April 18, 2015

Submission of Comments to the Securities and Exchange Board of India (SEBI)

on

"Discussion Paper on Issues Pertaining to Offer for Sale of Shares (OFS) through Stock Exchange Mechanism"

1. Background

The Securities and Exchange Board of India (SEBI), in order to take into consideration views of various stakeholders in the OFS process, invited comments / suggestions from interested stakeholders on issues pertaining to OFS through Stock Exchange mechanism.

Consumer Unity & Trust Society (CUTS, www.cuts-international.org) is a vigilant institution working in the area of economic regulation, financial sector, consumer protection, competition, trade, and investment since last 30 years.

2. Specific Comments/Suggestions

CUTS' specific comments on the subject are set out below:

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S.No	**Issues**	**Suggestions**	**Rationale**
1.	Appropriate notice period for OFS keeping in mind interest of investors as well as sellers.	1. OFS notice period should be reduced to 'T-1' day from existing 'T-2' day ('T' being the day of the OFS). 2. In addition, window for retail investors under OFS should be increased by one day.	1. At present, intimation of the sale of shares using OFS through stock exchange mechanism shall be given by the seller latest by 5.00 pm on 'T-2' day ('T' being the day of the OFS).[1] However, experience suggests that as notice for OFS is given on 'T-2' day, the price of the stock tend to fall sharply on 'T-1' day, owing to anticipation of discounted price under OFS.[2] Such price volatility makes it difficult for the seller to arrive at an appropriate floor price

[1] Circular No. CIR/MRD/DP/24/2014 dated August 08, 2014

[2] The price of shares of Coal India traded in the secondary market crashed by 6 per cent from the day of announcement till the completion of the stake sale. See *"Govt request on OFS rules hits Sebi roadblock"*, available at http://www.business-standard.com/article/markets/govt-request-on-ofs-rules-hits-sebi-roadblock-115020501281_1.html, last visited on April 17, 2015.

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			for OFS and thereby affecting the price offered by the sellers. In addition, it also affects seller's interests, rather adversely. Therefore, notice period for OFS, that is, currently two days should be reduced to one day to curtail such price volatility in the stock. Consequently, the intimation would be given by the seller latest by 5.00 pm on 'T-1' day, removing any possibility of volatility in stock prior to the offer. 2. The period of OFS notice was increased from 'T-1' day to 'T-2' days to ensure that reasonable time of at least one trading/banking day is available for retail investors to arrange for funds to participate in OFS. Despite of such increase in notice period, participation of retail investors does not appear to be encouraging.[3] Infact, reducing the mandatory notice period from existing 'T-2' Days to 'T-1' Day (as suggested above) could further hinder their participation in OFS as they may find it difficult to arrange for funds within such a short span of time. To alleviate the concerns of retail

[3] In the Coal India OFS, the retail quota was undersubscribed (around 44 per cent of the 20 per cent quota reserved at a discount of 5 per cent). See *"Coal India 10% stake sale fully subscribed; Govt garners Rs. 22,400 cr"*, available at http://www.business-standard.com/article/markets/coal-india-10-stake-sale-fully-subscribed-115013000864_1.html, last visited on April 17, 2015. Also see, *"Retail investors to get greater pie in next PSU divestment"*, available at http://www.thehindubusinessline.com/markets/retail-investors-to-get-greater-pie-in-next-psu-divestment/article6669968.ece, last visited on April 17, 2015.

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			investors, there is need to create greater awareness among retail investors to participate in stake sale (OFS). Also, the window for retail investors under OFS should be increased by one more day. Consequently, the offer will be open for two days for retail investors. This will provide them sufficient time to arrange funds. For non-retail investors, it can continue to remain open for one/first trading day only.
2.	Need for imposing price band on stock on the day prior to OFS day.	As notice period of 'T-1' Day is suggested, there is no need for imposing price band on stock on the day prior to OFS day.	
3.	Need for halt / suspension of trading in concerned stocks on the day of OFS.	1. There is no need for halt / suspension of trading of OFS stocks in the secondary market on the date of OFS. 2. Ensure more transparency and clarity in dissemination of information relating to OFS and price of share trading in the secondary market. Relevant information relating to OFS may be highlighted in increased font and underlined (in the notice for offer). In addition, there could be an additional section on 'How to Bid',	Trading halts or suspension of trading has emerged as the most common form of market interventions, to reduce market volatility. However, studies suggest that the volume and volatility in the subsequent trading day after a trading halt are higher. Consequently, trading halts have the potential to increase the market volatility, rather than reducing it.[4] Further, when trading halts are likely to occur, some market participants may alter their market strategy in anticipation of the halt, thereby increasing market volatility. This is known as gravitational or magnetic effect.[5]

[4] Lee, Charles M.C., Mark J. Ready, and Paul J. Seguin, 1994, Volume, Volatility, and New York Stock Exchange trading halts, *Journal of Finance*, 49, 183-214

[5] Harris (1998) and Subrahmanyam (1994)

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		which clearly specifies the difference between bidding under the OFS mechanism (at separate segment) and purchasing through normal segment, and requirement to take a positive confirmation from the investors about the intention to bid in issue or purchase the stock through secondary market.	Also, trading halt may tend to scare away potential buyers and leading to panic selling by existing shareholders.[6] Consequently, greater information requirements and transparency (as suggested) would aid in providing clarity to potential investors.
4.	Whether OFS should be held on Saturday	OFS can be held on Saturday. However, when the OFS is open for two days for retail investors (as suggested earlier), Saturday can be second day, and not the first day.	As this would obviate the need for having trading halt or suspension of trading in the OFS stocks, if any.
5.	Need for providing option to retail investors to bid at cut-off price in all OFS	Sellers should mandatorily provide option to the retail investors to place price bid or bid at cut-off price for better retail participation. In case the option to bid at cut-off price is not provided, the same should be mentioned clearly in the notice of offer for sale.	As this will reduce confusion among retail investors in terms of the price at which they should place their bid.

3. General comments

As per the Resolution of Financial Stability and Development Council (comprising financial sector regulators) dated October 24, 2013, it was decided that all regulations after Oct. 31, 2013 and all other subordinate legislations (including circulars, notices, guidelines, letters, etc.) issued after Dec. 31, 2013 must comply with the following requirements[7]:

1. No subordinate legislation may be published without a Board resolution determining the need for such subordinate legislation.

[6] Report of the Emerging Markets Committee of the International Organisation of Securities Commissions, *"Effectiveness of Market Interventions in Emerging Markets"*, 2010

[7] Department of Economic Affairs, Handbook on adoption of governance enhancing and non-legislative elements of the draft Indian Financial Code, December 26, 2013

2. All draft subordinate legislation should be published with statement of objectives, the problem it seeks to solve, and a cost-benefit analysis (using best practices).
3. Comments should be invited from the public and all comments should be published on the web site of the regulator.

While SEBI has invited comments from public on the proposed change in regulations, consequently complying with condition 3, the other two conditions seem not to have been complied with. Specifically, no statement objective, or cost-benefit analysis of regulations seems to have been undertaken.

CUTS has been implementing projects on undertaking regulatory impact assessment (through cost-benefit analysis) of select legislations in energy (http://www.cuts-ccier.org/ADB-RIA/) and financial (http://www.cuts-ccier.org/BHC-RIA/) sectors. We have also conducted training-cum-advocacy programmes for regulators, wherein representatives of SEBI have participated (http://www.cuts-ccier.org/BHC-RIA/event-Training_Programme_on-Regulatory_Impact_Assessment_(RIA).html).
We would be happy to work with SEBI to undertake cost benefit analysis of the proposed and other regulations.

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