

## **Review of book building framework for public issues**

### **1. Objective**

1.1. This memorandum seeks approval of the Board to amend SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2018 (“ICDR Regulations”) relating to framework of book building with respect to the following specific aspects:

- i. introduction of a minimum price band, and
- ii. rationalization of allocation methodology for Non Institutional Investors (NIIs).

1.2. Consequent to above, amendments would be required in Regulations 29, 32, 49 of the ICDR Regulations and Schedule XIII of the ICDR Regulations etc.

### **2. Background**

2.1. The market for Initial Public Offerings (IPOs) (i.e. primary markets) facilitate efficient allocation of financial resources by channeling investment between suppliers of capital (Qualified Institutional Buyers- QIBs, Retail Individual Investors - RIIs, and Non Institutional Investors- NIIs) and companies requiring capital (Issuer Companies).

2.2. In terms of ICDR Regulations, an IPO can be made either through fixed price method or book building method. Under the fixed price method, the issuer is required to mention the price in the Red Herring Prospectus (RHP) at which the shares would be offered. The book built method offers the investors an opportunity to bid for the shares based on their assessment of the issuer’s worth given the disclosures made in the Draft Red Herring Prospectus (DRHP) and RHP. For this purpose the regulations provides that the issuer in consultation with the merchant banker provide a price band for the issue.

2.3. In a book built issue, SEBI Regulations aim at making price discovery transparent and efficient for both investors and issuers. Further, it is expected that any public offering should aim to disperse the shareholding across a diverse set of shareholders such as QIBs, RIIs and NIIs with equitable opportunity to all investors especially RIIs and NIIs.

- 2.4. The aforementioned objective of fair and transparent price discovery and diverse offering in a book built issue appears to have been diluted over time due to evolving market practices. Thus, a need was felt to review the book building framework for public issues and reform the process of price discovery and allocation methodology for NIIIs.
- 2.5. The matter was deliberated at the meeting of the Primary Market Advisory Committee (PMAC). PMAC felt that any change in price band and allocation methodology for NIIIs may have wide ranging implications, hence a detailed deliberation is required on the matter and for this purpose PMAC constituted a sub-group of its members. The sub-group deliberated on the matter and also had brief consultations with market participants.
- 2.6. PMAC deliberated the proposals of sub-group and desired that a public consultation may be carried out on its recommendations w.r.t. Price Band and Rationalization of allocation methodology for NIIIs before SEBI takes a view in the matter.
- 2.7. Accordingly, a discussion paper was placed on the website of SEBI on October 04, 2021 seeking public comments on the proposal of PMAC. The discussion paper is placed at **Annexure-I** for reference
- 2.8. Since then, comments have been received from 14 entities including individuals, merchant bankers, and industry associations etc. on the PMAC recommendations. Further, the commentators have made additional suggestions as well. The comments relevant to the consultation paper have been analyzed and tabulated at **Annexure-II**. The following paragraphs (3-5) delve into the existing provisions, issue/concern, recommendations of PMAC, public comments, analysis of public comments and finally the proposals for consideration of the board.

### **3. Price Band**

#### **3.1. Existing Provisions**

- a) In terms of sub-regulations (1) and (2) of Regulations 29 of the ICDR Regulations, the issuer provides a price band (in case of book built issue) wherein the upper end of the price band should not be higher by more than 20% of the floor of the band (i.e. upper end of the price band shall be less than or equal to 120% of the floor of the price band).

### 3.2. Issue/concerns

- a) An Issuer Company can make a book built issue either under Regulation 6(1) or Regulation 6(2) of ICDR Regulations.
- b) Further, in terms of Regulation 29(4) of the ICDR Regulations, the issuer company announces the price band at least two working days before the opening of the issue.
- c) Over the last few years, there is a trend wherein the price band, as provided by the issuer companies on the main board are extremely narrow, sometimes as small as Rs 1, Rs 2 or Rs. 3. An analysis of issues from 2010 demonstrates that the average price band range has reduced significantly:

Calendar Year	Number of issues	Number of Book Built Issues	Number of Fixed Price Issues	Average of Price Band Range (in %age)
2010	64	62	2	8.42
2011	37	36	1	9.84
2012	11	11	-	9.50
2013	3	3	-	10.01
2014	5	5	-	7.03
2015	21	21	-	5.78
2016	26	26	-	5.09
2017	36	35	1	2.36

Calendar Year	Number of issues	Number of Book Built Issues	Number of Fixed Price Issues	Average of Price Band Range (in %age)
2018	24	24	-	1.77
2019	16	16	-	2.90
2020	15	15	-	1.48
2021*	47	47	-	1.75
<b>Total</b>	<b>305</b>	<b>301</b>	<b>4</b>	

\* Upto November 16, 2021

- d) Narrow price band raises certain concerns w.r.t. the objective of fair and transparent price discovery mechanism in a book built issue. Further, narrow price band presents an opportunity to an issuer company to camouflage a fixed price issue as book built issue thus circumventing the conditions/regulations attached to the fixed price method especially related to allocation methodology.
- e) Following table demonstrates eligibility requirements for an IPO (Regulation 6 of ICDR Regulations) and allocation to investors (Regulation 32 of ICDR Regulations) in case of book built issues and fixed price issues.

Type of Issue	Eligibility requirements	Pricing Method -Book built/fixed price method	Allocation to investors (expressed as percentage of overall issue size)		
			RILs (%)	NILs (%)	QIBs (%)
<b>Issue under 6(1)</b>	- Net tangible assets of at least Rs 3 crore in	Book Built	Not less than 35%	Not less than 15%	Not more than 50%

Type of Issue	Eligibility requirements	Pricing Method -Book built/fixed price method	Allocation to investors (expressed as percentage of overall issue size)		
			RILs (%)	NILs (%)	QIBs (%)
	<p>each of the preceding 3 years</p> <ul style="list-style-type: none"> <li>- Average operating profit of at least Rs 15 crore in each of the preceding 3 years</li> <li>- Net worth of at least Rs 1 crore in each of the preceding 3 years</li> </ul>	Fixed price	At least 50%	Remaining issue size	
Type of Issue	Eligibility requirements	Pricing Method -Book built/fixed price method	Allocation to investors (expressed as percentage of overall issue size)		
			RILs (%)	NILs (%)	QIBs (%)
<b>Issue under 6(2)</b>	- not satisfying the conditions mentioned under Regulation 6(1) of ICDR Regulations	Book Built	Not more than 10%	Not more than 15%	At least 75%

f) Following may be noted from the table above

- i. Fixed price issue is only allowed under Regulations 6(1) of ICDR Regulations and book built issue can either be made under Regulations 6(1) or 6(2) of ICDR Regulations.
  - ii. Allocation to retail investors is at least 50% of the net issue in the fixed price issue, which is higher than a book built issue (35% and 10% under 6(1) and 6(2) respectively). Thus allocation to retail investors is graded based on the risks involved, higher the risk - lower the allocation.
- g) Generally, it is understood that issuers may have to put in more efforts to market an issue to retail investors to fill up the retail portion, hence they may find it easier to apply under the reduced retail allocation even though they may otherwise be eligible for higher allocation to retail investors, as it is easier to market to relatively smaller number of QIBs than to a larger number of retail investors.

### **3.3. PMAC Recommendation**

- i. PMAC, pursuant to deliberations on the proposals of sub-group of PMAC, recommended that a minimum price band of atleast 5%. (i.e., upper end of the price band shall be more than or equal to 105% of the floor of the price band) and desired that a public consultation may be carried out on its recommendation.
- ii. Matter for public consultation
  - a. Is there a need for minimum price band in public issues?
  - b. If so, what should be the minimum price band?
  - c. Any suggestions on further reforms in fixed price issues, since, very few issuers have opted for fixed price IPO on Main Board

### **3.4. Public Comments and Analysis**

- a) Public Comments

- i. In all 9 persons have offered comments in respect of whether there is a need for minimum price band in public issue. 4 persons have agreed that there is a need for a minimum price band in public issues. Two persons have recommended on aspects not related to the recommendation of PMAC. Three persons have disagreed with the recommendation for minimum price band stating that price band is based on marketing considerations, the indication of willingness to subscribe to IPOs during the pre IPO road shows and meetings mainly with QIB etc.
  - ii. Of the four comments in agreement with the proposal, one person has suggested the minimum price band of 10% and not 5% as proposed in the discussion paper.
  - iii. Further, out of the five suggestions on reforms for fixed price issues, two persons have made vague suggestions on aspects unrelated to fixed price. Two persons suggested that the allocation norms w.r.t. fixed price issue may be rationalized with book building method. Another comment suggested for introduction of 'flexibility to change the price' before issue opening date, higher QIB allocation and permitting issuer companies making public offer under Regulation 6(2) to undertake fixed price issue.
- b) Analysis
- i. The objective of price band is to have a fair and transparent price discovery in a book built issue. The current market practice resulting in narrow price bands has resulted from various marketing considerations i.e. gauging willingness of QIBs to subscribe to IPOs during the pre IPO road shows and tendency of the anchor investor to reduce their risk exposure. Thus, narrow price bands provide little opportunity to RIIs and NIIs for making any meaningful contribution in the book building process as the range is very limited. In view of the comments received, the PMAC recommendation of a minimum price band of 5% be thus considered.

- ii. As regard to comments on fixed price issue, such as rationalizing the allocation norms to that of book built method, it may not be prudent to alter the allocation methodology intended for issuers under Regulation 6(1) of the ICDR Regulations to that of issuers under Regulation 6(2) of the ICDR Regulations. The risks associated with 6(1) & (2) issues are different requiring the QIBs to take a bigger role and limiting the exposure to RII in 6(2) issues
- iii. Over the past decade, only 4 issuers on the main board have used fixed price method, the last one being in 2017 while earlier ones were way back in 2011. Given that none of the persons has reasoned out the change, SEBI may revisit these requirements at a future date.

### **3.5. Proposal for consideration of Board**

- i. It is proposed to introduce a minimum price band of 5% in case of book built public issues under the ICDR Regulations.
- ii. **Implementation date:** The minimum price band stipulation shall be made applicable for Red Herring Prospectus (RHP) filed with RoC and SEBI after the date of gazette notification of the amendment to ICDR Regulations.

## **4. Rationalization of allocation methodology for Non Institutional Investors (NIIs)**

### **4.1. Existing Provisions**

- a) Regulation 32 of the ICDR Regulations, inter alia, states that:
  - i. Not less than 15% shall be allocated to NIIs in case of book built public issue by an issuer under Regulation 6(1).
  - ii. Not more than 15% shall be allocated to NIIs in case of book built public issue by an issuer under Regulation 6(2)

- b) Regulation 49(3) of the ICDR Regulations, inter alia, state that allotment to NIIIs shall be on a proportionate basis.

#### 4.2. Issue/concerns

- a) In case of an oversubscribed book built issue, allotment to NIIIs is made on proportionate basis whereas allotment to RIIs is based on draw of lots (i.e. allotting minimum bid lot to each applicants and balance allotment on proportionate basis).
- b) Further, minimum value for application size (also referred to as ‘bid amount’) for an applicant in the NII category is above Rs 2, 00,000.
- c) There are concerns w.r.t. proportionate allotment methodology in the case of NIIIs as proportionate allotment creates incentives to make application of higher bid amount in this category. It is observed that a few NIIIs with larger bid amounts are able to crowd out NIIIs with smaller bid amounts for allotment in an IPO.
- d) Towards this end, applicants in NII category are reportedly leveraging for making applications of higher bid amounts which results in higher oversubscription in NII category. As indicated by data, oversubscription in NII category has shown an increasing trend in last few years.

Year (FY)	No. of IPOs (A)	No. of IPOs with more than 10x subscription NII category (B)	% IPOs with more than 10x subscription NII category (B/A)	Range of subscription in NII category (for issues mentioned at B)
2017-18	45	18	40.00%	10 – 958
2018-19	15	3	20.00%	21 - 195

2019-20	15	8	53.33%	45 - 473
2020-21	31	19	61.29%	30 - 791
2021-22*	32	20	62.50%	10 - 955

\*till Nov 16, 2021

- e) From the above table, it is observed that as a percentage, the number of IPOs having more than 10x subscription in NII category is increasing consistently for the last 4 years. Further, during this period, the range of oversubscription in NII category, (for those IPOs having more than 10x subscription) is also increasing exponentially from a maximum of 195 times of the NII category, in FY 2018-19 to a maximum of 955 times of the NII category in FY 2021-22 (till November 16, 2021).
- f) Further, from an analysis of oversubscribed IPOs (during the period January 01, 2018 to April 30, 2021), it was observed that in 29 IPOs, on an average around 60% of the applicants in the NII category did not get any allotment. In a few cases, application for as large as Rs 75 lakhs was also unable to get allotment.
- g) It is expected that any public offering should aim to provide as dispersed and diverse offering as possible with equitable opportunity for retail and non-institutional investors. The current methodology of proportionate allotment carries a certain risk where few highly leveraged NIIs with larger bid amounts crowd out other NIIs.

#### 4.3. PMAC Recommendation

- a) PMAC pursuant to deliberations on the proposals of sub-group of PMAC, desired that public consultation may be carried out on the following recommendations:

- i. NII category may be further divided into two sub-categories:
    - a. Sub-category 1: One third of the allocation earmarked for NIIs shall be for application sizes ranging above INR 2 lakhs and upto INR 10 lakhs.
    - b. Sub-category 2: Two third of the allocation earmarked for NIIs shall be for applications above INR 10 lakhs.
  - ii. Proportionate allotment in case of NII category may be discontinued and “draw of lots” allotment to be introduced, as is currently applicable for RII category (i.e. draw of lots to allot minimum bid lot to applicants, in case of oversubscription and balance allotment on proportionate basis).
- b) Matter for public deliberation
- i. Should the NII category be subdivided into two, with one sub-category exclusively for NIIs having smaller application sizes?
  - ii. If so, what portion of the NII category should be earmarked for such NIIs?
  - iii. What should be the range for application size for NIIs in such earmarked portion?
  - iv. What should be the allotment methodology for NII category - Proportionate or Draw of lots?

#### **4.4. Public Comments and Analysis**

- a) Public Comments:
  - i. 14 persons have provided diverse comments on the matter. Five persons have agreed that NII category may be sub-divided in two with one sub-category exclusively for NIIs having smaller application sizes. One person has suggested that for the benefit of NIIs having smaller application sizes, 5% each from RIIs and NIIs allocation quota may be utilized for creation of a separate bucket. Four entities have disagreed

with the proposal stating that the existing portion of NII category may not be used for allocating to NIIs having smaller application sizes. Other persons have offered other suggestions such as increasing the minimum bid amount for NIIs to Rs 10 lakhs, introducing ceiling that no single applicant in the NII category can be allotted more than 5% of the NII portion etc. One person has suggested that the proposal may be deferred in order to assess the impact of RBI direction to NBFCs to limit IPO financing.

- ii. Two persons have suggested that 1/3<sup>rd</sup> of the NII portion should be utilized for NIIs having smaller application sizes. One commentator has suggested half of the NII allocation quota to be utilized for such NIIs.
  - iii. Majority of the comments that are in agreement for sub-division of a separate NII category have suggested a range of Rs 2 lakhs to Rs 10 lakhs for application size for NIIs in such earmarked portion (i.e. NIIs having smaller application sizes)
  - iv. As regards allotment methodology, a total no. of 11 comments have been received. Out of these, three commentators have suggested that a draw of lots should be mandated for the entire NII category. Further, two commentators have suggested that draw of lots may be considered for NIIs having smaller application sizes. Remaining comments support proportionate allotment. Further, it has been suggested that NII investor may not be interested in smaller allocation.
- b) Analysis:
- i. W.r.t. to creation of sub-category within NII, for the benefit of NIIs having smaller application sizes, many comments have suggested to increase the minimum bid amount for NIIs from Rs 2 lakhs to Rs 10 lakhs and correspondingly increasing the retail limit to upto Rs 10 lakhs akin to retail category for bonds. In this regard, it appears that the commentator has equated the minimum allotment in bonds in case of private placement as

“retail limit” which may not be appropriate. The face value of allotment in private placement has been prescribed as Rs 10 lacs as per the NCS Operational Circular; this is not applicable for public issues. Hence this argument is misplaced and the suggestion may not be considered.

- ii. Other suggestions such as creation of a separate bucket from the quota of RII and NII both, may not be in the best interest of retail investors. As regards, allocation quota for not so large NIIs, the suggestion to set the limit at at least 1/3<sup>rd</sup> of the NII category does have some merit. Given this, the range of application size for NIIs may be set as bids above Rs 2 lakhs and up to Rs 10 lakhs.
- iii. W.r.t. comments on proportionate allotment, stating that an entity willing to put big amount should be assured of allotment, it is observed that the PMAC proposal prescribes draw of lots only in case of oversubscription. Subsequent to allotment of minimum bid lot to applicants, the remaining portion would be available for proportionate allotment. It is worthwhile to mention that the minimum bid lot to applicants in NII category starts from Rs 2 lakh onwards. Under the current method, even sizable amount of application may not result in any allotment as there could always be a NII who has bid with a leverage. These concerns were also highlighted in the consultation paper wherein it was observed that in 29 IPOs, on an average around 60% of the applicants in the NII category did not get any allotment. In few cases, application for as large as INR 75 lakhs was also unable to get allotment. Accordingly, in view of the concerns highlighted above, and the proposal to have a sizable minimum bid lot of Rs 2 lakhs, the suggestions on proportionate allotment may not be considered.
- iv. As regards postponing implementation of the recommendations of PMAC in view of the fact that the RBI directives on limiting funding by NBFC for IPO financing is due for implementation from April 01, 2022, the suggestion may have some merit. The RBI circular formalizing the

internal working group recommendation came in after the discussion paper was already hosted on the SEBI website.

- v. [excised].
- vi. Thus, it is suggested that sufficient time period may be provided before any changes to allocation methodology are implemented for NIIs, say 3, months and may be made applicable along with the RBI circular date i.e. April 01, 2022.

#### **4.5. Proposal for consideration of Board**

- i. To introduce a new sub-category under the NII category for application sizes above Rs 2 lakhs and upto Rs 10 lakhs. The allocation quota for the new sub-category shall be at least 1/3<sup>rd</sup> of the total NII allocation quota.
- ii. Proportionate allotment in case of NII category may be discontinued and draw of lots allotment to be introduced, as is currently applicable for RII category (i.e. draw of lots to allot minimum bid lot to applicants, in case of oversubscription and balance allotment on proportionate basis).
- iii. **Implementation date:** The aforesaid proposal may be made applicable for Red Herring Prospectus (RHP) filed with SEBI on or after April 01, 2022.

#### **5. Proposal**

The Board is requested to consider and approve the proposals at para 3.5, 4.5, and related amendments to SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2018, and authorize the Chairman to take consequential and incidental steps to give effect to the decisions of the Board as contained in the draft placed at **Annexure III**.

**Date: December 14, 2021**

**Place: Mumbai**

**Jeevan Sonparote  
Chief General Manager**

## **Annexure - I**

Consultation Paper on 'Review of Price Band and Book Building Framework for public issues' is a publicly available document and same is placed on SEBI website.

**Annexure-II**

**(This has been excised for reasons of confidentiality)**

### **Annexure-III**

Amendments to Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements), 2018 notified on Jan 14, 2022. Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2022, is a publicly available document and same is placed on SEBI website.