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Expert Expressions
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GUILTY, NOT GUILTY OR NOT PROVEN?

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It is rare for fact-finding Committees to ascertain facts and not arrive at firm conclusions. But exceptions establish the general rule.

The Report of the 6-member Expert Committee (Committee) constituted by the Hon'ble Supreme Court of India in the context of the Hindenburg research report on the Adani Group, is out in the public domain. Predictably, there have been comments and critical observations, both informed and uninformed. Some who waited with bated breath, hoping that the Report would castigate SEBI, have had to drown their sorrows. One of them has gone to the extent of saying that "the mountain went into labour, and gave birth to a mouse".

When the Hindenburg report was published, there were only a handful of people (this author included) who opined that in the absence of adequate material, it would be unfair to rush to the conclusion that SEBI was sleeping on its job. In the words of the Committee "it would not be possible to return a finding of a regulatory failure in the context of the regulations prevailing when the transactions were affected".

The meandering Report of the Committee is not lacking in motherhood statements. In places it serves as a tutorial on the subject of how the market functions. Some of this need not have been gone into in such mindboggling detail. The other issue is a common Indian failing of adjectivitis, of which one example would suffice. While recommending the creation of a Central Unclaimed Property Authority, the Committee has stated that such an agency has to be "a full-time hands-on real-time proactive agency".

While discussing the need for financial literacy, even from the school stage, the Committee has observed that "the era of treating money with an unstated element of stigma must end". It would have been useful to state, as the scriptures have done, that money is not the root of evil. It is the love of money that is the root of evil.

In Chapter 1 of the Report, the Committee has stated as under:
"In its order dated February 10, 2023, the Hon'ble Supreme Court had expressed a view that there was a need to review the existing regulatory mechanisms in the financial sector to ensure that they are strengthened with a view to protect Indian investors from volatilities in the market."

Based only on the Hindenburg-Adani saga, should a doubt have arisen regarding the inadequacy of regulatory mechanisms, and the need for their strengthening, with a view to protect Indian investors from volatilities in the market? This controversy seems to be the basis on which the major terms of reference of the Committee has been conceived. As subsequent portions in the Report show, the volatility this time was less than on some earlier occasions in the past, when no need was felt to undertake a wholesale review of the regulatory environment in the securities markets.

While stating in the executive summary that "volatility is not an inherent vice for the market", the Committee has, in Chapter 2 of the Report, stated as under:
"By inherent character, stock markets are not meant to be still. Market indices see movement every nano-second when the market is open for trading. Intense volatility can be troublesome for investors of all kinds. Yet, some expectation of movement in prices is foundational in how markets function. Impact on stock prices arising from events and developments, is an inherent and inexorable feature of the securities market."

The question then might arise whether volatility is a virtue or a vice or something not to be described in either fashion.

Ordinarily, a committee or a group undertaking such an important exercise, involving public interest, should have reached out to a large number of persons, to get their views on the specific issues raised in the order of the Supreme Court. This Committee has reached out to 5 individuals, and 1 entity, namely, the Association of Mutual Funds in India, and obtained their views on the issues addressed in the terms of reference. It is interesting to note that the Committee also invited international banks and securities firms to present their views on the "facets of systemic measures to be suggested beyond the Hindenburg-Adani controversy". Some marquee international banks and securities firms were extended invitations. As the Committee has pithily noted, it became apparent that none of the international securities firms and banks were desirous of sharing their views in the matter. Some of them pleaded commercial relationships with the Adani group. One leading entity suggested that the Committee might profit from engaging with an Asian level industry body. Interestingly, that body, when reached out to, disclaimed any expertise or ability to contribute to the Committee. Some observers might raise the issue whether the 5 individuals that the Committee reached out to, and interacted with, were sufficiently representative of public interest. What is however curious is that there is no evidence of either the National Stock Exchange or the Bombay Stock Exchange having been invited to present their views. Considering Stock Exchanges are first level Regulators in the securities markets, this would appear to be a serious omission.

In paragraph 31 of Chapter 2, reference has been made to SEBI's submission that the events relating to the Adani group companies did not have any significant impact at a systemic level. While the shares of the group companies might have seen significant decline in prices on account of selling pressures, the markets remained largely stable and resilient. SEBI has gone on to state that the representation of the Adani group in major Indian equity indices is relatively minor, given the limited free float market capitalisation of the group. Were we then looking for a weapon of mass destruction where none existed?

Investor awareness is the subject of Chapter 3 of the Report. Several paragraphs of the Report have been devoted to the need for investor education, and SEBI's awareness of this need, as also the requirement of focussing on the process of educating and making investors aware. Paragraph 13 of Chapter 3 states as under:
"Therefore, the investor education and awareness content is proposed to be designed appropriately to meet the requirements of the different categories of individuals in the securities market – the traders/ short term investors and the buy-and-hold investors/ long term investors."

This gives rise to the question whether SEBI should focus equally on traders, short-term investors, and buy-and-hold investors/ long-term investors. The protection of the interest of investors envisaged in the Preamble to the SEBI Act, and the provisions in the SEBI Act and the regulations, would seem to indicate that SEBI's focus should rightly be on the retail investors. There are 3 categories whose requirements SEBI needs to address, namely, issuers of capital, intermediaries, and investors, the last named needing the most attention. Clubbing traders and short-term investors with the category of the buy-and-hold retail investors would seem to militate against the interest of the small retail investor.

Paragraph 26 of Chapter 3 states that SEBI has made submissions on its expenditure on investor awareness programmes, media campaigns, including social media, development of a mobile app etc. Along with SEBI, the two major Exchanges have also spent significant amounts to promote investor awareness. What is disappointing is that there is no recommendation of an impact assessment in order to determine whether all the outlays have translated to better awareness and education, thereby promoting informed investing. While on investor education and the disclosure regime, the Committee has, on the basis of a chart presented by SEBI, rightly noted that the disclosure

obligations in India are significantly more than in the US. In the words of the Committee, "this leads to noise and clutter that makes it burdensome and difficult for the investor to get to the core messaging that is needed". By way of example, the Report notes that while only material related party transactions are required to be disclosed in the US, every related party transaction is required to be disclosed in India. Over time, "give me a problem, and I will write you a regulation" had morphed into "give me a problem and I will prescribe one more disclosure". It is heartening to note that the Committee has identified this as a major issue that needs to be addressed. To those of us (including Excellence Enablers and this author) who had long argued against an increasingly prescriptive regime, the position taken by the Committee is like music to one's ears.

Chapter 4 deals with alleged contraventions and regulatory failures. The major point that emerges therefrom is that SEBI was undertaking investigations, not taking cognisance of the fact that the regulations had been amended a few years ago, and there was no requirement to define an opaque structure or for entities to conform to the pre-change requirements of the regulations. How this could have happened merits a separate investigation.

While expressing concern on the very large amount of unclaimed properties belonging to deceased investors, the Committee has recommended that the process would require imaginative reengineering, and it would be best served by creating a Central Unclaimed Property Authority. This is a recommendation that should not be seriously pursued. It is for each company or institution, and the sectoral Regulator, to put in place appropriate steps to ensure that funds/ properties belonging to investors do not remain outside their ownership for indefinite periods of time. The creation of a Central Unclaimed Property Authority would adversely impact the privity of relationship between the investor/ depositor and the company/ sectoral Regulator. With such institutions becoming passthrough agents, the Central Unclaimed Property Authority could end up as one more institution, that was neither well-conceived, nor properly constituted. Yet another instance of "give me a problem and I will give you an institution."

While the role of other central agencies is not the subject matter of this Report, paragraphs 54 and 55 of Chapter 4 merit comment. In the course of its interaction with the Committee, SEBI invited attention to references that they had made to the Central Board of Direct Taxes (CBDT) and to the Enforcement Directorate (ED), asking them to investigate for violation of tax laws and Prevention of Money Laundering Act, 2002 (PMLA) respectively. While responding to the Committee, CBDT made the following important statement "Unless a tax evasion petition (the reference from SEBI would be one) contains <u>specific, verifiable, and actionable</u> intelligence, it cannot be taken up for investigation" (emphasis supplied).

In paragraph 54(g), it has been stated as under:
*"Recent **intrusive searches** into Indian listed companies with substantial foreign funding did not show that there was any adverse inference capable of being drawn about such funding, as a rampant or endemic feature"*. Further comment is superfluous.

In paragraph 55 of Chapter 4, the ED, after examining SEBI's reference, stated that no allegation of contravention of Section 12A of the SEBI Act, or any violation of exchange controls, has been reported by SEBI. The ED further states that SEBI had not filed any case under the scheduled offences listed in PMLA, and the ED is not empowered to invoke the provisions of the PMLA without a prior registration of an offence falling within its scope. ED has gone on to state that "it has found intelligence about potentially violative and concerted selling by specific parties just ahead of the publication of the Hindenburg report, and this may lead to credible charges of concerted destabilisation of the Indian markets, and SEBI ought to be probing such actions under securities laws".

As far as seeking information from the member countries of International Organisation of Securities Commissions (IOSCO) is concerned, SEBI has stated that without information, which can be available only after it is provided by other agencies, SEBI is unable to make out a case for seeking information.

Looking back, and with great respect, it is submitted that the Supreme Court should not have entertained these Public Interest Litigations (PILs) just because the share prices in the Adani group companies fell significantly. The petitioners should have been advised to go to SEBI or other agencies, and to file appropriate complaints. Separately, the Government could have been advised to set up a committee to re-examine the regulatory structure in its entirety, rather than using the Adani-Hindenburg imbroglio to have an enquiry conducted within 2 months, and hoping for far reaching and comprehensive recommendations.

Postscript: As is the normal practice with such reports, the last two pages have been "Intentionally left blank". *Kahani abhi baki hai?*

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