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KEY CHANGES INTRODUCED BY SEBI IN THE FRAMEWORK OF OFFER FOR SALE THROUGH STOCK EXCHANGE MECHANISM

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Introduction

The Securities and Exchange Board of India (SEBI), through its circular dated 10 January 2023, has notified the 'Comprehensive Framework on Offer for Sale (OFS) of Shares through Stock Exchange Mechanism' (Circular), which modifies the earlier set of guidelines originally introduced on 18 July 2012. The said guidelines have been modified from time to time with the last significant updates made in December 2018. The Circular has been issued pursuant to representations made to SEBI by various stakeholders and recommendations of a working group of stock exchanges constituted by SEBI and subsequently concretised in SEBI's board meeting dated 30 September 2022 (discussed in our KCO Ergo Newsflash dated 14 October 2022, accessible here).

With the objective of introducing flexibility and making the existing OFS through stock exchange mechanism (OFS Mechanism) more efficient, SEBI has *inter alia*: i) removed the minimum shareholding requirement for non-promoter shareholders to offer their shares through the OFS Mechanism; ii) reduced the cooling off period for sellers to purchase/sell shares prior to or post the OFS, from 12 weeks to a range of 2 weeks to 12 weeks based on liquidity of such securities; iii) allowed retail investors to bid for unsubscribed portion of the non-retail segment; and iv) extended the OFS Mechanism to unitholders of listed infrastructure investment trusts (InvITs) and real estate investment trusts (REITs). The Circular shall come into effect from 9 February 2023.

Key changes introduced to the OFS Mechanism by the Circular:

1. ***OFS by non-promoter shareholders***: The OFS Mechanism was initially introduced to facilitate offloading of shares by promoters/promoter group entities to comply with the minimum public shareholding requirements under Rules 19 and 19A of the Securities Contracts (Regulation) Rules, 1957 (as amended) for listed companies (MPS). However, through a circular dated 8 August 2014, SEBI had extended the use of OFS Mechanism to non-promoter shareholders holding at least 10% of the share capital of an eligible company, for the first time. The Circular now relaxes this 10% minimum shareholding requirement and allows all non-promoter shareholders of eligible companies to offer shares through the OFS Mechanism. The minimum offer size continues to be INR 25 crores in line with the former guidelines.

   Comment: SEBI's objective is to remove the inconsistency in the dual eligibility test for non-promoter shareholders requiring: i) minimum 10% shareholding; and ii) minimum offer size of INR 25 crore, under the former guidelines. Earlier, if a non-promoter shareholder held less than 10% in an eligible company but otherwise met the value threshold for offer size being INR 25 crore or more, it was prohibited from diluting its shareholding through the OFS Mechanism. Guided by the rule of thumb of OFS i.e., large order transactions should not distort price discovery mechanism, the modification pursuant to the Circular concentrates on a sole substantive test of minimum offer size. This provides an alternative divestment/exit option to a larger universe of stakeholders. The availability of the OFS Mechanism is likely to benefit private equity investors and shareholders of professionally managed companies looking for a process which is more transparent and cost effective, involves less paperwork as compared to other ways of divesting shareholding (such as block trade) as well as permits wider participation from the public.

2. ***Cooling-off period for transactions in shares prior to and post OFS***: The procedure under the OFS Mechanism mandates a cooling-off period prior to and post the OFS during which sellers are prohibited from purchasing or selling shares of the target company. Under the former guidelines, this period was initially set as 12 weeks prior and post the OFS. This was subsequently relaxed by SEBI to allow promoters and promoter group entities to offer shares through OFS or institutional placement programme within the cooling off period, with a gap of 2 weeks between successive offers. SEBI later extended this exception to sale to employees as a part of the OFS transaction as well as qualified institutions placement (QIP) made within a period of 2 weeks. The Circular classifies the cooling-off period for both promoter/promoter group and non-promoter shareholders into three categories: (i) *most liquid shares:* ± two weeks; (ii) *liquid shares:* ± four weeks; and (iii) *illiquid shares:* ± 12 weeks. The determination of liquidity of shares as stated above will be as per the grouping of listed securities under SEBI's circular dated 23 February 2005 and is linked to the impact cost of trading.

   Consistent with former guidelines, the Circular clarifies that promoter/promoter group entities of companies with liquid or illiquid shares, may offer their shares during the cooling off period through OFS or QIP within a gap of 2 weeks between successive offers. In addition to the above, SEBI has allowed promoter/promoter group entities to offer the under-subscribed portion in an OFS of liquid and illiquid shares, in the open market within a gap of 2 weeks from the closure of the original OFS, when the OFS and the successive offer is made to comply with MPS norms.

   Comment: SEBI has brought out a distinction in the timeline for cooling off period based on liquidity of shares and impact cost. Accordingly, shareholders of most liquid stocks which are traded at higher frequency, can continue to buy/sell such shares pre and post this cooling offer period, with minimal market impact. Per data analysed by SEBI, this change will allow approximately 180 eligible companies to be categorised as most liquid, 290 eligible companies as liquid and around 430 eligible companies as illiquid. This change should lead to higher participation in the OFS specially by those sellers who otherwise had concerns with the OFS owing to the longer cooling off period(s) in the former guidelines.

3. ***Allocation of unsubscribed portion of non-retail segment to retail investors***: The Circular permits retail investors to bid in the unsubscribed portion of the non-retail segment. Prior to the Circular, while non-retail investors were allowed to bid for the unsubscribed portion of the retail segment, the vice versa position was not permitted. Consistent with former guidelines, the retail investors are required to bid in the retail segment based on the cut-off price determined in the non-retail segment. However, in an event of undersubscription in the non-retail segment, the retail investors can bid at floor price and accordingly retail bids below the cut-off price or floor price, as applicable, shall be rejected.

   Comment: SEBI has over time introduced changes in the OFS Mechanism to promote retail participation in the OFS. In August 2014, SEBI introduced the reservation of 10% of offer size for retail investors and permitted sellers to offer discount to retail investors. This change furthers SEBI's objective of encouraging greater participation of retail investors in the OFS and is expected to create a level playing field for both retail and non-retail investors.

4. ***Introduction of OFS Mechanism for sale of units of listed InvITs and REITs***: SEBI has extended the option of divestment through the OFS Mechanism to listed InvITs and REITS, thereby allowing dilution of unitholding of these entities by the unit holders.

   Comment: In the last couple of years, the markets have witnessed an increase in business trusts such as REITs and InvITs undertaking public issues. Making OFS Mechanism available for such listed REITs and InvITs is a logical step and showcases effort by SEBI to align aspects of the public issue and listing processes for business trusts with the framework applicable to equity shares. This change is expected to enable wider distribution of units, provide better liquidity to InvITs and REITs and to help the sponsors/sponsor group entities and other unitholders to dilute their stake in a cost effective manner with minimal paperwork involved. The OFS Mechanism will also serve as a feasible method to comply with the minimum public unitholding norms for listed InvITs and REITs.

5. ***Announcement or notice of the OFS to the stock exchanges***: Sellers in the OFS are required to announce the intention of sale of shares including the floor price of the OFS to the stock exchanges, latest by 5 PM on the day prior to the day of the OFS, through a notice of OFS. The Circular has introduced some flexibility wherein an extension up to 6 PM i.e. extension of one hour, can be granted by the stock exchanges on a case-to-case basis based on the seller's request, by recording reasons for such extension.

Remarks:

The changes to the existing OFS Mechanism, as introduced by the Circular, attempts to make the OFS Mechanism a more favourable option for both prospective sellers and buyers by broadening the contours of the existing system and bringing in more flexibility and efficiency in the process. While removing the shareholding threshold for non-promoter shareholders makes the OFS Mechanism a convincing alternative for investors looking to offload their shares in listed companies in a cost effective and time sensitive manner, permitting retail participation in non-retail segment may encourage more retail investors to consider OFS Mechanism as a suitable option to purchase securities at discounted rates from the market. In addition to tapping non-retail participation, higher retail participation also helps issuers expand their public shareholding base without having to go through the paperwork and processes involved in other mechanisms such as further public issues. The reduction in cooling-off period makes OFS more lucrative especially for shareholders of companies having liquid stocks, as they can continue to trade in securities of the said company without an embargo of 'no-trade' for a long period pre and post OFS which, being an eligibility criterion to undertake an OFS, could have been a hinderance otherwise. Further, the introduction of the OFS Mechanism for units of listed InvITs and REITs is a welcome change as it is expected to provide a lucrative option to unit holders to sell their stake in InvITs and REITs and to encourage further wider public participation in these instruments. Overall, in addition to providing a platform for complying with MPS norms, the changes which have been brought about by the Circular make OFS a viable avenue for divestment by various stakeholders in listed entities.

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