

**Retail investors and how to develop a confidence in the retail investors**

**Mr U K Sinha, Chairman, Jan 9 2013, 8<sup>th</sup> Annual National Conference on Capital Markets**

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This is the first conference I am attending where the theme is entirely focused on the retail investors and how to develop confidence in them. The confidence building measures for retail investors is a very timely and topical subject. I would like to bring in the perspective from SEBI into the discussion.

***Pension Fund***

Coming to the low penetration and involvement of the retail participants, the issue arises regarding retail directly investing into the market versus retail investing through institutions. I would like to dwell upon this point in relation with pension funds. We argue, only 1.3 per cent of the population invests in market in India in comparison to around 10 per cent in other countries such as China. But while making such comparison we forget that retail money may also come to the market through institutional route. Since all of you are from corporate world, I would also like to make a point and also challenge you about what you are doing individually in your companies, with regard to the pension fund? You are aware that in case of employee strength of 20 or more, companies are covered by the EPF act. Further, the EPF act also provides that if the employee is earning a salary of less than Rs 6500 per month, then EPFO is mandatorily covered for him. If the employee is earning more than Rs 6500 it not mandatory.

In my opinion, in the organizations we are working with, there would be hardly an employee who is earning less than Rs 6500 at present. So without waiting for the further pension reforms in this country, we may take the lead and invest the pension funds in the market. We have the example of NPS. Now we can compare over the period of 5 years the returns generated by the investment in securities market and investment in other products. Some of the investments are not even able to cover the inflation adjustment. Hence, I urge to all the members present here that instead of waiting for some bills to get passed, we should take some decision at our own level and take action immediately.

### ***Building confidence in Market***

I would like to come to the issue of 'confidence in the market', and the measures SEBI can possibly take in this regard. The most important point made by the previous speakers about boosting the confidence of the investors in the market is by avoidance of mishap. Examples have been quoted regarding how mishaps have happened in the past and people have been shying away from the market. I would like to bring it to your notice that since last amendment in the SEBI Act in 2002, we have a market relatively free from any mishap or organized misconduct. Culprits cannot get away with serious incidents of market misconduct without getting noticed and punished.

SEBI is taking all the possible decisions and measures on its part to ensure that nobody is permitted to misuse or avoid the rules of the game. Nobody is being allowed, especially on the continuous basis to do something which could harm the interest of investors, both retail and institutional. SEBI has come out with a new guideline in consent mechanism. It has provided us with a very high degree of discipline. There were allegations that if somebody is very powerful, he can get away with any offence by paying a certain amount of settlement charge to SEBI without admitting his guilt. Under the new consent mechanism, now certain measures do not fit for consent and not only that for any offence, the amount that can be imposed would be calculated as per defined formula. The whole idea is to remove arbitrariness and bring transparency.

Besides, we have now introduced a very sophisticated, surveillance mechanism. Every day we are getting about more than 100 alerts through our data warehousing system. There are teams which follow up the each and every alert and wherever we find those alerts are required to be taken to the stage of enforcement or adjudication, those are being taken. What I would like to assure you and through you to the rest of the investing community that if there is attempt on the part of any body to manipulate the market or to bypass the rules we are today in a much better position to detect them and penalize them.

### ***Initial public offerings (IPOs)***

Another area I would like to touch upon is the primary market. A retail investor, who seeks to invest in securities market, initially wants to be assured whether the market is being well regulated and secondly, if any problem arises whether there is any mechanism to resolve it. I will dwell upon the pricings of the initial public offerings in India.

In the analysis of price performance of the scrips listed during 2008 to 2011, it was observed that out of 117 scrips, 72 (around 62% issues) were trading below the Issue price after 6-months of their listing. Out of those 72 scrips which witnessed fall in price, in 55 scrips the fall was more than 20% of the issue price. In this scenario if the trend continued, the sentiments of the investors would be affected as they might lose confidence in the market. Thus, there is a need to provide Safety Net arrangement for RIIs to build their confidence in capital market.

Repeatedly, we have come across the instances where we find lack of transparency in pricing. SEBI has come out with a discussion paper on 'Safety Net Mechanism'. And rightly, it has evoked very strong response from both the sides. On one side the argument is that it is a risk capital. How can anybody ask for a guarantee and return of the money. And if other argument is, if two third of the issues continuously trade below the issue price year after year, months after month, even after the adjustment for general decline in the market, then it is difficult to expect retail investors to invest in the market. Our discussion paper is in the public domain. My personal opinion is that, we must introduce a 'Safety Net Mechanism', maybe in a milder form, primarily to give a signal that the pricing has to be right. Taking in view the recent post-listing price performance of IPOs, it is necessary to come up with some mechanism for right pricing of IPOs so as to reinforce investor confidence in the markets and discipline issuers and market intermediaries.

## ***Corporate Governance***

Another area of importance for attracting the retail investors in the market is good corporate governance in the country. Gauging India on the 32 principles defined by OECD, India is very good on 30 out of 32 principles. And even in case of the remaining two principles, we are partially compliant. But my personal belief is that we are compliant as a country more in form than in substance.

In order to strengthen the standards of corporate governance, SEBI introduced new provisions for listed entities in 2008-09. These requirements, *inter-alia*, include to have at least one-half of the board as independent directors, if the non-executive Chairman of the company is a promoter or is related to promoters or persons occupying management positions at the board level or one level below the board, specifying the minimum age limit of 21 years for independent Directors, specifying the maximum time gap (i.e., 180 days) between the retirement and resignation of an independent director and appointment of another independent director in his place, and require the listed companies to disclose the inter-se relationship between the directors in the filing made with stock exchanges.

There is an ongoing debate on the eligibility of independent directors. SEBI has come out with some guidelines with regard to corporate governance norms, dealing with the audit reports and qualified financial statements. In 2012, to enable wider participation of shareholders in important proposals, SEBI decided to make it mandatory for listed companies to implement e-voting facility for their shareholders and this was transacted through postal ballot. This encouraged wider participation of shareholders in important proposals. Further to bring in more transparency in the grievance redressal available in the stock exchanges, SEBI has directed all the stock exchanges to disclose the details of complaints lodged by clients/investors against the trading members and companies listed in the exchange, on their website. Besides, compulsory dematerialization of the promoter's holding has also been mandated by SEBI.

Among major developments in past few years, voting by institutional investors being mandated by SEBI, holds great significance. In case of Mutual Funds, SEBI mandated all the asset management companies (AMCs) to publish their general policies and procedures for exercising the voting rights in respect of shares held by them in their portfolio companies, as well as report their voting decisions in the meetings of their investee companies. Voting by mutual funds would ensure better corporate governance practices at investee companies. Another important development is the active role played by the proxy advisory firms in India. Going forward, this area of activity deserves to be properly recognized in the country. Further, the new company law bill also provides for a number of measures to improve the corporate governance.

### ***Minimum Public holding***

The promoter holding in this country on an average have been quite high, as compared to other parts of the world, including Asian markets. Traditionally Asian market have higher promoter holdings compared to the western world but within the Asian markets, it is even higher in India. So one measure on which SEBI has been focusing for the last one year is regarding the enforcement of minimum public shareholding in the listed companies. In this regard, SEBI has reduced the requirement of average free-float market capitalization from Rs 5,000 crore to Rs 3,000 crore. Besides, to help companies comply with the 25 per cent minimum public shareholding norm, SEBI has allowed companies to do so through rights and bonus issues.

A dispersed shareholding structure is essential for the sustenance of a continuous market for listed securities to provide liquidity to the investors and to discover fair prices. SEBI is very serious about the implementation of minimum public shareholding requirement (of 25 per cent) by June 2013 for private companies and August 2013 for government companies. SEBI is in dialogue with industry and is providing more and more avenues to the corporate. While SEBI is putting pressure on the private companies to meet the requirement, it is also expected that the government companies should also follow the rules. In this regard, SEBI has taken up this matter with the government and received confirmation from the government that the government companies will also abide by the minimum public shareholding guidelines within the given time frame.

### ***Primary Market***

In an effort to expand the reach of IPOs across the country, SEBI has notified wide-ranging reforms, which are not only targeted at facilitating an increase in retail investor participation but to also protect their interests. SEBI has taken recent initiatives to increase the reach of IPOs to investors across the country, greater disclosure by companies and their bankers and affording minimum allotment to a larger number of applicants. SEBI has simplified the application process for investing in Initial public Offer (IPO); the reach of ASBA is enhanced by mandating all ASBA banks to provide the facility in all their branches in a phased manner; at more than 1000 locations the nationwide broker network of stock exchanges are made available for distributing IPOs in electronic form. SEBI has also introduced 'basic service Demat account', which provides limited services at reduced costs to retail investors. These accounts are also called no-frills or basic trading accounts.

SEBI has faced criticism in the past with regard to the approval (or final comment from SEBI) on offer documents. The problem faced by SEBI was the incomplete and deliberately misleading information provided in the offer documents. In this connection, SEBI has come out with a set of specific criteria and if those criteria are not met, offer documents will be rejected. In this manner SEBI has induced self-discipline in its own functioning, investment banking community and industry at large. Any company before filing an offer document may go through the explicit SEBI rules and check its eligibility. SEBI has also introduced a mechanism of call auction in the pre-open market, to check the manipulation in opening price of an IPO. After the introduction of this mechanism, market has witnessed a very low volatility in the price and cases of manipulation have minimized if not completely eliminated.

### ***Investment in Mutual Funds***

To give a boost to investment in mutual funds by retail investors SEBI has taken number of measures particularly to incentivize and source more funds from beyond the top 15 cities. In order to increase penetration of mutual fund products and to energize the distribution network while protecting the interest of investors, SEBI permitted the Mutual Funds to charge additional Total Expense ratio (TER) upto 30 basis points, if the inflow of funds is from beyond top 15 cities. Mutual Funds may also charge Service Tax on investment and Advisory fees.

In order to facilitate investors, Mutual Funds are directed to launch the schemes under Single plan doing away with separate institutional and retail plans structure and ensure that all new investors are subject to single expense structure. Besides, Mutual Funds are also mandated to provide a separate plan for direct investments, i.e., investments not routed through a distributor, in existing as well as new schemes. Such separate plan will have a lower expense ratio excluding distribution expenses, commission, etc., and no commission may be paid from such plans.

To boost the investor education and awareness initiatives, SEBI directed all the Mutual Funds to set apart at least 2 basis points on daily net assets annually for such initiatives. Further, to enhance the reach of mutual fund products amongst small investors, SEBI permitted cash transactions in mutual funds to the extent of 20,000/- per investor, per mutual fund, per financial year subject to compliance with Prevention of Money Laundering Act, 2002. However, repayment with respect to these investments is permitted only through banking channel.

Keeping in view portfolio concentration risk in debt-oriented mutual fund schemes, SEBI required all Mutual Funds to ensure that total exposure of debt schemes of mutual funds in a particular sector (excluding investments in Bank CDs, CBLO, G-Secs, T-Bills and AAA rated securities issued by Public Financial Institutions and Public Sector Banks) should not exceed 30% of the net assets of the scheme.

For the convenience of the retail investors SEBI introduced KRA system and implemented a mechanism for centralization of the KYC records in the securities market. With this new system, once a client has undertaken the KYC with an intermediary registered with SEBI, he/she need not repeat the same process when he/she approaches another intermediary. Going forward, SEBI has taken up the case with other regulators and the government that, the same KYC should also suffice for other transactions in the financial market.

### ***Investor grievances redressal and investor education***

Lastly I would talk about the investor grievances redressal and investor education measures taken by SEBI. In SEBI, each operational department deals with the complaints in their area and Office of Investor Assistance and Education (OIAE) coordinates the efforts in this regard beside dealing with complaints related to non receipt of dividends, refunds etc. against listed companies. Standardized complaint formats are available at all SEBI offices and on the SEBI website for the

convenience of investors. Complaints are taken up with the concerned entities either directly by OIAE or by the Investor Complaint Cell of the concerned department. SEBI officers also hold meetings with the company officials or intermediaries to impress upon them their obligation to redress the grievances of investors.

SEBI has launched a web-based centralized grievance redress system called SEBI Complaints Redress System (SCORES) for assisting investors to lodge their complaints in a structured manner. It has reduced grievance process time at SEBI since physical movements of grievances are not required and the entire process is in electronic mode. Even the written complaints are scanned and entered into the electronic system. Complainants can track the Action Taken Report submitted by the company/intermediary with facility for online updation. Multiple correspondences from investors to know the status of their grievances is avoided.

SCORES commenced its operations on June 8, 2011. Since then, it has transformed the grievance redress process dramatically as reflected by the data on grievances. In March 2011, SEBI had 28,653 pending actionable grievances which came down to 23,725 in March 2012 and to 11,402 (provisional) in March 2013. Analysis also reveals that around 50 per cent of grievances received are getting resolved in 30 days and another 20 per cent in the next 30 days.

**Table 1: SCORES data on grievance redressal**

Financial year	Grievances received	Grievances redressed (cumulative)	Cumulative pending grievances*
2009-10	32,335	42,742	37,880
2010-11	56,670	66,552	28,653
2011-12	46,548	53,841	23,725
2012-13 (provisional)	42,409	54,854	11,402

Going forward, our attempt will be that we further improve upon this. Thank you.