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INVESTMENT MANAGEMENT

Securities and Exchange Board of India
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Introducing Close Auction Session in Equity Cash Segment

Norges Bank Investment Management (NBIM) appreciates the opportunity to respond to the Securities and Exchange Board of India's (SEBI) consultation paper on the introduction of a Close Auction Session in the equity cash segment.

NBIM is the investment management division of the Norwegian Central Bank ("Norges Bank") and is responsible for investing the Norwegian Government Pension Fund Global. NBIM is a globally diversified investment manager with assets valued at NOK 15,765 billion as of 31 December 2023, of which 320 billion NOK was invested in Indian equities.

As a long-term investor NBIM has an interest in well-functioning financial markets that facilitates the efficient allocation of capital and promotes long-term economic growth and thus in a regulatory environment for trading in financial instruments that facilitates such an outcome.

General comments

We welcome SEBI's initiative to introduce closing auctions in the Indian equity market. The Indian market is large, technologically advanced, and characterised by strong retail participation. We believe the introduction of a well-designed closing auction mechanism can complement the continuous trading session, strengthen overall market quality, and facilitate further international institutional participation in the Indian market.

The consultation paper documents that Indian stocks experience excessive volatility towards trading close on index rebalancing days compared to stocks trading on markets with established closing auction mechanisms. We agree that closing auctions has the potential to reduce end-of-day volatility linked to such indexation events, and thus will facilitate indexation type investment strategies.

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We would however emphasise the broader effects on the market that the introduction of a closing auction mechanism may entail. By aggregating diverse trading interests and establishing prices through a transparent, rule-based process a well-designed auction determines the clearing price that reflect investor supply and demand. The multilateral nature of the process where multiple buyers and sellers with fundamental transaction requirements interact simultaneously, facilitates efficient price discovery.

The international evidence from various major markets is that closing auctions is an increasingly significant “liquidity event” at the end of the trading day. The concentration of trading interest at a predictable time creates the opportunity for participants to match larger trades with reduced market impact. The closing auction should be available and relevant to all market participants. However, the combination of concentrated liquidity and efficient price formation make the closing auctions particularly important to institutional participants, who seek to execute large trades efficiently.

There is an international trend towards an increasing share of overall trading activity taking place at the closing auction. This development is the outcome of the choices market participants make and follows from the various trading needs across retail participants, asset managers and institutional investors. The high retail participation in the Indian market may initially limit the equilibrium position of the closing auction will take the trading day, and the introduction should not be expected to reduce the quality of the continuous trading session during ordinary hours. The introduction of a closing auction might facilitate further international and institutional participation in the Indian market which could add to overall activity and trading volumes.

The market closing price has specific significance for derivative markets. To avoid unforeseen effects SEBI should seek to address any uncertainties or ambiguities in relation to the use of the closing auction price as a reference for derivative markets in advance of implementation.

Specific design recommendations

We would recommend a model that aligns with established auction principles in European markets. European auctions importantly take place after the continuous markets session and have proven successful in providing orderly price formation and considerable liquidity while preventing manipulation through a combination of call periods, random ends, and final-price determination phases. Model one incorporates these key design elements.

The proposed price limits of $\pm 5\%$ from the reference price during the order input period, along with clear rules for determining equilibrium price based on maximum executable volume, and pre-trade transparency showing indicative auction prices and volumes provide a workable framework for price discovery. The pre-trade transparency regime should foster confidence in the price formation process while allowing sufficient flexibility for participants to manage their trading intentions.



We observe that the suggested limit order priority may be at odds with other markets standards and suggest that SEBI provide further rational for this design.

SEBI should follow the impact of the introduction of a closing auction closely. We are concerned by some developments observed in other markets. The closing auction position as a centralised liquidity event is reduced when liquidity is fragmented into different “at close” offerings by other market participants. The status of the auction is best protected if the exchange refrains from charging additional fees for auction participation relative to continuous trade facilitation.

Conclusion

We commend SEBI for undertaking this initiative to enhance India's market structure. We are of the opinion that a well-designed closing auction serves a purpose in a well-functioning market. It supplements a high-quality continuous trading session and meets investor trading requirements. The implementation of a closing auction can further strengthen the Indian equity market.

We appreciate this opportunity to share our perspective and remain at your disposal should you wish to discuss these matters further.

Yours sincerely,

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