

TEXT OF MR. M. DAMODARAN'S EX TEMPORE SPEECH DELIVERED AT A WEBINAR ON SINGLE SECURITIES MARKET CODE ORGANISED BY ARUN JAITLEY NATIONAL INSTITUTE OF FINANCIAL MANAGEMENT (AJ-NIFM)

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Thank you for making me part of this conversation. I thought I was in the wrong place, after seeing the several luminaries whose interventions would follow.

Thank you, Mr. Bajaj for ensuring that I got on this panel. It is certainly a learning opportunity for me. Let me cut to the chase straightaway. The Budget, that was presented for the forthcoming year, has several impactful sentences tucked away in several paragraphs. However, I suspect there was nothing to match this standalone single sentence in terms of impact, and in terms of the workload that it implies. I think it ushers in a whole lot of possibilities, and obviously a whole lot of activities. When I saw the 4 Acts that were proposed to be consolidated, I was very comfortable with three of them being consolidated. I had some questions in my mind about whether the Government Securities Act could easily go through this process of consolidation. I will get to that in a minute. I think it appropriate to mention upfront that Securities Law has been a lawyer's paradise. For that matter, most laws starting with the Constitution of India have been described as a lawyer's paradise. The marketplace has been, or at least had been, for a long time, nothing but a broker's paradise. A number of regulations came into being, to bring discipline to the marketplace. However, this will always be work-in-progress. I have always believed that laws and regulations cannot run ahead of practices, including malpractices, in the marketplace. Regulators have to run closely behind the suspected offenders, so as to address any problem within a reasonable time. Regulators cannot anticipate every conceivable problem that will arise in the market. I am hoping that the new Consolidated Code, when it comes into being, will be a Code that a common man can easily understand, and that it will not be subject to the requirement of periodic interpretation, like many of the laws, which are getting interpreted year after year. This lack of continuity creates uncertainty in the regulated universe as to what exactly the law is. Sometimes even lawyers complain that frequent changes in regulations make it difficult for them to keep upto speed with what is happening in this space.

The proposed consolidation is a very good move. I wish there had been a bigger paragraph in the budget speech, so that we could understand the immediate reason for this move.

Mr. Khan mentioned that this proposal owes its existence to the recommendations of the FSLRC. With clarity regarding the origin of the proposal, we should be prepared to address problems that the FSLRC recommendations brought in their wake. The Unified Financial Code is looking at only 4 laws, and not the others that the Srikrishna Committee mentioned. There is a very compelling case to consolidate 3 of these 4 laws, namely, the SCRA, 1956, the SEBI Act, 1992 and the Depositories Act, 1996. There are several inconsistencies in these enactments, whether they are in regard to provisions of penalties, or the powers that can be exercised at different times by different persons.

There will be inconsistencies when we have one Act of 1956, and another of 1992. If the problems in the 1956 Act were not addressed when the 1992 Act was being brought into force, clearly there would be issues. It must also be recognised that the SEBI Act of 1992 was right in the middle of the Harshad Mehta controversy, and I suspect, though I could be wrong, that it did not get the attention to detail that a major enactment of that kind entailed. Therefore, changes had to be made as the years went by. The case for consolidating 3 of these Acts is fairly strong, and does not need to be argued in any great detail. The Companies Act of 1956 finally gave way to the Companies Act of 2013.

It was long in the works, but it took final shape in 2013. The SCRA Act is of similar vintage. When we look at the phenomenal changes in the Securities market, it is clear that the problems in the SCRA Act need to be addressed sooner, rather than later. The regulated universe is more complex, the products are more complex and there are participants from all over the globe that invest in the Indian markets. There are also attempts made by various persons to circumvent the law and regulations, and SEBI has had to play catch-up to plug some of those loopholes. Therefore, there is a crying need to fix the SCRA Act. What could be better than to fold it into the larger Securities Code, where the inconsistencies that exist between the provisions of different enactments could get addressed.

Another issue which will hopefully get addressed is the twin problems of the regulatory gap and regulatory overlap. We had a major regulatory gap between 1996 and 1998, when a number of Tree Plantation Schemes suddenly came into being, with persons believing that money would grow on the branches of trees, and not in bank branches. There were several such schemes. SEBI initially said that these schemes were not meant to be regulated by SEBI. RBI declined to regulate these schemes, and there was no third authority which could be considered for this purpose. Therefore, till the Collective Investment Regulations came in 1998, a whole lot of trees, that were promised, did not come up, but a whole lot of money was made by unscrupulous persons, with unsuspecting investors parting with money in search of the promised fortune. As for regulatory overlaps, the classic case is of ULIPS, where IRDAI and SEBI claimed regulatory jurisdiction. It was my personal view that this dispute could have been resolved if an attempt would have been made to distinguish between an entity Regulator and a function Regulator. Consolidation must ensure that regulatory gaps and regulatory overlaps cease to exist.

Another point that I wish to make is that when consolidation takes effect under one regulatory organisation, the obvious candidate being SEBI, its regulatory capacity needs to be examined. This is something that should be done concurrently. The capacity of the regulatory organisation, both in terms of numbers and in terms of skillsets, should be significantly enhanced. In the rapidly growing and complex market, stronger regulatory organisations will be very necessary.

I have earlier mentioned the need for simpler regulations. Often laws and regulations contain complex sentences, which are violative even of syntax, giving room for mischief makers to take advantage. We must acknowledge, with considerable regret, that legislative drafting skills have significantly declined. I am aware that we have eminent lawyers on this panel, and when laws come into being, they would be looked at, and the wish expressed, that they could have been drafted better. Lawyers often do not articulate this problem because they are good persons, who are willing to live with the inelegance in legislative drafting. Let me cite one instance of why good drafting is critical. One of the matters to be disclosed in public domain at the right time was “changes in accounting policy, if any”. By necessary implication this regulation, worded thus, would countenance the possibility of a regulated entity transacting business without an accounting policy. Clearly what must have been meant was “changes, if any, in accounting policy”.

A couple of other thoughts, and then I will sign off. Let me refer to what Mr. Khan said. Since Mr. Khan is a very dear friend, he won't take it wrongly. There is a story of a lawyer in the Madras HC, several decades ago, who had so many cases that he once did not know on which side he was to argue. He started arguing for the party that was on the other side, and after he had made some progress, and resisted the attempts of his junior to interrupt him, he paused for breath. The junior managed to inform him that he was arguing the opposite party's case. Then in all seriousness, he told the Judge “I am told I am arguing the opposite party's case. I was just explaining to your Lordship how weak is the case that my friend is going to argue. That will save you the trouble of not

giving any serious attention to what he is going to say.” So, Mr. Khan, do not get me wrong. The elaborate account that you gave of the many difficulties, pitfalls etc, in getting the Government Securities Code included in the consolidation exercise, and your concluding that “you will agree to agree in the end” makes out an excellent case for the RBI or anyone else to resist the inclusion of the Government Securities Code.

My advice to the Ministry of Finance is that if you want this exercise to go through smoothly, and if you also want to bring in the Government Securities Act, it will only delay matters. Consolidating the other 3 Acts will be as easy as knife cutting through butter, and you will have the significant achievement of one consolidated Securities Code. In phase 2, you can examine how to integrate not just the Government Securities Code, but also some of the other Acts whose consolidation the Srikrishna Committee recommended, and which for good reasons, you have chosen not to address at this point of time. The background paper circulated by Dr. Ghosh, indicating some of the reasons for consolidation, would seem to indicate that the existing regulatory organisations are not doing a good job. This is an unfair conclusion. There are problems. Some of them are because the powers that have been sought have not been given. There is of course the problem of not adequately exercising existing powers. There are organisational inadequacies in terms of skillsets and in terms of numbers. These must be addressed sooner rather than later. While doing all of this, there is no harm in seeing what the outside world has done, and is doing. I hope I am permitted the liberty of a personal observation. At a post-lunch meeting, when I was SEBI Chairman, I was asked by someone whether SEBI was blindly copying the provisions of law and regulations that existed in the US. I was awake enough to tell that gentleman that we copy, on occasion, but with open eyes, and not blindly. We take what is relevant, and omit the rest. There are a number of excellent initiatives elsewhere, and I am sure Umakanth will certainly give us a perspective of what the rest of the world has in place.

Another point that I wish to make is that we should not rush through even with the consolidation of these 3 Acts just because there is a great opportunity to put something new in place. A reference has been made to the need for a sunset clause in legislation. I have been the one that has been advocating a sunset clause in regulations for a long time, but I would hesitate to have a sunset clause in an Act. I would rather have something that is well thought through, and can serve long enough until there is a compelling case for change. At that stage the law or the Code can be reinvented completely, and there will be no need for any consolidation to address issues that might have arisen. It is relevant in this context to refer to the role of SEBI. SEBI took over the commodities markets and absorbed it very well, but it did not happen overnight. It brought in people from outside SEBI, from the Forward Markets Commission (FMC), and elsewhere, and then ensured that it built up the requisite expertise to administer the laws and regulations that the FMC was dealing with. If for any reason you now want to handover the Government Securities Act to SEBI, I think you should get a large number of people, who have been hands on in dealing with this matter, to come to SEBI. This will enable SEBI to digest this particular piece with which SEBI, as of now, might not be entirely comfortable. I am aware that there has been a standoff between SEBI and RBI on the extent of regulation by each of them of the corporate bonds market.

I have no further specific point to add at this stage. My only request is not to let the tail wag the dog, and to hold up the process of consolidation. You can easily consolidate 3 enactments since there is no opposite party or Regulator whose interests are involved in this consolidation. There is no one who will raise the red flag. At worst, you will be told when the Bill is introduced, this must go to the Select Committee. This could lead to some further time being taken, but there is no serious reason to object to this. As for the Government Securities Code, should you want to do it at this stage, I would keep my fingers crossed and wish Dr. Bajaj luck for piloting this. Thank you very much.