

Hedge funds, FIIs dump StanChart's IDRs

Ashish Rukhaiyar & Mehul Shah / Mumbai June 7, 2011, 0:50 IST

New Sebi norms prevent conversion of the bank's Indian Depository Receipts into its shares.



Hedge funds and foreign institutional investors (FIIs), which were eyeing arbitrage gains by building large positions in Standard Chartered Plc's Indian Depository Receipts (IDRs), sold them in huge quantities on Monday. The selling spree was triggered by a Securities and Exchange Board of India (Sebi) clarification that the IDRs could not be converted into shares of the foreign

company even after one year of listing.

On Monday — the first trading session since the Sebi circular was made public — the IDRs lost nearly 20 per cent, falling to a new all-time low. On the National Stock Exchange (NSE), the IDRs fell to a low of Rs 91.90, before recovering some ground to close at Rs 97 — 15.54 per cent lower than Friday's close of Rs 114.85. On the Bombay Stock Exchange (BSE), more than 18 million IDRs changed hands, which is exponentially higher than its two-week average quantity of less than one million.

REGULATORY SHOCK

- StanChart IDR tanks 20% after Sebi clarifies it cannot be converted into equity shares
- Many hedge funds trim positions after fresh norms put a plug on arbitrage opportunities
- Marketmen slam regulator for taking a U-turn on IDR fungibility
- The new norms will kill the IDR market, they say
- IDR segment needs regulatory incentive for liquidity, say experts

According to market players tracking the IDR, hedge funds were quite active in the counter in the recent past as the Indian instrument typically traded at a discount to the shares of the bank listed on stock exchanges in London and Hong Kong. These investors were pinning their hopes on expectations the regulator would approve the fungibility of IDRs after one year of listing, which would allow them to get the shares cheaper.

"Investors including FIIs have bought Standard Chartered IDRs with an understanding they will be allowed to convert these receipts into underlying shares after one year without any approvals or conditions, a position also confirmed by the RBI. However, Sebi's new guidelines have made such redemption possible only in case of infrequently traded IDRs, which Standard Chartered IDRs are not. It is like the regulator suddenly changing the rules of the game, which the FIIs are finding unfair," said Siddharth Shah, head of corporate and securities practice at Nishith Desai Associates. "The new rules potentially resulting in diminished interest from FIIs could potentially sound the death knell for IDRs as a product, which has seen some success after much pain. Such a move could also raise questions over the stability of the regulatory environment in India," he added.

According to bulk deal data on stock exchanges, Credit Suisse (Singapore) sold 5.5 million Standard Chartered IDRs on Monday. Others such as Deutsche Securities Mauritius (1.3 million IDRs) and Swiss Finance Corporation (10.8 million IDRs) also sold Standard Chartered IDRs, data showed. On the other hand, ICICI Prudential MF bought 2.98 million Standard Chartered IDRs on Monday.

The interest of hedge funds and other overseas investors in the Indian instrument can also be gauged from the fact that the total foreign holding in the IDR, which was around 38 per cent at the time of issue, has increased to approximately 70 per cent.

When the Standard Chartered IDR issue was launched in May 2010, the draft document clearly mentioned the IDRs could not be redeemed before one year

of issue and fungibility into the underlying shares would be allowed only after RBI approval on a case-by-case basis.

Interestingly, many market players are of the view the regulator's move will kill the IDR market, which has till now seen only one foreign company taking the initiative. IDRs are shares issued by foreign companies and are listed on Indian exchanges. That gives Indian investors an opportunity to own an indirect share in a foreign company.

"From the large picture point of view, considering this set of guidelines of convertibility, global companies may shy away from issuing IDRs in India. If that is the case, the StanChart IDR issue may be the first as well as the last IDR issue from India," said a note by Jagannadham Thunuguntla, strategist & head of research, SMC Global Securities. "If India is keen on the IDR market, it is very critical to look into this matter and create an environment wherein there is an incentive for liquidity," it added.

Standard Chartered officials, however, reiterated their stance that IDRs have a good future in the Indian market. "We note that the guidelines for IDR fungibility have been clarified by Sebi. We have been very pleased with the investor interest in our IDR, both at the launch and subsequently, and we believe IDRs have a good future as fund-raising and investment vehicles in India," said Neeraj Swaroop, regional CEO - India & South Asia, Standard Chartered Bank, in an email response. "Standard Chartered continues to present a strong investment case -- recently announcing an eighth straight year of record income growth -- and the IDRs listed here represent an ideal access point for Indian investors," he added.

Every 10 IDRs of Standard Chartered Plc represent one equity share of the bank whose shares are trading at nearly 16 pounds or a little over Rs 1,200 on the London Stock Exchange (LSE). At Friday's close, 10 IDRs would have cost investors Rs 1,148.50, implying a discount of nearly five per cent to the LSE price.