

Discussion Paper on 'Issuance of partly paid shares and warrants by Indian companies'

Background

1. The Ministry of Finance has decided to permit issuance of partly paid shares and warrants ("the said instruments") by the Indian companies to foreign investors.
2. In this regard, RBI has notified the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) (Ninth Amendment) Regulations, 2014 on June 30, 2014. The said amendment essentially permits foreign investment in partly paid-up shares and warrants issued by Indian companies. RBI has also issued A.P. (DIR Series) circular No. 3 dated July 14, 2014 ("RBI circular") declaring the said instruments as eligible for the purpose of FDI and FPI subject to compliance with FDI and FPI schemes. The circular also lays down certain conditions in respect of pricing, receipt of balance consideration, reporting, etc.
3. The provisions in the said RBI circular are summarized as under:
 - A. Eligible instruments and investors -
Partly paid equity shares and warrants issued by an Indian company in accordance with the provisions of the Companies Act, 2013 and the SEBI guidelines, as applicable, have been made eligible instruments for the purpose of FDI and foreign portfolio investment (FPI) by Foreign Institutional Investors (FIIs) / Registered Foreign Portfolio Investors (RFPIs) subject to compliance with FDI and FPI schemes.

B. Pricing and receipt of balance consideration -

- I. Partly paid equity shares: The pricing of partly paid equity shares shall be determined upfront and 25% of the total consideration amount (including share premium, if any), shall also be received upfront. The balance consideration towards fully paid equity shares shall be received within a period of 12 months. The time period for receipt of balance consideration within 12 months shall not be insisted upon where the issue size exceeds INR 500 crores and the issuer complies with regulation 17 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("ICDR") regarding monitoring agency. This exemption of not mandating receipt of balance consideration within 12 months period has also been extended to the unlisted Indian investee companies.
- II. Warrants: The pricing of the warrants and price / conversion formula shall be determined upfront and 25% of the consideration amount shall also be received upfront. The balance consideration towards fully paid up equity shares shall be received within a period of 18 months. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such warrants, in accordance with the extant FEMA regulations and pricing guidelines stipulated by RBI from time to time.

- C. Reporting and other conditions - Certain requirements as regards reporting under FEMA regulations have been prescribed. The onus of compliance of all the conditions under FEMA as regards entry route, sectoral caps and all other conditions under FDI guidelines has been put on the investee company in case of issue of partly paid shares / warrants as well as upon resident transferor or transferee in accordance with extant guidelines in case of transfer of partly-paid shares / warrants. Certain other requirements including giving notice for transfer of partly-paid shares, FII's / FPI's complying with the individual limit of investment, compliance with sectoral caps, prior-approval of FIPB for investing under the government route, forfeiture of upfront payment on non-payment of call money, etc. have also been laid down under the said circular.

Need for review

4. In light of the aforesaid review of the regulatory framework under FEMA and in view of the perceived need to harmonize the framework for issuance of the said instruments under FEMA and ICDR, it is proposed to review the relevant provisions under ICDR. Accordingly, the various proposals for amendment to ICDR are outlined in the subsequent paragraphs.

Proposals for amendment

5. A. Issuance of partly paid shares

I. Requirement of upfront payment

a. Rights issue

In case of rights issues, the following is presently stipulated under regulation 54(7) of ICDR:

"54(7) The issuer shall give only one payment option out of the following to all the investors -

*(a) **part payment** on application with balance money to be paid in calls; or*

(b) full payment on application:

Provided that where the issuer has given the part payment option to investors, such issuer shall obtain the necessary regulatory approvals to facilitate the same."

As can be seen from the above, part payment option is available in rights issues. However, there is no specification as to the minimum amount to be paid with the application. To enable application by foreign investors and ensure uniformity with the RBI guidelines, the said regulation 54(7) of ICDR may have to be amended to specify that in case of part payment option being provided by the issuer in rights issue, the part payment on application shall not be less than 25 % of the issue price.

B. Issuance of warrants

I. Requirement of upfront payment

a. Public and Rights issue

In terms of regulation 4(3) of ICDR, warrants can be issued along with public issue / rights issue of other specified securities. The said regulation 4(3) reads as under:

"4(3) Warrants may be issued along with public issue or rights issue of specified securities subject to the following:

(a) the tenure of such warrants shall not exceed twelve months from their date of allotment in the public/rights issue;

(b) not more than one warrant shall be attached to one specified security."

Currently, there is no specific provision regarding minimum upfront payment to be received by issuer in respect of such issuance of warrants. However, as per schedule VIII - part A - paragraph 2(VII)(A)(6) read with regulation 57(2) of ICDR, full disclosures shall be made regarding the objects towards which the funds from conversions of warrants are proposed to be used. To ensure certainty regarding receipt of funds by the issuer company, a minimum upfront payment in respect of allotment of warrants may be stipulated.

Hence, in line with the norms prescribed by RBI, it may be stipulated under ICDR that pricing of the warrants and price / conversion formula shall be determined upfront and 25% of the consideration amount shall be received upfront. In case of non-exercise of warrants, entire upfront payment may be forfeited by the issuer.

II. Period of conversion

a. Public and Rights issue

Regulation 4(3) of ICDR permits warrants to be issued along with public issue or rights issue of specified securities subject to certain conditions including maximum tenure of warrants not exceeding 12 months from the date of allotment.



To ensure uniformity, regulation 4(3) of ICDR may be amended for increasing the tenure of warrants issued along with public issue or rights issue of specified securities to 18 months.

6. The following matrix summarizes the aforesaid proposals:

Mode of issuance	Partly Paid Shares		Warrants	
	Minimum upfront payment	Period within which to be made fully paid up	Minimum upfront payment	Period of conversion
Public	Existing - 25% Proposed - No change	Existing - 12 months Proposed - No change	<u>Existing - Not specified</u> <u>Proposed - 25%</u>	<u>Existing - 12 months</u> <u>Proposed - 18 months</u>
Rights	<u>Existing - Not specified</u> <u>Proposed - 25%</u>	Existing - 12 months Proposed - No change	<u>Existing - Not specified</u> <u>Proposed - 25%</u>	<u>Existing - 12 months</u> <u>Proposed - 18 months</u>
Preferential	Not applicable		Existing - 25% Proposed - No change	Existing - 18 months Proposed - No change

Public comments

7. Considering the implications of the said matter on the market participants, public comments on the proposals outlined above at paragraph 5 are solicited. Specific comments/suggestions as per the format given below would be highly appreciated.

Name of entity / person / intermediary:			
Name of organization (if applicable):			
Sr. No.	Pertains to proposal at sub-para number	Proposed / suggested changes	Rationale

8. Such comments may please be e-mailed on or before December 14, 2014, to partlypaid@sebi.gov.in or sent by post, to:

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