

# Securities Regulations 2015-16

F&A Area

Term III – Slot VI

Prof. Sandeep Parekh, Visiting Faculty

## Syllabus

### **General Information**

- e-mail: spp@iimahd.ernet.in (**preferred during duration of course** ; sandeep.parekh@finseclaw.com)
- Class days and timings: Please see the schedule given below (this will be updated by email – particularly see changes for guest sessions).
- Please check your emails regularly for updates and readings.
- Office Hours at Wing \_\_ (Ph: 6632 49\_\_)
  - Walk-in hours: After class.
  - Any other time: Please call/email and come.
- This class should be interesting and useful. This is not a pure law class, it has ingredients of strategy, economics, finance, capital markets operations backed up with several high profile cases and real life situations.

### **Course Objectives**

- To introduce you to the application of regulations in the capital and financial markets. You will notice how the subject impacts the daily lives of bankers, investment advisors, finance professionals and senior managers who must oversee corporate finance decisions. The importance of the course would be in helping future corporate leaders avoid the pitfalls faced by their predecessors – ignorance of the law is no excuse for violating it.
- As a senior manager, you will be responsible for the action of all your subordinates and it is important to have internal controls in place so that you don't get into trouble for the sins of others. Knowing the regulations will help you structure prophylactic internal controls.
- As a deal maker and negotiator in the corporate world, knowing what to put in a shareholders' agreement or any agreement for that matter will place you ahead of your colleagues in hard usable skills on a daily basis.
- To introduce you to legal strategy. Several successful businessmen have used the law and the courts as a sword and a shield in corporate disputes, in particular, takeover issues. The law is indeed a powerful weapon in the highly regulated field of securities and financial regulations. You will also be exposed to people who use the law and legal remedies to their strategic advantage.

- The course will show you how exciting legal issues and battles can be. You will be introduced to a few of the biggest financial scamsters, insider traders and fraudulent people in history and their modus operandi (Charles Ponzi and Ivan Boesky for instance) and their sometimes successful legal defenses. You will also see some of the largest Indian scams play out in the Indian system. You will see how much they got away with and how effective (really) are the regulations in curbing fraud, manipulation and insider trading.

Throughout the course you will be exposed to US regulations. In particular the law on insider trading and fraud is very highly developed in that country and will be used for filling up holes in the understanding of Indian regulations.

### **Pedagogy**

This session uses the ‘case law’ method of teaching – which is different from the case method used at the institute. This method uses primary material from actual cases from courts. From the previous years’ classes the students have found the reading material a little difficult initially because of the legal jargon but it did not seem to be a problem during the latter half of the class as people started getting used to the ‘case law’ method and the legal language.

Readings from the “course material” must be read *before* class. Everything in the course material and what is discussed in class is game for grading. Optional readings will be handed out by way of a small compilation. Optional readings are not used for grading purposes but are highly recommended for your future professional use. There will be marks for class participation, so read up before you participate. If for some reason you are unable to read before class please intimate me before class.

### **Number of sessions.**

15 sessions.

### **Evaluation criteria and Grading**

To a person who has not taken the course, the amount of work may seem excessive – however as you will see during the course, most of the grade based work that you do is not excessive and the exams are practical and fun.

**Exams:** There will be one objective type exam worth 75% at the end of the course.

**Class participation:** 25% is reserved for class participation. If you have a conflict with an important engagement you must inform me before the beginning of the class either in person or by email to escape penalty.

### **Rules of Engagement for exam**

- **Honour code:** For the exam, the statute book will be made available i.e. the written law – there is no requirement to memorize anything learnt.

May the curve be with you!

**Relationship of the course with the overall programme objective and related courses**

The course builds upon the basics of finance and market structure learnt in the core finance courses. As regulation is a key part of finance, and increasingly so, this course prepares the student to work in an environment where he will be faced with regulatory issues.

**Strongly Recommended courses:**

Finance I and II. You should refresh your memory regarding basic concepts of time value of money, the efficient capital market hypothesis (you are requested to look up the basic concept of the weak, semi-strong and strong forms – you will hear the phrase ECMH *ad nauseam* in this class), the CAPM and some basics of valuation.

**Text Book**

Fraud, Manipulation and Insider Trading in the Indian Securities Markets, Sandeep Parekh (Abbreviation: **FMIT**)

Additional course material (Abbreviation: **CourseMat**) to be provided by Publications department.

Reference material: Taxmann's SEBI Manual 2014 (or later) with SEBI

Rules/Regulations/Guidelines - copies have been made available in the reserve of the library (no need to purchase the Manual), you can also find the relevant laws on SEBI's website [www.sebi.gov.in](http://www.sebi.gov.in)

Session No.	Details
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**26 Dec 2015**

**1. Introduction to the course**

- Introduction
- Scope of “Securities Regulations”
- Benefits and potential beneficiaries of the course
- Charles Ponzi, financial scams and bubbles
- Legal methods and common Law, an introduction.

**26 Dec 2015**

**2. Market Bubbles and Regulatory Background – disclosures and the rule against fraud (Please note we will start the primary markets class towards the end)**

**FMIT pages 1 - 16**

- Tulip mania and recurrent bubbles
- Crash of 1929 and 1987.
- Indian regulations of securities
  - Definition of securities
- Twin prongs of securities regulations - Disclosure and Fraud
- Need for compulsory disclosure and game theory
- Statutory framework
- Prohibition on forward/futures and options on securities
- Wagering prohibition
- Stock Exchange Regulations

**31 Dec 2015**

**3. Primary Market regulations.**

**FMIT pages 108 - 126**

- Public offer
  - Regulations under Companies Act 2013
  - Regulations by SEBI
- Registration of Prospectus
- Consequences of offer of securities without registration – (Gun jumping).
- Misstatements in the prospectus (and free writing prohibition)
  - Remedy for compensation can be filed by shareholders
  - Director liability
  - Liability of auditors, bankers, underwriters and experts
  - Damages
  - Criminal liability

- Issues in allotment and listing of shares and debentures
  - Under-subscription of shares in a public offer
  - Listing process
- Integrated disclosure
  - Shelf registration
- Book building
  - Red herrings and Information Memorandum.
- Debt issue
- Rights issues and preferential allotment
- Buy back regulations.

**31 Dec 2015**

#### **4 Secondary Markets regulations and Clearance and Settlement**

- What are marketable securities and applicability of Securities Contracts (Regulations) Act (SCRA)

Structure of Stock Exchange

- Listing permission from SE
  - Listing by reverse merger – validity
- Capital requirements and Risk management – exchange as counterparty. Default regulations. Margining regulations.
- Rights and liabilities of brokers
  - Membership card of brokers not an asset subject to insolvency laws.
  - Natural justice rights of brokers
- Transfer of securities
  - Validity of refusal to transfer shares
- Depositories
  - Question of beneficial ownership and S. 153 Co. Act
  - Effect of complete fungibility of securities
- Debt and Government Securities

**1st Jan 2016**

#### **5. and 6. Takeovers – SEBI regulations**

##### **Takeovers - offense and defense strategies**

- Overview of takeovers and mergers of companies
  - Mergers v. Takeovers
  - Companies Act and court approval for merger of companies
    - Accounting for mergers pooling v. purchase methods
  - Sebi regulations and tender offer
  - Exchange controls and regulated industries.
- Disclosure requirements
- Acquirer, acquisition, issue of ‘Control’ and ‘Acting in concert’ –definitions.
  - Hub and spoke theory of acting in concert.

- Exemptions from the application of the Act.
- Regulatory requirements in a tender offer
- Strategic actions in structuring a hostile bid
  - Three rules of the game - speed, money and surprise
  - Two stage or three stage offers
  - Tender offer v. Proxy battle
  - Shareholder rights including access to register of members.
    - Edifar
- Process and substantive restrictions in tender offers
  - Public announcement
  - Minimum number of shares to be acquired
  - Best price rule (Price can be cash or boot)
  - All holders and Pro rata rule
  - Minimum duration rule
  - Conditional offer
  - Withdrawal of offer
  - Board of Target company – duties
- Strategic actions in foiling a bid
  - Defensive tactics and their legal validity
- Duties of directors
  - Three fiduciary duties
  - Conflict of interest of directors.
  - Standard of judicial review.
- US law – William’s Act.
  - Revlon duty to auction.
- Competing tender offer
- Issuer tender offer
- Fairness of valuation (particularly in freezeouts)
- MBOs, LBOs and freezeouts briefly discussed.
- Anti-trust issues.
  - Dominant holding
  - Anti-trust statute
- Tender offer shares acquired in contravention of takeover regulations
  - Civil remedies and penalties
    - Implied remedies
    - Express remedies

**2<sup>nd</sup> Jan**

**7 and 8. Fraud and fiduciary duties.**

**FMIT pages 20 – 34 and 54-62**

- Discussion of Indian and US frauds.
- Types of frauds
- Definition
  - Significance of inclusive definition
- Elements of and issues in a securities fraud action
  - Bespeaks caution
  - Forward looking statement

- Efficient capital markets hypothesis (ECMH) theory and its application by the US courts in fraud cases. Discussion on US Supreme court judgment on '*Fraud on the Markets theory*'
- Damages
  - Rescissionary
  - Actual Loss
- Other remedies
  - Express and implied
- Three types of liability
  - Statutory liability under SEBI regulations
  - Tortious liability under the common law 'Tort of deceit'
  - Criminal liability
    - ❖ Punishment
    - ❖ Deterrent
- SEBI actions
  - Administrative action
  - Civil action (in courts)
  - Criminal reference
    - Mens rea
    - Double jeopardy
    - Plea bargain
  - Parallel civil and criminal proceedings – standards of proof
- Private action
  - Civil action
  - Criminal reference
- Scope of civil action
- Secondary liability
  - *Respondeat superior*
  - Aiding and abetting liability
  - Failure to supervise
  - Conspiracy (primary)
- Prophylactics and whistle blowing
- Current Issues
- Who is a fiduciary
  - Directors
  - Brokers
    - Suitability
  - Agents
  - Breach of fiduciary duty v. fraud
- Director's fiduciary duties
  - Care
  - Diligence
  - Loyalty

## **Manipulation**

### **FMIT pages 79-95**

- Elements of manipulation
- ECMH and manipulation
- The importance of intent in manipulation – manipulation v. fraud.

- Manipulation v. Arbitrage
  - ❖ Short selling
- Domination of the market and other characteristics
- Manipulation in tender offer situations
- Types of manipulations
  - Wash sales
  - Matched orders
  - False statements
  - Scalping
- Permitted manipulations
  - ❖ Stabilisation

**7<sup>th</sup> Jan 2015**

## **9. Insider trading**

**FMIT pages 127-146**

- Economics and morality of permitting/prohibiting
- Who is 'insider' and who is a 'connected person', what is 'unpublished price sensitive information' and what is 'material'.
- When does a duty arise
- Information entering the public domain
- Tipper tippee obligations
- Temporary insiders
- Shut up AND don't trade rule.
- Locus of hurt tippee to bring action
- Consequences
  - Civil liability
    1. Chronological privity
    2. Damages
  - Criminal liability
  - Administrative action
- Corporate governance and insider trading
- US law on insider trading
  - Types
    1. Classical theory
    2. Misappropriation theory
    3. Possession theory
  - Short swing profits (strict liability)

**7<sup>th</sup> Jan**

**10.** Guest lecture – on tax issues in securities transactions. **(no reading)**

**8<sup>th</sup> Jan**

## **11. Regulation of intermediaries and regulation of funds**

- Conflicts of Interest and Legal restrictions
  - Universal Banking
- Investment bankers/Underwriters
  - Higher duty than other intermediaries – including duty to supervise



- Broker dealer regulations
  - Suitability
  - Inappropriate recommendations – know your client and risk disclosure document
- Mutual Funds
  - Structure
  - Rights and Responsibilities of the AMC Directors, Trustees
  - Fiduciary nature of relationship between Investor and Fund
  - Legal Structure in the U.S.-Investment Companies, Management Companies & Advisors
- SEBI (Portfolio Managers) Rules
- Other intermediaries: Exchanges, depositories and other SROs, FII, Primary dealers.
- SEBI enquiry
  - Process and Collateral consequences
- Private equity, Alternative Investment Funds
- Cross border investments – FDI and FPI

### **Foreign and transnational regulations of securities**

- US Regulations
  - Foreign issues
  - Foreign listing
  - GAAP
- US prohibition against offering securities in the US – long arm statutes
- ADRs/GDRs/IDRs and depository receipts
  - Legal structure
  - Level I, Level II and Level III ADR
- Rule 144A portal market
- Rule 144 – restricted securities and other exempt offerings
- Scope of Regulation S of the SEC.
- International Affairs division at the SEC
- European regulations and the committee of wise men
- Transnational enforcement and Co-ordination of standards
  - Enforcement of transnational crimes - crimes without borders
  - Accounting Standards
  - Specific coordination of regulations for reducing compliance burden
- Role of IOSCO in coordinating transnational deals.

**8<sup>th</sup> Jan**

**12 Guest session by SEBI Chairman on “Powers of SEBI, civil remedies of shareholders and penalties.”**

**FMIT pages 159-167**

- Departments of SEBI
- Civil and administrative powers
  - Express remedies under statute
    - Generic Sections 11 and 11A powers
    - Conflict with other bodies
  - Administrative actions of SEBI, civil actions of SEBI and shareholder actions
  - Implied remedies

- Disgorgement, restitution and accounting
- Rescission (declaring transaction void)
- Civil Monetary Penalties
- Asset freeze
- Interim Stay by SEBI and courts
- Injunctive relief
- Divestiture or sterilization of voting rights – takeovers
- Proxy remedies
- Search and seizure
- Bar from industry and capital markets
- Officer and Director bar
- Collateral consequences
- Interest
- Levy of interest
- Disclosure violation v. substantive violation
- Litigation a powerful tool
- Enforcement powers and criminal prosecution
- US law – powers of the SEC

**9<sup>th</sup> Jan**

**13 and 14 Final exam**

**11<sup>th</sup> Jan (optional)**

**15. Movie**

**Please note: Guest lectures are subject to change. Please follow your emails for any updates.**