

Securities investigations: Speed and quality a must

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July 22, 2023

The securities regulator conducts investigations where it has reasonable grounds to believe that the transactions in securities are being dealt with in a manner detrimental to the investors/securities market, or if any person has violated any of the provisions of the SEBI Act, 1992, Depositories Act, 1996, and Securities Contracts (Regulation) Act, 1956, etc.

The investigation is a fact-finding exercise. There are competing demands on the regulator—do it fast, and do it well—with strong votaries on both sides. There is no tradeoff, however. The effectiveness of enforcement actions depends on the investigation's quality and speed. To paraphrase a popular saying, an investigation delayed is justice denied, and an investigation hurriedly is justice buried.

If the quality of the investigation is not good, the final action taken by the regulator may not stand judicial scrutiny. If it is not done with care, it may add to the cost of doing business. It may even penalise the innocent or allow the offender to escape. If it takes longer to conclude, the market continues to suffer the alleged misconduct. It may make it difficult for the regulator to gather the evidence required to establish contravention while depriving the alleged offender of an effective defence.

Every investigation costs the regulator, the investigation, and associated agencies and persons. Therefore, the decision of whether to initiate an investigation requires the application of the mind. The surveillance departments of SEBI and stock exchanges, complaint databases, media, and whistleblowers generate several alerts. The regulator analyses them with other relevant details to meet the 'reasonable grounds' threshold. Recall the Satyam debacle of 2009. Satyam's chairman disclosed that the company had doctored its accounts for years. After due diligence, the regulator initiated an investigation. It received similar 'disclosures' for some days, purportedly from chief executives of several companies. It did due diligence and closed them. While the disclosure from Satyam was correct, others were not. Such due diligence often delays the launch of an investigation.

The appointment of an investigating authority (IA) is the first step. The IA gathers the necessary material and evidence to conclude that there is indeed a contravention. For example, an investigation into price manipulation, which is the most common type of unfair trade practice, typically entails gathering information and records—trade details from stock exchanges, demat accounts from depositories, fund flows from banks, etc. Some of these may be available with the regulator from regulatory filings and in regulatory records of exchanges and intermediaries, and some may have to be collected afresh.

The investigation proceeds fast if the regulator already has a real-time database and requires some additional information to top it up. Fortunately, the electronic database of securities transactions, securities transfers, and fund flows is readily available. There is a surfeit of regulatory disclosures—initial and continuous—and a plethora of regulatory records. These should be captured in a dynamic database which speeds up the investigation.

The time required to complete an investigation largely depends on its scope. It may take years if the scope is very large, say, it entails thousands of parties with millions of transactions over months/years. Recall the irregularity in illiquid stock options in 2014–16, which involved about 15,000 parties. Delays also arise if the scope of the investigation is not sharply defined. In such cases, the communications from the IA are unlikely to be precise and comprehensive, thereby requiring follow-ups. Or, it may seek too much information from all the entities, which only complicates the analysis and delays the completion of the investigation. In some cases, the scope evolves/expands as the investigation proceeds. The IA must not let it be a never-ending story.

Everyone associated with the market is duty-bound to cooperate with the IA. However, non-cooperation often prolongs the investigation. It may take excuses to submit relevant information, seek repeated extensions, and invite intervention from external agencies. In case of extreme non-cooperation, SEBI uses its powers to enforce the production of information and records and the attendance of persons. Where documentary evidence is not available or does not exist, investigation relies on the testimony of individuals, which contributes to the delay.

The securities market is global. A person sitting anywhere in the world may participate in Indian securities markets through intermediated holdings, trading in derivatives of Indian securities, or depository receipts of Indian companies. The person may manipulate the Indian markets or be a party to manipulation. SEBI seeks the assistance of foreign regulators who are signatories to the Multilateral Memorandum of Understanding (MMoU) of the International Organisation of Securities Commissions (IOSCO), or with whom it has entered into bilateral agreements. Nevertheless, this takes considerable time and follow-ups, and the desired information may not always be forthcoming.

The regulator is not helpless when an investigation takes a long time. In case of urgency, if a prima facie case exists, it may pass an interim order, pending completion of investigations, even without a hearing, restraining the alleged offender from continuing misconduct and even impounding the proceeds or securities related to the alleged irregular transactions. The interim order is confirmed or withdrawn after hearing the parties.

The speed of investigation also depends on the skill of the IA and its resources in terms of databases and technology. There is, however, no formal course that prepares someone for an investigative role with a regulator. One learns investigation while doing it under the guidance of an experienced officer. With the increasing sophistication of irregularities in the markets, the ecosystem should produce a trained pool of investigation professionals.

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