Submission of Comments to the Securities and Exchange Board of India (SEBI)
on

1. Background

The Securities and Exchange Board of India (SEBI) has proposed amendments to the regulations framed under the SEBI Act, 1992 with a view to impose restrictions on wilful defaulters from accessing the capital market. In line with the recommendations of the Financial Sector Legislative Reforms Commission (“FSLRC”) pertaining to framing of regulations, SEBI has invited comments from the public on draft recommendations proposed in this regard.

Consumer Unity & Trust Society (CUTS, www.cuts-international.org) is a vigilant institution working in the area of economic regulation, financial sector, consumer protection, competition, trade, and investment since last 30 years.

2. Comments / Suggestions

CUTS’ comments on the proposed amendments to the regulations framed under the SEBI Act, 1992 are as under:

• General comments / suggestions

SEBI has not specifically defined “Wilful Defaulter”. The definition of the ‘Wilful Defaulter’ as per the RBI’s regulation is based on the assertion of default in meeting the payment / repayment obligations to the lender. Therefore, the RBI regulations are framed as tailor-made for any default by borrowers in meeting their financial obligations in relation to borrowings from banks and financial institutions.

Without prejudice to the above, RBI regulations on ‘wilful default’ provides non-state actors such as commercial banks the ability to exercise the coercive power of the state, without adequate checks and balances. So, if a particular bank / financial institution determine a default as ‘wilful’, the defaulter (as aforesaid) is barred from availing credit facilities from banks and financial institutions as well. ¹

At present, as per SEBI Regulation², no issuer shall make public issue or right issue of specified securities, if the issuer of convertible debt instrument is in the list of wilful defaulter published by the RBI. Thus, access to the capital market is subject to the wilful defaulter’s policy set out under the

² Regulation 4(2) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
banking laws. Thus, while steps should be taken to safeguard the interest of the secured creditors, this should be grounded on the foundations of liberal democracy. The proposed SEBI regulations intend to extend such restriction to raising of funds from equity markets as well, merely on the basis of determination of ‘wilful default’ by a non-state actor.

“The wisdom of letting a non-state actorsuch as a commercial bank to trigger serious civil consequences (for a wilful defaulter) needs a review.”

Considering the above, it is advisable that before tagging a defaulter as ‘wilful’, there should be a judicial mechanism to review the nature of the default and RBI being banking sector regulator, should also ratify the same, after giving adequate opportunity to the relevant parties of being heard and being able to also place their arguments, as to why they should not be declared as “wilful defaulter”. Thus, it is important to ensure that the review must be even handed, so that the defaulters are not subjected to the arbitrary exercise of power. Separately, SEBI could specifically define who would qualify as the ‘Wilful Defaulter’, in accordance with the provisions of the SEBI (ICDR) Regulations, 2009, by specifying conditions in addition to those specified by the RBI, to restrain the perpetrator from raising funds from capital market since the nature and scope of both regulators is different.

- Specific comments / suggestions

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<th>S.No</th>
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<th>Proposed/suggested changes</th>
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<td>1.</td>
<td>Recommendation 1</td>
<td>Substitute the words “its promoter, group company or director of the issuer” with “person or persons under whose actual control the issuer is”</td>
<td>In accordance with the SEBI (ICDR) Regulations, 2009, promoter includes the person or persons who are in control of the issuer, or are instrumental in the formulation of a plan or programme pursuant to which specified securities are offered to the public, or named in the offer document as promoters. This is detrimental on the issuer company as well as investors because tagging someone as ‘wilful defaulter’, whose name is merely mentioned in the prospectus as ‘promoter’ or who is involved in the formulation of plan</td>
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4 Regulation (2)(1)(za) of the SEBI Regulations
for public issue, disqualifies the company from making public issue, unless such person is actually controlling the issuer.

Similarly, the ambit of “group companies” as per the SEBI (ICDR) Regulations, 2009 is wide enough to include companies, firms, ventures, etc. promoted by the promoters of the issuer. This means that any entity promoted by the promoters of the issuer company would come under the purview of this regulation and accordingly, will be barred from raising funds from the securities market.

As regards director of a wilful defaulter company, Hon’ble Gujarat High Court held that declaration of all directors of a company as wilful defaulters is unconstitutional. The reasoning given in the order was that inclusion of all such directors in the list of wilful defaulters poses serious implications on the ability of such directors (who may not be involved in the day-to-day management of such wilful defaulting company) to float new ventures and be involved in other ventures. Further, all such directors cannot become directors in any other company as banks and financial institutions cannot grant loans to a company having a person as director who has been declared as wilful defaulter.

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6 In the case of Ionic Metalliks vs. Union of India
Consequently, the suggested words should be substituted so as to enable genuine companies to raise funds and restrict only such companies which might be used as a conduit by, persons who are controlling it, for bypassing RBI regulations.

| 2. | Recommendation 2 | 1. Substitute the words “its promoter, group company or director of the issuer” with “person or persons under whose actual control the issuer is”. 2. Add the words “for a period of more than six months”, after the words “or repayment of principal amount” | 1. For rationale, please refer Point No. 1 above. 2. The draft amendment to the regulations mentions that if the issuer company is in default of payment of interest or repayment of principal amount in respect of debt instruments issued by it to the public, it shall not make a fresh public issue of debt securities. As per the SEBI (Issue and Listing of Debt Securities) Regulations, 2008\(^7\), where the issuer has defaulted in payment of interest on debt securities or redemption thereof or in creation of security as per the terms of the issue of debt securities, any distribution of dividend shall require approval of the debenture trustees. Further, there is a disclosure requirement on the part of debenture trustees to the investors and general public by |

\(^7\) Regulation 16(2) of the SEBI (Issue and Listing of Debt Securities) Regulations, 2008
issuing a press release in case of such default in accordance with SEBI Regulations. Despite of having such restrictions, the draft SEBI regulations propose to impose additional burden on the issuer, by restricting access to capital markets, which could be disproportional.

The SEBI (ICDR) Regulations, 2009 currently provide that in case of default of payment of interest or repayment of principal amount in respect of debt instruments issued to public, for a period of more than six months, an issuer is restricted from making public issue of convertible debt instruments. It is suggested that a similar time period be inserted in the proposed SEBI regulations.

| 3. Recommendation 3 | 1. Substitute the words “its promoter, group company or director of the issuer” with “person or persons under whose actual control the issuer is”.  
2. Add the words “for a period of more than six months”, after the words “or repayment of principal amount” | For rationale, please refer Point No. 1 and 2 above. |

| 4. Recommendation 4 | 1. Substitute the words “its promoter / group company / director of the issuer” with “person or persons under whose actual control the issuer is” | 1. For rationale, please refer Point No. 1 above. |

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8 Regulation 23(5)(a) of the SEBI (Issue and Listing of Debt Securities) Regulations, 2008
2. Substitute the words “right issue” with “right issue provided the right is not renounced”.

2. The draft recommendation allows the listed companies / its promoter / group company / director of the issuer categorized as ‘wilful defaulter’ to raise funds via right issue.

Without prejudice to point no. 1 (of S.No. 4), it appears that SEBI intends to protect only new investors from risking their money by permitting raising of funds under right issue. However, it should be kept in mind that the key feature of right issue is “rights renunciation”, wherein the shareholder can renounce his / her rights entitlement, in part or full. There may be a situation when the existing shareholder renounces his / her right in favour of some other person, which could be prejudicial to the interests of that other person, resulting in bypassing the restrictions intended by the proposed SEBI regulations.

As a result, the suggested words should be substituted in the proposed regulation.

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above.

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