SEBI Consent Regulations
Learnings and Challenges

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Background

The Securities and Exchange Board of India (SEBI), in appropriate cases involving violations of securities law, has been passing consent orders since 2007 in order to avoid time consuming and costly proceedings with a view to allow the full force of enforcement to focus on cases that truly merit its attention. The benefits of such an approach can be clearly noted from the system adopted by the Securities and Exchange Commission of the United States of America which settles nearly 99% of its administrative / civil cases via consent orders. However, settlements in India have not picked up steam in the same manner.

This article will review the development of the consent and settlement regime in India, the nature of its present iteration, and suggests measures that may help give effect to the intent behind creation of the consent mechanism.

History of Implementation in India

The Consent Guidelines of 2007

Until recently, the primary statutes governing securities law in India, i.e., the SEBI Act, 1992, the Securities Contracts (Regulation) Act, 1956 (SCRA), and the Depositories Act, 1996, did not contain any express provision specifically empowering SEBI to pass consent or settlement orders. However, one of the provisions therein stated that, with the consent of the parties, no appeal shall lie to Securities Appellate Tribunal from an order made by the Board or by an adjudicating officer. This was an enabling provision that implicitly permitting SEBI to pass consent orders.

SEBI issued its circular dated April 20, 2007, to bring into effect guidelines for consent orders. The circular also stipulated considerations relevant for compounding of offences where prosecution cases have been filed by SEBI before criminal courts. Under the Consent Guidelines, the proceedings might be initiated at any stage after probable cause of violation was found and, if the violation was serious / intentional, the consent order may be passed only after the investigation was complete. Consent applications were referred to a high powered committee (consisting of a retired judge of a High Court and two other external experts) who were to consider the proposal based on certain criteria. Consentable cases were then to be forwarded to the relevant authority, be it the adjudication officer or the whole time member, who would finally pass the consent order. Considerations include the intentions, track record, and economic benefits accrued to the violating party, the nature of the violation, and the amount of harm caused to investors.

At the time of making the proposal for consent, the party in violation may either do so by admitting its guilt or by neither admitting nor denying guilt, and will be required to furnish a written waiver preventing them from later preferring an appeal before SAT or any court, from claiming bias or prejudice on the part of SEBI, from making a plea of limitation against reopening the case if the party violates the terms of settlement, etc. If the proposal is rejected, such rejection shall not affect the continued validity of the waiver, but both SEBI and the violating party are permitted to resort to any recourse available under law.

Amendments to the Consent Guidelines

The Consent Guidelines having been in effect for about 5 years, as on March 31, 2012, SEBI had received 2558 consent proposals of which it settled 1116. It received a disgorgement amount of approximately Rs. 29 crore and a settlement charge of approximately Rs. 175 crore while incurring a minimal legal and administrative cost of approximately Rs. 1 crore. Further, the five-years of experience also highlighted certain areas that warranted regulatory review. Therefore, SEBI issued a circular on May 25, 2012, amending its Consent Guidelines.

The first major change brought in was a restriction against consent of certain serious offences. Instead of imposing a severe settlement fee for serious offences, such as, insider trading, PFUTP or takeover code related violations, SEBI decided not to entertain settlement applications pertaining to these. Second, to prevent repeat offenders from resorting to settlement over and over again, a cooling off period was prescribed between settlement applications.

Two of the other changes pertain to SEBI's powers to issue orders. Pursuant to the circular, it was expressly stated that SEBI may continue the proceedings before SEBI and shall only refrain from passing the final orders if settlement proceedings are underway. If settlement terms were accepted, SEBI was now required to pass a settlement order which would clearly spell out the alleged misconduct, legal provisions alleged to have been violated, facts and circumstances of the case and the consent terms.

Strengthening the legal enforceability through Securities Law Ordinances

While the legal validity of SEBI's power to settle cases with the consent of the parties has been upheld by the Courts, with a view to create specific enabling provisions for the consent procedure, amendments were proposed within the SEBI Act, the SCRA and the Depositories Act. An ordinance for the amendment of securities law was passed on July 18, 2013, and was repeatedly re-issued, until the Securities Law (Amendment) Act, 2014, was notified on August 25, 2014. The amendment Act added sections to the SEBI Act (section 15JB), SCRA (section 23JA) and the Depositories Act (section 19-IA), which specifically permit SEBI to pass settlement orders. These provisions were made retrospectively effective from April 20, 2007, thereby giving statutory backing to the consent guidelines and all consent orders passed under those guidelines.

The SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014

With a view to convert the guidelines into notified SEBI regulations having certainty of legal enforceability, SEBI first considered the draft regulations during their board meeting on June 26, 2012. The SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014 (Settlement Regulations), was then notified on January 09, 2014.

Under the Settlement Regulations, any person against whom any specified proceedings, under the SEBI Act, SCRA or the Depositories Act, have been initiated or may be initiated may make an application to SEBI, in the specified format along with applicable application fee. Such application can be made prior to issuance of show cause notice, within sixty days of service of show cause notice or supplementary show cause notice, whichever is later, or if proceedings are pending before the Securities Appellate Tribunal or any court. The mechanism allows for an out-of-court process before SEBI whereby administrative or civil proceedings may be settled either by admitting guilt or by not admitting or denying guilt. The applicant is free to withdraw the settlement application before the whole time members of SEBI decide.

Restrictions on Settlement

There are two kinds of restrictions on settlement. The first kind prevents certain entities from settling violations based on whether the applicant has settled too many applications within a specified period or has repeatedly attempted to settle the same offence. Further, settlement of cases where audit, inspection or investigation is underway is not permitted. The second kind is a restriction on the kinds of offences that may be settled. Defaults involving insider trading, failures to make an open offer, failure to address investor grievances, failure to make material disclosures in offer documents, serious fraudulent & unfair trade practices having market wide impact, etc. cannot be settled. However, SEBI does have the power to consider applications made in regard to such violations as well if the applicant makes out adequate grounds in support. This power has been infrequently used most notably in a few violations involving failures to make open offers under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Stages Involved

An applicant must make a settlement application containing specifics of settlement terms (the manner of arriving at the terms of settlement is discussed below), supported by undertaking and waivers. The information disclosed in the application must be full and true and any facts already established or admitted by the applicant in other proceedings regarding the same cause of action is deemed to be admitted. Assuming a complete application has been made by an eligible applicant in regard to a consentable offence, the application is considered by three separate bodies in sequence before the matter reaches its conclusion.

An Internal Committee of SEBI officers, with one of them being not below the rank of chief general manager, examines whether the proceedings may be settled and consider the terms of settlement. The Internal Committee may call for information from the applicant, call for the personal hearing of the applicant, and suggest to and permit the applicant to revise the settlement terms. Any representations that are to be made by the applicant can only be made before the Internal Committee and the remaining bodies are insulated from them.

The settlement terms are then placed before a high powered advisory committee (HPAC) which shall consist of a retired Judge of the High Court and three external experts. The HPAC shall consider the settlement terms proposed,

the undertakings and waivers, the relevant factors to be considered as per the Settlement Regulations, etc. and either refer the matter back to the Internal Committee for revision of settlement terms or place the case before a panel of whole time members of SEBI for their consideration. The last stage is before a panel of two whole time members of SEBI which again considers the application and the recommendation of the HPAC and decides on whether the settlement must be permitted. If the panel approves the application, the applicant may undertake the payment of the settlement amount or agree to such other conditions or bars as may be appropriate, and the relevant authority, be it the adjudicating officer, tribunal or court, passes the final order.

If the settlement application was filed prior to initiation of proceedings, the proceedings shall not be initiated until the application is rejected or withdrawn. However, if the proceedings are underway, a settlement application will not hinder them except in regard to the passing of the final order. The passing of the final order shall be held in abeyance until disposal of the settlement application.

Terms of Settlement

The terms of settlement under the Settlement Regulations that may finally be imposed range from a monetary sum or non-monetary terms, such as, suspension of certificate of registration or closure of business, removal from management, disgorgement, debarment from employment/ directorship, etc.

The monetary terms are to be arrived at based on the indicative amount calculated in accordance with the detailed rate card annexed to the Settlement Regulations. The formula states that the indicative amount is the base amount attracted by the particular violation multiplied by a multiplying factor, which considers the stage of adjudication/ civil proceedings underway against applicant as well as the past history of the applicant, along with any legal costs incurred by SEBI in regard to the case.

The final indicative amount arrived as per the above considerations is then subject to the existence of any mitigating factors in favour of the applicant. This may include considering the conduct of the applicant during the investigation, the nature, gravity and impact of alleged defaults, other pending proceedings against the applicant, harm caused to investors and gain by the applicant, corrective measures and actions implemented by the applicant, etc.

Developments Pursuant to the SEBI Board Meeting held in May, 2016

As discussed above, settlement of certain kinds of violations are not permitted. While only serious fraudulent and unfair trade practices having market wide impact were not consentable, SEBI resorted to a conservative approach and thereby left out most violations involving fraudulent and unfair trade practices from the purview of these regulations. SEBI, during its board meeting held on May 19, 2016, has decided to issue a guidance note clarifying whether violations relating to fraudulent and unfair trade practices may be settled under the Settlement Regulations.

As per the agenda paper from the board meeting, SEBI is set to clarify the position through a guidance note that violations involving fraudulent and unfair trade practices will not be consentable if they are serious in nature, have a market wide impact, and due consideration must be given to the impact of the violation on investors. To determine whether an offence is serious, it has been clarified that the weight and sufficiency of evidence must be considered as well. Mere seriousness of the charge may not be the deciding factor if there is a lack of evidence. Further, offences will not be said to have a market wide impact merely due to its effect on a particular company or its investors. It must have a bearing on the securities market as whole. Lastly, the qualitative and quantitative impact that the violation has had on investors must also be considered. This is a welcome move as it sets out some yardsticks, somewhat widens the scope of consentable cases, and thereby reduces the enforcement workload of SEBI in more minor cases.

Conclusion

While a robust consent mechanism can be found in the Settlement Regulations, it seems that few offenders are aware of the existence of the mechanism and even fewer resort to it. As the benefits of settling minor violations is clear, there needs to be push towards inviting more offenders to settle. Thus except for the most extreme examples, more cases should be settled. Where the offense if of a higher nature, the nature of the consequence would thus become stricter. In fact, an area SEBI has not explored well is the world outside monetary penalty. Thus barring a person from the market for a decade or obtaining an admission of guilt could be used in more extreme cases. Lastly, delays in passing settlement orders also remain a concern.