

## **Sebi wants monitoring agency to keep an eye on all IPO funds**

In the four-year period between April 1993 and March 1997, as many as 4,005 companies entered the capital markets with their initial public offerings (IPOs) to raise an aggregate of Rs 41,319 crore. The IPOs accounted for more than 9 per cent of the average market capitalisation of Bombay Stock Exchange over the four-year period.

If these many companies raised money from the public, several companies also duped investors in the pretext of public offer — vanishing from the market over the coming years. There are 238 companies in the ministry of corporate affairs' list of 'vanishing companies' and out of that, 87 remained untraceable till March 2012.

While nobody was held accountable for investors' loss then, the Securities and Exchange Board of India (Sebi) has now proposed that all companies that come up with IPOs need to set up a monitoring agency that will look into the use of issue proceeds. The market regulator has also looked into putting some onus on independent directors, management and audit committee in the same regard.

This is a big move by Sebi. Earlier, companies coming up with public offerings of raise less than Rs 500 crore were not required to have any monitoring agency.

A look into Initial Public Offers in the last three calendar years (2011-2013) shows that only 8 out of the 51 public issues raised over Rs 500 crore from the market, whereas more than 80 per cent of the issues had issue size of less than Rs 500 crore.

Therefore, going by the current market regulations, a large number of companies attracting a significant number of investors are not required to float a committee that monitors the use of the IPO money — a big gap in the regulations, which Sebi looks to bridged with its new proposal.

“It is a move in the right direction as it will provide protection to all investors against misuse of IPO funds in companies. If the regulator is worried about misuse of funds then all investors need to be protected,” said Prithvi Haldea, chairman, Prime Database.

### **Proposed regulations**

After almost four years that the government had asked the capital markets regulator to figure out ways to monitor the use of IPO proceeds, Sebi has finally come out with a discussion paper on the same, inviting public comments till March 25.

The market regulator has also proposed that the monitoring agency will have to submit its report on a quarterly basis (as against semi-annual basis) and should make the report public through dissemination to the stock exchanges.

“Considering that Companies Act, 2013 requires prior approval from shareholders for any change of object and a provision for exit to dissenting shareholders, it is very important that shareholders get regular update on utilisation of issue proceeds,” said the working paper, giving the rationale behind making the report public.

Earlier, in several cases, companies have given one reason in the object of raising the money while coming up with their IPO, and later, the promoter would change the stated object of use of funds by getting a resolution passed through a majority.

Experts say that while the new Companies’ Act provides minority shareholders with the power to recall their money in case of any change in the use of funds by the promoter, Sebi’s proposal on quarterly disclosure of the report at the stock exchanges would further empower investors as they would get an update on the use of funds on a quarterly basis.

On the categorisation of the report, it has been proposed that the monitoring agency will have to grade the deviation from stated use of funds on a two-digit scale — first stating the deviation from object (on a scale of 0-2 where 1 stands for no deviation) and the second indicating the range of deviation (on a scale of 0-5 where 1 indicates deviation up to 10 per cent).

“Monitoring Agency Reports where there is a deviation from objects of the issue should be segregated from reports where the utilisation is in line with objects of the issue. Companies Act, 2013 requires that the company shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and dissenting shareholders have been given opportunity for exit by the promoters and shareholders having control,” said the paper.

### **Responsibility on independent directors**

Not only has the role of promoters and management on the use of funds has come under the lens, the regulator has also brought independent directors’s role to the fore. While Sebi has proposed that the companies need to set up the a sub-committee of board of directors before the opening of the issue that will oversee the monitoring of utilisation of issue proceeds, it has further said that the majority of that committee will be constituted by the independent directors and will be headed by one of them.

“Constitution of such committee will be helpful in facilitating monitoring of utilisation of issue proceeds. Further, the said requirement will ensure active involvement of board of directors monitoring of utilisation of issue proceeds,” the discussion paper said, giving the rationale behind setting up of the sub-committee.

Along with the new corporate governance norms that look to put a check on the number of companies and the tenure that one can serve as an independent director, this move puts in additional responsibility on the shoulders of independent directors.

While the audit committee and the management were not in picture earlier, the regulator has said, “Audit committee and the board/ management shall provide their comments for the deviation, if any, pointed out in the report of monitoring agency.”

Sebi said that such comments will help understand the reasons for any such deviations.

### **The bottomline**

Once the proposals are approved by the Sebi board and implemented, it will go a long way in providing a safety net to retail investors. It will also act as a deterrent for promoters who enter the capital market with wrong motives. While the proposals look to empower and entrust independent directors with additional responsibility, it should also help in reduction of instances of promoters misusing funds raised through IPOs.

### **The vanishing act**

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Earlier, companies coming up with public offerings of raise less than Rs 500 crore were not required to have any monitoring agency. Sebi has now come out with a discussion paper inviting public comments on its proposal to require all public offers to have a monitoring agency.

A look into IPOs between 2011-2013 shows that only 8 out of the 51 public issues raised over Rs 500 crore from the market, whereas more than 80% of the issues had issue size of less than Rs 500 crore.

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