National Conference
Capital Market: Frauds and Malpractices

10 October 2013
What has IiAS looked at?

1. Accounting frauds
2. Broker-Operator-Promoter nexus
3. Demat scams
4. GDR frauds
5. Insider trading
6. IPO frauds
7. Market manipulation
8. Misleading disclosures
9. Mis-selling ULIPS
10. Ponzi schemes
11. (Unfair) buy-backs
12. Violation of takeover guidelines
13. Regulatory authorities
Summary findings

• Frauds occur with alarming periodicity
  – You cannot regulate against fraud, but try minimize its deleterious impact
• Historically, scams have led to (regulatory) reforms, including forming institutions and strengthening the institutional framework
• Increased co-ordination between the various regulators is imperative to ensure perpetrators do not fall between the cracks
• Not more regulations, but more effective implementation of the existing laws
• Punitive actions need to be harsh and time bound to deter future crimes

• Investors need clarity on whom to talk to
• All investors are equally gullible
Financial frauds are happening all the time

- India has witnessed a major financial fraud almost every year since the nineties
  - There is a whole history of frauds in the financial markets starting from the famous securities scam of 1992 masterminded by Harshad Mehta
- This has continued despite the introduction of electronic trading: operators exploit loopholes and regulatory arbitrage
- All sectors and products are vulnerable
- Regulatory response has been
  - forming new institutions
  - Strengthening exiting institutions and laws
Timeline

Harshad Mehta
CR Bhansali
MS Shoes
Telgi Stamp Scam
Mutual Fund
Ketan Parekh
Vanishing companies
‘Benami’ demat
Satyam Accounting Fraud
HomeTrade
ULIP Mis-selling
Saradha

Size of fraud is indicative


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Too Many Cooks?

- There are several agencies in India
  - to make regulations and to implement them,
  - to combat and investigate different types of fraud
- You need more co-ordination among the agencies
- The surveillance system of regulatory authorities needs to be souped up
- The incentive of committing / abetting a fraud is greater than the disincentive of being caught for companies, promoters, market intermediaries and other (financial) service providers
- Not necessary to bring in new regulations, but to administer and implement existing rules:
  - more effectively
  - in a timely manner
  - Prevention i.e. Minority report

SEBI and SFIO are the two agencies that have been the most proactive in detecting frauds, investigating them and taking regulatory action.
Who should you talk to?

- Regulators
  - Securities and Exchange Board of India
  - Forward Markets Commission
  - Insurance Regulatory and Development Authority
  - Pension Funds and Regulatory Development Authority
  - Reserve Bank of India
- Various exchanges
- Ministry of Corporate Affairs
  - Company Law Board
  - Serious Frauds Investigation Office
  - Various Institutes or National Financial Reporting Authority (NFRA)
- Prime Ministers Office
  - Department of Personnel and Training
    - Central Bureau of Investigation
- Ministry of Finance
  - Economic Intelligence Council
  - Specialist Agencies viz., Central Economic Intelligence Bureau, Directorate of Enforcement (DOE), Central Bureau of Narcotics (for drug related offences), Directorate General of Anti-evasion (central excise related offences), Directorate General of Revenue Intelligence (customs, excise and service tax related offences).
Constant Vigilance

Year-wise Investigation details

Nature of investigation

Cases taken up for investigation
Cases Completed

Market manipulation & Price rigging
Issue related to manipulation
Insider Trading
Takeovers
Miscellaneous

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Regulatory action

Year-wise amount collected through consent process

Type of regulatory action in 2013

Adjudication orders passed 64%
Suspension 4%
Prohibitive directions under Section 11 of SEBI Act 22%
Warning issued 1%
Advice letter issued 3%
Warning letter and Deficiency observations issued 6%
Empowering the Securities and Exchange Board of India

In July 2013 the Cabinet's approved Securities Laws (Amendment) Bill, 2013 in Parliament, to give more powers to the SEBI to protect the interests of investors:

- The Bill seeks to amend the Securities and Exchange Board of India Act, 1992, with consequential changes in the Securities Contracts Regulation Act, 1956 and the Depositories Act, 1996.
- Collective Investment Schemes (CIS) are a class of investment products regulated by SEBI. The Bill widens the definition to include all pooling of funds of Rs. 100 crore or above, that are not regulated by any law.
- The Bill empowers the Chairman of SEBI to authorise search and seizure of documents relevant to an investigation.
- The Bill provides SEBI with explicit powers to order disgorgement of unfair gains. It also permits SEBI to attach bank accounts and property, and arrest and detain a person for his failure to comply with disgorgement orders or pay any monetary penalty.
- The Bill establishes special courts to try offences under the Act.
- Two provisions are being enacted with retrospective effect – (i) SEBI is being given the powers to settle non-criminal proceedings by issuing consent orders, and (ii) it may sign agreements for exchange of information with foreign financial regulators.

SEBI’s employee-intermediary ratio is among the lowest in the Asia-Pacific region. The regulator’s 2012-13 annual report stated it regulated about 70,000 entities with a staff strength of just 666.
Empowering the Serious Fraud Investigation Office

• Under the **Companies Act 2013** statutory status has been conferred on the **SFIO**.
  – SFIO is empowered to make an arrest in respect of certain offences involving fraud.
• In its new avatar, the SFIO will be a statutory body with the ability to initiate prosecution when directed by the Central government rather than doing firefighting after investors being duped of their money.
• The investigation report filed by the SFIO with the criminal court, for framing of charges, will be deemed to be a report filed by the police under the Code of Criminal Procedure
Do institutional investors need handholding?

- Look at who is buying IPO’s
- Look at where PE funds are investing
I-T raid on HDIL office for alleged tax evasion

Updated: Thu, Sep 10 2009, 10:56 PM IST

Mumbai: The investigation wing of the income tax department in Mumbai on Thursday searched at least 14 offices of Housing Development and Infrastructure Ltd (HDIL), for alleged tax evasion. HDIL is India’s third largest realtor by market value, with a market capitalization of Rs10,674.43 crore at the end of trading on Thursday.

HDIL's shares dropped 3.80% on the Bombay Stock Exchange on Thursday to Rs308.85. The benchmark 30-stock Sensex rose 0.21% to close at 16,216.85 points. HDIL is listed on both the BSE and the National Stock Exchange (NSE).
As expected, the share price falls
The headlines on 12 September

THE ECONOMIC TIMES

Tax News

HDIL admits to Rs 350 cr in unreported income

Mumbai: HDIL, the Mumbai-based realty firm currently under the lens of the income tax department, has allegedly admitted to the existence of unreported income of around Rs 350 crore, said people familiar with the information. This, according to sources in the I-T department, is the highest ever admission of unreported income by any company.

The I-T department had carried out a raid on the residential and official premises of HDIL on Thursday, deploying over 100 officials, in what was described as one of the largest such moves in recent times. The unaccounted income, as allegedly admitted by the company, was related to transactions carried out since 2007, said the people connected with the matter.
You’d have expected the share price to fall
The long view
What we need?

- Clarity on whom to talk to
- Increased co-ordination between the various regulators
- Effective implementation of the existing laws
- Harsh and time bound punitive action

- But remember.....

Market participants will always be lured by easy money
IiAS occupies a niche space as a ‘proxy-advisor’

- IiAS has been set up in equity participation with reputed institutions including Bombay Stock Exchange, Axis Bank, Fitch Group, HDFC, ICICI Prudential Life Insurance and Tata Investment Corporation
  - Incorporated in 2010, commenced operations from 3Q 2011
- IiAS is a voting advisory firm dedicated to providing participants in the Indian market with independent opinions, research and data on corporate governance issues
- IiAS’ commitment and expertise contributes to a transparent market and informed investors
- IiAS is fiercely independent with its interests aligned to the investing community. We are trusted for our unbiased opinions
- IiAS’s processes and benchmarks ensure a consistency of views: Its clear commentary and pragmatic advice contributes to responsible investing
- Voting recommendations on meetings (AGM, EGM, Postal ballot, Court convened meetings) of 300+ companies
- Current team size 16 professionals.
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