

Tax Alert | Delivering clarity

5 July 2019

Key updates from SEBI Board Meeting dated 27 June 2019

Issuance of DVR framework

Background

At its Board meeting held on 27 June 2019, Securities and Exchange Board of India (SEBI) approved certain amendments, provided few clarifications and approved a framework for issuance of Differential Voting Rights (DVR) for tech companies with an aim to simplify the law and eliminate inconsistencies.

While amendments to the respective regulations are still awaited, this alert summarises the key proposals approved at the SEBI Board meeting, except provisions relating to payment towards royalty and brand usage under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR).

Key highlights

Framework for issue of DVR

A company having superior voting rights shares (SR shares) would be permitted to undertake an Initial Public Offer (IPO) of its ordinary shares subject to compliance with SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and the following conditions:

- **Eligibility:** A tech company i.e. intensive in use of technology, information technology, data analytics etc. (defined under Innovators Growth Platform).
- **Eligible Subscribers:** SR shareholder shall be part of promoter group, holding executive position in the company and whose collective net worth does not exceed INR 500 crores (excluding the investment by such shareholder in the issuer company).
- **Rights:** SR shares shall be treated at par with the ordinary equity shares in every respect including dividends, but excluding voting on resolutions. Ratio of voting rights of SR shares shall be minimum 2:1 to maximum 10:1, compared to ordinary shares. The total voting rights of SR shareholders (including ordinary shares) post listing has been capped at 74 percent.
- **Listing and Lock-in:** SR shares to be held for a period of at least 6 months prior to the filing of Red Herring Prospectus. Post IPO, SR shares, to be listed subject to a lock-in until conversion into ordinary shares. Transfer, pledge, lien of SR shares shall not be permitted.
- **Enhanced corporate governance:** Half of the composition of the total strength of the Board and two-thirds of all committees (other than audit committee) as prescribed under SEBI LODR, shall comprise of independent directors and the audit committee to comprise of only independent directors. The issue of SR shares has been authorised by a special resolution.
- **Coattail Provisions:** Post IPO the SR shares to be treated as ordinary shares in *inter alia* the following circumstances:
 - Appointment or removal of independent directors and / or auditors;
 - Transfer of control by Promoter to another entity;
 - Related Party transactions under SEBI LODR involving SR shareholders;

- Voluntary winding up of the company;
- Delisting or buy-back of shares.
- **Sunset Clauses:** SR shares shall be converted to Ordinary Shares on the 5th anniversary of listing or on occurrence of certain events such as demise, resignation of SR shareholders, merger or acquisition where the control would be no longer with SR shareholder, etc. The validity can be extended once by 5 years through a resolution passed by non-SR shareholders.
- **Fractional Right Shares:** SEBI has prohibited the issue of fractional right shares by existing listed company.

Impact: Issuance of DVR framework will help in fund raising for tech companies without dilution of control.

Payment relating to royalty and brand usage – Amendment to SEBI LODR

Payments made to related parties towards brand usage or royalty may be considered material if the transaction(s) exceed 5 percent (earlier 2 percent) of the annual consolidated turnover of the listed entity during a financial year and would require approval of the shareholders, with no related party having a vote to approve such resolutions.

These provisions are effective from 1 July 2019.

Impact: This gives more flexibility to management to pay higher brand usage or royalty.

Disclosure of Encumbrances

- Definition of 'Encumbrance' under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, which earlier included a pledge, lien or any such transaction, by whatever name called and now broadened to include:
 - any restriction on the free and marketable title to shares, by whatever name called, whether executed directly or indirectly;
 - negative lien, non-disposal undertaking;
 - any covenant, transaction, condition or arrangement in the nature of encumbrance, by whatever name called, whether executed directly or indirectly.
- Detailed reasons for encumbrance to be disclosed by Promoters to stock exchanges if combined encumbrance by Promoters and persons acting in concert (PAC) exceeds 20 percent of the share capital or 50 percent of their shareholding in the listed entity.
- Promoters to provide annual declaration to audit committee and stock exchanges that no encumbrances have been made directly or indirectly by PAC and Promoters other than those disclosed, during the financial year.

Impact: This will enable transparency as regards to disclosure of encumbrances done through complex structures.

Amendments to SEBI (Prohibition of Insider Trading Regulations), 2015 (SEBI PIT Regulations)

- SEBI has approved amendments to the SEBI PIT Regulations clarifying that the trading window closure for listed companies would mandatorily commence from the end of every quarter until 48 hours after declaration of financial results.

- In view of representations received from stakeholders, certain relaxations have been approved by SEBI for trading during closure of trading window in respect of following transactions:
 - off-market inter-se transfer between insiders;
 - transaction through block deal window mechanism between insiders;
 - transaction due to statutory or regulatory obligations;
 - exercising of stock options;
 - pledging of shares for bona fide transaction such as raising of funds and transactions for acquiring shares under further public issue, right issue and preferential issue;
 - exercising conversion of warrants / debentures;
 - tendering shares under buy-back;
 - open offer and delisting etc. under respective regulations, subject to conditions specified.

- Presently Designated persons (as defined under the SEBI PIT Regulations) are required to provide disclosures to the company on an annual basis and as and when the information changes as regards persons with whom such Designated person(s) shares a 'Material Financial Relationship'.

"Material Financial Relationship" has been defined to mean a relationship in which one person is a recipient of any kind of payment such as by way of a loan or gift during the immediately preceding 12 months, equivalent to at least 25 percent of such payer's annual income but shall exclude relationships in which the payment is based on arm's length transactions.

SEBI has approved clarificatory amendments with respect to Material Financial Relationship, which are awaited.

Impact: This will provide clarity as regards to timeframe for closure of trading window as well as permissible transactions during the closure of trading window.

Source: SEBI press release PR No. 16/2019 dated June 27, 2019 (www.sebi.gov.in)



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

This material and the information contained herein prepared by Deloitte Touche Tohmatsu India LLP (DTTI LLP) is intended to provide general information on a particular subject or subjects and is not an exhaustive treatment of such subject(s). This material contains information sourced from third party sites (external sites).

DTTI LLP is not responsible for any loss whatsoever caused due to reliance placed on information sourced from such external sites. None of DTTI LLP, Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this material, rendering professional advice or services. This information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser.

No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this material.

©2019 Deloitte Touche Tohmatsu India LLP. Member of Deloitte Touche Tohmatsu Limited