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insight

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SEBI's Proposed Amendments to the Framework Regarding Promoters, Promoter Groups and Group Companies under the ICDR

Introduction

During the last 14 months, the Securities and the Exchange Board of India ("**SEBI**") has undertaken various measures to address the pandemic-induced challenges and to ensure that capital markets in India continue 'business as usual'. In doing so, SEBI has not lost sight of the long-term issues and has released various consultation papers and/ or made amendments to regulations on a wide range of topics including business responsibility and sustainability reporting[1], delisting of equity shares[2], minimum public offer requirements[3] and re-classification of promoters/ promoter groups[4].

In the same vein, SEBI released a consultation paper on May 11, 2021 ("**Consultation Paper**") proposing amendments to the framework governing 'Promoters', 'Promoter Groups' and 'Group Companies' under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("**SEBI ICDR Regulations**")[5]. In this Case in Point, we have considered the amendments in detail, along with the rationale and implications of the proposed amendments.

I. Reduction in lock-in-period for minimum promoter contribution in IPOs

Historically, the requirement of maintaining a minimum Historically, the requirement of maintaining a minimum stake by promoters, directors and their family in companies proposed to be listed was a concept of the pre-SEBI era. It was a condition set out in consent orders issued to companies by the Controller of Capital Issues (i.e. the government body regulating capital issue of companies) for listing their shares on stock exchanges.[6]

Driven by the concerns of investor protection and awareness[7], SEBI, upon its incorporation in 1992, introduced the requirement of a minimum promoter equity contribution ("**MPC**") to be locked in with issuer companies after an initial public offer ("**IPO**") or a further public offer ("**FPO**"). Such requirements, which found their way into the SEBI ICDR Regulations, seek to restrict promoters from exiting companies immediately

1 SEBI consultation paper titled "*Format for Business Responsibility and Sustainability Reporting*", dated August 18, 2020.
2 SEBI consultation paper titled "*Review of SEBI (Delisting of Equity Shares) Regulations, 2009*", dated November 20, 2020.
3 SEBI consultation paper titled "*Review of requirement of Minimum Public Offer for large issuers in terms of Securities Contracts (Regulation) Rules, 1957*", dated November 20, 2020.
4 SEBI consultation paper titled "*Re-classification of promoter/ promoter group entities and disclosure of promoter group entities in the shareholding pattern*", dated November 23, 2020.
5 SEBI consultation paper titled "Review of the regulatory framework of promoter, promoter group and group companies as per Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018", dated May 11, 2021, available at https://www.sebi.gov.in/reports-and-statistics/reports/may-2021/consultation-paper-on-review-of-the-regulatory-framework-of-promoter-promoter-group-and-group-companies-as-per-securities-and-exchange-board-of-india-issue-of-capital-and-disclosure-requirements-re-_50099.html
6 Department of Economic Affairs of the Ministry of Finance, Government of India, *Capital Issues Control – A Booklet Containing Principles and Policy followed in the Administration of the Capital Issues (Control) Act, 1947, 1965*, available at https://dspace.gipe.ac.in/xmlui/bitstream/handle/10973/33760/GIPE-106838.pdf?sequence=2&isAllowed=n.
7 SEBI Annual Report 1992-92, page 7, available at https://www.sebi.gov.in/reports/annual-reports/mar-1993/annual-report-1992-1993_21050.html.

after a public offer and demonstrate 'skin in the game', i.e. continued association with the issuer company.

Over time, while SEBI has retained lock-in provisions of existing shareholders, it has introduced certain relaxations, which *inter alia*, include (i) limiting lock-in restrictions to the shares of contributing promoters (as opposed to friends, family and associates); (ii) reducing the lock-in period to three years from five years; and (iii) permitting certain regulated entities such as alternative investment funds ("**AIFs**"), foreign venture capital investors ("**FVCIs**"), scheduled commercial banks, public financial institutions and insurance companies to meet shortfalls in MPC by contributing up to 10% of the post issue capital of issuer companies without being named as promoters.[8]

Presently, in the IPO process, the following lock-in requirements are imposed on shareholders under the SEBI ICDR Regulations, subject to certain permitted transactions[9]:

a.) ***MPC*** - three years from the later of (i) the date of commencement of commercial production, or (ii) the date of allotment in the IPO.[10]

b.) ***Promoters' holdings in excess of MPC*** – one year from the date of allotment in the IPO.[11]

c.) ***Pre-issue capital of non-promoters*** - one year from the date of allotment in the IPO.[12]

Proposed framework and rationale

The SEBI Consultation Paper is now proposing a framework wherein IPOs undertaken with the objective of making an offer for sale or financing (other than capital expenditure for a project) will have the MPC locked-in only for a period of one year from the date of allotment in the IPO, as against the existing three years requirement.

Further,

a.) after a period of six months from the allotment under the IPO, shares held by promoters can be exempt from lock-in solely for purposes of meeting minimum public shareholding requirements under the Securities Contracts (Regulation) Rules, 1957 ("SCRR"), which are required to be complied within a period of three years; and

b.) The lock-in periods for (i) promoters' holdings in excess of the MPC, and (ii) the pre-issue capital of non-promoters, are proposed to be reduced to a period of six months from the allotment under the IPO as against the existing one year.

SEBI justifies the proposed amendments in the Consultation Paper on the rationale that a declining trend in aggregate promoter shareholding of the top 500 listed companies and a corresponding increase in shareholding of institutional investors in listed companies indicate a reduced relevance of the concept of promoters. Along with it, the presence of institutional investors in issuer companies with mature businesses is also a testament of promoters having extended their expertise and involvement years before listing.[13]

Our analysis

SEBI's proposals in respect of the lock-in provisions seem to bring the listing process in India closer to the international standards, and are expected to provide further flexibility to promoters with respect to their post-issue holdings (which in turn will further incentivise promoters to undertake IPOs of companies).

SEBI has historically maintained that the lock-in restrictions under the SEBI ICDR Regulations are to be reviewed at periodic intervals keeping in mind international practices.[14] In the UK and the USA, for

8 Proviso to Regulation 14(1) of the SEBI ICDR Regulations.
9 (i) Regulation 22 of the SEBI ICDR Regulations permits inter-promoter/ promoter group transfer of locked in shares as well as transfer of shares between two non-promoters whose shares are locked in. Shares thus transferred will remain locked in with the issuer company till the expiry of the balance lock in period. (ii) Regulation 22 of the SEBI ICDR Regulations permits promoters to pledge their locked-in shares as collateral with financial institutions as per terms prescribed therein.
10 Regulation 16(1)(a) of the SEBI ICDR Regulations.
11 Regulation 16(1)(b) of the SEBI ICDR Regulations.
12 Regulation 17 of the SEBI ICDR Regulations.
13 ET Bureau, *Modernising promoter, albeit gradually*, Economic Times, May 14, 2021.
14 Reforms in Primary Markets, SEBI Board Meeting dated August 16, 2012.

example, lock-in requirements arise from stock exchange regulations or market practice. Typically, underwriters enter into 90 -180 days[15] 'lock-up' arrangements with major shareholders so as to avoid material fluctuations in the stock price post listing, similar to contractual arrangements entered between the issuer and lead managers in a qualified institutional placement in India.

This proposal will also be welcomed by issuer companies which are professionally managed and institutional investors such as private equity firms who are usually not amenable to longer lock-ins.

Lastly, we believe that in the current investment and regulatory landscape, SEBI is confident that there are enough checks and balances (such as high quality boards, third party monitoring of issue proceeds utilization, stringent penal provisions under the SEBI Act, 1992 and the Companies Act, 2013 for misstatements in prospectus, and exit opportunity to dissenting shareholders of the issuer for deviation in objects for which the issue proceeds are proposed to be utilized) to reduce the lock-in requirements. As stated by SEBI, there is also an indicative trend where corporate governance is at the behest of monitoring authorities within as well as outside companies and is no longer linked to promoters.

With the proposed permission to Indian companies to list their securities on foreign stock exchanges, we see this proposal as a positive step in moving towards the international practices, and also the proposed shift from the concept of a 'Promoter' to that of 'Persons in Control' which is discussed in detail in Part III below.

II. Rationalisation of the 'Promoter Group' definition and streamlining disclosures concerning 'Group Companies'

Any company which seeks to undertake IPO of its equity shares is required to make certain confirmations and disclosures in its offer documents with respect to its 'promoter group' and 'group companies' as defined in

the SEBI ICDR Regulations. SEBI has now proposed to rationalize/ streamline the definition of 'promoter group' and the disclosure requirements for both promoter group and group companies.

It is expedient here to briefly set out the scope, and the disclosure requirement in relation to both 'promoter group' and 'group companies'.

a.) ***Promoter group***: Promoter group is defined under Regulation 2(1)(pp) of the SEBI ICDR Regulations, and the members of promoter group are identified based on the said criteria for each promoter.[16] The composition changes *inter alia* depending upon whether a concerned promoter is an individual or a corporate entity. Where a corporate entity is identified as a promoter of company A, the promoter group category will include within its ambit (i) promoter of A, (ii) subsidiary and holding company of A's promoter, (iii) any company which holds 20% or more of the equity capital of A's promoter, (iv) any company in which A's promoter holds 20% or more of the equity capital, (v) if a group of companies or individuals or combination thereof holds 20% or more of the equity capital each in A and also in another company B, then company B ("**Common Investee**"). The offer document is required to

15 US Securities and Exchange Commission, Fast Answers, *Initial Public Offerings: Lock-Up Agreements*, available at https://www.sec.gov/fast-answers/answerslockuphtm.html; *Initial Public Offerings 2020 | United Kingdom*, Global Legal Insights, available at https://www.globallegalinsights.com/practice-areas/initial-public-offerings-laws-and-regulations/united-kingdom

16 Certain category of persons specified by SEBI such as financial institutions, scheduled commercial banks, AIFs, FVCIs, foreign portfolio investors, venture capital funds etc. are not classified as members of a promoter group on account of holding 20% or more in the promoter.

17 Deletion of Regulation 2(1)(pp)(iii)(c) of the SEBI ICDR Regulations.

contain various disclosures in relation to each of the promoter group entities including their name, shareholding in the issuer, details of securities (if any) issued to them by the issuer at a price lower than the issue price etc.

The amendment under the Consultation Paper proposes to remove 'Common Investee(s)' from within the ambit of promoter group.[17]

b.) ***Group companies***: Group companies are identified in terms of Regulation 2(1)(t) of the SEBI ICDR Regulations, and includes (i) such companies (other than promoters and subsidiaries of the issuer) with which the issuer has entered into related party transactions during the period for which financial information is disclosed in the offer document; and (ii) other companies as considered material by the board. The offer document is required to contain inter alia the name of the group companies, along with details such as registered address, equity capital, nature and extent of promoter interest, and business description; financials of top five listed/ unlisted group companies; nature and extent of the interest (direct and indirect) of each group company in the issuer; and details pertaining to outstanding litigations involving the group companies.

The amendment under the Consultation Paper proposes disclosure of only the names and registered office addresses of the group companies. All other details such as outstanding litigations, nature and extent of interest in the issuer, financials of top five listed/unlisted group companies etc. are proposed to be omitted from the offer document.

Rationale for the proposed framework

The Consultation Paper specifies the following rationale for the proposed changes.

Promoter group:

a.) In its existing form, the broad definition of promoter group results in the offer document containing details even in relation to Common Investees, which are entities unrelated to the issuer in practice. Collation and disclosure of information from such entities, while being a challenging and time-consuming task, at most times also fails to add any significant value. A narrower definition will ensure that details of such non-material entities are excluded.

b.) Identification and disclosure of related parties and related party transactions ("**RPTs**"), which details are already required in the offer document, is a more relevant metric for the investors and serves the same purpose of disclosing inter-relationship of the issuer with group entities.

Group companies:

a.) Avoiding detailed disclosures concerning group companies, which may be entities not material to the issuer.

b.) The pre-existence of continuous disclosures concerning RPTs, both prior to and post listing, renders additional disclosures on group companies redundant.

c.) Rationalizing the pre-listing disclosure requirements with the post-listing framework, as the concept of group companies remains absent post-listing.

Our analysis

If implemented, the proposed amendment would reduce the overall disclosure burden on issuer companies at the time of IPO, alongside benefitting investors who will have lesser yet more effective disclosures before making an investment decision.

The change in definition of promoter group would:

a.) rationalise the list of promoter group entities which would benefit institutional investors who will be spared the possibility of their other investee companies becoming part of the promoter group of any issuer company; and

b.) be beneficial in cases where there is a dissociation between members of the promoter group and the promoter of the issuer company, and co-ordination in not feasible.

17 Deletion of Regulation 2(1)(pp)(iii)(c) of the SEBI ICDR Regulations.

The definition of 'group companies' under the SEBI ICDR Regulations is straitjacketed and offers no leeway for issuers to make exceptions. There are instances where companies have been classified as group companies despite having ceased to be related parties due to dissociation by the promoters, and other instances where private equity investors have been classified as group companies on account of their investments in the issuer and/or dividend payments by the issuer. SEBI has generally been amenable to grant limited relaxations for only the former and not the latter. The proposed change in the disclosure requirement for group companies will ensure that the offer document does not contain additional information of related parties which are not relevant for an investor's investment decision in the IPO.

Over the last few years, SEBI has been conscious that the concept of group companies is losing relevance and has accordingly made efforts to rationalise the disclosure requirement, particularly in view of the existing requirement to disclose RPTs in the offer document. However, SEBI is still hesitant in doing away with the concept of group companies altogether. Therefore, while the disclosures in the offer documents will be reduced, issuers will still be required to coordinate with each of its group companies and obtain certificates from such companies in order to comply with the proposed inclusion of such information on its website, which may lead to other implications. Further, if such certificates are not forthcoming, issuers may still be required to apply to SEBI for necessary exemptions.

III. Move from Promoter/ Promoter Group to Person In Control/ Controlling Shareholder

The concept of 'promoter' is unique to India, and finds mention at various points in corporate and securities law framework in India, and can be traced to as far back as the Capital Issues (Control) Act, 1947.

Historically, companies and enterprises in India have been founded and largely managed by families, making identification and regulation of promoters highly relevant in India. However, with the growing sophistication of the Indian economy and entry of

institutional investors and professional management, the concept of a promoter is increasingly becoming redundant. Further, unlike other countries where the concept of founder is relevant at the early stages of the company, in India, the concept of promoter continues indefinitely and is stated in statutory records, even when the promoter ceases to have substantial shareholding, interest or control in the company.

The SEBI ICDR Regulations define the term 'promoter' to include (i) a person who has been named as such in a draft offer document or offer document or is identified by the issuer in the annual returns of the company; or (ii) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or (iii) in accordance with whose advice, directions or instructions the board of directors of the company is accustomed to act.[18]

The issue and the implication of permanent promoter status was highlighted to the Standing Committee on Finance in 2010 when the Companies Bill (*which defined 'Promoter' on similar lines as the SEBI ICDR Regulations*) was being discussed.[19] The committee unequivocally clarified that it is not the intention to hold the person initially indicated in the offer document as liable even if there has been a change in the promoter of the issuer over a period of time. However, no substantive change in this regard has been forthcoming.

18 Regulation 2(1)(oo) of the SEBI ICDR Regulations.
19 Twenty First Report of the Standing Committee on Finance (2009-2010) on the Companies Bill, 2009, presented to the Lok Sabha and Rajya Sabha on August 31, 2010.

Our analysis

Drawbacks of the existing framework

An overreaching definition of 'promoter' has the following undesirable outcomes:

i.) The 'promoter' status may be disproportionate to the person's economic interest in the issuer.

ii.) Being a promoter subjects a person to a detailed set of obligations including disclosure obligations, lock in restrictions, providing exit opportunities, and ensuring compliance with the applicable law. In certain cases, such as when the issuer is in contravention of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**SEBI Listing Regulations**"), SEBI even has the power to freeze the shareholding of the promoter in the company.

iii.) Shift of focus away from the board of the issuer company, which has the duty as well as the requisite powers to govern the issuer company and take decisions.

iv.) The evergreening of the promoter tag and the resultant continuous obligations, even after a person ceases to be in control of the company, acts as a deterrent to foreign and institutional investors from making substantial investments in/ controlling Indian companies and from exiting through IPO.

Inadequacy of Promoter/ Promoter Group re-classification

The aforesaid issue of 'once a promoter, always a promoter' was identified and discussed by the Primary Markets Advisory Committee of SEBI in 2013 and 2014.[20] SEBI attempted to resolve this issue with the introduction of Regulation 31A of the SEBI Listing Regulations which allowed stock exchanges to re-classify promoters/ persons belonging to the promoter group as public shareholders, subject to fulfilment of certain specified conditions.

While some promoters/ promoter group entities successfully re-classified themselves in accordance with the SEBI Listing Regulations, there were a large number of cases where promoters have desired re-classification but have found it difficult particularly in view of the cumbersome process and requirement of shareholder approval. There have since been multiple requests to SEBI from companies seeking relaxation of the requirements under Regulation 31A of the SEBI Listing Regulation for the re-classification.[21]

Therefore, the current proposal of replacing the concept of promoter with persons who are in control of the company not only seeks to address this problem, but also goes much further in aligning the Indian securities market with developed markets such as the US, the UK and Singapore.

Rationale for shift towards the concept of 'Persons in Control'

The proposed amendments mark the evolution of the Indian markets and the changing investor landscape wherein shareholding in companies, both listed as well as unlisted, is increasingly being held by institutional investors, and not by traditional promoter families/ groups. One of the ways to incentivise further investment in India by such institutional investors, is to provide an equitable regulatory regime where they are not burdened with onerous post-exit obligations.

There is also an increased focus now on corporate governance and shareholder reliance on the board and management, as opposed to promoters. Post-IPO, issuer companies are also required to have minimum number of independent directors on their board, which ensures enhanced transparency and accountability. Therefore, Indian companies are progressively becoming professionally managed companies (with no identifiable promoter). One of the recent examples of this trend is the draft offer document of Zomato Limited, which specifies that it is a professionally managed company without any identifiable promoter. In such a case, it is the board and management of the

20 SEBI discussion paper on "*Re-classification of Promoters as Public*" dated December 30, 2014.
21 *Supra* n. 4. Following the Consultative Paper, certain amendments have been introduced to the SEBI Listing Regulations on May 05, 2021 in order to reduce the compliance burden on listed entities and the promoters seeking re-classification and consequently to minimize the exemptions sought on a case to case basis.

company which must be held accountable; and the concept of promoter group also becomes moot.

The reaction of the market participants to the proposed move from promoters to controlling shareholders has mostly been positive. While some participants do believe that SEBI's proposal is premature and will needlessly relax the necessary vigilance on promoters and promoter group entities, and is not required in light of the existing procedure for re-classification to public shareholders, the majority do agree with SEBI that 'promoter without control' concept has outlived its usefulness.

Challenges concerning Implementation of the Proposal

Now that the conceptual bridge has been crossed, the more challenging task is that of amending various SEBI regulations to align them with this stated objective. This is a colossal task not only because the concept of promoter is so hardwired into the Indian securities regulations but also because the concept and definition of 'control' itself is layered and has been interpreted and legislated widely.

In the past, SEBI has considered setting out bright line tests for what constitutes control under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, but stopped short of legislating the same.[22] It may, therefore, be helpful for SEBI to re-examine the definition of 'control' and introduce some objective criteria for determination of 'control' (and by consequence, the 'controlling shareholder') in order to clear the ambiguities existing under the prevalent laws. In case of a company with no identifiable controlling shareholder, the board and the management may be held liable for compliance and other obligations, and alternative enforcement tools (instead of freezing of promoter shares) may need to be considered which are directed towards the board and the management.

This shift will also have implications on laws administered by other sectoral regulators. Therefore, SEBI may also need to consult with these regulatory authorities before taking any further steps, given any changes to the concept of promoter will impact how the term is interpreted by other regulators as well. Further, any unilateral changes by SEBI to its regulations, without corresponding changes to other relevant laws may create regulatory gaps and uncertainty, which is undesirable.

Conclusion

It is imperative for regulators to re-look at the laws and to bridge the regulatory gaps in order to align with global standards and ensure that Indian companies have an edge over their foreign counterparts. In this context, the Consultation Paper and the proposals set out therein are crucial for the growth and development of the Indian securities market. However, for the proposed changes to be truly effective in addressing the existing gaps, it may be imperative for the market regulator to consider incorporating feedback from the market participants, including as detailed above, which can be provided by June 10, 2021 to SEBI.

Additionally, given the far-reaching impact of the changes proposed in the Consultation Paper, especially the shift from promoters to controlling shareholders, it becomes essential for SEBI, in consultation with other regulators, to consider the details and nuances of the new framework and the transition process before implementing the same.

22 SEBI discussion paper on "*Brightline Tests for Acquisition of 'Control'* under SEBI Takeover Regulations" dated March 14, 2016.

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