CONSOLIDATION OF SECURITIES MARKETS ACTS – WHAT, WHY AND HOW?
April 6, 2021

SUMMARY OF DISCUSSIONS

Background

In her budget speech, Finance Minister, Smt Nirmala Sitharaman, announced that 4 separate laws, namely, the SCRA 1956, the SEBI Act 1992, the Depositories Act, 1996 and the Government Securities Act, 2006 will be consolidated into a "rationalised single Securities Market Code". Considering that these 4 enactments came into being at different points of time to address different segments/ constituencies of the securities markets, consolidation of these Acts into a single Code, that is meaningful and pragmatic, will involve considerable effort. It would be useful therefore for persons who are intimately involved with securities markets' laws, as well as those who have a continuing interest in these matters, to brainstorm, and to make available their collective insights on the subject to those that are tasked with the process of consolidation of these Acts into a single Code.

DISCUSSIONS

- The announcement in the Budget speech that 4 enactments, namely, the SCRA 1956, the SEBI Act 1992, the Depositories Act, 1996 and the Government Securities Act, 2006, would be consolidated into a rationalised Securities Code, is as thought-provoking, as it is impactful. It throws up a number of questions.
    1. What, if any, is the intent behind the proposed consolidation?
    2. What purpose does it seek to achieve?
    3. Is this the right time to undertake an exercise of this kind?
    4. Is there a proximate trigger for setting in motion the thought process relating to consolidation?
    5. What would consolidation mean in terms of what is seen as the end product of the exercise?
- Irrespective of the immediate reasons for the Budget announcement, it is very clear that the proposed consolidation offers a great opportunity that must not be missed. A better platform for price discovery, as well as, a clearer remit for all the market infrastructure intermediaries will be a great benefit.
- The immediate reactions to the proposal have been that in the first instance, 3 of the 4 enactments, namely, the SCRA, the SEBI Act and the Depositories Act should be consolidated in the first phase since they have more commonalities in terms of a common Regulator, and the specific segment of the securities market. The Government Securities Act has much less in common with these 3 enactments, and hence a view has been expressed that this enactment should be kept out of the consolidation exercise in the first phase. This is not a desirable objective. The consolidation of the 3 enactments is the equivalent of low hanging fruit. It is necessary to include Government Securities Act in this exercise since the opportunity should not be lost sight of by a timid approach.
- Consolidation should not amount to having the separate enactments as silos in a consolidated Code, retaining their inefficiencies and inconsistencies. This opportunity must be availed of to address the problems that have arisen because of the indiscriminate use of subordinate legislation to make substantive changes in law. Consolidation should address the territorial conflict between MCA and SEBI. Further, with NBFCs raising money through instruments that are normally regulated by SEBI, it is necessary to expand the universe of coverage at the time of consolidation. This is also an opportunity to iron out inconsistencies in definitions as well as the content of the laws.

- It is recognised that including the Government Securities Act is the tougher part. The rest is a much less ambitious exercise. This is an opportunity to remove not only inconsistencies, but also redundancies. For example, fraud has been defined in 4 different ways in the 3 enactments as well as the subordinate legislation taken together. Matters of this kind, need to be immediately addressed.
- It was felt that this should be seen as an opportunity to have a relook into the entirety of Securities Laws. In the initial stages, Courts were inclined to give due deference to the views of Regulators in the matter of interpretation of Securities Laws, on the premise that the Regulators were invested with technical knowledge, that the Courts might not possess. This approach has been given a go-by in recent times.
- A major omission in the Acts under discussion is that none of them separately sets out the rights of investors. There is no mechanism built into the Acts to address the genuine grievances of investors. Absent this, the proposed consolidated Securities Code would not be entirely successful.
- One of the priorities should be the uniformity in the penal provisions. Similar offences should not have completely different penal provisions.
- As for the Government Securities (G-Secs) market, it is not normally a part of the securities market as commonly understood. The focus should be on growing the corporate debt market, which has been a continuing exercise for several years. Inter-regulatory cooperation would also be necessary for the success of a unified Securities Code. Historically, the RBI has been the debt manager for the Government. There are implications that the fisc has for monetary policy. This should not be lost sight of in the proposed consolidation exercise. A good first step would be to move debt management out of the RBI. If retail participation in the G-Secs market is the objective sought to be attained, clearly the Exchanges would have to be brought in, and SEBI's regulation would be a necessary consequence.
- The purpose of consolidation should be not only to improve the content of the laws, but to reimagine the structure. Consolidation is a structural exercise. This should also be seen as an opportunity to encourage and develop an OTC market. Over 22 years, a significant amount of Indian securities market has got exported. The focus in India has been to address the retail investors, whereas institutions constitute the bulk of the market.
- The consolidation of the Code also represents an opportunity to create a good commodities market. Also, overhaul of accounting standards is necessary, rather than a corrective application of the existing poor accounting standards.
- The focus of a uniform Code should be to regulate all market instruments. The definition of the term "security" has to be standardised. The definition in the Public Debt Act of 1944 will not serve the present purposes. SEBI LODR Regulations, 2015 applies only to "designated securities". CPs have to be listed since 2020. The only element of the securities market that is understood by the retail investor is the stock (equity) market. The proposed unified Code should address companies, Stock Exchanges, other MIIs and the entirety of Securities Market Regulation.
- The purpose of the proposed consolidation is ostensibly to bring more clarity. In addition to the Acts, the underlying Rules and Regulations should also form a part of the consolidation exercise.
- It would appear that the reason for the proposed consolidation, at this juncture, and the proposed inclusion of the Government Securities Act in the consolidated Code is to promote significant retail participation in the G-Secs markets, in order to enhance the Government's access to funds. RBI's continuing to regulate the G-Secs market has an underlying conflict of interest, since RBI is the debt manager of the Government, and a participant in the G-Secs market. Other things remaining the same, G-Secs constitute a better investment option than FDs for retail investors.
- It was also felt that the drafting of the consolidated Code would need to be given significant attention, since in all enactments, the devil lies in the detail.

- The 3 Securities Law enactments were not drafted with the requisite amount of clarity. Clarity came in subsequently on account of judicial pronouncements. These judicial pronouncements should not be lost sight of when the new law is made. The codified draft should be put out for consultation since the major changes that would be involved would require widespread consultation. Inadequacies in any Act lead to confusion, over time, leading to an expanded empire by creative interpretation of the provisions. The enforcement and the adjudication mechanisms must be separated. Failing this, the present practice of every show cause notice getting confirmed in adjudication proceedings will continue. Placing the retail investor at the centre is also not very helpful since the market is constituted largely by institutional investors. With more complex instruments in the market, the retail investors would be exposed to considerable risk if they invested in those products. For example, in the case of derivative trading, even institutions such as banks, came to grief because they did not understand the extent of risk in some of the products in which they were investing.
- The objective of each regulation must be clearly stated. There must be a problem statement, and an indication of how the proposed legislation will address that problem.
- The OTC market should not be viewed with suspicion, and treated as some evil that should be stamped out.
- While noting inadequacies in regulations, and in regulatory organisations, it must also be remembered that securities market players often play “ping-pong” in the markets to further their interests. Securities Regulators need to move faster so that trust and confidence is created. Capacity building in regulatory organisations should also be a major part of the consolidation exercise.

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