

Assessing Disclosures in Offer Documents



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With the Repeal of the Capital Issues (Control) Act, 1947 and establishment of Securities and Exchange Board of India (SEBI) a statutory body under the SEBI Act, 1992, there has been a paradigm shift in the capital market regulation from 'merit regulation' to 'disclosure regulation'. The most important functions mandated to

SEBI under the SEBI Act are:

1. Protection of the interest of the investors in transactions relating to Securities;
2. Development of the Securities market and
3. Regulation of the Securities Market.

SEBI regulates the Capital Markets sector in India with a special emphasis on the protection of the interests of the investors by ensuring compliance by the Issuer Company of the various regulations, rules and guidelines issued by it. SEBI ensures that the disclosures made in the Offer Document are true, fair and adequate so as to enable the investor to take an informed decision

With the shift of regulatory focus on Disclosures, a very pertinent question arises as to whether it is the quality of such disclosures or the quantity thereof, which should be the prime concern of the Regulator and/ or the Investors at large

In this article, an effort is being made to briefly reflect on the measures/ provisions by which both SEBI and MCA necessitate the minimum disclosures and also ascertain their quality by seeking certification by independent agencies like Legal Advisors Auditors, Merchant Bankers, Credit Rating Agencies etc. Further an analysis is also done of the aspect as to whether can it be 'Quality Vs. Quantity' or should it be 'Quantity and Quality' of the Disclosures.

After the scam in the nineties with respect to the Companies taking money from the public and disappearing into thin air was unearthed, a special term was coined i.e. 'Vanishing Companies' and a Central Monitoring and Co-ordination Committee was set up under the Joint Chairmanship of MCA Secretary and SEBI Chairman to trace all such companies with co-ordination with the Income-Tax Authorities, Passport Authorities, Registrar of Companies (ROC), etc. Subsequent to this, SEBI has become more conscious with regard to the quantitative aspect of the disclosures required to be

made in the Offer Document. For example, the photographs of the Promoters of the Issuer Company along with details like PAN Card number; Driving Licence, Passport number, etc are required to be disclosed in the Offer Document mandatorily. This method has been adopted so as to ensure that the 'fly by night' operators can be traced and made accountable for their misdeeds.

An Offer Document is defined under Regulation 2(x) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations) and means a Red Herring Prospectus or shelf prospectus in terms of section 60A of the Companies Act, 1956 (Act) in case of a public issue and letter of offer in case of a Rights issue.

The purpose of the Offer Document is to aid the prospective investor in making an informed decision in the Issue by disclosing to the investors all the material information which may affect his/her decision. The Act and the SEBI ICDR Regulations jointly protect the interest of the investors by prescribing set rules and guidelines for disclosure of material information to the investors.

Schedule II of the Act prescribes the disclosures to be made in the Prospectus and the reports to be set out therein. It includes details of the Company and its activities including its Main Objects; details of the compliance by the Company under various statutes; capital structure of the Company; terms and details of the Proposed Issue; details of the management of the Company; outstanding litigations against or initiated by the Company; and details of a previous issue and Listed Companies under the same management as that of the Issuer Company etc.

Over and above the above stated disclosures, the ICDR Regulations issued by SEBI (Schedule VIII) prescribe the mode of disclosure as well as the essential disclosures which need to be made by the Company. The disclosures prescribed inter-alia, include the following:

- Industry overview,
- Business overview including the location of the project; technology, technical and financial collaborations, infrastructure facilities for raw materials and utilities, the details about the market in which the company operates with special emphasis on the size of the market, company's market share and competition etc;
- Particulars and background of the Promoters and their stake in the company
- Principal Shareholders, Board of Directors including details of Independent Directors;
- Degree of risks involved in investing in the Issuer Company with the help of the Risks, both internal and external to the Company, identified and discussed by the management;
- Details regarding the objects of the issue and subsequent utilisation of funds;

- Details of the Key Management Personnel and other Employees of the Firm to show whether the Company is professionally managed under a qualified management;

The primary responsibility of the disclosures is that of the Company. However, SEBI enjoins a duty upon the Merchant Banker to verify all such information from the Company as well as from independent sources and give due diligence certificates to SEBI with regard to the information contained in the offer Document.

To ensure the quality of the Offer Document, SEBI has further mandated that in case of an IPO, grading should be obtained by the Issuer Company from any of the six credit rating agencies registered with SEBI. The grading/rating has to be compulsorily disclosed in the Offer Document. IPO grading represents the fundamentals of the proposed issue. In case of an adverse Rating by the Credit rating Agency, the Issuer may resort to Forum shopping and approach another Agency in the hope of a favourable Rating. To overcome this, SEBI mandates that in case of more than one Rating, the Issuer has to disclose them all, thereby ensuring that the Issuer Company portrays the true and actual affairs of the Company.

It needs to be emphasised that a reasonable degree of fairness in the information disclosed in the Offer Document is essential. The disclosures made in the Offer Document should not be overstated and should not be misleading.

Having dealt with the aspect of quality, the other important dimension of disclosures in the Offer Document is the element of 'Adequacy' which seeks to fulfil the requirement of 'Quantity'. The disclosures made in the Offer Document should be made in their entirety and the issuer should not withhold any material facts.

In the event of any material fact found to be incorrect or a material fact being concealed, the Directors of the

Company as well as all other persons who authorise the issuance of the prospectus or the Offer Document can be held liable. Such prosecution can be initiated on the basis of a complaint filed by the Investor, ROC and SEBI. To ensure that the Merchant Banker performs its duty, SEBI takes steps against the erring Merchant Bankers also.

- Section 62 of the Act imposes civil liability on the Directors/ Promoters of the Issuer Company for any mis-statement or concealment of a material fact.
- Section 63 of the Act, prescribes criminal liability for mis-statements in the prospectus. Historically SEBI has filed a number of cases under this section against many Companies for Mis-statement.
- Further, section 68 of the Act prescribes penalty, which includes imprisonment upto 5 years or fine or both, for fraudulently inducing persons to invest money in the Issuer Company.

Through these measures, both the Regulators-SEBI and the MCA have strived to ensure that the document, on the basis of which an Investor makes his/her decision to invest, has sufficient disclosures while ensuring that the said disclosures are true and fair as certified by independent agencies and also the intermediaries registered with SEBI.

In view of the aforesaid, it is clear that the terms 'Quality' and 'Quantity' with respect to disclosures to be made in the Offer Document are not to be taken as opposed to each other but are complimentary to each other. Neither quality nor quantity alone can be considered to be sufficient for the purpose of Disclosures required to be made in the Offer Document. Both quality and quantity go hand in hand to ensure that the investor makes an informed decision about his investment in the Issue.
