Update

ICDR Regulations Become More Friendly- Restrictions on Rights Issue, Bonus Issue and Preferential Issue Relaxed a Bit

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Update

It seems that ***Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 (hereinafter referred to as "the Regulations")***[1] is the most dynamic Regulation framed by the Securities and Exchange Board of India ("SEBI" or "the Regulator"). SEBI has been instant in making changes to the Regulation to keep the same updated in accordance with the changing needs of time.

After SEBI introduced the **Institutional Placement Programme** vide ***SEBI (ICDR) (Amendment) Regulations, 2012***[2], it has come up with ***SEBI (ICDR) (Second Amendment) Regulations, 2012 (hereinafter referred to as "the Amendment Regulations"***[3]***).*** The Amendment Regulations instill some small though important changes in the Regulations. The amendments are discussed in detail as follows:

❖ RESTRICTIONS ON MAKING RIGHTS ISSUE:

Regulation 53 of the Regulations deals with ***"Restriction on rights issue"*** in terms of which there was a restriction on making a rights issue of equity shares "if the issuer has outstanding fully or partly convertible debt instruments at the time of making rights issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof".

The terms have now been modified such that the issuer has to make reservation of rights shares in the favour of the holders of ***outstanding compulsorily convertible debt instruments***, if the issuer has any such debt instruments.

The new Regulation 53(1) will be read as under:
"No issuer shall make a rights issue of equity shares unless it has made reservation of equity shares of the same class in favour of the holders of outstanding ***compulsorily*** *convertible debt instruments,* ***if any*** *in proportion to the convertible part thereof."*

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[1] The Regulations amended till October 18, 2011 are available at: http://www.sebi.gov.in/cms/sebi_data/commondocs/icdrrequire_p.pdf
[2] SEBI (ICDR) (Amendment) Regulations, 2012 can be viewed at: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1328077505398.pdf
[3] SEBI (ICDR) (Second Amendment) Regulations, 2012 are available at: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1328681193686.pdf

The amended sub-regulation (2) becomes, *"The equity shares* ***so*** *reserved for the holders of fully or partially* ***compulsorily*** *convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms* ***at*** *which the equity shares offered in the rights issue were issued."*

Thus, the idea of optionally convertible debt instruments have been done away with in the above Regulation and it deals only with *compulsorily* convertible debt instruments. Previously, the Regulations dealt with both optional and/or compulsorily convertible instruments, but it seems that now the Regulations are only for those instruments, which are compulsorily convertible.

❖ CONDITIONS FOR PREFERENTIAL ISSUE TO MUTUAL FUNDS AND INSURANCE COMPANIES:

Chapter VII of the Regulations deals with **Preferential Issue of Shares**. *Regulation 70 specifies the circumstances where the provisions of the Chapter become non-applicable.* The amended regulations have added a new Sub-Regulation (4) according to which the provisions of Regulation 72(2) and Regulation 78(6) are not to apply to a preferential issue of specified securities where the proposed allottee is:

- ✓ A Mutual Fund registered with SEBI; or
- ✓ Insurance Company registered with Insurance Regulatory and Development Authority

[Regulation 72(2) states that, *"The issuer shall not make preferential issue of specified securities to any person who has sold any equity shares of the issuer during the six months preceding the relevant date:*
Provided that in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, the Board may grant relaxation from the requirements of this sub-regulation, if the Board has granted relaxation in terms of regulation 29A of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 to such preferential allotment.]

[Regulation 78(6) states that, *"The entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date*[4] *upto a period of six months from the date of preferential allotment"*.]

[4] Relevant date means-in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue; and in case of preferential issue of convertible securities, either the relevant date referred earlier or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

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At present preferential issue by companies is governed by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. It lays down several restrictions in case of issue of specified securities including restriction on pre-preferential lock-in restrictions. In 2003 the promoters of TV 18 took advantage and offloaded their shares at prevailing higher market price and thereafter approved a preferential issue within a week at reduced prices, having both profits and also maintaining their stake through the said allotment. There are several other cases as well where the promoters make unscrupulous profit and thus misusing preferential allotment. It was then that in 2004 SEBI decided to tighten the DIP guidelines in relation to such issuance. It decided that if shares or any financial instruments convertible/exchanged at a later date are issued on preferential basis, then the entire pre-preferential allotment shareholding of such allottees will come under the lock-in from the relevant date upto a period of six months from the date allotment. It laid down stricter norms to ensure that any shareholder who has sold his shares during the six month period prior to relevant date will not be eligible for such allotment. The reason is that the shareholder gets a discount and enjoys capital appreciation in a short period. There also becomes a possibility of insider trading in such transactions as only a few players are offered to buy the shares at a cheaper price.

But to the contentment of Indian Companies, SEBI in its Board Meeting held on January 28, 2012[5] plans to allow mutual funds and insurance firms to subscribe to preferential issues even if they have traded the shares of the issuing company in the past six months. This is surely a welcoming stride. The idea is to boost liquidity in the Indian market and make it easier for firms to raise funds from the domestic market. This restriction to be released only in case of mutual funds and insurance firms, therefore, still continues for the promoters, which is fair enough. SEBI finally felt the need of differentiating between he institutional investors and the promoters keeping in mind the need of the economy as this restriction unduly restricts the trading ability of institutional investors. The Indian Inc will surely look forward to more such news by the Market Regulator.

❖ RESTRICTIONS ON BONUS ISSUE:

Regulation 93 of the said Regulations imposes **Restrictions on Bonus Issue**.

[5] http://www.sebi.gov.in/cms/sebi_data/pdffiles/22979_t.pdf

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This Regulation has been amended on same lines as Regulation 53. The amended Regulation 93 will stand revised as,

1) *No issuer shall make a bonus issue of equity shares unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding* ***compulsorily*** *convertible debt instruments****, if any*** *in proportion to the convertible part thereof.*

2) *The equity shares* ***so*** *reserved for the holders of fully or partly* ***compulsorily*** *convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion* ***at*** *which the bonus shares were issued.*

   Therefore, the company issuing bonus shares needs to ensure that proportionate reservation is made for the holders of compulsorily convertible debt instruments only. No reservation is required for debt instruments convertible at the option of the holders of the debt instruments. Previously, it was mandatory for the issuer company to make reservation of equity shares, while making a bonus issue, in favour of the holders of outstanding convertible debt instruments, if it has any such has outstanding fully or partly convertible debt instruments at the time of making the bonus issue in proportion to the convertible part thereof

OUR ANALYSIS:

Keeping in view the amendments introduced in the ICDR Regulations, it can be said that SEBI is trying to adopt an easy-going attitude towards rights issue and bonus issue. The issuers need to reserve the rights shares or bonus shares, as the case may be for the holders of *compulsorily* convertible debt instruments only.

In case of preferential issue, the restrictions on selling the equity shares of the issuer and restrictions as to period of holding, i.e. lock-in-requirements have been waived for Mutual Funds and Insurance Companies, most probably, to ensure the liquidity of investments made by these entities.