some of the commentators have suggested modifications to the proposals contained in the consultation paper. Few of them have also suggested additional amendments to the LODR Regulations. Analysis of comments along with the rationale for acceptance/non-acceptance and final recommendations are placed at **Annex – II**.

3.3. Based on the analysis of the public comments, received from different entities, amendments proposed to the LODR Regulations are discussed in the following paras:

4. Applicability of constitution of RMC

4.1. **<u>Proposal in the consultation paper and rationale</u>**

4.1.1. At present, board of directors of the top 500 listed entities by market capitalisation are required to constitute the RMC. The above requirement was inserted in the LODR Regulations in 2019.

4.1.2. In light of the increasing importance of risk management function of the boards of the listed entities, it was proposed in the consultation paper to extend the requirement of constituting the RMC to the top 1000 listed entities by market capitalisation.

4.2. **Comments/suggestions received and our views**

4.2.1. The proposal has been welcomed by majority of the commentators. Suggestions have been received to extend the applicability of constitution of the RMC to all listed entities or any other class/classes of companies as specified by the Board from time to time. Some of the commentators have stated that the proposal may cause long-term hardship to companies that experience reduction in market capitalisation.

4.2.2. It is proposed to retain the proposal in the consultation paper without any modification, as it is in the interest of good corporate governance and going forward, the applicability of the regulations may be expanded to include a wider set of entities.

4.3. **Proposal**

4.3.1. Board of directors of the top 1000 listed entities by market capitalisation shall be required to constitute the RMC.

5. Frequency and quorum for RMC meetings

5.1. **Proposal in the consultation paper and rationale**

5.1.1. Kotak committee on corporate governance had recommended that all mandatory committees, except for audit committee, shall necessarily meet at least once in a year and the same was incorporated in the LODR Regulations in 2019.

5.1.2. Covid-19 pandemic and consequent lockdown restrictions imposed by the government have impacted businesses all over the world further underpinning the importance of risk management function. As it is imperative to identify risks of high priority and take timely measures to minimize their impact, it was proposed in the consultation paper to increase the frequency of meeting of RMC to at least two times in a year.

5.1.3. Further, there is no quorum requirement for meetings of the RMC at present. Considering the increasing importance of risk management function and to ensure that decisions in these meetings are not taken arbitrarily; presence of either two members or one third of the members of the committee, whichever is greater, including at least one member of the board of directors in attendance was proposed in the consultation paper.

5.2. **Comments/suggestions received and our views**

5.2.1. The aforesaid proposals have been welcomed by majority of the commentators. It has been suggested to increase the frequency of meeting to four times in a year and to specify a gap of at least three months between two meetings. With regard to the suggestion to increase the frequency of meetings to four times a year, it is felt that not all companies may require a quarterly RMC meeting and therefore, the suggestion may not be accepted.

5.2.2. The proposed amendment only prescribes the minimum number of meetings to be conducted, thereby providing flexibility to companies to conduct as many meetings as per the requirement of such companies.

5.2.3. Currently, majority of the members of RMC have to comprise of members of the board of directors and in case of a listed entity having outstanding SR equity shares, at least two thirds of the RMC shall comprise of independent directors. The proposal with regard to composition of the RMC was not a part of the consultation paper. However, suggestions have been received to mandate a minimum of three directors, including at least one independent director. This suggestion may be accepted.

5.2.4. It is also suggested that the Chairman of the committee shall be an independent director with minimum qualification and adequate experience in risk management.

5.2.5. While it is desirable that people with risk management expertise head the committee, the committee can always seek professional advice from outside members and therefore, we may not prescribe any qualification for the Chairman of the RMC. Further, suggestion for prescribing an independent director to chair the RMC may not be accepted. Suitability of a candidate for the role of Chairman of RMC is important and therefore, his/her selection may be left to the judgement of the listed entity.

5.2.6. Further, SEBI has not prescribed any minimum qualification for Chairman of any other committee (in respect of audit committee, all directors shall be financially literate – ability to read and understand basic financial statements).

5.2.7. It is also suggested that the MD/CEO/CFO and at least 2 other senior executives shall be permitted as invitees.

5.2.8. Suggestions on permanent invitees to the committee may be left to individual boards and therefore may not be prescribed through law.

5.2.9. Further, most of the commentators have suggested to mandate the presence of an independent director for quorum. The suggestion may not be practical since it is mandatory to have only one independent director in the RMC and if the independent director is unable to attend the meeting due to some genuine reasons then the meeting cannot take place.

5.3. **<u>Proposal</u>**

5.3.1. It is proposed that RMC shall meet at least twice in a year and not more than one hundred and eighty days shall elapse between two meetings. This is to ensure that companies hold at least one meeting of the RMC every half year.

5.3.2. Further, in view of the comments received and considering the enlarged role of the RMC, it is proposed to prescribe the minimum size of the committee which shall be not less than three members, with the majority being members of the board of directors, including one independent director.

5.3.3. The quorum for a meeting of the RMC shall be either two members or one third of the members of the committee, whichever is higher, including at least one member of the board of directors in attendance as proposed in the consultation paper.

6. Power to seek information or external advice

6.1. **<u>Proposal in the consultation paper and rationale</u>**

6.1.1. Presently, only audit committee has powers to seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary. It was proposed to provide similar powers to RMC to enable it to discharge its duties effectively.

6.2. **<u>Comments/suggestions received and our views</u>**

6.2.1. The majority of the comments received are in favour of the proposal.

6.3. **<u>Proposal</u>**

6.3.1. It is proposed to give powers to the RMC to seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.

7. Role and responsibilities of the RMC

7.1. <u>Proposal in the consultation paper and rationale</u>

7.1.1. It is desirable that a listed entity has robust risk management plan to avoid potential threats and minimize their impact. Currently, individual boards of listed entities are empowered to define the role and responsibilities of the RMC (except for cyber-security risk) unlike other board committees. Therefore, it was proposed in the consultation paper to define the role and responsibilities of the RMC which, inter-alia, included the following:

(1) To formulate a detailed risk management policy which shall include:
   (a) A framework for identification of internal and external risks specifically faced by the listed entity, in particular including financial, operational, sectoral, sustainability (particularly, ESG related risks and impact), information and cyber security risks
   (b) Measures for risk mitigation
   (c) Systems for internal controls and
   (d) Business contingency plan

(2) To monitor and oversee implementation of the risk management policy, including evaluating the adequacy of risk management and internal control systems;

(3) Ensure that appropriate methodology, processes and systems are in place to monitor and evaluate risks associated with the business of the Company;

(4) To review the risk management policy on annual basis, including by considering the changing industry dynamics and evolving complexity;

(5) To keep the board informed about the nature and content of its discussions, recommendations and actions to be taken;

(6) The appointment, removal and terms of remuneration of the Chief Risk Officer (if any) shall be subject to review by the risk management committee, jointly with the nomination and remuneration committee

The Risk Management Committee shall coordinate its activities with the Audit Committee in instances where there is any overlap with audit activities.

7.2. **<u>Comments/suggestions received and our views</u>**

7.2.1. Majority of the public comments received are in favour of the proposal. However, certain concerns were raised by the commentators with regard to systems of internal controls stating that monitoring the adequacy of internal control systems shall be limited only for identified risks, to avoid role conflict with the audit committee.

7.2.2. Commentators have also highlighted concerns with regard to overlapping roles with audit committee. Accordingly, it is proposed that RMC shall co-ordinate its activities with other committees in case of overlap and board of directors of listed entities shall lay down the guidelines for inter-committee co-ordination.

7.2.3. With regard to the proposal that appointment, removal and terms of remuneration of the Chief Risk Officer- CRO (if any) shall be subject to joint review by the risk management committee and the nomination and remuneration committee, suggestions have been made to appoint a dedicated CRO and to prescribe criteria for qualification. Others have commented that the appointment, removal and terms of remuneration of the CRO should be done only by the RMC or in order to avoid any overlap, there should be a clear segregation of the responsibilities of these committees. Considering that additional review by RMC would be onerous and it would lead to duplication, the proposal to involve nomination and remuneration committee in the review of appointment of CRO may not be considered. Instead, only RMC shall review the appointment, removal and remuneration of CRO, if any.

7.2.4. Comments were also received suggesting to remove impact with regard to sustainability risk (ESG risks and impacts), as at policy level it is difficult to assess the impact and the same will get covered under risk mitigation. Further, assessment of impact is not included for other types of risks and to maintain uniformity the same may be removed.

7.2.5. The commentators also suggested to replace ‘Business Contingency Plan’ with ‘Business Continuity Plan’ as the latter is broad based since it refers to the ability of businesses to carry out their normal activities and function after unplanned events have occurred and the same is broad based as against the contingency plan which is based on identification of all types of disruptions and action plan for redressal. This suggestion may be accepted.

7.2.6. Views expressed by the commentators on the frequency of review of risk management policy are divisive. While some suggestions state that the review shall be done annually or semi-annually; others have highlighted that review of risk management policy annually is too short to amend an elaborate policy, as the very implementation and streamlining practices would require a minimum period of one year and the review period shall be biennially. Considering the comments, it is thought prudent to mandate periodic review of the risk management policy but at least once in a two year.

7.3. **Proposal**

7.3.1. Based on the comments, it is proposed that the role of the RMC shall *inter alia*- include the following:

(1) To formulate a detailed risk management policy which shall include:

(a) A framework for identification of internal and external risks specifically faced by the listed entity, in particular including financial, operational, sectoral, sustainability (particularly, ESG related risks), information, cyber security risks or any other risk as may be determined by the Committee

(b) Measures for risk mitigation including systems and processes for internal control of identified risks

(c) Business continuity plan

(2) To ensure that appropriate methodology, processes and systems are in place to monitor and evaluate risks associated with the business of the Company;

(3) To monitor and oversee implementation of the risk management policy, including evaluating the adequacy of risk management systems;

(4) To periodically review the risk management policy, at least once in two years, including by considering the changing industry dynamics and evolving complexity;

(5) To keep the board of directors informed about the nature and content of its discussions, recommendations and actions to be taken;

(6) The appointment, removal and terms of remuneration of the Chief Risk Officer (if any) shall be subject to review by the Risk Management Committee.

The Risk Management Committee shall coordinate its activities with other committees, in instances where there is any overlap with activities of such committees, as per the framework laid down by the board of directors.

8. Proposal for the consideration of the Board

8.1. The Board is requested to consider and approve the proposals mentioned at para 4.3,5.3,6.3 and 7.3 of this memorandum and the proposed amendments in regulation 21 and schedule II of the LODR Regulations as placed at **Annex – III.**

8.2. The Board is also requested to authorize the Chairman to take consequential and incidental steps to give effect to the decisions of the Board.

Annex-I

The Consultation paper is available on www.sebi.gov.in

Annex – II

This has been excised for reasons of confidentiality

Annex-III

This shall be notified at a later date