



**THE INSTITUTE OF
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Shri U.K. Sinha, Chairman, SEBI addressing at the Inaugural Session of Capital Markets – The Growth Engine held on Monday, the August 04, 2014 at BSE International Convention Hall, BSE Ltd., Mumbai.

Sitting from L to R : CS Vikas Y. Khare, Vice-President, ICSI, Ashishkumar Chauhan, MD & CEO, BSE Ltd., CS R.Sridharan, President, ICSI, CS Atul H. Mehta, Programme Director & Chairman, Financial Services Committee CS M.S. Sahoo, Secretary, ICSI

Capital Markets – The Growth Engine

Chief Guest

Shri U. K. Sinha

Chairman, Securities and Exchange Board of India

August 04, 2014

BSE International Convention Hall, Mumbai



INAUGURAL SESSION



Ashishkumar Chauhan, MD & CEO, BSE Ltd., addressing at the Inaugural Session of the Programme : Capital Markets – The Growth Engine held on Monday, the August 04, 2014 at BSE International Convention Hall, BSE Ltd., Mumbai.

Sitting from L to R : CS Vikas Y. Khare, Vice-President, ICSI, Shri U.K. Sinha, Chairman, SEBI, CS R. Sridharan, President, ICSI
CS Atul H. Mehta, Programme Director & Chairman, Financial Services Committee, ICSI, CS M.S. Sahoo, Secretary, ICSI

INAUGURAL SESSION



CS R. Sridharan, President, ICSI addressing at the Inaugural Session of the Programme : Capital Markets – The Growth Engine held on Monday, the August 04, 2014 at BSE International Convention Hall, BSE Ltd., Mumbai.

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TECHNICAL SESSION I : MARKET DEVELOPMENT



Shri Sandip Ghose, Director, NISM, addressing at the Technical Session I, Market Development of the Programme : Capital Markets – The Growth Engine held on Monday, the August 04, 2014 at BSE International Convention Hall, BSE Ltd., Mumbai.
Sitting from L to R : CS Prakash Pandya, Member, WIRC of ICSI Shri Prashant Saran, Whole Time Member, SEBI, Shri Himanshu Kaji, ED and Group COO, Edelweiss Financial Services

TECHNICAL SESSION II : MARKET REGULATION



Sitting from L to R : CS Mahavir Lunawat, Past Chairman, WIRC of ICSI , Shri Manoj Joshi, Joint Secretary, Ministry of Finance, Government of India, Shri Rajeev Kumar Agarwal, Whole Time Member, SEBI, Shri Somasekhar Sundaresan, Partner, J. Sagar Associates, Advocates and Solicitors

TECHNICAL SESSION III : INVESTOR PROTECTION



Sitting from L to R : CS Hitesh Kothari, Member WIRC of ICSI , Shri Gyan Bhushan, Executive Director, SEBI, Shri Ashishkumar Chauhan, MD & CEO, BSE Ltd., Shri Shaji Vikraman, Sr. Editor, The Economic Times, Shri Amit Tandon, MD, Institutional Investor Advisory Services

CROSS SECTION OF THE AUDIENCE





Message from President



Dear Member,

In the recent budget, to energise capital markets, the government proposed a slew of measures, including tax benefits, easier regulations for foreign investors. Inflow of overseas capital through FDI route as well as via portfolio route through combination of changes in FDI investment stake ceiling and corporate bonds, besides creating a new instrument Bharat Depository Receipts [BhDR]. I am proud to record here that the scheme is based on recommendations of a committee headed by Shri M.S. Sahoo, Secretary, the Institute of Company Secretaries of India. The committee has proposed, a complete suite of BhDRs to be allowed and traded in India to make the Indian financial system more competitive, and to provide greater choice to Indian investors, really one of the significant market reforms in the recent times.

The ICSI has been actively engaged in the orderly development of the capital market in India and promoting the interest of investors. Company Secretaries play a major role in securities market related matters. Over a period of time, they have developed themselves as professional having core competence in compliance management and corporate governance. Being KMP under the Companies Act 2013, their responsibilities in complying regulatory norms have increased manifold. They are recognised as compliance officers under the listing agreement and have been authorised by SEBI to validate compliances and to undertake internal audit of capital market intermediaries.

As a continuity of this exercise, the Institute, since 2012 observing, Capital Markets Week, by organising innovative programmes across the country, on the role of capital market in the society and economy, functions of intermediaries and other market players as well as, to bring awareness amongst the investors. This apart, The Institute in association with Ministry of Corporate Affairs (MCA), Securities and Exchange Board of India (SEBI), and Stock Exchanges is making all efforts in educating the existing as well as prospective investors through organizing Investor Awareness Programmes through its Regional Councils, Chapters and Resource Persons. It has also partnered with MCA in organisation of India Corporate Week, India Investors Week and India Corporate and Investor Meet. The Institute has organized more than 3100 Investor Awareness Programmes. In the process we are trying to educate the investors about their rights, duties and responsibilities as well as importance of thorough understanding and studying before making an investment decision and in the process, they are getting educated about niceties of market



functions, including element of fluctuations. In order to take forward the above activities at next level, I am happy to inform that the Institute is conducting two mammoth investor awareness programmes jointly with MCA at Patna on 9th August 2014 and at Pune on 16th August 2014.

On 4th August 2014, the Institute has conducted a major programme on the theme “*Capital Markets -The Growth Engine*” jointly with BSE. Shri U K Sinha, Chairman, SEBI was the Chief Guest and Mr Ashishkumar Chauhan, MD & CEO, BSE Limited was the Guest of Honour. Underlining the importance of role of Company Secretaries in compliances segment, Mr Sinha said - “Governance should not be taken as a restriction on you; as something which you are being forced to do; this is something to your own benefit. Let me also remind you that while foreign investors are coming in, we have not been able to convince the trustees of provident funds in India even today that they should invest their money in the Indian stock markets. There is a directive from the Ministry of Finance; there is an investment guideline from the Ministry of Finance that 15% can be invested in the equity market. But even today the trustees are not yet convinced that everything is right in the Indian market and I would expect all of you, specially as members of the company secretary fraternity, to work hard towards the day when you will be able to convince the largest trustees of the pension funds in the country that they can invest in the Indian market and that things are well regulated and well governed in the Indian market. That should be one of our tasks.”

“My message to the company secretary fraternity is that instead of having an attitude of a push back from the status quo, because if you are having an attitude that if there is any change in status quo there must be push back, please refrain from it. Look at from medium to long term growth of your company, look at it medium to long term growth of India. If you still find there are areas where SEBI must look back, I assure you that we will do that. But we must try to make India a very trust worthy destination.”

Some of the brilliant minds from the Capital Markets, Regulators, Policy Makers handled the technical sessions, which added immense value to the programme and we are eager to share with you the technical papers and proceedings of the programme and hence this special issue of **CS-Nitor** is being released. I wish enjoyable week end reading.

With the quote from Paul Getty, I am ending this communication “***Money is like manure. You have to spread it around or it smells***”

CS R Sridharan

President

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Contents

- Message from the President
- Capital Market – The Growth Engine
- Convergence of Company Law and Securities Law
- Regulatory Changes in Capital Markets
- SME : The Growth Driver
- Investor Activism and Class Action Suits
- Rebuilding Investor Confidence



CAPITAL MARKETS – THE GROWTH ENGINE*

Capital Markets - A Curtain Raiser

The robust functioning of capital market is crucial for the economic development of an economy, as it facilitates efficient transfer of monetary resources from those who save money to those who need capital and who attain success in providing it a superior utilization; the capital market can influence largely the quality of investment decisions. The collecting of temporary capitals that are available in the economy, the reallocation of those that are inadequately or inefficiently used at a certain moment and even the favoring of some sectorial reorganizations, outline the capital market's place in the economy of several countries.

Among the processes which are specific for the capital market, the mechanism of financing the economy carries paramount importance, although, the fact is that a group of interconnected mechanisms contribute to the good functioning of the capital market, as, the way in which each of them function decides the quality of the ensemble. For example, the efficient distribution of resources, which is accomplished with the assistance of the capital market, depends on the information obtained on the basis of the secondary market prices.

It is quite interesting to note that capital markets play the dual role of a contact agent as well as a facilitator of transferring the current purchasing power, in monetary form, from companies which owns surplus funds to those who have a deficit, in exchange for reimbursing a higher purchasing power in the future; in this way the capital markets makes possible to distinguish the savings act from the investment one.

Moreover, the capital market's importance is not only restricted to efficient allocation of resources as per market's perspective, rather it also paves the way for allocation of funds according to the concepts of return and risk from an investor point of view, thereby, offering a large variety of financial assets/instruments with varying profitableness-risk characteristics, suitable for saving or risk covering.

Indian Capital Market: Its Performance Review

The year 2014 proved to be a blessing for Indian capital market in the form of flurry of investments, i.e., during March 2014, Rs.11,101 crore were mobilized in the primary market (equity and debt issues) by way of 18 issues in comparison to Rs. 4,860 crore mobilized through ten issues in February 2014, showing a rise of 128.4 percent from the previous month. Corporate sector mustered Rs. 2,126 crore through seven equity shares in March 2014 as compared to Rs.777 crore mobilized in the form of nine equity issues in February, 2014. The cumulative amount mobilized for the financial year 2013-14 registered at Rs. 56,004 crore through 90 issues as against Rs. 32,455 crore through 69 issues during 2012-13.

In almost all segments, that is, listing of Preferential Allotments at BSE and NSE, reporting of Private Placement of Corporate Debt to BSE and NSE and resource mobilization through mutual funds all have moved northwards, which is a clear indication of a vibrant capital market. There were 39 preferential allotments (Rs. 2418 crore) listed at BSE and NSE during March 2014 in comparison to 21 preferential allotments (Rs. 686 crore) in February 2014.

The cumulative mobilized amount for the financial year 2013-14, stood at Rs. 46,463 crore through 411 preferential allotments (of which 165 allotments amounting to Rs. 41,645 crore were listed at both BSE and NSE.

* *Contents Reproduced from Theme Paper 'Capital Markets – The Growth Engine' circulated at the Capital Markets Programme organised during ICSI Capital Markets Week. The views expressed in the Theme paper do not necessarily reflect those of the Institute.*



As far as, corporate debt market is concerned Rs. 33,263 crore were raised through 244 by embracing private placement listed at BSE and NSE during March 2014 compared to Rs. 20,171 crore procured through 162 issues in February 2014. The cumulative privately placed amount for the financial year 2013-14, stood at Rs. 2,76,054 crore through 1924 issues (of which 837 issues of Rs.1,40,713 crore reported to only NSE, 997 issues of Rs. 78,805 crore reported to only BSE and 90 issues of Rs. 56,536 crore reported to both BSE and NSE.

Further, there have been tremendous jump in ADRs/GDRs and ECBs. In 2000-01, the value of ADR/GDRs stood at \$831 million and ECB at \$4,303 million which rose to \$6,645 million for ADR/GDRs and \$22,609 million. However, substantial fall in ADRs/GDRs can be observed for the period April- December 2012, i.e. it stood at \$187 million.

One of the good news that filled in air in the capital market (February 2014), is regarding government's proposal to revamp the norms governing issuance of foreign-listed securities by Indian firms and mentioned that steps would be initiated to stimulate corporate bond and currency derivative segments. The news further mentioned that government is highly interested to completely revise the American depository receipt and Global depository receipt scheme and enlarge the scope of depository receipts. Besides, several measures were talked about with the motive of energizing and deepening the country's corporate bond and currency derivatives market. One of the prime reason cited for such measures is to entice retail and high net-worth investors towards this segment and to assist Indian companies in raising long-term funds in a cost-effective manner.

Capital Market: The Catalyst for Economic Growth

Economic growth of any modern economy revolves around efficient financial sector that pools domestic savings and mobilized foreign capital for productive investments. Absence of effective financial institutions will result into under exploitation or no exploitation of productive projects. In turn, the functioning of financial institutions largely depends upon the existence of efficient capital market. In case the capital market of an economy is underdeveloped or functions abysmally, then it will create illiquidity and make it expensive to deal in such a capital market. Illiquidity and high transaction costs also create bottlenecks in the capital raising efforts of both domestic and international corporations. In view of this, it becomes useful to study the linkage between two key variables, i.e., financial development and economic growth, as without an iota of doubt, it can be said that the existence of a robust capital market ensures sound financial development which in turn trigger economic growth. The following points shows the positive impact of financial development on three main elements, i.e. savings, investments and capital allocation.

- a) Financial development enhances the proportion of savings.
- b) Financial development may change the savings rate and hence influence investments.
- c) Financial development enhances the efficiency of capital allocation.

Out of the three mentioned vital factors, capital allocation bridges the gap between savings and investments, as it determines the allocation of funds among various sectors. The importance of finance (facilitated by capital market) is being manifested in its growing recognition over technological progress as a key factor for economic progress. The new model of economic progress shows that growth can be self-sustaining without technological progress (see Lucas 1988). The important mechanisms of growth are the positive externalities related with productive investments on the rest of the economy. An externality is an advantage or a cost that individuals or firms do not receive or bear.

Now, coming to the first important factor of economic progress, i.e. savings and its channeling to firms or business organizations demands efficient financial intermediation by banks, savings and loan institutions,



investment banks, mutual funds, and insurance companies. However, in absence of a formal financial system, informal markets will do the tasks albeit less efficiently. Of course, while aggregating the household savings and converting these into effective investments, financial intermediaries absorb some resources themselves. These resources may take the shape of wages for their human capital or of funds kept within the financial system (i.e. not invested) to accommodate withdrawals from savers. Such un-invested funds are called reserves.

The lack of properly developed financial institutions is the mirror image of underdeveloped capital market and this may prove very costly in terms of economic progress, as savers may get motivated to divert their savings in unproductive or passive financial assets like gold, instead of financial securities that possess the potential of igniting economic growth. For example in presence of a strong capital market, retail/corporate investors will prefer to invest in equity, bonds, debentures etc.

Apart from ensuring economic growth through active interplay of savings, investments and capital allocation, capital markets plays a crucial role in stabilizing the values of stocks and securities and reduce fluctuations in the prices to the minimum. The process of stabilization is facilitated by offering capital to the borrowers at a lower interest rate and reducing the speculative and unproductive activities.

Indian Capital Market- Key player in fostering growth

After having a generic discussion about the capital market, it is important to discuss regarding Indian Capital Market, as India being one of the emerging economies of the globe is playing a pivotal role in adding pace to the global economic growth and its capital market is contributing immensely in this growth process.

The discussion under this section will be further sub-divided into many sub topics for gaining comprehensive understanding about Indian capital market.

Renaissance

After remaining in hibernation for approximately two decades since around 1960, resource mobilization in the primary capital market showed an upward trend from the late 1970s. The growth accelerated towards the end of 1980s. The market capitalization ratio moved northwards from nearly 5 percent of GDP in 1980-81 to 63 percent in 1992-93. In eight years after 1986, the average daily turnover in the secondary market grew at about 35 percent per year. Between 1980-81 and 1992-93, the RBI index of securities prices went up almost thrice (20.7 percent per year) as fast as the wholesale price index (7.6 percent per year). This, in principle brought down the cost of equity capital and enhanced the prospects for capital gains. However, much of growth was observed for debt securities and about a third was noticed in convertible debentures. Proportion of equity (or risk) capital in market capitalization came down from nearly 90 percent in the early 1970s to approximately 30 percent two decades later. However, in absolute terms, nominal value fresh equity capital raised increased at 18 percent per year. A whopping jump in promoters' contribution was observed, i.e. from 21 percent in 1970-71 to 45 percent in 1990-91.

The Deep Journey

As already stated that one of the key drivers of growth in an economy is the availability of adequate capital to industry. Capital needs to be available at right time and at reasonable cost. In this regard, Indian capital market have made rapid strides but at times its momentum have been shackled by few major scams, resulting in erosion of investor confidence, and exposing certain lacunae and insufficiencies in the then prevalent regulatory mechanisms of the Indian capital markets. However, there were prompt regulatory responses. In 1992, there was a major refurbishing securities regulations in India, resulting in the enactment of the Securities and Exchange



Board of India (SEBI) Act, 1992, which constituted the Securities and Exchange Board of India (SEBI), followed by several initiatives, including imposing many risk management reforms like introducing additional deposit margins, placing restrictions on short selling, introducing mark to market margins and intra-day limits, circuit breakers etc. SEBI's main emphasis have been on protecting the interest of the retail investor, while at the same time, investing efforts in introducing reforms and plugging policy vacuums.

Post global economic crisis, leaving a few periods of frenetic activity, the Indian capital markets have suffered from prolonged periods of lethargy. Initial Public Offerings (IPOs) of substantial size have been handful and far between, and listed companies have also witnessed limitations in accessing the capital markets.

Coming to the issue of participation of households in equity/capital market, the facts are not much impressive. In a SEBI sponsored household survey which brought out astonishing insights into household saving preferences. The study estimated that merely 11 percent of Indian households (24.5 million of 227 million) invest in equity, debt, mutual funds, derivatives and other instruments in the capital market. The balance 89 percent were also considered to be net savers, but depend upon non-risky avenues like banks, insurance or post office savings instruments. Further it was observed that, while this 11 percent was very different for urban and rural India, it still translates into only 20 percent for urban households and 6 percent for rural households. The most unfortunate part is that this percentage has not undergone a drastic change over the past few years.

Reforms that enhanced pace of growth

There have been several key reforms that have taken place in Indian capital market which have provided an impetus to economic growth. Establishment of SEBI improved the Indian capital market scenario while there were other reforms also which have stoked the growth of capital market and economy as a whole. The discussion of the other key reforms are as under:

- a) Establishment of Credit Rating Agencies: Initially 3 creditors rating agencies were established as a part of reforms in Capital Market of India. The term used was 'Creditors' and not 'Credit'. However, later on 3 more 'credit' rating agencies came into existence. Six creditors rating agencies viz. CRISIL Limited, ICRA Limited, Credit Analysis & Research Limited (CARE), India Ratings and Research Pvt. Ltd., Brickwork Ratings India Pvt. Ltd. and SMERA Ratings Limited were established to evaluate the financial health of various financial institutions and agencies related to the stock market activities. They also act as a guide for the investors in evaluating investment decisions.
- b) Rise of Merchant Banking Activities: Several Indian and foreign commercial banks have established their merchant banking divisions in the last few years. These divisions offer financial services like underwriting facilities, issue organizing, consultancy services etc. They have proved as an assisting hand to factors pertaining to the capital market.
- c) Rise in FIIs: The overall good performance of Indian economy has lured Foreign Institutional Investments (FIIs). The huge flow of FIIs in the Indian capital market has provided good appreciation for the Indian investors. Similarly, several new companies have emerged on the horizon of the Indian capital market to raise capital for their expansions.
- d) Increase in electronic transactions: Due to rapid technological development, there have been huge decline in physical transaction involving more paper works. Paperless transactions have increased to a great extent, thereby resulting into saving of time, money and energy of investors. Thus paperless transactions, like buying and selling of shares through demat account have made investing safer and hassle free, encouraging populace to join the capital market.



- e) Mutual fund Industry on growth trajectory: Growth of capital market have triggered the growth of mutual fund industry. Public sector banks, foreign banks, financial institutions and joint mutual funds between the Indian and foreign firms have started several new funds. A big diversification in terms of schemes, maturity, etc. has occurred in mutual funds in India. It has provided a broad choice for the common investors to foray into the capital market.
- f) Rise in Stock Exchanges: The number of stock exchanges in India is increasing. Initially, the BSE was the main exchange, but now after the establishing of the NSE and the OTCEI, stock exchanges have spread across the country. At present there are 21 stock exchanges in India. In order to promote small and medium enterprises with high growth potential, the concept of SME exchange was coined. Two SME exchanges namely BSE SME exchange and NSE Emerge were established. The SME platform of the exchange is meant for SMEs whose post issue paid up capital shall be below than or equivalent to Rs25 crores. The platform is expected to provide a new and alternate asset classes to educated investors having longer investment horizon. The platform will allow new, early stage ventures and small quality organizations to raise much required growth capital, as they mature and transit to the Exchange's main board.
- g) Investor protection: The Institute of Company Secretaries of India is registered under Investor Education and Protection Fund (Awareness and Protection of Investor) Rules, 2001 since 2005. The Central Government of India constituted Investors Education and Protection Fund (IEPF) in 2001. It works towards guiding and educating investors. It make efforts to protect the interest of small investors from frauds and malpractices in the capital market. The Institute organises Investor Awareness Programmes through its Regional Councils, Chapters & Resource Persons and so far has organised 3100 Investor Awareness Programmes across India.
- h) Rise in Derivative Transactions: Since June 2000, the NSE has launched the derivative trading in equities. In November 2001, it started with the future and options transactions. These innovate financial products have provided variety for the investment resulting into growth of the capital market.
- i) Insurance sector reforms: Indian insurance sector has gone through substantial reforms. The Insurance Regulatory and Development Authority (IRDA) which was established in 2000, paved the entry of private insurance companies in India. With rising investments by insurance companies in the capital market, it has result in its expansion.
- j) Commodity Trading: Along with the trading of ordinary securities, the trading in commodity also received a boost. This resulted in the development of Commodity Exchanges. The volume of transactions is growing at an astounding pace.

Apart from the above mentioned reforms, the establishing of Clearing Corporation of India Limited (CCIL), Venture Funds, etc. have added fuel to the growth of Indian capital market.

Investors Approach towards Capital Market

Despite the fact that Indian share market is one of the oldest in Asia, the participation of retail investors is still very low. A substantial number of retail investors still opt for traditional investment avenues such as post office, banks, insurance etc. Mascarenhas (2012) reported that in terms of daily average volume of turnover, the retail investors' participation has shrunk by 51% in 2012 as compared to 2009 and investors inclined towards properties, gold, bank deposits and debt instruments. Rajeswari and Rama Moorthy(2001) mentioned that the most preferred destination for investment is bank deposits among eight choices, i.e. Currency, Life insurance, Pension and PF, Shares and Debentures, Units of UTI and MFs, Postal Savings and Chits. One of the reason that deter investors from investing in equity market can be attributed to the turbulences they observe, but it needs to



be noted that turbulences are short-term phenomenon, as keeping the funds tied up for longer period may fetch lucrative returns. Therefore, investors need to be educated regarding market behavior so that they can prepare themselves for all eventualities (Gupta & Jain, 2011).

Conclusion

It is important to remember that the stock markets in isolation, does possess the requisite capabilities to stimulate economic growth and effective resource allocation using the capital markets is possible only where the overall economic indicators of a country are efficient. Thus, the development of stock markets does not rely upon the government and the securities market regulator alone. Rather, the complete economic health of the country is an important determining factor for its capital market to develop and prosper.

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CONVERGENCE OF COMPANY LAW AND SECURITIES LAW*

Introduction

Countries across the development spectrum have instituted corporate governance reforms. These reforms have been propelled both by corporate scandals and a higher global emphasis on corporate governance. While corporate governance have long been a core issue in developed economies, developing economies are increasingly playing important roles in the corporate governance field. The pertinent question over here is that how to attain higher standards of corporate governance? Whether it is at all possible or a distant dream? Is it possible by running the corporate and securities laws parallel or convergence is the solution?

In order to understand and provide befitting answers to the flurry of questions, it is necessary to frame a crystal clear picture about corporate laws and securities laws and their impacts on the capital market. Taking up the concept of Corporate Law, a question that probably have not created storm among the erudite of corporate law is, "What is the common structure of the law of business operations- or, as it would be put in some jurisdictions, company law- across different national jurisdictions?" As stated that this question hardly finds space in the discussions of corporate law scholars, but it is critically important for the comparative investigation. Recent scholarship often stresses upon the deviation among European, American, and Japanese corporations in corporate governance, share ownership, capital markets, and business culture. But, albeit the very real differences across jurisdictions along these angles, the underlying uniformity of the corporate form is at least as impressive. Business corporations have a basically similar set of legal issues- in all jurisdictions.

The five common features of the business , i.e., legal personality, limited liability, transferable shares, delegated management under a board structure, and investor ownership are the ones that are mostly discussed about in corporate law. It follows that a principle function of corporate law is to offer business organizations with a legal form that have these five core attributes. However, the functioning of a business organization is not only impacted by the prevalent corporate law but also equally by various securities law, especially for those firms which meets their long-term financing needs from capital market.

Divergence to Convergence - An Integrated Approach

In order to address the issue of rapidly changing economic and commercial environment at domestic and global level, it was a necessity to launch a corporate law that can reduce the divergence between various securities and corporate laws. In this regard, the Companies Act, 1956 has been in need of a huge restructuring in order to make it more contemporary and relevant to corporate, regulators and other stakeholders in India. The Companies Act, 2013 is a giant leap which have encompassed all the requisite elements needed to bring in the much needed convergence in security and company laws. On the one hand it goes a long way in protecting the interests of shareholders (a vital component of securities laws) and removed administrative burden in several areas (the most common feature in corporate regulations), thereby building a synchronization between the two close but till now existing on different paths. This is why the Companies Act, 2013 is considered more outward looking and in several areas it attempted to align with international requirements. The amendments or changes made in the new companies act, affects investors, analysts and other stakeholders, which is an example of an integrative approach.

* *Contents Reproduced from Theme Paper 'Capital Markets – The Growth Engine' circulated at the Capital Markets Programme organised during ICSI Capital Markets Week. The views expressed in the Theme paper do not necessarily reflect those of the Institute.*



The study on convergence of securities and company laws remains unread, if due focus is not given on the study undertaken by KPMG (study titled, "Companies Act, 2013, New Rules of the Game), which have laid due emphasis on some key themes, each aimed at a different stakeholder community but finally culminating into one objective- 'Raising the Bar on Governance'. The main themes that have worked towards the convergence are:

- A) Increased Reporting Framework.
- B) Higher Auditor Accountability.
- C) Wider Director and Management Responsibility
- D) Stress on Investor Protection.

The discussion on the above mentioned key points are covered in the ensuing paragraphs :

- A) *Higher Reporting Framework*: In the 2013 Act, a substantial emphasis have been laid on corporate reporting framework, both internal and external and numerous changes have been incorporated keeping in view some key objectives, such as, the need for relevance and consistency in the financial information being reported, alignment with international practices, more attention on internal controls, etc. The 2013 Act mandates preparation of CFS (Consolidated Financial Statements) for all companies that have one or more subsidiaries. These would be in addition to the separate financial statements that are needed to be prepared in the same form and manner as the separate financial statements.

Till the onset of Companies Act, 2013, preparation of consolidated financial statements was compulsory only for listed companies under the Securities and Exchange Board of India (SEBI) Regulations. But now making it obligatory for unlisted and private companies also to prepare consolidated financial statements, it has not only broadened the compliance requirement but also linked up the security law (SEBI Regulations) and corporate law by extending the norms in the new companies act. Further, the linkage have been strengthened by encompassing those listed companies also, which has only an associate or a joint venture but not a subsidiary.

Regarding revision/restatement of financial accounts, in June 2012 there was an announcement from SEBI that it may require restatement of financial accounts of listed companies, where the auditors had issued a qualified opinion. However, this requirement to restate was not consistent with the provisions of the Companies Act, 1956. But the new companies act have synchronized this discrepancy and has provided an enabling legal framework for SEBI or any other regulatory authorities to apply for restatement of a company's financial statements.

- B) *Higher Auditor Accountability*: The Companies Act, 2013 have armed the auditors with necessary powers to report to the Central Government within the prescribed time and manner, in case the auditor has reason to believe that an offence involving certain fraud is being or has been committed against the company by officers or employees. The relevant draft rule mentions that matter should be reported immediately but not later than thirty days of his knowledge or information with a copy to the audit committee or in the event of non-constitution of audit committee by the company, to the Board. The traces of mentioned powers can be seen in Clause 10 of Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992, which talks about 'Appointment of Auditor'. It states that the Board may appoint a qualified auditor to investigate into the books of accounts or the affairs of the insider or any other person mentioned in clause (i) of sub-section (1) of section 11 of the Act. Therefore, a convergence in auditor's responsibility with reference to detection and reporting of frauds



can be observed in the security and new corporate law. Moreover, the convergence can be observed in Section 143 of Companies Act, 2013 (Powers and duties of auditors and auditing standards) and Chapter II, sub-section 2, Amendments to the Securities and Exchange Board of India Act, 1992, (Amendment of section 11). According to both the Acts, every auditor of a company possesses the right to access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or any other place shall be entitled to require from the officers of the company such information and explanation as he may think important for the performance of his duties as auditor and amongst other matters inquire into the following matters, namely:

- a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are detrimental to the interests of the company or its members;
- b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
- c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
- d) whether loans and advances made by the company have been shown as deposits;
- e) whether personal expenses have been charged to revenue account;
- f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading:

Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries.

- C) *Wider Director and Management Responsibility* : The Companies Act, 2013 for the first time have ushered in the concept of KMP (Key Managerial Personnel). According to the 2013 Act, it will be compulsory classes of companies, as prescribed by the Central Government, to appoint whole-time key managerial personnel by means of a Board Resolution. 'Key Managerial Personnel' defined to mean Managing Director (MD) or Chief Executive Officer (CEO) or Manager, whole-time director(s) (if any), Company Secretary, and Chief Financial Officer (CFO). Since KMPs are covered as 'officer who is in default' and thus would be liable in that position also. KMPs are also taken in 'related parties' of a company. The rules under Companies Act, 2013 state that a director or KMP of the holding subsidiary or associate company or his relative are also KMP.

A very important issue that plagued the capital markets and securities law, especially Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 that addresses the issue of insider trading, have also been given due emphasis in the Companies Act, 2013. The 2013 Act for the first time have defined insider trading and price-sensitive information, that prohibits any person including the director or key managerial personnel from entering into insider trading (section 195 of 2013 Act). Further, the Act also prevents directors and key managerial person from dealings in the company or its holdings, subsidiary or associate company (section 194 of 2013 Act). Thus, 2013 Act have not only provided a new



dimension to the hierarchy of corporates, but it has also ensured that key executives are dissuaded from embracing malpractices by integrating the security law on insider trading with the 2013 Act.

- D) *Stress on Investor Protection*: Section 125 of the Companies Act, 2013 and Chapter II (Amendments to the Securities and Exchange Board of India Act, 1992), sub-section 5, both lay due emphasis upon investors protection. As both of these section and sub-section of corporate and securities law respectively, stresses upon creation of a fund, which will largely work in the interest of investors. The areas where the funds raised under investor education and protection fund can be utilized are as follows:
- a) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;
 - b) promotion of investors' education, awareness and protection;
 - c) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;
 - d) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and
 - e) any other purpose incidental thereto, in accordance with such rules as may be prescribed:

Other Converging Areas

Search & Seizure: A lot of resemblance can be observed between Section 209 (Search and Seizure) of Companies Act, 2013 and Chapter II, sub-section 8 (Amendments to the Securities and Exchange Board of India Act, 1992), Amendment of Section 11 of the principal act. On the one hand, the 2013 Act states that (1) Where, upon information in his possession or otherwise, the Registrar or inspector has reasonable ground to believe that the books and papers of a company, or relating to the key managerial personnel or any director or auditor or company secretary in practice if the company has not appointed a company secretary, are likely to be destroyed, mutilated, altered, falsified or secreted, he may, after obtaining an order from the Special Court for the seizure of such books and papers,—

- (a) enter, with such assistance as may be required, and search, the place or places where such books or papers are kept; and
- (b) seize such books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books or papers at its cost.

On the other hand, the sub-section 8, Chapter-II (Amendments of the Securities and Exchange Board of India Act, 1992), Amendment of section 11 of the principle act states the almost the same lines, i.e. if during the course of an investigation, the Investigating Authority has reason to believe that any person or enterprise, as the case may be, to whom a notice under sub-section (3) has been issued and the concerned person or enterprise has omitted or failed to provide the information or produce documents as needed in the notice or would not provide the information or produce documents which shall be useful for, or relevant to the investigation or would destroy, mutilate, alter, falsify or secrete the information or documents useful for, or relevant to, the investigation, then Chairman, may authorize the Investigating Authority or any other officer of the Board to enter and search, with such assistance, as may be needed, the building, vessel, place, vehicle or aircraft where such information or documents are believed to be kept; break open the lock of any door, box, locker, safe almirah or other receptacle for exercising the powers conferred by sub-clause (i), where the keys thereof are not available; search any person who has got out of, or is about to get into, or is in, the building, place, vessel,



vehicle or aircraft, if the authorized officer has reason to suspect that such person has secreted about his person any such books of account or other documents; require any person who is found to be in possession or control of any books of account or other documents, maintained in the form of electronic record, to provide the authorized officer the necessary facility to inspect such books of account or other documents; seize any such books of account or other documents found as a result of such search; place marks of identification on any books of account or other documents or make or cause to be made extracts or copies there from; record on oath the statement of any person who is found to be in possession or in control of the information or documents referred to in sub-clause (i), (iii) and (iv).

Power of court to grant relief in certain cases & Settlement of Administrative Civil Proceedings:

Section 463 of the new Companies Act, 2013 and Settlement of Administrative Civil Proceedings (Insertion of new section 19-IA) draws lot of similarities, in the sense that, Section 19-IA (1) which states that, Notwithstanding anything contained in any other law for the time being in force, any person, against whom any proceedings have been initiated or may be initiated under section 19 or section 19H, as the case may be, may file an application in writing to the Board proposing for settlement of the proceedings initiated or to be initiated for the alleged defaults and 19-IA (2) stating that the Board, may after taking into cognizance the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by the Board in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992. Similarly, referring to Section 463 (Power of court to grant relief in certain cases) of new Companies Act, 2013, a much similar picture can be observed. The section states that (1) if any proceeding for negligence, default, breach of duty, misfeasance or breach of trust against an officer of a company, it appears to the court hearing the case that he is or may be liable in respect of the negligence, default, breach of duty, misfeasance or breach of trust, but that he has acted honestly and reasonably, and that having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused, the court may relieve him, either wholly or partly, from his liability on such term, as it may think fit:

Provided that in a criminal proceeding under this sub-section, the court shall have no power to grant relief from any civil liability which may attach to an officer in respect of such negligence, default, breach of duty, misfeasance or breach of trust.

(2) Where any such officer has reason to apprehend that any proceeding will or might be brought against him in respect of any negligence, default, breach of duty, misfeasance or breach of trust, he may apply to the High Court for relief and the High Court on such application shall have the same power to relieve him as it would have had if it had been a court before which a proceedings against that officer for negligence, default, breach of duty, misfeasance or breach of trust had been brought under sub-section (1).

(3) No court shall grant any relief to any officer under sub-section (1) or sub-section (2) unless it has, by notice served in the manner specified by it, required the Registrar and such other person, if any, as it thinks necessary, to show cause why such relief should not be granted.

Convergence - A Blessing

In the era of globalization, financial markets are deeply interlinked. A financial event, which may take place in one corner of the globe will definitely exert a positive or negative influence depending upon the nature of the financial event on other countries. For instance, most of the countries across the world have felt its negative impact. And the magnitude of negative effects differed from country to country depending upon their stage and velocity of growth, structure of their economies, degree of integration with the rest of the world and the depth



of the financial system. This demands for having an appropriate and robust institutional structures for managing the domestic market and integration of the global system.

Thus, the essence of the discussion is that integration of domestic and global financial market is only possible when the respective laws governing the securities and corporate are synchronized, so that a sound grip on the functioning of corporates, especially, with respect to the corporate governance can be achieved. Since corporate houses move on the wheels of funds, being provided by the shareholders, debenture-holders and financial institutions, it becomes extremely important to keep a strict vigil on their economic activities, i.e. from the procurement of funds to its allocation for various uses. Moreover, the provider of funds, bears the risk and equity shareholders who accept the highest risk, needs to be compensated properly. Apart from provider of financial sources, companies have obligations towards other stakeholders of the society also, as it is a well accepted fact that an organization is born in society, lives in society and grows in society, so it must discharge its due obligations towards customers, government, analysts etc. Therefore, a regulatory framework wherein an alignment between the securities laws (as corporate access capital markets for raising financial resources) and corporate laws (which broadly focuses upon corporate governance) can assist immensely in addressing the gaps, that currently being exploited by key corporate executives, speculators, stock brokers etc. Further, the convergence is a big leap towards curbing of financial frauds/scams in near future, that mostly takes place in CIS (Collective Investment Schemes), Mutual Funds, Chit Funds, Buying and Selling of shares etc.

Conclusion

The convergence move has started by incorporating components of some sections of new Companies Act, 2013 in the form of clauses and sub-sections in the Securities Law (Amendment) Second Ordinance, 2013, which deals with the further amendment of the Securities and Exchange Board of India Act, 1992, the Securities Contracts (Regulations) Act, 1956 and the Depositories Act, 1996. The process has taken off and probably in the future, more convergence will happen which will definitely assist in strengthening the capital market and its regulation. Moreover, convergence of both laws will help in removing ambiguities and facilitate speedy redressal of issues.

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REGULATORY CHANGES IN CAPITAL MARKETS*

Introduction

Over the last 20 years, India has taken several steps to streamline and strengthen financial market regulations. The Reserve Bank of India exercises regulatory jurisdiction over the government securities markets and the related derivatives segments, the money market and foreign exchange markets. SEBI regulates securities market having distinct responsibilities for regulation of the conduct of intermediaries, capital market and interaction between entities seeking to raise and invest in capital. It regulates securities market institutions such as the stock exchanges, depositories, mutual funds and asset management companies, market intermediaries- brokers, merchant bankers, credit rating agencies and venture capital funds etc.

Capital Market Perspective

Capital is essential for a business to conduct its operations and to grow. In a competitive and fast changing business environment, it is critical for business to raise capital of the requisite amount, in the right manner, at the right time and at an appropriate price. Therefore it calls for flexibility in managing capital dynamically and to enable reallocation of capital between businesses. In order to enable speedier access to capital and its effective management, there is a need to use a wide array of capital instruments in the backdrop of streamlined statutory and regulatory framework. A robust regulatory framework goes a long way in serving twin objectives of assisting issuers to meet their capital needs and monitoring of corporate's capital raising process through a well functioning capital market. However, matters relating to management and maintenance of capital are equally important.

The law should, therefore, address ownership rights effectively by enabling proper registration of ownership, transfer of shares, exercise of voting rights, equitable sharing in the profits of the company and participation in decision making on the basis of reporting requirements that enable transparency of financial operations by the corporate. At the same time, it should facilitate disclosure of actual control structures and prohibition of insider trading as well as management entrenchment. It is felt that international best practices be adapted to the Indian situation providing an enabling framework that ensures credibility of corporate operations in the minds of the stakeholders. Keeping this in view, certain regulatory changes have been initiated, which inter-alia includes:

The Amendment to Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999

The Securities Laws (Amendment) Ordinance, 2013 provides for regulation of pooling of funds under any scheme or arrangement, involving a corpus amount of one hundred crore rupees or more, to be deemed to be a Collective Investment Scheme, subject to sub-section (3) of section 11AA of the SEBI Act.

Accordingly, SEBI has approved the proposal to amend the Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999, providing a framework for regulation of such deemed Collective Investment Schemes and additional requirements for continuous compliance by a registered Collective Investment Scheme.

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Amendments to SEBI (Investor Protection and Education Fund) Regulations, 2009

Consequent to the promulgation of Securities Laws (Amendment) (Second) Ordinance, 2013, SEBI has approved amendment to SEBI (IPEF) Regulations, 2009 enabling utilization of such amounts primarily for restitution to investors and in case of failure of identification of investors, for the credit of amounts disgorged under the SEBI Act 1992, the Securities Contracts (Regulation) Act 1956 or the Depositories Act 1996 to the Investor Protection and Education Fund of SEBI.

Class of companies eligible to file shelf prospectus for public issuance of on convertible debt securities

While Companies Act, 1956 had allowed only Banks and Public Financial institutions to file Shelf Prospectus, the Companies Act, 2013 enables SEBI to specify the class of the companies which can be allowed to file Shelf Prospectus. In this regard, the SEBI has allowed the following class of entities to file Shelf Prospectus for public issuance of non-convertible debt securities:

- i. Public financial institutions and Scheduled Banks;
- ii. Issuers authorized by the notification of CBDT to make public issue of tax free secured bonds;
- iii. Infrastructure Debt Funds – Non- Banking Financial Companies;
- iv. NBFCs, registered with RBI, Housing Finance Companies registered with National Housing Bank (NHB) and entities which have listed their shares/ debentures in the stock exchanges for at least three years complying with the following criteria:
 - net worth of Rs. 500 Crores,
 - track record of three years of distributable profits,
 - having a credit rating of not less than "AA-",
 - having no default history or regulatory action pending with RBI, SEBI or NHB;

To avoid fragmentation of the issues, which will affect the floating stock and thereby liquidity, it is further stipulated that only a maximum of four issuances can be made under a Shelf Prospectus.

Further, companies filing a shelf prospectus with the Registrar of Companies are not required to file prospectus afresh at every stage of offer of securities, within the period of validity of such shelf prospectus i.e. one year. They are required to file only an information memorandum, containing material updations, with respect to subsequent issues.

SEBI (Procedure for Search and Seizure) Regulations, 2013

The Securities Laws (Amendment) Second Ordinance, 2013, inter alia, confers direct powers on Chairman, SEBI to authorize the Investigating Authority or any other officer of SEBI to search any premises where incriminating documents are lying and seize such documents for the purpose of investigation. The Ordinance also empowers SEBI to make regulations for executing the search operations and to ensure safe custody of any books of account or other documents that are seized. In this respect, the Board approved the SEBI (Procedure for Search and Seizure) Regulations, 2013, made on the lines of the provisions in the Income Tax Act, 1961 and for providing the detailed procedures for such search and seizures by SEBI.



Amendment to SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 - Making IPO Grading Mechanism Voluntary

Considering the requests received from market participants, viz. investor associations and association of Investment Bankers of India (AIBI), the recommendation of the advisory committee of SEBI, and to align with the principles laid down by Financial Stability Board (FSB) on reducing the reliance on Credit Rating Agencies, the Board approved the proposal to make the IPO grading mechanism “voluntary” as against the current provision of the same being “mandatory”. The move is part of the regulator’s effort to boost the dormant primary market and reduce the reliance on rating agencies, who have been under scanner globally for their role in overall financial sector.

SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2013

SEBI has recently released the Settlement of Administrative & civil proceedings Regulations 2014. These regulations help concerns who have defaulted on any SEBI laws & civil proceedings have been initiated against them, to settle the proceedings. These obviously do not settle proceedings which are under criminal in nature. The salient features of the SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2013 are as under:

- I. The Regulations lay down the stand alone common substantive procedure for settlement of administrative and civil proceedings under all the securities laws;
- II. The Regulations formalize the already existing settlement process;
- III. They also provide for the guiding factors for dealing with the settlement process;
- IV. Serious offences such as insider trading, etc. are excluded from the scope of settlement;
- V. In order to impart transparency in the process, the roles of the of internal committee(s) and high powered advisory committee are specifically defined;
- VI. The Regulations also provide for terms of settlement in monetary as well as non – monetary terms or combination of both.

Qualified Central Counterparties in Securities Market

National Securities Clearing Corporation Limited (NSCCL), Indian Clearing Corporation Limited (ICCL) and MCX-SX Clearing Corporation Limited (MCX-SXCCL) are the Qualified Central Counterparties (QCCPs) in the Indian Securities Market jurisdiction. These clearing corporations have qualified as QCCPs in view of the fact that these are regulated by Securities and Exchange Board of India (SEBI) under SEBI Act 1992, Securities Contract (Regulation) Act, 1956 (SCRA) and Rules and Regulations made there under. These are also subjected, on an on-going basis, to rules and regulations that are consistent with the Principles for Financial Market Infrastructures (PFMIs) issued by the Committee on Payment and Settlement Systems (CPSS) and International Organisation of Securities Commissions (IOSCO).

Clearing Corporations in securities market are established under SCRA and SEBI (Stock Exchange and Clearing Corporation) Regulations, 2012 to undertake the activity of clearing and settlement of trades in securities or other instruments or products that are dealt with or traded on recognized stock exchanges.

Clearing Corporations are designated as Market Infrastructure Institutions (MII) for oversight considering its systemic importance in Securities markets regulated by the SEBI. As such, it was subjected to regulation and supervision using the PFMIs framework thus necessitating its adherence to PFMI requirements. The “Principles for Financial Market Infrastructure” (PFMIs) were issued by the CPSS and IOSCO in April 2012. These were



issued to enhance safety and efficiency in payment, clearing, settlement, and recording arrangements, and more broadly, to limit systemic risk and foster transparency and financial stability. The members of CPSS and IOSCO are required to strive to adopt the PFMI in their respective jurisdictions in line with the G20 expectations. SEBI, as a member of Financial Stability Board (FSB) and IOSCO, is committed to the adoption and implementation of the PFMI.

FII Position Limits in Exchange Traded Interest Rate Futures (IRF)

SEBI in consultation with RBI, vide circular CIR/MRD/DRMNP/35/2013 dated December 5, 2013 prescribed the framework for Stock Exchanges to launch cash settled Interest Rate Futures on 10- year G-sec.

The following position limits were prescribed for FIIs:

“The gross open positions of the FII across all contracts shall not exceed 10% of the total open interest or INR 600 crores, whichever is higher.

Additional restriction: The total gross short (sold) position of each FII in IRF shall not exceed its long position in the government securities and in Interest Rate Futures, at any point in time. The total gross long (bought) position in cash and IRF markets taken together for all FIIs shall not exceed the aggregate permissible limit for investment in government securities for FIIs. FIIs shall ensure compliance with the above limits. Stringent action shall be taken against FII in case of violation of the limits.”

SEBI vide circulars dated April 1, 2013 and July 18, 2012 has put in place mechanism for monitoring and enforcing limits of FIIs in Government Securities and corporate bonds by directing depositories to disseminate information regarding the total FII investment values in Government and corporate bonds. It has been decided in consultation with RBI that this monitoring mechanism shall also incorporate monitoring of gross long positions of FIIs in Interest Rate Futures.

The mechanism shall be as follows:

- a. Stock exchanges shall provide information regarding aggregate gross long position in IRF of all FIIs taken together at end of the day to the depositories NSDL and CDSL and shall also publish the same on their website.
- b. NSDL and CDSL shall aggregate the gross long position of FIIs in IRF in each exchange and add it with investment of FIIs in Government Debt for monitoring adherence to the regulatory limit prescribed in paragraph 13 (d) of the SEBI Circular on IRF dated Dec 5, 2013 / paragraph 4.2 of the RBI directions on IRF dated Dec 5, 2013 and shall jointly publish/ disseminate the same on their website, on daily basis.
- c. As and when the total of cash and IRF of all FIIs as determined in sub paragraph ‘b’ above reaches 85% of the permissible limit, NSDL and CDSL shall inform RBI (CGM-in-Charge, Foreign Exchange Department), SEBI and Stock Exchanges.
- d. Once 90% of limit is utilized, NSDL and CDSL shall inform RBI, SEBI and Stock Exchanges about the same. Stock Exchanges shall notify the same to the market and thereafter FIIs shall not further increase their long positions in IRF till the time the overall long position of FIIs in cash and IRF comes below 85% of existing permissible limit.



(Information Technology) IT Governance for Depositories

Based on the recommendations of Depository System Review Committee (DSRC) constituted by SEBI, following guidelines are issued to strengthen the Information Technology (IT) governance framework of depositories.

1. Depositories shall formulate an IT strategy committee at the Board level of depository to provide insight and advice to the Board in various areas that may include:
 - a. Developments in IT from a business perspective.
 - b. The alignment of IT with the business direction.
 - c. The availability of IT resources to meet strategic objectives.
 - d. Competitive aspects of IT Investments.
 - e. Alignment of the IT architecture to the organization needs and its approval.
 - f. Setting priorities and milestones.
2. Depositories shall formulate an executive level IT Steering Committee to assist the IT Strategy Committee in Implementation of IT strategy. The IT steering committee shall comprise of representatives from IT, Human Resources (HR), Legal and various business functions as felt appropriate.
3. The Depositories shall formulate an IT strategy document and an Information Security policy which should be approved by the Board and reviewed annually
4. The Depositories shall create an Office of Information Security and designate a senior official as Chief Information Security Officer (CISO) whose work would be to assess, identify and reduce information technology (IT) risks, respond to incidents, establish appropriate standards and controls, and direct the establishment and implementation of policies and procedures.
5. Depositories shall designate a senior official as the head of Business Continuity Plan function.
6. Depositories are directed to:
 - a. Take necessary step and put in place necessary systems for implementation of the above.
 - b. Make necessary amendments to the relevant bye-laws, rules and regulations for the implementations of the above decisions, wherever applicable.

Review of Corporate Governance norms in India for listed companies

SEBI has approved the proposals to amend the Listing Agreement with respect to corporate governance norms for listed companies. The amendments, inter-alia, propose to align the provisions of Listing Agreement with the provisions of the newly enacted Companies Act, 2013 and also provide additional requirements to strengthen the corporate governance framework for listed companies in India. The amendments shall be made applicable to all listed companies with effect from October 01, 2014.

The Board approved the following proposals:

- Exclusion of nominee Director from the definition of Independent Director
- Compulsory whistle blower mechanism
- Expanded role of Audit Committee
- Prohibition of stock options to Independent Directors



- Separate meeting of Independent Directors
- Constitution of Stakeholders Relationship Committee
- Enhanced disclosure of remuneration policies
- Performance evaluation of Independent Directors and the Board of Directors
- Prior approval of Audit Committee for all material Related Party Transactions (RPTs)
- Approval of all material RPTs by shareholders through special resolution with related parties abstaining from voting.
- Mandatory constitution of Nomination and Remuneration Committee. Chairman of the said committees shall be independent.
- At least one woman director on the Board of the company.
- It has been decided that the maximum number of Boards an independent director can serve on listed companies be restricted to 7 and 3 in case the person is serving as a whole time director in a listed company.
- To restrict the total tenure of an Independent Director to 2 terms of 5 years. However, if a person who has already served as an Independent Director for 5 years or more in a listed company as on the date on which the amendment to Listing Agreement becomes effective, he shall be eligible for appointment for one more term of 5 years only.
- The scope of the definition of RPT has been widened to include elements of Companies Act and Accounting Standards.

In addition to the above, the SEBI has also approved the proposal to put in place principles of Corporate Governance, policy on dealing with RPTs, divestment of material subsidiaries, disclosure of letter of appointment of Independent Directors and the letter of resignation of all directors, risk management, providing training to Independent Directors, E-voting facility by top 500 companies by market capitalization for all shareholder resolutions and Boards of companies to satisfy themselves that plans are in place for orderly succession for appointments to the Board and senior management.

Long Term Policy for Mutual Funds in India

SEBI has approved a Long Term Policy for Mutual Funds in India. The long term policy includes all aspects - including enhancing the reach and promoting financial inclusion, tax treatment, obligation of various stakeholders, etc. to deal with the public policy objectives of achieving sustainable growth of the mutual fund industry and mobilisation of household savings for the growth of the economy. The recommendations of long term policy has been bifurcated in two buckets, tax incentive related proposals and non-tax related proposals.

(a) Tax related proposals

The objective of giving tax benefits is to incentivize and channelize savings into long term investment products. Schemes offering tax benefits are a powerful approach world over that helps to channelize household savings into long term investment products. The tax incentives for Mutual Fund schemes are recommended as under:



- i. A long term product such as Mutual Fund Linked Retirement Plan (MFLRP) with additional tax incentive of Rs. 50,000 under 80C of Income Tax Act may be introduced.
- ii. Alternatively, the limit of section 80C of the Income Tax Act, 1961, may be enhanced from Rs. 1 lakh to Rs. 2 lakh to make mutual funds products (ELSS, MFLRP etc.) as priority for investors among the different investment avenues. RGESS may also be brought under this enhanced limit.
- iii. Similar to merger/consolidation of companies, the merger/consolidation of equity mutual funds schemes also may not be treated as transfer and therefore, may be exempted from capital gain taxation.

(b) Non-Tax incentive proposals

In the long run, the objective is to ensure that Mutual Funds achieve a reasonable size and play an important role in achieving the objective of financial inclusion while further enhancing the transparency so that investors can take informed decision. Towards this objective SEBI has decided the following :

- I. Capital Adequacy i.e. minimum networth of the Asset Management Companies (AMC) be increased to Rs. 50 crore.
- II. The concept of seed capital to be introduced i.e. 1% of the amount raised (subject to a maximum of Rs. 50 lacs) to be invested by AMCs in all the open ended schemes during its life time.
- III. EPFOs be allowed to invest upto 15% of their corpus in Equities and Mutual Funds. Further, the members of EPFOs who are earning more than Rs. 6500 per month be offered an option for a part of their corpus to be invested in a Mutual Fund product of their choice.
- IV. Presently, Navratna and Miniratna Central Public Sector Enterprises (CPSEs) are permitted to invest in Public Sector Mutual Funds regulated by SEBI. It has been recommended that all CPSEs be allowed to choose from any of the SEBI registered Mutual Funds for investing their surplus funds.
- V. In order to enhance transparency and improve the quality of the disclosures, it has been decided that AUM from different categories of schemes such as equity schemes, debt schemes, etc., AUM from B-15 cities, contribution of sponsor and its associates in AUM of schemes of their mutual fund, AUM garnered through sponsor group/ non-sponsor group distributors etc. are to be disclosed on monthly basis on respective website of AMCs and on consolidated basis on website of AMFI.
- VI. In order to improve transparency as well as encourage Mutual Funds to diligently participate in corporate governance of the investee companies and exercise their voting rights in the best interest of the unit holders, voting data along with rationale supporting their decision (for, against or abstain) be disclosed on quarterly basis on their website. This is to be certified by Auditor annually and reviewed by board of AMC and Trustees.
- VII. Towards achieving the goal of financial inclusion, a gradual approach to be taken such that initially the banked population of the country may be targeted with respect to Mutual Funds investing. SEBI will work towards achieving the goal that the basics of capital markets and financial planning may be introduced as core curriculum in schools and colleges. Printed literature on Mutual Funds in regional languages be mandatorily made available by Mutual Funds. Investor awareness campaign in print and electronic media on Mutual Funds in regional languages to be introduced.



VIII. In order to develop and enhance the distribution network PSU banks may be encouraged to distribute schemes of all Mutual Funds. Online investment facility needs to be enhanced to tap the internet savvy users to invest in Mutual Funds. Also, the burgeoning mobile-only internet users need to be tapped for direct distribution of Mutual Funds products. The proposals relating to tax incentives, allowing EPFO to invest in equities/mutual funds and allowing all CPSEs to invest their surplus fund in mutual funds will be sent to the Government for its decision.

Amendment to SEBI {KYC (Know Your Client) Registration Agency} Regulations, 2011

SEBI (KYC Registration Agency) system ('KRA system') has evolved and stabilized over a period of two years and with inter-operability in place, there is easy exchange of KYC data among five SEBI registered KRAs. The client who has already done the KYC with any SEBI registered intermediary need not undergo the same process again when he approaches another intermediary. The system has benefited the investors as well as the intermediaries.

However, as per existing KRA Regulations, there is an option available to the intermediary that he may access the centralized KRA system in case of a client who is already KYC compliant or carry out fresh KYC process. As the KRA system has been working well, it is felt that there may not be a need to provide this option in the Regulations. Board has now approved the amendment to KRA Regulations and the option of taking fresh KYC has been done away with. However, as provided in the Regulations, the intermediary can undertake enhanced KYC measures commensurate with the risk profile of its clients. This would further facilitate the KYC process for the investors.

Inspection of Depository Participants (DPs) by Depositories

In order to enhance transparency, improve risk management and curb the risks of manipulations of investor accounts in dematerialized form, the Securities and Exchange Board of India had constituted a Committee named Depository System Review Committee (DSRC) in December 2012 to undertake a comprehensive review of the depository system of Indian Securities Market.

Keeping in view the recommendations of Depository System Review Committee (DSRC), SEBI issued guidelines for depositories [National Securities Depository Ltd (NSDL) and Central Depository Services Ltd (CDSL)] to inspect and grade depository participants. SEBI has advised the depositories to keep a strict vigil on client information, including checks to prevent possible money laundering activities, while carrying out inspection of their agents and prescribed 112 different areas of inspection for DPs. The basic parameters of inspection will include account opening and KYC documents; Basic Service Demat Account (BSDA); Client Data Modification (CDM); delivery instruction slips; transactions; compliance with prevention of money laundering norms; record maintenance; service centre details; information technology areas; power of attorney details; details of pledges and freeze; and inter-depository transfers among many others.

As per the circular CIR/MRD/DMS / 05 /2014 vide dated February 07, 2014 issued by SEBI, Depositories should periodically undertake risk-impact analysis for each of the Inspection areas, assign appropriate risk weightage, calculate risk scores for each DPs in the lines of Risk weightage Quantitative & Qualitative Score Calculation and total DP risk score. SEBI has also defined the Adaptive Sample Size Determination methodology for inspection of Depositories Participants. In order to assign risk-ratings to DPs, depositories will have to compute the total risk score of DPs. The total risk score will be a sum of quantitative risk score and qualitative risk score, which will be derived from the risk-weightage based on the inspection.



After completing inspection, depositories will categorize their DPs as 'high risk', 'medium to high risk', 'medium risk', and 'low risk', based on the percentile of risk score.

Anti-Money Laundering/Countering the Financing of Terrorism (AML/ CFT) Obligations of Securities Market Intermediaries under the Prevention of Money-laundering Act, 2002 and Rules framed there under

In view of the amendments to the Prevention of Money-laundering Act, 2002 (PML Act) and amendments to the Prevention of Money-laundering (Maintenance of Records) Rules, 2005 (PML Rules), it has been decided to make the following consequential modifications:

Risk Assessment

- i. Registered intermediaries shall carry out risk assessment to identify, assess and take effective measures to mitigate its money laundering and terrorist financing risk with respect to its clients, countries or geographical areas, nature and volume of transactions, payment methods used by clients, etc. The risk assessment shall also take into account any country specific information that is circulated by the Government of India and SEBI from time to time, as well as, the updated list of individuals and entities who are subjected to sanction measures as required under the various United Nations' Security Council Resolutions.
- ii. The risk assessment carried out shall consider all the relevant risk factors before determining the level of overall risk and the appropriate level and type of mitigation to be applied. The assessment shall be documented, updated regularly and made available to competent authorities and selfregulating bodies, as and when required.

Reliance on third party for carrying out Client Due Diligence (CDD)

- i. Registered intermediaries may rely on a third party for the purpose of (a) identification and verification of the identity of a client and (b) determination of whether the client is acting on behalf of a beneficial owner, identification of the beneficial owner and verification of the identity of the beneficial owner. Such third party shall be regulated, supervised or monitored for, and have measures in place for compliance with CDD and record-keeping requirements in line with the obligations under the PML Act.
- ii. Such reliance shall be subject to the conditions that are specified in Rule 9 (2) of the PML Rules and shall be in accordance with the regulations and circulars/ guidelines issued by SEBI from time to time. Further, it is clarified that the registered intermediary shall be ultimately responsible for CDD and undertaking enhanced due diligence measures, as applicable.

Record keeping requirements

- Records shall be maintained for a period of five years pertaining to transactions of clients: instead of ten years.
- Records evidencing the identity of its clients and beneficial owners as well as account files and business correspondence shall be maintained and preserved for a period of five years after the business relationship between a client and intermediary has ended or the account has been closed, whichever is later. Earlier, it was maintained for the period of 10 years.



- Sub-clause 8.3 (b) of Part II shall be substituted with “Registered intermediaries shall maintain and preserve the record of documents evidencing the identity of its clients and beneficial owners (e.g., copies or records of official identification documents like passports, identity cards, driving licenses or similar documents) as well as account files and business correspondence for a period of five years after the business relationship between a client and intermediary has ended or the account has been closed, whichever is later.”
- Monitoring of transactions shall be maintained and preserved for a period of five years from the date of transaction between the client and intermediary instead for ten years.
- Records of information reported to the Director, Financial Intelligence Unit - India (FIU-IND): Registered intermediaries shall maintain and preserve the record of information related to transactions, whether attempted or executed, which are reported to the Director, FIU-IND, as required under Rules 7 & 8 of the PML Rules, for a period of five years from the date of the transaction between the client and the intermediary.

Appointment of a Designated Director

- i. In addition to the existing requirement of designation of a Principal Officer, the registered intermediaries shall also designate a person as a ‘Designated Director’. In terms of Rule 2 (ba) of the PML Rules, the definition of a Designated Director reads as under:

“Designated Director means a person designated by the reporting entity to ensure overall compliance with the obligations imposed under chapter IV of the Act and the Rules and includes:

 - i.the Managing Director or a Whole-time Director duly authorized by the Board of Directors if the reporting entity is a company,
 - ii.the managing partner if the reporting entity is a partnership firm,
 - iii. the proprietor if the reporting entity is a proprietorship concern,
 - iv. the managing trustee if the reporting entity is a trust,
 - v.a person or individual, as the case may be, who controls and manages the affairs of the reporting entity if the reporting entity is an unincorporated association or a body of individuals, and
 - vi. such other person or class of persons as may be notified by the Government if the reporting entity does not fall in any of the categories above.”
- ii. In terms of Section 13 (2) of the PML Act (as amended by the Prevention of Money-laundering (Amendment) Act, 2012), the Director, FIU-IND can take appropriate action, including levying monetary penalty, on the Designated Director for failure of the intermediary to comply with any of its AML/CFT obligations.
- iii. Registered intermediaries shall communicate the details of the Designated Director, such as, name, designation and address to the Office of the Director, FIU-IND.
 - Registered intermediaries are directed to review their AML/CFT policies and procedures and make changes to the same accordingly. The other provisions specified in the SEBI Master Circular dated December 31, 2010 remain the same.



Commencement of Foreign Portfolio Investor (“FPI”) Regime.

SEBI (Foreign Portfolio Investors) Regulations, 2014 (“the Regulations”) have been notified on January 07, 2014. Subsequently, SEBI has issued Operational Guidelines for Designated Depository Participants (“DDPs”) vide SEBI Circular No. CIR/IMD/FIIC/02/2014 dated January 8, 2014.

In terms of Regulation 47 (3) (c) of the Regulations, “the Board may continue to grant certificate of registration as a foreign institutional investor or sub-account under the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995 till March 31, 2014 which may be extended upto June 30, 2014 by the Board”. In this regard, market participants have communicated to SEBI that they are still in process of putting in place necessary systems and procedures to discharge their assigned role effectively. Accordingly, they have sought an extension of time for implementation of the FPI regime. Considering the representations of the market participants, it has now been decided as follows:

- a) The FPI regime shall commence with effect from June 01, 2014.
- b) SEBI shall continue to accept all applications for registration of FIIs and Sub Accounts till May 31, 2014 provided such applications are complete in all respects.
- c) SEBI shall continue to accept all applications for acknowledgment of fee till May 31, 2014, in respect of those FIIs and Sub Accounts whose fee validity is expiring on or before September 30, 2014 provided such applications are complete in all respects.
- d) SEBI shall continue to accept all applications for miscellaneous requests till May 31, 2014 provided such applications are complete in all respects.
- e) With effect from June 01, 2014, the DDPs shall accept all applications for registration, acknowledgment of fees, and miscellaneous requests.
- f) Those Qualified Depository Participants (QDPs) who are deemed as DDPs under Regulation 11(1) of the Regulations may continue to open QFI accounts till May 31, 2014.

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SME : THE GROWTH DRIVER*

Introduction

The manufacturing of goods and services in the most efficient manner has continued to be the only viable and dependable alternative for development, growth and survival of any economy. In view of this, SMEs have been identified by government and development experts as an essential engine of economic growth and a key factor by extension in encouraging the realization of the financial systems strategy 2020. This is due to the fact that the development of this sub-sector is an important component in the growth strategy, not only in contributing to improved standard of living; they also play a pivotal role in local capital formation and accomplish high level of productivity and capacity.

From the point of view planning, SMEs are increasingly considered as an important vehicle for attaining equitable and sustainable diversification and dispersal and in majority of the countries, SMEs account for well over half of the total share in employment, sales and value added (Udechukwu, 2003). The statement holds water when we look at the industrial sector of Nigeria, which has not registered notable contribution to economic development since it gained independence in 1960 because it has not experienced and significant growth, traceable to indigenous industrial entrepreneurship (Adewale, 2007).

Taking the case of India, SMEs constitute the backbone of the Indian manufacturing sector, as it contribute immensely towards India's economic growth. It is estimated that SMEs for nearly 90% of industrial units in Indian and 40% of value addition in the manufacturing sector. Small industry has been one of the major planks of India's economic development strategy since independence. India have provided high priority to small and medium enterprises (SMEs) from the very beginning and followed supportive policies to make these enterprises sustainable and vibrant and over time, these have become key contributors to the GDP.

Thus, contribution of the small and medium enterprises (SME's) to economic growth cannot be ignored. In developing countries, as some authors argue (Leutkenhorst, 2004) the contribution of SME's towards employment creation is important because they

- a. Tend to use more labour intensive production processes than large business organizations, boosting employment and leading to more equitable income distribution.
- b. Provide livelihood opportunities through simple, value adding processing activities in agriculturally based economies;
- c. Nurture entrepreneurship; and
- d. Support the building up of systemic productive capacities and the creation of pliant economic systems, through linkages between small and large enterprises.

* Contents Reproduced from Theme Paper – 'Capital Markets – The Growth Engine' circulated at the Capital Markets Programme organised during ICSI Capital Markets Week. The views expressed in the Theme paper do not necessarily reflect those of the Institute.



Why SME Exchange?

Going Forward – The Indian Scenario

The contribution of micro, small and medium enterprises (MSME) sector to manufacturing output, employment and exports of the country is quite noteworthy. According to estimates, in terms of value, the sector accounts for approximately 45 percent of the manufacturing output and 40 percent of the total exports of India. The MSME sector provides employment opportunities to nearly 42 million persons in more than 13 million units throughout the country. There are more than 6000 products, ranging from traditional to high-tech items, which are being produced by the Indian MSMEs. There have been substantial growth in SMEs, i.e. from 67.87 lakhs in 1990-91 to 133.68 lakhs in 2007-08. The mammoth growth in SMEs in India can be ascribed to the congenial policy environment during the liberalization era (post 1991). Similarly, number of persons employed in MSMEs soared from 158.34 lakhs in 1990-91 to 322.28 lakhs in 2007-08. The widening gap between the two lines over the years is an indication of employment elasticity of the MSME sector has improved. However, majority of labor absorption has occurred in the unorganized/informal organizations. What is important to note is that the exports from small scale industry has risen from Rs9,664 crore in 1990-91 to Rs1,50,242 crore in 2005-06. However, export oriented SMEs have been impacted from global economic crisis to so some extent.

In order to strengthen MSMEs in India, an important step was the passage of the MSME Development Act 2006, which came into effect from 2nd of October, 2006, subsequent to which, both the Central and State Governments initiated effective measures towards implementation of the Act. In order to enhance the competitive edge of the MSME vis-à-vis the multinational corporations (MNCs), the Government of India announced the National Manufacturing Competitiveness Program (NMCP) during the budget speech 2005-06. One of the key objective of NMCP is robust growth of the MSME sector. Under NMCP, five elements have been made operational, which comprises of quality management systems and quality technology tools, building awareness on intellectual property rights, support for managerial development through incubators, establishing of new mini tool rooms and marketing assistance or support to MSMEs.

Further, in order to provide impetus to the growth of SMEs, the government has initiated a range of programs in diverse areas, viz; financing, technology, innovation, market information, technical training and developmental assistance. But it will be internal dynamics of industries, and the path India's industrial development takes, that will provide an impulsion to the development of SMEs.

SME's are playing a crucial role in India's economic growth. According to the Third All India Census of Small Scale industries conducted in 2004, the SME's have risen from nearly 80,000 units in 1940's to approximately 10.52 million units. Their total employment stood at 25 million and they manufactured about 7,500 products including high technology products. In the sports goods and garments sector their contribution to export is as high as 90% to 100%. They constitute 90% of the industrial units in the country and also contribute to nearly 35% of India's exports (Pandey, 2007).

Liberalization: Acceleration or Deceleration of SMEs?

The decade of 1990s was a game changer for Indian economy as it marked policy changes, national as well as internationally. Since the starting of the 1990s, policy changes have occurred at three various levels- global, national and sectoral- which have implications for working of small industry and its performance in India. The LPG (Liberalization, Privatization and Globalization) era, marked the introduction of an exclusive policy for small industry, which provided stress on imparting more vitality and growth impetus to the sector, is the sectoral facet of the important policy changes relevant to the industry. The policy marked: (1) the beginning of the end of protective measures for small industry, and (2) promotion of competitiveness by addressing the basic issues of



the sector, namely, technology, finance and marketing. Subsequently, the number of items reserved exclusively for small industry manufacturing has been gradually brought down from 842 in 1991 to 239 in 2007.

Therefore, the policy changes that have taken place at the global, national and sectoral levels have drastically changed the environment for the functioning of small industry in India. The growth of small and medium enterprises in the country needs to be analyzed against this surroundings. No doubt, due importance was accorded to the growth of small industry, as stated above, but liberalization policies have impacted SME growth.

Despite, according a high status to small industry, its emergence have been quite unplanned, uncontrolled and haphazard. They have emerged anywhere and everywhere, i.e., nearer to the location of resources and markets, in clusters and in dispersed manner, in industrial, commercial and residential areas. Around 2000-odd industry clusters differ in size with a population ranging from 100 to 1,000 units. What is important to note is that these clusters account for 1/3rd to ½ of the total small industry units in India.

However, a considerable number of these clusters are based on natural and traditional skills. They are devoid of reliable and efficient infrastructural facilities, like, power, road, water, transportation and communication, information and technical inputs.

Emerge : NSE SME Platform

The SME platform of NSE is a precious blessing for small and medium sized enterprises with high growth potential. The NSE platform has robust ties with leading institutions, such as, SBI, IDBI Bank & SIDBI as platform partners. The SME platform would be open for SMEs whose post issue paid up capital shall be less than or equal to Rs. 25 crores. The platform is expected to offer a new and alternate asset class to informed investors having longer investment horizon. The platform shall allow new, early stage ventures and small quality companies to raise much needed growth capital as they grow, mature and transit to NSE's main board. This platform is being founded on the following 4 cornerstone pillars of Credibility, Transparency, Liquidity & Growth.

NSE SME platform provides an efficient route to listing for prospective SME issuers. The SME companies would derive several benefits from listing on the SME platform:

- a) *Access to growth Capital* : with opportunities to raise capital for meeting growth requirements.
- b) *Exit to existing investors* : Early stage investors in the companies including angel and VC investors can be provided exit through listing on SME platform.
- c) *Wider shareholder base* : The companies shares would be held by a wider base of shareholders resulting in liquidity.
- d) *Employee incentives* : Listing would enable SME companies to provide stock based incentives to their key employees thus improving their retention.
- e) *Higher profile and visibility* : Improved visibility of the SMEs listed on the SME board would improve credibility with its various stakeholders including clients, suppliers, financiers, etc.
- f) *Higher Corporate Governance* : The listed SMEs would also be guided to adopt higher corporate governance standards which would help them in their journey to the main board.
- g) *Seamless path to the main Board* : The platform would provide a seamless path to the prestigious main board of the NSE as they grow in operations and size.



BSE SME Platform

The launch of BSE SME ITP is consequent to SEBI's provision in ICDR guidelines allowing SMEs to list on the exchange without bringing in Initial Public Offer (IPO). In addition to allowing SMEs and start-up companies to raise capital, the BSE SME ITP will provide easier entry and exit options for informed investors like angel investors, VCFs and PEs etc. The new platform offers better visibility and wider investor base while offering tax benefits to long term Investors. As per the regulatory norms, the BSE SME Institutional Trading Platform offers relaxed compliance and cost effective listing to SMEs. The regulator has provided an exemption to SMEs and starts from the requirements of rule 19(2)(b) of SC(R)R 1957, under which companies have to offer up to 25% of its shareholding through an IPO. Any company whose paid up capital has not exceeded 25 crore rupees in any of the previous financial years and has at least one full year's audited financial statements for the immediately preceding financial year at the time of making listing application or any company has not completed a period of more than 10 years after incorporation and its revenues have not exceeded 100 crore rupees in any of the previous financial years is eligible to get listed at the BSE SME ITP.

SME Exchange- SEBI Guidelines

1. An issuer with post issue face value capital up to Rs 10 crore will be invariably covered under the SME Exchange. An issuer with post –issue face value capital between Rs. 10 Crores to 25 Crores may get listed to either SME Exchange or Man Board, and issue with Post Issue face value capital above Rs 25 Crores has to be necessarily on the main board of the BSE.
2. No need to fulfill condition of track record of distributable profits in terms of section 205 of the companies act, 1956, for a least three out of proceeding five years for listed on SME exchange.
3. Suitable Position for migration to/from main Board from/to SME Exchange.
4. The minimum application amount as well as minimum trading lot shall not be less than Rs. 1,00,000. The trading lot shall be subject to periodically review by the exchange.
5. All Existing trading members would be eligible to participate on SME Exchange without any further registration.
6. 100% under written issues. Merchant/Banker's shall underwrite 15 % in their own account.
7. The Merchant Banker to the issue will undertake market making through a stock broker who is registered as market maker with SME Exchange. The Merchant banker shall be responsible for market making for a minimum period of 3 years.

The Silver Lining

Contribution of Small and Medium to the country's GDP is estimated to increase to 22% by 2020. Indian companies, products and services are being considered as budding stars and paving way for 'brand India', especially in West Asia and Africa, where Indian firms are gaining more preference over others.

The importance and contribution of SME sector to the economic growth is well established. Their importance in terms of employment creation, upholding the entrepreneurial spirit and innovation has been key in cultivating competitiveness in the economy. In order to attain the National developmental objective of a growth rate of more than 8% per annum on a sustainable basis, it is necessary for the industrial sector to grow at an astounding pace supported by a vibrant SME sector. In this regard, Government's policy initiatives such as enactment of the new Micro Small and Medium Enterprises Development Act, 2006, trimming of reserved SSI list, advising FIs to



enhance their flow of credit to the SME sector, are all initiatives towards promoting entrepreneurship, investment and growth.

With the bridging of the information gap on the SME sector with the help of periodical census, formation of CIBIL and SMERA, policy formulators prescription has been to make information available to the lenders to not only extend financial assistance to creditworthy SME units and to approach proactively SME units in initial stages of development. Providing quality information is particularly necessary in this era of globalisation wherein Indian SME sector face competition from domestic players as well as from imports. Their exists further possibility for enhancing their export potential, market share in domestic market and achieving status of serious players in the 'Global Value Chain'. Access to finance and capital are the essential resources for improved competitiveness and efficient operations of SMEs. Providing support to SMEs in this decisive area has been the underlying principle of SMERA Ratings Limited (formerly SME Rating Agency of India Ltd).

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INVESTOR ACTIVISM AND CLASS ACTION SUITS*

"Shareholder activism is not a privilege - it is a right and a responsibility. When we invest in a company, we own part of that company and we are partly responsible for how that company progresses. If we believe there is something going wrong with the company, then we, as shareholders, must become active and vocal."

*Mark Mobius, Executive Chairman
Templeton Emerging Markets Group*

Introduction

When an investor disagrees with company management on important substantive issues, they have three basic options:

1. They can maintain their investment and hope management's position proves to be the best (the "hold and hope" option).
2. They can sell their shares (the "sell and shrug" option). This is often referred to as the "Wall Street Walk." It is also sometimes described as "voting with your feet."
3. They can attempt to change the situation (the "push and prod" option).

Broadly speaking, the first two options are "passive" investment strategies, while the third is loosely referred to as "activism."

There is no doubt that when investors buy stock, under normal circumstances they delegate the making of business decisions to the board of directors and the management. But circumstances are not always normal. When management and the board make operational and strategic blunders, then what?

Shareholders invest in companies primarily because they are enticed by prospects of huge financial returns. As such, investing in a company is influenced by a number of factors, such as policy formulation, leadership, history of performance, dividend payout etc. If any of these factors are non-existent, potential investors are likely going to opt for other company stocks.

What is Investor/shareholder Activism?

Investor/Shareholder activism is the effort by the owner of equity capital to use voting power(embedded in their shares) to change the behavior of corporate management. It is the way in which shareholders can assert their power as owners of the company to influence its behaviour.

Investor activism is defined to include monitoring and attempting to bring about changes in the organizational control structure of a company not perceived to be pursuing shareholder-wealth-maximizing goals. The main objectives are:

- Establishing dialogue with the management on issues that concern you.

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- Influencing the corporate culture.
- Using the corporate democracy provided by law.
- Increasing general awareness on social and human rights issues concerning the organization. Internet and mass media are effective tools in building up pressure on the management.

It is about taking action or getting involved by asking questions, demanding accountability and offering suggestions by shareholders to management.

Active participation in company meetings is a healthy practice. Shareholders can ensure that the company follows good corporate governance practices and implements beneficial policies. They can resolve issues laid down in the annual and other general meetings. They can also raise concerns over financial matters or even social causes such as protection of the environment.

Shareholder activists include public pension funds, mutual funds, unions, religious institutions, universities, foundations, environmental activists and human rights groups.

Shareholder activism can take several forms such as proxy battles, publicity campaigns, shareholder resolutions, litigation and negotiations with management. The common method of activism is publicity campaigns. It is often invoked after proxy battles, negotiations and shareholder resolutions failed to achieve anything. Shareholder activism is good for shareholders return.

Shareholder activism, also known as shareholder advocacy, first gained momentum during the 1970s when religious investors formed a coalition (the Interfaith Center on Corporate Responsibility) to advocate for socially responsible changes in corporate policies.

What is the Subject of Shareholder Activism?

ProxyMonitor.org, a website sponsored by the Manhattan Institute's Center for Legal Policy has grouped shareholder proposals into three major categories:

- 1) Executive compensation. These proposals seek to increase shareholder power over managerial pay packages, including equity compensation plans, "golden parachutes" (payouts granted to executives in the event of a change in corporate control), or "golden coffins" (insurance-type payouts given to executives' estates in the event of untimely death).
- 2) Social policy. These proposals range from environmentalism to human rights, animal rights, and employment rights to corporate political activities. Like proposals concerning executive compensation, these proposals aim to change corporate actions directly. These proposals involve social or policy goals not related to the traditional concern of investors.
- 3) Corporate governance. These proposals typically seek to modify the rules for electing directors or for voting on other business (to enable shareholders to act outside the annual meeting process) or to separate the positions of chairman and chief executive officer. Unlike executive compensation or social policy efforts, these proposals are process-based: they seek to change the allocation of power among boards, management, and shareholders, rather than aiming to change a specific corporate policy or practice.



Types of Shareholder Activist

In “Here To Stay (Shareholder Activism)” an article by Robert Todd, Canadian Lawyer Magazine cites three types of shareholder activist as narrated by Emmanuel Pressman, co-chair of Osler Hoskin & Harcourt LLP’s mergers and acquisitions specialty group.

Value maximizers: These are the most common type of activists. This group consists of the more conventional shareholder activists, such as hedge funds, investors, and other value-drivers looking to get the most out of their investments. This group carefully examines the companies’ capital structures, balance sheets, stock prices, and conduct financial analysis. They might pile into a stock thinking that they can instigate change that creates more value. So these value maximizers are essentially looking for ways to enhance the value of their investments. They do so by attempting to put a company up for sale, encouraging a company to take on debt in a low-interest-rate environment in order to declare big stock dividends, or execute other recapitalization transactions. They may also simply take an opposing view to the business plan of the existing board, and seek to install those who represent their own views.

While value maximizers are the typical type of shareholder activists, it is important for the company to take a wider view of potential activists. Another group is of “corporate governance watchdogs.” This group will carefully examine how independent a board is and how executives are compensated.

Final category of shareholder activism is “corporate activism related to social responsibility and responsible corporate behaviour.” Again, all of those aspects have a significant impact on a company’s reputation. They are shareholders who are very concerned with how companies conduct themselves internationally, how they respect the environment, how their boards and management teams are represented as a matter of ethnic and gender diversity.

In a simplified language Shareholders can be categorized into:

- The advocates of governance reform. These are shareholders who are concerned with takeover policies, executive compensation, and the procedures for electing directors.
- *Social activists.* These are shareholders who are advocating for policies related to civil rights, environmental protection and labour standards.
- *Third type of activism* - targeting companies that are under performing are prompted and promoted to improve the good corporate governance practices.

Shareholder Activism by different Institutions

Financial markets contain many different investors. They all have strategies for maximizing returns; some of these strategies recognize activism as an important part. Still, many of them operate under different conditions and for this reason have diverse incentives to monitor targeted firms.

Some of the most important investors are discussed as under:

Mutual and Pension Funds

Mutual funds invest in companies for the purpose of achieving maximum return. The main intention is not to take an active role in the companies, but due to the high level of assets under management, these mutual funds are often forced to engage in monitoring of the companies. Contemporary pension funds show different forms of shareholder activism. Active involvement in target firms is present, not to mention litigation against companies acting outside the interests of shareholders (Wahal, 1996). But, even though institutional investors hold large



stakes in listed firms, they seldom participate in the most powerful forms of activism. Mutual and pension funds therefore rarely initiate takeovers, proxy fights, strategic voting, shareholder proposals and so on. Although these institutions own large stakes collectively, individually they are often limited to minority shares. This often makes the increase in return inadequate to pay for the monitoring.

Hedge Funds

Hedge fund activism is the subject of great attention in current literature. This is due to the fact that they face less regulatory barriers and conflicts of interest than traditional investors, and can therefore take a more active role. This can be seen in the fact that their demands are often far more drastic than usual activists, varying from board restructuring to public confrontations like shareholder proposals, lawsuits, and takeover efforts. By examining the structure of hedge funds one finds that funds engaging in activism are more probable to have longer lockups and withdrawal notification periods than other institutional funds which make their investments less liquid. This is in line with the proposal that reduced liquidity increases the incentives for active "Voice" activism by making its alternative, "Exit", more difficult. This means that they have an incentive to pursue longer-term strategies, namely engaging in order to increase value. They are also more focused on their objective and are unburdened by the politically-motivated agendas of many pension and mutual funds.

Labor Unions

Labor unions have diverted from their traditional role of passive ownership and investing in companies based on their openness to union activity. Today's labor unions have become aggressive investors, forgoing many ideological aspects in favor of maximizing return on capital. Theoretically, labor unions have a good standing position for activism due to their informational advantage. Their close ties with employees and the board, grant them insight into operations and give them the ability to gain inside information. Their monitoring benefit can also increase firm value by keeping management in line and reducing agency costs. This is done through the corporate voting course to push for diverse policy transformations, from redemption of rights plans and confidential shareholding to deciding management compensation.

Investment Companies

The core business of investment companies is to invest in listed companies with a good potential for increasing in value, and then through active ownership help to create value and to realize it in connection with a sale. The active ownership role requires considerable influence and means that the investment horizon is long term. An active investor perspective gives a good understanding of the holding companies' activities, environment and ongoing development. Work is conducted in a structured manner within the framework of three main processes. These are the processes of investment, active ownership and exit evaluation. The last one, exit evaluation, is what differentiates many investment companies from mutual and pension funds. Before targeting a company they have a clear goal when to make an exit. The main goal is to surpass the market index through active engagement. Investment companies operate in the same mode as hedge funds, with less legal barriers compared to mutual and pension funds. They have been involved in numerous engagements during the past few years. Much of the activism aims to improve financial figures, increasing dividends and achieving representation in the board.

Potential Advantages of Shareholder Activism

Individual shareholders generally do not have too much pull with management. That is because they may hold only a few hundred or few thousand shares, which is likely to be a relatively small percentage of the outstanding stock. However, collective approach makes the difference. As a result, management and the



board may be more willing to work for the benefit of shareholders. Activists can sometimes press for and/or demand certain changes from existing management. This in turn can make them work harder and force them to try to find ways to enhance stakeholder

Potential downside of shareholder activism is that when the activist investors decide to shed out the shares, it may logically place a significant amount of downward pressure on the share price.

It is claimed that the very presence of activists causes pressure upon management because they realize that they are being observed. In this way, activists play an important role for all shareholders of the firm working for the long-term value creation of the firm and for all investors.

CLASS ACTION SUITS

The concept of class action suits has been introduced for the first time in India, which would empower investors to sue a company for oppression and mismanagement and claim damages. This is a key weapon for individual shareholders to take collective action against errant companies. This acts as a deterrent for carrying out fraud. The law will allow shareholders' associations to take legal action against promoters and management through class action suits, a concept borrowed from developed economies.

Origin of Class Action

A class action suit is a lawsuit where a large group of people collectively bring a claim to court. The term "class action" owes its origin in the US law which is used to describe as sui generis area of litigation. While Indian law recognizes the concept of a representative suit, it has not, as opposed to the law in US, used the term or phrase class action to describe a sui generis area of litigation. In India, a representative suit may be instituted under the Civil Procedure Code, 1908 for the benefit of, or on behalf of, the interested parties. A similar concept has also been evolved by the Courts in India in the form of Public Interest Litigations and Social Interest Litigations.

Class Action is a well defined area of litigation in the U.S. The relevant provision for a class action is detailed under Rule 23 of the US Federal Rules of Civil Procedure. U.S. class action litigation can broadly be categorized into two different groups:

- a) Securities Class Action—instituted by shareholders involving violation of securities, regulations, accounting, fraud, etc.
- b) Consumer Class Action or Employee Class Action—instituted by a large number of consumers who suffer losses due to some illegal claims made by the companies, or those claims against illegal debt collection practices, unfair credit reporting, product liability, etc.

Shareholder class action in other countries

US-style class action does not exactly apply to Europe. On a generic basis, European jurisdictions allow class action to be pursued only by consumer associations rather than by individuals. This system is considered decisively superior than the US system, as it prevents entrepreneurial pursuits by law firms. Outside USA, Australia is a country where securities class litigation is widely prevalent.

Class Actions Suits in India

Need for class action suits was felt in India in recent past years. The concept of a class action by shareholders was also recommended, by the Dr. J.J. Irani Committee Report, which suggested that representative action may be initiated by one shareholder on behalf of one or more of shareholders, on the premise that they would all have the same locus standi to initiate an action against an erring company.



Indian investors suffered the most even though the fraud had happened in India. For the same company and same case, investors in the US had compensation but Indian investors did not get anything due to no similar provision in the Companies Act, 1956.

This lacuna has been sought to be addressed by the legislature while drafting of the Companies Act, 2013 and introducing the provision of class action by way of Section 245. Introduced for the first time in India, class action suits would empower investors to sue a company for oppression and mismanagement and claim damages. This is a key weapon for individual shareholders to take collective action against errant companies and acts as a deterrent for carrying out fraud.

Shareholders' associations may take legal action against promoters and management through class action suits. Salient features of the provisions in the new Act relating to class action are:-

- Specified number of member(s), depositor(s) or any class of them, may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the National Company Law Tribunal (NCLT) on behalf of members or depositors.
- Shareholders could directly approach the NCLT to seek relief on various issues and, inter alia, seek damages against company, its directors, auditors or advisors who have knowingly assisted in wrongdoings.
- Where members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.
- Order passed by the NCLT shall be binding on the company and all its members, depositors and auditors including audit firm or expert or consultant or advisor or any other person associated with the company. Non-compliance with directions and the orders of the NCLT would attract stringent penalties and imprisonment.
- In order to prevent frivolous litigations against the company and its personnel, several safeguards have been built into the law.

A class action, a class suit, or a representative action is a form of lawsuit in which a large group of people collectively bring a claim to court and/or in which a group of defendants is being sued.

Class-action lawsuits allow a large number of people with common interest in a matter to sue or be sued as a group. Sections 245 and 246 of the new Act contain these provisions. Under these, class-action suits may be filed by investors if they are of the opinion that the affairs of the company are being conducted in a manner prejudicial to the interest of the company, its shareholders or depositors.

Relevant Provisions in the Companies Act 2013

Clause 245 of the Companies Act, 2013 enables members and depositors or any class of them to file an application to the Tribunal (National Company Law Tribunal) on behalf of the members or depositors, if they opine that the management or affairs are being conducted pre-judicial to the interests of the Company.

Suit under Clause 245 may be filed by members or depositors or any class of them before the National Company Law Tribunal, if they believe that the management or conduct of the affairs of the company prejudices the interest of the company, its members or depositors.



Who can make an Application for Class Action?

Number of members required to file class action are:

1. In the case of a company having a share capital, more than one hundred members of the company or such percentage of the total number of its members as may be prescribed, whichever less is; or any member or members holding more than such percentage of the issued share capital of the company as may be prescribed. This is subject to the condition that the applicant or applicants has/have paid all calls and other sums due on his or their shares;
2. In case of a company without share capital More than one-fifth of the total number of its members.

Numbers of Depositors required to file Class Action

1. More than 100 in number or more than such percentage of the total number of depositors as may be prescribed, whichever is less, or
2. Any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.

Against whom action can be brought

The Act has brought the following individuals in the eyes of law, if their motives of the same were fraudulent, unlawful or wrongful act or omission or conduct on their part.

1. Directors by removing corporate veil
2. Auditors and auditor firm for any improper & misleading statement in the audit report.
3. An expert or advisor or consultant or any other person associated in this regard.

The power has also been given to the members and depositors to make an application for those actions which are yet to occur in the future, by the company. The order passed in this regard will be binding on the company, its members, depositors, auditors, advisors, consultants, experts and other persons associated with that aspect. If anyone fails to comply with the order, he will be liable to a minimum penalty of Rs. 5 Lakh but not more than 25 Lakh and in case of the officer of the company with an imprisonment of 3 years and with a penalty of minimum of Rs. 25 thousand but not exceeding Rs. 1 Lakh. The above mentioned provisions are not applicable to Banking Companies.

Impact of the Provision

On Stakeholders

- I. Stakeholders will definitely benefit with this provision. So far, filing a case of oppression and mismanagement was the only recourse available to aggrieved shareholders. Class action suit gives them additional rights and grounds to fight for their rights and any abuse of powers by the company, its management or for that matter even the auditor and consultant.
- II. Deposit holders, who had no option but to file a civil suit so far, can also take action against any wrongful act by the company or other specified persons. This should make them feel more secure about their investment.



- III. Including auditors and consultants of the company within the ambit of class action suit along with the company and its management provides additional empowerment to stakeholders to seek action against such person for specified wrong deeds. It will also ensure that experts, advisors and auditors of the company act carefully and diligently before advising the company and its management.
- IV. The facility to file suit through any person, group of persons or associations may also motivate NGOs and other activists to take up causes for the affected people.
- V. Likely to encourage faster action and speedy disposal of matters calling immediate attention.
- VI. Higher penalties and mandatory imprisonment, if proved wrong, would act as a deterrent to any fraudulent, unlawful or wrongful act or for any improper or misleading statement.
- VII. The provision to claim damages from the company or its directors and other specified persons for expenses of a class suit is a positive and encouraging move for stakeholders.

On Industry

1. For the corporate sector, class action means stakeholders will have more rights and powers to seek action against them.
2. At the same time, it will also ensure companies become more careful in their action and that actions are weighed for legal implications.
3. Since they can be sued in their individual capacity, companies can rely on their auditors, consultants, advisors or any others associated with the company to give more sound and accurate advice.

On Professionals

Professionals such as auditors, experts, advisors or consultants or any other persons associated with the company will exercise more independence, diligence and efficiency in their work.

Functions of Tribunal

The Tribunal while considering an application should take into consideration the following:

- a. Whether the member or depositor is acting in good faith in making the application for seeking an order;
- b. Any evidence before it as to the involvement of any person other than directors or officers of the company on the matters that the management or the affairs of the company is being conducted in a manner prejudicial to the interests of the company or its members or depositors.
- c. Whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section;
- d. Any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section;
- e. Where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—
 - i. Authorised by the company before it occurs; or



ii. Ratified by the company after it occurs;

f. Where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would likely to be, ratified by the company.

If the Tribunal admits an application, then the Tribunal shall also have regard to the following things:

- a. Public notice shall be served on admission of the application to all the members or depositors of the class in such manner as may be prescribed;
- b. All similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant's side;
- c. Two class action applications for the same cause of action shall not be allowed;
- d. The cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.

The order passed by the Tribunal shall be binding on the company, on all of its members, on depositors, on auditors and audit firm, it shall be binding on expert or consultant or advisor or any other person associated with company.

The company which fails to comply with an order passed by the Tribunal shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

If the application filed before Tribunal is found to be frivolous or vexatious, it shall for reasons to be recorded in writing, reject the application and make the order that the applicant shall pay to the opposite party such cost, not exceeding Rs 1 lakh, as may be specified in the order.

Conclusion

The introduction of class action suits is one of the major changes introduced by the Companies Act, 2013. The major objective behind the provision of class action suits is to safeguard the interests of the minority shareholders and to empower the investors. Class action suits may be undertaken as a redressal tool by minority shareholders having common interest for promotion of transparent corporate governance. Class action suits will be an apt platform for members and depositors to raise their grievances against the management of a company including directors, advisors, consultants, auditors etc for acts or omission that is prejudicial, to their interest.

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REBUILDING INVESTOR CONFIDENCE*

Introduction

Investment avenues are many and so it brings complexities and risks. Now and then some or the other innovative financial products is being launched and some of them are bizarre that investors fall in their trap and incur uncontrollable and irreparable financial losses. Now at sometimes these financial tremors are so severe (if at all they could have been measured under seismology), then one would appreciate the need for instituting measures aimed at building investors lost confidence, something resembling to building a complete city from debris. Now does it mean that investors should not pick any investment product? or they should simply close their eyes and ears and stop listening to various investment advises from doyens of finance? The answer is obviously a big 'NO', because incidents of financial frauds committed by various financial institutions does not mean that people should leave trusting financial system and its institutions. But the focal point is that ample measures or steps must be in place so that investors who have lost their moneys in various financial products, may be in the form of mutual funds, collective investment schemes, chit funds, debentures etc. is restored once again.

The Needed Path

Reconstruction of investor confidence can be traced to Sarbanes-Oxley Act, The Consistent Financial Reporting (England) Regulations 2003, IFRS and several other legislative initiatives which provided a mechanism in controlling corporate frauds and protect the interests of shareholders and investors.

In order to tackle the rising menace of corporate scams, now a day not only the corporate as an unit is scanned, rather every individual officer also witness dramatically higher personal fines and criminal sentences for misrepresentation on reports. Today the responsibilities are fixed with reference to certification of completeness and precision of periodic filings, thereby resulting in principal executives and financial officers to move cautiously by seeking assistance from disclosure committees and other management officials for ensuring accuracy of periodic filings before they sign such reports in the next level of certifications.

It can be said without an iota of doubt that without proper systems, controls, and procedures in place, companies risk facing a trade-off between accuracy and speed. In order to adhere with new and revised reporting requirements and to enhance investor confidence, companies are actively engaged in setting up of transparent financial reporting systems.

Investor Confidence Index

The year 2009, when investor confidence across the globe plummeted due to the onslaught of the global economic crisis, it was the time when investors across all strata were shying away from investing and were reluctant to embrace highly engineered and the so called lucrative investment products.

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ValueNotes, an independent market research company, was commissioned by J.P.Morgan Asset Management to conduct the survey. In order to construct the Investor Confidence Index (ICI), random sampling was used, wherein, retail investors (with a wallet size in excess of INR 200,000), corporate investors and financial investors were interviewed. The survey was conducted in July 2009, in eight cities across India: Delhi/NCR, Mumbai, Kolkata, Chennai, Ahmedabad, Bengaluru, Hyderabad and Pune.

The main objective of the ICI is to quantify confidence in the investment environment among investors and advisors. The ICI score was derived from responses to the following questions put forth before all target segments:

- 1) The probability of the Indian economic situation improving from current levels in the next six months.
- 2) The possibility of an improvement in the general investment market environment and atmosphere from the current levels in the coming six months.
- 3) The likelihood of the global economic environment improving from current levels in the coming six months.
- 4) The possibility of the BSE Sensex rising in the next six months.
- 5) The prospect of your/your client's investment portfolio increasing in the coming six months.
- 6) Expected increase or decline in the amount of investment and/or increase in mutual fund inflows in the coming six months.

Responses to the mentioned six questions also form the basis for deriving Retail Investor Confidence Index, Corporate Confidence Index and Advisor Confidence Index which were sub-indices of the Investment Confidence Index. At any given point, the indices can move from '0' to '200', with '0' indicating the most negative outlook, '200' showing full and absolute confidence and '100' depicting a neutral position.

Thus, ICI and its sub-indices are valuable tools to ascertain the magnitude of investor confidence but proper forecasting is demanded with reference to movement of BSE Sensex, the investment environment, probability of portfolio appreciation etc. as wrong or incomplete predictions/estimations for any of the variables mentioned about may result into misleading results.

The initiative of gauging investor confidence deserves applaud but efforts should be made to conduct such surveys on a more frequent basis as economic scenario changes quite often, thereby impacting the investor confidence on the financial market. Moreover, the questionnaire should be designed in such a manner that it could be easily understood by a literate investor as well as a not so literate investor. This is due to the fact that people who are not so financially literate also goes for huge investments. But since they do not possess in-depth knowledge about the financial avenues where they invest, i.e. nitty-gritty of the financial products, so they may not be in a position to provide suitable answers on the above mentioned parameters. Similarly, the surveyors while conducting the survey needs to put the complex questions in such simple terms so a layman may also understand what answers are expected from them.

SEBI & Investor Confidence

Confidence can be ensured among investors or in the scenario of lost confidence, the restoration of it is only possible when requisite investor protection measures are in place. As these measures instill a strong belief that their financial interests are safeguarded. Moreover, when securities market is thriving or financial institutions are



offering various exotic financial products, it becomes all the more important to lay due emphasis on investor protection. In this regard, it is worth to discuss some of steps initiated by SEBI (Securities & Exchange Board of India). Section 11(2) of the SEBI Act contains measures available with SEBI to implement the legislative intent of investor protection. The measures available with SEBI are as follows:

- (a) Regulating the business in Stock Exchanges (SEs) and any other securities markets.
- (b) Registering and regulating the working of intermediaries such as stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisors etc. associated with securities markets.
- (c) Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and other intermediaries.
- (d) Registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds.
- (e) Promoting and regulating self-regulatory organizations.
- (f) Prohibiting fraudulent and unfair trade practices with reference to securities markets.
- (g) Preventing insider trading in securities
- (h) Regulating substantial buying/acquisition of shares and takeover of companies.
- (i) Encouraging investors education and training of intermediaries of securities markets.
- (j) Carry out inspection/ audits of the SEs/ intermediaries etc.
- (k) Call for information from any bank/ any authority/ corporation/ agencies in regard of any transaction in securities which is under investigation by SEBI.
- (l) Performing such functions and exercising such powers under the Securities Contracts (Regulation) Act, 1956 (SCRA).
- (m) Levying fees or other charges
- (n) Conducting research
- (o) Performing such other functions as may be prescribed.

Apart from the above mentioned measures, there are other measures that have been initiated by SEBI for re-building of investor confidence comprises of, (a) Action against Directors of Vanishing Companies, (b) Investor Awareness Campaign, (c) Anchor Investors, (d) Listing of unlisted firms, (e) Issue of shares with superior voting rights, (f) Designing of advertisements focusing upon “dos and don’ts” regarding various aspects of securities market, (g) Preparation of educative materials, (h) Website dedicated to investor education etc. Brief discussion on some of the key points are as follows:

- a) *Action against Directors of Vanishing Companies* : With the passage of time emergence of Vanishing companies has sent tremors to the faith of investors. In order to ensure that such cases do not recur in future, SEBI has constituted a committee for examining and exploring different courses of action such as including authenticated photographs, passport numbers, PAN number etc. of the promoters/directors at the time of incorporation and in the prospectus along with supervising of the end use funds.



- b) *Investor Awareness Campaign* : SEBI have laid due emphasis on educating and informing the small investors which is clearly visible from the motto that 'An informed investor is a safe investor'. It has made endeavors to organize investor conferences, melas, seminars, union budget meetings and public meetings for small investors across India.
- c) *Anchor Investors* : With a view to create a significant impact on pricing of initial public offers, Securities and Exchange Board of India introduced the concept of "anchor investor" in public issues. The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 notified in August 2009 also contains a similar provision of anchor investor. Anchor investor means a qualified institutional buyer making an application for a value of ten crore rupees or more in a public issue made through the book building process in accordance with ICDR Regulations.

Under the new rules, the anchor investor will pay 25% of the total investment at the time of applying for the IPO, and the other 75% within two days of the closure of the issue. An anchor investor will have to invest a minimum of Rs1 billion and "no person related to the promoter, promoter group and book running lead managers can apply as anchor investor". Further, such an investor must adhere to a lock-in period of 30 days from the date of the share allotment.

Bidding for the anchor investor category opens one day before the bidding for other investors. Further, according to SEBI, for IPOs only qualified institutional buyers are eligible to be anchor investors and receive up to 30% of the portion reserved for qualified institutional buyers. SEBI has further added that the anchor investor will be required to bring in the additional amount if the price at which it has allotted shares, is lower than the price derived through the book-building route that qualified institutional buyers have. However, the anchor investor does not get money refunded if the book-built price is lower than the price at which the anchor investor is allotted shares.

- d) *Listing of Unlisted firms*: SEBI has made it compulsory for an unlisted company making an IPO to list the securities on at least one stock exchange with nationwide trading terminals. This is to provide a liquid trading platform to investors in securities of the company.
- e) *Advertisement*: SEBI has prepared in lucid language the "dos and don'ts" for investors regarding various facets of the securities market. By 2012 over 700 advertisements pertaining to various characteristics of securities market have found place in 48 different newspapers/magazines, covering nearly 111 cities and 9 regional languages, apart from English and Hindi.

Class Action Suites - Reviving Lost Hopes

'Contrary to the Bible, when David takes on Goliath in the real world, Goliath almost always win'. An example will clarify the mentioned phrase and in understanding the concept of Class Action Suites. Suppose an investor Mr.A purchased stock in Enron back in the late 1990s, believing it was one of the most successful and innovative energy companies in the globe. When the company failed in 2001 after evidence of substantial accounting fraud, the stock portfolio of Mr.A plunged, the question arises that whether Mr.A can sue Enron? Definitely, but it may happen that the cost of litigation may surpass the amount lost due to fall in value of the portfolio. Then what is the way out? Should Mr.A remain silent and relax or can he fight back? Now one thing is sure that the collapse of Enron has not only caused damage to Mr.A but an army of investors. So if the whole group of investors come together and sue Enron together it will become a Class Action Lawsuit. In this context, a class is any group of people who are claiming similar inquiries or damages from the same company or organization. And it works, as a class comprising of duped Enron investors settled its lawsuit for \$7.2 billion.



Class action lawsuits are a civil litigation “device”. Civil law, as opposed to criminal law, deals with private disputes where one party accuses the other of injury (physical, psychological, emotional or financial) and sues for damages. A class actions is considered a device of civil litigation as it doesn’t amend the rules of civil law, it simply permits parties to sue over the same legal grounds.

Mediation & Conciliation Panel (Section 442) - A Speedy Redressal Mechanism

In the Companies Act, 2013, the provision for Mediation and Conciliation panel have been provided for which will comprise of experts called as “Mediation and Conciliation Panel” for mediation between the parties during the pendency of any proceedings before the Central Government or the Tribunal or the Appellate Tribunal.

Any of the parties to the proceedings may apply for referring the matter relating to such proceedings to the Mediation and Conciliation Panel. The Central Government or the Tribunal or the Appellate Tribunal before which any proceeding is pending may suo motu refer any matter regarding such proceeding to the Mediation and Conciliation Panel.

After receiving application for referring the matter to Mediation and Conciliation Panel, the Central Government or Tribunal or the Appellate Tribunal, as the case may be, shall appoint one or more experts from such panel.

The matter is required to be disposed off within a period of three months from the date of such reference. The panel is required to send its recommendations to the Central Government or Tribunal or the Appellate Tribunal, as the case may be, within that period.

Thus, the mechanism of Mediation & Conciliation will definitely provide the needed pace in redressing the investor grievance.

IEPF – A New Sunrise for Investors

Financial literacy allows the investors to fully appreciate opportunities and associated risks, take informed decisions and participate actively in the economic growth of the country by converting savings into investments.

Investor Education and Protection Fund (IEPF) has been established under Section 125 of the Companies Act, 2013 (Section 205C of the Companies Act, 1956) for promotion of investors’ awareness and protection of the interests of investors. This section provides that the following will be credited to the IEPF :

- a) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;
- b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;
- c) the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub-section (5) of section 124;
- d) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;



- e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;
- f) the interest or other income received out of investments made from the Fund;
- g) the amount received under sub-section (4) of section 38;
- h) the application money received by companies for allotment of any securities and due for refund;
- i) matured deposits with companies other than banking companies;
- j) matured debentures with companies;
- k) interest accrued on the amounts referred to in clauses (h) to (j);
- l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;
- m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years

Provided that no such amount referred to in clauses (h) to (j) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment.

Utilisation of Fund

Section 125 stipulates that the IEPF shall utilise the fund as under :

- a) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;
- b) promotion of investors' education, awareness and protection;
- c) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;
- d) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal

The MCA has a website www.iepf.gov.in and in order to keep the investors posted with latest information pertaining to key elements of financial markets, MCA updates the information on following items on regular basis on this website so that investors are well informed about recent developments, thereby make prudential investment decisions and safeguard their legitimate rights: (a) Role of Capital Market, (b) IPO Investing, (c) Mutual Fund Investing, (d) Stock Trading, (e) Depository Account, (f) Debt Markets, (g) Derivatives, (h) Indices, (i) Indices (Cosmic Strip), (j) Index Funds, (k) Investor Grievances & Arbitration (SE), (l) Investor Rights & Obligations and (m) Dos and Don'ts.

RBI (Depositor Education & Awareness Fund) Schemes, 2014

An important initiative of Reserve Bank of India towards educating the depositors is the formation of Depositors Education & Awareness Fund Scheme (DEAF). Education is essential, as if a person is not aware of his/her legitimate rights then he/she will be vulnerable to various misuses and will be unable to recover the financial loss he/she incurs. In this direction, DEAF is a vital step, as it is proposed to be utilized for promotion of depositors' interest and such other purposes which may be essential for promotion of depositors' interest as may be specified by the Reserve Bank. In order to ensure proper operation of this fund, there is a committee which will look into the administration of the fund and shall exercise all powers on behalf of the fund, including incurring of all expenditures that may be charged to the fund, and keeping the corpus of the fund invested. One



of the important feature of this fund is that for the promotion of depositors' interests, the committee may register /recognize from time to time various institutions, organizations or associations, involved in activities regarding depositor awareness and education, including those proposing to conduct programs for depositors of banks, organizing seminars and symposia for depositors and undertaking of projects and research activities pertaining to these areas.

Role of ICSI in Investor Protection

The Investor's interest is of paramount importance in current economic scenario. Regulators are also focusing on the development of a fair, transparent and efficient capital markets having a participative, enlightened and informed investor. Concerted efforts are being made globally towards financial literacy.

Investor education and awareness is one of the core activities of the Institute towards promoting good corporate governance. In this direction, the Institute has partnered with Ministry of Corporate Affairs, SEBI and Stock Exchanges in organizing investor awareness programmes and seminars through its various Regional Councils/Chapters.

The Institute is registered under the Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001 since 2005 and has organized more than 3100 Investor Awareness Programmes under IEPF through Regional Councils, Chapters and Resource Persons.

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