



To,

20th April, 2019

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Corporation Finance Department

Securities and Exchange Board of India

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Via email to: abhishekr@sebi.gov.in

Sub: Issuance of Equity Shares with Differential Voting Rights (DVRs)

At the outset, we, at Indian Association of Investment Professionals (IAIP), a member society of the CFA Institute appreciate the opportunity to submit our response to the **CONSULTATION PAPER ON ISSUANCE OF EQUITY SHARES WITH DIFFERENTIAL VOTING RIGHTS (DVRs)**.

IAIP is an association of over 2000 local investment professionals who are CFA charter holders and about 4000+ professionals who have cleared exams, eligible and awaiting charter. The Association consists of valuation professionals, portfolio managers, security analysts, investment advisors, and other financial professionals, that; promote ethical and professional standards within the investment industry, facilitate the exchange of information and opinions among people within the local investment community and beyond, and work to further the public's understanding of the CFA designation and investment industry.

CFA Institute is a global non-profit association of investment professionals with over 155,000 members in over 152 countries. In India, the community of CFA charter holders is represented by the Indian Association of Investment Professionals.

Through our global research and outreach efforts, CFA Societies around the world endeavour to provide resources for policy makers, financial services professionals and their customers in order to align their interests. Our members engage with regulators in all major markets.

With regards to the above mentioned consultative paper, we have proposed a few suggestions.

We would be happy to hear and discuss the merits / demerits of suggestions proposed by other practitioners and request to be included in the deliberation process.



Our responses to the DVR Group Report and the various points made therein are mentioned below in the requested format:

1. Details of our Organisation:

- **Name:** Indian Association of Investment Professionals (CFA Society India)
- **Contact number:** +91 98196 30042
- **Email address:** advocacy@iaipirc.org
- **Postal address:** 702, 7th Floor, A Wing, One BKC Tower, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051

2. General Comment - Our Primary Position:

Before setting out our position on your consultation, we would like to highlight that CFA Institute and CFA Society India remain steadfast in the belief that **“one share, one vote” is the bedrock of good corporate governance standards and there should NOT be any unequal voting rights**. Shareholders are entitled to voting right as a tool to express their views on important, and at times contestable, matters related to invested companies. The introduction of a structure permitting disproportionate votes to one group of shareowners would allow a minority shareowner to override the desires of most owners for personal benefits, or other benefits not in the best interests of shareholders as a whole. Therefore, unequal voting rights would **weaken the checks and balances between shareholders and management, and immunize management against stakeholders’ critics and accountability, leading to potential entrenchment issues**. In short, **it remains our primary position that India should retain the corporate governance gold standard of “one-share, one-vote”**.

In the *probable* case where companies with DVR structures are introduced to the Indian market, CFA Society India as well as CFA Institute recommend that **proper safeguards must be in place to protect shareholders from self-dealing and other misuses of corporate resources by company insiders for personal gain, or other actors not in the best interests of shareholders as a whole. Other safeguards should also be in place to mitigate risks of weakening corporate governance**.

Here is a link to a research report which SEBI might be interested in:

<https://www.cfainstitute.org/en/research/survey-reports/dual-class-shares-apac-survey-report>

Through this research report, titled **“Dual-Class Shares: The Good, the Bad, and the Ugly”** (hereinafter referred to as **“APAC DCS Report”**), CFA Institute makes an objective and unbiased attempt to examine three key questions (among other things):

- What are the safeguards that investors can most rely on?
- What are the lessons learned that are most applicable for investors, standard setters, and regulators in APAC?
- Who should investors look to for investor protection?

With this background in mind and having set out **our strong conviction that “one-share, one-vote” remains the most optimal market practice**, we would like to make an alternative case for having in place much more stricter and additional safeguards to ensure and enforce adequate protection of investors’ interests in the probable environment of implementation of the proposed regulations in the present consultation paper allowing DVRs in the Indian market.



3. Suggestions / Comments on the Proposals in the DVR Group Report:

Sr. No.	Pertains to specific recommendation	Suggestion(s)	Rationale
1.	Sunset Clause / Conversion of SR Shares	<p>We appreciate and applaud SEBI and the DVR Group for proposing appropriate mandatory sunset provisions, both time-based and event-based. The importance of sunset provisions cannot be over-emphasised in a DVR regime and we consider a mandatory sunset that automatically converts super voting rights to regular voting rights in no more than five years and the proposed event-based sunset provisions to be appropriate.</p>	<p>Please refer Section 5.4 Mandatory Sunset Provisions on page no. 55 of the APAC DCS Report for a detailed rationale supporting time-based and event-based mandatory sunset provisions. Even when DVR structures may be a sensible choice at the time of an IPO, they may not make sense forever, as the potential costs of such structures outweigh the benefits over time. Thus, we strongly believe that super voting rights must not be perpetual.</p>
2.	Voting and Other Rights on FR Shares and SR Shares	<p>We appreciate SEBI’s attempt to set limitations on the maximum voting differentials, which could be considered as a measure to reduce entrenchment issues and is a common practice in some European markets. However, we strongly disagree with the proposed minimum ratio of 1:10 for FR shares and the proposed maximum ratio of 10:1 for SR shares. We suggest a minimum ratio of 1:3 for FR shares and a maximum ratio of 3:1 for SR shares, and imposing an additional clause that would cap the effective voting differential for the SR shareholders at 3:1 (which will be the effective voting differential in a company which issues both SR and FR shares), thus ensuring that the SR shareholders would need a minimum economic stake of 25.1% to have a majority vote at all times.</p>	<p>As explained in the APAC DCS Report in Section 5.5 Maximum Voting Differentials on page no. 61, this safeguard seeks to impose a minimum economic stake required to enjoy a majority vote. The higher the voting differential, the bigger the wedge is between control and equity ownership. Placing a cap on this number will ease this distortion.</p> <p>According to the Global Governance Principles of International Corporate Governance Network (ICGN), the misalignment of economic interests and voting rights could result in managerial entrenchment. Similarly, the Organisation for Economic Co-operation and Development also suggests that a higher degree of economic involvement by management could lead to lower transaction costs and discourage opportunistic behaviours.</p> <p>As requirements are currently laid out in the proposal, a shareholder with</p>



			<p>9.1% economic stake in a company would possess over 50% of the voting rights. Under such arrangements, management would have more incentives and opportunity to act for personal benefits than on behalf of other stakeholders. Such a lax corporate governance structure may lead to or induce management entrenchment.</p> <p>Therefore, increasing the ratio to 1:3 for FR shares, lowering the ratio to 3:1 for SR shares and imposing a cap on the effective voting differential for the SR shareholders at 3:1 would be more effective in holding the company management properly accountable for their actions, as they would need to have higher economic stake in the companies, thereby mitigating expropriation and entrenchment risks.</p>
3.	Disclosure of Rights of Shareholders	<p>(a) The issuer must disclose its DCS structure, holders of SR shares and their respective shareholding and voting percentage both at the point of listing and thereafter, on a continuing basis, in its annual report.</p> <p>(b) The shareholders' circulars must contain information on the voting rights of each class of shares.</p> <p>(c) The issuer must, in its prospectus, disclose the risks of DCS structures, rationale for adoption of its DCS structure, matters subject to the coat-tail provisions including implications to holders of ordinary and FR shares, and key provisions in the Articles of Association or other constituent documents relating to DCS structures in a prominent manner.</p> <p>(d) The issuer must include a prominent statement on the cover page of its prospectus, and on a continuing basis, in its announcements (including financial statement announcements),</p>	<p>We believe a higher standard of disclosure requirements and transparency is warranted, considering the complexity of DCS structures, to protect the interest of investors.</p>



		<p>circulars and annual reports, highlighting that the issuer is a company with a DCS structure.</p>	
4.	<p>Reporting of Engagement of Holders of SR Shares</p>	<p>The issuer must, in its annual report, disclose the need for continuation with the adopted DCS structure, the engagement of SR shareholders in management of the public company, remuneration paid to SR shareholders, gross value of related party transactions, if any, that SR shareholders may have with other related entities, attendance of SR shareholders in board committee meetings and any conflict of interest that SR shareholders may have with new ventures and activities engaged in post listing and/or disclosures made in the last annual report.</p>	<p>We note that the regulations do not require shareholders with SR shares to report their engagement to all shareholders. The area of concern we have is that after listing and satisfying the listing requirements, the original holders of SR shares become sleeping directors and not accountable for their future actions. Secondly, there is a risk of related party transactions undertaken by SR shareholders which over time impact the value share of ordinary shareholders. We believe there needs to be a further requirement to ensure that on a regular basis SR shareholders disclose in the annual report their engagement with the company, participation in management, etc.</p>
5.	<p>Investor Protection</p>	<p>While the DVR Group Report proposes many important safeguard provisions to prevent any compromise of corporate governance standards, we have noticed that it does not go far enough to clarify how SEBI will monitor and enforce some of these proposed provisions and what would be the punitive provisions for non-compliance or violations of the proposed regulations by issuers and promoters.</p> <p>On a related note, if public shareholders feel aggrieved, what channels of recourse would they have? What will be SEBI's specific role in enforcing and executing corrective actions to redress the grievances of investors?</p>	<p>SEBI needs to ensure effective monitoring and enforcement of the proposed regulations. The courts in the United States have taken on significant responsibilities in upholding investor rights. However, even in jurisdictions where courts have a history of stepping in and intervening, it can take years for cases to be resolved.</p> <p>In countries like India, legal action against rogue companies or management is not an avenue available to most investors. In markets such as ours, where direct retail participation is significant, not only does the caveat emptor (i.e., buyer beware) argument offer scant comfort to investors, in times when many investors feel taken advantage of, they inevitably turn to governments and regulators for assistance, which is seldom forthcoming.</p>



			<p>Our general recommendations for regulators, therefore, are as follows:</p> <ul style="list-style-type: none"> ▪ Exchanges and regulators should coordinate their efforts and invest in investor education and awareness. ▪ In jurisdictions such as ours where class and derivative actions are unavailable and/or uncommon, governments and regulators should establish a mechanism to enable small investors to seek recourse. ▪ Regulators must intervene in a timely manner when investors are taken advantage of or harmed. <p>Any clarity on SEBI’s endeavours in this important area would only help in increasing investor confidence on the integrity of capital markets and protect the interest of investors, which is our primary goal.</p>
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4. Concluding Remarks:

DCS structures are a relatively new development in India (if introduced) as well as APAC. We would continue to remain watchful of market developments and work with stakeholders to raise investor awareness. We would like to continue to engage with SEBI in this important policy matter going forward.

We reiterate that although the reasons outlined by the DVR Group favouring the introduction of a DCS regime in India seem compelling, they do not outweigh the need to not compromise SEBI’s long hard years of building reputation in promoting global best practices in the Indian market. Needless to say, introducing a policy regime which is currently the subject of an emotive debate around the world (including the developed world) can inevitably put to test SEBI’s ability to achieve the delicate balance between advancing corporate governance and facilitating capital formation. The introduction of the DVR-structured companies has the potential to encourage short-termism, and deter long-term capital and high-quality issuers from our market. Hence, we remain steadfast in the belief that **the “one share, one vote” principle that has served the markets well in the past decades should not be scrapped, and that SEBI should remain vigilant in protecting shareholders’ rights.**

If you or your staff have questions or seek further clarification, please do not hesitate to contact Mr. Rajendra Kalur, CFA @ +91 98196 30042 or at advocacy@iaipirc.org

Sincerely yours,

Rajendra Kalur, CFA
 Director - Research and Advocacy Committee
 Indian Association of Investment Professionals, Member Society of CFA Institute