



Consultation Paper

Review of provisions related to Preferential Issues Guidelines under Chapter V of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations)

1. Objective:

To solicit views on the proposal to review certain provisions related to Preferential Issue Guidelines as recommended by the Primary Market Advisory Committee (PMAC) of SEBI.

2. Background

- 2.1. SEBI has been receiving several suggestions and representations from market participants on review of various issues pertaining to the preferential issue guidelines like the pricing, lock-in requirements, pledge etc.
- 2.2. SEBI first introduced guidelines for preferential issue on August 04, 1994, mandating aspects such as pricing of securities (shares, warrants, convertibles), lock-in, validity of shareholders resolution, auditors report etc. These guidelines underwent slight changes through SEBI DIP Guidelines and SEBI (ICDR) Regulations, 2009. However, more or less, these guidelines have not undergone any significant change since 2009 except for changes on pricing, exemptions for resolution plans etc. These guidelines are now incorporated under Chapter V of the ICDR Regulations.
- 2.3. Recently, as part of response to situations arising out of COVID-19 pandemic, SEBI had introduced a temporary additional pricing methodology for preferential issues, i.e. higher of average of weekly high and low of VWAP for 12 weeks or 2 weeks, subject to enhanced lock-in provision.
- 2.4. In order to facilitate fund raising by the issuers through preferential allotment of shares while at the same time ensuring that such issuance is not detrimental to the interest of shareholders, a need is felt to carry out a comprehensive review of the entire guidelines for preferential issue so that the same may adequately reflect the present day requirements of the market.
- 2.5. The matter was deliberated at the PMAC which decided to constitute a sub-group of PMAC members to revisit the provisions of Chapter V of the ICDR Regulations.



2.6. The sub-group held internal deliberations as well as interacted with several industry representatives and stock exchange(s) to understand the various challenges faced in preferential issues. The recommendations of the sub-group were deliberated at the PMAC, which desired that a public consultation may be sought on the following proposed changes in preferential issue guidelines under ICDR Regulations:

3. Regulation 164 of the ICDR Regulations - Pricing of the specified securities

3.1. Current Regulatory Framework

Pricing of frequently traded shares:

164. (1) If the equity shares of the issuer have been listed on a recognized stock exchange for a period of twenty six weeks or more as on the relevant date, the price of the equity shares to be allotted pursuant to the preferential issue shall be not less than higher of the following:

a. the average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the recognised stock exchange during the twenty six weeks preceding the relevant date;

or

b. the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date

3.2. Concerns

3.2.1. In the past, a weekly settlement cycle was followed in the equity markets for settlement of shares. At that time when the market witnessed a rising trend of Issuers making preferential allotment of shares etc. at a price disconnected from the prevailing market price the preferential issue guidelines were introduced in August 1994, wherein, it was mandated that the preferential issue price will be higher of average weekly high and low of closing price for a period of 6 months' period preceding the relevant date or average weekly high and low of closing price for a period of 2 weeks period preceding the relevant date. The said norms were subsequently replaced with higher of average of weekly high low of the volume weighted average price (VWAP) for 26 weeks or VWAP for 2 weeks preceding the relevant date in ICDR Regulations 2009. This provision has also been retained in the present ICDR Regulations, 2018.



- 3.2.2. Representations have been received stating that the norm of 26 weeks' period is a very long period for determining the price considering the market volatility. Further, it is argued that there is a significant difference in the price determined on the basis of 26 weeks' average vis-à-vis 2 weeks' average. This may act as a deterrent for the promoters or existing willing investors to come to the aide of the company in times of need.
- 3.2.3. Considering the above anomaly in both the prices and also considering the reduction in the trade settlement period over the years from weekly to T+2 basis, there may be a need to review the pricing norms. SEBI has introduced moving from T+2 settlement cycle to T+1 settlement cycle on optional basis vide circular dated September 07, 2021. Subsequently, Market Infrastructure Institutions in a joint press release dated November 08, 2021 have finalized the roadmap for implementation of T+1 settlement cycle in a phased manner with bottom 100 stocks based on market capitalization being available for introduction of T+1 settlement cycle from February 25, 2022.
- 3.2.4. After the outbreak of COVID-19 pandemic, a temporary relaxation with respect to pricing was allowed to make preferential allotment by using 12 weeks' volume weighted average price, in addition to the existing pricing methodology subject to certain conditions. Such a relaxation was applicable to for the preferential issues made between July 1,2020 and December 31, 2020. Around 7 companies have raised funds using this temporary relaxation.
- 3.2.5. A sample analysis of the price movement of scrips post preferential issues was also carried out, which showed that in a majority of cases, the post preferential issue pricing converged closer to 60 trading days' VWAP than to 26 weeks' VWAP. It may be noted that the norm of 60 trading days VWAP is also used as one of the price points for determination of open offer price, in terms of SEBI (SAST) Regulations
- 3.2.6. There have also been some concerns w.r.t. valuation of scrip in case the preferential allotment results in any change in control or in case the allotment made to a single allottee or to some allottees acting in concert is more than 5 % of post issue fully diluted share capital of the issuer company. There are also concerns for those cases where a preferential allotment results in change in control and question arises as to whether the pricing arrived by the issuer for making the said preferential issue also has taken into account any form of control premium.



3.3. PMAC Recommendation

Pricing

- 3.3.1. Replace average of weekly high and low VWAP of 26 weeks with VWAP of 60 trading days and replace average of weekly high and low VWAP of 2 weeks with VWAP of 10 trading days.
- 3.3.2. For equity shares listed for a period of less than twenty six weeks as on the relevant date, to replace average of weekly high and low of VWAP of 26 weeks with VWAP of 60 trading days.
- 3.3.3. In Regulation 164A, for the purpose of pricing in case of companies having stressed assets, the recommendation is to replace average of weekly high and low VWAP of 2 weeks with VWAP of 10 trading days to maintain consistency.

Requirement for valuation report

- 3.3.4. Any preferential issue allotment resulting in change in control or allotment of more than 5% of post issue fully diluted share capital of the issuer company to an allottee or to allottees acting in concert, shall require valuation report from a registered valuer and consider the said valuation for pricing.
- 3.3.5. Stricter provisions in respect of pricing of preferential issue, if any already provided, under the Article of Association of the Issuer company shall also be considered for pricing in addition to pricing guidelines under ICDR Regulations for the purpose of making any preferential issue.
- 3.3.6. In case of any proposed preferential allotment results in change in control, the valuation report / certificate from registered valuer should also cover guidance on control premium.
- 3.3.7. Valuation report shall be hosted on the company's website and a reference to the same shall be made in the notice for calling a general meeting of the shareholders.

3.4. Additional suggestion by SEBI

- 3.4.1. Any preferential issue allotment resulting in change in control may be done only pursuant to a reasoned recommendation from a committee of independent directors. The recommendatory report shall consider all



aspects of preferential allotment including pricing. The committee shall also disclose the voting pattern of its meeting. Similar provision is available in SAST regulations, for open offer, and delisting regulations.

4. Regulation 167- Lock-in provisions

4.1. Current Regulatory Framework

4.1.1. *The existing lock-in provisions mandate minimum three years lock-in period for promoters/ promoters group for equity shares up to 20% of the total capital of the issuer and any equity shares allotted in excess of 20% are locked-in for a period of one year. For allotment to persons other than promoters, the shares are locked-in for a period of one year. In case of convertibles securities or warrants, allotted to any investor, are locked-in for a period of one year from the date of allotment.*

4.1.2. *Further, the entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date up to a period of six months from the date of trading approval.*

4.2. Concerns

4.2.1. The lock-in provisions are essential to ensure commitment towards the company, from the promoters and others to whom securities are allotted on a preferential basis so that they do not offload the shares immediately after receiving the same and take benefit of price arbitrage.

4.2.2. SEBI has received representations wherein it has been highlighted that for a company which has been listed for a reasonable no. of years on the stock exchange platform and whose promoters have continued to hold on to their stake all these years, the lock-in of 3 years is looks quite onerous and burdensome.

4.2.3. Recently, SEBI has reduced the lock-in requirements for promoters as well as persons other than promoters in case of public issues. Accordingly, there is a need to rationalise the lock-in requirements in case of preferential issues and harmonize the same with lock-in provisions for public issues

4.2.4. Presently there is no specific regulatory framework within the preferential issue guidelines regarding treatment of lock-in for a scenario where there is a change in control pursuant to a preferential issue allotment i.e. a non-promoter becoming promoter post issue. In such a case of an allotment



being made to a new shareholder, thereby triggering a change of control or an open offer, it is often witnessed that such an allottee is disclosed as a 'non-promoter' apparently on the ground that change of control has not been executed or completed.

4.2.5. It is viewed that such scenarios should be clearly covered in the regulations itself wherein, such allottees of preferential issue need to be disclosed as 'Promoter' in the notice for the meeting of shareholders (AGM) and the related information need to be updated accordingly by the company and also clarity may be brought on the lock-in period applicable for such allottees.

4.3. PMAC Recommendations

4.3.1. Lock-in for preferential issuance to promoters/ promoter group may be reduced from 3 years to 18 months and for preferential issuance to persons other than promoter/ promoter group, the lock-in may be reduced from 1 year to 6 months in similar lines with the lock-in applicable to Public Issues.

4.3.2. Lock in for an allottee who has become promoter due to change in control post allotment of preferential issue should be akin to lock-in requirements applicable for promoters / promoter group i.e. for 18 months.

4.3.3. It is also recommended that disclosures be made to shareholders in the explanatory notice for general meeting intimating therein the current and proposed status of the allottee post preferential issue.

5. **Pledge of securities allotted under Preferential Issue**

5.1. Current Regulatory Framework

5.1.1. *Current regulatory framework does not any specific relaxation of pledging of shares in case the same is required towards the objects of the preferential issue*

5.2. Concerns

5.2.1. Suggestions have been received that there is a need to permit pledging of shares allotted under preferential issue during the lock-in period as a collateral security for a loan granted by a scheduled commercial bank or a public financial institution or a systemically important non-banking finance company or a housing finance company in case the same is one of the



terms for the sanction of the loan to the issuer company or its subsidiary(ies) for the purpose of financing one or more of the objects of the preferential issue. Such a provision is already provided for public issue under Regulation 21 of the ICDR Regulations.

5.3. PMAC Recommendation

5.3.1. Specified securities allotted to promoter/ promoter group entities under preferential issue and which are under lock-in, should be permitted to be pledged if the pledge of such specified securities is one of the terms of sanction of the loan granted by a scheduled commercial bank or a public financial institution or a systemically important non-banking finance company or a housing finance company and the said loan is to be sanctioned to the issuer company or its subsidiary(ies) for the purpose of financing one or more of the objects of the preferential issue.

6. Regulation 158- Applicability of Preferential Issue Guidelines

6.1. Current Regulatory Framework

Regulation 158(1)(a) of the ICDR Regulations states as follows:

“158. (1) The provisions of this Chapter shall not apply where the preferential issue of equity shares is made pursuant to:

a) conversion of a loan or an option attached to convertible debt instruments in terms of sub-sections (3) and (4) of sections 81 of the Companies Act, 1956 or sub-section (3) and (4) of section 62 of the Companies Act, 2013, whichever is applicable.

6.2. Concerns:

6.2.1. Section 62(3) of the Companies Act, 2013 deals with increase of the subscribed share capital of a company caused by the exercise of an option attached to the debentures issued or to the loan raised by the company to convert such debentures or loans into shares in the company.

6.2.2. Section 62(4) of the Companies Act, 2013 deals with conversion of loan to a company by government into shares.

6.2.3. Based on the past experiences, it is felt that clarity may need to be provided with respect to preferential issuance referred to under Regulation 158(1) (a) by way of conversion of loan, so as to determine as to whether, such preferential issuance can be done only against the principal amount



outstanding as on the relevant date or against the principal including interest amount accrued thereon, as on the relevant date.

6.2.4. Further, as per present provisions, pricing and lock-in guidelines are also not applicable on preferential issue of equity shares made pursuant to such conversions in terms of section 62(3) of Companies Act, 2013.

6.3. PMAC Recommendation

6.3.1. In view of the concerns raised above, PMAC felt that there is also a need for such preferential allotments to comply with provisions of Preferential Issue guidelines prescribed in Chapter V including guidelines on pricing, and lock-in etc., where allotment is made pursuant to exercise of an option attached to the debentures issued or to the loan raised by the company to convert such debentures or loans into shares in the company.

6.3.2. Accordingly, PMAC has recommended that reference to sub-section (3) of section 62 of the Companies Act, 2013 in Regulation 158(1)(a) of the ICDR Regulations may be deleted so that exercise of an option attached to the debentures issued or to the loan raised by the company to convert such debentures or loans into shares in the company, have to comply with the guidelines Chapter V, unless stated otherwise.

7. **Regulation 159 – Issuers ineligible to make a preferential issue**

7.1. Current Regulatory Framework

7.1.1. *Regulation 159(1) of the ICDR Regulations states that preferential issue of specified securities shall not be made to any person who has sold or transferred any equity shares of the issuer during the six months preceding the relevant date.*

7.1.2. There is no regulatory framework ensuring that company making preferential issue has no outstanding dues to the Board, the stock exchanges or the depositories.

7.2. Concerns:

7.2.1. In view of the recommendation to review the look back period for pricing of preferential issue from 26 weeks (i.e. 6 months) to 60 trading days, it is felt that there is a need to align the lookback period of trading history of prospective allottee.



7.2.2. Further, it is desired that, in line with SEBI circular on Scheme of arrangement, issuer company making preferential issue, should clear the outstanding dues to the Board, the stock exchanges or the depositories.

7.3. PMAC Recommendation:

7.3.1. To reduce the condition of ineligibility period for a person who has sold or transferred equity shares from six months preceding the relevant date to 60 trading days preceding the relevant date.

7.3.2. It is proposed to add the following condition “The issuer entity shall not have any outstanding dues to the Board, the stock exchanges or the depositories”.

8. Preferential issue for consideration other than cash

8.1. Current Regulatory Framework

8.1.1. *In terms of Regulation 163 (3), where the specified securities are issued on a preferential basis for consideration other than cash, the valuation of the assets in consideration for which the equity shares are issued shall be done by an independent valuer, which shall be submitted to the stock exchanges where the equity shares of the issuer are listed:*

Provided that if the stock exchange(s) is not satisfied with the appropriateness of the valuation, it may get the valuation done by any other valuer and for this purpose it may seek any information, as deemed necessary, from the issuer.

8.2. Concerns:

8.2.1. ICDR Regulations, 2018 does not specify the different forms of consideration that can be allowed as “other than cash”. Also the other regulatory requirements pertaining to valuation of the assets to be accepted as consideration other than cash, there is no provision regarding additional disclosure about such consideration to be accepted by Issuer from the allottee. For eg. : If the consideration is to be accepted in the form of commodities, then it is not specified how the value of such commodities will be calculated and whether a valuation certificate for these commodities needs to be mandated and also disclosed.



8.2.2. Hence, a need is felt that appropriate safeguards should be incorporated in the ICDR Regulations with respect to the payment received by the company, other than cash, in addition to defining what other modes of payment are acceptable.

8.3. PMAC Recommendation:

8.3.1. After deliberation on various alternatives, PMAC recommended that only swap of shares backed by a valuation report may be considered as “other than cash”

9. PMAC recommendations on other procedural matters

9.1. Notice to Shareholders for General Meeting and application for In-Principle approval to Stock Exchange (s)

9.1.1. PMAC recommended that the issuer company must apply to the Stock Exchanges for in-principle approval under regulation 28(1) of SEBI LODR Regulations on the same day as dispatch of AGM / EGM / PB notice to shareholders

9.2. Regulation 160 (c) and (e) – Conditions for preferential issue - prior holding of the allottee in dematerialized form and proposed allottee must have PAN

9.2.1. It is proposed to clarify that these conditions are to be complied with at the time of making an application to Stock Exchanges for in-principle approval.

10. Considering the implications of the aforesaid issues pertaining to the subject matter of preferential issues on the market participants including issuer companies and investors, public comments are invited on the matters at Paras 3.3, 3.4 4.3, 5.3, 6.3, 7.3, 8.3, 9.1 and 9.2 above. Comments may be sent by email or through post, in the following format:

Name of entity / person :			
Contact Number & Email Address :			
Sr. No.	Reference Para of the consultation paper	Suggestion/ Comments	Rationale

While sending email, kindly mention the subject as "**Review of certain provisions related to Preferential Issue guidelines**"



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Securities and Exchange Board of India

The comments may be sent by email to consultationcfd@sebi.gov.in latest by December 11, 2021

Comments can also be sent through post (latest by December 11, 2021) to the following address:

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