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Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2022

The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2022 ("**2022 SEBI ICDR Amendment Regulations**") were notified in the official gazette of India on January 14, 2022. The 2022 SEBI ICDR Amendment Regulations amend certain specific regulations of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, as amended ("**SEBI ICDR Regulations**") based on learnings of the regulator, the Securities and Exchange Board of India ("**SEBI**"), in the last year. These amendments are aimed at, amongst other things, protection of public investors, exits by investors by way of IPOs and listings of new age tech companies. The key amendments and our analysis are as follows:

A. Amendments applicable to all DRHPs which are proposed to be filed from the date of notification (January 14, 2022)

i. Restrictions on IPOs filed under the non-profitability route (Regulation 6(2) of the SEBI ICDR Regulations

SEBI allows both, a profitable company and a non-profitable company, to undertake an IPO in India.

Previously, an issuer proposing to undertake an IPO under the non-profitability route was only required to ensure that at least 75% of the issue size was allotted to qualified institutional buyers ("**QIBs**"). SEBI had permitted this access to public markets for non-profitable companies to ensure that the retail exposure to such issues was reduced in such issues, as QIBs are deemed to be sophisticated investors. In the last year, the Indian capital markets has witnessed a spate of IPOs by companies (especially new age technology companies) which may yet not be profitable but desire to provide liquidity to their investors and generate more share capital.

SEBI now appears to be seeking to impose certain additional restrictions on non-profitable issuers accessing public funds, with the purported intention of protecting public investors, and hence has introduced the following changes in relation to offer for sale ("**OFS**") by shareholders in a public issue by way of the 2022 SEBI ICDR Amendment Regulations:

(a) shares offered for sale to the public by shareholder(s) holding, individually or with persons acting in concert, more than 20% of pre-IPO shareholding of the issuer on a fully diluted basis, <u>shall not exceed more than 50% of their pre-IPO shareholding on a fully diluted basis</u>. Thus, such shareholder is restricted from fully selling its shares in an IPO or even undertaking a secondary sale of equity shares not forming part of the IPO;

(b) shares offered for sale to the public by shareholder(s) holding, individually or with persons acting in concert, less than 20% of pre-IPO shareholding of the issuer based on a fully diluted basis, <u>shall not exceed more than 10% of the pre-IPO shareholding of the issuer on a fully diluted basis</u>; and

(c) if the shareholder(s) mentioned in (a) above are alternative investment funds (category I or II) ("**AIF**"), foreign venture capital investors ("**FVCI**") or venture capital funds ("**VCF**"), such shareholders shall continue to be subject to a six month lock in, post the IPO, for the remainder of the equity shares held by them.

It is pertinent to note that the restriction mentioned in (a) above, is capped to 50% of the pre-IPO shareholding of the selling shareholder in the issuer whereas the restriction in (b) is capped to 10% of the pre-IPO share capital of the issuer. Hence, a shareholder in the category falling under (b) can, depending on its shareholding, sell a greater proportion of shares than a shareholder falling under (a) or even completely exit in the IPO.

Further, the definition of "persons acting in concert" has been linked to the meaning ascribed to such term in accordance with the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, as amended.

Hence, investors in any company going public should be mindful of voting arrangements with other shareholders as this could have an impact on being categorised as a person acting in concert and consequently on the quantum of equity shares that may be offered for sale in the IPO. Existing arrangements may need to be revisited before the draft is filed with the regulator.

We understand that the intent of the regulator by way of the above is to: (a) control the quantum of the secondary components in the IPOs of non-profitable issuers and ensure continued skin in the game for pre-IPO investors in a company; (b) reduce post listing volatility in the listed securities of such issuers; and (c) nudge issuers to include a meaningful primary component in their IPO, which can enable such companies to be profitable in the future. However, the restrictions placed by the regulator on the use of fresh issue proceeds (discussed below under point (iii)) may run counter to this intent.

ii. Minimum holding period of six months of securities held by AIFs, FVCIs and VCFs to apply to bonus issues as well

Prior to the 2022 SEBI ICDR Amendment Regulations, in certain issues, a view was taken that bonus equity shares issued to AIFs, FVCIs and VCFs, prior to the filing of the DRHP, were also free from being locked-in as long as the underlying equity shares or convertibles were held for a period of six months.

Pursuant to the 2022 SEBI ICDR Amendment Regulations, the regulator has clarified that if bonus equity shares are issued to AIFs, FVCIs and VCFs prior to the filing of the DRHP, then the holding period of the bonus equity shares as well as the underlying equity shares together, must be six months for such equity shares to be exempt from the lock-in.

iii. Objects and monitoring of fresh issue proceeds

Objects of the Issue:

Under the 2022 SEBI ICDR Amendment Regulations, where the issue proceeds are proposed to be utilised towards inorganic acquisitions or investments in target entities that have not been identified ("**Blindpool Acquisition Object**"):

(a) the amounts proposed to be raised towards such Blindpool Acquisition Object together with general corporate purpose (for which a standalone limit of 25% of the issue proceeds is already prescribed) shall be capped at 35% of the total amount raised; and

(b) the Blindpool Acquisition Object, in any event, shall be capped at 25% of the total amount being raised.

The above limits shall not apply where the acquisitions or investment target has been identified in the DRHP and RHP and appropriate disclosures have been included.

We believe that the changes in paragraph (iii) herein have been made in light of recent IPOs of new age technology companies where the issue proceeds from the primary component of the IPO was proposed to be used to fund inorganic growth without specific identification of acquisition or investment targets. The regulator expects such amendments to safeguard investors' funds and reduce the uncertainty in deployment of funds towards such objects. However, as mentioned above, this restriction on the use of fresh issue proceeds can hamper the growth of new age technology companies, which are typically nimble and flexible in their approach and may seek opportunistic acquisitions from time to time.

Monitoring of Issue Proceeds:

SEBI has strengthened the post IPO monitoring mechanism of the funds raised under the primary component of the IPO by way of the following measures:

(a) only credit rating agencies registered with SEBI have been allowed to act as monitoring agencies instead of scheduled commercial banks and public financial institutions;

(b) the entire proceeds under the primary component of the IPO is to be monitored instead of 95% of the issue proceeds (as previously required). Proceeds earmarked towards general corporate purposes shall also come under the ambit of the monitoring agency; and

(c) revision in the format of the report to be issued by the monitoring agency to ensure the following:

- verification of sub-heads under each object by the monitoring agency;
- verification of documentary evidence by the monitoring agency against each object (including sub-heads); and
- inclusion of "general corporate purpose" as a separate heading in the report.

iv. ***Preparation of restated financial statements and proforma financials***

Prior to the 2022 SEBI ICDR Amendment Regulations, the restated financial statements of the issuer were required to be audited and certified by the statutory auditor who held a valid peer review certificate issued by the Peer Review Board of the Institute of Chartered Accountants of India ("**ICAI**"). The 2022 SEBI ICDR Amendment Regulations now permit not only the statutory auditors of the issuer, but also, a chartered accountant holding a valid peer review certificate issued by the Peer Review Board of the ICAI ("**CA**") to audit and certify restated financial statements that are required to be included in offer documents. Similarly, CAs are, in addition to statutory auditors, now permitted to certify proforma financials and issue certificates on the consideration paid or received and the mode of financing in case of non-material acquisitions or divestments.

This amendment will provide flexibility to issuers to approach CAs to audit and sign restated financial statements, certify proforma financial statements and issue certificates in case of non-material acquisitions or divestments. However, from a diligence perspective preference would

always be that the existing statutory auditor, who has knowledge of the financial statements of the company, prepares such restated financial statements / proforma financial statements. This position or potential concern has also been recognised by the regulator as it has, by way of the amendment, mandated issuers to include as a top 10 risk factor, the fact that restated financial statements or proforma financial statements have been prepared by a CA and not the statutory auditor of the issuer.

v. *Other amendments*

Under the 2022 SEBI ICDR Amendment Regulations, the regulator has also introduced a few additional compliance and disclosure requirements, including:

(a) confirmation from the issuer, promoters and directors that they have not been identified as a fraudulent borrower by any bank or financial institution or consortium thereof;

(b) reduction in timelines (to four days) for refund of IPO proceeds in case of (i) non receipt of minimum subscription; and (ii) failure to receive listing and trading permissions from the stock exchanges where the securities are proposed to be listed; and

(c) changes to the cover page of the DRHP so as to include the details of the selling shareholders in a tabular form along with the details of their offer for sale, average cost of acquisition and other details as specified by the regulator from time to time.

B. Amendments applicable to all IPOs opening for subscription on or after April 1, 2022

i. *Lock in period for Anchor Investors*

Prior to the 2022 SEBI ICDR Amendment Regulations, equity shares allotted to anchor investors were locked-in for a period of 30 days from the date of allotment in the IPO. Pursuant to the 2022 SEBI ICDR Amendment Regulations, 50% of the equity shares allotted to anchor investors shall be locked-in for a period of 30 days and the balance 50% shall be locked-in for a period of 90 days from the date of allotment in the IPO.

The additional lock-in period for the anchor investors is potentially intended to provide more confidence to the investors and reduce the trading volatility in listed equity shares once the anchor lock-in ceases. One hopes that there won't be volatility on the 30th day and then on the 90th day.

ii. *Revised allocation methodology for allocation to Non-Institutional Investors ("NIIs"):*

Prior to the 2022 SEBI ICDR Amendment Regulations, allotment to NIIs was undertaken on a proportionate basis. Typically, NIIs approach scheduled commercial banks and non-banking finance companies to obtain IPO financing. Such IPO financing is availed to enable NIIs to bid for large quantities of securities, with a view to receive a higher allocation of equity shares in the IPO and hopefully benefit from listing gains. In order to curb this practice and overall demand, SEBI has introduced the following allocation methodology for NIIs:

(a) 1/3rd of the allocation in the NII category shall be reserved for applicants with application size of more than Rs. 2 lacs but less than Rs. 10 lacs;

(b) 2/3rd of the allocation in the NII category shall be reserved for applicants with application size of more than Rs. 10 lacs;

(c) in the event of undersubscription in (a) or (b), inter-se spill over shall be permitted; and

(d) allotment to NIIs shall be based on the "draw of lots" (draw of lots to allot minimum application size to applicants, in case of oversubscription and balance allotment on proportionate basis).

It is pertinent to note that the above is distinct from the allocation methodology for retail investors. While retail investors are assured of a minimum of one bid lot in the IPO, the revised allocation methodology to NIIs proposes to provide a minimum application size (of more than Rs. 2 lacs or more than Rs. 10 lacs, as applicable) and thereafter a proportionate allotment. In the event the minimum application size cannot be provided to all NIIs who have bid in the IPO, a

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draw of lots will take place which will result in only certain NIIs getting the allotment equivalent to the minimum application size and the remaining NIIs not getting any allotment in the IPO.

C. Amendments applicable to all IPOs with immediate effect

i. Minimum statutory gap for Price Band

A gap of minimum 5% in price will need to be maintained between the lower end and upper end of the price band. This amendment has been introduced to (a) curtail the practice of keeping a small gap between the lower and upper end of the price band as had been done in past issues (where a one rupee difference was there between the lower and upper end of the price band); and (ii) ensure transparency in the book building and price discovery process.

Conclusion

The 2022 SEBI ICDR Amendment Regulations are primarily a reaction to some of the IPOs of 2021. While some amendments maybe considered a welcome step in the market regulator's endeavours to ensure growth and development of the Indian securities market, restrictions on secondary components for non-profitable issuers seem to disregard the principle of determination of the fate of an IPO by market forces. The bulk of the amendments may make undertaking an IPO in India more complicated than it already is and they also do not fully recognise the contribution of new age technology companies/non-profitable companies to India's growth. The effectiveness of the amendments and the impact of these amendments to listing in India will need to be analysed on their implementation.

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Key Contacts:

Cyril Shroff
Managing Partner
cyril.shroff@cyrilshroff.com

Yash J. Ashar
Partner (Head - Markets)
yash.ashar@cyrilshroff.com

Abhinav Kumar
Partner
abhinav.kumar@cyrilshroff.com

Gokul Rajan
Partner
gokul.rajan@cyrilshroff.com

Janhavi Seksaria
Partner
janhavi. seksaria@cyrilshroff.com

Vijay Parthasarathi
Partner
vijay.parthasarathi@cyrilshroff.com

Vinay Sirohia
Partner
vinay.sirohia@cyrilshroff.com

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Cyril Amarchand Mangaldas
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100 years of legacy | **850+** Lawyers | **Over 150** Partners

Peninsula Chambers, Peninsula Corporate Park, GK Marg, Lower Parel, Mumbai 400 013, India
T +91 22 2496 4455 **F** +91 22 2496 3666 **E** cam.mumbai@cyrilshroff.com **W** www.cyrilshroff.com
Presence in Mumbai | Delhi-NCR | Bengaluru | Ahmedabad | Hyderabad | Chennai | GIFT City | Singapore