Mint Explainer: Impact of Sebi steps on single stock derivatives, delisting

Neha Joshi | 6 min read | 01 Jul 2024, 12:42 PM IST

Sebi approved a fixed price process as an alternative to the reverse book building process (RBB) for delisting of companies. (REUTERS)

SUMMARY

Sebi approved revised criteria for single stock derivatives, regulated entities associating with finfluencers, and delisting . Experts said the changes would ensure market stability and investor protection.

Mumbai: The Securities and Exchange Board of India (Sebi) approved proposals ranging from revising the criteria for the entry and exit of single stock derivatives to imposing restrictions on regulated entities dealing with financial influencers (finfluencers) at its 206th board meeting on 27 June.

It eased the voluntary delisting process and introduced an optional mechanism to pay registered advisors and analysts.

Mint takes a closer look at these decisions and their impact.

Eligibility criteria for single stock derivatives

Sebi revised the eligibility criteria for the entry and exit of stocks in the derivatives segment of stock exchanges. This applies only to stocks that have completed at least six months in the segment. Derivatives include stock futures and options contracts.

Sebi also introduced a “Product Success Framework" (PSF) in this segment, which would apply six months after Sebi issues the circular. The framework provides for derivatives to be discontinued if trading volumes remain low over six months.

Kunal Sharma, a partner at Singhania & Co, said tweaking the criteria for the entry and exit of stocks in the derivatives segment would ensure that only stocks with sufficient liquidity and stability are included.

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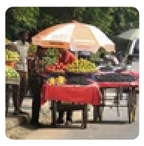

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“The grace period before new exit criteria for existing stocks minimises disruption but could lead to some stock movement as companies try to meet the new standards. The new framework might initially limit participation in some derivative products but could foster a more sustainable market in the long run," he said.

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Ravi Prakash, associate partner at Corporate Professionals, a financial consulting firm, suggested that Sebi may phase in the exit criteria, allowing a transition period.

“This could involve evaluating stocks quarterly instead of a sudden three-month deadline, providing market participants more time to adjust," he said.

Prakash suggested Sebi could consider introducing pilot programmes for new derivative products under PSF before full-scale implementation to help identify potential issues and make adjustments based on real-world performance.

Associating with financial influencers

Sebi said regulated entities must not associate with any person who directly or indirectly provides advice or recommendations, or makes claims on the performance of any security, unless permitted by it. Sebi clarified that regulated entities are required to ensure that people associated with them do not indulge in such prohibited activities.

This proposal excludes people engaged in investor education or those who do not advise or recommend or make claims on the performance of securities. It also excludes digital platforms that have a mechanism to take preventive and curative action so that they are not used for providing prohibited advice.

Experts said it was a necessary move because unsuspecting and naïve retail investors were losing substantial savings in the hope of making quick money due to ‘finfluencers.’

Sangeeta Jhunjhunwala, a partner at Khaitan Legal Associates, said this move was much needed becasue there were no specific guidelines governing influencers and their activities.

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“The Advertising Standards Council of India (ASCI) had issued guidelines on disclosure requirements for influencers. However, as ASCI is a self-regulatory body, these guidelines are not mandatory and there are no consequences if they are violated," she said.

Abhishek Dadoo, a partner at Khaitan & Co, appreciated the specific carve-out for investor education, which he said was a key element in the long-term growth and stability of our markets.

Prakash of Corporate Professionals suggested that Sebi come up with additional measures to ensure the effectiveness of this proposal. He said these could include “periodic audits of regulated entities to check compliance, monitoring of digital platforms to prevent misuse and increased investor education about the importance of seeking advice from registered professionals."

He suggested that Sebi establish a streamlined registration process for advisors to reduce administrative barriers that may hinder compliance.

Flexibile voluntary delisting framework

Sebi approved a fixed price process as an alternative to the reverse book building process (RBB) for delisting of companies whose shares are frequently traded.

In the fixed price process, the company sets a predetermined price for the securities; in the RBB process, share prices are based on investor demand at the end of the bidding process. The fixed price will be at a premium of at least 15% over the floor price determined by the delisting regulations.

Harish Kumar, a partner at Luthra and Luthra Law Offices, said under the existing delisting process, price discovery through the RBB mechanism was highly impractical and led to the failure of most delisting offers.

Sanjam Arora, a partner at Trilegal, said the fixed price process could smoothen the path for take-private transactions — private companies acquiring publicly traded companies, causing shares to be delisted — and boost public company mergers and acquisitions.

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“The fixed 15% premium is a reasonable representation of the control premium that an acquirer may be willing to pay to take a public company private. The fact that the offer price is fixed would also insulate the process from market speculation," said Arora.

Anjali Aggarwal, a partner of Capital Market Transactions at Corporate Professionals, anticipated the increased likelihood of minority shareholders getting a fair price or better terms during delisting, as also legal and operational implications for delisting companies.

“It could impact the timing and sequencing of corporate actions and communications as well as the preparation of necessary documentation and disclosure," she added.

Limiting the maximum extension for LVFs

Sebi set a maximum limit of five years for extending the tenure of Large Value Funds (LVF), which are alternative investment funds where only accredited investors invest a minimum amount of ₹70 crore.

Existing LVF schemes with no cap on extension tenure or whose extension period is beyond the permissible five years will get three months from the date the circular is issued to align with this requirement.

While realigning, Sebi will permit LVFs to revise the original base tenure of the scheme with the consent of all their investors.

Siddharth Mody, a partner at J Sagar Associates (JSA), said limiting the extension of the LVF tenure would protect investors by providing clear timelines for fund liquidation.

However, obtaining unanimous investor consent could be complex and time-consuming for existing LVFs revising their original base tenure to align with the five-year extended tenure, said Dibya Behra, a senior associate at Nishith Desai Associates in the Investment Funds team.

“Sebi should have considered applying the same two-thirds majority consent threshold for changes in the base tenure of existing LVFs," he suggested.

Mechanism for fee collection by registered advisers and analysts

Sebi approved an optional mechanism for registered investment advisers and research analysts to collect fees that are cost-neutral to their clients.

Ritu Sarraf, associate in the financial services & regulatory practice team at Nishith Desai Associates, said enabling investors to remit fees directly to the service provider may ensure minimum disruption.

“This initiative by Sebi is particularly relevant in today’s climate, where unregistered investment advisory activities and scams are frequently reported and should help in curbing the proliferation of unregistered entities," she said.

Easing business for InvITs and REITs

Sebi approved measures for facilitating business for Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs). InvITs are instruments that allow entities to invest in infrastructure projects. REITs, which are similar to mutual funds, own, operate or finance income-producing real estate.

One of the measures was reducing the trading lot for privately placed InvITs to ₹25 lakh.

Ratnadeep Roychowdhury, co-head of M&A and PE practice at Nishith Desai Associates, said reducing trading lots for privately placed InvITs could meaningfully increase investor participation in these products.

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