

PROFESSIONAL PROGRAMME

MODULE IV
PAPER 7

DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

SUPPLEMENT TO STUDY MATERIAL



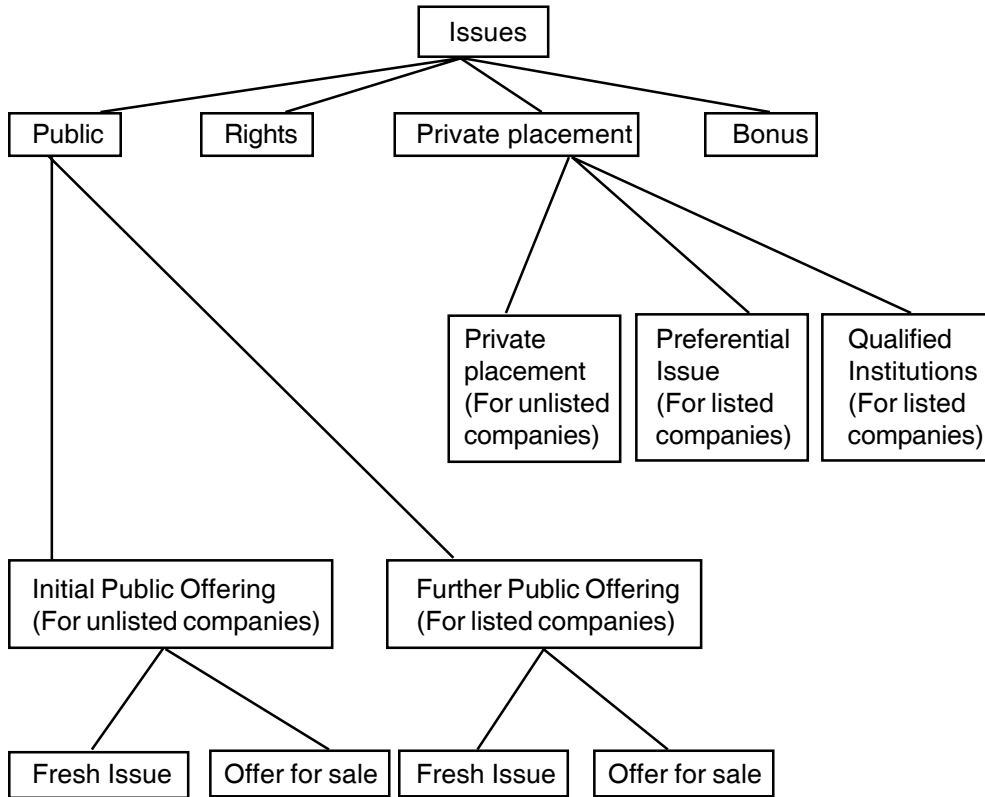
**THE INSTITUTE OF
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IN PURSUIT OF PROFESSIONAL EXCELLENCE
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STUDY II
DUE DILIGENCE — EQUITY ISSUES

I. INTRODUCTION AND REGULATORY FRAMEWORK

Introduction*

Primarily, issues can be classified as a Public, Rights or preferential issues (also known as private placements). While public and rights issues involve a detailed procedure, private placements or preferential issues are relatively simpler. The classification of issues is illustrated below:



Public issues can be further classified into Initial Public offerings and further public offerings. In a public offering, the issuer makes an offer for new investors to enter into shareholding family. The issuer company makes detailed disclosures as per SEBI (Issue 06 Capital and Disclosure Requirements) Regulations 2009 in its offer document.

* Source : sebi.gov.in

Initial Public Offering (IPO) is when an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer's securities.

A further public offering (FPO) is when an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document. An offer for sale in such scenario is allowed only if it is made to satisfy listing or continuous listing obligations.

Rights Issue (RI) is when a listed company which proposes to issue fresh securities to its existing shareholders as on a record date. The rights are normally offered in a particular ratio to the number of securities held prior to the issue. This route is best suited for companies who would like to raise capital without diluting stake of its existing shareholders unless they do not intend to subscribe to their entitlements.

Bonus issue : When an issuer makes an issue of securities to its existing shareholders as on a record date, without any consideration from them, it is called a bonus issue. The shares are issued out of the Company's free reserve or share premium account in a particular ratio to the number of securities held on a record date.

A **private placement** is an issue of shares or of convertible securities by a company to a select group of persons under Section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital.

A private placement of shares or of convertible securities by a listed company is generally known by name of **preferential allotment**. A listed company going for preferential allotment has to comply with the requirements contained in Chapter VII of SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 .

“qualified institutions placement” means allotment of eligible securities by a listed issuer to qualified institutional buyers on private placement basis in terms of SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009

Regulatory Framework

Public issue is mainly governed by the following legislations/regulations/rules:

1. The Companies Act, 1956
2. Securities Contracts (Regulation) Act, 1956
3. Foreign Exchange Management Act, 1999
4. Securities Contracts Regulation (Rules) 1957
5. SEBI (ICDR) Regulations 2009
6. Listing Agreement

II. DUE DILIGENCE-IPO/FPO

When the due diligence is carried out as part of the steps leading to an IPO, the exercise takes on added meaning and encompasses a wider scope, as it identifies the areas or the issues where the company exhibits weaknesses and the due diligence

process becomes a tool, which shows the company the way to optimize its potential and thereby increasing its value to potential investors. Pre-IPO due diligence process will result in a gap analysis between the present status of the company and the company that should be floated i.e., a gap is an expectations gap created as a result of how the market expects a listed company to conduct its affairs. In this scenario, once these gaps have been highlighted the due diligence exercise should not stop there but should include advice given by the advisors to the company on the processes and activities which are required to fill the gaps identified. In an IPO the due diligence exercise is a broader, fuller exercise which apart from identifying the weaknesses also looks at resolving them with the purpose of increasing the value of the company.

The due diligence process aspires to achieve the following:

- to assess the reasonableness of historical and projected earnings and cash flows;
- to identify key vulnerabilities, risk and opportunities;
- to gain an intimate understanding of the company and the market in which the company operates such that the company's management can anticipate and manage change;
- to set in motion the planning for the post-IPO operations.

It will result in a critical analysis of the control, accounting and reporting systems of the company and a critical appraisal of key personnel. It will identify the value drivers of the company thus enabling the directors to understand where the value is and to focus their efforts on increasing that value.

Due diligence spans the entire public issue process. The steps involved in due diligence are given broadly below:

1. Decision on public issue
2. Business due diligence
3. Legal and Financial Due Diligence
4. Disclosures in Prospectus
5. Marketing to Investors
6. Post issue compliance

Key areas to be focused:

- (a) the financial statements – to ensure their accuracy;
- (b) the assets – confirm their value, condition existence and legal title;
- (c) the employees – identification and evaluation of the key movers and shakers;
- (d) the sales strategy – analyzing the policies and procedures in place and assessing what works and what does not;
- (e) the marketing – what is driving the business and is it effective ?

- (f) the industry in which the company operates – understand trends and new technologies;
- (g) the competition – identify the threats;
- (h) the systems – how efficient are they ? Are upgrades required ?
- (i) legal and corporate and tax issues – is the shareholding structure robust? Are there any tax issues which need to be resolved ?
- (j) company contracts and leases – identify what the risks and obligations are;
- (k) suppliers – are they expected to remain around ?

Illustrative list of documents/information to be examined:

(i) *Basic documents*

Review of basic corporate documents like:

- Memorandum and Articles of Association of the Company
- Copies of Incorporation Certificate/Commencement of Business Certificate/Change of Name certificate (if applicable)
- Registered office address of the company
- History/businesses of the company
- Special rights available to any persons through shareholder or other Agreements.

(ii) *Promoters/Personnel*

1. Promoters' bio-data with special reference to qualification and experience. Track record of the promoters in the capital market – public issue by other group companies, violation of securities laws.
2. Directors' & Key Personnel – details bio-data including father's name, address, occupation, year-wise experience. Background of the Directors – including examining the list of willful defaulters periodically prepared by RBI.
3. Constitution of Audit Committee, remuneration Committee etc., Terms of reference of these committees.
4. Organization Chart.
5. Key Personnel/employees/Directors left in the last two years with reasons.
6. Break-up of employees – whether any agreement are entered into with employee – If so, copy of agreement.
7. Details of Pay scales/bonus (including performance)/PF/Gratuity etc.
8. Employment of contract labour – no. of workers, copy of contract.

(iii) *Financials*

1. Projections of combined operations (existing + proposed) for 5 years including the following:
 - Income details including prices

- Cash flow and Balance Sheet
 - Capacity utilization details
 - Interest calculation – Assn. of rate/Repayment schedule
 - Depreciation – Book & I.T.
 - Tax
 - Tax etc.
 - Assumptions w.r.t. cost items
 - Commencement of commercial production (Year to be mentioned)
 - IT depreciation table for past OR (in case projections have to be prepared)
 - Latest provisional accounts with all schedules
 - Latest income Tax Depreciation calculation
 - Input-Output ration (consumption norms) for each segment alongwith prices and input prices
 - Services-wise capacity & Capacity utilization projects for the next 5 years
 - Working Capital norms
 - Basis for working out various expenses
 - Month from which the commercial production will commence for the new project
 - IT depreciation table for past.
2. Bankers to the Company – name & addresses.
 3. Details of Banks Loan, Term Loan, Promissory notes, Hundis, Credit Agreements, Lease, Hire Purchase, Guarantees or any other evidences of indebtedness, Copies of Sanction letters, Original amount, Interest rate, Amount outstanding, Repayment schedule.
 4. Details of default/reschedulements, if any – copy of correspondence with lenders.
 5. Accounts for last 3 years and latest unaudited accounts.
 6. Associate/Group Companies' concerns accounts for last 3 years. Also give: Profile of the concerns.
 7. Audited Balance Sheet, P&L Account for last 3 years of the promoter company (i.e. if promoter is a Co.)
 8. In case any liabilities are not disclosed in the Balance Sheet, details thereof, or any secret reserves.
 9. Age-wise analysis of stocks, debtors, creditors and loans & advances given
 10. Terms of various loans & advances given
 11. If names of any associates/related units are present in the debtors or parties to whom loans & advances have been given
 12. Details of contingents liabilities including guarantees given by Co./directors
 13. Trends in profit ratios.

(iv) *Project Information*

1. Project Feasibility report
2. Reports/documents prepared by independent research agencies in respect of the state of the industry and demand and supply for the company's products
3. Break-up of Cost of Project:
 - Land – Locational site & map, area, copy of documents i.e. Sale/lease Deed for land, Soil Test Report, Order for converting land into Industrial land etc.
 - Building – Details break-up from Architect, Approval details from Municipality etc. and Valuation Report from a chartered engg. (for existing building and suitability of site)
 - Equipments – Invoices/Quotations of main items. (Indicate Imported mach. Separately)
 - Margin Money for Working Capital – Margin Money for Working Capital (calculation)
 - Preliminary & Pre-operative expenses – break-up
 - Provision for contingencies – break-up
4. Schedule of Implementation.
5. Status of Project as on a recent date – Amount spent & sources
6. Promoter's contribution till date (supported by Auditor's certificate if possible)
7. Current & proposed Shareholding pattern
8. Sanctions received by the issuer from bankers/institutions for debt financing in the project
9. Notes on the following: Technical process, utilities (power, water, transport, effluent treatment), location, land building, Plant & Machinery).
 - (a) Manpower
 - (i) Break-up of employees – whether any agreements are entered into with employee – If so, copy of agreement.
 - (ii) Details of Pay scales/bonus (including performance bonus)/PF/ Gratuity etc.
 - (iii) Employment of contract labour – no. of workers, copy of contract.
 - (b) Quality Control facilities, Research & Development.
10. Market (Demand/supply with sources alongwith copies),
11. Marketing & Distribution (network etc.) & relevant documents wherever applicable.

12. Arrangements and strategy of the company for marketing its products
13. Discussions with important customers, suppliers, Joint Venture partners, collaborators of the company.

(v) *General Information*

1. Details on Litigation, Disputes, overdue, statutory dues, other Material development and tax status of Company & promoters.
2. Copies of IT returns of the Company along with copies of Assessment orders for last three years.
3. Copies of IT/Wealth tax returns of the promoters along with copies of Assessment orders for last three years.
4. Copy of documents for Collaborations/Marketing Tie-ups/Other Tie-ups if any.
5. NOC/Approval/Sanctions from SEB/SPCB or copy of application.
6. Copy of SIA Registration/SSI Regn./EOU License/LOI or License.
7. Incentives if any – such as subsidy, Sales tax loans/exemption/concession/power subsidy (Copy of Booklet or notification).
8. List of existing plant & machinery with cost & age & type of ownership (lease etc.)
9. R&D (if any) cost for the project for the last three years. (Sources of any outside R&D funds including any joint venture agreements)
10. Summary of Bad Debts experience for the last five years.
11. Approvals from company's Board of Directors/Shareholders to issue securities to the public.
12. Copies of documents filed with Registrar of Companies.
13. Names of stock exchanges where shares of the Co. are listed.
14. Stock Market quotation of share, wherever applicable, as on recent date.
15. Special legislation applicable, if any, and compliance thereof (e.g. NBFCs etc.)

(vi) *Third Parties*

1. Brochure on collaborators, copy of Government approval for collaboration.
2. Copy of Agreement with Consultants, Copy of Government approval in case of foreign consultants.
3. Copies of important Agreements/Contracts of any sort with all the parties concerned with the company.
4. Copy of FIPB/RBI approvals (NRI/Foreign participant etc.), wherever applicable.
5. Details of Patents, Trademarks, Copyrights, Licenses etc., if any.
6. List of major customers/clients (attach copies of main pending orders).

7. Competitors & Market shares for Company's products (with sources, wherever possible).
8. Sales arrangements, terms & conditions.
9. Main suppliers – terms & conditions.

SECURITIES AND EXCHANGE BOARD OF INDIA (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009 (ICDR REGULATIONS)

The ICDR Regulations have been made primarily by repealing the SEBI (Disclosure and Investor Protection) Guidelines, 2000

While incorporating the provisions of the rescinded Guidelines into the ICDR Regulations, certain changes have been made by removing the redundant provisions, modifying certain provisions on account of changes necessitated due to market design and bringing more clarity to the provisions of the rescinded Guidelines.

The significant differences between SEBI (DIP) Guidelines 2000 and SEBI (ICDR) Regulations, 2009 as provided in SEBI Circular No. SEBI/CFD/DIL/ICDRR/2009/03/09 dated September 3, 2009 is enclosed at Annexure I.

Applicability of ICDR Regulations

These regulations shall apply to the following:

- (a) a public issue;
- (b) a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more;
- (c) a preferential issue;
- (d) an issue of bonus shares by a listed issuer;
- (e) a qualified institutions placement by a listed issuer;
- (f) an issue of Indian Depository Receipts.

Eligibility Requirements

Eligibility norms are made uniformly to all companies under SEBI (ICDR) Regulations, 2009 irrespective of whether it is a banking company or infrastructure company which were given exemptions under erstwhile SEBI (DIP) Guidelines. The following are the conditions for making initial public offer

- (a) The issuer has net tangible assets of at least three crore rupees in each of the preceding three full years (of twelve months each), of which not more than fifty per cent. are held in monetary assets and if more than fifty per cent. of the net tangible assets are held in monetary assets, the issuer has made firm commitments to utilise such excess monetary assets in its business or project;
- (b) it has a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least three out of the immediately preceding five years, excluding extraordinary items.

- (c) it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each);
- (d) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year;
- (e) if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.

If the above conditions are not satisfied, the issuer may make public offer, if

- (a) (i) the issue is made through the book building process and the issuer undertakes to allot at least fifty per cent. of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make allotment to the qualified institutional buyers; or
- (ii) at least fifteen per cent. of the cost of the project is contributed by scheduled commercial banks or public financial institutions, of which not less than ten per cent. shall come from the appraisers and the issuer undertakes to allot at least ten per cent. of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make the allotment to the qualified institutional buyers;
- (b) (i) the minimum post-issue face value capital of the issuer is ten crore rupees; or
- (ii) the issuer undertakes to provide market-making for at least two years from the date of listing of the specified securities, subject to the following:
 - (A) the market makers offer buy and sell quotes for a minimum depth of three hundred specified securities and ensure that the bid-ask spread for their quotes does not, at any time, exceed ten per cent;
 - (B) the inventory of the market makers, as on the date of allotment of the specified securities, shall be at least five per cent of the proposed issue.

Who is not Eligible ?

- (a) if the issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by the Board;
- (b) if any of the promoters, directors or persons in control of the issuer was or also is a promoter, director or person in control of any other company which is debarred from accessing the capital market under any order or directions made by the Board;
- (c) if the issuer of convertible debt instruments is in the list of wilful defaulters published by the Reserve Bank of India or it is in default of payment of interest or repayment of principal amount in respect of debt instruments issued by it to the public, if any, for a period of more than six months;

- (d) unless it has made an application to one or more recognised stock exchanges for listing of specified securities on such stock exchanges and has chosen one of them as the designated stock exchange:

Provided that in case of an initial public offer, the issuer shall make an application for listing of the specified securities in at least one recognised stock exchange having nationwide trading terminals;

- (e) unless it has entered into an agreement with a depository for dematerialisation of specified securities already issued or proposed to be issued;
- (f) unless all existing partly paid-up equity shares of the issuer have either been fully paid up or forfeited;
- (g) unless firm arrangements of finance through verifiable means towards seventy five percent. of the stated means of finance, excluding the amount to be raised through the proposed public issue or rights issue or through existing identifiable internal accruals, have been made.

A check list on Major IPO Compliances under SEBI(ICDR) Regulations 2009

1. Appointments of Intermediaries

- Check whether the issuer has appointed one/more merchant bankers to carry out the obligations relating the issue?
- Check whether the issuer has appointed SEBI registered intermediaries in consultation with lead merchant banker?
- Check whether the issuer has appointed syndicate member in respect of issue through book building?
- Check whether the issuer appointed registrars who has connectivity with both depositories.(ie NSDL/CDSL).
- Ensure that the lead merchant banker is not acting as registrar to the issue in which it is also handling post issue obligations.
- Ensure that in case of book built issue lead merchant banker and lead book runner are not different persons.

2. Filings/approvals/submissions

- Check whether the draft offer document is filed with SEBI at least thirty days prior to registering a prospectus, red herring prospectus or shelf prospectus with ROC or filing the letter offer with the registrar of companies.
- Check whether the draft offer document is made available to the public for atleast 21 days from the date of such filing with SEBI.
- Check whether a statement on the comments received from public on draft offer document is filed with SEBI.
- Ensure whether the observations/suggestions of SEBI on draft offer documents has been carried out while registering of prospectus with ROC.

- Check whether a copy of letter of offer is filed with SEBI and with stock exchanges where the securities are proposed to be listed, simultaneously while registering the prospectus with ROC /before opening of the issue.
- Check whether the company has obtained in-principle approval in respect of IPO/FPO from all the exchanges where the securities are proposed to be listed.
- Ensure whether the issuer has filed necessary documents before opening of the issue while
 - a. Filing the draft offer documents with SEBI
 - b. Required documents after issuance of observations by SEBI
 - c. Filing of draft offer document with stock exchanges where the securities are proposed to be listed.

It may be noted that contents of offer documents hosted on Websites are the same as printed versions filed with ROC. Further the information contained in the offer document and particulars as per audited financial statements in the offer document are not more than six months old from the opening of the issue.

- Ensure that the offer document/red herring prospectus, abridged prospectus etc contain necessary disclosures.

3. *Pre issue-Due Diligence Certificates*

Ensure whether the lead merchant bankers has submitted die diligence certificate with SEBI at the time of

- (a) filing of draft offer document with SEBI
- (b) At the time of Registering prospectus with ROC
- (c) Immediately before opening of the issue
- (d) After the opening of the issue and before its closure before it closes for subscription.

4. *Time limitation in opening of issue*

Ensure that subject to compliance of Section 60(4) of the Companies Act, 1956, public/rights issue is opened within

- (i) Twelve months from the date of issuance of observations from the SEBI on draft offer document or
- (ii) Within three months from the later of the following dates if there are not observations.
 - (a) Draft of Receipt of draft offer document by SEBI
 - (b) Date of receipt of satisfactory reply from the lead merchant bankers, where the SEBI has sought for any clarification/information

- (c) Date of receipt of clarification or information from any regulator or agency, where the SEBI has sought for any such clarification/information
 - (d) Date of receipt of a copy of in-principle approval letter issued by the recognized stock exchanges.
- (iii) In case of Fast Track issues the issue shall be opened within 90 days from the registration of prospectus with ROC.
 - (iv) In case of Shelf prospectus, the first issue may be opened within 3 months from the date of observation of SEBI.
5. *Dispatch of offer documents and other materials*
Ensure whether the offer document and other issue related instruments is dispatched to Bankers, Syndicate Members, underwriters etc in advance.
 6. *Underwriting for issue through book building*
Ensure whether the issue through book building route is underwritten.
 7. *Minimum Subscription*
Ensure whether the company has received minimum subscription of 90% of the offer.
 8. *Minimum allottees*
Ensure that the number of prospective allottees is at least one thousand.
 9. *Monitoring agency*
Ensure that the issue size of more than 500 crores has been monitored by a Public Financial Institution or by one of the scheduled commercial banks named in the offer document as bankers of the issuer.
 10. *Time limitation for receiving the call money*
Ensure the subscription money if made in calls, the outstanding subscription money is called within 12 months from the date of allotment.
 11. *Time limit for allotment or refund of Subscription money*
Ensure that the securities are allotted and the excess amounts are refunded within 15 days from the closure of the offer.
 12. *Pricing*
 - Ensure the norms relating to price/price band, cap on price bands is complied with.
 - Check whether the pricing norms are complied with respect to differential pricing
 - Check whether the floor price/final price is not less than the face value of securities.

13. *Promoters Contribution & restriction on transferability of their securities*

- Ensure that the promoters' contribution is
 - (a) in case of an initial public offer, not less than twenty per cent. of the post issue capital;
 - (b) in case of a further public offer, either to the extent of twenty per cent. of the proposed issue size or to the extent of twenty per cent. of the post-issue capital;
 - (c) in case of a composite issue, either to the extent of twenty per cent. of the proposed issue size or to the extent of twenty per cent. of the post-issue capital excluding the rights issue component.
- Ensure that the promoters contribution is kept in an escrow account with a scheduled banks and shall be released to the issuer along with the release of issue proceeds.
- Ensure that the securities ineligible for promoters contribution is not included while calculating the above limits.
- Ensure that the minimum promoters contribution and excess promoters contribution is locked in for 3 years and one year respectively.

For the computation of minimum promoters' contribution, the following specified securities(Equity Shares and Convertible Securities)shall not be eligible:

- (a) specified securities acquired during the preceding three years, if they are:
 - (i) acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction; or
 - (ii) resulting from a bonus issue by utilisation of revaluation reserves or unrealized profits of the issuer or from bonus issue against equity shares which are ineligible for minimum promoters' contribution;
- (b) Specified securities acquired by promoters during the preceding one year at a price lower than the price at which specified securities are being offered to public in the initial public offer subject to certain exemptions specified.
- (c) Specified securities allotted to promoters during the preceding one year at a price less than the issue price, against funds brought in by them during that period, in case of an issuer formed by conversion of one or more partnership firms, where the partners of the erstwhile partnership firms are the promoters of the issuer and there is no change in the management:
- (d) Specified securities pledged with any creditor.

14. *Other lock in requirements*

- Ensure that the pre-issue capital held by persons other than promoters is subject to lockin for the period of one year from the date of allotment, subject to speicified exemptions.

— Transferability of lock in shares

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997, the specified securities held by promoters and locked-in may be transferred to another promoter or any person of the promoter group or a new promoter or a person in control of the issuer and

the specified securities held by persons other than promoters and locked-in may be transferred to any other person holding the specified securities which are locked-in along with the securities proposed to be transferred:

However, lock-in on such specified securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in period stipulated in these regulations has expired.

15. *Minimum offer to the Public*

Subject to the provisions of sub-clause (b) of clause (2) of rule 19 of Securities Contracts (Regulations) Rules, 1957, check the net offer to public:

- (a) in case of an initial public offer, is at least ten per cent. or twenty five per cent of the post-issue capital, as the case may be; and
- (b) in case of a further public offer, is at least ten per cent. or twenty five per cent of the issue size, as the case may be.

However Government companies and infrastructure Companies are exempted from these provisions subject to exceptions.

16. *Reservation on Competitive Basis*

— *For issue made through the book building process*

(1) In case of an issue made through the book building process, the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:

- (a) employees of the issuer including employees of the promoting companies in case of a new issuer;
- (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in case of a new issuer; and
 - (ii) listed group companies, in case of an existing issuer:
- (c) persons who, as on the date of filing the draft offer document with the Board, are associated with the issuer as depositors, bondholders or subscribers to services of the issuer making an initial public offer:

— *For issue made other than through the book building process*

In case of an issue made other than through the book building process, the issuer may make reservation on competitive basis out of the issue size

excluding promoters' contribution and net offer to public in favour of the following categories of persons:

- (a) employees of the issuer including employees of the promoting companies in case of a new issuer;
- (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in the case of a new issuer; and
 - (ii) listed group companies, in the case of an existing issuer:

Ensure that reservations have not been made in respect of the following persons who are not eligible.

- (a) In case of promoting companies being financial institutions or state and central financial institutions, the shareholders of such promoting companies
- (b) In case of issue made through book building process, the issue management team, syndicate members, their promoters, directors and employees and for the group or associate companies of the issue management team and syndicate members and their promoters, directors and employees;

16. *Allocation of net offer to public*

In case of issue through book building

- (i) Not less than 35% to Retail individual investors
- (ii) Not less than 15% to non-institutional investors
- (iii) Not more than 55% to qualified institutional buyers and 5% of which shall be allocated to mutual funds. (up to 35% of the portion available for allocation of qualified institutional buyers may be allocated to anchor investor)

However at least 50% of net offer is to be allocated to qualified institutional buyers if an issuer has not satisfied the basic eligibility criteria and undertakes to allot so. Further if the issuer is required to allot 60% of the net offer to the public to Qualified institutional Buyers in terms of 19(2)(b) of Securities Contracts Regulation Rules, 1957, allocation to retail individual investors and non institutional investors shall be 30% and 10% respectively.

In case of issue other than book building

- (i) Minimum 50% to retail individual investors and
- (ii) Remaining to individual applicants other than retail individual investors and Other investors including corporate bodies or institutions, irrespective of the number of securities applied for.

17. *Period of subscription*

Ensure that the public issue is kept open at least for three working days but not more than ten working days including the days for which the issue is kept open in case of revision in price band.

18. *Advertisements*— *Pre issue*

Ensure that after registering the red herring prospectus (in case of a book built issue) or prospectus (in case of fixed price issue) with the Registrar of Companies, make a pre-issue advertisement in the prescribed format and with required disclosures, in one English national daily newspaper with wide circulation, Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.

— *Issue opening and closing*

Ensure that the advertisement on issue opening and closing is made in the specified format.

— *Post issue advertisement*

Ensure that advertisement giving details relating to oversubscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of dispatch of refund orders or instructions to Self Certified Syndicate Banks by the Registrar, date of dispatch of certificates and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

Major issues to be taken care while issuing advertisement/publicity material

- Ensure that issuer, advisors, brokers or any other entity connected with the issue do not publish any advertisement stating that issue has been oversubscribed or indicating investors' response to the issue, during the period when the public issue is still open for subscription by the public.
- Ensure that all public communications and publicity material issued or published in any media during the period commencing from the date of the meeting of the board of directors of the issuer in which the public issue or rights issue is approved till the date of filing draft offer document with the Board is consistent with its past practices.
- Ensure that any public communication including advertisement and publicity material issued by the issuer or research report made by the issuer or any intermediary concerned with the issue or their associates contains only factual information and does not contain projections, estimates, conjectures, etc. or any matter extraneous to the contents of the offer document.
- Ensure that the announcement regarding closure of the issue is made only after the receipt of minimum subscription.
- Ensure that no product advertisement contains any reference, directly or indirectly, to the performance of the issuer during the period commencing from

the date of the resolution of the board of directors of the issuer approving the public issue or rights issue till the date of allotment of specified securities offered in such issue.

- Ensure that no advertisement or distribution material with respect to the issue contains any offer of incentives, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise.
- Ensure that the advertisement does not include any issue slogans or brand names for the issue except the normal commercial name of the issuer or commercial brand names of its products already in use.
- Ensure that no advertisement uses extensive technical, legal terminology or complex language and excessive details which may distract the investor.
- Ensure that no issue advertisement contains statements which promise or guarantee rapid increase in profits.
- Ensure that no issue advertisement displays models, celebrities, fictional characters, landmarks or caricatures or the likes.
- Ensure that no issue advertisement appears in the form of crawlers (the advertisements which run simultaneously with the programme in a narrow strip at the bottom of the television screen) on television.
- In any issue advertisement on television screen, the risk factors shall not be scrolled on the television screen and the advertisement shall advise the viewers to refer to the red herring prospectus or other offer document for details.
- Ensure that no issue advertisement contains slogans, expletives or non-factual and unsubstantiated titles.
- If an advertisement or research report contains highlights, it shall also contain risk factors with equal importance in all respects including print size of not less than point seven size;

19. *Minimum Application Value*

Ensure that Minimum application Value is kept between Rs.5000 to Rs. 7000.

20. *Allotment procedure and basis of allotment*

The allotment of specified securities to applicants other than anchor investors shall be on proportionate basis within the specified investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed by the issuer

21. *Appointment of Compliance officer*

The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.

22. *Redressal of investor grievances*

The post-issue lead merchant bankers shall actively associate himself with post-issue activities such as allotment, refund, despatch and giving instructions

to syndicate members, Self Certified Syndicate Banks and other intermediaries and shall regularly monitor redressal of investor grievances arising therefrom.

23. *Post issue diligence*

- (1) The lead merchant bankers shall exercise due diligence and satisfy himself about all the aspects of the issue including the veracity and adequacy of disclosure in the offer documents.
- (2) The lead merchant bankers shall call upon the issuer, its promoters or directors or in case of an offer for sale, the selling shareholders, to fulfil their obligations as disclosed by them in the offer document and as required in terms of these Regulations.
- (3) The post-issue merchant banker shall continue to be responsible for post-issue activities till the subscribers have received the securities certificates, credit to their demat account or refund of application moneys and the listing agreement is entered into by the issuer with the stock exchange and listing/trading permission is obtained.
- (4) The responsibility of the lead merchant banker shall continue even after the completion of issue process.

24. *Post issue Reports*

The lead merchant banker shall submit post-issue reports as follows:

- (a) initial post issue report in specified form within three days of closure of the issue
- (b) final post issue report in specified format within fifteen days of the date of finalisation of basis of allotment or within fifteen days of refund of money in case of failure of issue. The lead merchant banker shall also submit a due diligence certificate in the specified format along with the final post issue report.

ROLE OF COMPANY SECRETARY IN AN IPO

The Securities Exchange Board of India Act, 1992 (SEBI Act) was formed, inter alia, to provide for the establishment of a Board (SEBI) to protect the interest of investors in securities and to promote the development of and to regulate the securities market.

SEBI regulates the securities market by prescribing measures to register and regulate the working of Capital Market Intermediaries associated with Securities market. Such intermediaries undertake following major activities relating to securities in addition to other activities:

- Management of an Issue of Capital
- Manager of Co-manager
- Advisor to issue
- Corporate Advisory Services

- Underwriting
- Registrar to an Issue and Share Transfer Agent
- Private Placement
- Public announcement and offer documents for acquisition of shares under Takeover code
- Portfolio Manager
- Brokers, Sub-brokers.

The main role of these Capital Market Intermediaries is to provide maximum information to the investors by means of disclosures carrying vital information. The intermediaries are necessarily compelled to associate with other professionals to advise the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., directly by the Board or the Central Government to point out the non-compliance and ensure the complete compliance. In a capital market issue, the major role in synchronizing these activities of intermediaries lies with a qualified Company Secretary.

Section 2(2) of the Company Secretaries Act, 1980 indicates the various areas of practice which are open to a Company Secretary holding certificate of practice issued by the Institute. The objective of authorizing members to practice is to make available professional services of a Company Secretary to the corporate sector.

The educational background, knowledge, training and exposure that a company secretary acquires makes him a versatile professional capable of rendering a wide range of services to companies of all sizes, other commercial and industrial organizations; including small and medium sized companies which are not required by law, to employ compulsorily a Whole-Time Company Secretary.

The plethora of services, which a Practising Company Secretary can render in IPOs can be listed as under:

1. Planning Stage
 - (a) Deciding the time line
 - (b) Compliance related issues
 - (c) Importance of Corporate Governance
 - (d) Structure of Board
 - (e) Promoters consent
 - (f) Method of issuance of shares (Demat/Physical/Both) - Compliance
2. Due diligence
 - (a) Company Contract and Leases
 - (b) Legal and Tax Issues
 - (c) Corporate issues
 - (d) Financial Assets
 - (e) Financial Statement

- (f) Creditors & Debtors
- (g) Legal Cases against the company
- 3. Appointing Advisors and other intermediaries such as:
 - (a) Investment Bankers
 - (b) Book Running Lead Managers
 - (c) Issues with Depository
 - (d) Legal Advisor
 - (e) Bankers
- 4. Offer Document
 - (a) Drafting the offer document
 - (b) Filing with SEBI
 - (c) In-principle approval of Stock Exchange
 - (d) Filing with Designated Stock Exchanges
 - (e) Complying with Comments received from SEBI
 - (f) Filing with ROC
- 5. Issue Period
 - (a) Adhering to Issue Opening/Closing Date
 - (b) Compiling Field Reports on subscription status
 - (c) Coordinating with Registrar/Bankers to the issue
- 6. Allotment of shares
 - (a) Basis of allotment
 - (b) Board meeting for allotment
 - (c) Crediting shares in beneficiary account/dispatch of share certificates
 - (d) Despatch of refund orders
 - (e) Payment of stamp duty
- 7. Listing
 - (a) Filing for Listing with Designated Stock Exchange
 - (b) Finalisation of Listing Process
- 8. Post issue compliances
 - (a) To ensure proper compliance with Listing Agreement
 - (b) Redressal of shareholder complaints
 - (c) Timely filing of required reports with ROC/SEBI/Stock Exchange

As can be seen from the above, a Company Secretary is a key member in an IPO team. Apart from checking the applicability and eligibility norms or exemption from eligibility norms and the pre-listing requirements of Stock Exchange, he is responsible for ensuring that the company has complied with the pre-issue, issue and post-issue obligations of the company and corporate governance requirements including disclosures with respect to, inter alia, material contracts, statutory approvals, subsidiaries and promoter holding and litigations.

Compliance of SEBI (ICDR) Regulation 2009 and other applicable Acts and guidelines is a primary responsibility of the Company Secretary in case the company proposes to list its securities abroad, he is also required to comply with conditions for listing abroad.

III. DUE DILIGENCE – ISSUES OTHER THAN IPO/FPO

Companies might issue shares through routes other than IPO/FPO. It might include preferential allotments, issue of shares through rights issue, bonus issue or ESOP scheme etc. various important aspects to be taken care of before and after the issue are discussed below.

III-A. DUE DILIGENCE – PREFERENTIAL ISSUE

Due diligence of preferential issue may be

- (a) Due diligence of preferential issues by listed companies.
- (b) Due diligence of preferential issues by unlisted companies.

Due diligence of preferential issues by listed companies

- (a) **Due Diligence Preferential issue of listed Companies- a Check list under Chapter VII of SEBI(ICDR) Regulations 2009**

Non Applicability

1. The provisions of this Chapter shall not apply where the preferential issue of equity shares is made:
 - (a) pursuant to conversion of loan or option attached to convertible debt instruments in terms of sub-sections (3) and (4) of sections 81 of the Companies Act, 1956;
 - (b) pursuant to a scheme approved by a High Court under section 391 to 394 of the Companies Act, 1956;
 - (c) in terms of the rehabilitation scheme approved by the Board of Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985:

Provided that the lock-in provisions of this Chapter shall apply to such preferential issue of equity shares.
- (2) The provisions of this Chapter relating to pricing and lock-in shall not apply to equity shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of clause (h) of section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (51 of 1993).
- (3) The provisions of regulation 73 (Disclosures) and regulation 76 (Pricing) shall not apply to a preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, where the Board has granted relaxation to the issuer in terms of regulation 29A of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, if adequate disclosures about the plan and process proposed to be followed for identifying the allottees are given in the explanatory statement to notice for the general meeting of shareholders.

Check list for preferential issue of listed companies

1. *Special Resolution*

- Check whether a special resolution has been passed by its shareholders;
- The special resolution shall specify the relevant date on the basis of which price of the equity shares to be allotted on conversion or exchange of convertible securities shall be calculated “relevant date” means:
 - (a) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue:

Provided that in case of preferential issue of equity shares pursuant to a scheme approved under the Corporate Debt Restructuring framework of Reserve Bank of India, the date of approval of the Corporate Debt Restructuring Package shall be the relevant date.
 - (b) in case of preferential issue of convertible securities, either the relevant date referred to in clause (a) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.
- The issuer shall, in addition to the disclosures required under section 173 of the Companies Act, 1956 or any other applicable law, disclose the following in the explanatory statement to the notice for the general meeting proposed for passing special resolution:
 - (a) the objects of the preferential issue;
 - (b) the proposal of the promoters, directors or key management personnel of the issuer to subscribe to the offer;
 - (c) the shareholding pattern of the issuer before and after the preferential issue;
 - (d) the time within which the preferential issue shall be completed;
 - (e) the identity of the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue;
 - (f) an undertaking that the issuer shall re-compute the price of the specified securities in terms of the provision of these regulations where it is required to do so;
 - (g) an undertaking that if the amount payable on account of the re-computation of price is not paid within the time stipulated in these regulations, the specified securities shall continue to be locked- in till the time such amount is paid by the allottees.

2. *Compulsory Dematerialisation*

Check whether all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form;

3. ***Condition for continued listing***

Check the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement.

4. ***Permanent Account Number of allottees***

Check whether the issuer has obtained the Permanent Account Number of the proposed allottees.

5. ***Shares not to be allotted to persons who has sold any equity shares of the issuer in preceding six months***

Ensure that the issuer has not make preferential issue of specified securities to any person who has sold any equity shares of the issuer during the six months preceding the relevant date: However, in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, the Board may grant relaxation from the requirements of this sub-regulation, if the Board has granted relaxation in terms of regulation 29A of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 to such preferential allotment.

6. ***Copy of the certificate of its statutory auditor***

The issuer shall place a copy of the certificate of its statutory auditor before the general meeting of the shareholders, considering the proposed preferential issue, certifying that the issue is being made in accordance with the requirements of these regulations.

7. ***Valuation by an independent qualified valuer***

Where specified securities are issued on a preferential basis to promoters, their relatives, associates and related entities for consideration other than cash, the valuation of the assets in consideration for which the equity shares are issued shall be done by an independent qualified valuer, which shall be submitted to the recognised stock exchanges where the equity shares of the issuer are listed: If the recognised stock exchange is not satisfied with the appropriateness of the valuation, it may get the valuation done by any other valuer and for this purpose it may obtain any information, as deemed necessary, from the issuer.

8. ***Time Limit for allotment***

Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution:

Exceptions

Where any application for exemption from the applicability of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 or any approval or permission by any regulatory authority or the Central Government for allotment is pending, the period of fifteen days shall be counted from the date of order on such application or the date of approval or permission, as the case may be:

Where the Board has granted relaxation to the issuer in terms of regulation 29A of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997,

the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, shall be made by it within such time as may be specified by the Board in its order granting the relaxation:

Requirement of allotment within fifteen days shall not apply to allotment of specified securities on preferential basis pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India.

(2) If the allotment of specified securities is not completed within fifteen days from the date of special resolution, a fresh special resolution shall be passed and the relevant date for determining the price of specified securities under this Chapter will be taken with reference to the date of latter special resolution.

9. ***Tenure of convertible securities***

The tenure of the convertible securities of the issuer shall not exceed eighteen months from the date of their allotment.

10. ***Pricing of equity shares***

(a) *If listed for more than 6 months*

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of six months or more as on the relevant date, the equity shares shall be allotted at a price not less than higher of the following:

- (a) The average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the six months preceding the relevant date; or
- (b) The average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(b) *If listed for less than 6 months*

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than six months as on the relevant date, the equity shares shall be allotted at a price not less than the higher of the following:

- (a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, pursuant to which the equity shares of the issuer were listed, as the case may be; or
- (b) the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the period shares have been listed preceding the relevant date; or
- (c) the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

This price shall be recomputed by the issuer on completion of six months from the date of listing on a recognised stock exchange with reference to

the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during these six months and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

c. *Preferential issue to qualified institutional buyer*

Any preferential issue of specified securities, to qualified institutional buyers not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

'stock exchange' means any of the recognised stock exchanges in which the equity shares are listed and in which the highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding six months prior to the relevant date.

11. ***Payment of consideration***

Full consideration of specified securities other than warrants issued under this Chapter shall be paid by the allottees at the time of allotment of such specified securities:

Exceptions

In case of a preferential issue of specified securities pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India, the allottee may pay the consideration in terms of such scheme.

An amount equivalent to at least twenty five per cent. of the consideration shall be paid against each warrant on the date of allotment of warrants. The balance seventy five per cent. of the consideration shall be paid at the time of allotment of equity shares pursuant to exercise of option against each such warrant by the warrant holder.

In case the warrant holder does not exercise the option to take equity shares against any of the warrants held by him, the consideration paid in respect of such shall be forfeited by the issuer.

12. ***Lock-in of specified securities***

- The specified securities allotted on preferential basis to promoter or promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to promoter or promoter group, shall be locked-in for a period of three years from the date of allotment of the specified securities or equity shares allotted pursuant to exercise of the option attached to warrant, as the case may be:

Exceptions/Conditions

Not more than twenty per cent of the total capital of the issuer shall be locked-in for three years from the date of allotment:

Equity shares allotted in excess of the twenty per cent. shall be locked-in for one year from the date of their allotment pursuant to exercise of options or otherwise, as the case may be.

The specified securities allotted on preferential basis to persons other than promoter and promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be locked in for a period of one year from the date of their allotment.

- The lock-in of equity shares allotted pursuant to conversion of convertible securities other than warrants, issued on preferential basis shall be reduced to the extent the convertible securities have already been locked-in.
- The equity shares issued on preferential basis pursuant to a scheme of corporate debt restructuring as per the Corporate Debt Restructuring framework specified by the Reserve Bank of India shall be locked-in for a period of one year from the date of allotment: However partly paid up equity shares, if any, shall be locked-in from the date of allotment and the lock-in shall end on the expiry of one year from the date when such equity shares become fully paid up.

If the amount payable by the allottee, in case of re-calculation of price after completion of six months from the date of listing, is not paid till the expiry of lock-in period, the equity shares shall continue to be locked in till such amount is paid by the allottee.

- The entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date upto a period of six months from the date of preferential allotment.

13. *Transferability of locked-in specified securities and warrants issued on preferential basis*

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997, specified securities held by promoters and locked-in may be transferred among promoters or promoter group or to a new promoter or persons in control of the issuer:

Provided that lock-in on such specified securities shall continue for the remaining period with the transferee.

Due diligence – Preferential issues of unlisted companies

Issue of preferential allotments by unlisted companies is mainly governed by Unlisted Public Companies (Preferential Allotment) Rules, 2003. These rules are applicable to all unlisted public companies in respect of preferential issue of equity shares, fully convertible debentures, partly convertible debentures or any other financial instruments which would be convertible into or exchanged with equity shares at a later date.

The following check list provides the details of compliances by unlisted companies.

- (i) Check whether there is a provision in the Articles of Association authorizing the Board to make preferential allotment.
- (ii) Check whether there is adequate unissued capital
- (iii) Ensure to pass necessary special resolution under Section 81(1A) of the Companies Act, 1956 and necessary filings with ROC

- (iv) Ensure that the explanatory statement to the notice for the general meeting as required under section 173 of the Companies Act, 1956 contains the following:
 - (a) the price or price band at which the allotment is proposed;
 - (b) the relevant date on the basis of which price has been arrived at;
 - (c) the object/s of the issue through preferential offer;
 - (d) the class or classes of persons to whom the allotment is proposed to be made;
 - (e) intention of promoters/directors/key management persons to subscribe to the offer;
 - (f) shareholding pattern of promoters and others classes of shares before and after the offer;
 - (g) proposed time within which the allotment shall be completed;
 - (h) whether a change in control is intended or expected
- (v) Ensure that, in case of every issue of shares/warrants/fully convertible debentures/partly convertible debentures or other financial instruments with conversion option, the statutory auditors of the issuing company / company secretary in practice certifies that the issue of the said instruments is being made in accordance with these Rules and such certificate is being laid before the meeting of the shareholders convened to consider the proposed issue.
- (vi) Ensure to complete the allotment within 12 months of passing special resolution
- (vii) Ensure to make necessary filings with ROC in respect of the said preferential allotment.

III-B. DUE DILIGENCE – EMPLOYEE STOCK OPTION

Issue of shares through Employee Stock Option Scheme/Employee Stock Purchase scheme by listed companies are regulated by Securities And Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. The following aspects are to be checked while issue of shares/options to employees under ESOP scheme.

(a) Employee Stock Option

1. *Eligibility to Participate*

- (i) An employee is eligible to participate in Employee Stock Option Scheme (ESOS) of the company.

Where such employee is a director nominated by an institution as its representative on the Board of Directors of the company—

- (i) the contract/agreement entered into between the institution nominating its employee as the director of a company and the director so appointed shall, inter alia, specify the following:
 - (a) whether options granted by the company under its ESOS can be accepted by the said employee in his capacity as director of the company;

- (b) that options, if granted to the director, shall not be renounced in favour of the nominating institution; and
 - (c) the conditions subject to which fees, commissions, ESOSs, other incentives, etc. can be accepted by the director from the company.
- (ii) the institution nominating its employee as a director of a company shall file a copy of the contract/agreement with the said company, which shall, in turn, file the copy with all the stock exchanges on which its shares are listed.
 - (iii) the director so appointed shall furnish a copy of the contract/agreement at the first Board meeting of the company attended by him after his nomination.
- (ii) Check that employee is not a promoter nor belongs to the promoter group.
 - (iii) Check that a director who either himself or through his relative or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company is not participating as he is not eligible to participate in the scheme.

2. *Compensation Committee*

- (i) Check that the disclosures, as specified in Schedule IV are made by the company to the prospective option guarantees.
- (ii) Check that the company has constituted a Compensation Committee for administration and superintendence of the scheme.
- (iii) Check that the Compensation Committee is a Committee of the Board of Directors consisting of a majority of independent directors.
- (iv) Check that the Compensation Committee has formulated the detailed terms and conditions of the scheme including:
 - (a) the quantum of option to be granted under the scheme per employee and in aggregate;
 - (b) the conditions under which option vested in employees may lapse in case of termination of employment for misconduct;
 - (c) the exercise period within which the employee should exercise the option and that option would lapse on failure to exercise the option within the exercise period;
 - (d) the specified time period within which the employee shall exercise the vested options in the event of termination or resignation of an employee;
 - (e) the right of an employee to exercise all the options vested in him at one time or at various points of time within the exercise period;
 - (f) the procedure for making a fair and reasonable adjustment to the number of options and to the exercise price in case of corporate actions such as rights issues, bonus issues, merger, sale of division

and others. In this regard, the following actions should be taken into consideration by the compensation Committee:

- (i) The number and the price of ESOS shall be adjusted in a manner such that total value of ESOS remains the same after the corporate action.
 - (ii) For this purpose global best practices in this area including the procedures followed by the derivatives markets in India and abroad shall be considered.
 - (iii) The vesting period and the life of the options shall be left unaltered as far as possible to protect the rights of option holders.
 - (g) the grant, vest and exercise of option in case of employees who are on long leave; and
 - (h) the procedure for cashless exercise of options.
- (v) Check that suitable policies and systems have been framed by the compensation committee to ensure that there is no violation of the following by any employee—
- (a) Securities and Exchange Board of India (Insider Trading) Regulations, 1992; and
 - (b) Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 1995.

3. *Shareholders' Approval*

- (i) Check that the approval of shareholders of the company has been obtained by passing a special resolution in general meeting.
- (ii) Check that the explanatory statement to the notice and the resolution proposed to be passed in general meeting for scheme containing the following information has also been sent:
 - (a) the total number of options to be granted;
 - (b) identification of classes of employees entitled to participate in the scheme;
 - (c) requirements of vesting and period of vesting;
 - (d) maximum period within which the option shall be vested;
 - (e) exercise price or pricing formula;
 - (f) exercise period and process of exercise;
 - (g) the appraisal process for determining the eligibility of employees to the scheme;
 - (h) maximum number of options to be issued per employee and in aggregate;
 - (i) a statement to the effect that the company shall conform to the accounting policies specified by SEBI in regard to ESOS;

- (j) the method which the company uses to value its options, i.e., whether fair value or intrinsic value.
 - (k) in case the company calculates the employees compensation cost using the intrinsic value of the stock options, the difference between the employees compensation cost so computed and employee compensation cost that shall have been recognized, if it had used the fair value of the options, shall be disclosed in the directors report and also the impact of this difference on profits and on EPS of the company shall be disclosed in directors report.
- (iii) Check that approval of shareholders by way of a separate resolution in the general meeting has been obtained by company in case of—
- (a) grant of option to employees of subsidiary or holding company and,
 - (b) grant of option to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

4. *Variation of Terms of ESOS*

- (i) Check that the company does not vary the terms of the Scheme in any manner which may be detrimental to the interests of the employees.
- (ii) However, if such variation is not prejudicial to the interests of the option holders, Check that the company has passed a special resolution in a general meeting to vary the terms of scheme.
- (iii) the provisions of clause 3(iii) as above shall apply to such variation of terms as they apply to the original grant of option.
- (iv) Check that the notice for passing special resolution for variation of terms of ESOS has been sent.
- (v) Check that the notice discloses full details of the variation, the rationale therefor and the details of the employees who are beneficiary of such variation.
- (vi) The companies have been given an option to reprice the options which are not exercised if ESOSs were rendered unattractive due to fall in the price of shares in the market. The company must ensure that such re-pricing should not be detrimental to the interest of employees and approval of shareholders in General Meeting has been obtained for such pricing.

5. *Pricing*

The companies granting option to its employees pursuant to the scheme have the freedom to determine the exercise price subject to adherence to the accounting policies. In case the company calculates the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the

employee compensation cost that shall have been recognized if it had used the fair value of the options, is required to be disclosed in the Director's Report and also the impact of this difference on profits and on Earnings per Share of the company shall also be disclosed in the Director's Report.

6. *Lock-in-Period and Rights of the Option-holder*

- (i) Check that there exists a minimum period of one year between the grant of options and vesting of option.

Also ensure that, in a case where options are granted by a company under an ESOS in lieu of options held by the same person under an ESOS in another company which has merged or amalgamated with the first mentioned company, the period during which the options granted by the transferor company were held by him shall be adjusted against the minimum vesting period required under this clause.

- (ii) The company has the freedom to specify the lock-in-period for the shares issued pursuant to exercise of option.
- (iii) Check that the employee does not have the right to receive any dividend or to vote or in any manner enjoys the benefits of a shareholder in respect of option granted to him, till shares are issued on exercise of option.

7. *Consequence of Failure to Exercise Option*

- (i) Check that amount payable by the employee, if any, at the time of grant of option has been forfeited by the company if the option is not exercised by the employee within the exercise period; or
- (ii) Check that the amount has been refunded to the employee if the option is not vested due to non-fulfilment of condition relating to vesting of option as per the Scheme.

8. *Non-Transferability of Option*

- (i) Check that option granted to an employee is not transferable to any person.
- (ii) (a) No person other than the employee to whom the option is granted shall be entitled to exercise the option.
- (b) Under the cashless system of exercise, the company may itself fund or permit the empanelled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares, subject to the provisions of the Companies Act, 1956.
- (iii) Check that the option granted to the employee is not pledged, hypothecated, mortgaged or otherwise alienated in any other manner.
- (iv) Check that in the event of the death of employee while in employment, all the options granted to him till such date are vested in the legal heirs or nominees of the deceased employee.

- (v) Check that in case the employee suffers a permanent incapacity while in employment, all the option granted to him as on the date of permanent incapacitation, shall vest in him on that day.
- (vi) Check that if an employee resigns or is terminated, all options not vested as on that day expire. However, the employee shall, subject to the terms and conditions formulated by compensation committee, be entitled to retain all the vested options.
- (vii) Check that, the options granted to a director, who is an employee of an institution and has been nominated by the said institution, has not been renounced in favour of institution nominating him.

9. *Disclosure in the Directors' Report*

1. Check that the Board of Directors disclose either in the Directors Report or in the Annexure to the Director's Report, the following details of the Scheme:
 - (a) options granted;
 - (b) the pricing formula;
 - (c) options vested;
 - (d) options exercised;
 - (e) the total number of shares arising as a result of exercise of option;
 - (f) options lapsed;
 - (g) variation of terms of options;
 - (h) money realized by exercise of options;
 - (i) total number of options in force;
 - (j) employee-wise details of options granted to—
 - (i) senior managerial personnel;
 - (ii) any other employee who receives a grant in any one year of option amounting to 5% or more of option granted during that year;
 - (iii) identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;
 - (k) diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of option calculated in accordance with International Accounting Standard (IAS) 33.
 - (l) Where the company has calculated the employee compensation cost using the intrinsic value of the stock options, the difference

between the employee compensation cost so computed and the employee compensation cost that shall have been recognized if it had used the fair value of the options, shall be disclosed. The impact of this difference on profits and on EPS of the company shall also be disclosed.

- (m) Weighted-average exercise prices and weighted-average fair values of options shall be disclosed separately for options whose exercise price either equals or exceeds or is less than the market price of the stock.
 - (n) A description of the method and significant assumptions used during the year to estimate the fair values of options, including the following weighted average information:
 - (1) risk-free interest rate,
 - (2) expected life,
 - (3) expected volatility,
 - (4) expected dividends, and
 - (5) the price of the underlying share in market at the time of option grant.
2. Ensure that until all options granted in the three years prior to the IPO have been exercised or have lapsed, disclosures are made either in the Directors' Report or in an Annexure thereto of the information specified above in respect of such options also.
3. Ensure that until all options granted in the three years prior to the IPO have been exercised or have lapsed, disclosure are made either in the Directors' Report or in an Annexure thereto of the impact on the profits and on the EPS of the company if the company had followed the accounting policies specified under clause 13 of these guidelines in respect of such options.
10. *Accounting Policies*
Check that the company which has passed a resolution for the scheme complies with the accounting policies specified by SEBI in regard to the Scheme under Schedule I of the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.
11. *Certificate from Auditors*
Check that the Board of Directors of company present before the shareholders at each AGM, a certificate from the auditors of the company that the Scheme has been implemented in conformity with these guidelines and in accordance with the resolution of the company in the general meeting.

(b) Employees Stock Purchase Scheme (ESPS)

1. *Eligibility to Participate in the Scheme*
- (i) An employee eligible to participate in the scheme should be:
 - (a) a permanent employee of the company working in India or out of India; or

- (b) a director of the company, whether a whole time director or not;
 - (c) an employee as defined in sub-clauses (a) or (b) of a subsidiary, in India or out of India, or of a holding company of the company.
- (ii) Check that the employee is not a promoter nor belongs to the promoter group.
 - (iii) Ensure that a director who either by himself or through his relatives or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company is not participating, as he is not eligible to participate in the scheme.

2. *Shareholder Approval*

- (i) Check that the Scheme has been approved by the shareholders by passing a special resolution in the meeting of the general body of shareholders.
- (ii) Check that the explanatory statement to the notice has been sent to the shareholders and it specifies—
 - (a) the price of the shares and also the number of shares to be offered to each employee;
 - (b) the appraisal for determining the eligibility of employee for the scheme;
 - (c) total number of shares to be issued.
- (iii) The number of shares offered may be different for different categories of employees.
- (iv) Check that special resolution states that the company shall conform to the accounting policies as specified in Schedule II of the SEBI (Employee Stock Option Scheme and Stock Purchase Scheme) Guidelines, 1999.
- (v) Check that approval of shareholders have been obtained by way of separate resolution in the general meeting in case of—
 - (a) allotment of shares to employees of subsidiary or holding company and;
 - (b) allotment of shares to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of allotment of shares.

3. *Pricing and Lock-in-period*

- (i) The company has the freedom to determine price of shares to be issued under an ESPS, provided they comply with the accounting policies specified.
- (ii) Check that the shares issued under an ESPS are subject to lock-in for a minimum period of one year from the date of allotment.

Also ensure that in a case where shares are allotted by a company under a ESPS in lieu of shares acquired by the same person under an ESPS in another company which has merged or amalgamated with the first mentioned company, the lock-in-period already undergone in respect of shares of the transferor company shall be adjusted against the lock-in required under this clause.

- (iii) If the scheme is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees under the scheme are not subject to any lock-in-period.

4. *Disclosure and Accounting Policies*

- (i) Check that the Director's Report or Annexure thereto shall contain, inter alia, the following disclosures:
 - (a) the details of the number of shares issued in the scheme;
 - (b) the price at which such shares are issued;
 - (c) employee-wise details of the shares issued to:
 - (i) senior managerial personnel;
 - (ii) any other employee who is issued shares in any one year amounting to 5% or more shares issued during that year;
 - (iii) identified employees who were issued shares during any one year equal to or exceeding 1% of the issued capital of the company at the time of issuance;
 - (d) diluted Earning Per Share (EPS) pursuant to issuance of shares under the scheme; and
 - (e) consideration received against the issuance of shares.
- (ii) Check that every company that has passed a resolution for the scheme complies with the accounting policies as specified in Schedule II to the SEBI (Employee Stock Option Scheme and Employee Stock Purchase) Guidelines, 1999.

5. *Preferential Allotment*

Nothing in these guidelines shall apply to shares issued to employees in compliance with the Securities and Exchange Board of India Guidelines on Preferential Allotment.

6. *Listing*

- (i) The shares arising pursuant to an ESOS and shares issued under an ESPS are required to be listed immediately upon exercise in any recognized stock exchange where the securities of the company are listed subject to compliance of the following:
 - (a) The ESOS/ESPS is in accordance with these Guidelines.

- (b) In case of an ESOS the company has also filed with the concerned stock exchanges, before the exercise of option, a statement as per Schedule V and has obtained in-principle approval from such Stock Exchanges.
 - (c) As and when ESOS/ESPS are exercised the company has notified the concerned Stock Exchanges as per the statement as per Schedule VI.
- (ii) (a) Ensure that the shares arising after the IPO, out of options granted under any ESOS framed prior to its IPO is being listed immediately upon exercise in all the recognised stock exchanges where the equity shares of the company are listed subject to compliance with clause 15.3 (i.e. options outstanding at IPO) and, where applicable, clause 22.2A (conditions for fresh grant of options prior to IPO).
 - (b) Ensure that any fresh grant of options under any ESOS framed prior to its IPO and prior to the listing of its equity shares is—
 - (i) in conformity with these guidelines; and
 - (ii) such pre-IPO scheme is ratified by its shareholders in general meeting subsequent to the IPO. However such ratification may be done any time prior to grant of new options under such pre-IPO scheme.
 - (c) Ensure that no change shall be made in the terms of options issued under such pre-IPO schemes, whether by repricing, change in vesting period or maturity or otherwise, unless prior approval of the shareholders is taken for such change. However, nothing in this sub-clause shall apply to any adjustments for corporate actions made in accordance with these guidelines.
- (iii) For listing of shares issued pursuant to ESOS or ESPS the company is required obtain the in-principle approval from Stock Exchanges where it proposes to list the said shares.
 - (iv) The listed companies is required to file the ESOS or ESPS Schemes through EDIFAR filing.
 - (v) When holding company issues ESOS/ESPS to the employee of its subsidiary, the cost incurred by the holding company for issuing such options/shares is required to be disclosed in the 'notes to accounts' of the financial statements of the subsidiary company.
 In a case falling under above clause, if the subsidiary reimburses the cost incurred by the holding company in granting options to the employees of the subsidiary, both the subsidiary as well as the holding company shall disclose the payment or receipt, as the case may be, in the 'notes to accounts' to their financial statements.
 - (vi) The company shall appoint a registered Merchant Banker for the implementation of ESOS and ESPS as per these guidelines till the

stage of framing the ESOS/ESPS and obtaining in-principal approval from the stock exchanges in accordance with these Guidelines.

7. *ESOS/ESPS Through Trust Route*

In case of ESOS/ESPS administered through a Trust, the accounts of the company shall be prepared as if the company itself is administering the ESOS/ESPS.

III-C DUE DILIGENCE- BONUS ISSUE

Checklist for issue of Bonus shares

- Ensure that is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc.: If there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of associations for capitalisation of reserve;
- Ensure that issuer has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- Ensure that the issuer has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;
- Ensure that the partly paid shares, if any outstanding on the date of allotment, are made fully paid up;
- It may be noted that no issuer shall make a bonus issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making the bonus issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof;
- The equity shares reserved for the holders of fully or partly convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion on which the bonus shares were issued.
- The bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash only and reserves created by revaluation of fixed assets shall not be capitalised for the purpose of issuing bonus shares.
- The bonus share shall not be issued in lieu of dividend.
- An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors: However, where the issuer is required to seek shareholders' approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

- Once the decision to make a bonus issue is announced, the issue can not be withdrawn.

III-D. DUE DILIGENCE- RIGHTS ISSUE

1. *Record Date*

- *Ensure that the record date has been* announced for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue. It may be noted that the issuer shall not withdraw rights issue after announcement of the record date.
- If the issuer withdraws the rights issue after announcing the record date, it shall not make an application for listing of any of its specified securities on any recognised stock exchange for a period of twelve months from the record date announced. However, the issuer may seek listing of its equity shares allotted pursuant to conversion or exchange of convertible securities issued prior to the announcement of the record date, on the recognised stock exchange where its securities are listed.

2. *Restriction on rights issue*

No issuer shall make a rights issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making rights issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof.

The equity shares reserved for the holders of fully or partially convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms on which the equity shares offered in the rights issue were issued.

3. *Letter of offer, abridged letter of offer*

The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post to all the existing shareholders at least three days before the date of opening of the issue. The letter of offer shall be given by the issuer or lead merchant banker to any existing shareholder who has made a request in this regard. The shareholders who have not received the application form may apply in writing on a plain paper, along with the requisite application money. The shareholders making application otherwise than on the application form shall not renounce their rights and shall not utilise the application form for any purpose including renunciation even if it is received subsequently. If any shareholder makes an application on application form as well as on plain paper, the application is liable to be rejected.

4. *Pricing*

The issue price shall be decided before determining the record date which shall be determined in consultation with the designated stock exchange.

5. *Period of subscription*

A rights issue shall be open for subscription for a minimum period of fifteen days and for a maximum period of thirty days.

6. *Pre-Issue Advertisement for rights issue.*

The issuer shall issue an advertisement for rights issue disclosing the following:

- (a) the date of completion of despatch of abridged letter of offer and the application form;
- (b) the centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;

7. *Obligation of issuer/intermediaries*

The obligation of issuer/intermediaries for a rights issuer, with respect to advertisement, appointment of compliance officer, redressal of investor grievances, due diligence, post issue reports, post issue advertisements etc is same as the public issue.

III-E QUALIFIED INSTITUTIONS PLACEMENT

1. *Conditions for qualified institutions placement*

Ensure to satisfy the following conditions:

- (a) a special resolution approving the qualified institutions placement has been passed by its shareholders;
- (b) the equity shares of the same class, which are proposed to be allotted through qualified institutions placement or pursuant to conversion or exchange of eligible securities offered through qualified institutions placement, have been listed on a recognised stock exchange having nation wide trading terminal for a period of at least one year prior to the date of issuance of notice to its shareholders for convening the meeting to pass the special resolution:

However, where an issuer, being a transferee company in a scheme of merger, de-merger, amalgamation or arrangement sanctioned by a High Court under sections 391 to 394 of the Companies Act, 1956, makes qualified institutions placement, the period for which the equity shares of the same class of the transferor company were listed on a stock exchange having nation wide trading terminals shall also be considered for the purpose of computation of the period of one year.

- (c) it is in compliance with the requirement of minimum public shareholding specified in the listing agreement with the stock exchange;
- (d) in the special resolution, it shall be, among other relevant matters, specified that the allotment is proposed to be made through qualified institutions placement and the relevant date.

“relevant date” means:

- (i) in case of allotment of equity shares, the date of the meeting in which the board of directors of the issuer or the committee of directors duly

authorised by the board of directors of the issuer decides to open the proposed issue;

- (ii) in case of allotment of eligible convertible securities, either the date of the meeting in which the board of directors of the issuer or the committee of directors duly authorised by the board of directors of the issuer decides to open the issue of such convertible securities or the date on which the holders of such convertible securities become entitled to apply for the equity shares.

2. *Appointment of merchant banker*

A qualified institutions placement shall be managed by merchant banker(s) registered with the Board who shall exercise due diligence.

3. *In-principle approval, due diligence certificate etc.*

The merchant banker shall, while seeking in-principle approval for listing of the eligible securities issued under qualified institutions placement, furnish to each stock exchange on which the same class of equity shares of the issuer are listed, a due diligence certificate stating that the eligible securities are being issued under qualified institutions placement and that the issuer complies with requirements under SEBI(ICDR)Regulations.

4. *Placement Document*

The qualified institutions placement shall be made on the basis of a placement document which shall contain all specified material information.

The placement document shall be serially numbered and copies shall be circulated only to select investors.

The issuer shall, while seeking in-principle approval from the recognised stock exchange, furnish a copy of the placement document, a certificate confirming compliance with the provisions of this Chapter along with any other documents required by the stock exchange.

The placement document shall also be placed on the website of the concerned stock exchange and of the issuer with a disclaimer to the effect that it is in connection with a qualified institutions placement and that no offer is being made to the public or to any other category of investors.

A copy of the placement document shall be filed with the Board for its record within thirty days of the allotment of eligible securities.

5. *Pricing*

The qualified institutions placement shall be made at a price not less than the average of the weekly high and low of the closing prices of the equity shares of the same class quoted on the stock exchange during the two weeks preceding the relevant date.

If eligible securities are convertible into or exchangeable with equity shares of the issuer, the issuer shall determine the price of such equity shares allotted

pursuant to such conversion or exchange taking the relevant date as decided and disclosed by it while passing the special resolution.

The issuer shall not allot partly paid up eligible securities. However, in case of allotment of non convertible debt instruments along with warrants, the allottees may pay the full consideration or part thereof payable with respect to warrants, at the time of allotment of such warrants. In case of allotment of equity shares on exercise of options attached to warrants, such equity shares shall be fully paid up.

The prices determined for qualified institutions placement shall be subject to appropriate adjustments if the issuer:

- (a) makes an issue of equity shares by way of capitalization of profits or reserves, other than by way of a dividend on shares;
- (b) makes a rights issue of equity shares;
- (c) consolidates its outstanding equity shares into a smaller number of shares;
- (d) divides its outstanding equity shares including by way of stock split;
- (e) re-classifies any of its equity shares into other securities of the issuer;
- (f) is involved in such other similar events or circumstances, which in the opinion of the concerned stock exchange, requires adjustments.

6. *Restrictions on allotment.*

— Allotment under the qualified institutions placement shall be made subject to the following conditions:

- (a) Minimum of ten per cent. of eligible securities shall be allotted to mutual funds:

If the mutual funds do not subscribe to said minimum percentage or any part thereof, such minimum portion or part thereof may be allotted to other qualified institutional buyers;

- (b) No allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to promoters of the issuer:

If a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the said rights in the capacity of a lender shall not be deemed to be a person related to promoters.

— In a qualified institutions placement of non-convertible debt instrument along with warrants, an investor can subscribe to the combined offering of non-convertible debt instruments with warrants or to the individual securities, that is, either non- convertible debt instruments or warrants.

— The applicants in qualified institutions placement shall not withdraw their bids after the closure of the issue.

7. *Minimum number of allottees*

The minimum number of allottees for each placement of eligible securities made under qualified institutions placement shall not be less than:

- (a) two, where the issue size is less than or equal to two hundred and fifty crore rupees;
- (b) five, where the issue size is greater than two hundred and fifty crore rupees:

Provided that no single allottee shall be allotted more than fifty per cent. of the issue size.

(2) The qualified institutional buyers belonging to the same group or who are under same control shall be deemed to be a single allottee.

8. *Validity of the special resolution*

Allotment pursuant to the special resolution shall be completed within a period of twelve months from the date of passing of the resolution.

The issuer shall not make subsequent qualified institutions placement until expiry of six months from the date of the prior qualified institutions placement made pursuant to one or more special resolutions.

9. *Restrictions on amount raised.*

The aggregate of the proposed qualified institutions placement and all previous qualified institutions placements made by the issuer in the same financial year shall not exceed five times the net worth of the issuer as per the audited balance sheet of the previous financial year.

10. *Tenure.*

The tenure of the convertible or exchangeable eligible securities issued through qualified institutions placement shall not exceed sixty months from the date of allotment.

11. *Transferability of eligible securities*

The eligible securities allotted under qualified institutions placement shall not be sold by the allottee for a period of one year from the date of allotment, except on a recognised stock exchange.

CHAPTER III

DUE DILIGENCE – ISSUE OF DEBT INSTRUMENTS

SEBI (ICDR) Regulations, 2009

“specified securities” means equity shares and convertible securities;

“convertible security” means a security which is convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of the security and includes convertible debt instrument and convertible preference shares;

Thus, the conditions specified under Chapter II regarding Due Diligence - Equity shares is equally applicable to public issue of convertible debt instruments also. Additionally, the issuer of debt instruments has to comply with the following.

In addition to other requirements laid down in these regulations, an issuer making a public issue or rights issue of convertible debt instruments shall comply with the following conditions:

- (a) it has obtained credit rating from one or more credit rating agencies;
- (b) it has appointed one or more debenture trustees in accordance with the provisions of section 117B of the Companies Act, 1956 and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993;
- (c) it has created debenture redemption reserve in accordance with the provisions of section 117C of the Companies Act, 1956;
- (d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:
 - (i) such assets are sufficient to discharge the principal amount at all times;
 - (ii) such assets are free from any encumbrance;
 - (iii) where security is already created on such assets in favour of financial institutions or banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such financial institution, bank or lessor for a second or pari passu charge has been obtained and submitted to the debenture trustee before the opening of the issue;
 - (iv) the security/asset cover shall be arrived at after reduction of the liabilities having a first/prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

The issuer shall redeem the convertible debt instruments in terms of the offer document.

Roll over of non convertible portion of partly convertible debt instruments.

- The non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds fifty lakh rupees, may be rolled over without change in the interest rate, subject to compliance with the provisions of section 121 of the Companies Act, 1956 and the following conditions:
 - (a) seventy five per cent. of the holders of the convertible debt instruments of the issuer have, through a resolution, approved the rollover through postal ballot;
 - (b) the issuer has, along with the notice for passing the resolution, sent to all holders of the convertible debt instruments, an auditors' certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer;
 - (c) the issuer has undertaken to redeem the non-convertible portion of the partly convertible debt instruments of all the holders of the convertible debt instruments who have not agreed to the resolution;
 - (d) credit rating has been obtained from at least one credit rating agency registered with the Board within a period of six months prior to the due date of redemption and has been communicated to the holders of the convertible debt instruments, before the roll over;
- The creation of fresh security and execution of fresh trust deed shall not be mandatory if the existing trust deed or the security documents provide for continuance of the security till redemption of secured convertible debt instruments;

Provided that whether the issuer is required to create fresh security and to execute fresh trust deed or not shall be decided by the debenture trustee.

Conversion of optionally convertible debt instruments into equity share capital.

- An issuer shall not convert its optionally convertible debt instruments into equity shares unless the holders of such convertible debt instruments have sent their positive consent to the issuer and non-receipt of reply to any notice sent by the issuer for this purpose shall not be construed as consent for conversion of any convertible debt instruments.
- Where the value of the convertible portion of any convertible debt instruments issued by a listed issuer exceeds fifty lakh rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments shall be given the option of not converting the convertible portion into equity shares:

If the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it shall not be necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.

- Where an option is to be given to the holders of the convertible debt instruments

and if one or more of such holders do not exercise the option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer shall redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

Issue of convertible debt instruments for financing

No issuer shall issue convertible debt instruments for financing replenishment of funds or for providing loan to or for acquiring shares of any person who is part of the same group or who is under the same management: However., an issuer may issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

STUDY VIII
INDIAN DEPOSITORY RECEIPTS

Check list under Chapter VIII SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 for issue of Indian Depository Receipts

Eligibility

Ensure that

- (a) the issuing company is listed in its home country;
- (b) the issuing company is not prohibited to issue securities by any regulatory body;
- (c) the issuing company has track record of compliance with securities market regulations in its home country.

Explanation : For the purpose of this regulation, the term “home country” means the country where the issuing company is incorporated and listed.

Conditions for issue of IDR

Ensure that the following conditions are satisfied

- (a) issue size shall not be less than fifty crore rupees;
- (b) procedure to be followed by each class of applicant for applying shall be mentioned in the prospectus;
- (c) minimum application amount shall be twenty thousand rupees;
- (d) at least fifty per cent. of the IDR issued shall be allotted to qualified institutional buyers on proportionate basis as per illustration given in Part C of Schedule XI;
- (e) the balance fifty per cent. may be allocated among the categories of non-institutional investors and retail individual investors including employees at the discretion of the issuer and the manner of allocation shall be disclosed in the prospectus. Allotment to investors within a category shall be on proportionate basis:

It may be noted that atleast thirty per cent. of the said fifty per cent. IDR issued shall be allocated to retail individual investors and in case of under-subscription in retail individual investor category, spill over to the extent of under-subscription shall be permitted to other categories.

- (f) At any given time, there shall be only one denomination of IDR of the issuing company.

Minimum subscription*For non-underwritten issues*

- (a) If the issuing company does not receive the minimum subscription of ninety per cent of the offer through offer document on the date of closure of the issue, or if the subscription level falls below ninety per cent. after the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the issuing company shall forthwith refund the entire subscription amount received.
- (b) If the issuing company fails to refund the entire subscription amount within fifteen days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay.

For underwritten issues

If the issuing company does not receive the minimum subscription of ninety per cent. of the offer through offer document including devolvement of underwriters within sixty days from the date of closure of the issue, the issuing company shall forthwith refund the entire subscription amount received with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay beyond sixty days.

Fungibility

The Indian depository Receipts shall not be automatically fungible into underlying equity shares of issuing company.

Filing of draft prospectus, due diligence certificates, payment of fees and issue advertisement for IDR

The issuing company making an issue of IDR shall enter into an agreement with a merchant banker on the lines of format of agreement specified.

If the issue is managed by more than one merchant banker, the rights, obligations and responsibilities, relating inter-alia to disclosures, allotment, refund and underwriting obligations, if any, of each merchant banker shall be predetermined and disclosed in the prospectus on the lines of format as specified in the Schedule.

The issuing company shall file a draft prospectus with the Board through a merchant banker along with the requisite fee, as prescribed in Companies (Issue of Indian Depository Receipts) Rules, 2004.

The prospectus filed with the Board under this regulation shall also be furnished to the Board in a soft copy on the lines specified in the **Schedule**.

- (5) The lead merchant bankers shall:
 - (a) Submit a due diligence certificate as per specified format to the Board along with the draft prospectus.
 - (b) Certify that all amendments, suggestions or observations made by the Board have been incorporated in the prospectus.

- (c) Submit a fresh due diligence certificate as per format specified, at the time of filing the prospectus with the Registrar of the Companies.
- (d) Furnish a certificate as per specified format, immediately before the opening of the issue, certifying that no corrective action is required on its part.
- (e) Furnish a certificate as per specified format, after the issue has opened but before it closes for subscription.
- (6) The issuing company shall make arrangements for specified mandatory collection centres.
- (7) The issuing company shall issue an advertisement in one English national daily newspaper with wide circulation and one Hindi national daily newspaper with wide circulation, soon after receiving final observations, if any, on the publicly filed draft prospectus with the Board, which shall be on the lines of the format and contain the minimum disclosures as required.

Display of bid data

The stock exchanges offering online bidding system for the book building process shall display on their website, the data pertaining to book built IDR issue, in the format specified, from the date of opening of the bids till at least three days after closure of bids.

Disclosures in prospectus and abridged prospectus

The prospectus shall contain all material disclosures which are true, correct and adequate so as to enable the applicants to take an informed investment decision.

The prospectus shall contain :

- (a) the disclosures specified in Schedule to Companies (Issue of Indian Depository Receipts) Rules, 2004; and
 - (b) the specified disclosures.
- (3) The abridged prospectus for issue of Indian Depository Receipts shall contain the specified disclosures.

Post-issue reports

The merchant banker shall submit post-issue reports to the Board as follows:

- (a) initial post issue report, within three days of closure of the issue;
- (b) final post issue report, within fifteen days of the date of finalisation of basis of allotment or within fifteen days of refund of money in case of failure of issue.

Undersubscribed issue

In case of undersubscribed issue of IDR, the merchant banker shall furnish information in respect of underwriters who have failed to meet their underwriting devolvement to the Board on the lines of the format specified.

Finalisation of basis of allotment

The executive director or managing director of the stock exchange, where the IDR are proposed to be listed, along with the post issue lead merchant bankers and registrars to the issuesshall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the specified allotment procedure.

ANNEXURE I

<i>Sr. No.</i>	<i>Subject Matter</i>	<i>Provision under the rescinded Guidelines</i>	<i>Provision under the ICDR Regulations</i>
1.	Exemption from eligibility norms for making an IPO	Exemption available to banking company, corresponding new bank and infrastructure company.	Exemption removed. Eligibility norms made applicable uniformly to all types of issuers.
2.	Debarment	Company prohibited from making an issue of securities if it had been prohibited from accessing the capital market under any order or direction passed by the Board.	Issuer not to make public issue or rights issue of specified securities if: (a) the issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by the Board; (b) if any of the promoters, directors or persons in control of the issuer was or also is a promoter, director or person in control of any other company which is debarred from accessing the capital market under any order or directions made by the Board.
3.	Offer for sale by listed companies	No provision.	Provided for.
4.	OTCEI Issues and E-IPO	Contained in Chapter XIV and Chapter XI A.	Omitted.
5.	Firm allotment in public issues	Permitted.	Omitted.
6.	Reservation on competitive basis in public issues	(a) For Indian and multilateral development financial institutions, Indian mutual funds, foreign institutional investors and scheduled banks. (b) For shareholders of the promoting companies in the	(a) Omitted. (b) For shareholders (other than promoters) in respect of listed promoting

<i>Sr. No.</i>	<i>Subject Matter</i>	<i>Provision under the rescinded Guidelines</i>	<i>Provision under the ICDR Regulations</i>
		case of a new company and shareholders of group companies in the case of an existing company.	companies, in case of a new issuer and listed group companies, in case of an existing issuer.
7.	Book building process	Book building process through 75% or 100% of issue size.	75% book building route omitted.
8.	Allotment / refund period in public issues	30 days for fixed price issues and 15 days for book built issues.	15 days for both fixed price and book built issues.
9.	Disclosure of price or price band	Required in draft prospectus in case of fixed price public issues.	Not required to be disclosed in draft prospectus.
10.	Transfer of surplus money in Green Shoe Option (GSO) Bank Account	Surplus money to be transferred to Investor Protection Fund of Stock Exchanges.	Surplus money to be transferred to Investor Protection and Education Fund (IPEF) established by the Board.
11.	Issue period for Infrastructure companies in public issues	21 days, as against 10 days for other issues.	Uniform period of 10 days for all types of issuers.
12.	Currency of financial statements disclosed in the offer document	Particulars as per audited financial statements not to be more than 6 months old from the issue opening date for all issuers, except Government companies.	Government and non-government issuers treated at par.
13.	Definition of "Key Management Personnel"	Not defined.	Defined.
14.	Disclosure on pledge of shares by promoters	Not provided.	Provided for.
15.	Extent of underwriting obligation	Not explicit.	Where 100% of the offer through offer document is underwritten, underwriting obligations shall be for the entire amount underwritten.

<i>Sr. No.</i>	<i>Subject Matter</i>	<i>Provision under the rescinded Guidelines</i>	<i>Provision under the ICDR Regulations</i>
16.	Financial institution as a monitoring agency	The term "Financial Institution" open to interpretation.	The term "financial Institution" replaced by "public financial institution or a scheduled commercial bank".
17.	Definition of "employee"	Includes permanent employee / director of subsidiary or holding company of the issuer.	Excludes permanent employee / director of subsidiary or holding company of the issuer and promoters and immediate relatives of promoters.
18.	Restrictions on advertisements	If issue opening and closing advertisement contained highlights, then the advertisement required to contain risk factors.	If advertisement contains information other than the details specified in the format for issue advertisement, the advertisement shall contain risk factors.
19.	Forfeiture of money on unexercised warrants in preferential issues	Open to interpretation.	Where the warrant holder exercises his option to convert only some of the warrants held by him, upfront payment made against only such warrants can be adjusted. The balance upfront payment made against the remaining unexercised warrants shall be forfeited.
20.	Outstanding convertible instruments in case of initial public offer (IPO)	Compulsory conversion of outstanding convertible instruments and other rights held by promoters or shareholders.	Compulsory conversion of all outstanding convertible instruments held by any person.
21.	Minimum promoters' contribution	Could be brought in by promoters / persons belonging to promoter group / friends, relatives and associates of promoters.	Shall be brought in only by promoters whose identity, photograph, etc. are disclosed in the offer document.
22.	Issue period in case of public issues	Issue period not clear in case of revision in price band in book built public issues.	Total issue period not to exceed 10 days, including any revision in price band.
23.	Timing of pre-issue advertisement for public issues	Pre-issue advertisement to be made immediately after receipt of observations from the Board.	Pre-issue advertisement to be made after registering of prospectus / red herring prospectus with Registrar of Companies before opening of the issue.

<i>Sr. No.</i>	<i>Subject Matter</i>	<i>Provision under the rescinded Guidelines</i>	<i>Provision under the ICDR Regulations</i>
24.	Documents to be attached with due diligence certificate	Documents such as memorandum of association and articles of association of the company, audited balance sheet, checklist for compliance with the rescinded Guidelines etc.	Only checklist to be attached.
25.	Group companies	The term "group companies" not explained.	The term "group companies" explained.
