A letter to the new chief of Sebi: Some issues that merit attention

Investor education and the market regulator's capacity for adjudication deserve to be high priority for Tuhin Kanta Pandey

M. DAMODARAN
is chairperson, Excellence Enablers, and former chairman, Securities and Exchange Board of India

REUTERS

Dear Chairman Pandey,

At the outset, let me wish you a rewarding and productive tenure as the head of India's securities market regulator. I would have personally preferred a 5-year term, with no re-employment or extension.

You assume office at a very critical time in the history of the organization. In terms of both products and processes, there have been significant achievements. At the same time, for reasons good or bad, the reputation of the organization has been somewhat dented. I am sure that with your experience in the area of finance, and perhaps in the arena of securities markets, you will hit the ground running with a plan to address urgent and important matters. It is not my intention to burden you with unsolicited advice. However, there are a few issues which are significant enough to merit your attention.

The first of these derives from the Preamble to the Securities and Exchange Board of India (Sebi) Act. The Preamble mentions development of markets, regulation of markets and the protection of the interests of investors. Some choose to read these as three different tasks that Sebi has to address. My own view is that both development and regulation are means to an end, which is protecting the interest of investors. I am cognizant of the fact that in addition to investors, there are two other 'I's, namely, issuers and intermediaries, that cannot be ignored. Primacy would, however, have to be accorded to the investor.

Many steps have been taken from time to time and many safeguards put in place to attempt to protect investors, especially small investors. Without their coming into markets in significant numbers, either directly or through the mutual fund route, markets would not have within their fold the numbers that can contribute to stability and soundness. It is universally recognized that an educated investor is a protected investor. Therefore, the attempt ought to be to scale up efforts to promote investor education. Regrettably, this seems to have gone significantly lower in the pecking order, with only ₹2.8 crore being deployed by Sebi's Investor Protection and Education Fund in 2023-24. Further, the original design of the National Institute of Securities Markets (NISM), contemplated a separate School for Investor Education. This seems to have been placed on the back-burner, if not entirely lost sight of, by its focus on capacity-building programmes for Sebi officials and intermediaries. This would need to be remedied soon.

A related aspect is that India has not had a history of suitably trained, qualified and motivated investment advisors. Those who are in this profession are mostly in metropolitan and urban areas, and therefore the ability to educate investors in rural areas, and to get them to look at equity and debt as asset classes, is missing. A few years ago, Sebi had started a programme called SMARTS, to train investment advisors in order to replace product pushers who were masquerading as investment advisors. It is not clear whether this programme is getting the kind of push that it needs, to percolate to all corners of the country.

Yet another area that I am sure will merit your attention is the quality of adjudication orders being passed by Sebi officials. Adjudicating Officers (AOs) in Sebi are persons drawn from different departments, without necessarily having the kind of judicial training required to weigh evidence and pass reasoned orders. Many of them, in earlier years, were placed as AOs because they did not measure up in their other assignments. This is clearly an unacceptable proposition. As a consequence of not having the right number of adequately trained persons, Sebi's adjudication orders often come to grief when challenged at the Securities Appellate Tribunal. This also impacts the reputation of the organization, besides the injustice that could be caused to individuals and institutions. Perhaps there is a case, as in some other jurisdictions, of getting judicial officers on deputation to discharge these responsibilities.

A related point is the time taken for the entire process of surveillance, investigation and enforcement. From the time that a matter is taken in hand, it takes years in the normal course of events for enforcement action to kick in. Meanwhile, those that game the system continue to make unjust gains. Speed and exemplary punishment are the two ingredients that will quickly bring order to the market place, and discourage and dis-incentivize persons with wrong ideas.

Conflict of interest and asymmetry of information are the terrible twins of the securities market. While Prohibition of Insider Trading Regulations and curbing Related Party Transactions are important measures, it is neither necessary nor desirable to amend them with extraordinary frequency. Clarity and continuity in regulations is what makes for orderly conduct in the market place.

One last thought before I sign off. The tendency to keep defining and redefining 'Independent Directors' should be given up. Independence is a state of mind, and cannot be legislated or regulated.

As you take guard, and we look forward to a stroke-filled productive innings, you carry our good wishes, our expectations and our hopes.