# Dr. Stya Paul Annual Lecture

**(February 18, 2006)**

***On***

# Regulatory Issues in the Context of the Indian Capital Market

**ASERF**

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# Welcome Address

***Mrs. Sushma Berlia**** 

"Shri M Damodaran, Chairman, SEBI, distinguished dignitaries on the dais, Excellencies, other leading luminaries from different fields and Industries, distinguished guests, ladies and gentlemen.

***"Guru Govind dovu khade kake lagu paay?***
***Balihari guru aapne Govind diyo bataye."***

*(The Lord and my Guru are both standing in front of me and I am in a dilemma as to who I should offer my salutations first. However, I know that I am more grateful to my Guru because he was the one who indicated the path to the Lord. Hence, I shall bow to my Guru before I bow to the Lord.)*

It is my privilege to welcome you all to the Inaugural 'Dr. Stya Paul Annual Lecture' being organized by the Apeejay Stya Education Research Foundation today. This is the first in a series of lectures that would be organized by the ASERF in various disciplines to honour the legacy of excellence of a great visionary –Dr. Stya Paul - eminent industrialist, educationist, philanthropist and freedom fighter.

He is a man who overcame innumerable odds, physical and otherwise, throughout his life, and by virtue of his vision, accomplishments and life-long commitment to excellence, has become a source of inspiration for millions in the country.

Afflicted by polio at the tender age of one and half years, he did not let his handicap stand in the path of his dreams. He tried to live as normal a life as possible, even playing hockey with his friends while still on crutches. It was only after over 30 years, that he was able to walk with the help of calipers and walking stick.

He was a brilliant scholar, both at school and college, with a special talent for Mathematics. Studying by lantern light during his school years, since his family could not afford electricity, he passed his matriculation with flying colours and won a merit scholarship. Going on to college, his love for Mathematics not only helped him to secure first position in BA (Honors) but also a Merit List position in MA (Mathematics) at the University. He was a Gold Medalist in combined Punjab in those days.

A staunch nationalist, he was drawn into the Independence movement and was imprisoned for 42 days for being actively involved in the distribution of anti-British literature during the Quit India Movement. This did not deter him; rather his prison experience only strengthened his resolve and made him a stronger person.

He lost both his parents in quick succession, and being the eldest son, had to not only take up the responsibility of managing a large family on his young shoulders, but also keep the family business afloat. Perhaps from there, he developed the trait of putting others before self. These were very difficult years, during the time of partition, when finances were low and businesses were crumbling. But he refused to give up and kept working hard along with his brothers to keep the family business running. Their resolve paid off, and together they forged one of the biggest industrial success stories of the

* President, Apeejay Stya Group

nation, when they turned their family concern into one of the largest industrial conglomerates of the country – the Apeejay Group.

Dr. Stya Paul was among the pioneering industrialists who recognized the great role that industry could play in the field of education, and he longed to set up an exemplary institution that would not only lay emphasis on academic excellence, but also the inculcation of human values and the appreciation of Indian culture, arts and heritage - unlike most missionary school of those days. He set up the first Apeejay School in Jalandhar in 1967 with only 4 students on rolls during the first year. But he persevered with his dream, as this was not a profitable venture for him, rather his way of giving back to society and nation. Today, the Apeejay Education Society runs 26 schools and higher institutions in the country imparting education to over 32,000 students, right from Pre-Nursery to Doctoral levels. Its higher institutions offer over 80 courses in myriad disciplines such as Fine Arts, Management, Engineering, Information Technology, Architecture and Mass Communication, to name a few. Each Apeejay institution has become a symbol of excellence in its respective fields, molding the future generations, and sharing the vision of Dr. Stya Paul– "*of quality education of global dimensions, leading to man making and nation-building*".

As part of his social commitment, Dr. Stya Paul has established the 'Apeejay Stya Education Research Foundation' to promote excellence in education at all levels in the country in its entirety. The Foundation shall strive to address the problems of Indian education in a professional manner, including networking with other foundations with similar objectives, in order to formulate strategies to find research-based solutions. It has on its Advisory Board eminent luminaries from the field of Education, Management, Science and Technology, Law, Strategic studies, Media and Industry, who would be able to link policy-makers, key administrators and the research community in a creative dialogue on the central issues facing contemporary education.

Innumerable laurels and accolades have come his way, in a life full of accomplishments and philanthropy. But they sit very lightly on him, for he is not a man who likes to take any credit, but only like to pass it around. He is a man of action who believes in doing his *kar*ma, and who considers his greatest reward to be the joy and happiness of those around him. He has courageously faced all of life's challenges with indomitable spirit, and accepted all rewards with modesty and humility.

He does not desire any monuments to himself. But there are living monuments, in the shape of multitude of people one meets in different corners of the world, who know him, and have been touched by his kindness and benevolence at some time or the other.

Many years ago, Swami Ranganathananda of the Ramakrishna Mission said three words to him - "Be a Man". This, my father tells me, changed the entire perspective of his life. Today, I would like to say that this is what he has been all his life. "A man in the true sense of the word" - a Purushottam, who combines brilliance, matchless integrity and an infinite capacity for hard work and service. He is not just a successful human being, but a human being with sense of values. It has been said in Gita : –

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And he has equivalently faced life, the up's and down's, and enormously gone ahead and therefore more the achievement, perhaps that is why he is an inspiration to all those who came I touch with him.

I am especially grateful to Mr. M. Damodaran, Chairman SEBI, for kindly acceding to our request to come and be with us here today. I know how difficult it must have been to take out the time to be with us on this occasion. I also know that some of you must be wondering that what is the connection between a topic like SEBI and what we have been talking about in terms of Dr. Stya Paul. But I think that the connection goes very deep. Because Dr. Stya Paul has always believed in creation of wealth, but creation of wealth not for hoarding, not for dissipation, but for using wealth and using wealth wisely-and hence this topic is topical in this sense and also because given the issues and the challenges that are been faced in the context of the regulations of the Indian Capital Market, I think it is this sense of values and sense of ethics, that one is looking for in all the participants.

Today's inaugural Stya Paul Annual Lecture deals with a very topical issue– that of "Regulation in the Context of Indian Capital Market". Capital market regulation has come a long way since SEBI was set up way back in the 1990s. While commendable work has been done in this direction, including making our capital markets quite transparent and one of the best regulated ones, regulation is a continuous process. New challenges emerge almost on a daily basis.

As Chairman of the SEBI, and as someone who has spent over 35 years in the financial sector, who better than Shri Damodaran to shed light on this pertinent issue.

Though a detailed introduction to Shri Damodaran's achievements would shortly follow, I would like to take the liberty of sharing with all of you a few less-known facts about him.

Apart from his very distinguished career spanning over 35 years, his handling of Human Resources during the peak Kashmir Militancy in 1989-90, while serving in Doordarshan, was indeed commendable. This ensured that the D.D Transmission went uninterrupted despite militants' threat. He is an avid sports fan, and has a special love for cricket but mostly football. At a personal level, I understand his son Aditya has published a book of his poems in English while still studying in the school. Coincidentally, my son whose name is also Aditya, has also published a book of poems when he was in class X.

I am sure that Shri Damodaran's talk today, and the interaction that follows, will immensely help us in understanding the financial regulations and related challenges of the Indian capital market.

I am also grateful to Prof. Bibek Debroy for being with us today and participating in this discussion and to all the distinguished guests who have gathered here today to be with us on this so very special occasion, and lastly I must share with you an Urdu couplet which my father has often recited and it the inspiration behind the motto of Apeejay *Soaring High*

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***You are a falcon. Soaring high is your nature. There are skies yet for you to conquer. There are skies yet for you to conquer***.

Thank you"

## Introductory Note

***Mr. Nishant Berlia*†**

The year 2005 has been a very exciting time for Indian capital markets. Indian indices have been among the best performing worldwide – a testament to our great strides in capital market regulation. The value of this soft infrastructure, can be seen in the fundamental testament for a market economy, that markets are the best able to allocate our resources. Indeed, what we should really celebrate is that our capital efficiency is far better than those of most emerging markets including China.

In many ways, our new found economic resurgence has been characterized by India's march towards globalization. In the same spirit, I believe it is also important to consider a few global perspectives:

First, is the changing dynamic of information. Economic theory cites that at any given point the price of security in a market will perfectly reflect information driven expectations that eventually meet reality. Better your information, better your ability to predict the future reality. Consequently, in an age of information technology, one would have assumed that more information and a wider dispersion of that information would help investors take wiser choices. There are two flaws in the argument: first, that more information means quality information. As an example, we only have to look back to the internet bubble where many analyst recommendations, some later found tainted, in part drove valuations that in retrospect were clearly unsustainable And secondly, that more information and technology means equal access to that information – in other words we risk a technology divide translating in capital markets into an information divide. The danger here is that too much variance in information leads to more volatility, more and larger boom and bust cycles and a higher cost of capital for investment in the economy. As a result, for emerging capital markets such as those of India's, how and on what parameters we educate our investor base and promote the role of financial intermediaries will continue to be a central issue, [especially if we want to attract larger sections of our population to shift their assets into modern capital markets.]

Secondly, is the challenge of the changing demands of regulation. We have firmly entered a new era of financial engineering with the advent of derivatives, structured products and new innovations in corporate structures. Financial frauds in the recent past have demonstrated that even in the most regulated markets, analysts, fund managers and credit advisors have been unable to fully appreciate the complexities of this new era of finance. Corporate governance and disclosure norms, however, are not the only issues at hand. As more and more hybrid financial transactions take place the more the walls between different sectors of finance and their regulators are falling apart. For example, hedge funds in more developed debt markets are already beginning to play a role earlier dominated by banks. So are risks – derivatives today allowed a level of leverage to both investors and corporate unimaginable earlier. Consequently, the struggles of regulators in funding constraints and lack of available talent is no longer the prime matter alone, increasingly we must question the very basic architecture and design of regulation of the financial system in entirety.

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† Board Member, Apeejay Stya Group

Finally, we must keep in mind the lessons of the East Asian economic crisis. An event where financial crisis in far away Mexico and Russia spooked foreign investors to withdraw nearly overnight billions of dollars from East Asian financial markets. The resulting financial crisis forced otherwise strong and growing economies into recession. Economists termed this phenomena as contagious, implying the virus like ability of financial crises in an era of globalization to travel from one part of the world to the other and use weaknesses in financial markets to maim otherwise perfectly healthy economies. While we have rightly cheered and attracted FPI or Foreign Portfolio Investment to fund our growing economy, we must remember that it is dramatically different from FDI or Foreign Direct Investment which is much less liquid. The challenges that FPI presents us are issues that not only us but many nations around the world are facing with few truly resolute answers.

While we have achieved many laurels in the development of capital markets, we must remember that we have only really begun our journey, particularly, in other asset classes such as secondary debt markets, commodities, derivates, hedge funds and private equity, and, of course, in the slow march to full capital convertibility to foreign currencies. At the same time, we must also be careful of over-regulation – we only have to look to our recent economic past to see the dangers. In order to hopefully answer many of these questions, I take great pleasure in inviting Prof. Bibek Debroy to introduce our honourable Chief Guest and Keynote speaker, Mr. M. Damodaran, Chairman of the Securities and Exchange Board of India.

# Introducing Mr. M. Damodaran

*Prof. Bibek Debroy*[‡]

"Mr. Damodaran, three generations of the Berlia Family, Ladies and Gentleman. As Secretary General of PHDCCI, I know that my President, Mrs. Sushma Berlia often does half of my job and I am at a terrible disadvantage. As, I am supposed to do the introduction, but she said all the good things about Mr. Damodaran. Nonetheless, let me begin by thanking Apeejay Stya Education Research Foundation (ASERF) for granting me this honour and privilege for introducing Mr. Damodaran. Although Mr. Damodaran needs no introduction, but before I formally introduce him let me make two preliminary housekeeping announcements.

First please switch off your mobile phones and secondly there is an intervention slip, which can be passed on to us if you have any query, after Mr. Damodaran's speech.

Normally when you introduce any one you start with the past, and the present, and the present needs no introduction, as we all know that he is the Chairman of SEBI. We barely introduce people by introducing their future. I will first spend couple of minutes on Mr. Damodaran's future. I have no clear vogue, so what I mean by Mr. Damodaran's future is not his personal future, but SEBI's future, and I am greatly concerned and disturbed by what has generally been happening in the Capital Market. So let me state in very bulleted form as what are my concerns:-

- We have created this great deal of hype, largely thanks to the media which, I sometime represent in part time fashion about the sensex. The sensex is only a limited number. The sensex does not represent the entire Capital Market.
- The Capital Market is growing not only because of foreign institutional flows but also because of investments by retail investors, and these retail investors do not always invest as they should through mutual funds.
- No regulation can ever take care of human stupidity and human greed
- Sooner or later there will be a correction, and
- The moment there is a correction people will begin to scream from the roof tops that there is a scam! Allegation of bull cartels, allegation of bear cartels and then Mr. Damodaran will not only have to follow the *Gita* exhortations which Mrs. Berlia mentioned:

दुःखेष्वनुद्विग्नमनाः सुखेषु विगतस्पृहः ।
वीतरागभयक्रोधः स्थितधीर्मुनिरुच्यते ॥ ५६ ॥

***He whose Mind is not shaken by adversity, Who does not hanker after pleasures, Who is free from Attachment, Fear and Anger, He is the Sage of Steady Wisdom.***

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[‡] Secretary General, PHDCCI

- And he will also require all his media management skills in his role in Doordarshan and AIR to manage the flake.

Mr. Damodaran's present specialization, which headed up to his present, really began in 1995 from the banking division. Before that he did what he was asked to do as it is there in the civil services, often has no values and rationale, just as recently until the recent cabinet reshuffle Mr. Mani Shankar Aiyar has to look after both Petroleum and Panchyati Raj and there was no logical relation except both started with the letter P. In exactly the same ways, Mr. Damodaran handled the two T's Textile and Tripura. Since 1995 his specialization began onto RBI, IDBI, UTI and now Chairman SEBI".

We welcome Mr. Damodaran and invite him for the inaugural speech.

# Regulatory Issues in the Context of Indian Capital Market

*Shri M. Damodaran*[*]

"Thank you for giving me the privilege of participating in this inaugural lecture honouring a fantastic human being. As I sat there listening to the account of Dr. Stya Paul's life and work, I can tell that he is extremely humble, extremely smart creation of God who in difficult times battled the reconcilable difficulties, braved all odds, taken every obstacle in his stride and got to where he had to get, not in the pursuit of self interest but in the pursuit of the interests and concerns of society.

I believe, it was Swami Vivekananda who said long years back, that ***"Education is the manifestation of the perfection that is already in Man".*** It is given to very few to help less fortunate who move in search of that perfection that is benign in excellence. It is given to very few to recognize that physical, financial, locational and other disadvantages represented those best only challenges to the infinite capability of man. To deal with them, to overcome them, to seek solutions so that after they have been implemented would make the biggest of obstacles seem trifles.

If we had a few more people like him in our county, then perhaps we would have made much more progress than now. I sensed the daughter's pride when she mentioned that. I am delighted to note that not just two but three generations are working in pursuit of the same cause, which means a lot to the society, and lot to less privileged of our society and I am delighted to be a part of this evening function.

I was also a little puzzled when my friend from my Doordarshan days Mr. Ashok Ogra suggested me to be a part of this function because of not having had too much to do with Educational Institutions.

Over my long tenure in the Civil Service, I have worked o various capacities, but always stood up against those who wanted me to do things that were inconsistent with what I believe was right. Therefore I had more career moves then most people, who joined service with me and walked up the ladder with one. It's a continuous process. Sometime in 1995 I was asked to come to the Ministry of Finance and I would like to believe that as I was preparing to be a Civil Servant, strayed into area of finance, lost way and is still trying to find a way out. In a process of course, there has been some learning too and that I will share with you

Before I talk to you about what regulation means, let me tell you what I heard in Shanghai three days ago, from a person of Chinese origin. He doesn't live in Shanghai but had developed the expressions that Chinese use and some of you might know that when the Chinese says, may you live in interesting times, that is not a blessing nor a good wish for the future, that somewhat corresponds towards what Prof. Debroy mentioned to what interesting time connotes: "*He said that the only worst comment that you can make to somebody is become a regulator of the capital market in your next life*". So I stand here in bold that if I do this time wrong and don't get it right, I won't be asked to do it again.

[*] Chairman, Securities and Exchange Board of India (SEBI)

Let me share with you what regulations in the capital market means. What is the Indian capital market? It is a market wedged around all manners of players. The good, the bad, the indifferent, the big, the small, the individual, the corporate, the Indian, the Foreign, you name it, that category of market participation exists in India. Do they all exist in India with noble motives? Do they all act in enlightened self-interest? Do they all act with long terms interests that are consistent with the larger societal objectives? If that was the case, you wouldn't need regulations, you would need a regulator. Unfortunately some of them often believe that if you step out of line on occasions there are profits to be taken, there are benefits to be had, there is an appreciation by those that believe that you pulled something over somebody's eyes, and that you have been the smartest individual who has outdone somebody, you have scored more goals than other had and things of that kind and therefore regulations exists.

I say this because in the context of liberalization, in the context of freeing up from the line of controls, from prescriptive arrangements, question have been raised that how much regulations do we need? Do we need regulations at all? Isn't it better to leave people to the judgment of the market and let the market decide whether they function well, they function badly or well delivered or not delivered well, shared well not shared well. If things were so simple as I said we would not have been here on a Saturday evening to discuss the Capital market. We have more than 20,000 brokers and sub-brokers with 23 exchanges, which have a dimension of every variety of intermediaries. You have investors who are extremely savvy; investors who don't know what the market is? And yet are parting with their money, if the market says. You have issuers who come to raise capital with good productive intentions, hoping to play their part in National efforts and you have people- luckily you don't have too many of them, you don't have too many people who come to the market hoping to sell you dreams and walk away with your money and leave you with the typical Indian concept of a vanishing or a vanished company, that's something that the Ministry of Company Affairs deals with on a continuing basis: -companies that come to the market, raised money, disappeared without a trace. It is that market that the SEBI seeks to regulate and what is the mandate given by parliament to the SEBI. The mandate stated in the preamble to the SEBI Act of 1992 says that you have to protect the investors; you have to develop the market; and you have to regulate the market. The two ways of looking at these three objectives. One is to look at each of these in isolation from the other two, look at this disjunctively, look at these as three separate objectives and if you look at that you could raise the kind of questions which a bright young colleague of mine, a seemingly difficult question that I keep thinking that bright young people are in the habit of raising seemingly difficult questions. She asked me which is our primary constituency? Is it the issuer who comes to the market to raise money? Is it the investor who comes to the market parting with his savings in order to help somebody else to set up productive enterprises so that national wealth multiplies? Is there a conflict of interest between issuer and investor? Are they both matching on the same side? Is there an adversary relationship that some people seem to believe based on past experience between unsuspecting investors and those who come to the market to raise money? Are development and regulation- two horses facing opposite directions, which we are trying to ride at the same time? Do these go hand in hand? What is regulation? Is regulation the synonym for control? Does regulation translates into micro management? I think these are the large philosophical questions that derive from the mandate that parliament had given to SEBI in the effort to bring some order some sense to the capital market.

The way I choose to look at it is, that if the investor protection –the investor interest is paramount, the best way to do that is by growing the market to a size where the size itself is some kind of insurance to the investor, that things can’t go terribly wrong and adding his growth to that size in an orderly fashion by ensuring that the participants don’t step out of line i.e., the regulation aspect. I see this as three pieces of a pancake, which come together not as separate pieces that are at conflict with each other. To my mind, all of us whether we are the issuer, seeking to raise money in the capital market or investors that invest in the market or the regulator are all on the same side. There is no adverse information. And this brings me to regulatory philosophy.

What is regulatory philosophy? The philosophy of a regulator in my book is that at the end of the day you should not look at the scoreboard. Ask yourself where the sensex or the NIFTY has reached. Ask yourself how many people you have punished before you went to office. Ask yourself how many times you said no to people that had legitimate reasons to access the market. Tell yourself that god or government, whoever, has placed you in a position where you can exercise raw power and enjoy the exercise of raw power even if it hurts at one level, individual at any other level or the country as a whole. That in my book is not regulation. I believe that the philosophy of regulation derives from, as was mentioned, my favorite game of football-that’s the best pattern that I can think of. Before I take up football the rule is made clear to everyone, they are fairly simple. You know what is to be done, you know what is right, and you know what is wrong. You know that there is one chap there in the playground with the whistle and should things go wrong, he is going to blow that whistle, should things go terribly wrong he is going to put his hands in his pockets and come up with a yellow card or a red card. That I believe is the philosophy of regulation. You state the rules simply, you state the rules clearly, ensure that everyone understands what the regulations in the books are, get the game started- don’t blow the whistle too often-blow it when you think it must be blown –pull out the cards when you need to pull the cards- take the bad-guys out of the game and let the game go on-don’t disturb the game. Regulation should not be to disrupt. If that is the underlying philosophy of regulation, I believe that those who are in the market will play by the rules, will ensure that they themselves contribute to the identification of bad elements and ensure that the market is a cleaner place, a better place, a more profitable place for all concerned. It is that philosophy which I would urge you to believe in the process of regulation in the Securities and Exchange Board of India.

There have been many changes made since SEBI was set up in 1992. Prior to SEBI’s being set-up, the capital market had some body, it was not a vacuum into which SEBI worked, there was a person called the Controller of Capital Issues who occupied a reasonably big room in the North Block where the Ministry of Finance is housed. There used to be a squad that time, “a merit based system in which that individual and the supporting anchors in that division of the ministry asked a few questions to those seeking to access the capital market and then arrive at a decision on whether that company, that promoter, should be allowed access to the market at that point of time and what would be the size of the issue and what would be the price of the issue”. Like beauty lies in the eye of the beholder, the merit was in the eyes of that individual who headed the capital markets division of the Ministry of Finance. We moved on since then to a disclosure-based regime. I mention this because the paper given to me by the organizers as a concept note mentions that SEBI needs to approve issues not vent issues and comment on offer documents and prospectuses.

Nowhere in the world, does the capital market regulator sets a stamp of approval and say approved or endorsed or worthy on any proposed attempt to raise money from the market. The regulator's job is to ensure that there is maximum disclosures, that there is transparency, that everything needed to be communicated to the investor is communicated as clearly and as elaborately as possible and then leave it to the wisdom of that investor to take a call on whether he or she should invest in that stock at the price when the issue comes to the market. I don't think there is a case, no matter whatever the climate of any regulator or any regulatory organization to substitute its judgment for the judgment of the investing community. It is for the investing community to decide, whether someone that goes to the market needs to get the money or not. You cannot have someone sitting in the office to decide on who can go to the market and who cannot. Clearly the bad names would be discouraged from going to the market but there is no process of saying yes to something we have approved and other which we have not. We insist on more and more disclosures. This is not a concealed based regime. This is a disclosure based regime. This is a regime that is based on transparency. This is a regime that seeks to address at one level the asymmetry of information. It seeks to ensure that those who are unaware of what a company intends to do with their money and those who know and have different levels of information but not differently placed when they go to the market; that asymmetry of information is what increasing disclosures seeks to address and to enable people who come into the market to open eyes to take decisions. What it also necessitates is simple processing. If our processes are not simple, we would discourage the very intention of seeking money in our market and they would go elsewhere for money. Today if you raise 10% of your money in the Indian Market, you can raise all your money outside and if the processes outside are simpler, faster, and are less costly- then people would prefer to go outside.

So the gamut of regulation is to promote and encourage more disclosures to ensure that there is maximum transparency- with the regulatory path and at the same time make processes more simpler and efficient.  It also involves writing regulations in much simpler language, not just in the area of securities market regulation, but starting with the constitution of India.  We have enactments, which I believe could have been written in much simpler form to facilitate better understanding and interpretation. But unfortunately that has not happened.

Our endeavour at SEBI is to rewrite regulations in a simpler language so that people in the market understand and are not encouraged to take liberty because of the interpreted skills of some lawyer.  Long years ago, I heard this phrase that language was given to man to conceive his thoughts not to express his thoughts. And if you read some of our regulations, you will find evidence of that proposition that what we intended to state is not stated in the regulation and what we state in the regulation is often unclear.

That is the challenge of regulation, which we address on a continuing basis.  In the context of the primary market itself, there is one move that SEBI has made in recent times to make life little easy for the average first time investor, ***We have put in place the***

***price list of optional grading of IPO's by rating agencies.*** However as soon as we had announced that, analysts, commentators, experts went to towns saying that it is something that the western world does not do – and which no other market has done. How can you actually grade IPO's, which are equity issues, without bothering to understand what it is that we were attempting to do when we spoke about grading and not rating?

Let me spend a minute to tell you what it is that we are doing and why is it that we are doing. Because it is very important to explain to do this in order to deal with the confusion that might have been caused by reading some of those comments in the press on how we have taken the wrong course at this point of time. If you have seen as an investors – the documents, that are put out prior to an initial public offers – the first thing you would have noticed is how many pages there are. You are also told to at least read all of those before you make an investment decision. Now if you did not read all of that, and you made a decision, and that decision turned out to be wrong, the perfect explanation that any regulator / any investment advisor / anyone in the Govt. / anyone who shoulders to seek to inform would say that why didn't you read the document, something there should have alerted you. Now all of us have different vocations, all of us have time constraints. All of us do not begin and end the day or spend all the days in reading these documents. And the presumption that you invest after reading these documents is what lawyers call a vulnerable presumption and one that can be easily rebutted. I do not have to ask you to raise hands as how many people really read these documents before reaching out to the chequebooks. If you invest in the mutual funds and if you see the mutual funds advertisements these days on TV as well as print media (product advertisement), they tell you, please read the offer document before investing, count the number of pages in the document, ask yourself if you have nothing better to do, then read that offer document. And if that mutual fund or that asset management company is trying to persuade you to invest in that and your job is to go to the nearest bank branch and put it in a deposit where nobody asks you to read pages and pages of print that made no sense to you, I do not think there are any prizes to be given on what course of action to be followed.

At one level, we are telling people please come to the market in large numbers, please participate in this great Indian growth stone and at the same time putting them on a notice that if you make this investment without reading this document, do not come back to ask from us as why you told us to come to this market. To address that concern, i.e. for the first time investors concern we are experimenting it on an optional basis with grading of IPO's where much of what is contained in pages after pages of these documents is captured by a rating agency in two or three paragraphs and when numerical grade will be given indicating that on the basis of these parameters, we believe that this is where this issues you time. It makes no mention of whether it is an investment proposition worth considering at a price. All that it says is from the supply to the voluminous data in the document, what is the track record of the promoter in terms of the expected cash flow of the investment proposition, in terms of the criminal proceedings that they could be facing. We are doing this because unlike the developed countries, you do not have a cardinal of trained financial advisors in sufficiently large numbers to reach out to potential investors all over the country and advise them on the best investment references. As I mentioned, we will not lower the regulatory bar. Our approach to regulation is that in terms of benchmarks, we must rank with the best.

To give you just one example. Post Enron, related problems in United States, legislation was enacted, it was passed by a statute book called the *Sarbanes-Oxley statute*. We have legislated on similar lines but we have a clause in our listings which is an agreement between the stock exchanges and the NET's listings, which has all of the important ingredients of *Sarbanes-Oxley Statute*, whether it is the board composition, the role of audit committees, the composition of audit committees, issues they are required to address the certification of systems by CEOs and CFOs, all of that is captured here in one long clause : In terms of regulatory standards, we rank with the best and 2005 is the year when that became a part of the listing agreement. 2006 is the year as per my expectation, where we will see significant compliance with those standards. This will ensure that Indian corporates, that are listed on Indian Exchanges, in terms of the essential requirements of governance, would measure to be the best. I say this because: in the recent past, especially in the last 12 months, we had the unseemingly expected of exchanges from some other parts of the world coming to India as they have done in some other countries too and canvassing business on the basis of lower regulatory standards. There are exchanges that have come and told Indian corporates that you do not have to comply with such high standards, if you come and list on our exchanges then life will be simpler, money will be easier to raise less questions will be asked, costs will be less, cost to the system will be overtime.

Now, if you know our regulatory system, someone somewhere will pay a price at some point of time. We are not part of the rat race; we would do without that business. We are happily willing to part with those companies that in search of lower regulatory standards seek to list elsewhere. Our expectations is that Indian corporates in large numbers would want to be seen in good companies, would want to be seen as measuring up to higher standards, would want to demonstrate the regulatory world to deal with the same and that they will in search of long term results list on our exchanges and therefore while we will address simplification of processes we will not lower regulatory standards. What that means by way of regulatory standards is the requirement of finding the adequate number of people with the right skills, the right motivation to stay in the regulatory environment and play the role of the regulator. Regulators all over the world are paid significantly less than people in the regulatory entities and so it is a continuing challenge whether U.S. or in Australia or here to recruit and retain people in regulatory organizations. That is an essential part in the regulatory standards, it is an in-house challenge. How do you get good people? How do you retain good people? Is there a trade off between the pride of working for a regulator versus the money that you see at the end of the month working in a regulatory entity and what kind of a trade off is that – that's the challenge that people who work in regulatory organizations address on a continuing basis.

We need to also understand SEBI's position in the regulatory environment. Whenever something small goes wrong somewhere, there are people who would immediately come to us and say, we lost some money, we did not get this on time, somebody did not give us this information, we have not got the annual report as yet, etc. Yesterday in another context, I mentioned this and believe it is best to be mentioned.

In any capital market, the stock exchange is the first limited Director. It is the stock exchange that ensures that there is orderly conducts by those that seek to raise money and those that seek to invest in those productive enterprises. The capital market regulator whether it is the SEBI in India, (FSA) in the United Kingdom or Securities & Exchange Commission (SEC) in U.S. all are at one level detached from primary regulation. It does not mean that we are absolved of responsibilities; it means that we have to ensure that first level regulation is carried on prominently. It is a challenge in the Indian market as far as regulation is concerned, as far as development is concerned and in fact development is the need to provide for more products. We keep looking around us, exchanges keep looking around, merchant bankers keep looking around to see what are the products on offer in other markets and whether those products need to be offered in India. This is a continuing task and overtime we have introduced products. Last year we have optimized the gold exchange credit fund. This year hopefully real estate would pick up. Center-stage in our thought process-there would be fewer derivative products. There are all kinds of derivative products that are available in the country and world these days, we would have some of them. In fact, when we first heard of weather derivates, I asked myself whether derivatives are going to address human beings, products or even nature's products. You get more and more products of that kind; our markets would get it too. We will have this year, one more introduction and that is short selling by institutions. This is one market where institutional participants are not allowed to short sell- that will get addressed this year. There will be a system of stock where borrowing is going to be introduced. Physical settlements will get introduced. All of these are International practices and we will catch up all of them during calendar year 2006. We have also done something, which has not been done anywhere else. Again there was a problem, but now things have stabilized. We did away with the discretion that, lead managers had in allotting shares of IPO's to qualified institutional buyers, i.e. institutional investors. Nowhere else in the world is this being done. We also imposed margins on it. A 10% margin and we were told that your market will collapse as these people will shy away from your markets. They will go to markets that are less prescriptive and where people need to have discretion. None of that happened.

After we did introduce these measures, there were a few big issues in the market, which were oversubscribed. But that is something for which we believe we have not been entirely forgiven because in the context of some problems presently, being experienced in regard of the IPO, where some people have stepped out of line – they have been caught and are in the process of being punished.

Now persons, who believe that we need to do away with the retail quota for investors, we need to give everything to institutional buyers. Retail investors must invest in the mutual funds and we need to go back to the practice, which existed several years ago. In my book, that is just not throwing the baby in the bath water. That is throwing out the baby, the bath water, the bath tub and the bathroom also. We are not going to have a market; it is only to have a market, where there are investors, whether they are individual or institutional, whether they are big or meaty. But one thing was that the demand has come up in the year 2006, when this was introduced in the year 2001 – nobody complained. It is because we chose to strike where it hurt and that is we did away with the discretion, which some people had who decides who gets how many shares in the IPO's. Why am I lingering on this? I am lingering on this point to get this message across that in capital market regulation, India is not going to be a follower. We will set standards; we will raise the bar ourselves. We will do things that others have not done. We will go into regions, which looks like regions, where people fear to tread, even if we are briefly seen on that line, we do not mind even if it is the larger public literacy – we believe that people will follow us there over time.

I want to talk about corporate governance and then close. In the area of corporate governance, we have a lot of misinformation. We first heard it said that we were waging a turf war with the Ministry of Company Affairs on who needed to deal with corporate governance. We were told that we needed to wait for the implementation of Irani Committee's recommendations on company law which to some who read it superficially seemed to be in agreement with what we were seeking to do, forgetting that there was scope for harmonious reconstruction between Clause 49 and what exists in the Irani Committee recommendations. We saw criticism that in a country of billion plus people, you will not be able to find a few thousand people, who are willing to serve on board of company as independent directors. That myth, I believe, has been eroded this time. We were told that PSU's did not need to have the requirements of corporate governance that were initiated in Clause 49 because they were down in tone. In my book, ownership and management are different. In my book, ownership and good conduct are different. It doesn't matter who owns you, who is the largest shareholder. You can go wrong if owners themselves start believing that there is no difference between ownership and management and that is something we seek to address and that is why I extended Clause 49 to public sector also. There are no exemptions, which have been made to any company, whether big or small. I refer briefly to the concept papers, which commented briefly, that in the context of globalization, one of the biggest challenges facing regulators is what to do with the problem of money moving too quickly across or investors moving too quickly across. That is a lesser problem than it was some years ago because there is an organization called International Organization of Securities Commissions. India is one of its original members, we are signatory to multi-lateral memorandum of understanding, which enables sharing of information, sharing of expertise and on that basis, we believe we have the confidence to deal with whatever problems globalization might bring in our way in the capital market regulations.

The last problem that I would like to deal with today is a huge problem. In capital market regulation, this is a problem of dissemination of information. Information is critical in the market place. Information not just in regard to some small development that may be taking place in exchanges or companies but information in regard to what regulators seeks to look at in the market. Given the large number of investors, the size of the country, the diversity of investors, and the heterogeneity, there is no way that regulators can directly reach out to investors, however, hard they try. We believe that this is the role that media can play respectively. Media can really hype the expectations / problems. Media can bring a halo to the sensex. Can hype the sensex to an extent, which neither the sensex nor any other index deserves because it's just another number. In all of that, what we experienced and what sometimes shocks us, sometimes surprises us, sometimes saddens us is that when we are there to communicate, what gets disseminated is often the exact opposite of what is being communicated. And this is something, which we experience day in and day out.

I will close by telling you something that I experienced this morning. I was at a couple of functions yesterday, where I had to share some thoughts and did share some thoughts, some of which have been reported in some newspapers today. I got two phone calls this morning. One from gentleman, who was not present and who said I am sure you could not have said that and another from a gentleman, who was present and who said I did not hear you say that. If that is dissemination, I believe the biggest challenge in regulation is going to be not products, not processes, not standards, not people, not mindsets, not regulatory philosophies, but simply getting across our messages to those who need to hear us, hear us in time, hear us right, and hear the purpose of taking investment decisions. And, I believe that those of you, who have spent a Saturday afternoon to be here, will aid us in that process by sharing this concern not just of the Indian regulators but of regulators worldwide with audiences / your friends / friends of investors.

***Thank you very much".***

## INTERACTIVE SESSION

***The interactive session was conducted by Prof. Bibek Debroy in which he read out the interventions made by the participants which was responded by Shri. M. Damodaran.***

Few observations were made on Prof. Debroy's comment:

(i) Sensex is not on hype;

(ii) SEBI & stock exchanges are on an alert and chances of further scams are remote;

(iii) Retail investors are investing heavily through mutual funds; and

(iv) Every correction in the market is always healthy

Considering all these, the future of Mr. Damodaran and SEBI is very bright and same is of the Indian investors.

Two questions were also addressed to Mr. Damodaran as

(i) Merits and Demerits of short selling to be allowed to Institutional investors

(ii) Role of clause - 49 in corporate Governance.

While answering other queries Mr. Damodaran replied the above.

**Q.** At present the Indian Share Market is mainly dependant on FII's investments so, what decision is SEBI taking to persuade normal investors to invest more in the share market?

**Mr. Damodaran:** First, it is true that in the last 12 months or so, there are Foreign Institutional investors that are plying into Indian Market, we believe that this is not over yet and my interaction with some of them in the recent times has made me believe that there is more money coming, but that's not the whole story. Indian Mutual Funds if you have noticed have in the last few months invested significantly in the Indian market. What is more is that in the last one month, around 8000 crores have been raised by Indian mutual funds. This hasn't been invested as yet. We would incorporate most of that money in either way into the market. Therefore, unlike two years ago, a very disproportionate presence of FII's in the Indian market was there, but now while the presence is large- we need not believe that they are the only significant investors today in the Indian market. Our belief is that the market that has increasingly better regulations, will bring direct investments of retail investors - will have more Indian institutional investment, and have Indian mutual fund investment in the market.

**Q.** Is there a move to approve the price of new issues?

**Mr. Damodaran:** The simple answer is 'No'! Some of the problems that you are seeing today are because of the inappropriate pricing of an issue. Conventional is that when an IPO comes to the market, it will need something on the table for the investor, that on listing day the price needs to be a little higher than the price on which it come (that is conventional). But if the expectation is that on listing you will see a significant difference, there will be a scramble for the IPO. On occasions we do not fix prices; we would persuade those who fix prices to be a little more realistic.

**Q.** According to the SEC, only a few credit rating agencies are allowed leading to an Oligopoly, what are the pros and cons of doing this and does SEBI have any rules so that only a few limited credit rating agencies are allowed?

**Mr. Damodaran:** Credit rating is a very difficult game and the difficulty in this exercise is that to ensure that not so many of them set up shops and that not too many of them in past have been on regulators. Presently we have four and I don't see there will be a fifth one in the horizon. You see internationally there aren't any more. You don't need any second hand to back rating agencies.

**Q.** What advice would you have for a normal middle class man who earns 10-15 K a month to invest in terms of share trading given the asymmetry of information that exists? What is SEBI doing to bring about transparency?

**Mr. Damodaran:** I think no one can advice you on the basis of this information. If you are earning 10-15 K and you are the tenth earning member of the family and 9 others are earning several multiples thereof – you won't get terribly hurt if you put all your money in the market. If you are the only breadwinner in the family you need to ask yourself a few more questions. The point I was trying to make is that unlike in other countries you don't have large number of advisors who would sit across the table, look at your family situation, your capital, look at your specific needs in terms of liquidity and returns. There are a few; I don't think the person in the income group you mentioned could afford their services. Someday when that service is available a little cheaper or when you get an honest advice through the media maybe you can partake the advice and answer the question yourself. I in any case don't invest in the market and, therefore, I can't advice on that.

**Q.** Enquiry proceedings regulations were recently amended to remove the timeframe within which the enquiry by SEBI must be concluded. There are instances that clearly demonstrate that there is no internal procedure within SEBI to review as to how many enquiries are pending. Would you like to comment?

**Mr. Damodaran:** Let me take the last part first. It is not true that there are no internal procedures. Even as late as 15 days ago, we did a thorough review of what is pending, why is it pending, why has it been pending for years, do we need to look at things chronologically or do we need to take out some of the bigger things as a part of the message we are trying to send out to the market. All of that does tend to get addressed regularly on a continuing basis. Why were the time limits done away with? I won't get into the specific case but we had a peculiar case and allow me a minute of your time to share because that is yet another challenge of regulation in India which does not happen in too many other countries. There was an audit passed or rather there was a hearing that was taking place. The regulation at that time said that within 30 days of completion of the year, the order needs to be passed. At 6.00 clock one evening the gentleman who was hearing the case said: Enough is enough- I have been hearing you for the last few days, anything else that you want to say, give it to me in writing. This let to an exchange of letters and when one month got over, they said we have nothing more to say and that the order must be passed. And while the clock ticked over (30 days went by), the technicality did not get into the specifics of the case. Learning from that incident, we decided at SEBI to do away with the timelines.

**Q.** Why is there such negligence and ignorance on SEBI's part w.r.t scams? Why is SEBI always reactive and not pro-active enough in stopping these before they happen?

**Mr. Damodaran:** Let me use the words from the question itself: 'Negligence' and 'Ignorance'. It's rather ignorance. Forgive me for making a statement that might seem a bit provocative. I think much of that question is rooted in a lack of knowledge. I won't say it was ignorance of what really happened. What the scam was all about? And I think we could spend a couple of minutes at understanding what it was. Because there were some issues where the demand in the interest of the investor was significantly higher than the supply, some people decided to open- what we initially thought were *De-mat accounts*. A little probing showed that they were bogus *De-mat accounts*. A little more probing showed that they were non existent accounts. All the details would be in public domain soon as a colleague of mine is dealing with the case. You have regulations in place; you have customer norms in place but if a banker opens bank accounts without verifying who you are, if depository participants open depository participant accounts on the basis of those bank accounts believing that the bankers must have checked out the credentials. If everybody drops the guard, somebody will walk away happily to the bank. This has happened in a handful of branches. In one place, we have identified every single person- that was involved. This was not a case where SEBI was sleeping; this was a case which SEBI found through its sources and market investigation. Nobody gave us the information. This was going on since 2003 and those who are dealing with investigations today were not around at that time. They got information from sources they had in the market. The International body that studies market trends says that we have addressed the concerns correctly and put in place the right kind of systems. Therefore, some people clearly decided that it was worth taking the risk to sabotage the procedure and get away with the money. There are several agencies behind these people and not just us. As newspapers say: 'Watch this space for more tomorrow'- you will see more. Therefore we were not sleeping. Regulation is preventive. Catching up a criminal can only be reactive because you can't anticipate that who in this world is going to commit a crime and post a policeman outside. Let me share a small story. Sometime ago, from an Olympic contingent's tent, valuable item was stolen and the thief was running away. So the fastest runner in the contingent was called on by the team manager and was asked to run after that guy and get the thing back. They both disappeared out of sight and after some time the man returned without the item. When the team manager asked him- did you catch the thief? He said: catch him? I overtook him! This was the only occasion when the policeman was not aware that he was running after the thief, on every other occasion you hope to run faster so as to be able to catch the thief.

***There were some questions centered around the role of the smaller exchanges and the regional stock exchanges.***

**Q.** Wouldn't it be more efficient to have a few major exchanges? What does one do with the smaller exchanges; can they be authorized to get into commodity exchange activities?

**Mr. Damodaran:** I think that's a very topical question because a few months ago we signed a scheme for de- neutralization of these exchanges. What that means is that the trading function and the ownership function will get separated. Given a year to complete the process of corporatization and de- neutralization, we hope that within one year, each of these exchanges will ask themselves precisely this question: Way forward; where do we exist? Because we can't exist with the NSE & BSE having pan- India presence and being established, it is important for another exchange to hold its place. 15 of them have set up subsidiaries, which are trading on these two exchanges. One possible way would be for the parent exchange to personalize into the subsidiaries. Some of them are looking at bringing in strategic investors and also looking at mergers of some of these so that they can then get into commodities exchanges. So they need to invent the business and not us.

**Q.** This question is related to Children's Mutual Funds, which ostensibly promise to provide security to the child but on the other hand actually provide security to the parents. In issues like these funds, who does one go to- the Consumer Court or the SEBI?

**Mr. Damodaran:** There are two sets of issues here. One of them is premature closure. I was also associated with a fund house sometime back which during my tenure and even after that had prematurely closed down some schemes- i.e. didn't let them run the complete term. Since, the fund house had promised a return at a rate which was totally unsustainable due to the decline in interest rate. It was challenged and the courts allowed the fund house to close the schemes. But what that meant for the investor was that they don't get the entire money they expected as a long-term return but only what was promised to them for a reduced term. The second problem, which is still somewhat current, is more a banking issue than a mutual fund issue. When schemes are terminated, in whose name a cheque is issued, since the child is still a minor. Some banks issue the cheques in the name of the Father. Fathers don't want those cheques to come into their accounts because they don't want to explain those. I am told that many fund houses are resolving this on the basis of the number of problems they get and the issues involved but that is still on the books. I think the first step for the consumer is to go to the Asset Management Company, ask them to find a solution. If that fails, you write to the trustee because mutual funds in India are structured in a way that you have trustees on behalf of the investors. They are the guardians and the first level of investor's rights. If you fail there too, please write to us. Because I don't want somebody to go to the court, loose the case and then wonder where to go?

**Q.**. When will currency futures and options be introduced? At present, the market does not allow individuals to operate and who will regulate the foreign exchanges?

**Mr. Damodaran:** Let me answer the third one: We will not regulate the Foreign Exchange Market!!

## CONCLUDING REMARK

*Prof. Bibek Debroy*

Ladies and Gentlemen, we would agree that this has been an extremely educative talk sliced with interaction and I am not going to summarize but again make some very pointed and bulleted statements and I will invoke the two G's that Mr. Damodaran mentioned first i.e. God and Government. For years and years, the government persuaded us that higher returns were possible with zero risks. And unfortunately that mindset continues. The fact of the matter is that we cannot have higher returns without higher risks. The second 'G' involved in this is God and unfortunately, the only person who has the complete information is God.

If I may use the cliché and expression, as the returns in safe assets are declining, we are now increasingly being asked to step out on the road. The road earlier was a road where only Fiat's and Ambassadors were available. They were no fast cars and so the chances of accidents and the chances of being run down were lower. Now the road is a fairly fast road and it is therefore a very dangerous road. If you ostensibly look at the traffic rules in Delhi, the traffic rules are no worse than traffic rules in most developed countries. Unfortunately, as all of us know, we tend to drive not just on the left hand side but also on the right hand side of the road when we are O.K probably. But we also tend to drive on the middle of the road when we are not O.K.

Which brings me to the third 'G', which Mr. Damodaran did not directly mentioned indirectly and that is the issue of Governance not Corporate Governance? Question marks about SEBI do not concern so much on whose but SEBI's credibility is linked to the actual prosecution punishment all of which are subsets of that governance act. To take the Football match example: generally crowds in football matches tend to be more violent than in cricket matches. In football matches, there is not only a referee but there are also two linesmen. Mr. Damodaran, I don't think has any linesmen that can publicly brandish. This is all up to the referee. Also in cricket matches, the umpires do zero running- they do a little bit of walking but in Football matches, the referee has to run much more than even the players do. So that is why Mr. Damodaran is in a very unenviable position but we do need that position and if we are going to have that position- given his background and given his expertise- we probably would not have asked for a better regulator!

### *Vote of Thanks*

The session ended with vote of thanks by ***Dr. Mithilesh Kumar Singh***, ***Senior Research Fellow,*** Apeejay Stya Education Research Foundation.