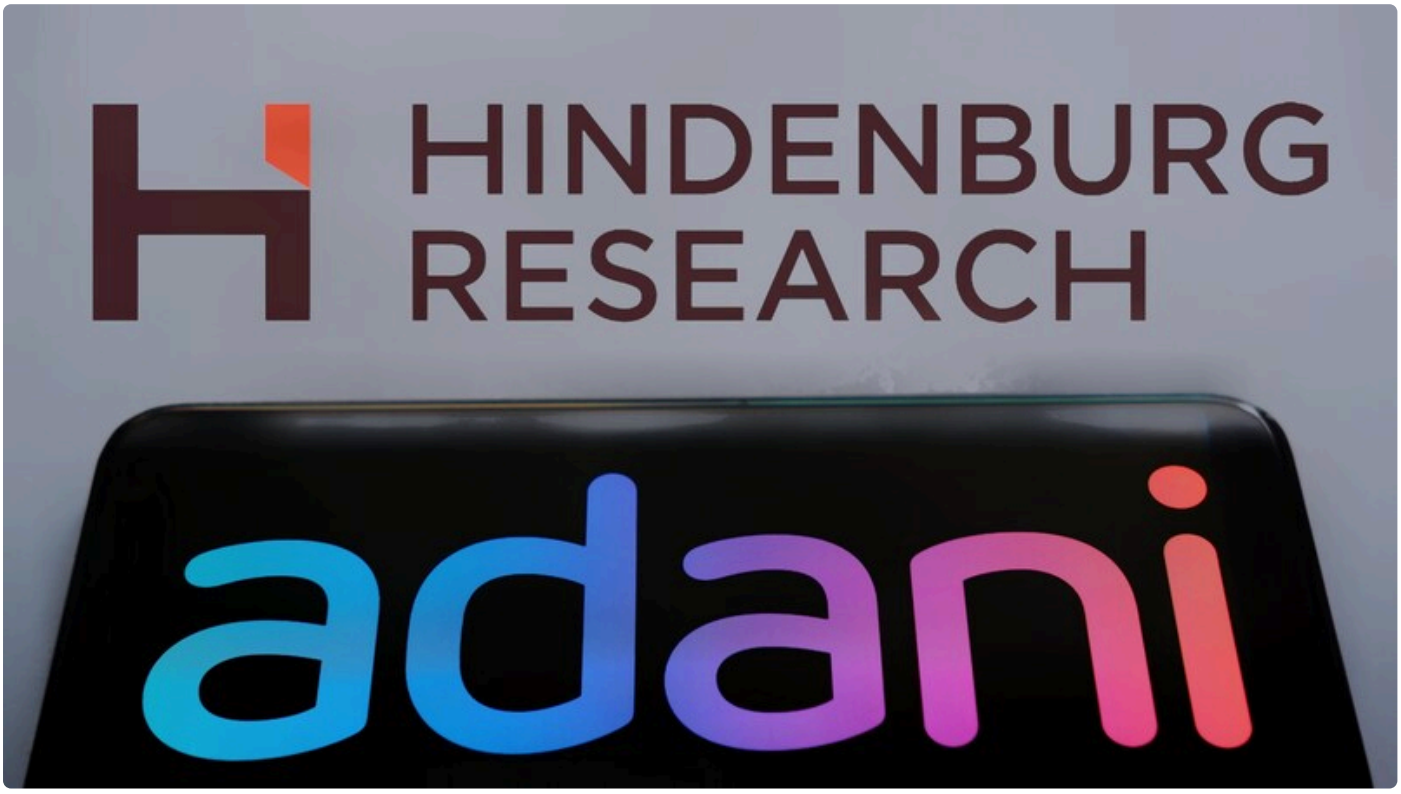
Business Standard

Smoke, fire and fog: Looking beyond the haze of Hindenburg allegations

Rather than being ensnared by the specifics of individual allegations, our focus should be on safeguarding Sebi's integrity as an institution

M S Sahoo | Sumit Agrawal |



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There is no smoke without fire. While this is mostly true, sometimes fog is mistaken for smoke, and artificial smoke and fog can further blur the lines. The recent blog post by Hindenburg Research about the Securities and Exchange Board of India (Sebi) chairperson exemplifies this, appearing more like fog than smoke to the authors. Initially, we regarded Hindenburg as a research institution. However, a closer look at its work prompted us to doubt the appropriateness of the term "Research" in its name. The blog post appears motivated, as it comes as a reaction from an interested party to a show-cause notice. It is heavily laden with disclaimers, aimed at avoiding accountability, including disclaiming the accuracy of its information and opinions.

Regardless, the blog post has dented the reputation of both an individual and an institution. This has wider ramifications for capital formation and economic growth, given the critical role the institution plays in the securities market and the

broader economy. We, however, refrain from delving into the specifics of the allegations ourselves, as doing so would overstep legal boundaries despite our professional expertise. Given the severity of the dent, we recommend a thorough and expeditious examination by a competent authority with access to all relevant material and quick follow-up action. As such situations, whether they involve genuine concerns or mere speculation, are routine for Sebi chairpersons and Sebi itself, we advocate robust institutional safeguards that protect against misinformation while ensuring accountability when real issues arise.

At the core of the confusion lies the allegation of conflict of interest (conflict), where personal interests could potentially influence official decisions. A common form of personal interest is investment in securities. If an individual with investments takes on a regulatory role, there is a risk that her decisions are dictated by her interest in such investments. A simplistic solution is debarring such individuals from occupying regulatory positions. That may be throwing the baby out with the bathwater. Historically, there was even a push in the early 1990s to include individuals with investments on the Sebi Board to leverage their expertise in crafting regulations. A balance was struck by amending the Sebi Act in 1995, which allowed individuals with investment interests to serve in regulatory roles, with mechanisms to resolve conflicts. Sebi pushed the envelope further by voluntarily adopting the Charter of Conduct for Sebi Members, in 2008 to address and mitigate conflicts.

Not every alleged conflict warrants action; it must be substantial and it must be substantiated. In *SC AOR Association & Ors Vs Union of India* (2016), the Supreme Court clarified that only a genuine risk of bias necessitates recusal, emphasising that judges should deliver justice impartially despite any prior connections with lawyers or litigants. The Court stressed that recusal should be based on a reasonable apprehension or real danger of bias to prevent manipulative litigants from evading specific judges. Similarly, in *Vishal Tiwari Vs Union of India* (2023), the Court dismissed unsubstantiated allegations against three members of the Expert Committee that was examining the allegation made by Hindenburg relating to Adani group companies.

A conflict is rarely a straightforward, black-and-white issue. It often demands a thorough contextual analysis, considering factors such as the timing and duration of the individual's interest, the potential gains or losses involved, and the nature of the interest. It is crucial to assess whether the interest is substantial enough to influence regulatory decisions. Even with such careful examination, it is not always possible either to reach a definitive conclusion or to eliminate conflicts. Therefore,

the goal should be to establish a dynamic institutional mechanism that combines principles and rules to mitigate conflicts while recognising that some level of conflict may be inevitable.

Effectively managing conflicts is essential for individuals in high positions. There are several standard measures to address them. On an individual level, these include (a) disclosing the conflict to relevant parties, (b) recusing from decision-making processes, and (c) divesting any conflicting investments. On an institutional level, measures include (a) establishing independent third-party reviews, (b) empowering parties to raise concerns about conflicts, and (c) sensitising individuals to recognise and appropriately manage potential conflicts.

While the Sebi Charter offers a foundational framework, there is room for enhancement. A statutory fervour would enhance its legal sanctity and enforceability. It should be prescribed through government rules that outline principles for identifying conflicts and require the recusal of the chairperson or members when a conflict is perceived. Additionally, stakeholders should be empowered to flag any conflicts they perceive involving the chairperson or a member in their quasi-legislative, executive, or quasi-judicial roles. Such conflicts could then be resolved by the chairperson (in the case of members) or by the Board (in the case of the chairperson).

Sebi introduced a disclosure-based regulatory regime in the 1990s, requiring market participants such as issuers, intermediaries, directors of market infrastructure institutions and mutual funds, and even shareholders to make ongoing disclosures of material and deemed material events. A similar disclosure regime could be implemented for Sebi itself. Under this system, individuals would disclose relevant information upon assuming a regulatory position, provide annual updates, and report material transactions or developments as they occur. However, all disclosures need not be made public. Publicly sharing certain information could be problematic; it might lead to situations where some investors may choose to invest in companies where the Sebi chairperson has personal investments. Instead, certain disclosures could be made exclusively to the Sebi Board and kept confidential until a need arises, while others could be made available to the public.

Rather than being ensnared by the specifics of individual allegations, our focus should be on safeguarding the integrity of the institution. The priority must be to strengthen and rigorously enforce conflict-of-interest protocols to ensure they operate effectively and maintain public trust. A robust conflict management framework will reinforce Sebi’s unwavering commitment to transparency, accountability, and strict adherence to established procedures. This dedication to

institutional integrity is crucial for preserving the credibility of the securities markets and fostering enduring confidence in our regulatory institutions. Such a mechanism must be implemented across all regulatory bodies and for all public servants with substantial decision-making authority.

The writers are legal practitioners who previously worked for Sebi

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