

Corpsec Hotline

October 16, 2008

SEBI DISCLOSURE ON OVERSEAS SECURITIES LENDING: FALLING 'SHORT'?

In order to address the current Indian market scenario and the continuous selling on the Indian stock exchange, Securities and Exchange Board of India ("SEBI") has taken certain steps to monitor the selling activity on the Indian stock exchange.

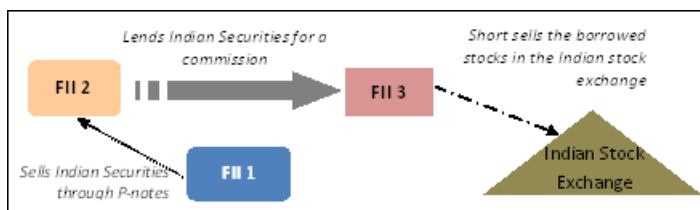
Background

In India, short selling of securities is made permissible provided it is in pursuance of the short selling ("SS") framework coupled with the Securities Lending and Borrowing scheme ("SLB") introduced by SEBI recently, which lays down specific guidelines for short selling on the floor of Indian stock exchanges.

But, SEBI had noticed that FIIs had been borrowing and lending securities in the offshore derivatives instruments market resulting to enormous amount of sales by FIIs on the Indian stock exchanges, which were not within the purview of the SS framework and the SLB. Also, there is no form of monitoring for such form of short selling activity. Therefore, SEBI has issued instructions to the FIIs and custodians in by way of a press release on October 15th 2008 the implications of which have been discussed hereunder.

This kind of offshore borrowing and lending may be demonstrated by way of the following example.

Example



Explanation:

- FII 1 holds Indian securities and sells these securities to FII 2 by way of P-notes
- FII 2 now holds the Indian securities by way of P-notes. It further lends these securities, held by way of P-notes to another FII 3 and gets a commission in return
- FII 3 feels that the price of these securities will drop and thus sells these borrowed securities on the Indian stock exchange, with an intention to buy it when the stock price falls and returning the borrowed securities to FII 2

Press release

SEBI has indicated that the FIIs who lend such securities will have to submit a bi-weekly report to SEBI

- This report shall include the position of the securities lent by these entities abroad
- The report shall be submitted Tuesdays and Fridays of every week on a consolidated basis
- Such information will be first provided on the SEBI website on Friday October 17, 2008 covering the activity between Friday October 10, 2008 to Tuesday October 14, 2008

NDA view

We understand that the rationale behind SEBI seeking such information might be:

- SEBI might have sensed that short selling was taking place even outside of the SS and SLB framework by way of transactions involving offshore derivative instruments. Therefore, to assess the impact of overseas lending and borrowing of underlying Indian securities, SEBI might be seeking further information on the same
- Though unlike the other jurisdictions, SEBI has not yet imposed any blanket ban on short selling of securities possibly on the basis that the amount of short selling in the Indian markets through SS and SLB has been

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insignificant to warrant any such immediate ban, however, SEBI may want to examine the impact of such overseas borrowing and lending undertaken by FII and its indirect impact on the Indian stock markets. Depending on the data that comes out based on such reporting obligations, SEBI may consider whether any specific ban on short selling (both direct as well as indirect) is warranted.

- The imposition of such reporting and disclosure obligation in itself may result in some hesitance within the FII from engaging into such indirect short selling transactions overseas thereby reducing the volatility in the Indian markets.

Source: [PR-SEBI to disseminate further information on FII activity](#)

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You can direct your queries or comments to the authors

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