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Analysing developments impacting business

SEBI AMENDS NORMS GOVERNING RIGHTS ISSUES - RATIONALISING ELIGIBILITY, DISCLOSURES AND OTHER CONCEPTS

8 October 2020 The Securities and Exchange Board of India (SEBI) has notified the fourth amendment to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (SEBI ICDR Regulations) on 28 September 2020 (Amendment) with the intention of permitting listed companies to undertake rights issues with brevity. The Amendment eases the eligibility requirements, significantly truncates the disclosure regime and introduces supportive changes to existing legal norms, applicable to rights issues. The Amendment is consistent with the regulator's recent efforts to relax regulations applicable to right issues by listed companies. Our ERGO on the previous relaxations accorded by SEBI is available [here](#).

Some of the key changes introduced by the Amendment are:

1. **An overhaul of the disclosure regime:** The Amendment has overhauled the disclosure regime applicable to rights issues by significantly truncating the disclosure requirements. Prior to the Amendment, a letter of offer was required to include either (i) exhaustive disclosures, comparable to offer documents prepared for initial public offerings (IPO), as provided for in Part A of Schedule VI or (ii) limited disclosures (or commonly referred to as Part B disclosures), if the issuer company satisfied certain eligibility tests. Consequent to the Amendment, companies are no longer required to make exhaustive, 'IPO-standard' disclosures. Under the new regime, a letter of offer is required to include either (i) limited disclosures, as per Part B of Schedule VI of the SEBI ICDR Regulations, if it satisfies certain eligibility tests; or (ii) limited disclosures as per Part B-1 of Schedule VI, if such eligibility tests are unmet. While Part B of Schedule VI of the SEBI ICDR Regulations have been amended significantly, Part B-1 is altogether a new concept, both of which are discussed in subsequent paragraphs. For details, see para 8 - "Key Changes to Disclosure Requirements" below.
2. **Change in certain eligibility criteria for 'fast track' rights issue:** Prior to the Amendment, an issuer company was ineligible to undertake a fast track rights issue if SEBI had issued show cause notices or initiated prosecution proceedings, which were pending against the issuer, its promoters or whole time directors. The Amendment has relaxed this stringent eligibility requirement by permitting issuer companies to undertake fast track rights issues (a) if pending show cause notices were issued in proceedings for imposition of penalty, or (b) if prosecution proceedings have been initiated against issuer, promoters or whole time directors, as long as necessary disclosures have been included in the letter of offer.

Further, an issuer was previously ineligible to undertake a fast track rights issue if the financial statements, which were required to be disclosed in the letter of offer, were subject to audit qualifications. However, the SEBI Circular SEBI/HO/CFD/CIR/CFD/DIL/67/2020 dated 21 April 2020 (SEBI Relaxation Circular) had temporarily permitted such companies to undertake fast track rights issues if (a) the financial statements were restated, adjusting for the impact of the audit qualifications, or (b) where the impact of such audit qualifications could not be ascertained, disclosed such inability in the letter of offer. The Amendment has made such temporary relaxation a permanent change to fast track rights issue eligibility.

- 3. Eligibility to prepare the letter of offer with Part B disclosures:** From an issuer company's perspective, Part B, Schedule VI of the SEBI ICDR Regulations is the most '*disclosure friendly*' route to accessing capital through a rights issue. The disclosures mandated by Part B are significantly lesser, compared both to the 'IPO-standard' disclosures as well as with the new Part B-1 disclosure standard (as discussed above). In order to be eligible to undertake a rights issue under Part B, an issuer is required to meet several eligibility criteria, one of which was compliance with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for a period of three years immediately preceding the filing of the draft letter of offer with SEBI (or filing of the letter of offer with the designated stock exchange, in case of a fast track rights issue). The Amendment, with the objective of permitting a larger number of listed companies to undertake Part B rights issues, has reduced such time period for past compliance to 12 months from the earlier mandated three-year period.

Further, an issuer company was ineligible to undertake a part B rights issue if (a) its management had undergone any change pursuant to acquisition of 'control' in accordance with the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 or the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, as applicable, or (b) whose specified securities have been listed consequent to the relaxation granted by SEBI under Rule 19(7)(b) of the Securities Contracts (Regulation) Rules, 1957 for listing of its specified securities pursuant to a court sanctioned scheme, and such company was undertaking a rights issue for the first time subsequent to such change in control or listing, as applicable. The Amendment has now permitted such companies to undertake a Part B rights issue if a period of three full years have elapsed since such change in control or listing, as applicable.

- 4. Application modes in case an eligible shareholder does not receive an application form:** In case an eligible shareholder does not receive an application form to apply for securities in a rights issue, they are permitted to send in their application through a "plain paper application", which is quite literally an indication to apply for securities in a rights issue, written on a plain paper. The Amendment has made the standards applicable to acceptance of plain paper applications consistent with application forms. Application made on a plain paper is liable to be rejected by self-certified syndicate banks, if all details, required to be incorporated in an application form as per the SEBI ICDR Regulations, are not incorporated in the plain paper application.

Further, the Amendment has now also permitted an eligible shareholder, who does not receive an application form, to make an application through the application forms available on the website of the registrar, stock exchanges or the lead managers.

- 5. Minimum subscription:** Prior to the Amendment, if a rights issue did not receive at least 90% subscription, the issue was deemed to have failed and application money was required to be refunded to the investors. This criterion of receipt of minimum subscription is no longer applicable to an issuer if (a) the objects for which funds are being raised in the rights issue does not involve financing of capital expenditure for a specific project; and (b) the promoter(s) and the promoter group of the issuer undertake to subscribe fully to their respective rights entitlements and do not

renounce their rights entitlement, except to the extent of renunciation within the promoter group.

As a note, the SEBI Relaxation Circular had reduced the minimum subscription threshold to 75% of the issue size. This relaxation is applicable to rights issues opening for subscription on or prior to 31 March 2021.

6. **Convertible debt instruments:** A company undertaking a rights issue is required to reserve equity shares for holders of compulsorily convertible debt. Such reserved equity shares are required to be issued to the holder of convertible debt instruments at the time of conversion, on the same terms at which the equity shares were offered in the rights issue. The Amendment has clarified that for the purpose of the rights issue, an issuer is not required to credit the rights entitlement of the holders of fully or partly compulsorily convertible debt instruments prior to the rights issue opening date.
7. **Applicability:** Prior to the Amendment, other than in the case of a fast track rights issue, the letter of offer prepared by an issuer for rights issues of Rs 10 crores or more was required to be filed with SEBI for its review and comments. By increasing this threshold of Rs 10 crores to Rs 50 crores, the requirement of filing the letter of offer with SEBI for review for rights issues of less than Rs. 50 crores has been done away with. The letter of offer is only required to be submitted with SEBI, for information and record purposes.

SEBI has however not followed the above relaxation in the matter of filing fees in Schedule III of the SEBI ICDR Regulation. However, in our view, Schedule III may also be read to have been modified through the Amendment, since SEBI has increased the threshold as a concept. However, before this view is confirmed, a discussion with SEBI would be necessary.

8. **Key Changes to Disclosure Requirements:**

A. Some of the material changes to Part B are:

- **Inclusion of financials in the letter of offer:** SEBI has clarified that audited financial statements for the last completed year need to be disclosed along with the latest limited review financial statements disclosed to the stock exchange(s) (with the comparative prior period). If a company has subsidiaries, it would be required to incorporate consolidated financial statements for the above-mentioned periods. This information should not be earlier than six months prior to the date of the opening of the issue. SEBI has also granted issuers the flexibility to voluntarily include additional financial statements, such as audited financial statements for three years, additional stub periods and audited standalone financial statements. It is no longer necessary to include summary financial statements, the capitalisation statement and changes in accounting policies of the issuer in the letter of offer. Since the summary financial statements, statement of capitalisation and changes in accounting policies are included in the financial statements of an issuer in any case, SEBI has done away with duplication of disclosures.
- **Business sections:** A letter of offer prepared under Part B is now required to include sections related to the business, industry (issuers may choose to create a separate section for industry or include details of the industry in the business section) and management discussion and analysis on the financial conditions and results of operation (MD&A). These requirements were not a part of the erstwhile Part B disclosure regime. However, as mentioned in the paragraph above, a company is required to include only a single year financial statements

(with the comparative prior period) in the letter of offer - in relation to preparation of a MD&A section, a comparison of the latest two year financial year performance may not bring out a commercially meaningful picture of the business performance and affairs of a company in all cases. Hence, companies may prefer to disclose their financial statements for the last three financial years and accordingly disclose a year on year comparison in the MD&A.

- **Objects:** In case one of the objects is retirement of debt, then additional disclosures in relation to details of the loans proposed to be repaid is now a mandatory disclosure. Such details include the name of the lender, tenure of the debt, brief terms and conditions and amount outstanding as leverage. SEBI has clarified that in case one of the objects is to fund a project, break-up of the cost of the project and means of financing for the project need to be disclosed. As market practice, certain level of 'IPO-standard' disclosures for such objects of the issue were common in letters of offer under the erstwhile Part B disclosure regime. With this Amendment, the extended disclosures akin to 'IPO-standard' disclosures have been made mandatory.
- **Government approvals and history:** Only material pending government and regulatory approvals pertaining to the objects of the issue need to be disclosed as opposed to the earlier requirement of including all material pending government and regulatory approvals for an existing line/ new line of activity or project. Further, the requirement of including a brief history of the issuer company has been done away with under Part B disclosure requirements.

B. By formulating Part B-1 of Schedule VI of the SEBI ICDR Regulations. SEBI has eliminated the need of rights issues to comply with the exhaustive 'IPO-standard' disclosures of Part A of Schedule VI. Although the requirements of Part B-1 are less exhaustive compared to Part A, these remain more detailed compared to the new Part B. Some of the material differences between Part A vs Part B-1 are:

- Part B-1 does not mandate disclosures pertaining to group companies;
- Disclosures in the capital structure section have been considerably reduced. The most significant change is that the letter of offer is no longer required to contain the share capital build-up since incorporation, which significantly increased transaction timelines due to the extent of diligence required. Other amendments include the deletion of the requirement to disclose the share premium account, details of top shareholders in the past years and details of employee stock option schemes and grants thereunder. It is evident that SEBI has attempted to align the capital structure disclosures mandated by Part B with Part B-1;
- In respect of Part B-1 disclosures, details of the sources of funds and the deployment of these funds on the project (where the issuer is raising capital for a project) can be certified by a chartered accountant. The same certification was earlier required from the statutory auditor, as is still required under Part A for public issues;
- Sections describing the key regulations governing the business and the history of the issuer are no longer required to be disclosed;
- In the litigation section, under Part B-1, there is no requirement to disclose overdues to creditors.

- As part of the approvals related disclosures, only material pending government and regulatory approvals pertaining to the objects of the issue need to be disclosed;
- Disclosures in respect of management and promoters have been reduced to exclude requirements such as – (i) disclosure of remuneration paid to directors and key managerial personnel (KMP); (ii) interest and shareholding of directors and KMP; (iii) interest of promoters, payment or benefits to promoter, disassociation by the promoter;
- Price information of past issues handled by lead managers are not required to be disclosed under Part B-1; and
- However, the requirement to disclose audited restated consolidated (if applicable) financial statements for the last three financial years, is retained in Part B-1. SEBI has also mandated the disclosure of the latest limited review financial statements of the issuer disclosed to the stock exchange with the comparative prior year period.

Conclusion

The Amendment will assist companies to significantly reduce transaction cost and time consequently, should generate a keen interest in listed companies, in need of capital during uncertain times, to access the primary market through rights issues.

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