

The curious case of Chairman SEBI

- Sunil Kumar

The Indian Stock Market is enjoying a bull run! TV and newspaper headlines scream that Stock Index has crossed the 17000 mark and viewers and readers are expected to rejoice at this feat and wait expectantly for the 'bull' run to cross the 21000 mark! Perhaps good times are back again, as one ad-campaign for a soft drink company had declared sometime back.

But is it really so? There are other newspaper headlines which declare that – ***FII investments at \$15 billion & counting*** and ***Subbarao a worried man!*** Sometime back the National Security Advisor Narayanan was a worried man. Reports of slush funds of corrupt politicians, industrialists, bureaucrats coming back to the country and finding its way in the Stock Market also intermittently make their way in the Press. But 'there is no cause for concern', 'Government is strictly monitoring the situation', 'Stern action will be taken against the wrongdoers' comes the reassurance from senior Government functionaries and we, honest tax-paying citizens of India, are expected to lose no further sleep over these trivial matters!

But can we afford to sleep? Just consider these facts.

- Between 1996-97 to 2001-02 there was FII inflow of \$10.4 billion
- Between 2002-03 to 2007-08, FII inflow increased to \$52.76 billion
- In 2009-10, net FII inflow has already crossed \$15 billion and may touch \$18 billion
- Participatory Notes (PNs) accounted for more than 50% of the FII inflows in 2007.

Is increased flow of foreign funds into the stock market a good thing? What is it about Participatory Notes that makes one uneasy? To put it simply, Participatory Notes (PNs) are instruments used by foreign funds, not registered in India, for trading in the domestic market. They are a derivative instrument issued against an underlying security that permits the holder, some of whom may not be eligible to trade in Indian stock markets, to get a share in the income from the underlying security.

Reserve Bank of India had sought a ban on PNs as it believed that it is difficult to establish the beneficial ownership or the identity of the ultimate investor. Further, trading of these PNs will lead to multi-layering, which will make it difficult to identify the ultimate holders of PNs. Dr.Ashok Lahiri Committee **Report on Encouraging FII flows and Checking the Vulnerability of Capital Market to Speculative Flows** had also observed that:

“With PNs issued to various types of entities abroad, the identity of the actual investor need not necessarily be known to the regulatory bodies. The investors could be individuals or corporate who are not subject to the Indian laws. This has given rise to the concerns that some of the money coming into the market via PNs could be unaccounted wealth of some rich Indians camouflaged under the guise of FII money. This money might even be tainted and linked with such illegal activities as smuggling and drug-running.”

National Security Advisor had voiced concerns of terror funds of even someone like Dawood Ibrahim finding its way into Indian stock market. Prof.R.Vaidyanathan feels that the PN system is discriminatory and seems to favour the ghost investors.

Yet even when the RBI sought the phasing out of PNs and SEBI came out with a draft for discussion on ways to regulate PNs in 2007, the Union Finance Minister was quick to come out with the assurance that Government was not going to phase them out. This brings us to the curious case of Chairman, SEBI.

In early 2008, Mr. Damodaran completes his tenure as Chairman of SEBI and in February 2008 Government appoints Mr. C.B.Bhave as Chairman of SEBI even though it knew very well that SEBI was conducting proceedings against National Securities Depository Limited (NSDL) of which Shri Bhave was the Chairman and Managing Director from its inception in 1996 and as Chairman SEBI he could not possibly conduct an inquiry against himself! However, he was appointed and SEBI immediately withdrew the Discussion Paper on regulation of PNs.

Next, the SEBI Board, in its meeting on August 13, 2008, constituted a committee of two of its members to take over and dispose of the on-going proceedings as on February 18, 2008 against NSDL. The Committee accordingly took up three proceedings pending against NSDL and concluded them vide three separate orders dated December 4, 2008. Now, SEBI Board has in its meeting held on November 9, 2009 declared two orders of the said Committee comprising of Dr.G.Mohan Gopal and V.Leeladhar, which had reportedly entered findings that the Board failed as a Regulator, as without the authority of law and hence null and void and non est. However, the third order of the same Committee, has been found to be in order and has been directed to be served on the affected parties. Copies of all the three orders are on the SEBI website and in the public domain.

A perusal of these orders raises some disturbing questions.

- i. How can the SEBI Board overturn the decision of the two member Committee which was constituted to exercise the powers referred to in item No.12 of SEBI's order dated 24th April, 2003 relating to delegation of powers issued under Section 19 of the SEBI Act, 1992 with respect to matters in which, in the opinion of the Board, the Chairman has a conflict of interest?
- ii. Further, the IPO scam could not have taken place if there was no failure on the part of both NSDL and SEBI, whose delegated powers are exercised by NSDL. Instead of accepting the systemic failures and taking steps to remove them, SEBI Board has chosen to take a short-sighted and a self-righteous view and declared the very order as non-est just to avoid embarrassment to Chairman, SEBI!

As a matter of fact, it is the Appointing Authority of Chairman, SEBI who is responsible for the current mess. Just because time has passed and public memory is short, the entire **IPO scam** of 2006 has been conveniently forgotten. If after so many years, not even a notice is to be served to the scamsters, then, pray, what else can the Government do to punish those who illegally 'cornered' share allotments in the Initial Public Offerings (IPOs) of Yes Bank and IDFC Ltd. that would otherwise have been allotted to genuine retail investors.

In the infamous IPO scam, twenty four entities (key operators) first opened thousands of demat accounts in fictitious/benami names through Depository Participants who are agents of the two Depositories. NSDL was one of the two Depositories. Using these benami/fictitious names, the 'key operators' submitted applications for allotment of IPO shares. Each application was for a small size of shares so as to be eligible for allotment under the retail category. These IPO applications were financed by a group of 'financiers'. After receipt of IPO allotment and the credit of the allotted shares to the benami/fictitious demat accounts, the key operators transferred these shares from the benami demat accounts to their own demat accounts and from there (for the most part) to the financiers or to others for the benefit of financiers. In turn, the financiers sold most of these shares on the first day of listing, realizing a huge windfall gain consisting of the difference between the IPO price and the market price.

In the unsavoury IPO scam, role of NSDL has to come under the public scanner and it is gratifying that the two orders of the Committee relating to IPO irregularities and DSQ Software Ltd. have been placed on the web site as now we can study them and draw our own conclusions. To say the least, it shows NSDL, SEBI and the Government in poor light. We may also ask the Government and the regulators to place in the public domain what action they have taken in some of the major scams in the last 15 years such as Chit Funds Scam, Preferential Allotments Scam, Plantation Companies Scam, Securities Scam of 2001, US 64 Scam to name a few. Promoters have minted money while ordinary investors have lost their life time's savings. Profit is 'private' and loss, after all, is 'public'!

To return to the main issue, time has come to abolish PNs. All investors in India's stock markets must be asked to declare their name and address. So far, SEBI has not even declared the country-wise break up of PN funds flow. SEBI should be asked to immediately place this information in public domain.

Indian Growth Story will not fade away if it is based on sound fundamentals. And if it is not, then it is better that it collapses now than later. The price of non-action by Government in the shape of inflation and rising prices is ultimately paid by the ordinary people of India and not the miniscule few (less than a crore) who invest in the capital market and in whose name Government continues to take all decisions meant to favour the 'chosen few'. The NSA, as the papers report, has been repeatedly expressing his concern about stock markets and mergers/amalgamations et al possibly being used to route terror funds. Why has the unaccounted for PN route not raised his hackles? This is an issue having serious bearing on national security.

Further, when we have weak regulators like SEBI, NSDL and RBI, then who needs the services of ISI to weaken our financial system and Capital Markets! Slush funds of Madhu Koda and his ilk will continue to flood Indian stock market and Government will continue to look on benignly as this country has survived 'Ram bharse' over the ages and may possibly continue to do so despite the existence of all Jaichands!