Balancing Objectives of Financial Regulation – Development, Regulation & Investor Protection

Presented by-

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Framework before 1992

- Capital Issues Control Act (CCI)- 1947
- Companies Act, 1956
- Securities Contract (Regulation) Act, 1956

  Stock Exchange Division- Ministry of Finance
- UTI Act and Public Sector MFs by RBI

- The Economic Survey of 1992-93 mentioned, *“…the process of reforms needs to deepened to bring about speedier conclusion of transactions, greater transparency in operations, improved services to investors, and greater investor protection while at the same time encouraging corporate sector to raise resources directly from market on an increasing scale. Major modernisation of the stock exchanges, to bring them in line with world standards in terms of transparency and reliability, is also necessary, if foreign capital is to be attracted on any significant scale.”*

Statutory Independent Regulatory Agencies

- With initiation of process of economic liberalization in the early 90s government withdrew from many activities which, hitherto were monopolized by it.
- Entry of the corporate sector necessitated certain measures to boost the investor competence and to safeguard public interest.
- A market based economy needs to be regulated in order to ensure a level playing field to all and also to safeguard the larger public and national interest.
- Increasing complexities and advancement of technologies required handling of issues by experts.
- Public interest is best served by insulating decision making in certain issues from political interference.

New Regulatory Framework

- SEBI is established as an Independent Statutory Regulatory Body.
- Objectives:

  Regulatory
  - To protect the interest of investors
  - To regulate the Securities Markets

  Developmental
  - To promote the development of Securities Markets

- Giving market greater role in shaping resource allocation.

- Merit to Disclosure.

- SEBI’s role is purely facilitating development of securities market through enabling framework.
- SEBI does not establish market infrastructure like RBI which established market infrastructure such as Clearing Corporation of India (CCIL), financial institutions such as NABARD (National Bank for Agriculture and Rural Development), NHB (National Housing Bank) etc.

Reforms and changes brought about by SEBI

Few Changes & reforms broadly discussed here-

- Increasing efficiency of financial markets
- Penetration of Mutual Funds
- Raising of Capital by Corporates
- Development of Bond markets & Infrastructure financing
- Alternative Investment Funds
- Financing of new-age tech companies

Increasing efficiency in financial markets

- Electronic trading (initiated in 1994).

The floor based or ‘open outcry’ trading lacked price-time priority and also lacked anonymity. The price and volume was not transparent to all the market participants except for the brokers who were market makers. The price discovery was inefficient and non-transparent resulting in malpractices.

The electronic trading provided a a nation-wide order-driven trading system allowing brokers to provide terminals in smaller cities and reaching every nook and corner of the country.

Increasing efficiency in financial markets

- Dematerialization of securities (initiated in 1998).

Transfer of physical securities took 3 months.

Dematerialisation removed inefficiencies due to bad deliveries, theft, forgery, mutilation, loss of share certificates, delayed settlements leading.

The Companies (Amendment) Act, 2000,

Mandated that every IPO in the excess of Rs. 10 Crores (100 million) has to be issued in demateralised form.

From April, 2019- only shares in dematerailsed form can be traded in the secondary markets.

Demutualization of stock exchanges (1994)

- National Stock Exchange (NSE) was one of the first demutualized Stock Exchange in the world set up financial institutions in 1994.
- Subsequently, Bombay Stock Exchange (BSE) was demutualized in 2005.

Increasing efficiency in financial markets cont..

- Trading Cycle

  (account period settlement)

  1990s – 14-30 days for settlement

  (rolling period settlement)

  2001 – T+5

  2002 – T+3

  2003 – T+2

  Moving forward – T+1 (2022)

- Clearing corporation (commenced operations in 1996).

  It is the counterparty to the net obligations of each brokerage firm.

  Settlement Guarantee Funds (SGF) was established to guarantee settlement of trades irrespective of default by brokers.

  2014-15: SGF was refined implementing Core SGF (readily available to meet settlement obligations), Default Waterfall and Stress testing.

Continuing efforts for increasing efficiency in financial markets

Pledge re-pledge system for stocks w.e.f August 01, 2020.

Earlier, clients had to transfer securities from his account to the broker’s account for obtaining margins.

In the pledge re-pledge system, the stocks don’t leave the investor’s demat account, instead a pledge is marked in favor of the broker. The broker is required to open a separate demat account labelled ‘TMCM – Client Securities Margin Pledge Account’ for this purpose (TMCM stands for Trading Member Clearing Member). The broker then re-pledges these securities in favour of the Clearing Corporation and obtains margins.

Brokers cannot misuse client securities.

Growth & Penetration of Mutual Funds

- Private sector mutual funds were allowed in 1993.
- Mutual Funds (MFs) mainly invest in transferable securities
- MFs are not allowed to borrow for investments except for meeting redemption requirement (to the extent of 20% of AUM of a scheme)
- MFs are not allowed to lend funds.
- Investment restrictions-issuer, sectoral
- Transparency through portfolio disclosures - equity monthly and debt fortnightly, commission disclosures, daily NAV declaration, etc.
- Investments in derivatives mainly for hedging & portfolio balancing
- Variable NAV & not constant NAV /assured return barred

Growth & Penetration of Mutual Funds

- Assets Under Management has increased by USD 91.74 billion from USD 424.68 billion as on December 31st, 2020 to USD 516.43 billion in December, 2021.

- 423.84 billion to USD 519.05 billion in the same period. The number of Folio has increased by 25,871,098 from 94,335,478 to 120,206,576 in the same period.

- Rs. 113.5 billion (approximately $151.8 million) collected as Monthly Systematic Investment.

- 20 New Fund Offers in December, 2021 which collected Rs. 206.16 Billion.

MFs as Countervailing force to FPI

- In the past five years, the cumulative Mutual Fund SIP inflow was Rs 4.9 lakh crore (49000000000 Billion), 1.6 times higher than the flow of foreign portfolio investors (FPIs).

Yearly Flows

	SIP	FPI
2017	59,482	51,253
2018	88,607	-33,013
2019	98,612	1,01,120
2020	97,033	1,70,260
2021	1,14,012	26,951
Cumulative 5 years	4,57,746	3,16,571

(Fig in ₹crore) Source: AMFI, NSDL, compiled by ETIG

Raising of Capital

- Through IPOs governed by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018. (ICDR)

Raising of Capital

Regulation 6(1) of ICDR	Regulation 6(2) of ICDR
By companies having track record in preceding three years- Net tangible Assets worth Rs. 30 millions Average operating profit of at least Rs. 150 millions Net worth of Rs. 10 millions	By Companies without track record as given in Regulation 6(1) of ICDR. IPO can be made only if the issue is made through book-building process and the issuer undertakes to allot 75% of the net offer to qualified institutional buyers.

- Indian IPOs hit record high of approximately $16.6 billion in 2021 more than 4 times the amount raised in the previous year.

- The number of such offerings also grew 172.7 per cent Year on Year.

IPOs by companies under Regulation 6(2) ICDR (without track record) from January 1, 21- November 30, 21

Sr. No.	Name of the issuer	Date of Listing	Issue Price (in Rs.)	Listing Price (in Rs.)	Closing Price on December 15, 2021 (in Rs.)
1	STOVE KRAFT LIMITED	5-Feb-21	385	467	1019.5
2	Nureca Limited	25-Feb-21	400	634.95	1462.4
3	Easy Trip Planners Limited	19-Mar-21	187	206	587.35
4	Nazara Technologies Limited	30-Mar-21	1101	1971	2400.45
5	BARBEQUE-NATION HOSPITALITY LIMITED	7-Apr-21	500	492	1446.1
6	Sona BLW Precision Forgings Limited	24-Jun-21	291	302.4	796.7
7	Krishna Institute of Medical Sciences Limited	28-Jun-21	825	1008.9	1321.4
8	Zomato Limited	23-Jul-21	76	115	140.6
9	Devyani International Limited	16-Aug-21	90	141	185.4
10	Krsnaa Diagnostics Limited	16-Aug-21	954	1025	675.85
11	Chemplast Sanmar Limited	24-Aug-21	541	525	561.65
12	FSN E-Commerce Ventures Limited	10-Nov-21	1125	2001	2128.8
13	Fino Payments Bank Limited	12-Nov-21	577	548	396.15
14	PB Fintech Limited	15-Nov-21	978	1150	1119.55
15	Sapphire Foods India Limited	18-Nov-21	1180	1311	1188
16	One 97 Communications Limited	18-Nov-21	2150	1955	1379.95
17	Latent View Analytics Limited	23-Nov-21	197	530	601.75
18	Go Fashion (India) Limited	30-Nov-21	690	1316	1148.1

Superior Voting Rights

- Companies with SVR Shares are required to have a minimum of two-thirds of independent directors on all committees except the audit committee, which must consist of only independent directors.
- Coat - tail provisions: Post-IPO, the SVR shares shall be treated as ordinary equity shares in terms of voting rights (i.e. one SVR share one vote) in the following circumstances:
- provisions relating to appointment or removal of independent directors and/or auditor;
- in case there is a change in control of the company;
- any contract or agreement of the company with any person holding the SVR shares, in excess of the materiality threshold prescribed under Regulation 23 of the SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015 ("LODR Regulations");
- voluntary winding up of the company;

Superior Voting Rights contd..

Sunset provisions have also been introduced, based on-

- validity (with SVR Shares having a five year validity period, which can be extended by a resolution on which holders of SVR Shares are not entitled to vote)

- specific events (death of the shareholder, resignation from office, relinquishing of control, etc.)

New rules for IPOs (December 28, 2021)

Old rule	New Rule
No requirement to earmark funds raised for acquisitions, and/or for routine investments.	If no acquisition or investment target is identified, there is a 35% spending cap on the total funds raised in the IPO 25% spending cap for acquisition of an unidentified target
35% of the IPO was earmarked for Non-institutional investors (NIIs).	1/3rd of the portion available to NIIs to be reserved for IPO application size of Rs 0.2-1 million.

New rules for IPOs cont…

Old rule	New Rule
No cap on sale of shares by existing shareholders	Existing shareholders holding more than 20% shares cannot offer more than 50 % of their shares in an IPO. Existing shareholders holding less than 20% shares cannot sell more than 10 % of their shares.
All anchor investors are locked-in for a period of 30 days from the date of allotment.	Anchor investors can only sell 50% shares after the 30-day lock-in, and the remaining shares have a lock-in of 90 days from the date of allotment.
Price band was at the discretion of the issuer	Upper price band has to be at least 105 percent of the lower price band

New rules for preferential allotment

Old rule	New Rule
Floor price was required to be the higher of the volume weighted average price (VWAP) of the last two weeks or the last 26 weeks.	Floor price is required to be higher than the VWAP of the last 90 days or 10 days.
In case preferential allotment leads to change in control or more than 5% shares are offered through preferential allotment no valuation report from a registered independent valuer is required.	The new rule mandates valuation report from a registered independent valuer in such cases.
Utilisation of IPO proceeds is not monitored by rating agencies	Utilisation of IPO proceeds to be monitored by rating agencies.

"SEBI Reforms On Preferential Allotment: Both Facilitative And Protective"- BloombergQuint Opinion, Umakanth Varottil, January 17, 2022

Development of Bond Markets
In 2008, the total amounts raised through bonds was approximately $34.3 billion

Electronic book provider (EBP) mechanism for issuing debt securities.

- More than 90% of the corporate bond issuances happen on private placement basis.

- Historically, the private placements of debt securities were usually negotiated by the issuers directly by issuers with investors such as Qualified Institutional Buyers (QIBs) /HNIs or placed through arrangers over-the-telephone market and then listed on stock exchanges.

- It is usually post listing that many investors get to know about the more granular details of the issue. Thus, this mechanism lacked transparency, was time consuming and hence not an efficient way to discover price.

EBP platform contd..

- On April 21, 2016, SEBI introduced a framework for issuance of debt securities on private placement basis which are subsequently proposed to be listed through an Electronic book provider (EBP) platform with an aim to provide an efficient way of price discovery and more transparency by disseminating bidding data.

- EBP platform is a web-based portal for online bidding and allotment of debt securities on private placement basis in primary market.

- For issuers of debt securities/NCRPS/municipal bonds, intending to raise funds on a private placement basis, if the issue size is above Rs.200 crore including green shoe option, they have to mandatorily come through this EBP platform.
- SEBI has permitted the recognised Stock exchanges to provide this platform.

Funds raised through Bonds

	2018-19 amount raised in Rs.cr	2019-20 amount raised in Rs. Cr.
Public issues	36,679.36	14,984.02
Private placement	610,317.61	674,702.88

Over the next five fiscals, corporate bond issuances othstanding could more thatn double from 16 per cent of gross domesting product (GDP) at the end of fiscal 2020 to 22-24 per cent of GDP - by the end of fiscal 2025 - Crisil Debt market survey, 2021.

Request for Quote (RFQ) platform

- RFQ platform of the Stock Exchanges is meant for market participants who would like to negotiate transactions in debt securities amongst themselves.

- RFQ platform reduces information asymmetry by providing information about bonds, term sheets, pricing, market quotes etc. to all market players to trade in securitized debt, bonds, commercial paper, treasury bills and government securities.

- From December, 2021 Mutual Funds have to undertake a minimum of 25% (up from 10%) of their total secondary market trades by value in corporate bonds on the RFQ platform of stock exchanges.

- Mutual funds would also have to undertake a minimum of 10% of their total secondary market trades by value in commercial papers by RFQ platforms.

InvITs

- Infrastructure investment trusts (InvITs) allow developers to monetise income-generating infrastructure assets and enable investors/unit holders to invest without actually owning these assets.
- The move is aimed at increasing private participation in infrastructure sector in India.
- Regulated under SEBI (Infrastructure Investment Trusts) Regulations, 2014.
- Total Assets: Approximately $42,818 million.

Funds raised by InVITs

Sn.	Name of entity	Structure	Total Unit capital (USD mn)	Approx asset value (USD mn)
1	IRB INVIT Fund	Public listed	800.15	981.08
2	India Grid Trust	Public listed	896.72	1,919.46
3	Indinfravit Trust	Privately placed listed	895.07	1,430.81
4	India Infrastructure Trust	Privately placed listed	897.30	1,029.46
5	Oriental Infra Trust	Privately placed listed	787.94	1,738.92
6	Tower Infrastructure Trust	Privately placed listed	3,407.43	3,177.16
7	Digital Fibre Infrastructure Trust	Privately placed unlisted	2,634.41	26,073.65
8	IRB Infrastructure Trust	Privately placed unlisted	1,155.46	2,823.38
9	National Highways Infra Trust	Privately placed listed	812.37	994.92
10	Powergrid Infrastructure Investment Trust	Public listed	1,229.73	1,403.38
11	SHREM InvIT	Privately placed listed	527.66	876.88
12	Virescent Renewable Energy Trust	Privately placed listed	271.62	369.39
	InvIT Total		14,315.87	42,818.48

Alternative Investment Funds (AIFs) (started in 2011)

- Category I AIF:

Venture capital funds (Including Angel Funds)

SME Funds

Social Venture Funds

Infrastructure funds

- Category II AIF – AIFs which do not fall in Category I and III, such as real estate funds, private equity funds, funds for distressed assets, etc.

  (Account for approximately 80% of Industry assets)

- Category III AIF – AIFs which employ diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives, such as hedge funds.

Salient Features of AIF Regulations

- Minimum investment by an investor- USD 0.17 mn (INR 1 crore)
- Minimum corpus – USD 3.33 mn (INR 20 crore)
- Not more than 1000 investors
- Schemes may be launched under an AIF subject to filing of information memorandum with the Board along with applicable fees.
- Listed/Unlisted Regime
  - Category I AIFs
    - VCFs shall invest at least two-thirds of the investible funds in unlisted securities
    - Others shall invest at least 75% of the investible funds in unlisted securities
  - Category II AIFs shall primarily invest in unlisted securities
  - Category III AIFs may invest in securities of listed or unlisted investee companies or derivatives or complex or structured products

AIFs assets stood at approximately Rs. 5.3 trillion in December, 2021

- Mandate of development & regulation & do not necessarily lead to conflict.
- Development and regulation reinforces each other.
- Development leads to investor protection.
- Regulation leads to development of market.

- What are the necessary conditions for that-
  -Regulators should be independent of industry
  - Regulators should avoid regulatory capture

Markets develop faster with reform by the regulators rather than leaving it to the market alone.

Now technological changes and competition is accelerating the deepening of the market

Thank you