



SEBI and the protection of the investors

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Abstract

It is believed that a liberalised securities market helps promote economic growth. The more liberalised a securities market is, the better is its impact on economic growth. The main object of the SEBI Act, 1992, (Securities and Exchange Board of India), is to protect the interests of investors in securities market and to promote the development, and to regulate the securities market. It was considered desirable to expand the jurisdiction of SEBI, enhance its autonomy and empower it to take a variety of punitive actions in case of violations of the Act. The investor forum as well as other authorities should have power to dispose of the cases summarily and to award compensation to the investor. It is not enough if the culprit is punished. The culprit needs to be punished in an exemplary manner, while investor should have means to recover his loss caused by the culprit. The law should empower the authorities not only to levy penalties, but also award compensation to investor.

Keywords: securities, depository, public issue

Introduction

Investors are the backbone of the securities market. Protection of their interest is essential for sustenance of their interest in securities and hence development of market. The Primary function of Securities and Exchange Board of India under the SEBI Act, 1992 is the protection of the investors' interest and the healthy development of Indian financial markets. No doubt, it is very difficult and herculean task for the regulators to prevent the scams in the markets considering the great difficulty in regulating and monitoring each and every segment of the financial markets and the same is true for the Indian regulator also. But what are the responsibilities of the regulators to set the system right once the scam has taken place, especially the responsibility of redressing the grievances of the investors so that their confidence is restored? The redressal of investors' grievances, after the scam, is the most challenging task before the regulators all over the world and the Indian regulator is not an exception. One of the weapons in the hand of the regulators is the collection and distribution of disgorged money to the aggrieved investors.

SEBI had issued guidelines for the protection of the investors through the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000^[1]. These Guidelines have been issued by the Securities and Exchange Board of India under Section 11 of the Securities and Exchange Board of India Act, 1992. It is of importance to be informed in the context about few important definitions stated under the guidelines. The guidelines speaks of Issuer Company-which means a company which has filed offer documents with the Board for making issue of securities in terms of these guidelines, Listed Company- is a company which has any of its securities offered through an offer document listed on a recognised stock exchange and also includes Public Sector Undertakings whose securities are listed on a recognised stock exchange, Merchant Banker- is an entity registered under

Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992, Offer Document- means Prospectus in case of a public issue or offer for sale and Letter of Offer in case of a rights issue, Offer for Sale- means offer of securities by existing shareholder(s) of a company to the public for subscription, through an offer document^[2].

SEBI guideline for the investor's protection:

SEBI has from time to time provided guidelines to the securities issuing companies in order to protect the investors. Provisions regarding this are enshrined in Chapter-II of the said guidelines. No company shall make any issue of a public issue of securities, unless a draft prospectus has been filed with the Board, through an eligible Merchant Banker, at least 21 days prior to the filing of Prospectus with the Registrar of Companies (ROCs)^[3]. Provided that if, within 21 days from the date of submission of draft Prospectus, the Board specifies changes, if any, in the draft Prospectus (without being under any obligation to do so), the issuer or the Lead Merchant banker shall carry out such changes in the draft prospectus before filing the prospectus with ROCs. No listed company shall make any issue of security through a rights issue where the aggregate value of securities, including premium, if any, exceeds Rs.50 lacs, unless the letter of offer is filed with the Board, through an eligible Merchant Banker, at least 21 days prior to the filing of the Letter. Provided that if, within 21 days from the date of filing of draft letter of offer, the Board specifies changes, if any, in the draft letter of offer, (without being under any obligation to do so), the issuer or the Lead Merchant banker shall carry out such changes before filing the draft letter of offer. No company shall make an issue of securities if the company has been prohibited from accessing the capital market under any order or direction passed by the Board.

¹ Securities and Exchange Board of India (disclosure and investor protection) guidelines, 2000.

² Avadhani V.A., SEBI Guidelines and Listing of Companies, 1st edition 2009, Himalaya publication,

³ Depository Act, 1996 & Rules

These provisions are being dealt in the Chapter-III of the guidelines^[4]. A listed company whose equity shares are listed on a stock exchange, may freely price its equity shares and any security convertible into equity at a later date, offered through a public or rights issue. An unlisted company eligible to make a public issue and desirous of getting its securities listed on a recognised stock exchange pursuant to a public issue, may freely price its equity shares or any securities convertible at a later date into equity shares. An eligible company shall be free to make public or rights issue of equity shares in any denomination determined by it in accordance with Sub-section (4) of Section 13 of the Companies Act, 1956 and in compliance with the following and other norms as may be specified by SEBI from time to time^[5].

In case of initial public offer by an unlisted company, if the issue price is Rs. 500/- or more, the issuer company shall have a discretion to fix the face value below Rs. 10/- per share subject to the condition that the face value shall in no case be less than Rs. 1 per share; and, if issue price is less than Rs. 500 per share, the face value shall be Rs. 10/- per share; The disclosure about the face value of shares (including the statement about the issue price being "X" times of the face value) shall be made in the advertisement, offer documents and in application forms in identical font size as that of issue price or price band.)

Pre- Issue Obligations

The pre issue obligations are provided in Chapter-V, they are as follows:-

- The lead merchant banker shall exercise due diligence.
- The standard of due diligence shall be such that the merchant banker shall satisfy himself about all the aspects of offering, veracity and adequacy of disclosure in the offer documents.
- The liability of the merchant banker shall continue even after the completion of issue process. No company shall make an issue of security through a public or rights issue unless a Memorandum of Understanding has been entered into between a lead merchant banker and the issuer company specifying their mutual rights, liabilities and obligations relating to the issue.

Contents of Offer Document

In addition to the disclosures specified in Schedule II of the Companies Act, 1956, the prospectus shall also contain all material information which shall be true and adequate so as to enable the investors to make informed decision on the investments in the issue. The prospectus shall also contain the information and statements specified in this chapter and shall as far as possible follow the order in which the requirements are listed in this chapter and summarised in Schedule VIIA.

Consequence of Non-Observance of the Guidelines

In case of non-observance of these guidelines (Section 11B) as it seems to be a bar from doing such things which may prejudice the interest of the investors the board can give the following directions:

Direct the persons concerned to refund any money collected under an issue to the investors with or without requisite interest, as the case may be, direct the persons concerned not to access the capital market for a particular period, direct the stock exchange concerned not to list or permit trading in the securities, direct the stock exchange concerned to forfeit the security deposit deposited by the issuer company and any other direction which the Board may deem fit and proper in the circumstances of the case.

Subject to condition that before issuing any directions the Board may give a reasonable opportunity to the person concerned. Provided further that if any interim direction is sought to be passed, the Board may give post decisional hearing to such person.

Future Overcast of the Investors

SEBI being a premiere institution for dealing with the problems relating to securities has advanced a long way towards protecting the investors from the hazards of the predators existing in the market. As already stated before it has compiled a great bunch of guidelines dedicated to this cause. But the real scenario which came as a consequence was that only the big fishes could escape the net and the small ones were still striving to uphold their existence. In this matter, according to Financial daily (newspaper)^[6] it has become clear that SEBI had already received suggestion and advice regarding the need for a separate enactment concerning the small investors. As far as it is concerned, the Government has thought of introducing an independent legislation on investor protection to safeguard the interests of small investors. A separate legislation had also been recommended in the report prepared by Mr. Mitra, who was commissioned by the Finance Ministry to draw up the terms of reference for a new Bill. A debate has been on over the need for a separate legislation for protecting the interests of small investors, considering that there are multiple agencies involved in policing companies that raise funds from the public be it public listed companies, or NBFCs (Non-Banking Financial Companies). These include the capital markets regulator, SEBI, the banking regulator, RBI, and the Department of Company Affairs (DCA) which is responsible for regulating unlisted companies. SEBI has been in favour of a separate regulatory agency for the protection of small investors. The regulator had earlier submitted a proposal to the Finance Ministry, outlining the need for a new Act. The setting up of a comprehensive fund for the protection of investors has also been recommended by Mr. Mitra which we see in reality to have been already existing today. In fact, the report has suggested that the existing Investor Protection Fund, the corpus of which is to come from unclaimed dividends, should be merged with the new fund.

Conclusion.

As we have seen that via different guidelines it has been made it sure that no stone remains unturned in the path of the mission of protecting the investors. The investor forum as well as other authorities should have power to dispose off the cases summarily and to award compensation to the investor. It is not enough if the culprit is punished. The culprit needs not only to

⁴ SEBI Act, 1992, Rules & Regulations

⁵ SC(R)A, 1956 & Rules

⁶ Business Line (Financial Daily), The Hindu Group of Publication, Friday, 24th June, 2001

be punished in an exemplary manner, while investor should have means to recover his loss caused by the culprit. The law should empower the authorities not only to levy penalties, but also award compensation to investor.

Presently the two greatest challenges are the scams relating to mutual fund and the disgorgement of money. As regards to the mutual fund problem, it had become clear that, the Capital market regulator SEBI is concerned about the kind of service mutual funds are providing to their investors and wants the industry to focus on the hassle-free redemptions and also conduct an investor survey, in their own interest. Furthermore Mr. C.B. Bhavé (Chairman of SEBI) while pointing towards the mutual fund institutions commented that, "Take up investor survey to find out what they feel about your products, why do they like certain products.....", "Focus on what the client wants, as this will be in your interest." He also assured that SEBI would be having an advisory committee for the MF institutions. The SEBI Chairman also suggested setting up of a depository that will maintain database of all mutual fund investors across the country, similar in line with the depositories for the equity market. SEBI is also planning to hold a workshop for the trustees to get their feedback and to know their requirements. The regulator has also decided to set up a mutual fund advisory committee to address the issues faced by the industry.

In India, the position is not so well and hence the picture is not clear as to how the disgorged money is to be treated. Generally, the payments received by way of penalties are deposited in Consolidated Fund of India. In its first ever disgorgement order on 21st November, 2006, in Karvey case, SEBI directed NSDL(National securities Depository Limited), CDSL (Central Depository services ltd) and eight depository participants (DPs) to return Rs115.81 crore in six months. The DPs include Karvey, HDFC Bank, Khandwala Securities, IDBI Bank, Jhaveri Securities, ING Vysya Bank, PR Stock Broking and Pratik Stock Vision. On the issue of disgorgement, in the order passed in the Karvey case, SEBI said, "It is well established worldwide that the power to disgorge is an equitable remedy and is not a penal or even a quasi- penal action. Thus it differs from actions like forfeiture and impounding of assets or money. Unlike damages, it is a method of forcing a defendant to give up the amount by which he or she was unjustly enriched. The point of importance here is that the order was passed with the need felt need to restore confidence about the market process in the minds of investors who were deprived of their entitlement to shares under the IPO(Initial Public Offer) as a result of illegal cornering of shares by some financiers. The Wadhwa Committee report of December 2007 recommended making good the deprived investors in money terms, which, it seems, went well with the SEBI, as understood from its order of disgorgement ^[7].

The depositors are protected up to Rs. 1 lakh in the event of liquidation/bankruptcy of a bank. This protects innocent depositors and thereby contributes to the stability of the financial system. A similar mechanism may be instituted to compensate an investor up to Rs. 5 lakh if he suffers a loss on account of the failure of the system or mischief by any market participant. An organisation called Securities Investor

Protection Corporation operates in the USA to provide similar protection to investors

The confidence of the investors can be maintained and enhanced by making provision for professional intermediation services. Industry/Regulators have made a modest beginning, but not adequate given the dimensions of the market. There must be a formal and adequate arrangement to equip the personnel working with the intermediaries with the skills required to operate in the securities market. Probably an institute like ICSI or ICAI is necessary for securities market

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⁷ Circular No. - SEBI/CFD/DIL/DIP/29/2007/03/12; Dated: - December 03, 2007