

# **SEBI'S PROPOSED CHANGES TO THE PREFERENTIAL ISSUE GUIDELINES AND INFORMAL GUIDANCE ON INVESTMENT ADVISER REGULATIONS**

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# Review of Preferential Issue Guidelines

The SEBI has released a consultation paper on the preferential issue guidelines prescribed under Chapter V of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (the “ICDR Regulations”), along with the recommendations discussed below.

- Pricing – current position
  - As per Regulation 164(1) of the ICDR Regulations, if the equity shares have been listed for 26 weeks or more as on relevant date, the price of the equity shares allotted pursuant to the preferential issue shall be higher of: (i) average of the weekly high and low of volume weighted average price (“VWAP”) during 26 weeks preceding the relevant date; or (ii) average of the weekly high and low of VWAP during 2 weeks preceding the relevant date.
  
- Recommendations
  - It is proposed to replace the average of the weekly high and low of VWAP of 26 weeks with VWAP of 60 trading days and VWAP of 2 weeks with VWAP of 10 trading days.
  - Any preferential allotment which results in a change of control, or more than 5% allotment, shall require a valuation report from the registered valuer for pricing and guidance on control premium.
  - Any preferential allotment which results in a change of control can be done only pursuant to the recommendation of a committee of independent directors.

# Review of Preferential Issue Guidelines

- Minimum lock-in period
  - As per Regulation 167 of the ICDR Regulations, the securities allotted on preferential basis to the promoters or promoter group up to 20% shall be locked in for a period of 3 years, and in excess of 20% for 1 year, respectively. The securities allotted to persons other than promoters shall be locked in for 1 year.
  
- Recommendations
  - It is proposed to reduce the lock-in requirement for promoters from 3 years to 18 months and for persons other than promoters from 1 year to 6 months.
  - If a non-promoter becomes a promoter pursuant to a change in control following the preferential issue, it is proposed to have a lock-in for such an allottee akin to a lock-in for promoters, i.e., 18 months. Earlier, such an allottee was treated as a non-promoter on the ground that change of control had not yet taken place.
  - The current and proposed status of the allottee post preferential issue shall be disclosed to the shareholders in the explanatory notice of the general meeting.
  - ☐ Impact: The reduction of lock-in requirements in case of preferential issue will harmonize the lock-in requirements with those applicable to IPOs.

# Review of Preferential Issue Guidelines

- Pledging of shares
  - Currently, there is no framework for pledging of shares in case of a preferential issue.
- Recommendations
  - It is proposed to allow pledging of shares allotted under a preferential issue during the lock-in period as security for a loan granted by a scheduled commercial bank, public financial institution, systemically important NBFC or housing finance company, in case a pledge is a condition for the sanction of the loan to finance the object(s) of the preferential issue.
    - ☐ Impact: Pledging of shares in case of public issues is allowed in accordance with Regulation 21 of the ICDR Regulations. Allowing the pledging of shares under a preferential issue will further harmonize the provisions.
- Ineligibility to receive shares under a preferential issue
  - As per Regulation 159(1) of the ICDR Regulations, a preferential issue cannot be made to any person who has sold or transferred any equity shares of the issuer during the 6 months preceding the relevant date (i.e., 30 days prior to the meeting date when shareholders consider a preferential issue).

# Review of Preferential Issue Guidelines

- Recommendations
  - It is proposed to reduce the ineligibility period from 6 months to 60 trading days preceding the relevant date.
  - The issuer entity should not have any outstanding dues to the SEBI, the stock exchanges or depositories.
    - ❑ Impact: It is a step in the right direction and has been done to align the duration of ineligibility with that of preferential issue pricing, i.e., from 26 weeks (6 months) to 60 trading days.
- Preferential issue for non-cash consideration
  - As per Regulation 163(3) of the ICDR Regulations, specified securities can be issued on a preferential basis for consideration other than cash.
  - The concern is that the ICDR Regulations do not specify the different forms of consideration allowable as “other than cash” and their process of valuation.
- Recommendation: It is proposed that only swap of shares backed by a valuation report may be considered as “other than cash.”

# Review of Preferential Issue Guidelines

- Applicability of preferential issue guidelines
  - As per Regulation 158(1)(a) of the ICDR Regulations, Chapter V of the ICDR Regulations shall not apply to a preferential issue pursuant to a conversion of a loan or an option attached to convertible debt instruments into shares of the company.
- Recommendation
  - The foregoing preferential allotment must comply with preferential issue guidelines, including guidelines on pricing and lock-in, as prescribed in Chapter V of the ICDR Regulations.
- Procedural conditions for preferential issue
  - Regulations 160(c) and 160(e) of the ICDR Regulations prescribe certain conditions for preferential issues, i.e., prior holding of all the equity shares in dematerialized form and obtaining the permanent account number (PAN) card of the allottee unless exempt from specifying PAN.
- Recommendation
  - It is proposed to clarify that the foregoing conditions shall be complied with at the time of making an application to stock exchanges for in-principle approval.

# Informal Guidance on IA Regulations

- An interpretative letter by the SEBI under the SEBI (Informal Guidance) Scheme 2003
- Facts
  - SV Capital (the “Indian company”) is registered with SEBI as an investment advisor and has entered into an agreement with a US company.
  - The US company creates, owns and provides an online platform to enable customers, including Indians, to purchase and invest in foreign securities. The Indian customer can invest in any foreign security and/or stacks, i.e., pre-configured basket of foreign securities using the platform.
  - As per the agreement, the Indian company creates and rebalances stacks exclusively for the US company based on pre-defined financial or qualitative criteria without any involvement of customers.
  - The Indian or the US company do not provide any direct or indirect advice to Indian customers, including advice on investment amount, choice of stacks, financial planning, and portfolio management. The Indian customers can invest based on their discretion or through personal third-party advisors.

# Informal Guidance on IA Regulations

- The Indian company has also entered into an agreement with a US-based stockbroker identified by the US company to facilitate the purchase of foreign securities (i.e., opening a brokerage account, conducting KYC of the Indian customers, etc.).
- The Indian company is entitled to a service fee and a commission on brokerage from the US company and US stockbroker, respectively.

## ➤ Key provisions of SEBI (Investment Advisers) Regulations, 2013 (“IA Regulations”)

- Regulation 2(1)(l): “*investment advice*” means advice relating to purchase, selling or dealing in securities or investment products, and includes financial planning.
- Regulation 2(1)(m): “*investment adviser*” means any person, who for consideration, is engaged in the business of providing investment advice.
- Regulation 22(3): An investment adviser shall have segregated investment advisory and distribution services.

## ➤ Issues

- Whether creating and rebalancing stacks by the Indian company for the US company constitutes “investment advice” under the IA Regulations.



## Informal Guidance on IA Regulations

- Whether facilitating the account opening and KYC process of Indian customers with the US stockbroker by the Indian company constitutes “distribution services” under the IA Regulations.
- Whether the Indian company is entitled to separate service fee and commission by the US company and US stockbroker, respectively.

### ➤ Response by SEBI

- The SEBI observed that creating and rebalancing stacks by the Indian company for a US company and receiving compensation in the form of a fixed monthly fee does not fall within the purview of investment advice under the IA Regulations.
- The reasons being that the Indian company does not have any agreement with Indian customers, and it does not provide any direct or indirect advice to them. It merely provides services to the US company and the US stockbroker to facilitate the purchase of foreign securities by the Indian customers.

# Thank You

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