

## Corpsec Hotline

May 12, 2006

### QUALIFIED INSTITUTIONS PLACEMENTS

The Securities and Exchange Board of India ("SEBI") has introduced the regime of private placements of securities by Indian listed companies called Qualified Institutions Placements ("QIP"). The regulations for the QIPs are very similar to the Regulation D offerings (Rule 144A) under US Securities Act of 1933. The new regime has been introduced in the form of Chapter XIIIA of the SEBI (Disclosures and Investor Protection) Guidelines, 2000 ("DIP Guidelines") on May 8, 2006 (the "Amendment").

SEBI, in its release introducing the QIPs, has stated that it wanted Indian companies to use the QIP route to raise capital rather than raising funds through the American Depository Receipt ("ADR") or the Global Depository Receipt ("GDR") or the Foreign Currency Convertible Bond ("FCCB") routes. In the current market scenario, a lot of Indian companies are raising funds through the issuances of ADRs, GDRs or FCCBs.

Simply put, QIPs are basically the issue of "specified securities" by Indian companies to Qualified Institutional Buyers ("QIBs"). The Amendment defines the specified securities as equity shares, fully convertible debentures, partly convertible debentures or any securities other than warrants, which are convertible into or exchangeable with equity shares at a later date.

### Objectives of the Amendment

The SEBI would like to achieve the following objectives through the Amendment:

- a. Providing an impetus to the current booming Indian stock market scenario
  - The Amendment specifies the eligibility criteria for issuing QIPs by companies. The criteria, inter alia, state that the issuer company has to be listed on stock exchanges that have nationwide terminals. Under the ADR/GDR regime, the issuing company need not be listed at all on the Indian stock exchange.
  - Additionally, this listing of the issuer company would assist in increasing the amount of participation of retail investors. But it has to be remembered that a QIP cannot substitute an IPO.
- b. Restricting "export" of capita: The "export" of capital that usually takes place when a company opts for an ADR/GDR/FCCB would not take place, as the capital would remain within the country and with the QIBs.
- c. Increasing the liquidity in the market

### Eligibility criteria

#### Issuer Company

The issuer company that is making the QIP has to meet with the eligibility criteria of being listed on either the Bombay Stock Exchange or the National Stock Exchange, and also has to comply with the prescribed minimum public shareholding that forms a part of the listing agreement, which generally is 25% for most companies, however, in certain cases, this limit can be 10% as well.

#### Investor

As is evident from the terminology itself, QIPs are those private placements that are made to QIBs exclusively. The amendment categorically states that no allotment can be made under this amendment, either directly or indirectly, to any QIB, which is a promoter of the issuer company, or any person related to promoters.

A QIB, as defined under the DIP Guidelines can either be a public financial institution as defined in section 4A of the Companies Act, 1956, a scheduled commercial bank, a mutual fund, a foreign institutional investor ("FII") registered with SEBI, a multilateral and bilateral development financial institution, a venture capital fund ("VCF") registered with SEBI, a foreign venture capital investor ("FVCI") registered with SEBI or a State Industrial Development Corporation, an insurance company, certain provident funds and certain pension funds.

In general SEBI is looking at QIBs being the beneficiaries for such placements and investments due to their appetite and the ability to invest large amounts and the fact that QIBs are informed investors, who are aware of the risks involved for such investments. The reason for specifically naming them as the exclusive investors can also be attributed to the fact that they usually possess strong research facilities and a vast experience that supplements their expertise in investments. Moreover, not only are they the target for a QIP, but they are also the only eligible subscribers to an issue of Indian Depository Receipts, a topic covered extensively in our prior hotline, *Indian Depository Receipts have Arrived!*, April 4, 2006.

### Additional Qualifications for QIPs

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- **Percentage of Issue:** At least 10% of the total proposed QIP has to be offered to mutual funds. If the mutual funds are not agreeable to this issue or a part thereof, then this issue to mutual funds or part thereof may be offered to other QIBs.

- **Number of QIBs:** The minimum number of QIBs who would be issued the specified securities through the QIP depends on the size of the proposed issue. The aggregate funds that can be raised through QIPs in one financial year cannot exceed five times of the net worth of the issuer company at the end of its previous financial year.
- **Ceiling limits for investment by the FIIs/FVCIs that comprise QIB group:**
  - **FIIs:** A ceiling limit of 5% of the total amount of issued capital is placed on the holding of a single sub-account by FIIs, in any company, when invested by way of preferential allotment.
  - **FVCIs:** FVCIs will not be able to invest in QIPs due to the Reserve Bank of India restriction on any investment by FVCIs into listed entities in India.
- **Issuance amount:** There is no specification of a minimum amount to be raised pursuant to the issue of QIPs, however, if the issue is for less than or equal to Rs. 2.5 billion (approximately US\$ 55 million at current rates) then it has to be made to a minimum of two investors. But if the issue exceeds Rs. 5 billion (approximately US\$ 111 million at current rates), then the minimum number of investors is five. Furthermore, the issuing companies are not allowed to make more than 50% of the total issue to any one single investor.
- **Consecutive issues:** There has to be a gap of at least six months between any QIPs.
- **Lock-in requirement:** The security subscribed to by way of a QIP can only be sold on stock exchanges.

## Pricing

The most important part of any issue- whether a private placement, ADR/GDR/FCCB, an IPO or even a QIP, is it's pricing. The pricing stipulations in the amendment are analogous to the ones prescribed for making a GDR/FCCB, which is basically the same as has been prescribed under Chapter XIII of the DIP Guidelines. It is normally the higher of the 26-week average and the 2-week average price of the shares on a given stock exchange.

## Issue Procedure

**Issuance of the security:** The issuer has to procure the requisite statutory approvals from its existing shareholders by holding a general meeting under section 81 (1A) of the Companies Act, 1956.

Importantly, the approval so received remains valid for a period of 12 months from the date on which it was granted. This is distinct from the shareholders resolution under Chapter XIII of the DIP Guidelines, where the allotment has to be made within 15 days from (i) the date of the shareholders meeting or (ii) the receipt of any regulatory approval (for the acquisition of shares or the transaction), where necessary.

**Filings:** The issuer company has to prepare a "placement document" containing all the relevant and material disclosures. These disclosures range from disclosing the actual computation of the price of the issue, the size of the issue, the manner in which the proceeds from the issue will be used by the company, financial statements, capitalization statements, etc.

This placement document does not have to be filed pre-issue with SEBI but it has to be filed and placed on the websites of the Stock Exchanges and the issuer, with an appropriate disclaimer to the effect that the placement is meant only for QIBs on private placement basis and is not an offer to the public.

**Merchant Bankers:** The Amendment requires that the QIPs have to be managed by a SEBI registered merchant banker. The merchant banker shall exercise due diligence and furnish a due diligence certificate to Stock Exchanges stating that the issue of QIPs complies with all the relevant requirements and subsequently file a copy of the placement document and post issue details with SEBI within thirty days of the allotment, for record purpose.

## Implications of the Amendment

As far as the impact on listed companies is concerned, they would welcome this amendment as it may provide an alternative to the ADR, GDR or FCCB route. It would also prove to be a speedier manner of raising funds, as the placement would be made to a set of informed investors. This decreases the number of disclosures and procedural stipulations as compared to the public issue process. This mechanism would complement the existing public issue and preferential issue mechanisms.

Therefore, in conclusion, it is definitely a commendable move by the SEBI and it remains to be seen whether or not QIPs become the preferred route for India Inc. to raise funds in order to fuel its increasing demands for capital.

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You can direct your queries or comments to the authors

Source: *Sebi circular on the new Chapter XIII A of DIP Guidelines dated May 8, 2006*

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