INDIA – SECURITIES LAW WRAP 2015

Introduction

In 2015, Indian securities regulations underwent many changes with the Securities and Exchange Board of India (the "**SEBI**") playing an active role in making the markets more efficient and investor friendly. This update highlights some of the important changes implemented last year.

New insider trading regulations

Previously, insider trading was regulated under the SEBI (Prohibition of Insider Trading) Regulations, 1992 (the "**Previous Insider Regulations**") and Sections 194 and 195 of the Companies Act, 2013. On May 15, 2015, the SEBI (Prohibition of Insider Trading) Regulations, 2015 (the "**New Insider Regulations**") became effective.

The New Insider Regulations are applicable to securities which are listed or proposed to be listed. Set out below are certain key changes introduced by the New Insider Regulations:

- Definition of an "insider": The scope of the definition of an "insider" has been expanded to include persons who, during the preceding six (6) months, have been or continue to be, associated with the company in any capacity, including by reason of frequent communication with the officers of the company, or by any contractual, fiduciary or employment relationship. Further, the immediate relatives of all such persons are also presumed to be "insiders." Note that lawyers, accountants and other professionals are also now covered under the definition of an "insider."

- Definition of unpublished price sensitive information ("**UPSI**"): The New Insider Regulations clarify that "generally available information," i.e., information that is accessible to the public on a non-discriminatory basis (widely understood to be the stock exchange platform) will not constitute UPSI. However, they do not prescribe any objective criteria to assess what constitutes "UPSI." Additionally, there is no inclusive list specifying UPSI (akin to the list under the Previous Insider Regulations). The definition of UPSI has been made subjective under the New Insider Regulations, and this can result in diverse interpretations to the detriment of insiders.

- Clear prohibition on insider trading: The Previous Insider Regulations prohibited dealing in securities while in the possession of UPSI. However, in addition to prohibiting trading in securities when in possession of UPSI, the New Insider Regulations prohibit communication or provision of access to UPSI by an insider to any person, including other insiders, except in furtherance of legitimate purposes, performance of duties or discharge of legal obligations. The burden on insiders is now much greater, and they will have to deal with and hold UPSI very confidentially.

- Applicability to pledge of securities: In the guidance note issued by the SEBI on August 24, 2015, the SEBI has clarified that the New Insider Regulations will apply when creating and invoking a pledge, although the pledgor or the pledgee can prove that such pledge was created or invoked, as the case may be, in compliance with the exceptions provided under the New Insider Regulations.

- Non-disclosure obligations: As per the New Insider Regulations, UPSI may be communicated to third parties for transactions that may:

- entail an open offer and where the board of directors of the company is of the informed opinion that the proposed transaction is in the best interests of the company; or

- not entail an open offer, but where the board of directors of the company is of the informed opinion that the proposed transaction is in the best interests of the company and the UPSI is made generally available at least two (2) trading days prior to the proposed transaction being effected.

In such instances, parties to whom UPSI is communicated are required to execute confidentiality and non-disclosure agreements and cannot trade in securities when in possession of UPSI. Therefore, access to UPSI for due diligence is now permitted subject to execution of a non-disclosure and confidentiality agreement. However, the New Insider Regulations do not clarify at what stage the recipients of UPSI may commence trading in securities if a transaction is terminated or aborted. Moreover, at what stage of a proposed transaction should the board of directors of a company be approached is unclear. Typically, an auction process involves several bidders, and the due diligence process can last awhile. However, a final bidder emerges only after several rounds of negotiations.

- Concept of "trading plan": The New Insider Regulations introduce a safe harbor trading concept in the form of a "trading plan." Under this, insiders are now permitted to trade in securities six (6) months after disclosure of a trading plan duly approved by the compliance officer of the company. Such a trading plan permits trading for at least twelve (12) months, but not more than one (1) trading plan can operate at a given time. As such, insiders can trade in securities in a compliant manner in accordance with the trading plan formulated before they become privy to UPSI.

- New disclosure requirements: The New Insider Regulations have introduced an enabling provision for listed companies to seek disclosures from connected persons or a class of connected persons of their securities holdings and trades of the company's securities effected by them, in such form and frequency as the company may determine.

With the introduction of the New Insider Regulations, Indian insider trading rules have been brought on par with international standards. Additionally, the SEBI has been receptive to feedback from industry on aspects of the New Insider Regulations which required more clarity. For instance, the SEBI has clarified that exercise of employee stock options will not be considered as "trading," although the sale of shares so acquired will have to be in compliance with the New Insider Regulations. The New Insider Regulations also include notes to various regulations which indicate the intent proposed to be covered under such regulation, which is helpful from an interpretation standpoint.

Simplification of the delisting process

On March 24, 2015, the SEBI approved certain amendments to the SEBI (Delisting of Equity Shares) Regulations, 2009 (the "**Delisting Regulations**") in order to simplify the process of delisting for listed companies. The amendments to the Delisting Regulations, *inter alia*, include the following:

- A delisting process may be initiated by an acquirer in addition to a promoter.

- The timelines for various steps, including issue of an in-principle approval by the stock exchange(s), despatch of the letter of offer and opening of the offer have been considerably reduced, thereby reducing the overall timeframe for the delisting process.

- The method for determining the floor price for delisting will be the same as in case of an open offer.

- The final offer price will be the highest price at which the shares tendered in the delisting offer result in the acquirer's shareholding reaching the prescribed threshold of 90%.

- Share trading and settlement will be through the stock exchange mechanism, thereby enabling shareholders to take benefit of reduced capital gains by payment of the securities transaction tax.

Exemption from making an open offer

On May 5, 2015, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 were amended to exempt any consortium of banks, financial institutions or secured lenders converting debt owed by a listed entity into equity from the requirement of making an open offer. This amendment aims to simplify the process of converting debt into equity as per the Strategic Debt Restructuring Scheme issued by the Reserve Bank of India.

Restrictions on suspended companies

A suspended company is a listed company in whose shares trading is suspended by the stock exchange on account of non-compliance with listing requirements. On July 20, 2015, the SEBI issued a general order (the "**Order**") prohibiting:

- suspended companies, their holding companies or subsidiaries, their promoters and directors from raising capital from the public until revocation of the suspension by the stock exchange or until the securities of such companies are delisted in accordance with the applicable delisting requirements, whichever is earlier; and

- suspended companies and depositories from effecting a transfer of their shares by way of sale or pledge, held by their promoters, promoter group or directors for a period of three (3) months after the date of revocation of suspension by the stock exchange or until the securities of such companies are delisted in accordance with the applicable delisting requirements, whichever is earlier.

The Order reinforces the SEBI's attempt to ensure strict compliance of the listing requirements to protect investor interests.

Raising further capital under the fast-track route

In 2007, the SEBI had introduced the fast track issuance route to allow listed companies to raise further capital within a shorter time-period. In order to enable more listed companies to raise capital under the

fast-track route, the SEBI has amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (the "**ICDR Regulations**") and has permitted listed companies having an average market capitalization of INR10,000,000,000 (approx. US$150,557,061) to undertake a follow-on public offer and companies having average market capitalization of INR2,500,000,000 (approx. US$37,639,265) to undertake a rights issue under the fast track route subject to compliance of certain additional conditions.

Previously, in order to raise further capital (by way of a follow-on public offer or a rights issue), companies had to have an average market capitalization of INR30,000,000,000 (approx. US$451,671,183). As very few companies could meet this criterion, listed companies were not able to take benefit of the fast track route. The reductions will allow more companies to raise further capital under the fast track route.

Simplification of the listing process for start-ups

On August 13, 2015, the SEBI announced certain measures to simplify the process of capital-raising by start-ups in India by amending Chapter XC (Listing on Institutional Trading Platform) of the ICDR Regulations. The changes will permit start-ups to make a public offer of their securities. Listed below are the key amendments:

- Eligible companies: The following companies may make a public offer on the institutional trading platform: (i) companies which use technology, information technology, intellectual property, data analytics, biotechnology or nanotechnology intensively to provide products, services or business platforms with substantial value addition and of which at least 25% of the pre-issue capital is held by Qualified Institutional Buyers ("**QIBs**"); and (ii) any other company in which at least 50% of the pre-issue capital is held by QIBs. QIBs are defined under the ICDR Regulations and include, *inter alia*, venture capital funds, alternative investment funds, registered foreign venture capital investors and foreign portfolio investors (other than category III). However, the ICDR Regulations do not specify the meaning of the term "substantial value addition," and therefore, the scope of the first category remains unclear.

- Cap on shareholding: No person can hold more than 25% of the post-issue capital of the company, which will include the individual shareholding of the person and the shareholding of persons acting in concert.

- Lock-in requirements: A uniform lock-in period of six (6) months from the date of allotment will be applicable to all shareholders for the entire pre-issue capital. The ICDR Regulations prescribe a lock-in period of three (3) years from the date of allotment for the minimum promoter contribution and a lock-in period of one (1) year from the date of allotment for all contributions in excess of the minimum promoter contribution, but excluding equity shares held by venture capital funds, alternative investment funds (category I) and foreign venture capital investors (who are locked-in for a period of one (1) year from the date of purchase). Therefore, while the lock-in period has been reduced, it is applicable uniformly to all financial investors.

- Eligible investors: The ICDR Regulations provide that only the following two (2) categories will be eligible to invest in the securities of the issuer pursuant to a public offer: (i) institutional investors, i.e.,

QIBs, family trusts, systematically important non-banking financial companies registered with the Reserve Bank of India and intermediaries registered with SEBI having a net worth of more than INR5,000,000,000 (approx. US$75,278,531); and (ii) non-institutional investors. The SEBI has excluded retail investors from investing in securities of start-ups as the SEBI considers these companies to be high risk companies without an established profitability track record. This will not help in deepening the investor base.

- Disclosure requirements: Companies which intend to list on the institutional trading platform will be required to file a draft offer document with the SEBI in compliance with the ICDR Regulations. However, they will be required to disclose only the broad objects of the issue and information with respect to group companies, litigations and creditors in accordance with the policy on materiality as defined by the issuer. All other disclosures can be made available on the website of the issuer. Further, unlike a conventional public issue, the issue price may be justified on any alternative basis except for projections based on standard valuation parameters such as price-earnings ratio and earnings per share, which are not relevant for start-ups. The applicability of extensive disclosure requirements for start-ups was a major roadblock for them to access the Indian capital markets. The SEBI has relaxed the disclosure requirements in line with international practices. Also, issuers have been given the liberty to justify the issue price on any basis other than forward looking statements, taking into account their business model.

- Use of funds raised: The ICDR Regulations provide that a company cannot utilize more than 25% of the issue proceeds from the sale of shares or convertible debentures for general corporate purposes. However, there is no such cap on the use of the issue proceeds for start-ups. This change is significant as it gives start-ups the ability to utilize the capital raised for general corporate purposes, which is the primary objective for start-ups.

- Application size and trading lots: The public offer should be made to at least 200 investors, and the minimum application size for each investor and the minimum trading lot should be INR1,000,000 (US$15,056). As the minimum application size is quite high, the SEBI has ensured that only high net worth persons having the capability to assess the prospects of the issuer and take risks should invest in such companies.

- Migration to main board: Start-ups listed on the institutional trading platform will also have an option to migrate to the main board after three (3) years subject to compliance with the requirements of the stock exchange.

While foreign countries had introduced beneficial norms for public offers by start-ups, Indian start-ups had to comply with the conventional public offer norms, which made listing cumbersome. Consequently, Indian start-ups preferred to access and raise capital in foreign markets. With these changes, it is hoped that Indian start-ups will not shift their base outside India to access the capital markets abroad.

Consolidation of listing obligations and disclosure requirements

With a view to consolidating the listing and disclosure requirements specified under the listing agreement (required to be executed and complied with by listed entities), on September 2, 2015, the SEBI introduced

the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the "**Listing Regulations**"). Apart from the norms dealing with related party transactions, and disclosures required to be made by and conditions for reclassification of promoters (which were in effect from the date of notification of the Listing Regulations), all other requirements became effective on December 1, 2015.

The Listing Regulations consolidate the requirements under the listing agreement and align them with those under the Companies Act, 2013 and the rules there under. Set out below is a broad overview of the Listing Regulations:

- Chapter II: This chapter lists the principles governing the disclosures and obligations of listed entities.

- Chapter III: This chapter lists the requirements applicable to all entities listed on the main board or the SME Exchange or the institutional trading platform, such as appointment of a company secretary as a compliance officer, share transfer agent and establishing an investor grievance redressal mechanism.

- Chapters IV to VI: These chapters deal with requirements applicable to a listed entity which has listed: (i) equity shares or convertible securities; (ii) non-convertible debt securities and/or non-convertible redeemable preference shares; and (iii) equity shares or convertible securities, and non-convertible debt securities and/or non-convertible redeemable preference shares, respectively, on the main board or the SME Exchange or the institutional trading platform.

- Chapters VII to IX: These chapters deal with requirements applicable to a listed entity which has listed Indian depository receipts, securitized debt instruments and mutual fund units, respectively.

- Chapter X: This chapter deals with duties and obligations of stock exchanges.

- Chapter XI: This chapter sets out the procedure for an action based on default in complying with the Listing Regulations.

The Listing Regulations incorporate a clear framework for re-classification of "promoters" as "public shareholders," and accordingly, promoters may be re-classified as public shareholders (subject to compliance with certain additional conditions):

- in case of change in the promoter pursuant to an open offer or in any other manner subject to approval of shareholders at a general meeting;

- in case of change in promoter due to transmission, succession or inheritance;

- in a professionally managed company where there is no identifiable promoter, provided that no person or group along with persons acting in concert holds more than 1% shares of the company (including convertibles, outstanding warrants, American Depository Receipts or Global Depository Receipts) and no mutual fund, bank, insurance company, financial institution or foreign portfolio investor holds more than 10% shares of the company (including convertibles, outstanding warrants, American Depository Receipts or Global Depository Receipts).

Earlier, there were no clear rules for re-classification of promoters to public shareholders. In the past, the SEBI had taken action against companies and promoters of companies for re-classifying promoters. The Listing Regulations now provide clarity on the norms required to be complied with for re-classification of promoters.

One of the major issues in the Listing Regulations is the deletion of a "materiality" threshold for disclosing acquisitions by listed entities. As the term "acquisitions" has been defined to mean acquisition of 5% in any other company and a movement of 2% in shareholding thereafter, or acquisition of control over any other company, insignificant acquisitions by listed entities will also have to be disclosed.

The Listing Regulations also empower stock exchanges to impose fines, suspend trading and/or freeze promoter or the promoter group's holding of designated securities in co-ordination with depositories in case of contravention of the Listing Regulations. This is in addition to actions that may be taken in terms of any other applicable securities laws.

The Listing Regulations were introduced as the listing agreement, being a contract between the listed entity and the stock exchange, could not be made applicable to third parties. Further, the listing agreement had been amended and modified by the SEBI on various occasions, which was perceived to be not in line with common law contractual principles under which a contract can be amended only by a party to such contract. The Listing Regulations now codify all corporate governance, disclosure requirements and obligations of a listed entity in India, and work as a handbook of ongoing and event-based compliances by listed entities.