

BJ REVIEW OF POLICIES AND PROGRAMMES

A review of the major policy developments and programmes of SEBI during 1999-2000 is given below:

i. Primary Securities Market

Rationalisation of guidelines for public issues

Keeping in view the changes in the capital market emanating from free pricing of shares and free access to market for funds by the issuers, the SEBI with the objective of broadening the investors' base, dispensed with the requirement of standard denomination of Rs.10 and Rs.100 (in terms of government circulars) and gave freedom to companies with dematerialised shares, to issue shares at any denomination but not below Re.1/- or decimal of a Rupee to be determined by them. This decision is also in conformity with the recommendation made by the Informal Group on Primary Market. The existing companies, which have issued shares at Rs.10 and Rs.100, also can avail of this facility by consolidating/splitting their existing shares.

In order to enable the investors to take informed investment decisions, the stock exchanges were directed to indicate the denomination value of shares as fixed by the company along with the market quotation. However, the companies availing of this facility are required to strictly adhere to disclosures and accounting norms.

As a further measure towards rationalization of existing guidelines, the SEBI decided that there would be only one set of disclosures and entry norms for all the issues irrespective of the issue price. Thus, the different requirements for making issues at par and premium were merged to create a common set of requirements.

Marketing initial public offers through the secondary market

To facilitate the process of public offerings, the SEBI introduced the new system viz. 'Online Securities Offer System' which seeks to extend the benefits of on-line trading in the secondary market to the primary market. The system not only uses the existing infrastructure of the exchanges (viz.. terminals, brokers and systems) besides making necessary improvisations in software packages and improved means of connectivity.

- The present primary issue process involves printing of a large number of application forms and dispatching of refund orders and, therefore, leads to increase in cost and time required for the public issues. The new system would reduce the cost and time involved in a public issue process and do away with the blocking of funds of the investors.

Compulsory linking of issuer companies with a depository and compulsory trading by new IPOs

All new IPOs will be compulsorily traded in dematerialised form and guidelines of public issues were modified to make admission to a depository for dematerialization of securities, a pre-requisite for making a public or rights issue or an offer for sale. But the investors have been allowed to exercise option of either subscribing to securities in physical form or dematerialised form.

Disclosure of credit rating

On the basis of recommendations of the Committee set up to frame regulations for Credit Rating Agencies, the following additional requirements for companies issuing debt securities to public/ on rights basis, have been prescribed:

- All companies making public or rights issue of debt instrument (including convertible instrument) irrespective of their maturity/conversion period, shall obtain credit rating by at least one approved credit rating agency and disclose it in the offer document.
- Where credit rating is obtained from more than one approved credit rating agency, all the credit ratings, including the unaccepted ratings, shall be disclosed.
- The issuer shall give an undertaking in the offer document stating that they would give necessary co-operation to the credit rating agency (s) in providing true and adequate information till the debt obligations in respect of the securities are outstanding

Association of stock exchange personnel in allotment

In order to improve the sanctity of the allotment procedure for public issues it was decided that Executive Director/Managing Director of the regional stock exchange along with the post issue lead merchant banker and the registrar to the issue, shall be responsible to ensure that the basis of allotment is finalized in a fair and proper manner.

Lock in of pre-issue capital

The practice of issuing shares at a price below the public issue price prior to the public issue, prima facie, gives a price advantage to such allottees. In order to discourage such practice, especially in view of high premiums to the issue price at which information technology stocks were being listed, it was decided to lock the entire pre- issue capital in case an allotment was made in above manner.

Disclosure and investor protection guidelines

The Disclosure and Investor Protection Guidelines of SEBI were amended to provide for enhanced investor protection.

- The appraising agency would bring in the required contribution at least one day before the opening of the issue.
- The promoters contribution has been made uniform at 20 per cent irrespective of the issue size.
- Only such securities have to be offered for promoters contribution for which a specific written consent has been obtained from the shareholders for lock-in.
- Mandatory provision made for appointment of registrar for rights issues.

Malegam committee for disclosures in offer documents

A Committee was set up under the Chairmanship of Shri. YH Malegam to review the prevailing disclosure requirements in offer documents for public and rights issues and to recommend additions / modifications thereof in pursuance of SEBI's objectives for investor protection, promotion and development of transparent securities market.

Modifications in eligibility requirements for information technology companies

Companies in the information technology sectors submitted that in view of the factors like high valuation enjoyed by these companies coupled with low capital requirements, importance of employee stock options (as employees are the main asset for these companies) and attractiveness of ADR route for listing on overseas stock exchange with capital dilution as low as 10 per cent , they may be granted relaxation from requirement to offer to the public at least 25 per cent of the securities issued for the purpose of listing.

In view of the fact that accumulation of excess capital by these companies would result in unproductive utilization and crowd out the other industries in need of capital, it was decided to allow these companies to list their shares by making a public offer of 10 per cent of the post

issue capital instead of 25 per cent, subject to requirements of issue of minimum number of securities and a specified minimum issue size.

A concern had arisen about the misuse of high valuation of IT industry by some unscrupulous promoters who may charge unreasonably high premiums from the investors. It was, therefore, thought necessary to stop the access to public funds by such promoters so that the interest of genuine promoters is protected.

Thus, in continuation of efforts to ensure that the offer document contains adequate disclosures to enable the investors to make an informed investment decision, additional disclosure requirements were stipulated for companies which changed their names in the recent past to give an impression of being into information technology.

To encourage only genuine information technology companies to be eligible to make initial public offer and to raise capital from public and to protect the interest of investors, it was stipulated that unlisted companies in the information technology industry should have a track record of distributable profits in three out of five years from the information technology activities. If a company fails to fulfil this criterion, it can access the market through the alternative route of appraisal and financing by a bank or financial institution. The same conditions would apply to a listed company also which has changed its name to reflect the activities in information technology.

Amendments of book building guidelines

Book building is a price discovery mechanism used by the corporates issuing securities, to discover the price of their securities. The mechanism also helps the small investors to subscribe to securities at a price, which is arrived at by a transparent process. The importance of this mechanism was recognized by the SEBI and book-building guidelines were introduced in 1995. However, while book building became an accepted practice in the market for private placement of debt securities, it remained absent in the public issue market despite the regulatory framework being in place.

This year saw the book building exercise being conducted for the first time for initial public offering as during the year five initial public offers were made using the book building route. The practice of book building is comparatively new to the Indian capital market and the procedure is still evolving. On the basis of feed back from the market intermediaries, some areas of existing framework were identified for modification in order to improve the existing mechanism. The SEBI Board approved these modifications in October 1999. Under the modified guidelines an issuer has been given the option to book build either 90 per cent of the net offer to the public or 75 per cent of the net offer to the public. The balance issue is offered to the public at the fixed price determined through book-building exercise. The book-building mechanism is designed keeping in view the international practices and procedures for book building (Box 1.2).

Box 1.2 : Modified features of the book building framework

- **Additional disclosures with respect to the scheme to make up the deficit through book building in financing and the pattern of deployment of excess funds, shall be made in the offer document.**
- **Allotment in the book built portion may take place before that in the fixed price portion**
- **Excess subscription in fixed price portion can be spilt to book built portion reserved for allocation to individual investors bidding for upto 10 tradable lots, to the extent of short fall in the latter**
- **In the 75 per cent book building scheme the allotment in the book built portion should be in dematerialised mode only**

The Accounting Standards Committee, was set up by the SEBI as Standing Committee under the Chairmanship of Shri Y H Malegam, to inter-alia review the continuous disclosures requirements under the listing agreement for the listed companies and provide inputs to Institute of Chartered Accountant of India (ICAI) for evolving new accounting standards and review the existing ones, wherever required in order to make disclosure standards and accounting practices at par with the international practices.

Major recommendations of the Committee that have been implemented by the SEBI are given below :

- With a view to make the unaudited financial quarterly results of the companies more transparent and meaningful, certain additional disclosure norms have been prescribed and also half yearly results have been subjected to a 'Limited Review' by the Auditors with effect from half year ending March 31, 2000.
- In order to harmonize the disclosure requirements under the Listing Agreement and the Accounting Standards issued by Institute of Chartered Accountants of India (ICAI), it has been prescribed that the Cash Flow Statement being disclosed by the companies in terms of Listing Agreement, be prepared in accordance with the relevant Accounting Standard.
- In order to avoid excessive volatility in stock prices due to announcements of dividends, rights, bonus etc., during the market hour, it has been prescribed that such announcements be made outside the market hours.
- The Committee has emphasized the need for formulation of accounting standards on Consolidation of Accounts, Segmental Reporting, Deferred Taxation and Related Party Disclosures and has urged the ICAI to expedite the issue of Accounting Standards on the above.

Employee stock options scheme

The SEBI had issued guidelines on employee stock options in 1992 and modified them further in 1995. In view of the phenomenal growth in the knowledge-based industries, it

was felt that there is a need to review the guidelines to suit the changed environment. As such a Committee was set up under the chairmanship of J.R. Varma to make recommendations and to frame the guidelines for Employee Stock Options and Stock Purchase Scheme. The guidelines were framed on the basic principles of complete disclosure and shareholder approval. The framework for employees stock option has been designed to give maximum flexibility to the corporates to formulate schemes keeping in mind the objectives of such a scheme subject to their following these basic tenets.

Box 1.3 : Guidelines on Employee Stock Options Scheme

- The ESOS/ESPS would mean the scheme under which a company grants option to employees and offers shares to its employees as part of public issue or otherwise.
- The employees have been given flexibility of exercising their option during the exercise period and to exercise option in accordance with the ESOS. The companies can offer equity shares and securities convertible into equity shares. The scheme includes American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) or other Depository Receipts representing underlying equity shares or securities convertible into equity shares.

- The company has the freedom to determine the exercise price or pricing formula.
- The employees have been given option to avail of such right but not an obligation to apply for shares of the company at a predetermined price.
- The employees can exercise the time period granted to them as a matter of their right to apply for shares against the option vested with them in accordance with the guidelines under ESOS.
- The right of option vested with the employees can lapse in case of termination of employment for misconduct.
- The ESOS can be offered to employees of the company provided the shareholders of the company approve the proposal by passing a special resolution in general meeting.
- There shall be a minimum period of one year between the grant of option and vesting of options. The company shall have the freedom to specify the lock-in period for the shares issued in accordance with the provisions of ESOS.
- The employee shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to him till shares are issued on exercise of option.
- Option granted to an employee shall not be transferable to any person. The option granted to the employee shall not be pledged, hypothecated or mortgaged.
- In respect of options granted under ESOS during any accounting period, the accounting value of the option shall be treated as another form of employee compensation in the financial statement of the company.
- The accounting value of options shall be equal to the aggregate, over all employee stock options granted during the accounting period, of the fair value of the option.