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Who will gain from new Sebi norms?

Small step in cleaning up price discovery

THE Sebi decision that requires all investors including qualified institutional buyers (QIBs) to bring in the entire application money as a margin in public securities offerings is a welcome measure. This is a small step in cleaning up the price discovery process under Indian securities laws; many more are due.

Not requiring QIBs to commit funds when they quote a price for a stock being issued led to an uneven playing field. Issuers were able to claim oversubscription within minutes of the book opening, leading to inflated demand for the offering. A QIB today need not put in money for its application and could, therefore, bid for a multiple of what it actually wants and give a sense of high demand for the offering.

The perceived oversubscription leads to others bidding a multiple of what they really want, because they would only get proportionate shares. Each bid — inexpensive because one does not need to put the money where the mouth is — fuels the next; and retail investors herd towards the issuer.

There was also a settlement risk for issuers and the QIBs alike — if adverse market conditions were to induce the QIBs to change their mind, the offering would effectively have to be called off, leading to undesirable consequences for the market. The QIBs too do not have to worry about the risk of being out of funds while waiting for allotment. They could use the applications supported by blocked amounts facility, whereby their funds would be earmarked and blocked but they would not have to actually part with funds till very close to the allotment of shares.

Further reform is overdue in other areas. In book-building for securities issuances as well as in reverse book-building for delisting, there is no bar on withdrawing a bid from rebidding. Till date, there has not been a single known usage of Sebi's enormous powers to act against abusive price discovery in the primary market. 'Purveying information not believed to be true' seems to be an allegation reserved exclusively for the secondary market.

FACE - OFF

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Reasonable chance of success for issues

SEBI's move to prescribe 100% margin for QIBs is not surprising. It is a logical extension of the phased approach to create a level playing field across different categories of investors. When book-building was introduced in public issues, there were no margin requirements for QIBs. The minimum 10% margin requirement was introduced in September 2005, along with scrapping of the discretionary allotment for QIBs.

Under Sebi regulations, QIBs are treated differently from other investors. Signals from QIBs, in terms of appetite and pricing, are cues for decision-making by retail and non-institutional investors. So, the QIB book must reflect genuine demand. Today, a part of the QIB demand reflected in oversubscribed issues may not be genuine as of them leverage on the 10% margin requirement and make more applications to maximise allotment.

With Sebi looking to reduce the time-frame for allotment, post-book closure and introduction of application supported by blocked amount (Asba), the compulsions of differential standards between QIBs and other investor categories lose relevance.

Fears of the move impacting the success of public issues are not entirely justified. In the short term, there could be some effect on the QIB appetite and levels of oversubscription from QIBs that are looking for immediate listing gains. As such, oversubscription, driven by non-serious demand, is only a psychological measure of an issue's success, rather than a barometer of its future price performance. So, a drop in the level of oversubscription should not be a concern.

What may cause anxiety is a possible shift of some QIB bids to the later part of bid periods, resulting in build-up of uncertainty during the initial period. However, long-term investment decisions of QIBs would not be affected by the margin size. The quality of demand books created in public issues will improve with this change. With a full margin, there would be virtually no underwriting risk for the underwriting syndicate. *(Views are personal)*