

## Corpsec Hotline

December 23, 2008

### SEBI AMENDMENTS - WARRANTED AND TIMELY?

In a sign that markets drive government and regulatory policies, the Securities and Exchange Board of India (“SEBI”) has amended the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 (“DIP Guidelines”). SEBI vide its press release December 8, 2008 has permitted the introduction of certain financial instruments that a company can issue to raise capital from public through a qualified institutional placement. In furtherance of the same, SEBI has provided for relaxations from certain minimum requirements prescribed by regulations with respect to the said financial instruments. Apart from permitting the issue of these financial instruments SEBI has, vide an earlier press release dated December 4, 2008, also relaxed certain procedural requirements and introduced measures to provide for better transparency in the functioning of SEBI. For the purposes of convenience both these press releases are referred to as the “Amendments”.

The recent Amendments can be briefly summarized as hereunder:

#### Extension of validity of offer letter

Earlier, a company upon receipt of an observation letter by SEBI for issue of shares in an Initial Public Offer (“IPO”) / for a rights issue (“Rights Issue”) had to offer its shares to the public within three months from the date of the observation letter. However, given the present market circumstances, various companies have delayed their IPOs / Rights Issue due to lack of investor confidence in the market. With a view to provide comfort to such companies, SEBI has provided for the extension of the validity of the observation letter from three months (currently) to one year, subject to filing of an update document with SEBI if there are material changes.

Earlier a company was required to follow the entire process of seeking approval from SEBI for IPO/ Rights Issue, if it did not issue shares within three months from the date of the SEBI observation letter. The Amendment has come as a welcome respite for companies that have been forced to shelve carefully laid out IPO / Rights Issue plans.

Companies now have the ability to time the issue of shares through an IPO / Rights Issue to take advantage of favorable market conditions.

#### Issue of Non-Convertible Debentures and Warrants

Prior to the Amendments, in a qualified institutional placement a company could issue to Qualified Institutional Buyers (“QIBs”) equity shares/ fully convertible debentures (“FCDs”) / partly convertible debentures (“PCDs”) or any securities other than warrants, which are convertible into or exchangeable with equity shares at a later date. Considering the recent growth in the bond market in India, SEBI considered possible alternative structures similar to Domestic Convertible Bonds which would yield similar flexibility to the issuers and enhance the suite of products available to an investor for subscription, and available to a company for issue to QIBs. This mechanism requires basic enablers like the existence of long tenor callable Credit Derivatives market, ability to borrow stock for long tenors to enable short selling, etc, which SEBI seems to have implicitly acknowledged now exist. Accordingly, SEBI has permitted issue of Non Convertible Debentures (“NCDs”) and Warrants (“Warrants”), by listed companies in a qualified institutional placement. This Amendment has marked a departure from SEBI's earlier embargo on the issue of Warrants by a company in an IPO/ Rights Issue.

SEBI in its earlier amendment to the DIP Guidelines in August 28, 2008 (please refer to our hotline dated August 29, 2008) had omitted the definition of “debt instruments” and introduced the definition of “convertible debt instruments”. *Convertible Debt Instruments are defined as instruments or securities which create or acknowledge indebtedness and are convertible into equity shares at a later date, at or without the option of the holder of the instrument or the security of a body corporate.* Reference to “debt instrument” had been replaced by “convertible debt instrument” and provisions pertaining to non-convertible debentures had been omitted. Accordingly, the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 notified on June 6, 2008 have been made applicable to the public issue of debt securities and listing of debt securities issued through a public issue or on a private placement basis.

While, NCDs would qualify as debt instruments, there are no specific guidelines for issue of NCDs to QIBs under the SEBI (Issue and Listing of Debt Securities) Regulations, 2008. The Amendments seek to create an exception whereby despite being debt instruments, issue of NCDs to QIBs in a qualified institutional placement are governed by the provisions of the DIP Guidelines, and not the SEBI (Issue and Listing of Debt Securities) Regulations, 2008.

SEBI has however set the minimum contract value for trading of NCDs/ Warrants at Rs. 1,00,000/-, thus ensuring that these products are available only to sophisticated investors and not retail public investors.

#### Change to guidelines with respect to maintaining on a continuous basis a minimum public shareholding

Under the current regulations pertaining to listing of securities, a listed company is required to comply with the Securities Contract (Regulation) Rules, 1957 (“SCRR”). Under Rule 19(2)(b) of SCRR, one of the conditions for

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listing of securities on the stock exchanges is that at least 25% or 10% of each class or kind of securities issued by a company is offered to the public for subscription. However, under Rule 19(7) of SCRR powers have been granted to SEBI to exempt a company from the applicability of the provisions of Rule 19(2)(b).

In order to enable companies to issue NCDs and Warrants, SEBI has relaxed the applicability of the provisions of the SCRR pertaining to the mandatory requirement of issuing and maintaining on a continuous basis a public shareholding of at least 10% of the total number of issued shares of a class or kind. Since Warrants are instruments which can be converted into shares at a later date, SEBI has allowed a company issuing Warrants in a qualified institutional placement, to be eligible to seek exemption from the requirement of maintaining the minimum public shareholding with respect to such Warrants. It is relevant to note that since NCDs are debt instruments and are not convertible into equity, the provisions of the SCRR relating to the issue and maintaining of minimum public shareholding with respect to NCDs are not applicable to the issue of NCDs in a qualified institutional placement.

Presently there are no specific guidelines available based on which the SEBI considers applications seeking exemption from the minimum offer requirement under SCRR. In light of the recent exemption granted by SEBI to Tata Motors from complying with the minimum offer requirement under SCRR for its issue of shares with differential voting rights, it was proposed in SEBI's Board Meeting to formulate conditions subject to which, exemption would be granted by SEBI from the minimum offer requirement under the SCRR. It was stated that such provisions in the DIP Guidelines will provide adequate guidance to the market and will also enable SEBI to take a consistent stand in such cases. However, no such conditions have been formulated by SEBI as yet.

### **Introduction of ASBA in Rights Issue process**

Earlier, SEBI, vide circular dated July 30, 2008 had introduced an alternative mode of application i.e. Applications Supported by Blocked Amount ("ASAB") for IPOs. Under these provisions a person, through a bank notified by SEBI for this purpose, could make an application supported by a blocked amount for subscribing to shares in an IPO. Under the ASAB, the application money is blocked in the applicant's bank account till the time of allotment of the shares. The application forms for this payment mode are to be submitted to banks whose names appear in the list of Self Certified Syndicate Banks ("SCSBs") notified by SEBI.

The objective of the introducing the ASAB mode was to streamline the process of issue of securities and enable an expeditious issue of such securities. Considering the reduction in the timeline for Rights Issue (vide SEBI circular dated August 28, 2008), SEBI has now extended the facility to subscribe to securities of a company in a Rights Issue through the ASAB mode. It has been noticed that the ASAB mode has become a channel accepted by a large cross section of the public. Extending the use of this mode of application to a Rights Issue complements the reduction in time lines for a Rights Issue. By way of the Amendments, a person can now subscribe to securities by giving instructions to any of the banks notified as SCSBs.

### **Introduction of electronic rights entitlements in Rights Issue process**

SEBI, vide its circular dated August 28, 2008, reduced the timelines for Rights Issue. The minimum and maximum time period for which a Rights Issue can remain open was reduced to 15 days and 30 days from the earlier 30 and 60 days respectively. Further, the timelines for making the allotment/ refund was reduced to 15 days from the earlier 42 days from the date of closure of the Rights Issue. With a view to further, rationalize the disclosure requirements for Rights Issue, SEBI has contemplated providing for electronic trading of "rights entitlement".

Earlier a shareholder intending to renounce his rights entitlements had to fill up part B of the consolidated rights issue application form for renouncing his rights in favor of another person, such person the "renounee" having to sign Part C of the application form. In the current process, a "renounee" had to necessarily apply in Part C of the application form. The process of renunciation, and trading of such rights was entirely paper-based and resulted in administrative and procedural delays in completing the Rights Issue process. Therefore, SEBI seems to have felt that there is scope for exploring the possibility of electronic processing of renunciation of such "rights entitlement". Pursuant to the Amendments, the rights entitlement will now be made available in dematerialized form for all shareholders holding the underlying shares in dematerialized form. Following electronic processing of such renouncement, and consequent trading of such rights a faster and less cumbersome process has been proposed. These Amendments have been made with the objective of facilitating easier access by the general public to the stock market, and to provide greater participation of the investors in the market.

### **Transparency in the working of the Board**

As a progressive measure towards better, and a more visibly democratic, functioning of SEBI and in order to bring transparency to the working of SEBI, SEBI has decided that the agenda papers submitted to SEBI on all policy issues would be made available in the public domain by putting them up on SEBI's website, after a decision has been taken by SEBI on the issue. The minutes of the meeting relating to such items will also be made available on SEBI website after the Board has approved the minutes. This move is aimed at bringing better corporate governance in the functioning of SEBI, and enabling the public to ascertain the reasons for SEBI decisions. It is hoped that such transparency will help to reduce market speculation on reasons for SEBI decisions, and provide a guide to reduce speculation on possible outcomes of similar issues brought before SEBI in the future.

### **Conclusion**

With this slew of amendments, allowing for Warrants, introducing new instruments for qualified institutional placement, extension of time lines, facilitating more expedient avenues to complete a Rights Issue and bringing more transparency to its function SEBI is making strides towards addressing companies affected by the currently adverse economic circumstances. These amendments are a welcome sign of the resolve of the market regulator to kick-start the markets, facilitate investment by a broader spectrum of investors and protect investor interest by curbing speculation with respect to policies and decision making.

These Amendments certainly are warranted and appear to be timely. The lingering question is whether they are enough or more needs to be done, and only time will tell. We will continue to bring you updates in this era of shifting market sentiment and fast changing regulations.

Source: [SEBI's Press Release dated December 4, 2008](#) and [SEBI's Press Release dated December 8, 2008](#)

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