

Regulatory Alert: MCA notifies Companies (Share Capital and Debentures) Amendment Rules, 2019

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Summary

The Ministry of Corporate Affairs (MCA) on 16 August 2019 notified the Companies (Share Capital and Debentures) Rules. The amended rules relax norms and enhances the limit for issue of shares with Differential Voting Rights (DVRs). Further, the amended rules also provide for the period for issue of employee stock options by start-up companies and relaxation in respect of creation of Debenture Redemption Reserves (DRR) by certain class of companies.

Key highlights

Differential Voting Rights

- **Cap on issue of share with DVR:** The amended rules substitute the existing cap for issue of shares with DVR of 26% of the total cost issue paid up equity share capital to 74% of the total voting power including voting power in respect of equity shares with differential rights.
- **Relaxation in eligibility condition:** The amendment has also done away with the condition of having three years of distributable profits for a company to be eligible to issue shares with DVRs.

Issue of employee stock options by start-ups

A start-up, as defined¹ by the Department for Promotion of Industry and Internal Trade (DPIIT), was earlier allowed to issue employee stock options to the following personnel for a period of 5 years from the date of incorporation or registration:

- An employee who is a promoter or a person belonging to the promoter group, or
- A director who either himself or through his relative or anybody corporate, directly or indirectly holds more than 10% of equity shares of the company

This eligibility period, for issue of employee stock options by a start-up to its promoters and directors has now been extended to **10 years** in the amended rules.

Debenture Redemption Reserves (DRR)

Under the erstwhile rule, an unlisted company was required to create DRR of at least 25% of the value of outstanding debentures. However, the amended rules have exempted the following classes of companies from creating DRR:

- a) All India Financial Institutions (AIFIs) regulated by the Reserve Bank of India (RBI) and banking companies for both public as well as privately-placed debentures.
- b) Debentures issued through public issue or private placement by the following **listed companies** (other than AIFIs and banking companies):
 - NBFCs registered with the RBI
 - Housing finance companies registered with the National Housing Bank, or
 - Any other listed companies

¹ Notification no. G.S.R. 127(E), dated 19th February, 2019

- c) Debentures issued through private placement by the following **unlisted companies** (other than AIFs and banking companies):
- NBFCs registered with the RBI
 - Housing finance companies registered with the National Housing Bank, or

For other financial institutions², DRR shall be as applicable to NBFC registered with the RBI.

In addition to the above, the amended rules provide that companies (other than unlisted NBFCs and housing finance companies) are required to invest or deposit, on or before the 30th day of April each year, a sum which shall not be less than 15% of the amount of its debentures maturing during the year, ending on the 31st day of March of the next year in any one or more methods of investments or deposit as prescribed in the rules.

Our comments

The amended rules allow Indian companies to raise share capital without diluting the voting rights of the existing shareholders thereby ensuring creation of long-term value for shareholders. This move would help promoters retain control when raising capital from new investors.

The streamlining of requirement of creation of DRR by certain companies is consequent to the announcement made in the Union Budget. The measure would reduce the cost of the capital for raising debentures and is expected to significantly deepen the bond market.

² within the meaning of section 2(72) of the Companies Act, 2013

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