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Analysing developments impacting business

INDIA PUBLIC MARKETS REFORMS | SEVERAL NEW FLEXIBILITIES FOR FINANCIAL SPONSORS

9 August 2021

SEBI on 6 August 2021 announced several policy changes which should be very positively factored by the financial sponsor community. Set out below is a snapshot of these announced changes, and we will keep you posted on when SEBI announces corresponding updates to the implementing regulations.

Relaxation of Post IPO Lock-ups

- The lock-up obligation of all pre-IPO shareholders (barring the lock-up restrictions on promoters) has been reduced to 6 months; from the existing 1 year lock-up.
- The obligation on promoters to lock-up 20% of the aggregate share capital, post IPO, is reduced to 18 months (from 3 years).
 - There are a few conditionalities on this relaxation of the promoter lock-in, which may not be difficult to satisfy:
 - The entire IPO involves a secondary sale / offer for sale of shares; or
 - The IPO does not contemplate more than 50% of the primary raise proceeds being deployed for capital expenditure on a project.
- No post-IPO lock up on FVCIs and AIFs to continue; except that in order to be eligible for the exemption, they must have held the equity securities for at least 6 months prior to the IPO (instead of the existing 1 year).

Impact: A shorter lock up by SEBI is the answer to a consistent call from the financial sponsor community. The current change will provide greater flexibility on investment (pre-IPO) and exit (post-IPO), and not to mention increase market liquidity and enhance price discovery.

Relaxation in “Promoter” tagging of Financial Sponsors

- SEBI has acknowledged that PE / institutional investors holding significant shareholding do not fall within the conventional concept of “promoter”, and responsibilities / liabilities are now shifting towards the Board / management.
- Accordingly, it has in-principle agreed on a shift away from the concept of promoter to that of “person in control” / “controlling shareholder” - in making a determination of rights and obligations of such persons in an IPO. To this effect, SEBI will engage with other relevant regulators and prepare an implementation roadmap.

Impact: Given the unique characteristics (and inherent limitations) of the concept of promoter - SEBI has in our view rightly decided to shift to a more practical and globally accepted standard. Much would now depend on the fine print, but this should allow financial sponsors greater flexibility / incentive in taking public Indian companies, especially where they are majority owners or exert significant control.

Relaxation in IPO Disclosure

- SEBI has re-assessed the scope of IPO disclosures, with the current formulation veering towards excess. In the new regime, amongst others, requirement to disclosure ‘promoter group’ will exclude companies having common financial investors (where promoter is a corporate body).

Impact: A common concern for the financial sponsor community was the unwitting inclusion of their other portfolio companies as part of the issuer’s promoter group in IPO documentation. To this end, SEBI has now provided a specific carve out for other portfolio companies controlled by the financial investor; putting the issue to rest.

Relaxation in SEBI Takeover Compliances

- The disclosure obligations on acquirers and promoters pertaining to acquisition of shares in listed stock (ie, initial 5%, and subsequent change of 2%), annual disclosure of holding, creation or release of encumbrance registered in the depository system will be removed (effective 1 April 2022).
- All such disclosures would be recorded and disseminated through a system driven disclosure mechanism which effectively automates the process based on data aggregated with Indian depositories.

Impact: Acquisition compliance is often difficult to track or missed by financial sponsors leading to potential settlement proceedings with SEBI, payment of fines, etc. An automated system would substantially reduce the compliance burden and de-risk financial sponsors from unintended breach of law.

More flexible approach towards Management ESOPs

- SEBI regulations limited share-based benefits to only a listed company’s own employees and those of its subsidiaries. SEBI has now also allowed employees of an ‘associate company’ (presumably, as defined under the Companies Act, 2013) to be granted benefits under an ESOP scheme floated by a listed company. Thus, if a listed company holds 20% or more in, or exercises

significant control over business decisions of another company, it can now grant share-based benefits to the employees of such company as well.

Impact: This was a gap area in the provision of management incentive plans by listed portfolio companies and could certainly come handy while formulating a bolt-on acquisition which is consummated in tranches.

- SEBI has (welcomingly) increased the time limits for appropriation of “inventory”. Currently, if a listed company implements an ESOP or SAR scheme which involves purchasing shares from the market via a trust, the regulations required that the purchase should be backed by grants before the expiry of the financial year subsequent to the year of purchase. This limit has now been increased from 1 financial year to 2 financial years.

Impact: This gives sufficient time to the listed portfolio company to identify employees to whom grants can be made while making purchases (via the trust) of shares of the listed company at an opportune time.

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