

**PARALYZING SMALL INVESTORS UNDER THE GUISE OF MELIORATION: A
CRITICAL EVALUATION OF SEBI ICDR FIFTH AND SEVENTH AMENDMENT
NOTIFICATIONS**

MALCOLM V. KATRAK & JIGAR S. PARMAR *

Introduction

Initiation of the capital market in India dates back to the 18th Century when the East India company securities were traded in the country. The birth child of the group of traders in Bombay called “The native Share and Stock Broker’s Association” became the first official stock exchange renamed the Bombay Stock Exchange. Change of economic policies at the helm, resulted in another leading stock exchange establishment in Mumbai in the year 1992- the National Stock Exchange, which went on to become the largest stock exchange in India, with a market share of nearly 70% in equity trading and 98% in futures and options trading in India.¹ For a healthy growth of capital markets and to prevent malpractices in trading, the Government had decided to “set up a separate board for the regulation and orderly functioning of the Stock Exchange and the securities industry.” This resulted in the formation of Securities and Exchange Board of India (hereinafter referred to as ‘SEBI’) as an interim administrative body to function under the overall administrative control of the Ministry of Finance of the Central Government, by a notification issued on the 12th April 1988.² SEBI as a statutory authority which was established through an ordinance promulgated on January 30, 1992 established as a body corporate having separate legal personality under Section 3 of the SEBI Act, 1992.³ The genesis of the SEBI Act can be viewed thoroughly through its preamble which imposes a statutory duty on SEBI to protect the interests of the investors in securities and promote the development

* IV Year, S.V.K.M.’s Pravin Gandhi College of Law, Mumbai.

¹ For a detailed history see, e.g., *BSE - Heritage*, www.bseindia.com/about/heritage.asp (last updated Mar. 2, 2016). See *A Historical Perspective Of The Securities Market Reforms In India*, www.sebi.gov.in/chairmanspeech/histspeech.html (last updated Mar. 2, 2016).

² Ministry of Finance, Dept. of Economic Affairs (Investment Division), *No. 1/44/SE/86*, GAZETTE OF INDIA EXTRAORDINARY (Apr. 12, 1988).

³ Securities and Exchange Board of India Act § 3 (1992). See also, Securities and Exchange Board of India Ordinance § 3 (1992).

of the securities market. The then Finance Minister Shri Pranab Mukherjee on the occasion of the 'SEBI Foundation Day' on 12th April, 2010 encompassed the reason for the formulation of SEBI in a few lines emulated herein "... *It becomes incumbent not only for the Government but also for the regulator to safeguard the interests of the retail investors who typically invest their hard earned savings. Besides this is required to encourage retail participation for ensuring greater depth of the market and to promote the inclusive growth strategy of the Government... ..*"⁴ It becomes absolute through this, that the essence of SEBI is the protection of the investors, the Authors have laid emphasis on this Preamble and solitary vow of the regulatory authority throughout the paper to point out the fallacies of various amendment notifications and circulars. The contentions which the authors will put forward in the paper will picture an ex facie bad law provided by SEBI in the guise of generic application of Information and Communication Technology (ICT), Speeding up of the process and streamlining the process of application and payment of rights issues and public issues. The issues raised by the authors negate the propositions put forward by SEBI for bringing into effect such a law which affects the retail investors thereby violating the provisions of its own parent act and the provisions of the Constitution of India. In a new dawn, a rather dusky sky has risen with the ICDR seventh Amendment Notification⁵ and ICDR fifth Amendment Notification⁶ which pertains to the Disclosure in the Abridged Prospectus and the Price Information of past issues handled by Merchant Bankers' and the latter being an amendment pertaining to 'Streamlining the Process of Public Issue of Equity Shares and Convertibles'. Deduction of the paper is essentially into three parts viz. the Seventh Amendment pertaining to abridged prospectus, the Fifth Amendment pertaining to the Mandatory ASBA system and the Constitutionality of the Amendments r/w respective Circulars. The constants being the role of SEBI and its retail investor protection provisions and the scenario of the current Indian

⁴ Ministry of Finance, *Securities and Exchange Board of India Press Release No. 93 of 2010; Finance Minister Initiates Process of Disbursal of Disgorgement Proceeds to Investors*, (Apr. 12, 2010), <http://www.pib.nic.in/newsite/erelcontent.aspx?relid=60264> (last updated Mar. 1, 2016).

⁵ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Seventh Amendment) Regulations § 4, (2015).

⁶ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Fifth Amendment) Regulations § 4 (2015).

Capital Markets. Research is also cumulated by the Authors to study the impact of Information and Communication Technology (hereinafter referred to as 'ICT') and its pace in societal diffusion. This paper holistically aims at the retail and small investors' participation in the capital markets for which it adopts an internal influence model. The aim of the paper is not to demean the role of the regulatory authority viz. the Indian Securities Market but to remind the regulatory authority of the necessity of retail investors and small investors in the bulls and bears market.

Disclosures in the Abridged Prospectus- The Fallacy of the SEBI ICDR Seventh Amendment Notification

While the Agricultural Revolution is often considered the starting point of man's transition from being a nomad relying on nature's bounty to a civilized being depending on the fruits of his labor. It also laid down the foundation of the concept of trade and the notion of a contract. At its nascent stage, the idea of an exchange was to trade one's own superfluous cultivation for other items of need, cattle or harvest. With the emergence of various civilizations, trade was now a very important aspect of human life and this led to a host of flourishing societies.⁷ The idea of risk and return has been commissioned and recognized right from the Mesopotamian era, it was groomed by the Merchants of Venice, utilized to the optimum by the East India Company and ultimately made its way onto the Banyan tree at Horniman Circle, Bombay in the 1850's. Hence, the practice of making an investment with some amount of risk attached to it with the aim of making profitable returns has existed since the onset of the human civilization itself. Chartered Corporations established during the Colonial period can be termed as the genesis of modern companies. The surfacing of corporations can be attributed *inter alia* to the need of expanding commerce by raising more capital. The Promoters of these modern corporations then approached the common masses by way of Initial Public Offerings (hereinafter referred to as 'IPOs'). An IPO allows a company to generate capital from the public who as investors accede to risks which come with an open market. The dividend declared by the company acts as a prime motivator for the retail investors to subscribe to the shares of the

⁷ B. Mark Smith, A HISTORY OF THE GLOBAL STOCK MARKET: FROM ANCIENT ROME TO SILICON VALLEY, 76-78, (University of Press Chicago, 2004)

company which can also be sold in the secondary market for profit making purposes. Though at a quick glance it seems to be a win-win situation for the investors as well as the companies, the South Sea Bubble shattered this myth. As Julian Hoppit puts it, the bubble was a spectacular rise and precipitous collapse of one company's share price. This forced the British Parliament to pass the famous Bubble Act for preventing the market from collapsing altogether. Therefore, it became a matter of paramount importance that these dealings between the corporations and the retail investors must be accompanied by regulations to safeguard the interests of the retail investors.⁸ In the Indian context, the Harshad Mehta Scam forced the Government to recognize the eminent threats to the hard earned savings of the public and ultimately the SEBI Act was passed in 1992.⁹

When a company allots shares to its subscribers, it is the allotment of a unit into which the proprietary interests of a corporation are divided. These shares are considered to be 'movable property' under the Companies Act, 2013¹⁰ as well as the Sale of Goods Act, 1930¹¹ and hence the transaction between the subscriber and the company is at its source, a contract between the two. Here, the offer comes from the subscriber in the form of an application the acceptance of which is at the discretion of the company. The primary basis of this offer comes after a careful reading of the Prospectus of the issuer. Though this document is not an offer in itself, it is an invitation to receive an offer and is governed by the contractual rule laid down in *Harvey v. Facey*.¹² From the perspective of a common man, the Prospectus of a Company is a document which aids him in the attainment of an informed decision. The statutory definition states that a "*Prospectus means any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or a shelf prospectus referred to in section 31 or any notice, circular, advertisement or*

⁸ Julian Hoppit, *The Myths of South Sea Bubble*, 12 Transactions of the Royal Historical Society, 141-65 (2002).

⁹ Joint Committee to Enquire into Irregularities in Securities and Banking Transactions Observations/Conclusions/Recommendations, *Joint Parliamentary Committee Report - Harshad Mehta*, 2.7-2.8 (1992).

¹⁰ Companies Act § 44 (2013), Gazette of India, Registered No. DL. N(04)/0007/2003-13, Part II § 1, 36 (2013).

¹¹ Sale of Goods Act § 2(7) (1930).

¹² *Harvey v. Facey*, 1893 AC 552 (PC).

other document inviting offers from the public for subscription or purchase of any securities of a body corporate'.¹³ Hence, any document by which the offer of sale is made to the public is deemed to be a prospectus issued by the company. The object of a prospectus is to make the subscriber aware of the risk he will opt for if he applies and is thereafter allotted the shares of the body corporate. In any contract the parties must always be *ad idem* and at its very core, a prospectus enables the public to understand the risk they are undertaking. It serves a mode for raising capital for the companies and is basically an invitation to attain offers so that the buyer does it so after being wholly informed of what he is entering into. However, this very document can also be employed for the purposes of defrauding the members of the public. Such instances may not only put a healthy economy into jeopardy but also discourage retail investors from investing in the capital market. Though the Indian Contract Act, 1872 as well as the Indian Penal Code, 1860 provide for general provisions regarding such deception, looking at the graveness and the specificity of the situation the provisions of Companies Act, 2013, the rules made thereunder, the SEBI Act, 1992 as well as the constantly revised rules under the Act lay down stringent provisions and the complete procedure that is to be followed. In furtherance of this Section 34 and Section 35 of the Companies Act, 2013 provides for criminal and civil liability upon the person who has authorized the issue of such a prospectus. The 5 categories of persons upon whom liability can be imposed include:-

All persons holding the position of the Director of the company at the time of the issue of the Prospectus

1. A person who has authorized himself to be named and is named in the prospectus as the director of the company or has agreed to become such a director, either immediately or after an interval of time;
2. Promoters of the Company;
3. Any other person who has authorized the issue of the prospectus;
4. Every person who is an expert referred to in section 26 of the Act.¹⁴

¹³ Companies Act § 2(7) (2013).

¹⁴ *Id.* § 35.

These remedies provide for an imprisonment ranging from 6 months to 10 years along with a fine. The civil liability extends to the payment of compensation to the person who has been affected by the untrue and misleading statement in the prospectus.

Section 26(1) of the Companies Act, 2013 read with Companies (Prospectus and Allotment of Securities) Rules, 2014 assign a catalog of information to be included in the prospectus. This exhaustive list consists of a wide array of information which has to be presented in the prescribed format and then submitted to the Registrar of Companies (hereinafter referred to as 'ROC') on or before the date of its publication. The ROC will thereafter register the prospectus only if the requirements under Section 26 have been met with. Such a Prospectus will furthermore not be valid if it is published 90 days after it is delivered to the ROC. The vastness of information encompassed in this document makes it a hard task for the retail investors to comprehend the information given and analyze it to reach at a conscious decision. Therefore, Section 2(1) of the Companies Act, 2013 lays down the concept of an Abridged Prospectus which has been defined as a '*memorandum containing such salient features of a prospectus as may be specified by the Securities and the Exchange Board of India*'.¹⁵ Section 30 of the Companies Act, 2013 provides that no form of application for the purchase of any securities of a company shall be issued unless such form is accompanied by an abridged prospectus.¹⁶ Hence, SEBI has been granted the power to ordain the features required to be mentioned in the Abridged Prospectus by virtue of Section 2(1) of the Companies Act, 2013 read with the Preamble of the SEBI Act which lays down that the protection of investors is a crucial reason for the very existence of SEBI as well as Section 30 and Section 11A of the SEBI Act which empowers it to make rules to carry out the purposes of the SEBI Act. The preamble of the SEBI Act provides that it is

¹⁵ *Id.* § 2(1).

¹⁶ *Id.* § 30.

‘An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto’¹⁷

Section 11 A lays down—

- (1) Without prejudice to the provisions of the Companies Act, 1956, the Board may, for the protection of investors,—*
 - (a) specify, by regulations—*
 - (i) the matters relating to issue of capital, transfer of securities and other matters incidental thereto; and*
 - (ii) the manner in which such matters shall be disclosed by the companies;*
 - (b) by general or special orders—*
 - (i) prohibit any company from issuing prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities;*
 - (ii) specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.*
- (2) Without prejudice to the provisions of section 21 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956), the Board may specify the requirements for listing and transfer of securities and other matters incidental thereto.*

And lastly section 30 empowers SEBI to make regulations consistent with the said Act and the rules made thereunder to carry out the purposes of the Act.¹⁸

All potential investors of the company receive the Abridged Prospectus which is attached to the application form from the bidding centers. The objective of an Abridged Prospectus is to retain the salient features of a prospectus enabling any probable investor to make a low risk investment with a surety of returns. SEBI

¹⁷ See, *Lafarge Umiam Pvt. Ltd. v. Union of India* 7 SCC 338 (2011) (The Role of SEBI is ‘pro-active’ in contradistinction to courts which are primarily ‘reactive’, as the role of any other regulator is); Cf. *SEBI v. Ajay Agarwal* 3 SCC 765 (2010) (The Apex Court pointed out that SEBI is preeminently a social welfare legislation seeking to protect the investors who are small investors).

¹⁸ See *Kimsuk Krishna Sinha v. SEBI* 100 SCL 197 (Del) (2010) (The Emphasis on these Sections is of extreme importance as they provide the power of issuance of regulations which under the provisions of the Act can be made only in accordance with Section 30 and 31 of the Act).

was formed for the protection of the investors and a condensed source of gathered facts would be a logical furtherance of the legislation and in line with the principles enshrined in the Directive Principles of State Policy. Hence, the importance of having adequate safeguards and rules not harming the interests of the prospective shareholders by having an investor friendly and a control free regime cannot be exaggerated. In pursuance of this goal, the SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009 (hereinafter referred to as the 'ICDR Regulations, 2009') were revised from its previous 2000 edition keeping in mind the evolving nature of the market.¹⁹ Regulation 58(1) and Part D of Schedule VIII deals with the prerequisites of the information to be disclosed in the Abridged Prospectus as well as the format. These rules underwent a revolutionary modification vide notification dated 27th October 2015 issuing the SEBI (Issue of Capital and Disclosure Requirement) (Seventh Amendment) Regulations (hereinafter referred to as 'ICDR Seventh Amendment Notification') and Circular no. CIR/CFD/DIL/7/2015 dated 30th October 2015. The ICDR Seventh Amendment, Rule 3 (ii) relating to the 'DISCLOSURES IN ABRIDGED PROSPECTUS' General Instruction No. (II) Dictates that '*the abridged prospectus including the application form shall not exceed 5 sheets (printed both sides)*'.²⁰ The Circular, explaining the rationale behind the move states '*it has been observed that the abridged prospectus has become voluminous and thereby defeats the very purpose of abridged prospectus. With a view to address the issue, the disclosure requirements in the abridged prospectus have been rationalized in consultation with Investor Associations and market participants. The revised abridged prospectus improves the readability and contains relevant information for the investor to take well informed investment decision. Also, the investor has the option to obtain full prospectus from the market intermediaries associated with the public issue and can also download from the websites of stock exchanges, merchant bankers and SEBP.*'²¹ Annexure I provides the revised format of abridged prospectus as per Regulation 58 (1) and Part D of

¹⁹ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations § 4 (2009).

²⁰ Supra note 5, § 58 (1).

²¹ Securities and Exchange Board of India, *Disclosures In The Abridged Prospectus And Price Information Of Past Issues Handled By Merchant Bankers*, 1-2 (Oct. 30, 2015) pdicai.org/docs/SEBi_5112015122031929.pdf

Schedule VIII of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.²²

It is argued that these revised regulations create an unnecessary barrier to the information which is disclosed to the public in an abridged prospectus. Considering the reliance of the investors on the abridged prospectus, it is important to shed light on *the golden rule*.²³ The rule stipulates that all the relevant facts which may affect the decision of the buyer ought to be disclosed in the prospectus and any missing piece of information would be a fraud on the members of the public and thereby attracting liability for the same. The golden rule begins with the presumption that the public is at the mercy of the company promoters. Everything therefore must be stated with strict and scrupulous accuracy. Hence, the new regulation which requires that the information in the abridged version of the prospectus must be concentrated within 10 pages is against the very fabric of investor protection. By restricting the amount of data to be placed, it affords the corporations to exclude important aspects which are sanctioned by the very authority constituted to regulate such fraudulent acts. The underlying principle as spelt out in the Ordinance, assumes that a 40-60 page abridged prospectus is too voluminous for the general masses to make an informed decision. This fallacious approach carries a regressive undertone and hampers the process of investor education which is the need of the hour in the Indian Economy.

Absence or Reduction of Significant Inducing Elements

The new format requires the issuer to give a brief of the top 5 outstanding material litigations against it. Any pending regulatory action pending against the corporation must be summed up in 200-300 words. Also, in the case of any outstanding criminal litigation against any of the promoters of the company must be described in 200 -300 words. It is noteworthy that any the new format entirely overlooks disclosures of any pending litigations against the directors of the company. The reputation of a company and those who control it play a very

²² *Id*, Annexure I, 3.

²³ The Golden Rule of framing a prospectus was first enunciated in the leading case of *New Brunswick & Canada Railway & Land Company Ltd. v Muggeridge* 3 LT 651 (1860). *But See, Rex v. Kyslant: A New Golden Rule for Prospectuses*, 45 HAR. LAW. REV., 1078-1083, (1932).

important role in the rise and fall of its stock prices. Restriction on the number of words to be used and neglecting the disclosures of Directors altogether presents an opportunity to the issuer company to provide relatively undermined information to the public.

Disclosure of information related to Internal Risk factors has been restricted to a minimum of 5 and a maximum of 10 issues and carries a limit of 500 words in total. Assessment of risk which threatens implementation the project for which the IPO has been issued ought to be given a prominent place as incomplete data regarding the internal risks which the project may face may play a decisive role in the investor's final decision. Putting a cap on the number of internal risk factors that may be highlighted in the abridged prospectus gives a free hand to the issuer company in providing selective information and concealing the decisive aspects under the full protection of the law.

Information related to group and subsidiary companies has also been given a cold shoulder in the new format. Accordingly, the new format does not require the company to disclose information about its subsidiaries and group companies. This ill afforded scheme completely ignores the very existence of any other group companies which may prove impactful in light of the increasingly *mala fide* usage of subsidiaries for willful fraudulent acts. There is no provision for disclosing the pending litigation against the subsidiaries of the issuer.

The earlier format of the prospectus required the body corporate to disclose related party transaction involving 'restated standalone summary statement of related party transactions' and 'restated standalone consolidated statement of related party transactions'. The new format has omitted the entire provision and no such requirement is now mandatory or even optional. Related-party transactions (hereinafter referred to as 'RPTs') refer to transactions between a company and its related entities such as subsidiaries, associates, joint ventures, substantial shareholders, executives, directors and their relatives, or entities owned or controlled by its executives, directors, and their families.²⁴ . Indian Accounting

²⁴ P. Srinivasan, *An Analysis of Related Part Transactions in India*, WORKING PAPER NO. 403 INDIAN INSTITUTE OF MANAGEMENT BANGALORE (Sept. 2013).

Standards considers parties to be related to each other “if one party has the ability to control or significantly influence the other in making financial and/or operating decisions in a particular reporting period”.²⁵ As Selarka et. al. hypothesized in the working paper after using a sample of 1757 firms listed on the National Stock Exchange in 2014 that related party disclosures decrease the crash risk faced by the companies. It is based on the fact disclosure of related party transactions reduces the asymmetry in the market.²⁶

The Notification and the Circular have negated the consequential aspects in an attempt to simplify the load of information to the public. The most palpable consequence of the new norms is that the companies can resort to concealment of major information which the public ought to know under the ploy of succinctness. Omission of vital and crucial parameters from the abridged version altogether routs the very purpose of the establishment of SEBI. The policy approach towards the investor’s protection must not be hampered by extraneous and unnecessary limitations. Not only does the new format negatively affect the investors as to reduction of information to help them come to a sound decision but it also fundamentally builds up a scenario wherein non-disclosure and concealment can be used under garb of this new policy. The Supreme Court, in its observation that the SEBI Act qualifies as a social welfare legislation has made Securities and the Exchange Board of India the custodian and the protector of the common masses and hence, no policy which allows a free reign to the issuer in suppression of material facts behind the veil of compliance ought to be encouraged or practiced.²⁷

²⁵ Ministry of Corporate Affairs, *Ind AS 18*, 271-281, (Mar. 3, 2016) www.mca.gov.in/Ministry/notification.pdf

²⁶ E. Selarka et. al, *Related Party Transactions and Stock Price Crash Risk: Evidence From India*, WORKING PAPER NO. 129 MADRAS SCHOOL OF ECONOMICS (Oct. 2015), [www.mse.ac.in/pub/Working%20Paper%2012%209.pdf](http://www.mse.ac.in/pub/Working%20Paper%202012%209.pdf)

²⁷ R.H.Patil, *The Capital Market in the 21st Century*, 35 EPW, 4097, (Nov. 2000).

Application Supported by Blocked Amounts: A Herculean Blow to the Investors

The proliferation of the markets in the developing countries with the internationalization of financial markets and the advent of technology has raised some eyebrows with the increasing complex roles of the regulatory mechanisms. Pumping of money in these countries have diversified the investors' category which has affected the regulatory mechanisms being attracted to diametrically opposed techniques hampering all the institutes and mechanisms of raising medium and long-term funds. Change of power at the helm of affairs of the state and induction of new foreign policies have made India a boon for Non Resident Indians' (NRI) and High Net-Worth Individuals for investment but the encouragement of broader ownership of productive assets by small savers and retail investors enabling them to benefit from India's economic growth and wealth distribution is still astern in the capital markets. The deep in roads of Information Technology in the capital markets in India is at a slower pace rather than the fast paced positive intrusion in the other areas such as Banking.²⁸ Role played by the Government in recent years and positivism showered by the regulatory mechanisms such as the Securities and Exchange Board of India (SEBI) has injected perturbation for embracing of the technology once counted as retrograde to capital markets. Whilst these technological inroads, the regulatory authority pursuant to the ICDR Fifth Amendment Notification, issued a circular No. CIR/CFD/POLICYCELL/11/2015 dated November 10, 2015 pertaining to 'Streamlining the Process of Public Issue of Equity Shares and Convertibles'.²⁹ Organized Capital markets in India is quite narrow to analyze the role played by the Investors' regarding the capital in flow and adjudging the qualitative and quantitative factors attached towards the same, the regulatory authority with the aforementioned law has frustrated the retail category by clarifying that all investors applying in public issue shall use only Application Supported by Blocked Amounts (hereinafter referred to as 'ASBA') facility for subscribing to securities and for

²⁸ *Id.*

²⁹ Securities and Exchange Board of India, *Streamlining the Process of Public Issue of Equity Shares and Convertibles*, 1-2 (Nov. 10, 2015), www.sebi.gov.in/cms/sebi_data/attachdocs/1447148033366.pdf

making payment post allotment of the securities. Genesis of ASBA was for making an application to a public issue or rights issue along with an authorization to Self –Certified Syndicate Banks’ (hereinafter referred to as ‘SCSBs’) to block the application money in a bank account. This instrument requires the applicant to give an authorization to block his application money in the bank account for subscribing to the public issues, debited only after the basis of allotment is finalized.³⁰ Raising bar of ASBA has made the growth of Information Technology in the capital markets, as Fama observes that Information Technology has made the capital market more resilient and dropped a tinge of sophistication. His school of thought can be guided through this research on First World countries with developed capital markets.³¹ On the other hand, the observations by Singh et. al. using his multivariate regression analysis on cross sectional data from 63 countries concluded with a normative thinking of diluting capital markets with Information Technology.³² Diffusion defined by Rogers being a process in which innovation is communicated through certain channels over time among the members of the social system, the pertinence of diffusion provides an image of how far information technology is fathered in a society.³³ The problem facing India and the Government is the acceptance of mass scale technology reforms in the Capital market system, the deep rooted ancient broker structure cannot be heaved away with a single blow. Diffusion is a sluggish process in developing countries, the portraying of an S-Curve with its slow beginning, rapid expansion and leveling off cannot be executed by milking away the retail investors. Inventory of cheques and paper modes of payment for placing of bids for the public issue are practices which the regulatory authority has cast out are detrimental to the objects of the SEBI which are to protect the interests of the investors in securities, promote the development of securities and regulate the securities market, the onerous duties. Regulatory authorities mass coerced deeds reminiscent the words of Vijay Joshi

³⁰ The Procedure is enumerated on the National Stock Exchange and Bombay Stock Exchange, www.nseindia.com/products/content/equities/ipos/asba_procedures.htm (last updated Mar. 9, 2016).

³¹ E.F.Fama, *Efficient Capital Markets II*, 46 JOF, 1575-1617 (Dec. 1991).

³² Singh A et. al., *Information Technology, Venture Capital and the Stock Market: A paper prepared as a background paper for the International Labour Organization’s World Employment Report (2000-2001)*.

³³ E.M.ROGERS, *DIFFUSIONS OF INNOVATIONS* (5th ed., New York Free Press 2004).

and IMD Little's description of Indian Stock Market as "a snake-pit, lacking in fairness and integrity, prone to speculative excess and showing scant regard for the interests of small investors."³⁴

i. ASBA Facility as an Anomaly

Capital Market has to fulfill the country's economy, to liquefy capital by enabling a person who has invested money to a factory, to convert it into cash by disposing of his share in the enterprise to someone else. Transition of these markets can be amenable if institutional and legal changes are made which are undoubtedly identifiable and amendable, the SEBI ICDR Regulations, 2009 was a step in the right direction by amalgam of the Banking Sector and the Capital Markets which since years India had been longing. Regulation 2(1)(d) of the SEBI ICDR Regulations, 2009 peculiarly mentions SCSBs' to block the application money in the bank account, these SCSBs' are recognized by the SEBI as capable of providing ASBA services to the customers.³⁵ ASBA is truly an innovation made through the Book Building Route, introduction of e-forms from the website of Book Running Lead Managers website (BRLM) has induced an energy in the diffusion process. Patil rightly nuanced that India in the viewpoint of adoption of information technology in the tools of trading and in the settlement mechanisms as also in the efficiency of capital markets, not only is ranked in the top league but is considered to be way ahead of even developed countries. Applause for the transformation is rightly attributed by Patil to the National Stock Exchange (NSE) which battered the broker system with the adoption of new cheaper computerized techniques vis-à-vis the Bombay Stock Exchange (BSE) and the lobby of brokers, however the cause of the feat is the adoption of Information Technology through the modular basis of societal diffusion.³⁶ SEBI by the virtue of the provisions of Section 30 of the SEBI Act, 1992 brought into force the ICDR Fifth Amendment Notification, Circular dated November 10, 2015 which has under the guise of endeavoring to streamline the process of public issue of equity shares and Convertibles and the interest of attaining the healthy and sustained growth on the Indian Capital

³⁴ VIJAY JOSHI, *INDIA'S ECONOMIC REFORMS, 1991-2001* (Clarendon Press Oxford, 1996).

³⁵ *Supra* note 19, § 2(1)(d).

³⁶ *Supra* note 27, at 4098-4099.

Markets made the usage of ASBA system mandatory. An ignoble decision for the retail investors and a noble decision for the High Net-Worth Individuals (HNI's) and other investor categories. The embracement of this type of technology for payment post allotment of securities obviates the alternative mode of payment which is paramountcy fact considering the prominent challenges which the Government of India is facing at present is Financial Inclusion, the noting of the Reserve Bank of India portrays that there are severe challenges within the areas of the country to make people reach within the financial inclusion and financial literacy programme.³⁷ Differing level of computerization and risk management practices of several market players affects the overall system of coagulation of sectors, the sole reason the mandatory rule of ASBA facility will hinder the steady growth of the Indian Securities Market, which is the fundamental objective behind the establishment of SEBI. The role of technology assumes prime importance in the capital market system and overtime it does take an S-Shape curve as provided by the Gompertz model of diffusion innovated by Chow³⁸, this model assumes the slow advancement of technology, eventual rapid usage and can be given as :-

$$\log \eta_{it} - \log \eta_{it-1} = \theta_i [\log \eta_i^* - \log \eta_{it-1}]$$

Where

η_{it} is used in Country 1 in the year t

η_i is post diffusion equilibrium

θ_i is the speed of adjustment

The Gompertz model portrays the slow adoption of technology on the very same basis a mutated model was provided Eziram et.al. to adjudge the impact of technology in the Nigerian system³⁹ and given as :-

$$\log X_{it} - \log X_{it-1} = \theta_i [\log X_i^* - \log X_{it-1}]$$

³⁷ Chapter IV: Credit Delivery and Financial Inclusion, RESERVE BANK OF INDIA ANNUAL REPORT, 68-74 (2015).

³⁸ G.C.Chow, *Econometrics* (McGraw Hill 1983) Cf. A.H.Hallet, *Professor Chow's Econometrics: A Review*, 3 JAE, 157-164 (1988).

³⁹ C.B.Eziram et. al., *Capital Market Growth and Information Technology: Empirical Evidence from Nigeria*, 4 IJBEP, 8-9, 11 (2009). See also, A. Bhunia, *An Impact of ICT Growth of Capital Market: Empirical Evidence from Indian Stock Market*, 1 INFORMATION AND KNOWLEDGE MANAGEMENT, 7-14, (2011) (The Author concludes that the results of the Indian Stock Market are analogous to the impact of ICT in Nigeria utilizing the same mutated model of the Gompertz provided by Eziram).

Mutated model took the variables of stock brokers, market trade, stock market volume trade, turnovers through which resultant conclusions were reached which then indicate rightly the usage of information and communication have increased the capital market scenario which is directly proportional to the raise of bar in the investor category. The model was based on the increase and significant changes in the ICT system, however the lacking of the author regarding the comparison to the statistics of adoption of macro level technological change to the information technology untapped sectors is stubbed. Broad scheme of Technology flourishment is possible with the requisite digital systems in and outside the capital market sector firmly established, the Finnish have provided indicators to view the statistical data and information regarding the technical infrastructure, penetration rates and networks and the comparable use of Information and technology.⁴⁰ Computation of this data with the permutation and combination provides a holistic approach towards the capital market viz. the number of people with financial literacy and thereby gives a clearer picture of the mechanism for mandatory ASBA. Anomalies in the Indian Market, is the financial inclusion which is affirmed by the Reserve Bank of India in its Annual Report, which states the current situation of unbanked villages, which in its effect has banking phases yet to be completed. The identification of 4, 90,000 villages with a population of less than 2000 were allotted to banks in the ongoing Phase II and that the operational effect of the newly made bank accounts is possible only if all the Government payments are routed through the banks, which will remunerate the banks, howsoever the success of this system depends critically on the availability of proper network connectivity throughout the country.⁴¹ A formation of the committee for a medium term path of financial inclusion is in its infancy, which provides for an inference of the situation regarding the financial inclusion of the country. Issuance of priority sector lending certificates (PSLC's) which essentially is a fragment of the Banking Sector, has not yet been fruitfully placed throughout the country, an implication that the country has not reached a stage where for the

⁴⁰ Statistics Finland, *On the road to Finnish Information Society II* (May. 1999) tilastokeskus.fi/tk/yr/tttietoti_en.html (last updated Mar. 4, 2016) See also, Nordic Council of Ministers, *Guidelines For Measuring Use Of Information And Communication Technology (ICT) In Enterprises- A First Step Towards Harmonized Nordic Surveys* (1998).

⁴¹ Supra note 37, at 73-74.

advancement of Information and Technology a chunk of the category of the investors are rooted out of system.⁴² The expansion of bricks and mortar branches of banks has accelerated but notwithstanding this development, the number of financial branches per 100,000 in rural and semi urban areas is still less than half than that of the urban and metropolitan areas.⁴³ Role played by registered sub-brokers initiates the formulation of bank accounts which in turn raises the number of retail and small investors market however without this financial inclusion of these investors the steady growth of the Indian securities market is hampered. Recognition of this practice by the Organization of Economic Co-operation and Development in its National Strategies for financial education Handbook enumerate the essentiality of Institutional Changes and Governing arrangements, urging the users to include financial education as their top priority.⁴⁴ In the words of the then Hon'ble Finance Minister Shri Pranab Mukherjee "... *In India where the majority of its population is financially excluded and coexisting with various other financially included sections of population which invest in capital markets and use other advanced financial products, we first need a tiered approach under National strategy for spreading awareness about basic financial products to link them to the formal financial sector, educating the existing users of financial products and services to make the informed choices...*". ASBA facility has advantages beyond any measure, encouragement of the use of ASBA facility is appropriate and a reasonable measure but the facility of mandatory use of the same is not viable. SEBI Act is pre-eminently a social welfare legislation, the unfortunate sketch which the regulatory mechanism provides is the one where SEBI itself eschews it.

Role Played by the Small and Retail Investors in the Capital Markets

The Statement of Objects and Reasons appended to the SEBI Bill, 1992 states inter alia: "*The capital market has witnessed tremendous growth in recent times characterized particularly by the increasing participation of the public. Investor's confidence in the capital market can be sustained largely by ensuring investor's protection...*" In the modern tradition of

⁴² *Id.* at IV.21, 74.

⁴³ *Id.*

⁴⁴ Organization for Economic Co-operation and Development/ International Gateway for Financial Education Policy Handbook, *National Strategies for Financial Education and Expert Sub-Group on National Strategies for Financial Education*, POLICY HANDBOOK, 19-79 (2015).

finance, financial economic organizations are existing because of the function they serve, the paradigm of making a law is with the empirical research which contains the view of the current state of the society, the ignorance of which will ensue the making of laws which are arbitrary and capricious. In view of the ICDR Fifth Amendment Notification r/w the Circular dated November 10, 2015, SEBI has clarified that all investors in a public issue shall use only ASBA facility for subscribing to the securities. Under this Section the authors attempt to dissect the working of the ASBA system and infer its impact on the retail investors, the role of retail investors in the capital markets and their protection is the foundation which the authors have perused through the SEBI Act, 1992 and pursuant to that the authors adjudge the bearing of the low retail investors in the Capital Markets. For a developed capital market there is a need to expand the participation of retail investors, the healthy and sustained growth of capital markets will not be achieved without the adequate participation of the retail investors, the confidence of investors and proper attention to their interests no securities market can develop. A consumer of financial services i.e. an investor has been noted to require the protection of a greater degree than that of the consumer of tangible goods, as what he in fact buys, while investing is a 'promise', a 'hope' and his future consumption.⁴⁵ This promise which the report lays down can be achieved by rapid and healthy development of well-regulated structures. SEBI pursuant to the aforesaid, brought into force ICDR Regulations 2009 which repealed the erstwhile 'Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000' for bringing clarity and resolving certain identified lacunae in securities and investor protection laws, principally pertaining to issue of securities of a company to public, shareholders, and institutional investors through primary and secondary market. The step was widely criticized and the fall in the number of retail investors due to the formulation of the ASBA system was portrayed. The gradual fall in participation of the investors, in the public issues, reflects the inconvenience caused to the retail investors, lack of faith and low confidence in

⁴⁵ *Securities and Exchange Board of India Annual Report*, 4 (1988-89), www.sebi.gov.in/sebiweb/home/Annual-Reports.

the Indian Securities Market.⁴⁶ This ASBA mechanism terrified the retail investors of bulls and bears. Unfortunately SEBI on 14th August 2015 vide ICDR Fifth Amendment Notification passed a severe blow to the retail investors making the ASBA facility compulsory. ASBA has discouraged the small investor category from participating in the Indian Securities market, culminating in the frustration of the principal objectives of SEBI. This proposition can be considered through a hypothetical. A person in India lives where large portions are unbanked and such areas do not have any entity providing the ASBA facility, the harsh and extreme conditions, of the nature of the compulsory use of ASBA facility, will drive the person away from the capital market, though keen on investing the savings in public issues. Whereas previously, even in the case of non-availability of the ASBA centers in the rural and semi-urban areas of the country, the small investors therein had the option of placing their bids for the public issues by the traditional method of applying through cheques, which was secure as well as convenient for all. The problem arises when the regulatory authority amends its ways and instead of striving to achieve new heights of bulls and bears, tries to act as a sly wolf, trying to slowly shred the market to pieces. SEBI in its Approach Paper on comprehensive legislation for securities market back in the inglorious days of the Indian Capital Markets had emphasized the need for retail investors. Reproduction of a few extracts is extremely essential, through these extracts the authors create a foundation to nuance the emphasis on the provisos of the SEBI Act which the mandatory ASBA system contradicts to. “...*Awareness of, and interest in, investment opportunities available in the securities markets has grown significantly in the recent years. This awareness and interest has, however, not yet crystallized into a committed, discerning and growing pool of investors. Some of the main constraining factors are high volatility in market prices, several undesirable practices and structural inadequacies which have led to a severe erosion of investor confidence. These have hampered sustained growth in the securities market... ..For promoting sustained growth in the securities markets over a long period of time, it has now become necessary to evolve a comprehensive securities law with a unified set of objectives, development approach, a single administrative authority and an integrated framework to deal with all aspects of the securities markets... .. To this end, it is necessary to promote markets which ensure... ..*”

⁴⁶ In U-Turn SEBI Chariman Says Not Concerned About Low Retail Investors in IPOs, BUSINESS STANDARD (Dec. 2, 2015).

the markets must inspire confidence in both investors and issuers to actively participate in and rely more on the securities markets... Regulation would be kept to the minimum necessary to ensure adequate investor protection and to serve the interests of development of the markets.”⁴⁷

Ironizing this sight for the development of the Indian Securities Market, the regulatory authority has stooped low with the ICDR Fifth Amendment, which is *ex facie* bad in law apart from being discriminatory, arbitrary and unreasonable.

Embracing SEBI under its womb, the International Organization of the Securities Market Commission (IOSCO) rather evidently put forward its view on the emerging markets and the role of institutional and retail investors in the markets, IOSCO which rather determined to put forward its stronghold on the concept of small investors joining its market raised the bar with its overview and emphasis on Investor Education, a study showing the reasons relating to the indulgence of the small investors in the markets. In 17 out of 19 jurisdictions the problem of Information and Communication technology and connectivity were the reasons why population of the members of Emerging Market Committee (EMC) do not want to indulge in the markets.⁴⁸ The concept of ‘one size fits all’ cannot be the basis of generic law making procedure, the prejudice to the interests of the public at large outweighs the callousness of the amendment of the mandatory ASBA system.

Violations of the Provisions of Constitution and the pertinent question of *Cui Bono*

“A thousand years scarce serve to form a State; an hour may lay it in the dust.” These words by Byron keep ringing when a question of *Cui Bono* is asked for the formulation of a law. The decisions of SEBI has writhed the investors, shattered the backbone. Words of passion and power, actions with supplementary backing

⁴⁷ Securities and Exchange Board of India, *Approach Paper on Comprehensive Legislation for Securities Market* (July. 1988).

⁴⁸ Public Reports: International Organization of Securities Commission, *Protecting The Small Investors: Combating Transnational Securities And Futures Fraud*, (Mar. 5, 2016) www.iosco.org/library/pubdocs/.pdf See also, Public Reports: International Organization of Securities Commission, *Report on Investor Education Initiatives Relating to Investment Schemes* (Feb. 2013) www.iosco.org/library/pubdocs/pdf/IOSCOPD404.pdf

of necessity are essentialities to withstand the shaky ground questions of *cui bono*.⁴⁹ If one has a bare reading of the SEBI Act, a defiance of the classical doctrine of Separation of Powers can be viewed, on this the Supreme Court observed, “..*The SEBI Act confers a wide jurisdiction upon the board. Its duties and functions thereunder, run counter to the doctrine of separation of powers. Integration of power by vesting legislative, executive and judicial powers in the same body, in future, may raise a several public law concerns as the principle of control of one body over the other was the central theme underlying the doctrine of separation of powers. Our constitution although does not incorporate the doctrine of separation of powers in its full rigor but it does make horizontal division of powers between the legislature, executive and judiciary. The Board exercises its legislative power by making regulations, executive power by administering the regulations framed by it and taking actions against any entity violating these regulations and judicial power by adjudicating disputes in the implementation thereof. The only check upon exercise of such wide ranging power is that it must comply with the Constitution and the Act...*”⁵⁰ With the wide ranging agitation against SEBI regarding the amendments viz. Mandatory ASBA mechanism and abridged prospectus, one can only assume that the time of these laws is limited, the likeliness of a writ petition is imminently rising and a more hopeful direction by the court that such amendments disruptive to the facilitation of capital market of the country. Lackadaisical attitude of SEBI with its SEBI notifications and SEBI circulars have resulted in the formation of unreasonable, irrational and arbitrary laws, thereby being in a total denial of the essence of ‘Rule of Law’. The discretion of the statutory body is never unfettered, it is this discretion which is to be exercised in accordance with the law, if such discretion is exercised and influenced by extraneous consideration which it ought not to have taken into consideration, the decision cannot stand. Authors after deliberation gradate that the SEBI Fifth Amendment Notification and the Circular dated November 10, 2015 and SEBI Seventh Amendment and the Circular dated October 30, 2015 are arbitrary, unreasonable, discriminatory as it discriminates between the investors belonging to the retail category, which being the masses vis-à-vis high net-worth individuals and institutional investors category. “Article 14 does not require a fanatical

⁴⁹ *Cui Bono* is frequently translated, for what good, for what useful purpose, for whose use or benefit. BLACK’S LAW DICTIONARY, 377 (6th ed. 1991).

⁵⁰ *Clariant International Ltd. v. SEBI* AIR 2004 SC 4236.

approach”⁵¹ said Alagiriswami J., continuing this he said: “*But the point we wish to make, and we cannot over-emphasize it, that Art 14. Enunciates a vital principle which lies at the core of our republicanism and shines like a beacon of light pointing towards the goal of classless egalitarian socio-economic order which we promised to build ourselves when we made a tryst with destiny on the fateful day when we adopted our Constitution. If we choose between fanatical devotion to this great principle of equality and feeble allegiance to it, we should unhesitatingly prefer to err on the side of the former as against the latter. We should be breaking our faith with this high and noble principle of which is pregnant with hope for the common man and which at once was a goal as well as a pursuit, for history shows that it is insidious encroachments made in the name of pragmatism and expediency that the freedom and liberty are gradually but imperceptibly eroded and we should not allow the same fate to overtake equality and egalitarianism in the name of expediency and practical convenience.*”⁵² The point of convergence between an ultra vires law to that of an intra vires is the pertinent question of *cui bono*, for what good the draft has been made and on what basis was the same made. SEBI in pursuance of bringing about clinching changes through technology and adaptive approach has failed to apply and adhere to the principle enshrined under Article 39 (c) of the Constitution of India which states the state shall superintend that operation of the economic system does not result in the concentration of wealth and means of production to the common detriment. It is within the knowledge of SEBI that the abridged prospectus is essentially the most important document for the retail investor category as it is nominally the only reasonable source of authentic, material and relevant information about the issuer company based on which the smaller investors are in a position to take a sound investment decision, reduction of the pages of the same has not only made it difficult for the retail investors to take a sound and prudent investment decision but has also put their investment to a higher degree of risk, the cause for the discouragement of the retail investors in the Indian securities market. SEBI with its bravado in the ASBA process has faltered miserably the brunt of which has been on the retail investors using the traditional methods of investing. A concluding caveat the present situation is ideal for the growth of capital markets, the new amendments are nothing but hindrances on a rather smooth sailing road.

⁵¹ Maganlal Chaganlal (P) Ltd. v. Municipal Corporation of Greater Bombay & Ors. 1974 AIR 2009.

⁵² *Id.*

Conclusion

The assessment and review of the amendments of ICDR regulations, lays down the most telling story in the history of capital markets that ‘markets agonize not with the falls or mega scams but with the lower level of participation.’ It is truly a battle of Shakespearian proportions with the retail investors fighting for their rights, or survival to put it mildly and the regulatory authority who are pursuing vigorously financial sector reforms which they feel, will bring a massive transformation in the capital markets. The role played by SEBI which is statutorily constituted to be an autonomous regulator with independent legislative, executive and quasi-judicial powers, has been enthralling to say the least. The authors laud the role played by SEBI in boosting the capital markets however the paper urges SEBI to reflect to the fall of retail investor participation and their inconvenience and lack of faith in the Indian Securities Market. It is also of due importance and necessity that under the circumstances when laws *ultravires* to the constitution have been passed, the Union of India under the provisions of Section 17 of the SEBI Act, 1992 should have superseded SEBI. It is legally the duty and responsibility of the Union to intervene in the matters of SEBI under the provisions of Section 17 and to prevent any further violation of the tenets of the SEBI Act, 1992 and the Constitution of India. The words of J. Bronowski rightly ring the bells “We are all afraid- for our confidence, for the future, for the world. That is the nature of the human imagination. Yet every man, every civilization has gone forward because of its engagement with what it has set out to do. The personal commitment of a man to his skill, the intellectual commitment and the emotional commitment working together as one.” The authors believe that the synthesis of the criticisms to the SEBI circulars r/w amendments and the ideas presented for the betterment of the capital markets shall go a long way in molding both the thought process of the regulatory authority and safeguarding the foundations of the Indian securities market.