One answer to many identities

The problem of multiple applications in public issues is as old as the primary market. The solution: unique ID for each investor

Create a unique ID for every investor, to be used for transactions in both the primary and the secondary market

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Many investors I know are stunned that one investor could make 6,315 applications in a public issue -- as happened in the recent YES Bank IPO (initial public offering) -- and escape detection in a system that prides itself on being at the vanguard of technology, in a system where the operations of intermediaries like depositories, depository participants, banks and registrars are overseen by a regulator. So much for technological advancements, they say, with outrage and resignation.

The problems

The bigger point is this: Is this YES Bank IPO fiasco an isolated case or is it a malaise that runs deeper? My sense is that this must have definitely happened in several other earlier public issues too. Ever since the ongoing primary market boom began, there have been stories circulating that the system is being misused for unfair allotment of shares.

In the case of FPOs (follow-on public offerings), the misuse in some cases even extends to issue pricing. In the run-up to the issue, the share price of the company making the FPO is ramped up. In the pre-issue grey market, these shares are sold to unsuspecting investors at these high prices, the delivery for which is made through large cornering of shares via the multiple applications mechanism. The promoters too could be involved as it allows the company to charge a higher premium on its shares.

Let's accept it: the public issue process is far from perfect. The imperfections go back many decades. In the eighties and nineties, it was common for investors to make multiple applications to improve their chances of allotment which went undetected due to voluminous paper work. The small investor played around with random permutations and combinations of his name and those of his family members. The moneybags -- high net worth individuals, brokers, market operators and companies -- turned it into an art form.

They turned into 'application factories'. Some of them put in thousands of benami applications and got huge allotments. Since many of them were acting in collusion with promoters, merchant bankers, banks and registrars, it made their job easier. Compounding the antiquated process has been the problem of inefficient infrastructure, the worst of which was seen in the divestment issues made in February-March 2004.

The solutions

All these are problems that, with some planning and intent, can be easily resolved. A new system need to be devised, one that is more seamless, one in which the primary market and secondary market are integrated better. As part of this…

- A unique ID should be created for investors, using the time-tested Dedupe software, which identifies duplicate records. This ID should compulsorily require a PAN, irrespective of the size of the investor. It is ironical that we exempt applications below Rs 50,000 from the PAN requirement in the name of small investors, though a person who invests Rs 50,000 in risk capital can hardly be called a small investor.

- Every investor should state details of the bank account(s), from which he will transact his capital market trades.

- Technology should be used to improve the application, allotment and refunds processes.

It's imperative that all this is done soon. Scams, even the whiff of them, drive small investors away from the capital market. As it is, this class of investors finds it difficult to manage the risk of equity. To expect them to manage the risk of fraud is, well, just expecting too much.

It's not as if we haven't moved forward. This year, momentum in that space has come from one policy change and one revelation. The policy change was Sebi asking qualified institutional buyers (QIBs) to pay 10 per cent margin money on public issue applications to rein in the oversubscription hype that was being created and banning discretionary allotment to preferred QIBs. And now, Sebi has opened the lid on operators who were profiting at the expense of small investors by fraudulently acquiring huge quantities of shares in public issues.

Sebi now needs to ensure it closes this backdoor for good. It better, for the stakes are high. The IPO pipeline is huge, with several divestments also likely to come through. Issues might get bunched up towards the end of the financial year, and the system should be fortified to ensure that doesn't happen. For investors, infrastructure collapse is as bad as misuse.

Sebi also needs to come down harder on offenders. Banning them from the market doesn't work, as they continue to operate using benami identities. Instead, punitive action should be centred around taking away their illegal profits and distributing it to investors who lost money in the fraud, and levying fines, besides other penalties. So, in the YES Bank case, for instance, it would be poetic justice if the YES Bank IPO profits of the investor who submitted 6,315 applications were distributed pro-rata among the issue applicants who missed out on allotments.

Sebi needs to recognise better that, in a free market, the objective of all entities -- issuers, intermediaries and investors -- is profits. So, they require greater regulation, which doesn't just react to irregularities, but rather tries to pre-empt them. If the big goal is to move more household savings into the capital market, investor confidence needs a big boost. Debacles like YES Bank don't help.