SEBI's order on shell companies

What is the issue?

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The recent order of SEBI to suspend the trading of suspected shell companies is alleged to be a baseless decision without any proper investigation.

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What is the case?

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- A shell company serves as a medium for business transactions without itself having any significant assets or operations.
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- They are also used for tax evasion or tax avoidance.
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- The **Ministry of Corporate Affairs** shared a list of 331 listed companies that are suspected to be shell entities.
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- This was after consultations with the Serious Fraud Investigation Office and the Income Tax department.
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- It directed **SEBI** to investigate the companies and take necessary action against them under the SEBI Act.
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- SEBI, subsequently, ordered to suspend trading in 331 suspected shell companies' shares.
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- It also placed them on a strict watch under its Graded Surveillance Measure **(GSM) framework.**
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- Following this, the Securities Appellate Tribunal **(SAT)** has ordered the **lifting of the trading restrictions** imposed on two of the 331 companies.
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- SAT has also questioned SEBI for passing an order "without any investigation".
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What was SEBI's rationale?

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- It is suspected that trading on the shares of these “shell” companies was used as a way to **launder black money**.
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- Since demonetisation the Centre has deregistered well over 1,60,000 dormant companies, identified over 37,000 shell firms and over 3,00,000 firms engaged in suspicious dealings.
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- The decision comes as a measure to ensure a sound business environment.
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What is the impact?

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- The government’s resolve to act against dodgy companies is valid.
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- However, the present move has failed to give suspect companies an adequate chance to explain their positions.
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- Not all shell companies are illegal. Some were formed to raise funds to promote start-ups.
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- The economic costs of freezing the trading are disproportionate with the proposed benefits of such action as stocks witnessed a sharp fall after the order.
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- A hasty order without an independent investigation has dealt a serious blow to SEBI's credibility.
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- Though, the SAT order has brought some fairness to the entire proceedings, SEBI and the government must give a convincing rationale behind their actions.
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Quick Facts

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SEBI

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- The Securities and Exchange Board of India (SEBI) is responsible for protecting the interests of investors in securities, to promote and to regulate the securities market.
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SAT

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- Securities Appellate Tribunal (SAT) is a statutory body established under the provisions of Securities and Exchange Board of India Act, 1992.
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- It is a three-member tribunal to hear and dispose appeals against orders passed by the Securities and Exchange Board of India.
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- A second appeal lies directly to the Supreme Court.
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Graded Surveillance Measure (GSM)

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- SEBI and stock exchanges had introduced the graded surveillance measure framework which came into force from March, 2017.
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- This is to monitor securities which have witnessed abnormal price rise not commensurate with their financial health and other fundamentals.
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- SEBI may lay additional restrictions on market participants dealing in identified securities subject to the satisfaction of certain criteria.
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- At present, there are six stages defined under GSM framework. Surveillance action has been defined for each stage.
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Source: The Hindu

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