On SEBI's trade restrictions: A hasty order

The order of the Securities and Exchange Board of India imposing trading restrictions on 331 companies suspected of being shell entities is an example of rash regulatory action. The Securities Appellate Tribunal has since rightly ordered the lifting of the trading restrictions imposed on two of the companies that approached it, namely J Kumar Infraprojects and Prakash Industries. In fact, the tribunal stated in its order that “it is apparent that SEBI passed the impugned order without any investigation.” Interestingly, the regulatory body had acted on a list of suspect companies that the Ministry of Corporate Affairs had forwarded after consultation with the Serious Fraud Investigation Office and the Income Tax department. Instead of conducting an independent investigation into these suspect companies, SEBI passed the buck to the exchanges and asked them to impose immediate trading restrictions on the companies. Before a proper investigation by SEBI or the exchanges, the companies were put under stage four of the Graded Surveillance Measure, whereby trading is limited to one day a month, the trading price is capped, and buyers are required to deposit money. It is suspected that trading on the shares of these “shell” companies was used as a way to launder black money. In fact, 169 out of the total list of 331 companies had already been suspended from trading before the order. But on the list were also companies with huge market capitalisations, and it is reasonable to assume that the predominant share of trading on any given day is legitimate.

An interesting unknown, meanwhile, is the basis on which the MCA prepared the list of suspect companies that was forwarded to SEBI. The government’s resolve to act against dodgy companies, for the sake of bringing business practices under the purview of the law, is indeed warranted. According to Finance Minister Arun Jaitley, since demonetisation the Centre deregistered well over 1,60,000 dormant companies until early July. It has also identified over 37,000 shell firms and 3,00,000 firms engaged in suspicious dealings, according to Prime Minister Narendra Modi. At the same time, a sound business environment also requires that the government adhere to the basic rules of justice at all times. Handing out extremely harsh punishment on suspect companies without giving them an adequate chance to explain their positions smacks of heavy-handedness. The economic costs of freezing the trading of shares of popular companies are not commensurate with the purported benefits of such action. While the SAT order has brought some fairness to the entire proceedings, SEBI’s action will deal a blow to its credibility among investors as being an effective and unbiased regulatory body. Not surprisingly, investor unease was at least partially evident on the street where stocks witnessed a sharp fall after the order. In order to restore confidence, SEBI and the government must explain the rationale behind their actions.

Rajasthan’s ordinance shields the corrupt, threatens the media and whistle-blowers

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