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SECURITIES AND INVESTMENT REGULATIONS

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Dealing with Gun-Jumping

Under the Companies Act, 1956, offers of securities by companies to more than 49 persons were deemed to be public offers and required the issuance of a prospectus. This threshold has been increased to 200 offerees/ allottees under the Companies Act, 2013. Until now, SEBI had been initiating penal action against companies offering securities to over 49 persons in violation of the Companies Act, 1956. However, in light of the enhanced cap for private placement, SEBI, through its circular dated December 31, 2015, has sought to extend the benefit of the enhanced cap to cases prior to April 01, 2014 as well. SEBI has decided that in cases where securities were offered/allotted to over 49 persons but not more than 200 persons in a financial year, companies may avoid penal action.

To avail this benefit, companies would be required to provide the investors an option to surrender the securities and get the refund amount at a price not below the subscription money, paid along with 15% interest per annum or such higher return as promised to investors. Companies would be permitted to adjust the amounts already paid to investors as interest/dividend from the refund amount.

As the number of offerees/ allottees in cases of gun-jumping is usually much higher than 200 persons, it appears that the benefit of this circular may be limited and errant companies would continue to get orders prohibiting them and their key persons from accessing the securities market and directing them to refund the monies collected.

Supreme Court bowls a googly in SEBI v. Roofit Industries

The Supreme Court's recent decision in the case of *SEBI* v. *Roofit Industries* is likely to have far reaching implications for participants in the securities market in India. The facts are that an Adjudicating Officer of SEBI ("AO") passed an order against Roofit Industries ("Roofit") imposing a penalty of Rs. 1 crore under Section 15A(a) of the SEBI Act, 1992 for not furnishing necessary information in compliance with a summons issued in connection with an investigation for market manipulation by Roofit. Roofit appealed against the AO's order before the Securities Appellate Tribunal ("SAT"), contending that it had suffered several financial hardships and that it had no resources to pay the penalty. SAT analyzed Section 15J of the SEBI Act, 1992 which lays down certain factors to be considered by the AO before imposing a penalty. Although SAT did concede that impecuniosity was not one of the factors listed under Section 15J, it observed that the ability of the party to pay a penalty in monetary terms would also be a valid factor to be considered while passing an order imposing a penalty and reduced the penalty to Rs. 75,000. SEBI went in appeal to the Supreme Court against this decision of SAT. The Supreme Court held that the factors under Section 15J were exhaustive and not inclusive, and that SAT erred in holding impecuniosity as one of the factors.

Further, it also held that Section 15A(a), as it stood after its amendment in 2002 and before it was subsequently amended in 2014, did not confer any discretion on the AO to impose penalties. While it appears that SEBI itself was under the impression that the AO had discretion in deciding the quantum of penalty, the Supreme Court held that the language of Section 15A(a) did not permit any discretion to the AO in deciding the quantum of penalty. The Supreme Court also held that Section 15J would be inapplicable where the language of the provision laying down the penalty did not confer any discretion on the AO. The ratio of this judgment can be applied for proceedings under other provisions of the SEBI Act, 1992 that are similarly worded as Section 15A(a). If SEBI were to apply the ratio of this judgment to other provisions as well, there is a real possibility that securities laws violators will find themselves having to pay egregious penalties for relatively minor offenses. It still remains to be seen whether SEBI would apply the ratio of this judgment to offences other than failures to comply with disclosure obligations.

SEBI Board Meeting

SEBI in its board meeting dated January 11, 2016 decided on the following key issues:

Prudential limits on debt investments by Mutual Funds: All fresh investments by a new or existing mutual fund schemes will have to comply with stricter investment restrictions in relation to debt securities. In order to better equip mutual funds to handle adverse credit events and provide enhanced diversification benefits to mutual fund investors, SEBI has reduced debt exposure limits for mutual funds at the issuer, sector and group levels. The maximum exposure of a debt scheme to the debt securities of a single company has been brought down from 15% to 10% of the corpus. Sector exposure has been brought down from 30% to 25%. Exposure to Housing Finance Companies has been brought down from 10% to 5%. These changes appear to have been prompted by recent payment defaults on debentures. Although some consider diversification as a half measure towards mitigating risk, the move may bring additional comfort to investors.

Debt E-Book: SEBI had recently mooted the idea of having an electronic book for better price discovery in primary market issuances of debt, which, until now, have primarily been negotiated over-the-counter private placement deals. In furtherance thereof, the board of SEBI has approved the said proposal and has proposed to make it mandatory for private placement of bonds above Rs. 500 crore to use the electronic book. Given that the debt market primarily comprises sophisticated investors who have functioned efficiently through flexible negotiated issuances, the purported improvements in efficiency and transparency through the electronic book will have to be tested with time.

Exit opportunity to dissenting shareholders: Variations in objects of an issue after raising of capital is usually looked at with suspecting eyes. Sections 13 and 27 of the Companies Act, 2013 require a company, which has raised money from public through prospectus, to secure a special resolution for changing the objects of the issue or varying the terms of a contract referred to in the prospectus. Further, dissenting shareholders have to be provided an exit opportunity by the promoters and shareholders having control over the company. Towards this, SEBI seeks to amend the SEBI (ICDR) Regulations, 2009 to provide for a framework for operationalising the exit mechanism for dissenting shareholders. In brief, dissenting shareholders would get an exit opportunity if a proposal is dissented by at least 10% of the shareholders and if the amount to be utilized for the objects for which the prospectus was issued is less than 75% of the amount raised. On the face of it, this does not sound problematic. However, such over protective arrangements hinder the flexibility needed by a company to efficiently use its resources in turbulent economic conditions, and must be avoided.

Exit Policy for Commodity Derivatives Exchanges

Post the merger of SEBI and the Forward Markets Commission ("FMC"), SEBI has been working towards integrating commodities markets and its participants under various SEBI regulations. Pursuant to the merger, SEBI notified 12 commodity derivatives exchanges as recognised exchanges out of which 6 are national commodity derivatives exchanges and the rest are regional commodity derivatives exchanges. However, most of these exchanges have suspended their trading operations due to low trading volume and market conditions. In order to provide a framework for the exit of non-operational commodity derivatives exchanges, SEBI recently issued a circular, dated January 11, 2016, prescribing an exit policy.

According to the circular, a commodity derivatives exchange will be liable to exit if there has been no trading operation for more than 12 months. Further, national commodity derivatives exchanges which do not have a turnover of at least Rs. 1000 crore per annum and regional commodity derivatives exchanges which do not have at least 5% of the nation-wide market share, for 2 consecutive years, shall be liable to exit.

Exiting commodity derivatives exchanges would have to seek prior approval from SEBI before alienating their assets. Further, on obtaining the approval to exit, sufficient funds have to be set aside by the exchange for settlement of any claims, arbitration awards and other contingent liabilities. Also, the de-recognised exchange would be required to contribute a portion of its assets, as decided by SEBI, towards the SEBI Investor Protection and Education Fund for investor protection, and in order to cover any future liabilities.

Additionally the circular states that the commodity derivatives exchanges which have suspended trading operation can resume their trading operations by seeking prior approval from SEBI. These exchanges will have to ensure that adequate and effective trading systems, clearing and settlement systems, monitoring and surveillance mechanisms and risk management systems are put in place, in addition to complying with all other regulatory requirements stipulated by SEBI from time to time.

At present, 6 out of the 12 SEBI recognised commodity derivatives exchanges have suspended their trading operations for various reasons. This move streamlines the exit procedure and paves the way for defunct commodities exchanges to apply for voluntary exit from business.

Ensuring Compliance while Listing Stock Exchanges

The Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 ("SECC Regulations"), permits recognised stock exchanges to list their securities on any recognised stock exchange other than itself. In recent months, there has been a push from shareholders to list recognised stock exchanges with a view to make the divestment of their shareholding easier. While there is still no consensus on whether permitting them to list is desirable, certain stock exchanges have raised macro concerns regarding the present regime. For instance, stock exchanges would prefer to be listed on their own platforms as opposed to that of a rival exchange, citing concerns regarding confidentiality. Further, there are concerns regarding the foreign investment limit of 49% being very high.

Without addressing these concerns, SEBI has issued a circular dated January 01, 2016, prescribing modalities and additional requirements to ensure compliance with the SECC Regulations at the time of listing of a stock exchange. The SECC Regulations also prescribes maximum limits for individual and group shareholding in stock exchanges. In order to ensure compliance with these restrictions post listing, the circular has tasked depositories with putting in place mechanisms to prevent acquisition of excess shareholding. Coordination between depositories has been mandated and monitoring must take place on a daily basis. If these limits are breached, depositories have been empowered to initiate actions such as freezing of voting rights and corporate benefits until the shareholding is divested through a special window.

While the circular is a necessary measure to ensure compliance with the applicable regulations, it would be prudent to take measures to address the macro concerns of the stakeholders as well.

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