

Discussion Paper on 'Review of framework for public issuance of Convertible Securities'

1. Background

- a. Convertible securities offer a unique combination of debt and equity to investors. Holder of such a security can convert the security into equity and benefit if the issuer of the securities performs well. However, if the issuer is not performing as per expectations, the security holder has the option of redeeming the security at a pre-determined maturity date. Issuing convertible securities help a corporation secure equity financing in a delayed manner, as securities will be converted to equity at a future date. This process delays dilution of the common stock and earnings per share. Companies can sell convertible securities at a lower coupon rate than standard debt issuances because of the conversion option. Convertible security holders only receive interest, resulting in more operating income to the common stockholders until the securities are converted to equity.
- b. Between 1990 and 2001, the Indian markets saw 284 issues of convertible debentures by small, medium and large companies with a total fund raising of around Rs. 14,000 crore, with 57 issues being larger than Rs. 50 crore. However, since 2000 the market for public issue of convertible securities has dwindled. Market participants have assigned variety of reasons for the same including popularity of instruments like FCCB which were permitted since mid-90s, lower tenure for convertible instruments issued in India, higher tax incidence on convertibles as compared to equity, etc.

2. Need for review

Association of Investment Bankers of India (AIBI) and other market participants had made representations to facilitate issuance of convertible securities through suitable regulatory measures. With a view to revive issuances of convertible securities by existing listed entities and provide an additional avenue for investors to invest as well as companies to raise funds, various issues in this respect were deliberated in the Primary Market Advisory Committee (PMAC) of SEBI. Based on the recommendations of PMAC, various suggestions made in this regard are placed below for public comments.

3. Suggestions made in respect of public issuance of compulsorily convertible securities by a listed entity

- a. Presently, there is no specific provision for tenure of convertible securities issued to public, except for financing of a group company where the maximum tenure can be 18 months. It is suggested that the tenure of convertible securities issued to public by an existing listed entity may be a maximum of 5 years.
- b. Presently, whether an issuance can be made on a fixed price basis or through the book building route depends on issuer meeting the specified eligibility criteria. The conversion price may either be pre-fixed at the time of issue or linked to market price at the time of conversion. The disclosure in this regard shall be made upfront in the offer document.
- c. Currently, while the existing shareholders are permitted to sell their shares to public, the same is not specifically mentioned for convertible securities. It is suggested to explicitly permit the existing holders of convertible securities as well to sell their securities to public.

4. Suggestions relating to public issuance of optionally convertible securities by a listed entity

- a. Optionally Convertible Debentures (OCDs) and Optionally Convertible Preference Shares (OCPs) may be treated as debt and may comply with the provisions of SEBI (Issue and Listing of Debt Securities) Regulations, 2008, (“Debt Regulations”), as applicable. Accordingly, listing regulations/agreement as applicable for debt securities shall apply.
- b. Tenure and pricing of such optionally convertible securities may be as per the suggestions specified above at para 3.

5. Suggestions made in respect of public issuance of compulsorily convertible securities by an unlisted entity

In case an unlisted company is desirous of making a public issue of compulsory convertible securities, it is proposed that in addition to the requirement of maximum tenure, conversion price, etc as mentioned at point 3 above, such companies shall also comply with all the requirements as prescribed under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 in this regard. Further, the listing of such securities is proposed to be done on Institutional Trading Platform (ITP).

6. Other suggestions

- a. The term “convertible securities” may be used uniformly in place of convertible debt/security/instrument in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (“ICDR Regulations”) so as to avoid ambiguity and permit issuance of convertible debentures and convertible preference shares. Suitable conditions may be imposed for public issuance of such convertible securities in line with conditions currently prescribed for convertible debt.
- b. In rule 19(2)(b) of SCRR, each class or kind of “debentures convertible into equity shares” may be replaced with “debentures and preference shares convertible into equity shares”, to permit public offering of a wider array of convertible securities.

7. Public comments

Considering the implications of the said matter on the market participants including issuers and investors, public comments are solicited on the suggestions made at paragraphs 3 - 6 above and specifically on the following points:

- a. Should the price of such convertible securities be pre-fixed or market linked? Alternately, should the price be fixed based on bids received under the book building methodology?
- b. Should offer for sale of convertible securities be permitted?
- c. Should OCDs and OCPs be treated as debt and be required to comply with Debt Regulations? Or should it be considered as equity and require to comply ICDR Regulations?

Specific comments/suggestions as per the format given below would be highly appreciated:

Sr. No.	Pertains to serial number under paragraph (3-7)	Sub-serial number (a-c)	Agree / Disagree to the suggestion at the said serial number	Proposed changes / suggestions	Rationale

However, any other suggestions for developing convertible securities market are also welcome.



Such comments may please be e-mailed on or before December 23, 2015, to convertibles@sebi.gov.in or sent by post, to:

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