

Review of certain provisions related to Superior Voting Rights Shares Framework

1. Objective

This memorandum seeks approval of the Board to modify the framework relating to superior voting rights shares contained in the SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2018 (“ICDR Regulations”).

2. Background

- 2.1. SEBI introduced superior voting rights framework specifically for issuer companies intensive in use of technology by amending the ICDR Regulations in 2019. The introduction of Superior Voting Rights (SR) shares was guided by the premise that new-age tech companies are generally asset light in nature and such companies have raised capital over the years through dilution of holding of the promoters/ founders. In such new technology firms, the promoter/ founders are instrumental in the success of the firms. It is therefore argued that there is a need for a structure to enable them to retain decision-making powers and rights vis-à-vis other shareholders such as financial/ economic investors, who are interested only in returns/ economic value of their investments.
- 2.2. The existing framework in Chapter II of the ICDR Regulations allows promoters/ founders in such companies to hold SR shares subject to SR shareholder, holding an executive position in the issuer company and not being part of promoter group having net worth more than Rs. 500 crores. Certain other conditions have also been prescribed such as the ratio of voting rights, the manner of issuance of SR shares etc.
- 2.3. The framework also has other checks and balances such as coat tail provisions- i.e. matters in which SR shares shall have the same rights as that of ordinary shares and sunset clause i.e. time period until which such an SR shareholder shall enjoy superior voting rights.

2.4. Issuer companies have so far not utilized the SR shares framework. Based on interaction with market participants, it was gathered that some of the provisions of the framework are cumbersome and not conducive. These relate specifically to the eligibility requirements. At present, under Regulation 6(3) of the ICDR Regulations, a company having SR shareholders is permitted to do an initial public offering (IPO) of ordinary shares subject to certain conditions. The market participants have sought review of the following two conditions:

- The SR shareholder shall not be part of the promoter group whose collective net worth is more than Rs 500 Crores.
- SR shares should have been held for a period of atleast 6 months prior to the filing of Red Herring Prospectus (RHP)

2.5. Further, it has been suggested that SR shares may be permitted to be issued to Trusts/ holding companies/ other entities.

2.6. PMAC deliberated the matter and advised that a public consultation may be carried out. Accordingly, a consultation paper (**Annexure I**) was published on the website of SEBI on July 01, 2021 seeking public comments.

2.7. Comments have been received from 07 entities including Law Firms, Auditors, Academician, Merchant Banker and Corporate. All of them have supported the proposals. Further, some commentators have made additional suggestions as well. The comments relevant to the consultation paper have been analyzed and tabulated at **Annexure-II**. The following paragraphs (3-5) delve into the recommendations of PMAC, public comments, analysis thereof, and proposals for consideration of the board.

3. Net-worth requirements on superior voting rights (SR) shareholders

3.1. Existing Provisions

- i. Regulation 6(3)(ii) of the ICDR regulations mandates that an SR shareholder shall not be part of promoter group whose collective net

worth is more than rupees 500 crores. An explanation to the regulation states that for the purpose of determining the collective net-worth, the investment of SR shareholder in the shares of the issuer company shall not be considered.

- ii. Primary Market Advisory Committee (PMAC) deliberated the matter and considered revising the net-worth test of SR shareholder to be applied on an individual basis rather than the collective (promoter group) basis. The PMAC also considered enhancing the threshold for such net-worth requirement and excluding proceeds of sale of shares of the issuer company by an SR shareholder for the purpose of determining net-worth. Public comments were sought on the following points:
 - a. Whether the net-worth requirement for SR shareholder be determined individually or as part of promoter group?
 - b. Whether the net-worth threshold for SR shareholder should be retained at Rs 500 crores or enhanced? If it is to be enhanced, what should be the new threshold?
 - c. Whether the proceeds from sale of shares of the issuer company should be excluded while determining the net-worth?

Public Comments

- iii. Most of the commentators have broadly agreed that net worth threshold of Rs 500 crore should be enhanced and that proceeds from sale of shares of the issuer should be excluded for determination of such net-worth. Some commentators have suggested that the net-worth requirement for SR shareholder be determined individually and that it should not be combined with the group. Further, one commentator has suggested that net-worth may consider investments in “listed company”. One commentator has raised concern regarding challenges faced by merchant bankers in computation and certifying net-worth.

3.2. PMAC Recommendations pursuant to public comments

PMAC observed that the current threshold of Rs. 500 cr. may be enhanced. It further observed that the current requirement of including promoter group for computing net worth requirement is onerous as the promoter group definition is wide and includes relatives. In respect of treatment of proceeds from sale of shares of the issuer company, PMAC observed that one of the rationales for providing SR shares to promoter/ founder holding executive position was to ensure that such persons retain control on decision-making powers and rights vis-à-vis other shareholders as they have been instrumental in the success of the firms. Thus, any wilful dilution should be considered for computation of net-worth. Accordingly, PMAC has recommended the following:

- i. To determine the eligibility of SR shareholders, the net-worth requirements shall be computed on individual basis.
- ii. An SR shareholder should not have a net-worth exceeding INR 1000 Crs.
- iii. For the purpose of computation of net-worth, the existing criteria of excluding investments in the issuer company shall continue. However investments in other listed companies shall be considered for the computation of net-worth.
- iv. Valuation of net worth shall be done by a registered valuer.

3.3. Proposal

Based on recommendations of the PMAC after public comments, the following changes are recommended in the differential voting rights framework in the ICDR Regulations

- i. An SR shareholder should not have a net-worth exceeding INR 1000 crs
- ii. The net-worth requirements shall be computed on individual basis.

- iii. For the purpose of computation of net-worth, the existing criteria of excluding investments in the issuer company shall continue, however investments in other listed companies shall be included.
- iv. Valuation of such a net worth shall be done by a registered valuer.

4. Timing of issuance of SR shares

4.1. Existing Provision

- i. Regulation 6(3)(v) of the ICDR regulations mandates that SR shares are to be held for a period of atleast 6 months prior to filing of the red herring prospectus (RHP).
- ii. PMAC deliberated the matter and advised that public consultation may be sought on “Whether the requirement of holding SR shares for a period of 6 months prior to the date of RHP should be deleted”

Public Comments

- iii. Majority of the commentators have suggested that the provision may be retained. It is argued that deleting the provision may put retail investors at a disadvantage, as they may not have the opportunity to study the impact of SR shares on the company, corporate governance and its capital structure if they are issued too close to the IPO.

4.2. PMAC Recommendations pursuant to public comments

PMAC deliberated the comments received in the matter. Comments were also received from PMAC member subsequent to the PMAC meeting highlighting the need to reconsider the requirement of holding SR shares for a period of 6 months prior to RHP. The rationale for the same is as follows:

- i. It is observed that in the case of new age tech companies, the capital structure prior to filing of draft red herring prospectus (DRHP) comprises of equity, and convertibles. Further, there is also a need

for bonus/ split. Convertibles are also required to be converted into equity before the IPO. Thus, all capital structuring decisions are taken closer to the IPO.

- ii. PMAC observed that having SR shares 2-3 months ahead of the DRHP/ RHP will have no bearing on the decision of investors to invest in the company.
- iii. Reducing the time period will help issuers in accessing the capital markets effectively.

Accordingly, PMAC has recommended that the existing requirement of holding SR shares atleast 6 months prior to RHP may be reduced to 3 months.

4.3. Proposal

It is proposed that SR shares shall be issued prior to the filing of draft red herring prospectus and shall be held for a period of atleast 3 months prior to the filing of the red herring prospectus.

5. Issuance of SR shares to trusts/ entities on behalf of founders/ promoters in executive position

5.1. Existing Provision

- i. Regulation 6(3)(iii) of the ICDR regulations mandates that SR shares are issued only to the promoters/ founders who hold an executive position in the issuer company.
- ii. PMAC deliberated the matter and advised that public consultation may be sought on “Whether holding companies/ registered family trust/ partnerships where promoters/ founders are in control or sole trustees, can also be permitted to hold SR shares as long as such promoters/ founders/ trustee continue to hold executive positions in the issuer company?”

Public Comments

- iii. Majority of the commentators have suggested that such structuring should be permitted with certain caveats such as ultimate beneficiary is SR shareholder itself, there is permanence of 'control' for period of holding SR shares through irrevocable trust structure, there should be restriction on layering of trust and holding vehicles, appropriate disclosure of ownership, beneficiaries etc.
- iv. Some commentators have argued that such structure raises concerns as vehicles/ trusts may have ineligible non-SR shareholders as beneficiaries or as shareholders.

5.2. PMAC Recommendations pursuant to public comments

- i. PMAC concurred that while such structures may be suitable from a tax perspective for an SR shareholder, significant amount of checks and monitoring would be required to ensure that non-SR shareholders do not gain any benefit. Further, the benefits of SR shares are only temporary in nature, with a maximum validity of 5 years upon listing extendable by another 5 years subject to shareholders approval. Considering that trust structures may not be very transparent, PMAC recommended that the current provision may be retained.

5.3. Proposal

In view of recommendations of PMAC, it is proposed that the existing provision mandating issuance of SR shares only to individuals may be retained.

6. Proposal

- 6.1. The Board is requested to consider and approve the proposals at para 3.3, 4.3 and 5.3 above and related amendments to SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2018, and authorize the Chairman to take consequential and incidental steps to give effect to the decisions of the Board.

Annexure I

(Consultation paper available on SEBI website)

Annexure II

(This has been excised for reasons of confidentiality)

Annexure III

(This shall be notified at a later date)