Discussion Paper on 'Mandatory Safety Net Mechanism'

Background

Regulation 44 of SEBI (ICDR) Regulations, 2009 addresses the concept of Safety Net in public Issues. Excerpts from the same are reproduced below:

"An issuer may provide for a safety-net arrangement for the specified securities offered in any public issue in consultation with the BRLM after ascertaining the financial capacity of the person offering the safety-net arrangement, subject to disclosures specified in this regard in Part A of Schedule VIII of SEBI (ICDR) Regulations, 2009.

Provided that any such arrangement shall provide for an offer to purchase up to a maximum of one thousand specified securities per original resident retail individual allottee at the issue price within a period of six months from the last date of dispatch of security certificates or credit of demat account."

Reasons for review

In the analysis of price performance of the scrips listed during 2008 to 2011, it was observed that out of 117 scrips, 72 (around 62% issues) were trading below the Issue price after 6-months of their listing. Out of those 72 scrips which witnessed fall in price, in 55 scrips the fall was more than 20% of the Issue price. In this scenario if the trend continues, the sentiments of the investors would get affected and they may lose confidence in the capital market. Thus, there is a need to provide Safety Net arrangement for RIIs to build their confidence in capital market.

Discussion in Primary Market Advisory Committee meeting held on 31/07/2012

The Primary Market Advisory Committee (PMAC) was of the view that considering the recent post-listing price performance of IPOs, it is necessary to make the safety net mechanism mandatory for IPOs so as to reinforce investor confidence in capital markets and discipline issuers and market intermediaries. Thus, the Committee was, broadly, in concurrence with SEBI on the need for such a mechanism. However, the Committee was of the view that the proposed mandatory Safety Net mechanism would impact various segments of market participants such as investors, issuers, promoters, BRLMs, etc., and that public comments be sought.

Discussions in the SEBI Board held on 16/08/2012

, Considering the Indian market dynamics and the recent post-listing price performance of IPOs, the Board opined that besides disclosures, other measures are needed to bring in self-discipline in IPO pricing. One such measure which could help protect the interests of small investors is a safety net mechanism. While agreeing with the approach in this regard, it was of the view that more public consultation on the details of the proposal was needed, before it could be implemented. Accordingly, the following proposed broad framework for a 'Mandatory Safety Net Mechanism' is hereby placed for public comments.

Proposed Broad Framework for Safety Net Mechanism

A. Safety Net provision shall be mandatory for all IPOs.

B. Safety Net Trigger:

Safety Net provision shall trigger only in cases where the price of the shares depreciate by more than 20% from the issue price. The price for this provision shall be calculated as the volume-weighted average market price of such shares for a period of 3 months from the date of listing.

Further, the 20% depreciation in share price shall be considered over and above the general fall, if any, in market index. The market index for this purpose may be BSE-500 or S&P CNX 500. The market index to be considered for this purpose shall be disclosed, in advance, in the offer document.

Following illustrations will explain the point further:

Illustration-1

Assume listing price for share is Rs. 100 and market index on listing date is 1000. After 3 months, volume-weighted average market price of the shares is Rs. 79 (drop of 21%) and the market index is 1000 (drop of 0%). The Safety Net provision will trigger since relative fall of 21% (21%-0%) is more than 20% trigger level.

Illustration-2

Assume listing price for share is Rs. 100 and market index on listing date is 1000. After 3 months, volume-weighted average market price of the shares is Rs. 79 (drop of 21%) and the market index is 900 (drop of 10%). The Safety Net provision will not trigger since relative fall of 11% (21%-10%) is less than 20% trigger level.

Illustration-3

Assume listing price for share is Rs. 100 and market index on listing date is 1000. After 3 months, volume-weighted average market price of the shares is Rs. 69 (drop of 31%) and the market index is 900 (drop of 10%). The Safety Net provision will trigger since relative fall of 21% (31%-10%) is more than 20% trigger level.

Illustration-4

Assume listing price for share is Rs. 100 and market index on listing date is 1000. After 3 months, volume-weighted average market price of the shares is Rs. 89 (drop of 11%) and the market index is 1100 (increase of 10%). The Safety Net provision will not trigger even if relative fall of 21% (11%-(-10%)) is more than 20% trigger level since the absolute drop in share price is 11% which is less than 20% trigger level.

C. Eligibility:

The facility will be available for all the allotted securities to original resident retail individual allottees who had made an application for up to Rs 50,000 subject to following:

- The total obligation on Safety Net provider will be capped at 5% of the issue size.
- In case the total number of shares offered under the safety net scheme works out to be more than 5% of issue size, the purchase of securities from original resident retail individual allottees shall be done on proportionate basis such that total obligation does not exceed 5% of the issue size. For eg., in an issue of size Rs. 1000 Cr., post-issue promoter holding is 50% of the capital of the company and market capitalisation of the company is Rs. 2000 Cr., the safety net obligation would work out as under:-
    i. The maximum obligation of the promoter would be 5% of Rs. 1000 Cr., i.e., he will be obliged to buy the shares worth Rs. 50 Cr. at the issue price.
    ii. Even if more than 5% of the issue size has been originally allotted to RIIs who had applied for Rs. 50,000 or less and all of them tender their shares, the promoter will be obliged to

buy shares worth Rs. 50 Cr. only at the issue price, i.e. 5% of Rs. 1000 Cr., the issue size. The acceptance will be done on a proportionate basis.

iii. However, if the number of eligible shareholders or the number of shares tendered is less than the above, the cost for the promoter in providing the safety net would be limited to fall in the value of the actual number of shares tendered. For eg., if 5% shares (i.e. approx 15% of the RII quota of 35%) are tendered in safety net and if the fall in price is 20% from the issue price, the cost of providing safety net will be Rs. 10 Cr. only, i.e. 1% of the issue size of Rs. 1000 Cr. In this case, if the shares tendered are less than 5% of the issue size, the cost will be even lesser.

D. Period for Safety Net:

- The Issuer/ BRLM to announce, within 3 working days from the date of completion of three months from listing date, triggering of Safety Net provision and invite eligible shareholders to tender their shares.
- Safety Net arrangement shall be open for 10 working days from the date of announcement. Eligible investors may tender their shares to Safety Net Provider under the scheme during this period. The shares so tendered shall be kept in escrow account till successful settlement of shares and funds.
- The settlement of shares and funds shall be completed within 10 working days of the completion of the last date for surrender of shares by eligible shareholders.
- Eligible investors may tender their shares through a separate exchange window (similar to buyback of shares).

E. The primary safety net obligation would rest with the promoters of the issuer. However, they may choose to fulfill the same, directly or through BRLMs/any other Safety Net Provider.

F. The arrangements made for the purpose of meeting the Safety Net obligationshall be disclosed in the offer document.

G. Any acquisition of shares under the scheme of Safety Net shall be exempt from the provisions of SEBI (SAST) Regulations, 2011.

Public Comments

Comments on the above framework may be emailed on or before October 31, 2012, to pranav@sebi.gov.in/ cfddil@sebi.gov.in or sent, by post, to:-

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