SEBI ICDR REGULATIONS AMENDMENT OF NOVEMBER 2022 | PART I | SEBI INTRODUCES CHAPTER ON PRE-FILING OF DRAFT OFFER DOCUMENTS FOR IPOS ON MAIN BOARD

KHAITAN & CO
ADVOCATES SINCE 1911

Background

Securities and Exchange Board of India (**SEBI**) has amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2022 (**SEBI ICDR Regulations**) through its notification SEBI/LAD-NRO/GN/2022/107 dated 21 November 2022 (**Amendment**), pursuant to which it has introduced confidential pre-filing of draft offer document for IPOs on main board. The Amendment materialises SEBI's decision in its board meeting, discussed in our KCO Ergo Newsflash dated 14 October 2022.

Applicability

The option to confidentially pre-file draft red herring prospectus (**PDRHP**) with SEBI and the stock exchanges is available to all issuers who wish to undertake an initial public offering (**IPO**) on the main board of stock exchanges. The PDRHP process has been introduced primarily for issuers who wish to keep their business information confidential at the initial stages of the IPO process and until a definitive decision of the IPO is made by the issuer. Comparable confidential filing mechanisms have become a popular and preferred alternative in jurisdictions like the US, where new-age companies like Airbnb, Inc.; Lyft, Inc.; Spotify Technology SA; Uber Technologies Inc.; Snap Inc. amongst others have opted for this route.

Timeline

The PDRHP process involves an additional filing of offer document with SEBI and stock exchanges, which increases the timeline for undertaking an IPO.

Stage 1		Stage 2		Stage 3	Stage 4	Stage 5
PDRHP	SEBI OBSERVATION	UDRHP-I	PUBLIC COMMENTS	UDRHP-II	RHP	Prospectus
Confidential filing with SEBI and SE Public announcement to be made within 2 days of PDRHP filing stating the fact of confidentially filing PDRHP and with no details of the intended issue No advertisement or marketing permitted except limited QIB interactions	Within 30 days from the later of date of receipt of (i) PDRHP; (ii) response to any SEBI interim observations; (iii) clarification/information from any other regulator or agency (if approached by SEBI); (iv) in-principle approval from SE; (v) intimation on closure of permitted QIB interaction; or (vi) intimation on conversion of convertible securities or exercise of right entitling option to receive equity shares (except as permitted to exist till RHP, as discussed further below) Issuer may be required to file updated PDRHP/ fresh PDRHP if events/changes in Schedule XVIA of the SEBI ICDR Regulations occur post receipt of SEBI observations	First public filing with SEBI and SE post incorporation of SEBI observations 7 days gap between intimation on closure of QIB interaction and UDRHP-I Public announcement inviting comments to be made within 2 days of UDRHP-I filing Publicity restrictions become applicable UDRHP-I to be filed within 16 months from date of issuance of SEBI observations	UDRHP-I available to public for comments on the websites of SEBI, SE and lead managers for atleast 21 days Issuer may be required to file updated PDRHP/fresh PDRHP/ fresh DRHP if changes/events specified in Schedule XVI occur post UDRHP-I This stage is akin to DRHP filing under the standard IPO process	Confidential filing after incorporating changes pursuant to public comments This stage is akin to UDRHP filing under the standard IPO process	Filing with SEBI, RoC and SE Issue must open within 18 months from date of issuance of SEBI observations	Filing with SEBI, RoC and SE post pricing

Notes: PDRHP: Pre-filed draft red herring prospectus; DRHP: Draft red herring prospectus; UDRHP-I: Updated draft red herring prospectus-I; UDRHP-II: Updated draft red herring prospectus-II; RHP: Red herring prospectus; SEBI: Securities and Exchange Board of India; SE: Stock exchanges; QIB: Qualified institutional buyers; RoC: Registrar of companies

Eligibility requirements and certain conditions

Eligibility requirements under the SEBI ICDR Regulations as applicable to the standard process of IPO are also applicable to PDRHP filings, subject to certain modifications.

In terms of Regulation 5(2) of the SEBI ICDR Regulations, issuers are not permitted to have outstanding convertible securities, unless these are fully paid-up and compulsorily convertible, or any rights which entitle a person with an option to receive equity shares except outstanding options granted to employees pursuant to an employee stock option scheme in compliance with applicable law. These are required to be converted on or before the filing of the draft red herring prospectus. Under the PDRHP filing mechanism, issuers are now permitted to have outstanding convertible securities (for instance optionally convertible securities or partly paid-up convertible securities) and/or any rights to receive equity shares, at the time of filing of the PDRHP and until SEBI provides observation on the PDRHP. Further, similar to the standard IPO process, fully paid-up compulsorily convertible securities are permitted to exist until the filing of the red herring prospectus (**RHP**) however, details of maximum number of shares such convertible securities can be converted into, is required to be disclosed in the UDRHP-I.

In terms of Regulation 56 of the SEBI ICDR Regulations, issuers are restricted from issuing securities from the date of the DRHP till listing, unless relevant details in respect of such issuance are disclosed in the DRHP. Under the PDRHP filing mechanism, issuers are permitted to issue securities between filing PDRHP and until SEBI issues its observations on the PDRHP subject to intimation to SEBI and stock exchanges, giving greater flexibility to issuers to raise funding even after the IPO process has commenced.

Further, under the PDRHP filing mechanism, the eligibility for shares to be offered in the offer for sale must be tested at the UDRHP-I stage. This provides increased opportunity to new investor shares and/or recently acquired shares by existing shareholders to become eligible, since the minimum 1 (one) year holding period is calculated backwards only from the date of filing the UDRHP-I, instead of DRHP in case of the standard IPO process.

Similarly, the test for eligible shares to be contributed towards minimum promoters' contribution (**MPC**) is required to be done at the UDRHP-I stage, instead of DRHP in case of the standard IPO process. The extended timelines may help promoters to meet MPC at a later stage. Further, the PDRHP filing mechanism also allows promoters to retain the pledge on their shares as collateral for a longer duration ie, until UDRHP-I, which would otherwise be required to be free from any encumbrance at the time of filing of DRHP. However, promoters' consent for MPC will be required upfront at the PDRHP stage, along with an undertaking that such shares will not be disposed, sold or transferred between date of filing of PDRHP till commencement of lock-in period.

Publicity and permissible marketing

Under the PDRHP filing mechanism, public communications by the issuer between its board meeting approving the public issue and until the filing of the UDRHP-I, are required to be consistent with its past practices. The publicity restrictions applicable to standard process of IPO, as set out in Schedule IX of the SEBI ICDR Regulations, would be applicable post filing of UDRHP-I. This essentially means that barring the mandatory public announcement about filing of the PDRHP, the issuer's public communications must continue to be "business as usual", without any reference to the proposed IPO or its details, during this interim period.

Post filing of the PDRHP, no marketing for the proposed IPO is allowed, except for limited interactions with qualified institutional buyers (**QIBs**) till SEBI issues its observations. SEBI has introduced the mechanism of 'Testing the Waters' (**TTW**) which is consistent with foreign jurisdictions. TTW allows issuers to gauge the preliminary investment interest of the QIBs for the proposed IPO, without soliciting an offer. Such interactions are strictly required to be limited to the information contained in the PDRHP. Lead managers to the IPO are required to (i) make a list of QIBs with whom they have interacted; and (ii) provide written communication confirming closure of QIB interactions to SEBI. A cooling off period of 7 (seven) days has been introduced between the date of confirmation to SEBI on closure of QIB interaction and filing of UDRHP-I.

Refiling

After SEBI issues its observations on the PDRHP, issuers may be required to file an updated PDRHP or a refile its PDRHP along with the prescribed fees, depending on the nature of changes or factual developments, in accordance with the newly introduced Schedule XVIA of the SEBI ICDR Regulations. The refiling threshold for PDRHP in case of variation in the offer size has been increased to more than 50% (including within the fresh issue and offer for sale components respectively) under the Schedule XVIA of the SEBI ICDR Regulations, in comparison to the threshold of 20% under existing Schedule XVI of the SEBI ICDR Regulations applicable to standard process of IPO. In case of any changes post UDRHP-I, the triggers of existing Schedule XVI of SEBI ICDR Regulations would apply and consequently require the issuer to file an updated PDRHP or fresh DRHP or fresh PDRHP.

Whilst SEBI has permitted variation in the offer size up to 50%, any variation between 10% to 20% would require filing of an updated PDRHP along with fees. The delta, in case the variation in offer size is more than 20% and up to 50%, remains a grey area. We believe that this is an oversight and will be addressed in due course by the regulator through an amendment.

Concluding Remarks

The PDRHP filing mechanism is a promising bet for companies with novel business models to test market sentiment before IPO plans come to fruition. Promoter(s) get the benefit of extended timeline to bring in the required MPC and continue to pledge shares until a later date, meanwhile the issuer jump-starts the IPO process. Further, in recent times several issuers have filed addenda to the DRHP in order to market the IPO with more updated information between DRHP and UDRHP. The PDRHP filing mechanism largely eliminates the requirement of addenda since the first publicly available offer document (UDRHP-I) shall be substantially updated and shall contain more relevant information closer to the IPO, for investors' decision making.

Similar to the standard IPO process, under the PDRHP filing mechanism, issuers would need to complete corporate actions such as conversion from a private to public company, comply with various corporate governance requirements, including board and committee composition, obtain signed consents from auditors and other experts before filing the PDRHP. The PDRHP will also have to be approved by the board of directors of the issuer and signed by the issuer, directors and selling shareholders. This contrasts with jurisdictions like the US where the confidentially submitted document is not treated as a 'filing' and is not required to be signed by the registrant or any of its officers or directors, or require consents from auditors and other experts at the non-public review stage.

Further, issuers will have to test the validity of restated financial statements at each stage of filing of the offer documents starting from PDRHP stage. The eligibility conditions as per Regulation 6 (1) or 6(2) of the SEBI ICDR Regulations would also be tested at each stage, starting from PDRHP.

- *Oishik Bagchi (Partner), Tishita Mukherjee (Associate), Johann Valladares (Associate) & Saisha Bacha (Associate)*

For any queries please contact: editors@khaitanco.com

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