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SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018—Key Considerations for a Selling Shareholder in an IPO

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SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018—Key Considerations for a Selling Shareholder in an IPO

The Securities and Exchange Board of India ('SEBI') notified the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ('ICDR 2018') on September 11, 2018, which came into effect on November 10, 2018, thereby rescinding and repealing the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ('ICDR 2009').

These regulations primarily govern the process of an initial public offering ('IPO'), which is an offer of specified securities by an unlisted issuer to the public for subscription for the first time. An IPO consists of either or both of the following components:

- i. a primary component, being a fresh issue of securities by the issuer,
- ii. or a secondary component, being an offer for sale by existing shareholders of the issuer ('OFS').

Some of the key changes brought about by and salient features of ICDR 2018 along with existing practices, more specifically provisions which are relevant from a private equity investor's perspective *vis-à-vis* IPOs are summarized below:

1. Selling Shareholders

- i. ICDR 2018 has introduced a definition of 'selling shareholder(s)' which is defined as any shareholder of the person who is offering for sale the specified securities in a public issue. Consequently, the definition of 'issuer' has also been amended to mean a company or a body corporate authorized to issue specified securities under the relevant laws and whose specified securities are being issued and/or offered for sale in accordance with the provisions of ICDR 2018 ('Issuer'). Therefore, the ambiguity under ICDR 2009 on whether a selling shareholder would amount to an Issuer, has been clarified.
- ii. Pursuant to the inclusion of the aforesaid definitions, corresponding provisions for disclosures / confirmation requirements have been provided, which, *inter alia*, include the following:
 - Statement by the selling shareholder on the cover page of the draft offer document/ offer document stating that it accepts responsibility for, and confirms, the statements made by it in the offer document to the extent of information specifically pertaining to it and its portion of the offered shares and that such statements are true and correct in all material respects and not misleading in any material respect;
 - Aggregate pre-issue shareholding of the selling shareholder as a percentage of the paid-up share capital of the Issuer;
 - Weighted average price at which specified security was acquired by the selling shareholder in the last one year;
 - Average cost of acquisition of shares for the selling shareholder;
 - Pre-IPO details (if applicable);
 - A confirmation that the selling shareholder is not prohibited from accessing the capital market or debarred from buying, selling or dealing in securities under any order or direction passed by SEBI or any securities market regulator in any other jurisdiction or any other authority/court; and
 - A confirmation that the selling shareholder is in compliance with the Companies (Significant Beneficial Ownership) Rules, 2018.

2. Eligibility

- i. Some of the changes introduced in respect of the eligibility requirements for promoters, directors and selling shareholders for an IPO are set out below:
 - The debarment of selling shareholders from accessing the capital markets has now been made an eligibility condition. However, ICDR 2018 clarifies that this restriction will not apply to a person or entity whose period of debarment has expired as on the date of filing of the draft red herring prospectus ('DRHP') by the Issuer with SEBI.
 - Further, none of the promoters or directors of an Issuer should be fugitive economic offender (as defined under the Fugitive Economic Offenders Act, 2018).
- ii. Additionally, the following amendments were introduced in respect of financial information linked to eligibility:



- The condition that the size of the IPO, including any previous issues in the same fiscal year, must not exceed five times the net worth of the Issuer, has been done away with.
 - It has been clarified that the net tangible assets, average operating profits (with operating profit in each of these preceding three years), net worth and revenue of the Issuer has to be calculated on a restated and consolidated basis.
- iii. It has also been clarified that the offered shares arising from convertible instruments may now be converted prior to filing the red herring prospectus ('RHP').

3. Group Companies

- i. Group companies have been defined to include: (a) companies with which the Issuer has had related party transactions during the past three fiscal and stub periods (as appearing in the audit report and financial statements), and (b) other companies considered material by the board of directors of the Issuer.
- ii. Promoters and subsidiaries have been excluded from the definition of group companies.

4. Definition of Promoter

- i. The definition of 'promoter' has been aligned with the definition provided under Section 2(69) of the Companies Act, 2013. Accordingly the following persons can be classified as promoters: (a) persons named as such in the offer document or identified by the Issuer in the annual return; (b) persons who have control over the affairs of the Issuer, directly or indirectly whether as a shareholder, director or otherwise; and (c) persons in accordance with whose instructions the board of the Issuer is accustomed to act (except a person acting in a professional capacity).
- ii. The threshold of shareholding which exempts a person from being categorized as a promoter has been increased from 10% to 20%. Further, venture capital funds, alternate investment funds ('AIFs'), foreign venture capital investors ('FVCIS') and insurance companies have been added to the list of investors who (in addition to financial institutions, scheduled commercial banks, foreign portfolio investors other than Category III foreign portfolio investors, mutual funds) will not be deemed to be promoters merely because they hold 20% or more in the Issuer. Consequential changes have been made in various provisions, including, the definition of promoter group.
- iii. Persons instrumental in formulation of a plan or programme of the offer have now been excluded from the definition of promoter.
- iv. The proviso under the definition of 'promoter' under ICDR 2009 in relation to a financial institution, scheduled commercial bank, foreign portfolio investor other than Category III foreign portfolio investor and mutual funds, continuing to be deemed promoters of the subsidiaries or companies promoted by them or mutual funds sponsored by them has been done away with.

5. Minimum Promoters' Contribution, its Eligibility, Pledging and Certification

- i. In addition to the promoters of an Issuer, certain regulated entities such as AIFs, FVCIS, scheduled commercial banks, public financial institutions ('PFIs') or insurance companies registered with Insurance Regulatory and Development Authority of India ('IRDAI'), are now permitted to contribute in a manner which would enable meeting the shortfall (if any) in the minimum promoters' contribution, subject to a limit of 10% of the post-issue capital (without being identified as promoters).
- ii. Ineligibility conditions have now been extended to securities which are contributed towards promoters' contribution by the additional regulated entities identified above, i.e., securities acquired by promoters, AIFs, FVCIS, scheduled commercial banks, PFIs or insurance companies registered with IRDAI, during the preceding one year at a price lower than the offer price of the IPO.
- iii. As per ICDR 2018, promoters' contribution and other securities held by the promoters (and locked-in) can also be pledged with systemically important non-banking financial companies and housing finance companies, in addition to scheduled commercial banks and PFIs.
- iv. In line with ICDR 2009, ICDR 2018 provides that lock-in on minimum promoters' contribution is effective for a period of three years from the latter of the date of allotment in the IPO or the date of commencement of commercial production. However, the definition of the term 'date of commencement of commercial production' has been amended to mean the last date of the month in which commercial production of the 'project' in respect of which the IPO proceeds are proposed to be



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utilized as per the DRHP/ offer documents, is expected to commence.

- v. Statutory auditors are mandatorily required to certify the amount paid as well as credited to the Issuer's account by each of the promoters.

6. Pre-IPO / Restriction on Further Capital Issues

For further capital issuances between the date of filing the DRHP and the listing of the specified securities offered in the IPO, the Issuer is required to disclose details of either the number of securities proposed to be issued or amount proposed to be raised in the DRHP/ offer document and not both. ICDR 2018, as was the case in the ICDR 2009, contemplates only issuance of securities.

7. Re-filing of the Draft Offer Document

Pursuant to the amendment to ICDR 2018, which was effective from December 31, 2018, any changes in the draft offer document, as elaborated below, will require re-filing of the draft offer document with SEBI:

- i. in case of a fresh issue of securities, any increase or decrease to the estimated issue size by more than 20%;
- ii. in case of an offer for sale, any increase or decrease in either the number of equity shares offered for sale or the estimated issue size by more than 50%; and
- iii. in case of a fresh issue of securities and an offer for sale, the respective limits set out above will apply.

The aforesaid changes brought about by ICDR 2018 to the regulatory regime governing Indian capital markets transactions will have a bearing on investors in private companies who intend to exit by way of an OFS as part of an IPO. Accordingly, investors may take note of the factors impacting any transactions that are contemplated subsequent to the date of notification of ICDR 2018.



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