Corpsec Hotline

July 10, 2013

SEBI NOTIFIES REGULATIONS FOR ISSUE AND LISTING OF NON-CONVERTIBLE REDEEMABLE PREFERENCE SHARES

The Securities and Exchange Board of India ("**SEBI**") vide press release[1] dated June 14, 2013, notified the SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013 ("**NCRPS Regulations**")[2] allowing non-convertible preference shares ("**NCRPS**") as another instrument for public fundraising for Indian companies. Hitherto, optionally convertible preference shares and optionally convertible debentures could be listed under the provisions of the SEBI (Issue of Capital and Disclosure Requirements") Regulations, 2009 ("**ICDR Regulations**"), however, there was no regime for listing of NCRPS.

From a foreign investment perspective, only equity shares and instruments fully and mandatorily convertible into equity could be held by a non-resident under the foreign direct investment ("**FDI**") regime, and since there was no regime for listing of NCRPS, foreign portfolio investment in NCRPS was not possible.

In 2009, SEBI issued the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 ("**Debt Regulations**") with the objective of simplifying debt issuances by Indian companies. Such issuances permitted simplified listing of non-convertible debentures ("**NCDs**"). With dormant equity capital markets, issuers turned to raising debt by way of listed NCDs.[3] Foreign investors received the instrument with enthusiasm as it allowed them assurance of exit and assurance of return without being qualified as ECB (as in case of FDI) and also allowed collateralization benefits. However, NCDs, even though in many cases linked to cash flows, reflected as debt on the books of the issuer and a need was felt to look for alternative forms of raising 'capital'.

Whilst the Reserve Bank of India ("**RBI**") has not yet permitted acquisition of listed NCRPS by foreign investors under the portfolio investment regime, it does seem likely that such permission may be introduced shortly to allow for investment through NCRPS as well. This Hotline is based on the premise that foreign portfolio investment in NCRPS may be allowed eventually and examines the benefits of the NCRPS Regulations issued on private placement basis in such light.

BACKGROUND

The NCRPS Regulations are modeled on the lines of the Debt Regulations as recommended by the Corporate Bonds & Securitization Advisory Committee ("**COBOSAC**"). The COBOSAC recommended that the draft regulations ("**Draft Regulations**") for issue and listing of NCRPS be drafted in line with Debt Regulations, yet with some key differences, in view of the distinctive nature of the instrument. COBOSAC inter-alia recommended[4]: (i) stricter eligibility criteria for making public issuances of NCRPS; (ii) relatively liberal framework for private placement of NCRPS, which is proposed to be listed and such private placement be restricted to institutional investors and high net-worth individuals; and (iii) comprehensive disclosure requirements for both public issuances and private placement. The Draft Regulations proposed by COBOSAC, however underwent several changes before SEBI notified the NCRPS Regulations. In this Hotline, we look at some of these changes and the advantages of NCRPS from an issuer and subscriber perspective and how does the NCRPS regime hold up against the NCD regime from foreign portfolio investment perspective.

Salient Features

- **What is the nature of the instrument?**
  - While some of the accounting principles may consider NCRPS in the nature of debt, the Indian generally accepted accounting principles ("**Indian GAAP**") would consider NCRPS to be a part of shareholders' funds.
  - It may add to the net worth of a company as it is part of the paid-up capital as against debt, which is a liability.
- **Who can issue?**

  The NCRPS Regulations specify that only the following category of companies shall be eligible to issue NCRPS: (i) public company as defined under Section 3[5] of the Companies Act, 1956 ("**Act**"); and (ii) public sector undertaking or statutory corporation, which has its securities listed on any stock exchange or which seeks to list its NCRPS on a recognized stock exchange.

  It is interesting to note that under the Draft Regulations, COBOSAC had recommended that the term 'issuer' shall include "any company, public sector undertaking or statutory corporation", which proposal was in line with the definition provided in the Debt Regulations.
- **Is there a minimum public float required?**

Research Papers

Medical Device Industry in India
April 28, 2025

Clinical Trials and Biomedical Research in India
April 22, 2025

Structuring Platform Investments in India For Foreign Investors
March 31, 2025

Research Articles

2025 Watchlist: Life Sciences Sector India
April 04, 2025

Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?
February 04, 2025

INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals
January 15, 2025

Audio

CCI's Deal Value Test
February 22, 2025

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice
December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps
November 19, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Vyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX

Regulation 19 of the NCRPS Regulations specifies that Rule 19 (1) and Rule 19 (3) of the Securities Contracts Regulation Rules, 1957 ("**SCRR**") shall not apply in case of listing of NCRPS by way of public issue or private placement. However, exemption from Rule 19(2)(b) has not been provided for, even though such exemption was provided for in the Draft Regulations.

Analogous to this, Regulation 22 of the Debt Regulations also grants a relaxation from the strict enforcement of (i) Rule 19(1) and 19(3) of the SCRR; and (ii) Rule 19 (2)(b) of the SCRR[6] in respect of listing of debt securities issued by way of private placement and public issue by an infrastructure company, a government company, a statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in the infrastructure sector.

In the absence of a specific exemption granted under the NCRPS Regulations in relation to applicability of Rule 19(2)(b) of the SCRR, it could mean that without a minimum public float of 25% of the issuer's securities, the issuer will not be permitted to list its NCRPS on any stock exchange. Though we understand that SEBI has been steadfast in its stance of enforcing the minimum public shareholding requirement and has already penalized several companies which have been in breach of the norm[7], by not providing issuer companies under the NCRPS Regulations an exemption from Rule 19(2) (b) can severely hamper the ability of unlisted issuer companies to issue and list the NCPRS.

- **Issue and Listing of PNCPS and PDIs by banks**

In order to enable the banks to meet the capital adequacy norms as prescribed under the Basel III[8]norms, SEBI has extended the applicability of the NCRPS Regulations to the issue and listing of perpetual non-cumulative preference shares ("**PNCPS**") and perpetual debt instruments ("**PDIs**") by banks. The Basel III norms which aim to improve the quality, quantity and transparency of regulatory capital issued by banks, requires all classes of instruments, especially the non-equity regulatory capital instruments of a bank (in Tier I Capital) should be capable of fully absorbing loss either by capable of being written off or be converted into common equity at the point of non-viability of the bank.

Some of the specific criteria for inclusion of PNCPS and PDIs in Tier I Capital are as follows:

- PNCPS and PDI shall be perpetual, i.e. there is no maturity date and there are no step-ups or other incentives to redeem;
- PNCPS and PDI shall be issued by banks only and not by any SPV etc. set up by the bank and shall be fully paid-up;
- While complying with minimum Tier 1 of 7% of risk weighted assets, a bank cannot admit PNCPS together with PDI in Additional Tier 1 Capital, more than 1.5% of risk weighted assets;
- PNCPS and PDIs shall not be issued with a 'put option', but banks may issue the instruments with a call option at a particular date subject to prescribed conditions;
- The bank must have full discretion at all times to cancel distributions/payments of dividends.
- The dividend shall not be cumulative.

Further in case of PNCPS, claims of the investors shall be:

- Superior to the claims of investors in equity shares;
- Subordinated to the claims of PDIs, all Tier 2 regulatory capital instruments, depositors and general creditors of the bank; and
- Neither secured nor covered by a guarantee of the issuer nor related entity or other arrangement that legally or economically enhances the seniority of the claim vis-Г-vis bank creditors.

In case of PDIs, the claims of the investors in instruments shall be:

- Superior to the claims of investors in equity shares and PNCPS;
- Subordinated to the claims of depositors, general creditors and subordinated debt of the bank;
- Neither secured nor covered by a guarantee of the issuer nor related entity or other arrangement that legally or economically enhances the seniority of the claim vis-Г-vis bank creditors

- **Issue of NCRPS by non-banking financial companies ("NBFCs")**

As per the provisions of the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 ("**Prudential Norms**"), every non-banking financial company is required to maintain a capital adequacy ratio consisting of Tier I[9] and Tier II[10]capital which shall not be less than 15% of its aggregate risk weighted assets on the balance sheet and of risk adjusted value of off-balance sheet items.

NCRPS does not fall into the category of Tier I Capital because the definition of 'owned funds'[11] as prescribed thereunder includes only equity shares and compulsorily convertible preference shares ("**CCPS**"). However the definition of Tier II capital includes inter alia preference shares other than those which are compulsorily convertible into equity and hybrid debt instruments.

With the inclusion of NCRPS in the Tier II capital, non-banking finance companies may find it relatively easier to comply with the capital adequacy ratio as prescribed under the Prudential Norms. However, it needs to be ensured that Tier II capital does not exceed Tier I capital. This is applicable only to systemically important NBFCs.

- **End-use restriction**

Similar to the restriction contained under the Debt Regulations, SEBI has vide Regulation 4(4) of the NCRPS Regulations mandated a significant end-use restriction by specifying that NCRPS shall not be issued for the purpose of providing loan to or acquisition of shares of any person who is part of the same group or who is under

April 01, 2025

Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business

March 19, 2025

SIAC 2025 Rules: Key changes & Implications

February 18, 2025

the same management, other than to subsidiaries of the issuer. Unlike in the case of privately placed NCDs, SEBI has placed this end-use restriction on privately placed NCRPS also.

This provision seeks to impair the ability of issuer companies to use the funds raised through NCRPS for lending it to promoters/ promoter group companies unless such borrower entities are subsidiaries of the issuer.

- **Listing of NCRPS**

The listing of NCRPS, issued on a private placement basis on a recognized stock exchange has to adhere to certain prescribed conditions, some of which are as follows: (i) compliance with the provisions of the Act; (ii) credit rating for the NCRPS proposed to be listed, from at least one credit rating agency registered with SEBI and all ratings, including the unaccepted ratings to be disclosed in the offer document; (iii) prescribed set of disclosures to be made appropriately; (iv) minimum application size for each investor in a private placement shall be at least INR 10,00,000; (v) creation of a capital redemption reserve in accordance with the provisions of Section 77A of the Act.

The NCRPS Regulations have prescribed a detailed set of disclosures to be made by the issuer companies seeking listing of NCRPS which inter-alia include: (i) summary of business activities of the issuer in a particular prescribed format; (ii) details regarding shareholding, directors, promoters and borrowings of the issuer; (iii) any material event/ development or change having implications on the financials/credit quality which may affect the issue or the investor's decision to invest / continue to invest in the NCRPS.

ANALYSIS

As indicated earlier, NCRPS serves as an alternative mode of investment besides equity, debt, and compulsorily convertible instruments such as CCPS. Since NCRPS Regulations are largely modeled around the Debt Regulations, table below comparing NCRPS with NCDs issued on private placement basis may be helpful to evaluate on the choice of fundraising instrument.

Particulars	**NCRPS**[12]	**NCD**
Basic Character	Part of share capital. Forms part of net-worth.	Debt product. Does not form part of capital.
Returns	Dividends or redemption. Dividends must be paid out of distributable profits. Redemption may be out of distributable profits, proceeds of fresh issue of shares made for the purpose of redemption. Redemption premium shall be paid out of securities premium account.	Interest or redemption is not dependent on profits.
Who can issue and list	Any "public company", PSU or statutory corporation can issue or propose to issue, or seek to list its NCRPS on a recognized stock exchange.	Any company.
Limits to payment	No limit on dividends	No limit on interest
Tax treatment for issuer	Dividend or redemption will not be a tax deductible expense for the issuer.	Both interest and redemption premium may be a tax deductible expense for the issuer.
Tax treatment on distribution of dividend/ interest	Subject to additional dividend distribution tax of 15%.	Interest expense is deductible at the hands of Indian company. Withholding tax of 40% (5% until June '15) as reduced under tax avoidance agreements.
Tax treatment at the hands of investor	- Dividends are tax free at the hands of the recipient. - Redemption premium classified as capital gains. As a result, capital gains tax on redemption premium may be reduced to 0% under Singapore, Mauritius, Cyprus or similar jurisdictions under the relevant double taxation avoidance agreement ("**DTAA**"). - Redemption premium classified as capital gains. As a result, capital gains tax on redemption premium may be reduced to 0% under Singapore, Mauritius, Cyprus or similar jurisdictions under the relevant double taxation avoidance agreement ("**DTAA**").	- Interest/ redemption premium likely to be qualified as interest and subject to a withholding tax of 40% as reduced to 5% if held by foreign institutional investor ("**FII**") or qualified financial investor ("**QFI**") until June 2015. - Tax rates may be reduced subject to applicable DTAA. 15% in case of Singapore or 10% in case of Cyprus. - In case of an Indian resident, interest income and redemption premium received may be taxed at 30%. - For non-resident, interest is taxable in the respective jurisdiction as business income or other income.
Deemed dividend	Redemption premium may be classified as deemed dividend to the extent of accumulated profits.	No risk of deemed dividend.
Liquidation preference	Subordinated to NCDs, senior to equity.	Senior to NCRPS and equity.
Benefits from a NBFC perspective	NCRPS shall form part of Tier II capital.	NCDs may not qualify as Tier II capital if not classified as subordinated debt.

- Nikhil Joseph, Harshita Srivastava & Ruchir Sinha
You can direct your queries or comments to the authors

[1] The SEBI press release can be accessed here.

[2] The full text of the NCRPS Regulations can be accessed here.

[3] For details, please refer to our research paper titled Private Equity and Debt in Real Estate.

[4] Draft Regulations for Issuance and Listing of Non-Convertible Redeemable Preference Shares, accessible here.

[5] Section 3(1) (iv) of the Companies Act, 1956 defines the term 'public company' to mean a company which (a) is not a private company; (b) has a minimum paid up capital of INR 5,00,000 or such higher paid up capital, as may be prescribed; (c) is a private company which is a subsidiary of a company which is not a private company.

[6] Rule 19(2)(b) of SCRR:

(i) At least twenty five per cent of each class or kind of equity shares or debentures convertible into equity shares issued by the company was offered and allotted to public in terms of an offer document; or

(ii) At least ten per cent of each class or kind of equity shares or debentures convertible into equity shares issued by the company was offered and allotted to public in terms of an offer document if the post issue capital of the company calculated at offer price is more than four thousand crore rupees:

Provided that the requirement of post issue capital being more than INR 4,000 crore shall not apply to a company whose draft offer document is pending with the Securities and Exchange Board of India on or before the commencement of the Securities Contracts (Regulation) (Amendment) Rules, 2010, if it satisfies the conditions prescribed in clause (b) of sub-rule 2 of rule 19 of the Securities Contracts (Regulation) Rules, 1956 as existed prior to the date of such commencement:

Provided further that the company, referred to in sub clause (ii), shall increase its public shareholding to at least twenty five per cent, within a period of three years from the date of listing of the securities, in the manner specified by the Securities and Exchange Board of India.

[7] Please refer to our detailed hotline on this subject 'SEBI walks the talk on minimum public shareholding'.

[8] "Basel III" is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector. These measures aim to: (i) improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, (ii) improve risk management and governance, (iii) strengthen banks' transparency and disclosures. Please refer to the following link for details: http://www.bis.org/bcbs/basel3.htm.

[9] Section 2 (1) (xix) of the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 defines the term 'Tier I Capital' to mean owned funds as reduced by investment in shares of other non-banking financial companies and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, 10% of the owned funds.

[10] Section 2 (1) (xix) of the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 defines the term 'Tier II Capital' to mean (a) preference shares other than those which are compulsorily convertible into equity, (b) revaluation reserves, (c) (d) hybrid debt capital instruments, (e) subordinated debt.

[11] Section 2(1) (xiv) of the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 defines the term 'owned funds' to mean paid up equity capital, preference shares which are compulsorily convertible into equity, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, as reduced by accumulated loss balance, book value of intangible assets and deferred revenue expenditure, if any.

[12] Comparison table has been made on the assumption that NCRPS may be allowed by RBI to be subscribed to under the portfolio investment regime.

[13] Short-term capital gains tax of 15% under the provisions of Section 111A of the Income Tax Act, 1961 apply only where the total income of an assessee chargeable under the head capital gains arising from the transfer of short-term capital asset, being an equity share in a company or a unit of an equity-oriented fund. This may be amended in Finance Act, 2014.