

## Corpsec Hotline

May 31, 2012

### INDIAN CAPITAL MARKET REGULATOR AMENDS CONSENT ORDER CIRCULAR: SCOPE SIGNIFICANTLY REDUCED

#### INTRODUCTION

The Securities and Exchange Board of India ("SEBI") recently amended the Guidelines for Consent Orders and for considering requests for composition of offences<sup>1</sup> ("Consent Circular"). The amendments<sup>2</sup> made to the Consent Circular (the "Amendment") excludes a number of violations, which are now, in effect, beyond the consent order mechanism, thereby significantly reducing the scope of violations which may be previously covered. Hence the availability of the consent order mechanism stands narrowed, available only in cases of minor violations. However, as a welcome move, the Amendment prescribes objective parameters in determining the consent terms thereby bringing more transparency and accountability in the process.

#### BACKGROUND

Consent order mechanism is a proceeding in which the regulator and the alleged violator negotiate a settlement in lieu of administrative/civil proceedings, in the process saving cost, time and efforts for the parties involved. Such a mechanism helps in achieving enforcement action, remedial measures and deterrence effect from a regulatory perspective whereas provides clarity and predictability of outcome from the perspective of the alleged violator. SEBI was inspired by the success of such a mechanism in the United States administered by its securities market regulator, the Securities and Exchange Commission, when it introduced Consent Circular in India in the year 2007.

Subsequent to the introduction of the Consent Circular, the consent mechanism received some success which is reflected in the table below from the amount of fine collected and matters resolved under the Consent Circular, since its introduction.

#### DATA RELATING TO THE CONSENT APPLICATIONS UNDER THE CONSENT CIRCULAR TILL MARCH 31, 2011

Year	No. of Applications received	No. of Applications disposed by way of		Amount Collected (INR in million)
		Acceptance	Rejections	
2007-08	617	54	25	21.7
2008-09	666	428	164	457.1
2009-10	680	359	317	685.7
2010-11	333	171	237	721.4
Total	2,296*	1,012	743	1,885.9**

Source: Securities and Exchange Board of India

\*Of these, 284 applications have been treated as withdrawn/infructuous.

\*\*As a part of settlement process, apart from the amount collected, the settlement in 132 cases includes debarment from dealing in securities market/suspension of certificate of registration for varying period of time.

However, the Consent Circular recently came under scrutiny as various offences, adversely affecting the interest of the investors, were settled under the Consent Circular, for relatively lesser amounts. Further, the consent order mechanism was seen to be adopted by habitual violators in order to avoid long drawn litigation process, and began to be perceived as an easy way out. This was heavily criticized and therefore SEBI has now introduced the Amendment in order to streamline the process.

#### KEY AMENDMENTS

The following are some of the salient features<sup>3</sup> of the Amendment:

1. Certain defaults including insider trading, front running, failure to make an open offer, redress investor grievances and respond to the summons issued by SEBI are excluded from the consent order process. The defaults falling in the category of fraudulent and unfair trade practices, which in the opinion of SEBI are very serious and/or have caused substantial losses to the investors, shall also not be consented.

**Implication :** The erstwhile Consent Circular made the avenue of consent mechanism available even in cases of serious and intentional violation, although the consent process in such cases could not have been completed until completion of the fact finding process by way of investigations or otherwise. The Amendment excludes a wide range of violations, which are now outside the ambit of the consent order mechanism, thereby in effect, limiting the utility of having such a scheme, and as such it may result in increased litigation. SEBI has however left a window open to consider serious and intentional violations under the consent mechanism, but it is likely to be used in rare instances.

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2. If an enforcement proceeding, in respect of which the consent application is filed, is pending before SEBI, the authority within SEBI upon being informed can now continue with the proceedings except passing the final order till the conclusion of the consent proceedings.

**Implication :** The Amendment makes it explicitly clear that in cases where enforcement proceedings are pending before the consent process is initiated, the authority within SEBI before whom such enforcement proceedings are pending may continue to pass orders which are not in the nature of a final order (such as for e.g. the authority may pass an interim order), until a decision is taken on the consent application.

3. No consent application shall be considered, if any violation is committed within a period of two years from the date of any consent order. However, if the applicant has already obtained more than two consent orders, no consent application shall be considered for a period of three years from the date of the last order.

**Implication :** The Consent Circular did not have any limitation on the number of consent orders which may be obtained in a predefined time period. The Amendment will limit the ability of parties who have already obtained a consent order to re-approach SEBI for another consent order within a two year time period. Further, it will now limit the ability of parties who have already obtained more than two consent orders to re-approach under the consent order mechanism for a period of three years.

4. No consent application shall be entertained by SEBI before the completion of investigation / inspection, if any

**Implication :** The erstwhile Consent Circular does not impose a general restriction on SEBI to consider consent applications prior to completing its investigations/inspections. It only requires completion of investigations/inspection in cases of serious and intentional violations, before consent order proceedings are completed in those cases. The Amendment now makes it mandatory for SEBI to consider consent applications only after the completion of investigation/inspection. This may further result in prolonging the proceedings as SEBI would now be required to actually conduct and complete its investigations/inspection before considering a consent application.

5. In respect of proceedings pending before SEBI, no consent application shall be considered if filed after 60 days from the date of the service of the show cause notice.

**Implication :** Unlike the erstwhile Consent Circular, the Amendment now requires that the alleged violator approach with a consent application within 60 days from the issue of a show cause notice/subsequent notice. For proceedings currently pending before SEBI, the amendment provides a 60-day period (i.e. until July 24, 2012) from the date of the amendment, to make a consent application.

6. The consent terms may also include other directives viz. disgorgement of ill-gotten profits, etc., if considered necessary.

**Implication :** The Amendment expressly clarifies that the consent terms may include remedial measures such as disgorgement of ill-gotten profits and other measures, if found to be appropriate from case to case. It is pertinent to note that a remedial measure such as disgorgement of ill-gotten profits, which is usually pronounced for under a serious offence, is a new step considering the limited scope of the consent order mechanism subsequent to the Amendment.

7. The consent terms shall be determined in terms of prescribed guidelines in order to achieve objective parameters.

**Implication :** The Amendment introduces the concept of Benchmark Amount, although not defined, it refers to the penalty to be imposed on the alleged violator in terms of the consent order. The Amendment suggests that SEBI might come out with slabs reflecting minimum penalties to be levied for various violations. The Amendment also highlights a few factors such as past awards passed by the Adjudicating Officer and the Whole Time Member of SEBI, past record of violations, impact on investors etc. as factors to be considered for deciding the quantum of penalty to be imposed.

8. In case of rejection of the consent application, no subsequent application with respect to the same default shall be considered by SEBI at any stage thereafter.

**Implication :** The Consent Circular did not contain a provision specifying that once a consent application has been rejected, no further consent applications shall be accepted in the similar matter. The Amendment makes it clear that once a consent application has been rejected, no further consent application would be allowed in the same matter. However, the Amendment states that this provision of the amendment shall come into effect only after 30-days from the date of the Amendment i.e. from Jun 25, 2012 onwards.

9. SEBI shall dispose of the consent application expeditiously preferably within a period of six months from the date of registration of the consent application.

**Implication :** In a welcome move, the Amendment now provides a time limit of six months, within which it endeavors to resolve a consent application.

10. Consent order to spell out the alleged misconduct, legal provisions alleged to have been violated, facts and circumstances of the case and the consent terms and all consent orders to be hosted on SEBI's website.

**Implication :** The Amendment now places a positive onus on the authorities making decision on the consent application to expressly state the alleged misconduct, legal provisions alleged to have been violated, facts and circumstances of the case and the consent terms in the consent order. The Amendment also requires SEBI to host all consent orders on its website. Although, SEBI had been hosting consent orders on its website ever since the Consent Circular came into effect, the Amendment places an explicit onus on the authorities to give a detailed, reasoned and a speaking order (a fundamental tenet in law), such a requirement would greatly help in achieving transparency and reducing discretion to a large extent.

## CONCLUSION

SEBI has tried to streamline the consent order process through the Amendment by introducing objective criteria in determining and imposing a penalty which will certainly go a long way in improving transparency and reduce discretion. While some features of the Amendment are promising and encouraging in nature, some may require a re-think in light of the significantly narrowed scope of the consent order mechanism and the eventual likelihood of increased litigation and delay. Further, the reduced scope does not provide enough incentive for violators of serious offences to suo motu approach SEBI for consent order and therefore there is an increased probability of irregularities going unnoticed/ undetected. Although compounding of offences is generally permissible under various laws, its reduced scope under the Amendment may limit its availability and cast a shadow on its utility, efficacy and its viability as an alternative to full-fledged enforcement proceedings.

– Aditya Shukla, Ruchi Biyani & Vyapak Desai  
You can direct your queries or comments to the authors

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<sup>1</sup> SEBI Circular No. EFD/ED/Cir-1/2007 (April 20, 2007).

<sup>2</sup> SEBI Circular No. CIR/EFD/1/2012 (May 25, 2012).

<sup>3</sup> Streamlining of the consent process, SEBI Press Release No. 63/2012 (May 25, 2012).

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