

**CHAPTER 2**

## SEBI reviews regulatory framework of promoter, promoter group and group companies

**This article aims to:**

Summarise SEBI's proposals on matters relating to promoter and promoter group including rationalisation of definitions and disclosures by group companies under the SEBI ICDR Regulations.

**Introduction**

The Securities and Exchange Board of India (SEBI) (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations) lay down guiding principles for various kinds of issues by a company including public and rights issue. It also provides detailed provisions governing minimum promoter's contribution, lock-in of specified securities held by promoters and disclosure of transactions of the promoters, promoter group and group companies.

In May 2019, Primary Markets Advisory Committee (PMAC) of SEBI had constituted a subgroup to examine the relevance of 'concept of promoter' in the context of Indian securities market. The subgroup held extensive deliberations with various stakeholders and also did a study of various international jurisdictions, where concept of 'controlling shareholder' is used rather than the term 'promoter'.

Based on the recommendations of the subgroup, recently SEBI has issued a

consultation paper and proposed amendments to be made under the ICDR Regulations including rationalisation of definition of promoter group and streamlining disclosures of group companies.

It also seeks views on the need to shift the concept of promoter and promoter group to 'person in control' or 'controlling shareholders' and 'persons acting in concert'.

Additionally, SEBI has proposed changes to the provisions relating to lock-in periods for minimum promoter's contribution and other shareholders for public issuance on the main board.

**Overview of the proposals**

The proposals in the consultation paper relate to the following topics:

- **Rationalisation of definition of 'promoter group':** Currently, Regulation 2(1)(pp) of the ICDR Regulations define promoter group to, *inter alia*, include:
  - a. The promoter.
  - b. An immediate relative of the promoter.
  - c. In case promoter is a body corporate then any body corporate in which a group of individuals or companies or combinations thereof acting in concert, which hold 20 per cent or more of the equity share capital in that body corporate and such group of individuals or companies or combinations thereof also holds 20 per cent or more of the equity share capital of the issuer and are also acting in concert.

The present definition of promoter group focusses on capturing holdings by a common group of individuals or persons. However, it has been observed that unrelated companies with common financial investors also get captured in this definition.

As per SEBI, capturing details of holdings by financial investors may not result in any meaningful information to investors. Rather, it is more relevant to identify and disclose related parties and related party transactions post listing of an entity.

### Proposal

SEBI has proposed to do away with the requirement of including entities specified in point (c) above from the definition of promoter group. Accordingly, it proposed to remove point (c) from the definition to give effect to the proposal. The removal is expected to rationalise the disclosure burden and bring it in line with the post listing disclosure requirements.

- **Shift from concept of 'promoter' to concept of 'person in control':** Currently, Regulation 2(1)(oo) of the ICDR Regulations defines 'promoter' to include 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 return referred to in Section 92 of the Companies Act, 2013 (2013 Act)
- Who has control over the affairs of the issuer, directly or indirectly whether as a shareholder, director or otherwise, or
- In accordance with whose advice, directions or instructions the board of directors of the issuer is accustomed to act.

SEBI observed following concerns relating to the present concept of 'promoter':

- Change in nature of ownership of listed companies:** There has been a significant increase in the number of

private equity and institutional investors who invest in companies and take up substantial shareholding, and in some cases control. Also, traditional and family run companies with identified promoters are now increasingly open to merger and acquisition opportunities and exits instead of maintaining a 'once a promoter, always a promoter' status.

The said changes in ownership could lead to situations where the persons with no controlling rights and minority shareholding continue to be classified as a promoter. Such persons may, thereby, have influence over the listed entity disproportionate to their economic interest, which may not be in the interests of all stakeholders.

#### **b. Increased focus on quality of board and management:**

The increased focus on quality of board and management has also reduced the relevance of the concept of promoter. Shareholders now look to the board of directors and management to protect their rights and add value, while discharging their duties.

#### **c. Utility of identification of promoter group:**

The identification and updation of promoter group is required to be done for each promoter of a listed entity which could become challenging over the time, in particular, for large conglomerates. It could

also result in identification of persons who are not involved with the business of the issuer and such information may not be meaningful for investors.

### Proposals

To address the above concerns, SEBI has sought views as to whether the existing concept of promoter and promoter group should continue or there is a need to shift to the concept of 'person in control' or 'controlling shareholders' and 'persons acting in concert', respectively. If so, it seeks views on the timeframe and manner for making such a shift.

In addition to ICDR Regulations, the change if notified would necessitate removal of reference to promoters and promoter group and introduction of concept of person in control or controlling shareholders in various other SEBI Regulations such as SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR), SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (Takeover Regulations) and SEBI (Prohibition of Insider Trading) Regulations, 2015.

It could also have implications on laws administered by other regulators such as the Ministry of Corporate Affairs (MCA), the Reserve Bank of India (RBI) and the Insurance and Regulatory Development Authority of India (IRDAI).

- **Streamlining the disclosures of 'group companies':** In accordance with Regulation 2(t) of ICDR Regulations, the term 'group companies' should include such companies (other than promoter(s) and subsidiary(ies)) with which the issuer company has had related party transactions, during the period for which financial information is disclosed (as covered under the applicable accounting standards) and also other companies as considered material by the board of the issuer.

An issuer is required to make certain disclosures in the offer document with respect to five largest listed group companies<sup>1</sup> for the last three years. Some of the key disclosures are as following:

- Date of incorporation
- Nature of activities
- Equity capital
- Reserves
- Sales
- Profit after tax
- Earnings per share and diluted earnings per share
- Pending litigation involving the group company which has a material impact on the issuer.

1. To be determined on the basis of the market capitalisation one month before the date of filing the offer document and in case of a fast track issue, one month before the reference date.

In case, there are no listed group companies, the financial information has to be given for the five largest unlisted group companies based on turnover.

SEBI observed that financial investors, generally get covered under the definition of group companies on account of investments made and/or dividend paid, etc. despite no other transactions between them and the listed company. Further, entities which are not material also get covered under the present definition. Also, there could be situations where companies may have ceased to be group companies during the last three years, but issuers are required to reach out to such companies and seek their cooperation for providing information.

It is to be further noted that the concept of group companies is not required to be disclosed after listing and there is no reference to this term either in the LODR or the Takeover Regulations. Further, there is a separate requirement to disclose related party transactions in an offer document (including in the financial statements) along with post listing disclosures to be made in accordance with LODR. Accordingly, additional disclosures with regard to group companies might not be required.

### Proposals

SEBI has proposed that only names and registered office address of all the group

companies should be disclosed in the offer document. All other disclosure requirements like financial information of top five listed/unlisted group companies, litigation, etc., presently done in the draft red herring prospectus may not be required to be disclosed. However, these disclosures may continue to be made available on the websites of the listed companies.

- **Reduction in lock-in period for minimum promoters' contribution and other shareholders:**

Currently, following lock-in period has been prescribed under the ICDR Regulations during which promoters and persons other than promoters cannot transfer specified securities held by them:

- Minimum promoters' contribution<sup>2</sup>:* Lock-in period of **three years** from the date of commencement of commercial production or date of allotment in the initial public offer, whichever is later
- Promoters' holding in excess of minimum promoters' contribution:* Lock-in period of **one year** from the date of allotment in the initial public offer.
- Specified securities held by persons other than promoters:* The entire pre-issue capital held by such persons should be locked-in for a period of **one year** from the date of allotment in the initial public offer.

As per SEBI, the specified lock-in period

of three years for minimum promoters' shareholding was required when companies used to raise public capital for project financing/greenfield projects. However, in current times, it observed that the companies that are going public are well established with mature businesses, have pre-existing institutional investors like private equity firms, alternate investment funds, etc. and their promoters have demonstrated 'skin in the game' for several years before proposing listing. Further, greenfield financing through initial public offer has also become non-existent.

Also, in respect of issue size exceeding INR100 crore (excluding the component of offer for sale) an issuer is required to make arrangements for the use of proceeds of the issue to be monitored by a monitoring agency to ensure that the funds mobilised are used for the intended purpose of the objects of the issue.

### Proposals

In accordance with above, SEBI has proposed to revise the lock-in period specified under the ICDR Regulations with respect to following:

- Minimum promoters' contribution:* If the object of the issue involves offer for sale or financing other than for capital expenditure for a project, then minimum promoters' contribution should be locked-in for a period of **one year** from the date of allotment in the initial public offer.

Further, the shares held by promoter(s) would be exempt from lock-in requirements after six months from date of allotment in the IPO, only towards the purpose of achieving compliance with minimum public shareholding norms.

- Promoters' holding in excess of minimum promoters' contribution:* Lock-in period of **six months** from the date of allotment in the IPO has been prescribed.
- Specified securities held by persons other than promoters:* The entire pre-issue capital held by persons other than the promoters should be locked-in for a period of **six months** from the date of allotment in the IPO.

2. At least 20 per cent of the post-issue capital including contribution made by alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with IRDAI.

## Next steps

With the evolving changes in the Indian capital markets, there was a need to revisit some of the existing provisions, most importantly those relating to promoter and promoter group companies. While some of these are aimed at easing restrictions and extent of disclosures related to promoter and promoter group companies, the most fundamental change being proposed is shift from the concept of 'promoter' to 'person in control'.

The proposed reduction in prescribed lock-in period for promoters and other shareholders is expected to be welcomed by the investor community. Further, the proposed rationalisation of disclosures vis-à-vis group companies and promoter group aim to align the current regulations with that of the international practices and ease out the reporting burden being faced by the companies that are in the process of listing. However, these relaxations should be accompanied by a corresponding strengthening of the disclosure requirements around linkages, dependencies and transactions with such entities that are related to the promoter/person in control that are relevant for investors' understanding of a company. This may require a further refinement of the definition of 'related parties'.

Shift in the concept from 'promoter' to 'person in control' seeks to address the recent changes in the organisation structures of companies in India with the extent of promoters' holding in Indian companies showing a decreasing trend. While there is a case for revisiting the concept, the identification of the 'promoter' or 'person in control' still remains relevant in the Indian context considering the extent of promoter holdings. This is evident from the OECD report on 'Ownership structure of Listed Companies in India, 2020'<sup>3</sup> which depicted a downward trend in aggregate shareholdings of promoters in the top 500 listed companies, while still being a very dominant share of holdings (from 58 per cent in 2009 to 50 per cent in 2018). On the other hand, there has been a significant increase in the shareholding of institutional investors in the top 500 listed companies (from approximately 25 per cent in 2009 to 34 per cent in 2018)<sup>3</sup>. There are private equity and other institutional investors that invest in unlisted companies and continue to hold shares post listing, many times being the largest shareholders, having special rights on the listed company, such as the right to nominate directors. On the other hand, many companies these days including new age and technology companies, are

non-family owned and/or do not have a distinctly identifiable promoter group and may have a diverse set of financial investors.

The proposed change is also expected to address situations where persons continue to remain promoters of companies even if they don't hold any controlling rights or have minority shareholding subsequently.

Therefore, the concept of 'person in control' needs to strike the right balance in recognising the various classes of dominant shareholders and bringing a framework that is well suited for all, but most importantly one that is relevant and protects the interests of the investors, including public shareholders. Further, as SEBI seeks to bring in the concept of 'person in control', it would need to provide guidance on what constitutes 'control' in the context of defining 'persons in control', clearly recognising that a majority shareholding may not be required to be considered as a 'person in control'. In this context, SEBI has identified that it would need to harmonise the definitions of control and persons in control under its regulations e.g., LODR, SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and SEBI (Prohibition of Insider Trading) Regulations, 2015. As an extension,

SEBI should also discuss the interplay between definition of control vis-a-vis the concept and definition of control in Ind AS and the Companies Act, 2013.

Comments on the proposals have been invited up to 10 June 2021. Companies should take cognisance of these proposals as once notified, there would be significant shift in their present processes, in particular those relating to classification of promoter and promoter group and resultant disclosures to be made. Consequent changes are also likely to be made in other SEBI regulations including LODR and Takeover Regulations. Companies should watch out for development in this area.

(Source: SEBI 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) Regulations, 2018' dated 11 May 2021)

3. Report on 'Ownership structure of listed companies in India, issued by Organisation for Economic Co-operation and Development (OECD) on 6 July 2020