THE DISCLOSURE-BASED REGIME DOES NOT DISTINGUISH BETWEEN THE ISSUERS WHO COMPLY WITH REGULATIONS IN BOTH LETTER AND SPIRIT, AND THOSE WHO COMPLY IN LETTER ONLY

# Disclosures and disconnects

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**THE REGULATION OF** securities markets is founded on correct, complete, and timely disclosures by entities who issue securities or provide services. Disclosures commence when an issuer wishes to list its securities or a person seeks registration as a service provider. Disclosures are obligatory till the entity exits the market. Though the breadth, depth, and frequency of disclosure vary across persons/activities/services/products, the overarching objective is to enable market participants make informed decisions. This commentary deals with the initial and continuous disclosures by issuers/listed entities, since those disclosures are the most elaborate and significant to the investors, market and the economy.

A company intending to list its securities files a draft red herring prospectus (DRHP) with Sebi and the stock exchange(s). Sebi only gives its 'observations' on the DRHP. The merchant banker incorporates/responds to these and files an updated RHP with Sebi and the Registrar of Companies (RoC), based on which the initial public offer (IPO) proceeds. On successful completion of the IPO, the issuer files the prospectus with the RoC and Sebi. The prospectus discloses everything material for an investor to take an investment decision. After the securities are listed, the listed issuer makes disclosures of material information to stock exchange(s) at quarterly, half-yearly, yearly, and event-based frequencies. It also confirms or denies any information reported about them in the media.

The disclosure requirements flow mainly from four regulations of Sebi: Issue of Capital and Disclosure Regulations (ICDR), Listing Obligations and Disclosure Regulations (LODR), Substantial Acquisition of Shares and Takeover Regulations (SAST), and Prohibition of Insider Trading (PIT) Regulations. The law also provides for consequences for delayed, inadequate, and inaccurate disclosures on the persons responsible.

The investors and market typically deal with one disclosure at a time, but not with a series of disclosures made over time in respect of an issuer/ promoter/ director/ associated professional/ related parties. Such a database is not even compiled systematically by any authority. If such disclosures are captured in a dynamic database, the regulator can generate, at any time, an updated and complete dossier of each listed issuer/ promoter/ director and each professional associated with the market, complete with all chronological developments and interconnections in a matter of hours. This will speed up regulatory approvals, inquiries and inspections, assessment of the conduct of the persons, and intervention, if any, to put the house in order.

In the absence of such a dynamic database of the listed entities, the regulator struggles to gather information when an alleged contravention is to be dealt with. A recent case in point is the Hindenburg Research Report on the Adani group entities. As reported, the regulator is facing considerable difficulty to ascertain with reasonable certainty within a reasonable time the conduct of the entity, interconnections, and sources of the volatility of share prices. Effectively, the regulator starts from the scratch to collect all information and to come to a reasonable conclusion, which often takes years with all the resultant consequences to the issuer, its investors, and at times, to the market/economy.

**For the disclosure regime to achieve the behaviour modification of the regulated entities, the current approach of only punishing violations must change**

The regulator can use the disclosures, starting with the DRHP stage onwards, to build up a fact-verified-database of issuers on a near-real-time basis. It can maintain a folio that presents a 360° view of every listed entity, starting with the large ones and the conglomerates. The folio will enable it to have a deep understanding of the trajectory, health and conduct of an issuer at any point in time and detect inconsistencies and deviations over time. In case of an alleged contravention, the existing database and a short enquiry on the alleged violation will help the regulator quickly unravel the issue and come out with findings.

Inadequate focus on building a database systematically is not fair to the listed entities who make full, fair, and timely disclosures. The disclosure-based regime, as practised now, does not distinguish between the issuers who comply with regulations in letter and spirit and the issuers who comply in letter only. In the process, the disclosure-based regime has promoted a culture of tick-boxing compliance.

Full and fair disclosure relating to promoters/persons in control, promoter group, and related parties is crucial in understanding the issuer and its conduct. Given the growing complexity of corporates, any deficit in basic fields of information on transactions through layered structures and involving multiple jurisdictions, will make the issuer non-transparent. The regulator will not be able to correctly identify the shareholding pattern, related party transactions or promoter entities, group entities, and related parties involved in violations, including the role of the listed entity in the manipulation of the share prices, if any. Further, if the group position is not fully known, even complete/consolidated financial position of the entity becomes a casualty. Therefore, absence of a database tracking the disclosures from the beginning and on a continuous basis is a serious black hole of the disclosure-based regime.

Since the regulator now approaches the issue only as a violation, it is a post-mortem. For the disclosure regime to achieve the behaviour modification of the regulated entities, the current regulatory approach of only punishing violations must change to a reward-and-punish model. Rewarding can be in terms of recognising the entities high on disclosure matrix for fast regulatory approvals. For instance, follow-on public offers, applications for commencing a new business, and so on by such entities can be approved in fast-track mode. In case a fully compliant entity is facing a business headwind, the regulator can stand by it with a public statement. It is even possible to provide them with regulatory forbearance and safe harbours. This will enhance the ability of the regulator to address the stability of large companies or large group companies and their impact on systemic stability at critical times.

The ongoing disclose-and-leave approach has neither served meaningful market regulation nor entity/systemic stability. It just helps the status quo of that smart compromise between the 'free marketers' and the reluctant policymakers in creating a facade of regulation, which gets seriously exposed at times of stress/crises. Given the 2023-24 budget announcement for reviewing all regulations, it is an opportune time to shift to a fact-verified, cumulative, and dynamic disclosure-based model of regulation with a reward-and-punish approach by the regulator.