Discussion paper on review of buy-back of securities

1. Objective

1.1. The objective of this discussion paper is to seek comments / views from the public on suggestions relating to review of conditions for buy-back of securities.

2. Background

2.1. The following regulatory provisions govern buy-back of securities (including equity shares):

i. The Companies Act, 2013 (previously The Companies Act, 1956)

ii. Securities and Exchange Board of India (Buy-back of Securities) Regulations, 2018 (previously Securities and Exchange Board of India (Buy back of Securities) Regulations, 1998).

2.2. The main conditions for buy-back of securities, wherein financial statements of the company are to be considered, are:

i. The buyback offer size cannot exceed 25% of the aggregate of paid-up capital and free reserves of the company;

ii. The buy-back has to be approved through Board Resolution in all cases. Further, if the buyback offer size is more than 10%, approval of shareholders by way of special resolution is required.

iii. The buy-back of securities is permitted only if the ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and free reserves, provided that if a higher ratio has been specified under the Companies Act, 2013, the same shall prevail.

iv. The relevant sections of The Companies Act, 2013 and regulations of Securities and Exchange Board of India (Buy-back of Securities) Regulations, 2018 (Buyback Regulations) have been brought out at **Annexure I**.

2.3. SEBI has taken a view that the financial statements would be considered on a conservative basis (i.e. both standalone and consolidated basis) for evaluating the various thresholds / conditions of buy-back of securities, mainly for the following reasons:

i. The consolidated financial statements are presented by a parent (also known as holding enterprise) to provide financial information about the economic activities of its group. These statements are intended to present financial information about a parent and its subsidiaries) as a single economic entity to show the economic resources controlled by the group, the obligations of the group and results the group achieves with its resources.[1]

ii. There is a concern that much of the activities of the subsidiaries are not available in the public domain. It is possible that the subsidiaries of a listed company would be having large amount of debts. The consolidated financial statement allows the investors to get a complete overview of the parent company.

iii. The subsidiaries could be either a listed company or an unlisted company. SEBI would have very limited role in case of unlisted subsidiaries.

iv. Therefore, it would not be prudent to exclude the debts of the subsidiaries and consider only the standalone financials while evaluating the size of the buyback or the debt to paid-up capital and free reserves ratio for the

[1] Accounting Standard (AS) 21

purpose of meeting the conditions for buybacks.

v. In case of IPOs also, the profitability and other financial statements are considered on a consolidated basis as per SEBI (ICDR) Regulations, 2018.

vi. Further, the SEBI Committee on corporate governance (Kotak Committee) was formed on June 2, 2017 under the Chairmanship of Mr. Uday Kotak with the aim of improving standards of corporate governance of listed companies in India. The Kotak Committee submitted its recommendations in October 2017. The Kotak Committee in its report recommended that consolidated financial results should be made mandatory for listed entities. The relevant extract from the Kotak Committee report is as follows:

"<u>Consolidated financial results:</u> Currently, the Companies Act and SEBI LODR Regulations mandate the submission of consolidated financial statements by a listed entity every financial year. However, SEBI LODR Regulations do not mandate that a listed entity submit consolidated financial results on a quarterly basis. In the interest of greater transparency at the group level, it is recommended that that disclosure of consolidated financial statements should be made mandatory for all listed entities on a quarterly basis. It is also clarified that standalone results shall continue to be required to be published. The Committee also believes that in due course, SEBI may, based on experience gained, consider requiring only consolidated accounts to be published."

vii. Accordingly, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 have been amended and w.e.f. April 01, 2019, all the listed companies having subsidiaries are required to submit quarterly/year-to-date consolidated financial results.

viii. Considering that the consolidated financials present the aggregate information of the company/ group which is material for decision making, SEBI believes that it is in the interest of investors that the stipulated thresholds/ conditions (mentioned at 2.2 above) are better evaluated based on standalone as well as consolidated financials, wherever consolidated financials are required to be prepared.

2.4. In the recent times, several issues have been raised with regard to considering financial statements for the purpose of meeting the conditions of buybacks, including the following:

i. Section 68(2)(d) of The Companies Act, 2013 as well as rules made thereunder do not specifically provide for consideration of standalone or consolidated financials for determining the requirement of debt to capital & free reserves ratio.

ii. The subsidiaries of a company could be Non-Banking Financial Companies (NBFCs), Housing Finance Companies (HFCs) and Infrastructure Companies. Such subsidiaries that would be having higher debts because of the nature of their businesses in which they operate. For example, Reserve Bank of India (RBI) allows leverage of 7:1 for non-deposit-taking NBFCs (NBFCs-ND) with assets less than Rs. 500 crores.

3. Issue

3.1. Whether SEBI should consider a different approach if the subsidiaries of a listed company proposing buybacks are NBFCs, HFCs and Infrastructure companies?

4. Proposal

4.1. Ministry of Corporate Affairs (MCA) has vide notification dated March 10, 2016 already permitted government companies that carry on Non-banking Finance Institution activities and Housing Finance activities coming out with buy-backs to have a debt to capital and free reserves ratio post buy-back of its shares of not more than 6:1.

4.2. The proviso to Regulation 4(ii) of Buyback Regulations already provides that – *"Provided that if a higher ratio of the debt to capital and free reserves for the company has been notified under the Companies Act, 2013, the same shall prevail."* Therefore, debt to capital and free reserves ratio of 6:1 is applicable for such government companies coming out with buyback in terms of Companies Act, 2013 and Buyback Regulations.

4.3. It is being argued that similar approach could be considered if the subsidiaries of a listed company coming out with buy-back are NBFCs, HFCs and Infrastructure companies.

4.4. The Primary Markets Advisory Committee (PMAC) of SEBI discussed the issue and suggested the following approach with respect to meeting conditions for buy-back for companies having NBFCs and HFCs as subsidiaries:

i. Post buyback debt to capital and free reserves ratio of 2:1 (except for companies for which higher ratio of the debt to capital and free reserves for the company has been notified under the Companies Act, 2013) to be considered on consolidated basis, excluding subsidiaries only if the subsidiaries are regulated and have issuances with AAA ratings;

ii. Such subsidiaries should have debt to equity ratio of not more than 5:1 on standalone basis.

4.5. Further, PMAC suggested that infrastructure companies are not separately regulated and have better use of money and therefore no such exclusion may be considered for infrastructure companies.

5. Public comments

5.1. Comments from public are invited on the above proposal in the following format:

Name of entity / person			
Sr. No.	Reference Para of the discussion paper	Suggestion / Comments	Rationale

The comments may be sent by email to buyback@sebi.gov.in or sent by post at the following address latest by June 12, 2019:

Mr. Rajesh Gujjar
General Manager
Corporation Finance Department
Securities and Exchange Board of India
SEBI Bhavan
Plot No. C4-A, "G" Block
Bandra Kurla Complex
Bandra (East), Mumbai - 400 051

Annexure - I

1. The Companies Act, 2013

Sections 68 - 70 of The Companies Act, 2013 are relevant for buy-back of securities. Section 68 is on power of company to purchase its own securities. Section 68(2) provides several conditions that have to be met for buy-back of securities including requirements for Board Resolution and Special Resolution (if applicable), Buy-back Offer size and post buy-back ratio of debt to paid up capital and free reserves.

The relevant provisions of Section 68(2) are as follows:

(2) No company shall purchase its own shares or other specified securities under sub-section (1), unless –

……

(b) a special resolution has been passed at a general meeting of the company authorising the buy-back:

Provided that nothing contained in this clause shall apply to a case where—

(i) the buy-back is, ten per cent. or less of the total paid-up equity capital and free reserves of the company; and

(ii) such buy-back has been authorised by the Board by means of a resolution passed at its meeting;

(c) the buy-back is twenty-five per cent. or less of the aggregate of paid-up capital and free reserves of the company:

Provided that in respect of the buy-back of equity shares in any financial year, the reference to twenty-five per cent. in this clause shall be construed with respect to its total paid-up equity capital in that financial year;

(d) the ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves:

Provided that the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies.

2. SEBI (Buy-back of Securities) Regulations, 2018

The relevant sections of The Companies Act, 2018 have been incorporated in the SEBI (Buy-back of Securities) Regulations, 2018 ("Buyback Regulations"). The conditions and requirements for buy-back of shares and specified securities have been provided in Regulation 4 of Buyback Regulations.

Regulation 4(i) of Buyback Regulations requires that:

(i) The maximum limit of any buy-back shall be twenty-five per cent or less of the aggregate of paid-up capital and free reserves of the company:

Explanation: In respect of the buy-back of equity shares in any financial year, the reference to twenty-five per cent in this regulation shall be construed with respect to its total paid-up equity capital in that financial year;

Regulation 4(ii) of Buyback Regulations requires that:

(ii) The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back shall not be more than twice the paid-up capital and free reserves.

Provided that if a higher ratio of the debt to capital and free reserves for the company has been notified under the Companies Act, 2013, the same shall prevail.

Further, Regulation 5 of Buy-back Regulations provides for general compliance and filing requirements for buy-backs. Regulation 5(i) of Buyback Regulations requires that:

(i) The company shall not authorise any buy-back (whether by way of tender offer or from open market or odd lot) unless:

a) The buy-back is authorised by the company's articles;

b) A special resolution has been passed at a general meeting of the company authorising the buy-back:

Provided that nothing contained in this clause shall apply to a case where the buy-back is, ten per cent or less of the total paid-up equity capital and free reserves of the company; and such buy-back has been authorised by the board of directors by means of a resolution passed at its meeting.