Corpsec Hotline

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SEBI'S COMPREHENSIVE FRAMEWORK ON OFFER FOR SALE THROUGH STOCK EXCHANGES

BACKGROUND

Offer for Sale ("**OFS**") is a form of transaction undertaken by promoters or major investors of a listed company to sell existing shares of the listed company to the public. OFS was introduced in the Indian security law regime in 2012 to allow promoters of listed companies to achieve minimum public shareholding. SEBI on January 10, 2023 issued a circular on Comprehensive Framework on OFS of shares through stock exchange mechanism ("**2023 Framework**")[1]. This 2023 Framework by SEBI overrides the earlier issued framework dated July 18, 2012 ("**2012 Framework**")[2] along with amendments made to the 2012 Framework. The 2023 Framework comes in the after-math of the market study on OFS by the working group comprising the major stock exchanges which was further reviewed by the Secondary Market Advisory Committee ("**SMAC**").[3]

In its transition from the 2012 Framework to the 2023 Framework, SEBI has taken a more inclusive approach to ensure that the true market potential of OFS as a route for sale of large volume of shares on stock exchanges is unlocked. Through this hotline, we analyze the shift in approach of SEBI from the 2012 Framework to the 2023 Framework and the rationale behind such a shift.

REDEFINED ELIGIBILITY CRITERIA

***Eligible Stock Exchanges*:** The 2023 Framework provides that the facility to undertake OFS of shares would be available through the Bombay Stock Exchange, National Stock Exchange and the Metropolitan Stock Exchange of India.[4] The 2012 Framework had only provided for the OFS of shares to be undertaken at the Bombay Stock Exchange and the National Stock Exchange.[5]

Eligible Sellers for OFS: One key shift from the 2012 Framework is the eligible sellers who can make an OFS on the eligible stock exchanges. As mentioned earlier, the concept of OFS was introduced to allow for the promoters of a listed company to sell their shares in order to reach the minimum public shareholding as prescribed by SEBI. Therefore, the 2012 Framework only provided for two categories of eligible sellers: (a) promoter/promoter group entities of listed companies who are required to increase the public shareholding to meet the minimum public shareholding requirements and (b) promoter/promoter group entities of the top 100 companies based on the average market capitalization of the last completed quarter.[6]

However, over the course of time, the definition of eligible sellers underwent changes by subsequent amendments. By the amendments in 2013 and 2014, SEBI increased the eligibility to the promoter/promoter group entities of the top 200 companies based on the average market capitalization of last completed four quarters. Additionally, 2014 also marked the entry of non-promoter sellers into the ambit of eligible sellers. As per the 2014 amendment, eligible sellers included *"non-promoter shareholder of eligible companies holding at least 10% of share capital"*.[7] This amendment showed the intent of SEBI to allow the use of OFS for more than just reducing the promoter shareholding to achieve minimum public shareholding.

The 2023 Framework has taken a further step in the earlier thought process of SEBI as it increases the ambit of eligible sellers to: (a) all promoter and promoter group entities of companies that are required to increase public shareholding to meet the minimum public shareholding requirements and (b) any promoter, promoter group entity and non-promoter of companies with market capitalization of INR 1,000 crores and above, with the threshold for market capitalization computed as the average daily marker capitalization for six months' period to the month in which the OFS opens.[8] Therefore, the 2023 Framework allows OFS by non-promoters of companies with market capitalization of INR 1,000 crores and above.

Eligible Buyers for OFS: Under the 2012 Framework, all investors who were registered with the brokers of the stock exchanges other than the promoter/promoter group entities of such companies making the OFS were considered as eligible buyers.[9] However, vide an amendment in 2014, the criteria for eligible buyers included a carve out that in case it is the non-promoter shareholders who are offering shares through OFS, the promoter and the promoter group entities of such company can be eligible buyers, subject to compliance with the applicable SEBI regulations.[10] This has been retained in the 2023 Framework as well.

COOLING-OFF PERIOD

Both the 2012 Framework and the 2023 Framework provide for a cooling-off period applicable before and after the OFS. Under the 2012 Framework, the promoter/promoter group entities shall have not (a) purchased and/or sold the

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shares of the company in the 12 weeks prior to the OFS and (b) shall undertake to not purchase and/or sell the shares of the company in the 12 weeks period after the OFS.[11] The SMAC, while reviewing this cooling-off period was of the view that such a blanket cooling-off period might not be appropriate for a very liquid share that has minimal market impact.

Therefore, the proposal of SMAC, which is also reflected in the 2023 Framework, was to have a more share-specific cooling-off period. The shares would be divided into three categories: (a) most liquid shares[12], (b) liquid shares[13] and (c) illiquid shares[14]. The cooling-off period for most liquid shares shall be 2 weeks before and after the OFS, for liquid shares shall be 4 weeks before and after the OFS and for illiquid shares shall be 12 weeks before and after the OFS.[15] These cooling-off periods shall be applicable on both promoters and non-promoter shareholders who are sellers in an OFS.

Additionally, as a carve out to the aforementioned cooling-off periods, the promoters/promoter groupentities of the companies whose shares are either liquid or illiquid, can offer their shares only through OFS or Qualified Institutional Placement with a gap of 2 weeks between successive offers.[16] However, this carve out is only available to promoter/promoter group entities and not to non-promoter shareholders. Additionally, in case the OFS is being undertaken for meeting the requirement of minimum public shareholding by the promoters, and the OFS is undersubscribed, in such a case, the promoters can offer the unsubscribed shares in the open market with a gap of 2 weeks from the closure of OFS.[17]

MINIMUM SIZE OF OFS, FLOOR PRICE AND DISCOUNT

Size of the offer: Both the 2012 Framework and the 2023 Framework provides that the minimum size of the OFS shall be INR 25 crores. However, as a carve out to the minimum offer size of INR 25 crores, the 2012 Framework and the 2023 Framework provide that an OFS of size lesser than INR 25 crores can be made by thepromoter/promoter group entities so as to achieve minimum public shareholdings in a single tranche.[18]

Floor Price: Floor price in an OFS is the minimum price at which the sellers intend to sell the shares. Under the 2012 Framework the sellers in an OFS had the option to disclose the floor price. In case they chose to disclose the floor price, they had to declare it (a) after the close of trading hours and before the close of business hours of the stock exchanges on T-1 day (T being the day of OFS) or (b) shall give the floor price in a sealed envelope to the stock exchanges before the opening of the OFS on T day.[19] However, this position was amended in 2014, post which it was made mandatory for the sellers to inform the floor price to the stock exchanges before 5 PM on T-1 day in case they were offering a cut-off price to the non-retail investors.[20] The 2023 Framework makes it mandatory for the seller to disclose the floor price along with the announcement/notice of the OFS by 5 PM or latest by 6 PM if an extension is granted by the stock exchanges on T-1 day.[21] This extension from 5 PM to 6 PM was a recommendation by SMAC based on their market study that there have been instances of difficulties being faced by the merchant bankers, sellers in foreign jurisdictions, etc.

Discount by sellers: While the 2012 Framework did not have a concept of discount on the cut-off price, vide an amendment in 2014, the concept of discount on the cut-off price was introduced for retail investors.[22] The same concept has found its way in the 2023 Framework. Under the 2023 Framework, sellers may offer discounts to the retail investor by providing the details of the discount and the percentage of reservation for retail investors upfront to the stock exchange.[23]

TIMELINES, ORDER PLACEMENT AND ALLOCATION

Timeline and order placement: As mentioned above, the details of the OFS would be informed by the sellers to the stock exchanges on T-1 day. As per the 2023 Framework, on T day only the non-retail investors shall be permitted to place their bid and the retail investors shall place their bids on T+1 day.[24] Cut-off price shall be determined based on the bids received on T day. The bidding by retail investors shall be based on the cut-off price determined in the non-retail category on T day. A new addition to the 2023 Framework is that any unsubscribed portion of the non-retail category after allotment shall be eligible for allocation in the retail category and vice versa. The 2012 Framework only allowed for the non-retail segment to carry forward their bids to the retail segment in case there is not much demand in the retail segment. However, the retail segment was not allowed to participate in the unsubscribed portion of the non-retail segment. This change comes in light of the recommendation by SMAC that retail participation has always been lagging behind the non-retail bids in terms of number of times subscribed.

Allocation: The 2023 Framework provides that (a) a minimum of 25% of the offered shares shall be reserved for mutual funds and insurance companies and any unsubscribed portion thereof shall be available to the other bidders, (b) minimum 10% of the offer size shall be reserved for retail investors[25] and (c) no single bidder other than mutual funds and insurance companies shall be allocated more than 25% of the size of OFS.[26] The allocation requirements did not change from the 2012 Framework. However, it is interesting to note that the SMAC had recommended against this allotment requirement. As per the SMAC, the requirement that minimum 25% of the shares shall be allotted to mutual funds and insurance companies, while is beneficial to companies seeking to achieve minimum public shareholding, would be counter-productive to companies already compliant with the minimum public shareholding. Such a restriction on companies already adhering to the minimum public shareholding might amount to an artificial barrier and affect efficient price discovery.

As per the SMAC, since the company is a listed company with information available in public domain, the allotment shall be solely on a price-priority basis and without any restrictions on the amount of allotment. Therefore, SMAC had recommended that the restrictions on the allocation shall not be applicable on companies that are already in compliance with minimum public shareholding. However, SEBI in its board meeting, while deliberating on the SMAC recommendations was of the view that removing the restriction would create the risk of concentration with single bidder other than mutual funds and insurance companies, which may not be desirable.

WITHDRAWAL AND CANCELLATION OF OFFERS

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***Withdrawal*:** The 2023 Framework provides that an OFS may be withdrawn prior to its proposed opening day. In case of a withdrawal, there should be a cooling-off period of 10 trading days from the date of withdrawal before an OFS is made again. The stock exchanges shall disseminate information about such withdrawal. The withdrawal requirements remain the same as the 2012 Framework.[27]

Cancellation: The cancellation of an OFS is not permitted as per the 2023 Framework during the bidding period. Additionally, in case the sellers do not get sufficient demand from non-retail investors at or above the floor price on T day, then the seller may choose or cancel the OFS in full (for both retail and non-retail) on the T day itself without proceeding to the T+1 day. The cancellation restrictions also remain the same as the 2012 Framework.[28]

OFS FOR REITS AND INVITS

One new addition, which was neither in the 2012 Framework, nor was contemplated in any of the amendments that followed, is the concept of OFS for sale of units in Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) by sponsors or sponsor group entities or other unitholders. The 2023 Framework provides for the same, however, only for publicly issued and listed REITs and InvITs. The OFS framework for the shares under the 2023 Framework shall be applicable to units as well.[29]

NDA VIEWS

The 2023 Framework is a great step in making OFS a favorable mechanism for sale of shares in a listed company by promoters and bigger shareholders. Few of the beneficial aspects of the 2023 Framework are as follows:

Removal of minimum percentage holding of non-promoter shareholders: As recommended by SMAC, the requirement of a non-promoter shareholder to hold at least 10% of the company along with the requirement that the minimum offer size shall be 25 crores made it cumbersome for non-promoter sellers. A key point, as also acknowledged by the SMAC was that in case a non-promoter holds 5% of a company, they would not be eligible sellers for OFS even if the value of the 5% held by them was 100 crores. However, a non-promoter with 10% share in a company where the 10% amounts to 30 crores, would be able to undertake an OFS. As rightly pointed out by SMAC, such a scenario would be against the guiding principle for OFS - *large order should not distort the market/price discovery mechanism*.

OFS as a replacement to block deals: As a result of allowing non-promoter shareholders to be eligible sellers without any minimum shareholding requirement, SEBI has paved the way for more OFS as a replacement to block deals as the non-promoters will now be able to sell larger block of shares at a better price. Block deals are privately negotiated before the execution of the actual trade. In a block deal, there is a restriction on pricing in form of a one per cent band above and below the market price. OFS can be done at whatever price the seller wants and it is open to the market. This provides the sellers with more flexibility. Therefore, post enforcement of the 2023 Framework, there could be a shift from block deals to OFS. However, this also comes with the caveat that, as compared to a block deal, OFS would have to abide by the allocation requirements thereby making it less desirable in cases of pre-negotiated deals.

***Applicability of OFS to REITs and InvITs*:** The OFS mechanism being incorporated into the REIT and InvIT segment would now allow for unitholders and sponsors of the REITs and InvITs to divest their unitholding, either for achieving minimum public shareholding or otherwise. The option of OFS would provide sponsors and unitholders an opportunity to divest with greater price flexibility and in a transparent manner, thereby also providing a wider participation. As already acknowledged by SMAC, a wider distribution of units under OFS would ensure better liquidation and depth of REITS and InvITs. Prior to SEBI allowing OFS in sale of InvIT and REIT units, block deals were used for sale of listed InvIT and REIT units by sponsors and unitholders. Now they will also have the option to do it through an OFS.

– Anurag Shah & Ratnadeep Roychowdhury

You can direct your queries or comments to the authors

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[1] SEBI Circular SEBI/HO/MRD/MRD-PoD-3/P/CIR/2023/10 (Comprehensive Framework on Offer for Sale (OFS) of shares through stock exchange mechanism, available at: https://www.sebi.gov.in/legal/circulars/jan-2023/comprehensive-framework-on-offer-for-sale-ofs-of-shares-through-stock-exchange-mechanism_67157.html

[2] SEBI Circular CIR/MRD/DP/18 /2012 available at: https://www.sebi.gov.in/legal/circulars/jul-2012/comprehensive-guidelines-on-offer-for-sale-ofs-of-shares-by-promoters-through-the-stock-exchange-mechanism_23115.html

[3] Review of the existing framework for OFS of shares through stock exchange mechanism, available at: https://www.sebi.gov.in/sebi_data/meetingfiles/oct-2022/1667217040766_1.pdf

[4] Clause 2.1 of 2023 Framework.

[5] Clause 1(a) of the 2012 Framework.

[6] Clause 1(b) of the 2012 Framework.

[7] Clause 3.2 of the SEBI Circular No. CIR/MRD/DP/24/2014

[8] Clause 2.2 of the 2023 Framework.

[9] Clause 1(c) of the 2012 Framework.

[10] Clause 3.3 of the SEBI Circular No. CIR/MRD/DP/24/2014

[11] Clause 1 (b) (ii) of 2012 Framework.

[12] Most liquid Shares as per the 2023 Framework is defined as listed securities forming part of Group I securities as per SEBI Circular No. MRD/DoP/SE/Cir-07/2005 dated February 23, 2005 and having mean impact cost of up to 0.05 percent of a trade of Rupees One Lakh.

[13] Liquid shares as per the 2023 Framework is defined as listed securities forming part of Group I securities as per SEBI circular No. MRD/DoP/SE/Cir-07/2005 dated February 23, 2005 and having mean impact cost of greater than 0.05 percent and less than or equal to 0.10 percent for a trade of Rupees One Lakh. .

[14] Illiquid Shares as per the 2023 Framework is defined as securities not forming part of “Most Liquid Shares” and “Liquid Shares”.

[15] Clause 2.4.1 of the 2023 Framework.

[16] Clause 2.4.2 of 2023 Framework.

[17] Clause 2.4.3 of the 2023 Framework.

[18] Clause 3 of the 2023 Framework and Clause 3 of the 2012 Framework.

[19] Clause 5 (c) (i) of the 2012 Framework.

[20] Clause 2.1 of SEBI Circular CIR/MRD/DP/32 /2014

[21] Clause 5.6.3 of the 2023 Framework.

[22] Clause 3.12 of SEBI Circular No. CIR/MRD/DP/24/2014

[23] Clause 5.4.2 of the 2023 Framework.

[24] Clause 5.5 of the 2023 Framework.

[25] Clause 7 of the 2023 Framework

[26] Clause 7.8 of the 2023 Framework.

[27] Clause 11 of the 2023 Framework.

[28] Clause 12 of the 2023 Framework.

[29] Part B of the 2023 Framework.