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Issue and Pricing of Shares by Private Sector Banks

The Reserve Bank of India has recently started issuing master directions, instead of the annual master circulars, which consolidate instructions issued by the RBI on each subject matter. These master directions will be updated regularly as and when a circular is issued on the respective subject. RBI issued such a master direction, on April 21, 2016, in relation to the norms governing issue and pricing of shares by private sector banks.

The erstwhile norms required private sector banks to seek prior approval of RBI for initial public offers and preferential issues, including qualified institutional placements. No such approval was required in case of rights and bonus issues. The master direction has done away with this requirement entirely by stating that banks have general permission to undertake all such issues without prior-approval of the RBI. However, certain other requirements that private sector banks must comply with at the time of undertaking an issue include the following:

- Compliance with Foreign Exchange Management Act, 1999, and the applicable foreign investment policy.
- Compliance with the Companies Act, 2013, the rules thereunder and applicable SEBI guidelines, which include requirements such as board and shareholder approvals.
- Compliance with RBI prior approval requirements, if any of the investors subscribing to shares as part of the issue are breaching the 5% shareholding threshold.
- Compliance with the pricing norms prescribed by SEBI in case of listed banks, and prescribed by the Companies Act, 2013, and the rules thereunder, for unlisted banks.

Under the new regime, the bank will be required to interact with RBI only on completion of allotment, i.e., when they are required to report all details of the issue in the prescribed formats. Due to the removal of the prior-approval requirements entirely, the issue process for private sector banks is now simplified and has been made quicker and more efficient. Although the master direction does not contain any other significant changes, it brings in clarity and certainty regarding RBI's position on issue of shares by private sector banks.

Merger of Private Sector Banks

The Reserve Bank of India, on April 21, 2016, issued the master direction on Amalgamation of Private Sector Banks, Directions, 2016. The master direction is applicable to: (i) all private sector banks licensed to operate in India by the RBI; (ii)RBI-registered non-banking financial companies (NBFCs), and (iii) to the extent appropriate, to public sector banks. The master direction prescribes conditions for merger of private sector banking companies and amalgamation between banks and NBFCs.

A voluntary amalgamation of two banking companies has to be approved by the RBI, while an amalgamation between an NBFC and a bank has to be approved by the National Company Law Tribunal. The decision of amalgamation is required to be approved by two-third majority of the total board members, and not merely of those present and voting. Further, the draft scheme of amalgamation needs to have approval of two-thirds shareholders of each banking company, present (in person or by proxy) at the meeting. The draft scheme has to be approved by the board of directors of the respective banks, before the shareholders' meeting is convened. The board, while granting approval has to consider a number of factors, especially whether the amalgamated company has been subject to due diligence, the nature of the consideration which the amalgamating company would pay to the shareholders of the amalgamated company, etc. Furthermore, in case RBI approves a scheme, a dissenting shareholder may claim within 3 months, from the concerned banking company, the value of the shares held by him, as determined by the RBI while sanctioning the scheme.

When an NBFC is amalgamated with a bank, the latter needs RBI's approval, post approval by the respective boards and before seeking the Tribunal's approval. Further, the board of the banking company has to examine whether all accounts of the NBFC are Know Your Customer (KYC) compliant. This is to avoid financial risks as the NBFC accounts would eventually become accounts of the bank post amalgamation. The directions specify that SEBI's regulations on insider trading will be strictly applicable in case of listed banks/NBFCs and applicable in spirit and to the extent possible in case of unlisted banks/companies.

The master direction is in line with RBI's earlier directions. In 2009, RBI had passed directions mandating only deposit taking NBFCs to take prior permission of RBI in case of their merger/amalgamation. Later in 2014, RBI prescribed such requirement even for non-deposit accepting NBFCs, to ensure that the fit and proper character of the management of NBFCs is maintained. The master direction envisages a significant role of the board of directors of private sector banks. Further, promoters of the banks/NBFC have to exercise caution while buying/purchasing shares directly or indirectly, during and after the discussion period, lest they be hit by the SEBI insider trading norms.

Foreign Investments in Regulated Collective Investment Vehicles

The Reserve Bank of India has been sequentially making new avenues for foreign investment into Real Estate Investment Trusts (REITs), Infrastructure Investment Trusts (InvITs) and Alternative Investment Funds (AIFs) since late last year, through a series of amendments to the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 and the Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000. Recently, SEBI and RBI permitted Foreign Portfolio Investors (FPIs) to invest in units of REITs, InvITs, AIFs and NCDs/bonds under default.

With a view to further facilitate foreign investment in collective investment vehicles registered and regulated by SEBI or any other competent authority, RBI has issued a notification, dated April 21, 2016, prescribing certain clarifications regarding the new investment regime. Persons resident outside India, including FPIs and Non-Resident Indians (NRIs), are now permitted to invest in units of REITs, InvITs and AIFs) For this purpose, a "unit" shall mean a "beneficial interest of an investor in the Investment Vehicle and shall include shares or partnership interests". Such investors may sell or transfer or redeem the units as per regulations framed by SEBI or directions issued by RBI.

Interestingly, downstream investments by these investment vehicles would be considered as foreign investment if either the sponsor or the manager or the investment manager is not Indian 'owned and controlled'. It has to be noted that even if a majority of the contributors to the REITs, InvITs and AIFs are foreign, the downstream investments made by them would still not be considered to be foreign 'owned and controlled', if the sponsor or the manager or the investment manager is Indian owned and controlled. Further, where they are foreign 'owned and controlled,' the downstream foreign investments made by such funds will have to comply with sectoral caps and other conditions under the FDI policy, where applicable. These investments can be made by way of an inward remittance through the normal banking channel, including by debit to a Non Resident Rupee (NRE) or a Foreign Currency Non-Resident (FCNR) account.

Clarification on Applicability of Indian Accounting Standards

SEBI has recently issued a clarification on the applicability of Indian Accounting Standards or 'Ind AS' to disclosures made under the offer documents under SEBI (ICDR) Regulations, 2009. This clarification shall be applicable to all issuer companies whose offer document is filed with SEBI on or after April 1, 2016. Hitherto, most issuer companies followed the Indian Generally Accepted Accounting Principles or 'Indian GAAP' while disclosing financial statements in offer documents. Earlier, the Ministry of Corporate Affairs had issued a roadmap for implementation of 'Ind AS' in a phased manner beginning from the accounting period 2016-17. SEBI has issued this clarification in order to align the disclosure requirements for financial information in offer documents as specified under the SEBI ICDR Regulations. Typically, SEBI requires issuer companies to disclose financial information for the previous 5 financial years immediately preceding the filing of the offer document, while following uniform accounting policies for each of the financial years. The road map issued by SEBI through this clarification is as follows:

- For those issuer companies filing an offer document upto March 31, 2017 all of the financial statements filed by them can be under Indian GAAP.
- For those issuer companies filing an offer document between April 1, 2017 and March 31, 2018, disclosures in the latest previous three financial years will have to be made under the 'Ind AS' principles while disclosures for the remaining two financial years may be done under Indian GAAP. However, as far as disclosures for the third latest financial year are concerned, suitable restatement adjustments to the accounting heads from their values as on the date of transition following accounting policies consistent with that used at date of transition to Ind AS.
- For those issuer companies filing an offer document between April 1, 2018 and March 31, 2019, disclosures in the latest previous three financial years will have to be made under the 'Ind AS' principles while disclosures for the remaining two financial years may be done under Indian GAAP.
- For those issuer companies filing an offer document between April 1, 2019 and March 31, 2020, disclosures in the latest previous four financial years will have to be made under the 'Ind AS' principles while disclosures for the remaining one financial year may be done under Indian GAAP.
- For those issuer companies filing an offer document on or after April 1, 2020, disclosures in all the previous five financial years will have to be made under the 'Ind AS' principles.

SEBI has also provided discretion to issuer companies to present financial statements for all five financial years under 'Ind AS' should those companies volunteer to do so. Issuer companies are also required to disclose the fact that the financial information has been disclosed in accordance with Ind AS while suitably explaining the difference between Ind AS and the previously applicable accounting standards, and the impact of transition to Ind AS.

However, it has to be noted that this clarification issued by SEBI only relates to disclosures made in initial public offers or follow on public offers. This clarification does not apply to issuer companies coming out with rights issue. It remains to be seen whether SEBI would be issuing a separate clarification for those companies or whether they would be expected to follow the road map provided through this clarification.

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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