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Exit Offer to Dissenting Shareholders

SEBI released a consultation paper on *"Exit to dissenting shareholders"* on December 01, 2015. The paper is pursuant to the requirement under the Companies Act, 2013, for promoters or persons in control of a company to provide an exit offer to dissenting shareholders when the company intends to: (1) change the objects for which it raised money through a public issue; (2) change the terms of a contract referred to in its prospectus. The paper discusses the procedure for providing an exit offer, and proposes to utilise the pricing guidelines in the takeover regulations to determine the exit price and provide an exemption from making an open offer, if any, under the takeover regulations.

The basic premise behind providing an exit offer is that, a company must use the funds raised through a public issue for the stated objects; any modification thereof is seen as a dubious activity. It seems to protect shareholders by providing a money back guarantee. While this sounds harmless on the face of it, in reality there are certain issues. For instance, a company might have raised funds for a particular project, say deep sea oil discovery in 2013 or a beer factory in Kerala in 2014. These objects might become unviable if oil prices drop unforeseeably or sale of beer is banned in Kerala. Some promoters/controlling shareholders may prefer to continue with the original objects, to avoid the substantial economic cost of an exit offer, thereby sinking valuable capital raised from the public into an unviable project. Hence, the requirement is unwholesome in its application and wealth destructive for genuine shareholders.

Further, it is counterintuitive when promoters hold a minority stake in the company and exercise no control over the board of directors, and hence do not decide to alter the objects. In this light, a discussion paper on whether promoters/controlling shareholders should be obligated to provide an exit offer to dissenting shareholders would be preferred to the present consultation paper on the logistics of SEBI norms governing the exit offer.

Private Placement of Debt through E-Book

SEBI on December 04, 2015, released a consultation paper on *"Primary market debt offering through private placement on electronic book"*, seeking to develop the corporate bond market. Majority of corporate bonds are issued through private placement, which are negotiated over-the-counter deals. Hence, SEBI has proposed having an electronic book for private placements, as opposed to an over-the-telephone market, to make the price discovery mechanism transparent and reduce the cost and time taken for issuance of corporate bonds. In the proposed mechanism, an issuer would enter into an agreement with an Electronic Book Provider which would provide an electronic platform for collection and processing of bids from potential private investors. Eligible EBPs would include regulated market infrastructure institutions, such as recognized stock exchanges and depositories, and Category-I Merchant Bankers (having minimum networth of Rs. 100 crores). Further, SEBI wishes to provide for efficient dissemination of information and resolution of disputes between the issuer, EBP and bidders through arbitration.

Although the concept of the E-book appears attractive, it may be more dangerous than useful. SEBI needs to treat the issue, at best, as a slow experiment. While transparency and structure are desired in the corporate debt market, they would come at the cost of flexibility. The parties involved are large corporates, mutual funds and sophisticated institutional investors who need the flexibility to negotiate terms of the issuance, for instance, whether to have arbitration or not. As shown in the paper, a sophisticated negotiated private placement market is preferred to public offers of debt securities. The needs of such investors regarding comfort, transparency and structure are already being met through credit rating and listing. Further, parties already negotiate greater details than those sought to be introduced through the E-book. Introducing regulatory rigidities which neither the issuer nor the investor want, or need, may shrink the market, which has been growing considerably over the past decade.

Therefore, the apparent benefits of an E-book, such as those pertaining to timing, yield details, arbitration, in our view, may not be significant given the needs of a sophisticated market. Introducing a mandatory E-book would, in fact, hurt the growth of the market without any benefit to investors, corporates or the economy in general. Nevertheless, the E-book may be introduced strictly on an optional basis, in order to evaluate its benefits better.

RBI should Disclose Information regarding Banks

The Supreme Court passed a judgment on December 16, 2015, in the case of *Reserve Bank of India* v. *Jayantilal N. Mistry*, wherein the RBI and other banks had challenged the orders of the Central Information Commission, which directed them to furnish information as sought by citizens under the Right to Information Act, 2005.

The Court had to determine whether RBI and other banks can deny information sought for under the RTI Act to the citizens on the grounds of economic interest, commercial confidence, fiduciary relationship vis-a-vis public interest. The Court rejected RBI's contentions that the information sought for was exempted under the RTI Act since it was obtained in a fiduciary

capacity and providing such information relating to banking would pre-judiciously affect the economic interest of the country. The Court held that exemptions apply to exceptional cases and only with regard to information for which disclosure is unwarranted or undesirable. The Court maintained that the information shared by banks with RBI cannot be brought under the purview of fiduciary relationship. Further, the Court held that RBI does not have a legal duty to maximize any bank's benefit, and thus there is no relationship of 'trust' between them. It was held that RBI has a statutory duty to uphold the interest of the public at large, the country's economy and the banking sector, and hence should act with transparency and provide information regarding private and public banks as sought by citizens under the RTI Act.

The judgment will have implications on other regulators, whereby they may have to provide information, gathered through inspection and audit reports, regarding the entities they regulate under the provisions of the RTI Act. However, the regulators will be immune from providing information regarding any pending investigation or if the information affects someone's privacy.

Public Issuance of Convertible Securities

In order to boost the market for public issue of convertible instruments, SEBI released a discussion paper on *"Review of framework for Public issuance of Convertible Securities"* on December 01, 2015. Although, the existing regulatory structure allows for the public issuance of convertible securities, there have hardly been any issues since the year 2000. One of the reasons is that, currently, convertible securities cannot be issued for a period exceeding 18 months. The paper discusses certain measures to facilitate and revitalise the issuance of convertible securities.

The paper proposes a maximum tenure of 5 years for convertible securities issued by a listed entity. While this is an improvement from the existing scenario, the provision should be flexible to accommodate a greater period. Limiting the tenure to 5 years will militate against corporate and investor choice for an unspecified regulatory benefit. Further, the paper proposes upfront disclosure of the conversion price in the offer document, whether it is pre-fixed at the time of issue or linked to market price at the time of conversion. Furthermore, the paper proposes to allow existing holders of convertible securities to sell the same to the public. This would provide an exit to such holders and help deepen the secondary market for such instruments. Further, the paper provides that optionally convertible debentures and optionally convertible securities of a listed company may be treated as debt and accordingly comply with the SEBI (Issue and Listing of Debt Securities) Regulations, 2008. Further, in case of an unlisted company seeking to make a public issue of compulsorily convertible securities, the paper suggests compliance with the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Most of the proposals discussed in the paper, when implemented, will help revive the issuance of convertible securities. However, in our view, the time period for conversion should be guided by commercial considerations and companies should be able to manage their financing strategies in a sensible manner. A suitable regulatory framework will encourage companies to raise funds and entities to invest through convertible securities.

Additional Tier I Instruments issued by Banks

SEBI on December 18, 2015, released a consultation paper on additional disclosure norms for retail/public issuance of *"Additional Tier1 (ATI) instruments issued by banks"*. Previously, RBI through a circular dated September 01, 2014, had allowed banks to issue AT1 instruments to retail investors. AT1 instruments are traditionally a form of capital and Indian banks, in the recent years, have been seeking to raise more capital to meet Basel-III capital requirements. However, prior to the RBI circular, AT1 instruments were issued to sophisticated institutional investors. Given the sheer magnitude of the funds that Indian banks need to raise to meet Basel-III norms, the RBI has allowed banks to tap into retail investors, as well. However, RBI is mindful of the fact that retail investors may not fully appreciate the characteristics of AT1 instruments and may not fully understand the risks involved in investing in them. Accordingly, the RBI in its Master Circular on Basel-III Capital Regulations dated July 01, 2015, specified certain additional disclosure requirements for issuance of perpetual non-cumulative preference shares and perpetual debt instruments, which form a part of the AT1 instruments. SEBI had issued the SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013 to facilitate the issuance of these instruments by banks, financial institutions and certain other companies.

In view of the fact that AT1 instruments carry additional risks compared to other debt instruments, such as risk of loss of coupon and principal, SEBI has proposed that only well informed retail investors with adequate risk tolerance levels subscribe to these instruments, and it has proposed a minimum amount of investment of Rs. 2 lakh for retail investors. SEBI has also proposed certain additional disclosures in the abridged prospectus to be issued, about the risk characteristics of such instruments. It has proposed that issuers clearly specify that the return on AT1 instruments may be influenced by bank's performance and the principal amount invested may be subject to losses due to loss absorbency features, and that they are significantly different from term deposits offered by banks.

The opening up of this sector for retail investors is a commendable initiative by the RBI as it would help retail investors to invest in a new asset class and participate in the growth of Indian banks. The proposals mooted in the paper help clarify the nature of risks involved in investing in these instruments without creating too much of a burden for issuers.

About Us

Finsec Law Advisors is a financial sector law firm which provides regulatory advice and assistance focusing on the securities, investments and banking industry.

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