

Corpsec Hotline

June 20, 2009

CAPITAL MARKET: SEBI BOOSTER!

Snapshot

- Concept of Anchor Investor introduced for IPOs
- No superior voting rights for listed companies anymore
- Rights issue made easier
- Offer for sale, holding period clarified
- Rationalization of fee – boost for brokers, traders, mutual funds, FILs, FVCIs
- Commission to mutual fund distributors made transparent

With the incumbent Congress led government being re-elected with a comfortable majority, the SENSEX—the benchmark index of Bombay Stock Exchange—recorded a jump of more than 2000 points on a single day of trading on May 18, 2009, relenting only after trading was suspended for the day. The SENSEX has risen over 70% in the last three months (Mar 1, 2009 to June 1, 2009).

The Indian capital market regulator, Securities and Exchange Board of India (“SEBI”), has been proactive to address the changing need of the times as it has been taking swift steps time and again. Addressing both a phase of boom as well as a phase of gloom, SEBI has over the last one year repeatedly acted to address the balance. To this effect, various sentiment stimulating amendments to the SEBI (Disclosure and Investor Protection) Guidelines, 2000 (“DIP Guidelines”) (please refer to our hotlines dated [February 25, 2009](#), [May 15, 2009](#) and [June 16, 2009](#)) have been introduced by SEBI.

Yet another proposal has been made by SEBI in its Board meeting dated June 18, 2009 (“Board Meeting”), to provide a further booster shot. The said proposals are summarized herein below:

I. Investor – Who?

An Anchor Investor is a principal investor who brings in a specified commitment to subscribe to a certain percentage of shares of the company.

Under the DIP Guidelines, a Qualified Institutional Buyer¹ (“QIBs”) is permitted to subscribe to upto 50% of securities offered in an Initial Public Offer (“IPO”) through a book-building process. QIBs have been defined under DIP Guidelines and are regarded as sophisticated investors having a demonstrated track record.

A resolution has been approved in the Board Meeting to allow an issuing company to allocate on a discretionary basis up to 30% of overall QIB allocation limit in favour of multiple Anchor Investors, provided each Anchor Investor agrees to subscribe at least INR 100 Million, of which 25% is to be brought up front and the balance within 2 days of the closure of the public issue. It is also proposed that the Anchor Investor(s) will be subject to a minimal lock-in of 30 days from the date of allotment. Promoters and other entities related to the promoters are excluded from investing as an Anchor Investor.

Implications: The introduction of the novel concept of anchor investor at the stage of book building during an IPO will not only expedite the process but also render a higher degree of guaranteed financial commitment at a rather early stage of the IPO process. By rendering its brand power and upfront financial contribution, the Anchor Investor will serve as a catalyst, thereby ensuring that the success criteria for the IPO process are achieved.

Intriguingly, SEBI has proposed a lock-in of 30 days on the shares allocated to the Anchor Investor(s) from the date of allotment. This seems to be in line with the spirit of an Anchor Investor being a principal investor in the issuing company. Whilst a lock-in period of 30 days ensures that the Anchor Investor bears the commercial risk of investing and indirectly results in reduction of volatility that immediately follows an IPO process, it also provides it with the unfettered ability to deal with the shares post a minimal lock-in period. A higher lock-in may not have been reasonable for an investor as it would have prejudiced it against other large institutional investors.

While, Anchor Investor(s) are distinct from the promoters and will ensure that corporate governance principles are more scrupulously enforced, it shall also enable the issuing company to identify a preferred institutional investor for part placement of the QIB quota.

II. No superior voting rights for listed companies anymore

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The [Indian] Companies Act, 1956 presently provides that a company may issue equity shares with differential rights as to voting, dividend or otherwise subject to compliance with the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001. In a recent judgment², the Company Law Board upheld the validity of allotment of shares with differential voting rights. However, SEBI yesterday, has proposed that no listed company can issue shares with superior voting rights.

Implications: Differential voting rights in a public listed company has been a grey area ever since the ability to issue shares with differential voting rights was introduced in the year 2000.

Shares with differential voting rights can be structured so as to give specific shareholders (usually promoters or founders) higher voting control as compared to ordinary equity shareholders and thus ward-off takeover threats. Financial investors are the biggest exploiters of differential voting rights because they provide unique structuring options, which enable the financial investor to have a stake in the financial growth of the company without actually taking active participation in the management of the company.

Even despite the advantages, not many companies have gone this route due to the accompanied uncertainties. The pending Companies Bill (if passed will replace the present Companies Act, 1956) also has taken away the ability to issue differential voting right shares. Having voting power without having commensurate economic interest in a company poses the threat of (i) misuse of voting power as no or little financial loss may be incurred; (b) reduces accountability thereby resulting in poor corporate governance; and (c) takes away the managerial authority of the management.

III. Rights issue made easier

Presently, a listed company coming out with a rights issue to its existing shareholders is required to comply with Chapter VI of the DIP Guidelines and come out with a rights issue offer document that is very similar in disclosure requirements to an offer document under an IPO process. SEBI has now proposed to do away with disclosures in a rights issue, such as, summary of industry, business of the issuer company, promise vs. performance with respect to earlier/ previous issues, management discussion and analysis. Disclosures relating to financial statements, litigations, risk factors have also been simplified for a rights issue.

Implications: Appreciating the difference between fresh investment in a company and further investment in an already invested company, SEBI has done away with the additional and onerous disclosure requirements that were associated with a rights issue offering. Since the already invested shareholders will be privy to much of the information of the company due to their previous investment in the company, such elaborate disclosures did not serve any additional purpose and rather proved to be stumbling blocks in terms of process timelines and cost.

IV. Offer for sale, holding period clarified

A public offer for sale by existing shareholders in a company can be made provided they have held the shares for at least 1 year. SEBI has now proposed to include the period of holding of convertible securities³ as well as that of resultant equity shares together for the purposes of computing the 1 year holding period.

Implications: Typically private equity investors (“PE Investors”) prefer to invest in unlisted companies by subscribing to instruments which are convertible into equity at a later date. The PE Investors prefer to convert their convertible instruments into equity at the time of IPO of the company and use the IPO as an exit route from the company. With the aforesaid proposal, clarity has been brought about by SEBI that the lock-in on their convertible instruments like compulsorily convertible preference shares or compulsorily convertible debentures would be calculated from the date on which the said instruments were subscribed, rather than from the date of their conversion into equity shares. Thus, it has now become easier for the existing shareholders (including financial investors) to make public offer for sale of their shares. This will provide additional impetus to the Indian capital market.

V. Rationalization of fee – boost for brokers, traders, mutual funds, FIs, FVCIs

To encourage more participants and higher volume of trading in the capital market, SEBI has in its Board Meeting proposed to revise the fee applicable to almost all capital market participants including Brokers, Mutual Funds and Custodian of Securities. SEBI has also proposed revision of registration fee (3 years) for FIs from its existing USD 10,000 to USD 5,000. For, Foreign Venture Capital Investors, SEBI has made twin proposals, firstly the application fee (non-refundable) has been revised from USD 5,000 to USD 2,500 and secondly, the one-time registration fee has been revised from USD 20,000 to USD 10,000.

Implications: Revision of fee is expected to benefit both retail as well as institutional investors and would bring about higher participation in capital market. Also, with Cayman Island Monetary Authority (Cayman Island's capital market regulator) becoming an ordinary member of International Organization of Securities Commission (see our hotline dated **June 16, 2009**), a huge inflow of applications for FI registration from Cayman Island based fund entities is expected. A reduced registration fee would further attract Cayman Island based fund entities to seek registration as FI.

VI. Commission to mutual fund distributors made transparent

SEBI has proposed prohibiting entry load for all schemes, existing or new, of a mutual fund in India. Any distributor commission, from now, has to be paid directly to the distributor by the investor and the distributor has to make adequate disclosure for all commissions received by them.

Implications: This proposed change will impact the mutual fund industry as it makes it more investor friendly and transparent at the cost of the distributors. SEBI has made it clear that the general public investing into mutual funds is a priority as compared to the distribution chain or mutual funds.

With the proposed change, an investor can now dictate the commission that it pays to the distributor. This will ensure higher competition amongst distributors ensuring lower commissions and better service, thus increasing consumer welfare. Disclosure by the distributors about their commission trail will further increase transparency, reduce mis-selling and bring the practice in India in step with the global practice.

Conclusion

The proposed amendments are keeping in line with the SEBI's role of a pro-active regulator. SEBI has proposed changes to stimulate the Indian capital market and has adopted an integrated approach bearing in mind the interests of the various players involved therein like the retail investors, the institutional investors, mutual funds, issuing companies, brokers, traders, FIs, FVCIs.

*The above is subject to publication of detailed guidelines by SEBI. Source: **Press Release dated June 18, 2009** issued by SEBI.*

1 As clause 1.2.1 (xxiv a) of the DIP Guidelines, a QIB is defined as:

- a. *a public financial institution;*
- b. *a scheduled commercial bank;*
- c. *a mutual fund registered with the Board;*
- d. *a foreign institutional investor and sub-account registered with SEBI; other than a sub-account which is a foreign corporate or foreign individual;*
- e. *a multilateral and bilateral development financial institution;*
- f. *a venture capital fund registered with SEBI;*
- g. *a foreign venture capital investor registered with SEBI;*
- h. *a state industrial development corporation;*
- i. *an insurance company registered with the Insurance Regulatory and Development Authority;*
- j. *a provident fund with minimum corpus of Rs. 25 crores;*
- k. *a pension fund with minimum corpus of Rs. 25 crores;*
- l. *National Investment Fund set up by Government of India.*

2 *Anand Pershad Jaiswal and Ors. Vs. Jagatjit Industries Ltd. and Ors*, Principal Bench, New Delhi, Company Law Board decided on March 12, 2009

3 Fully paid compulsorily convertible securities including depository receipts.

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You can direct your queries or comments to the authors

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