REFORMING THE REGULATORY STATE

M. S. Sahoo

The rise of regulators to share governance with Government is now a hard reality and governance through regulators probably constitutes the most important governance reforms in the last century. A regulator sits in the middle of a hierarchy of agencies: Government and economic agents. It generally does not share the 'social' obligations of Government; nor is it subject to the pressures of 'interest' groups. It provides the same level playing field to all kinds of participants without fear or favour. It builds the expertise matching the complexities of the task and evolves processes to enforce authority rapidly and proactively. It operates at arm's length from government, insulated from daily political pressures and embedding their decisions in technical expertise. But there are significant concerns due to the fusion of legislative, executive, and judicial powers in one entity; Governments continue to remain accountable for the governance carried out through the regulator, thereby posing an example of the classical principal-agent problem. India has now more than two decades of experience with governance through regulators, It has been increasingly felt that a comprehensive review of the experience so far with a view to learn to improve the spacing and design of the regulators within the constitutional schema to make them more effective is the need of the hour. This paper undertakes this review on the basis of which it attempts to propose a more effective regulatory framework.

BACKGROUND

The rise of regulators to share governance with Government is now a hard reality and governance through regulators probably constitutes amongst the most important governance reforms in the last century. Regulators are a class of body corporates mostly created by statutes. They provide public goods in public interest just as Government does. They have responsibilities - consumer protection, development, and regulation - like those discharged by Government. They have powers - legislative, executive, and judicial - like those of Government. They resemble Government in many respects, yet they are not the 'Government'. They are, in a sense, Governments within a Government, *imperium in imperio,* and carry out governance on behalf of Government in a predefined framework. They are epistemically known as 'regulators' as their responsibilities include regulation, though they are formally described as authority, commission, board, council, etc.

A regulator sits in the middle of a hierarchy of agencies: Government and economic agents. There are, in fact, significant advantages of governance through a regulator. It generally does not share the 'social' obligations of Government; nor is it subject to the pressures of 'interest' groups. It provides the same level playing field to all kinds of participants without fear or favour. It builds the expertise matching the complexities of the task and evolves processes to enforce authority rapidly and proactively. It operates at arm's length from government, insulated from daily political pressures and embedding their decisions in technical expertise. However, there are also significant concerns. The fusion of legislative, executive, and judicial powers in one entity carries the tension of potential misuse. It suffers from democratic deficit as it is not directly accountable to people or their representatives. Government continues to remain accountable for the governance carried out through the regulator,

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M.S. Sahoo is Chairperson, Insolvency and Bankruptcy Board of India, New Delhi. Views are purely personal. Concise version of Ph.D. thesis approved by the University of Mumbai, 2016. For more details, see Sahoo [2016]. Some updating has been attempted.

which poses a classic example of the principal-agent problem. In case of exigencies, Government is called upon to explain and carry out rescue operations. The challenge is to minimise the concerns while harnessing the advantages. Given the complex agency and accountability issues posed by regulators as new mechanisms of governance, their design and location must be an integral part of a larger vision and unifying goal of public interest.

India has now more than two decades of experience with governance through regulators, which have become an important plank of her institutional edifice. Every administrative ministry has its unique approach to establishing regulatory institutions. A comprehensive review of the experience so far and using that learning to improve the spacing and design of the regulators within the constitutional schema to make them more effective is the need of the hour. Regulators' basic design, functions and powers, independence, and accountability mechanisms, etc., must be similar. A common template may be developed covering critical overarching principles as a charter to guide the establishment as well as operation of regulators irrespective of their sphere of operation. This charter should be something like the Constitution of India or the Companies Act, 2013, which provides for all aspects of the Government / a company, its operations, management, and governance, irrespective of the kind of business / activity it is engaged in. An example of this is given in UK [2018].

It is against this background that we attempt, in this paper, to provide the context for a regulator which is the securities market following which we move over to the design of a regulator. The structure of the presentation is as follows: Section 2 provides a general understanding of the role of institutions in securities market and in an economy (Part 1) followed by a review of the rationale, scope and tools of regulation in securities markets and highlights certain regulatory issues and concerns and contemporary discourses on the same (Part 2) while in Part 3, an attempt has been made to present a profile of Indian securities markets in terms of its importance, market outcome and reforms since 1992. Section 3 provides a comprehensive review of the experience so far of governance through Securities Exchange Board of India (SEBI) I and uses the learning to improve the spacing and design of SEBI within the constitutional schema to make it more effective and address the felt concerns. Section 4 has attempted an analysis of the processes and systems currently in place to make regulations and the principles governing them with a view to improve the quality and effectiveness of regulations. Section 5 describes the experience so far of enforcement actions undertaken by SEBI with an attempt to critically examine this experience with a view to use the learning to improve its effectiveness in dealing with the contraventions. Section 6 provides our concluding remarks. Finally, in Section 7, we provide for a model statute which attempts to design the regulator for securities markets within the constitutional scheme of things based on the experience so far and contemporary thought processes.

SECTION 1

INTRODUCTION

Ideally speaking, the securities market attempts to decouple savings from investment, to allocate resources to rewarding enterprises while assigning enterprises to good managers thereby promoting capital formation as well as the returns on the capital. It determines the cost of capital, cost of raising capital and cost of transferring capital and thereby the cost and ease of doing business. It, therefore, constitutes a crucial and critical institution for a market economy.

However, the market has often revealed a great tendency for market failure, which, basically, arises from the existence of information asymmetry, externalities and market power. The market failure gets accentuated by principal agency problems and layers of contracts, which characterise securities markets. In extreme cases, this has the potential to trigger the Great Depression [Galbraith, 1954]. If the securities market is to be harnessed for economic growth and development, the potential for market failure needs to be adequately addressed. One did not have to take great care earlier when most of the transactions required approval of authorities and when there was no market in the true sense of the term. However, the shift from a command and control regime to a market economy empowered the economic agents to undertake transactions in their best interests and ushered in the invisible hand into play at the market place which needs to play in compliance with the rules of the game to ensure orderly development of the market sans market failure to serve the economy. The rules of the game became, thus, necessary for the success of a market economy [Doyle, 1997, Pp. 35-42].

The securities market has developed, over time, a set of institutions to prevent or reduce the possibility of market failure. The institutions lay down and enforce incentive structure for economic agents and define their behaviour and performance. These have two components, namely, the institutional environment (rules of the game) and the institutional arrangements (the way the rules of the game are developed, modified and enforced). The institutional environment defines the contours of freedom of economic agents, protects their rights, enforces their obligations, and thereby brings predictability of their actions and certainty of outcomes. The environment in securities market includes the rule of the game encompassing the legal and regulatory framework, disclosure norms, audit and accounting standards, corporate governance practices, compliance culture, sanctions for infractions, financial literacy, investor protection mechanism, professional ethics, protection of property rights, enforcement of contractual obligations, press, judiciary, etc. Many of these are exclusive for securities markets, while others serve the entire economy. Some of these are preconditions to development of securities market, while some others develop along with the market. Some of these come from informal sources such as customs and practices or have developed spontaneously while the rest are formally prescribed.

The institutional arrangement develops, modifies, administers and enforces the institutional environment and thereby determines the relationship among the participants. An institutional innovation in this context has been establishment of independent, statutorily empowered, regulatory agencies [Nair, 2011]. Perhaps the establishment of independent regulators constitutes a significant change to formal institutions of governance [Westrup, 2007]. These are, in fact, the governors of the markets, known as regulators in common parlance. India has been developing and nourishing the institutional arrangement for building institutional environment for the securities markets over the last two decades. It established the Securities and Exchange Board of India (SEBI) in 1992 with the objectives to protect the investors in securities and to develop and regulate the securities market. SEBI regulates activities and conduct of market participants and builds in various safeguards in the market place to ensure that investors enjoy investing and the deserving issuers enjoy raising resources from the securities market. The institutional arrangement - the spacing of SEBI in the overall scheme of governance, its own governance (internal design and architecture), and the way it develops, modifies, administers and enforces the regulatory framework - holds the key to the success of SEBI. However, a country can't develop a strong securities regulator before it has some publicly traded securities for the regulator to gain experience with [Black, 2000, Pp. 1565-1607]. The regulator develops along with the development of the market in a virtuous circle and would keep on developing through its existence. Probably, building a regulator will always remain a work-in-progress just as any other mechanism of governance.

The institutions are deeper determinants of economic growth [Rodrik & Subramanian, 2003]. This is not to ignore the fact that economic growth has substantial bearing on the development and quality of institutions. The securities market [Bekaert & Harvey, 1998; Bernstein, 2004], the rules of the game in securities market [North, 1990; Doyle, 1996; Black, 2000, World Bank, 2014], and the securities regulator [Black, 2000; Subramanian, 2007] are among the critical institutions having substantial bearing on economic performance. The institutional arrangement (like SEBI) determines the shape, size, colour, smell, strength and health of the institutional environment (rules of the game) which, in turn, determines the shape, size, colour, smell, strength and health of the securities market which, in turn, impacts economic growth of the country. SEBI holds the key to the contours of institutional environment and, consequently of the Indian securities market and its effectiveness as an engine of growth.

In recognition of the fact that the key differentiator between the countries is "institutions" [Acemoglu & Robinson, 2012], the present paper has attempted a fairly comprehensive review of the key institutional arrangement, namely, SEBI, governing securities markets in India with a view to improving it further, notwithstanding the fact that it could probably be the most evolved regulator. Before doing this, to begin with, an overview of institutional economics is outlined.

1.1 Institutional Economics

The father of Economics, Adam Smith [Smith, 1776], who was a major exponent of laissez faire economic policies, recognised the significance of institutions in economic growth: "Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government" (p. 546). Research reaffirms the significant role of institutions in promoting and sustaining long-run development [Davis & North, 1971; North & Robert, 1973; North, 1990; North, 1994, Pp. 359-67; Williamson, 2000; Acemoglu et al., 2001, Pp. 1369-1401; Rodrik & Subramanian, 2003, Pp. 31-34; Rodrik et al., 2004, Pp. 131-165; Subramanian, 2007, Pp. 196-220].

Though the exact relationship between institutions and economic growth is yet to be precisely determined, empirical studies evidencing the very high positive correlation between the two have put institutional economics at the centre stage. Acemoglu, et al., [2001] claimed: "Many economists and social scientists believe that differences in institutions and state policies are at the root of large differences in income per capita across countries. There is little agreement, however, about what determines institutions and government attitudes towards economic progress, making it difficult to isolate exogenous sources of variation in institutions to estimate their effect on performance" (p. 1395). Davis & North [1971] argued that it is difficult to believe that the exploration of long-run economic change can be achieved without development of a body of theory that can incorporate the innovation, mutation and demise of institutions. Matthews [1986, Pp. 903-918] had this to say: "The economics of institutions has become one of the liveliest areas in our discipline. It has, moreover, brought us more closely in touch with a number of other disciplines within social sciences. A body of thinking has evolved based on two propositions: (i) institutions do matter, (ii) the determinants of institutions are susceptible to analysis by the tools of economic theory" (p. 903).

1.2 Institutions do Matter

Every enquiry into the causes of wealth[1] has reinforced the idea that the institutions do matter. Every institution matters, be it commercial, economic, political, social or ethical, and whether it is formal or informal. Institutions matter because these lay down and enforce the incentive structure of economic agents, and thereby determine their economic performance. Some institutions matter more in some context and may matter less in some other context. Depending on the kind of institutions a country has, similar policies relating to macroeconomic stabilisation, trade liberalisation, privatisation, market microstructure, etc., yield different economic outcomes in different countries. In the absence of conducive institutions, the policies and measures, such as, fiscal stimulus, monetary expansion, welfare measures, that are taken to uplift the economy or quality of life of people, have often not yielded the desired outcomes. The malfunctioning of institutions can thwart an economy's progress and render the more visible policy instruments, such as good fiscal and monetary policies, less effective [World Bank, 2014]. The institutions differentiate the countries in terms of the level of economic prosperity and it is not a coincidence that a change in institutions changes the growth trajectory. In other words, a country can get rich if she improves the quality of her institutions and / or changes the existing institutions. Davis & North [1971] assert that if external economic factors make an increase in income possible but which is not attainable within the existing institutional infrastructure, new institutions must be developed to achieve the potential in income.

While the jury is out to find the answer to the question, "What are the fundamental causes of the large differences in income per capita across countries?", differences in institutions and property rights have received considerable attention in recent years. Countries with better institutions, more secure property rights, and less distortionary policies invest more in physical and human capital, and use these factors more efficiently to achieve a greater level of income [North and Robert, 1973]. Acemoglu, et al., [2001] argue: "At some level it is obvious that institutions matter. Witness, for example, the divergent paths of North and South Korea, or East and West Germany, where one part of the country stagnated under central planning and collective ownership, while the other prospered with private property and a market economy" (p. 1369). Though there is lack of conclusive evidence that institutional differences can have a large enough effect to explain the phenomenal differences in output per capita across countries, it is concluded: "Interestingly, we show that once the effect of institutions on economic performance is controlled for, neither distance from the equator nor the dummy for Africa is significant. These results suggest that Africa is poorer than the rest of the world not because of pure geographic or cultural factors, but because of worse institutions" (p. 1372).

Rodrik, et al., [2004] argue that economic growth has many proximate determinants such as physical capital and human capital accumulation, technological innovations, etc. But why do some countries manage to accumulate and innovate more rapidly than others do? The deeper or fundamental factors that determine the level of accumulation and innovation are geography, integration and institutions. These deeper factors determine which societies will innovate and accumulate, and, therefore, develop, and which will not. The trust barometer [Edelman, 2015] reinforces a strong correlation between trust in institutions in a country and its willingness to accept innovation: higher trust creates opportunities for faster innovation. An empirical study [Rodrik & Subramanian, 2003] shows that the quality of institutions (as measured by a composite indicator of a number of elements that capture the protection afforded to property rights as well as the strength of the rule of law) is the only positive and significant determinant of income levels. Once institutions are controlled for, integration has no direct effect on incomes, while geography has at best weak direct effects. Further, the study indicates that an increase in institutional quality can produce large increases in income per capita.

Acemoglu & Robinson [2012] argue that the key differentiator between countries is "institutions". A country develops if she has political and economic institutions that unleash (these are not restrictions of individual behavior but instruments of liberation of individuals from uncertainty), empower and protect the full potential of each citizen to innovate, invest and develop, i.e., when she has "inclusive" institutions. She fails to develop if she has "extractive" institutions that concentrate power and opportunity in the hands of a few or uses energy and creativity of a small part of the society. If institutions are not conducive, policies and schemes may not promote growth. Institutions lubricate the transactions in the economy. Inability or difficulty to enter into transactions, or failure to fructify them holds up the growth even if necessary, resources are available. "Central to our theory is the link between inclusive economic and political institutions and prosperity. Inclusive economic institutions that enforce property rights, create a level playing field, and encourage investments in new technologies and skills are more conducive to economic growth than extractive economic institutions that are structured to extract resources from the many by the few and that fail to protect property rights or provide incentives for economic activity" [Acemoglu & Robinson, 2012, p. 470].

1.3 The meaning of "Institution"

Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction [North, 1990]. These include values and norms, laws and regulations, and firms and authorities. These shape behavior of economic agents and coordinate their interaction, and thereby determine their performance. In the words of North [1991], "Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights). Throughout history, institutions have been devised by human beings to create order and reduce uncertainty in exchange". (p. 97) He further refines the definition [North, 1994]: "Institutions are the humanly devised constraints that structure human interaction. They are made up of formal constraints (rules, laws, and constitutions), informal constraints (norms, behavior, and conventions) and their enforcement characteristics. Together they define the incentive structure of societies and specificially economies". (p. 360) It is the admixture of formal rules, informal norms, and enforcement characteristics that shapes economic performance.

It is worth noting in this context the two concepts distinguished by Davis and North [1971]. The 'institutional environment' is the set of fundamental political, social, and legal ground rules that establishes the basis for production, exchange, and distribution. Rules governing elections, property rights, and the right of contract are examples of the type of ground rules that make up economic environment. An 'institutional arrangement' is an arrangement between economic units that governs the ways in which these units can operate and or compete. The institutional arrangement is probably the closest counterpart of the most popular use of the term 'institution'. It can provide a structure with which its members can cooperate to obtain some added income that is not available outside the structure. Or, it can provide a mechanism that can effect a change in laws or property rights designed to alter the permissible ways that agents can legally compete.

Bernstein [2004] argued that the pace of economic advance picked up noticeably beginning around 1820 thanks to an explosion of technological innovations. Four institutions that supported innovations and thereby growth is: (a) Property rights: Innovators and tradesmen must rest secure that the fruits of their labours will not be arbitrarily confiscated, by the State, by criminals, or by monopolists. The assurance that a person can keep most of his just reward is the right that guarantees all other rights; (b) Scientific rationalism: Economic progress depends on the development and commercialisation of ideas. The inventive process requires a supportive intellectual framework - an infrastructure of rational thought, with a reliance on empirical observation and on the mathematical tools that support technologic advance; (c) Capital markets: The large-scale production of new goods and services requires vast amounts of money from others -"capital." Even if property and the ability to innovate are secure, capital is still required to develop schemes and ideas. Since almost no entrepreneur has enough money to mass-produce his inventions, economic growth is impossible without substantial capital from outside sources; (d) Fast and efficient communications and transportation: The final step in the creation of gadgets is their advertisement and distribution to buyers hundreds or thousands of miles away. Even if entrepreneurs possess secure property rights, the proper intellectual tools, and adequate capital, their innovations will languish unless they can quickly and cheaply put their products into the hands of consumers.

Rodrik & Subramanian [2003] and Subramanian [2007] classify institutions into four categories, namely, (a) Market creating: These protect property rights, ensure enforcement of contracts and provide law and order, and thereby provide an environment for business and investment to flourish. These include rule of law, judiciary, and police; (b) Market regulating: These deal with market failures arising from externalities, economies of scale (market power), and imperfect information. The examples include regulatory agencies; (c) Market stabilising: These ensure low inflation, minimise macroeconomic volatility, and avert financial crises. The examples include central banks, exchange rate regimes, and budgetary and fiscal rules; and (d) Market legitimising: These provide social protection and insurance, involve redistribution, and manage conflict. The examples include pension systems, unemployment insurance schemes, and other social funds and democracy which is the ultimate institution for legitimising markets. Rodrik and Subramanian [2005] in fact, considers political democracy as a meta institution that helps societies make choices about the institutions they want.

1.4 The Securities Markets - A Unique Market

The securities market is a sub-set of the capital market which enables pooling of long term and intermediate term resources for capital formation. It encompasses only those forms of pooling of resources that are evidenced by transferable instruments called securities. It links savings to investments through securities and enables exchange of securities for funds among savers and investors. There is a set of economic units who demand securities in lieu of funds and another set of units who supply securities for funds. The supply of securities comes from those who wish to invest but do not have adequate resources. They create and exchange securities for funds. The demand for securities comes from those who generally have surplus budgets, but do not have immediate use for them. They exchange funds for securities. The demand for securities is equal to supply of funds and supply of securities is equal to demand for funds. The demand for and supply of securities and funds determine the prices of securities and also of funds; the efficiency of price discovery depends on the competitive conditions in real and financial markets.

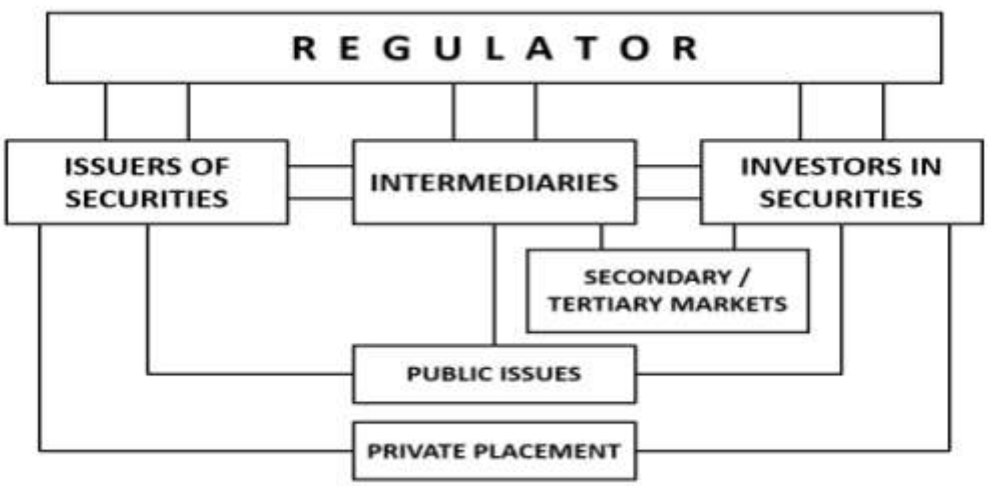
The securities market is unique in many ways and its products are interesting products. These are called securities which include shares, bonds, units of Collective Investment Schemes (CIS), Government securities, derivatives of securities, rights or interests in securities, etc. These instruments have nothing in common except the insecurities associated with all of them! These do not have any shape and size, but move the entire world electronically in fraction of a second. These change hands with a click of a mouse. These do not have any value of own; these acquire and lose value in thin air. But the consequences of such valuation are grave; a sharp fall in their valuation has the potential to trigger the Great Depression [Galbraith, 1954]. The stock market crash of 2008, triggered by a collapse in house prices caused the Great Recession [Farmer, 2011, Pp. 693-707]. This potential form a major basis for regulations of securities markets.

This is the market where one loves prices to go up and up and never to come down, unlike other prices. A steep fall in prices of securities has the potential to bring down governments because the prices here reflect the changes and the likely changes in the whole environment, domestic or overseas and natural or artificial, and the changes at sea, in air and on the ground. The prices here move even if there is no change in the securities market or in the performance of issuers of securities. These moves take place because something has happened or even has not happened elsewhere. The prices of securities faithfully, dispassionately and objectively, reflect these happenings and thereby emit different signals for economic agents. This is because of demand and supply where demand includes investment demand, speculation demand, and arbitrage demand, with each taking a view on present and also future.

It is a misnomer that the securities market disintermediates by establishing a direct relationship between the suppliers of funds (investors in securities or investors) and the suppliers of securities (issuers of securities or investees) [Sahoo, 1997, Pp. 1261-1269]. It does not work in a vacuum; it requires services of a large variety of intermediaries like merchant bankers, brokers, etc., to match the preferences of the investors and issuers, to bring them together for a variety of transactions and to help them in settlement of such transactions. The disintermediation in the securities market is, in fact, an intermediation with a difference; it is a risk-less intermediation, where the ultimate risks are borne by issuers of securities and investors in securities, and not the intermediaries, in contrast to banks who, as intermediaries, who really intermediate and shoulder the entire risk Banks take deposits on their balance sheet and then on lend, while merchant bankers facilitate a deal outside their balance sheet, but for a fee.

Those who receive funds in exchange for securities and those who receive securities in exchange for funds often need the reassurance that it is safe to do so. The law and custom, often enforced by the regulator, provide this reassurance. The regulator develops fair market practices and regulates the conduct of the issuers of securities and the intermediaries so as to protect the interests of the investors in securities and maintain market integrity. It should ensure a high standard of service from the intermediaries and supply of quality securities and non-manipulated demand for them in the market. The relationship among the participants in securities markets is presented in Figure 1.

Figure 1. Participants in Securities Markets



Unique products, unique prices and unique intermediaries make the securities markets very special. It is continuously in a state of flux and firmly on the path of the Darwinian Evolution. The market today has no resemblance with what it was yesterday and would have no resemblance with what it would be tomorrow. It seems present everywhere, literally everywhere; one has access to the market the moment he switches on his handheld device. It not only knows what would be price five years hence; it even tells us the same in advance. The havoc the market plays such as during the Great Depression of 1930 or the financial tsunami of 2008, brings the entire world economy to its knees.

1.5 Institutions of the Securities Market

The securities market has probably the ideal recipe for market failure. While the market is information driven, parties on both sides of a transaction as well as the regulator do not have access to the same level of information. Most of the transactions, which are built on layers of contracts, are carried out by agents who do not have the same level of motivation as do their principals. The valuations in this market have huge influence on macroeconomic performance and financial wellbeing of the people. Most importantly, this market provides substantial resources for capital formation and thereby promotes growth of the economy. Given its characteristics, its importance in the economy and its potential for market failure, reforms all over the world have brought in sizable regulations along with a dedicated regulator. The reforms aimed at liberalisation (reducing regulation) have only increased the volume of regulations. In fact, freer markets often call for more regulations as the experience with liberalisation and regulatory reforms in advanced countries indicates [Vogel, 1996]. There is a trend of decline of self-regulation and growth of statutory regulators [Davies, 2004, Pp. 12-20]. As dependence on regulations increases for governance, the responsibilities of the statutory regulator in making regulations and enforcing them increase sharply.

Black [2000] believed that a strong securities market rests on a complex network of supporting institutions to deal with two critical and related investor protection issues, namely, information asymmetry and self-dealing. He has identified a set of 17 core institutions to control information asymmetry (see Box 1) and a set of 19 institutions to protect against self-dealing (see Box 2). He has also identified a few additional useful institutions, such as credit rating, institutional investors, fund managers, venture capital funds, liability of securities lawyers, etc.

Box No. 1. Core Institutions that Control Information Asymmetry

(1) Extensive financial disclosure, including independent audits of public companies' financial statements;

(2) Accounting rules that address investors' need for reliable information;

(3) A rule-writing institution with the competence, independence, and incentives to write good accounting rules and keep the rules up to date;

(4) A sophisticated accounting profession with the skill and experience to catch at least some instances of false or misleading disclosure;

(5) Securities or other laws that impose on accountants enough risk of liability to investors if the accountants endorse false or misleading financial statements so that the accountants will resist their clients' pressure for more favorable disclosure;

(6) Procedural rules that provide reasonably broad civil discovery and permit class actions or another means to combine the small claims of many investors;

(7) A sophisticated investment banking profession that investigates the issuers of securities that the investment bank underwrites, because the investment banker's reputation depends on not selling fraudulent or overpriced securities;

(8) Securities or other laws that impose on investment bankers enough risk of liability to investors if the investment bankers underwrite securities that are sold with false or misleading disclosure, so that the bankers will resist their clients' entreaties for more favorable disclosure;

(9) Sophisticated securities lawyers who can ensure that a company's offering documents comply with the disclosure requirements;

(10) A stock exchange with meaningful listing standards, and the willingness to enforce them by fining or delisting companies that violate disclosure rules;

(11) Securities or other laws that impose severe sanctions on insiders for false or misleading disclosure, including criminal sanctions where appropriate;

(12) A securities regulator (and, for criminal cases, a prosecutor) that is (i) honest; and (ii) has the staff, skill, and budget to pursue complex securities cases involving false or misleading disclosure;

(13) A judicial system that is (i) honest; (ii) sophisticated enough to handle complex securities cases; (iii) can intervene quickly when needed to prevent asset stripping; and (iv) can produce decisions without intolerable delay (and with appropriate adjustments for the time value of money);

(14) Rules ensuring market "transparency": the time, quantity and price of trades in public securities must be promptly disclosed to investors;

(15) Rules banning manipulation of trading prices (and effective enforcement of those rules);

(16) An active financial press and an active securities analysis profession that can uncover and publicise instances of misleading disclosure, and criticise not only the company, but (when appropriate) the investment bankers, accountants, and lawyers as well; and

(17) A culture of disclosure that develops over time, among accountants, investment bankers, lawyers, and company managers, that concealing bad news is a recipe for trouble.

Source: Black [2000]

Box No. 2. Core Institutions to Protect against Self-dealing

(1) Securities or other laws that require extensive disclosure of self-dealing transactions;

(2) Review of self-dealing transactions by a company's accountants, to ensure that they are accurately disclosed;

(3) A sophisticated accounting profession with the skill and experience to catch at least some non-disclosed self-dealing transactions, and insist on proper disclosure;

(4) Securities or other laws that impose on accountants enough risk of liability to investors if the accountants endorse nondisclosure or misleading disclosure of self-dealing transactions, so that the accountants will investigate suspect transactions and resist their clients' entreaties to let them hide self-dealing transactions;

(5) Company law or securities law that establishes procedural protections for self-dealing transactions, such as approval after full disclosure by independent directors, non-interested shareholders, or both;

(6) Ownership disclosure rules that ensure that outside investors know who the insiders are, and that interested shareholders don't vote to approve a self-dealing transaction that requires approval by non-interested shareholders;

(7) Strong sanctions against insiders for violating the disclosure or procedural rules governing self-dealing transactions, or for engaging in insider trading, including criminal sanctions where appropriate;

(8) Procedural rules that provide reasonably broad civil discovery and permit class actions or another means to combine the small claims of many investors;

(9) A securities regulator (and, for criminal cases, a prosecutor) that: (i) is honest; and (ii) has the staff, skill, and budget to untangle complex self-dealing transactions;

(10) A judicial system that is (i) honest; (ii) sophisticated enough to understand complex self-dealing transactions involving multiple intermediaries; (iii) can intervene quickly when needed to prevent asset stripping; and (iv) can produce decisions without intolerable delay (and with appropriate adjustments for the time value of money);

(11) Company or other law that (i) requires public companies to have a minimum number of independent directors; and (ii) imposes on independent directors enough risk of liability for approving self-dealing transactions that are grossly unfair to the company, so that they will resist pressure from insiders to approve these transactions;

(12) Sophisticated securities lawyers who can ensure that a company satisfies the disclosure requirements and procedural protections governing self-dealing transactions;

(13) An active financial press and an active securities analysis profession that can uncover and publicise instances of self-dealing;

(14) A culture of compliance that develops overtime, among accountants, lawyers, and company managers, that concealing self-dealing transactions, approving a transaction that is seriously unfair to the company, ignoring the procedural safeguards that accompany these transactions, or trading on inside information is improper and a recipe for trouble;

(15) Securities or other laws that prohibit insider trading, suitably defined, and active government enforcement of those rules;

(16) A good overall financial disclosure regime;

(17) A stock exchange with meaningful listing standards, the willingness to enforce them by fining or delisting companies that violate the rules governing self-dealing transactions, and the financial resources and skill to run a surveillance operation that can catch at least some insider trading;

(18) Rules ensuring transparency of trading prices; and

(19) Enforced rules banning manipulation of trading prices.

Source: Black [2000].

1.6 The Securities Market in India

It is believed that there was a survey in early 2000 to find out the most televised structure in India The finding of the survey revealed that it was not the temple of power like the *Rashtrapati Bhawan or Parliament House*; nor the temple of beauty like Taj Mahal nor even the temple of nirvana (emancipation) like *Tirupati Devasthanam* Temple or modern temples of learning like IITs or IIMs. It was the temple of wealth, *Sir Pheroze Jeejeebhoy Towers* that houses the oldest stock exchange in Asia, BSE Ltd., [Bajpai, 2004, Pp. 5-11]. The temple is symbolic; it is a proxy for securities markets. Given its role in the life of the people, the securities market is a key institution of the Indian economy.

1.6.1 Securities Regulations

The securities market fails for various reasons. It is synonymous with the market for information. However, all the parties to a transaction may not have the same level of information about the securities under the transaction. The suppliers of securities have full knowledge about the rights and obligation associated with these over different time horizons, which the purchasers may not have. If asymmetry of information is acute, the parties may refrain from undertaking transactions leading to collapse of the market This means that the market is very sensitive to information. Securities market is alternatively called a market for information. This only tells that market does not develop without the comfort of regulation. This is a theoretical underpinning of regulation of securities market. Regulations address this issue by requiring the parties to make full and accurate disclosures about themselves and the products to enable the other party take informed decisions. Further, transactions in securities market are generally undertaken through an intermediary. The intermediaries, being the agents of the issuers of securities or investors, may not always act in the best interest of their principals, as they strive to maximise their own interests, reflecting the concerns of principal-agency and conflict of interests. For this, the regulations prescribe due care and diligence for intermediaries, eligibility norms and prudential requirements for them, and penalties in case they promote their interests over the interests of their clients. The valuation of securities has grave implications on the economic performance. The poor equity valuations in bear markets can hurt economic growth particularly if the erosion (for example, decline in NIFTY[2] from 6139 to 2959 in 2008) in equity valuation in a year is as high as the size of the gross national product (GNP). The 1930 great depression also provided us an example of this. The valuation of securities is reflected in the movement of stock index NIFTY. Regulations ensure non-manipulated demand for and supply of securities to avoid unwarranted overvaluation or undervaluation of securities.

Accordingly, a host of regulations have developed over time to address the potential of market failure, to protect the interests of investors in securities and to maintain systemic stability. These have become fundamental to success of market economy and constitute a critical institution of the securities market. There has been an all-round improvement in the institutional framework of the securities market in India [Sabarinathan, 2010, Pp. 13-26]. India has created a good and comprehensive regulatory system tailored to its own market and societal needs [Wright, 2014]. As per the assessment of 27 top jurisdictions conducted by IOSCO [2010], a total of six countries,[3] including India, got the top-most rating on a scale of one-to-four. Some have, however, differing views: the regulations are excessive [Bhalla, 1999, Pp. 103-112] and are of spotty quality [Shah, 2013], etc.

1.6.2 Securities Regulator

The policy stance has been changing over time. Along with this, new institutions are emerging. Initially, Government focused on direct provision of goods - public or private - in pursuance to its socialistic stance. On realising its limitations of doing so, it gradually withdrew itself from provision of private goods and allowed private sector to undertake this since the 1980s. The reforms further liberalised the economy with a view to encouraging private initiative and competition [Sriraman & Roy, 2009]. Though both the Government and the private sector are now engaged in provision of goods, Government has a predominant share in public goods while private sector has a predominant share in private goods. Government has allowed economic agents to be guided by the pulse of the market since the 1990s. However, to ensure that the market does not fail, it came up with regulatory institutions to exercise oversight over the markets. To ensure that Government does not fail, regulatory institutions were subjected to several checks and balances. Though both the Government and the private sector are now engaged in regulation of markets, the Government has a predominant role. The key, however, is to develop a mutually supportive structure of market and non-market institutions, which is well-suited to promote economic development [Datta-Chaudhuri, 1990, Pp. 25-39] and a good policy requires a balance between Governments and markets that is crafted with intelligence [Basu, 2006]. After decades of debate, there is some convergence in economics about the roles of the market and the state [World Bank, 2014].

Subramanian [2007] summarises this trend: "And India too, albeit more slowly than most countries, has followed this path of less provision and more regulation, creating institutions such as the Securities and Exchange Board of India (SEBI)..." (p. 198). In fact, the establishment of SEBI constitutes major governance reforms in India since liberalisation in the 1990s [Sahoo, 2012b, Pp. 1250-1255] and marks the real beginning of transfer of governance from Government to statutory regulators in India. Many such regulators have come up in different spheres of the economy since then and many more are in the offing. All over the world, regulators have come up because they are found to be more effective in comparison to usual statecraft in an incomplete legal regime as they are vested with proactive law enforcement and residual law-making powers [Pistor & Chenggang, 2003, Pp. 931-1013].

SEBI is considered one of the most evolved regulators established in India. The SEBI Bhawan which houses SEBI, evokes respect and fear from all concerned depending on which side of the law one is. Bhattacharya & Patel [2005, Pp. 406-456] believe that SEBI is a notable success partially due to its supervision of a sector where the Government recognised the correct structure and devised, more or less, the right policies to foster competition and efficiency. Subramanian [2007, Pp. 196-220] writes: "Further, some of the institutions, such as the TRAI, SEBI, and IRDA, have performed very respectably, especially considering the novelty of the terrain they have had to navigate" (p. 199). Dhume [2010] observes: "Unlike many developing countries, India has a record of sustaining credible institutions, among them the Supreme Court, the Election Commission and the Securities and Exchange Board of India".

Bhalla [1999], however, believes that SEBI has turned out to be nothing more than a licensing authority, characterised by over-regulation. While acknowledging great success of SEBI, Shah [2013] observes: "The objectives of SEBI were not adequately defined, and it has frequently pursued quirky objectives or succumbed to lobbying. The flow of regulations is of spotty quality. The temptation to do central planning - that is rampant elsewhere in Indian finance - has not been purged at SEBI. SEBI regulations are law - but the process through which regulations are drafted leaves a lot to be desired. Neither regulation-making nor post-mortem analysis of regulations is shaped by evidence". SEBI protects everyone but the common investor it was created to protect [Dalal, 2013]. SEBI has become a dragon overreaching beyond what the company law states [Srinivasan, 2014].

We now turn to a review of Securities Regulations in Section 2.

SECTION 2
A REVIEW OF SECURITIES REGULATIONS

2.1 Market Physiognomies

The securities market is unique in many ways. It has products, prices, issuers, intermediaries, institutions, and investors that make the market very special and present the ideal recipe for market failure, which essentially, forms the basis of regulation.

Ingredients of Market Failure

The securities market has all the three classical ingredients of market failure, namely, information asymmetry, externalities and excess market power, which cause misallocation of resources and shatter the neo-classical firm faith in a market. First, the securities market is synonymous with the market for information. However, all the parties to a transaction may not have the same level of information about the securities under the transaction. The suppliers of securities have full knowledge about the rights and obligations associated with these over different time horizons, which the purchasers, even the regulators, may not have. The information asymmetry increases as the financial engineers churn out more and more complicated products and sophisticated issuers of products beyond the comprehension of the average users of the market. If asymmetry of information is acute, the parties may refrain from undertaking transactions leading to collapse of the market. Or, this would cause misallocation of resources with investors paying too much or too little for securities depending on the information they have and consequently firms issuing securities producing too much or too little. Regulations address this by requiring the parties to make full, accurate and timely disclosures about themselves and the products to enable the other parties take informed decisions. These often oblige the former to take measures to upgrade the ability of the later to undertake effective KYP (know your product and know your participants) based on disclosures, while the regulator ensures KYC (know your client/ customer) as well as KYP.

The second relates to externalities where all the costs and benefits of an action do not get reflected in the market/prices and as a result, the concerned economic agents produce or consume too much or too little. More importantly, the externalities arise from systemic risk which has potential to have an adverse effect on the economy. The US stock market crash of 1929 is believed to be main culprit of the Great Depression of 1930s. Galbraith [1954] explained that the stock market had been overvalued. As buyers and sellers became aware of this overvaluation, the stock market prices fell which caused a drop in personal wealth and consequently spending of the people. This reduced demand and consequently employment. This caused a further fall in the prices of securities which set off the downward spiral again, leading to the Great Depression in a vicious circle. Regulations are, therefore, required to address systemic concerns to ensure that the market is neither overvalued nor undervalued by manipulation and the market promotes capital formation. Kawai & Pomerleano [2010] proposed that each country should establish an effective, powerful systemic stability regulator that is in charge of crisis prevention, management and resolution. India set up the Financial Stability and Development Council (FSDC)[4] in 2010 for maintaining systemic stability. Canada has been contemplating[5] to enact a dedicated legislation entitled 'the Capital Markets Stability Act', the revised draft of which came out in 2016 but is yet to be approved by Parliament. It aims to identify an organisation as systemically important, if the activities or material financial distress of the organisation or the failure of or disruption to its functioning could pose a systemic risk related to capital markets and extends special treatment to them.

The third relates to excess market power. An economic agent having excess power, such as a monopolist or oligopolist, generally operates with excess capacity, that is, at less than the efficient level with higher price and lower quantity. This becomes worse if it is accompanied by information asymmetry. For example, some investors and investees are more powerful than others in the market either because of their resources and / or their information base. The impact is large when a big investor trades even a small quantity, an insider transfers a negligible quantity on over-the-counter a promoter hypothecates a small portion of its holding. There are regulations such as insider trading, bulk deals and block deals, etc., to moderate the impact of transactions by them. The securities market used to have huge barriers to entry. For example, the stock exchanges were clubs where membership was limited. This has been addressed by demutualising the exchanges which delinked ownership rights and trading rights. Brokering is now easily available. With liberalisation, an entity does not need approval to make a public issue. Nor does it need a license to provide an intermediation service. On meeting the eligibility requirements, one makes a public issue or obtains a registration from regulator. The exchanges are natural monopolies arising from huge net worth requirement, economies of scale arising from technology, and the fact that liquidity begets liquidity, it is difficult for a new entrant to compete effectively. The regulations, therefore, provide various measures to protect customers from market power when competition is non-existent or ineffective. One stock exchange having other market segments did not charge any fee for transactions in currency derivatives segment. This reportedly came on the way of other exchanges, not having any other segment, from charging any fee in currency derivatives segment. Waiver of transaction fee altogether in the newly established currency derivative segment by the former exchange was considered[6] by Competition Commission of India (CCI) as abuse of dominant position by predatory pricing. When the idea of depository was first conceived in 1980s and early 1990s, it was thought of having a single central depository[7] which would store the securities. However, a conscious decision was taken to have multiple depositories for the sake of competition and in course of time inter-operability between the depositories was mandated. It has been a conscious strategy to allow and encourage multiple service providers in the space of Market Infrastructure Institutions (MIIs).

Accelerators of Market Failure

The ingredients discussed above are not unique to securities market. But the incidence of market failure is relatively high in securities market because of two reasons. First, the transactions in securities market are generally undertaken through an intermediary. The intermediaries, being the agents of the issuers of and investors in securities, may not always act in the best interests of their principals, as they strive to maximise their own interests, reflecting the concerns of principal-agency and conflict of interests. The regulations generally address this by prescribing due care and diligence for intermediaries, eligibility norms and prudential requirements for them, and penalties in case they promote their interests over the interests of their clients.

Second, transactions are built on layers of contracts, often contingent/sequentially interrelated ones. For example, a ‘share’ is a contract between its issuer and the holder. The shares are traded in the secondary market between two parties. The derivatives on the shares are traded in the tertiary market. The relationships among the parties to a transaction and consummation of transactions are defined by layers of contracts. There is a contract between the issuer of shares and the subscribers to shares while the issue is managed by a host of intermediaries (merchant bankers, syndicate members, stock brokers, registrars to issue, depositories, and stock exchanges) under contractual arrangements. Similarly, the transactions in secondary markets are executed and consummated under a series of contractual arrangements among the listed companies, depositories, exchanges, Clearing Corporations (CCs), clearing banks, trading members, clearing members and clients. In fact, what are traded in tertiary markets are contracts. The fraud, deception or manipulation at any stage of any of the contracts by any of the parties may lead to collapse of pyramid of contracts, often resulting in domino effect. The regulations generally address this by prohibiting certain contracts, such as insider trading, fraudulent trades, and ring fencing the contracts so that these can’t be undone. For example, a trade once executed on a stock exchange would be settled by the central counterparty (which is a financial institution that takes on counterparty credit risk between parties to a transaction and provides clearing and settlement services for trades in foreign exchange, securities, options, and derivative contracts,) even if the parties to the trade do not honour their obligations, fully or partly.

2.2 Cognitive Limitations

Two additional considerations weigh in favour of regulations in the securities market. One relates to protection of disparate retail investors *vis-à-vis* well organised, often cartelised, issuers and intermediaries. According to a burgeoning "law and finance" literature pioneered by La Porta, et al., [1998, Pp. 1113-1155], adequate investor protection is necessary for capital markets to flourish. Kitch [2001, Pp. 629-652] observed : "The consensus understanding of securities regulation has been that the laws protect investors and would-be investors against their own folly. Investors are inadequately informed, unwise, and subject to manipulation by issuers and their hired henchmen - the investment banking and brokerage industries. The regulation corrects this imbalance by imposing mandatory requirements on the sale and trading of securities, requirements which at least proximate the terms on which an adequately informed, wise and unmanipulated investor should transact" (p. 631). At one level, the regulator is considered an agent of the investors and *raison d’être* of its existence is protection of the interests of investors. At another level, SEBI likes to be called ‘Har Investor ki Taaqat’, which translates to ‘the strength of every investor’, while it has statutory mandate to protect the interests of investors in securities.

Second, the economic agents often fail to notice signals emitted by markets. Since the performance of a market economy depends on the perception of economic agents regarding the technological and market opportunities available to them, unaided market mechanisms may be unable to realise potential economic gains in some cases, because economic agents fail to perceive those options [Datta-Chaudhuri, 1990]. For example, there was a time when we needed a large number of exchanges spread across the length and breadth of the country. The circumstances have changed making most of them redundant. There are over a dozen exchanges which do not have any business for over two decades. An economic agent carries on business as long as it earns normal profits. It pulls down shutters when it fails to earn normal profits. However, these exchanges are not voluntarily exiting from the market. It resembles a typical soft state where economic agents do not receive or fail to receive the signals emanating from the economic environment and respond to them appropriately and consequently, the market has failed to arrive at desirable outcome in resource use. This is striking because these are the institutions who profess to ensure best allocation of resources. If market is efficient and yielding desirable outcome, the State is not expected to interfere in the functioning of the market in normal circumstances. The State is, however, expected to interfere if the market malfunctions. The State needs to guide the economic agents who fail to receive the right signals for whatever reason. The continued existence of so many defunct exchanges presents a classic case of market failure and State failure.

2.3 Objectives of Regulations

Viewed in the above context, regulations are meant to address market failures. The International Organisation for Securities Commissions [IOSCO, 2010] has laid down 38 principles of securities regulations. Regulators across the world implement these principles to: (a) protect investors' interest, (b) ensure fair, efficient and transparent functioning of the securities markets, and (c) reduce systemic risk. Financial Sector Legislative Reforms Commission (FSLRC) [MOF, 2013a] envisages four main objectives of regulations in financial markets:

(a) Consumer protection: Without the trust of the consumers, the financial market cannot perform its primary function of allocating resources from savers to spenders. At the same time, financial firms may have perverse incentives to exploit the trust of consumers in an unfair manner. Most consumers are in an unequal bargaining position and sometimes financial firms stand to gain out of monopolies and related rent-seeking behaviour. In this context a 'buyer beware' approach is not adequate. Regulators must place the burden upon financial firms of doing more in the pursuit of consumer protection. This perspective shapes interventions aimed at prevention (inducing financial firms towards fair play) and cure (redress of grievances) of consumer abuse.

(b) Micro-prudential regulation: When a financial firm makes promises to consumers, regulators are required to monitor the probability of the financial firm failing to honour its promise and undertake interventions that reduce this probability. The higher the intensity of promise, the stricter should be the regulations. If financial firms are allowed to go back on their promises with impunity, consumers' faith in the financial system will be hampered.

(c) Systemic risk: Micro-prudential regulation addresses the possibility of collapse of one financial firm at a time. A very different point of view is required when addressing the possibility of the collapse of the entire financial system. This calls for measurement of systemic risk, and undertaking interventions at the scale of the entire financial system (and not just one sector) that diminish systemic risk.

(d) Resolution: Micro-prudential regulations reduce the probability of firm failure. However, eliminating all failure is neither feasible nor necessary. At the same time, failure of a large financial firm or a large number of financial firms can be highly disruptive for households that are customers of the failing firm(s). This requires a specialised 'resolution mechanism' to ensure orderly resolution of troubled firms before they reach the stage of insolvency.

2.4 Rationale of Regulations

The purpose of regulation is not to displace competitive pressures, but to correct for market imperfections which produce sub-optimal outcomes and distort consumer choice. Once effective competition is in place, less rather than more regulation is required [Doyle, 1997]. The competition may substitute the regulator in course of time. In that respect regulation reinforces the efficiency of competition rather than impedes it. The rationale behind regulation, therefore, is to increase the efficiency of markets and is based on three principal strands of analysis. [Liewellyn, 1995, Pp. 12-17]

(a) The correction of identified market imperfections and failures that reduce consumer welfare and distort competitive and market mechanisms. There are many potential market imperfections in securities market such as inadequate information, asymmetric information, difficulty in ascertaining the quality of contracts at the point of purchase, imprecise definitions of products and contracts, under-investment in information, agency costs and principal-agent problems. In a regulation free environment, these imperfections impose costs on consumers. An informed judgement about the purchase of products and services cannot be made unless consumers know the true costs of the product; the precise nature and full terms of the product or contract; the basis upon which a product is offered or what is the benefit to an agent. These are real investment costs to the consumer. A high degree of information disclosure is required to make consumers effective in the market place. If regulation requires the issuer or intermediaries to provide necessary information, this adds cost to them but reduces cost on consumers.

(b) There are potentially substantial economies of scale to be derived from collective regulation and supervision of issuers and intermediaries. As investment contracts are long term in nature and often involve a fiduciary role in a principal-agent relationship, there is a need for continuous monitoring. In the absence of regulation and supervision by a specialist agency, which ensures certain minimum standards, consumers are required to spend time, effort and resources in investigating and monitoring suppliers. This entails two types of costs: (i) substantial replication and hence excessive social costs as all consumers are replicating the same process, (ii) the loss of economies of scale that are derived through a specialist regulator/supervisor acquiring expertise and establishing effective authorisation and monitoring system. In the absence of such an agency, an occasional consumer would find investigation and monitoring excessive and free-rider problem are likely to arise. With such an agency, the consumers in effect delegate to the regulator and supervisor at least some of the monitoring responsibilities and in the process reap the benefits of economies of scale.

(c) Signalling minimum standards of quality enhances confidence in markets. With a known asymmetric information problem, risk averse consumers may exit the market altogether. In its extreme form the market breaks down completely as potential investors know there are high- and low-quality products but they cannot distinguish them ex ante, while the suppliers can make the distinction but are unable to communicate the distinction with credibility. When consumers know that there are low quality products in the market, good suppliers and their products may become tarnished by the generalised reputation of poor products and suppliers. In such a case, the regulator sets minimum standards and thereby removes the bad products from market.

There are two caveats here. One, the objective is to protect consumers against lack of information, asymmetric information, deliberate malpractice and mismanagement, that is from market failure but not against risks, which would mean regulating away the very essence of finance. No regulatory system can or should relieve the consumer of responsibility for exercising judgement and care in deciding how to use his money. If he makes a foolish decision on the basis of adequate disclosure, he cannot look to any regulator to make good the loss arising from his own misjudgement. Second, it is grossly insufficient to assert that the existence of market failure implies that there is a case for regulation. Regulation should be brought in only if there is a specified set of criteria or procedures for deciding what fits within the scope of the enunciated policy, and also an administrative apparatus for implementing the policy [Krueger, 1990, Pp. 9-23]. It should address the targeted market failure and do no more.

2.5 Regulation is Costly

Implementation of regulation imposes direct and indirect costs on participants in the securities market. Economists emphasise four reasons why regulation is costly [Gowland, 1990]. First, there are costs that arise from moral hazard, which refers to changes in private sector behaviour which, occurring in response to some institutional or other change, usually produce counter-productive effects. When a regulatory or supervisory authority is created, an implicit contract is perceived as being created between consumers and the regulator. The danger is that the consumer assumes, because there is an authorisation procedure, that specific aspects of regulation are established, and that the supplier of products is in some sense authorised and supervised, so that the institution is, therefore, safe. This creates an impression that the consumers need not take care with respect to the suppliers with which he deals. This becomes a moral hazard of regulation that less care need be taken.

Secondly, there are direct and indirect costs of compliance with regulations both by the regulator and the regulated. These include administrative mechanism for implementation of regulations, the cost of dedicated capital to comply with regulations and contribution to funds needed to compensate the clients of failed firms, and cost of auditing, monitoring and enforcing compliance, both by the participants regulated and the regulators. These are direct resource costs of the regulatory system - people, equipment and building - which could have been used for other purposes. These are often called ‘regulatory tax’ as this is unavoidable for any market participant. An interesting facet is that there is a tendency for the regulations to multiply over time with corresponding increase in ‘regulatory tax’. Regulations governing securities market exceeds 10,000 pages today. Datar [2014] argues that

India has a unique combination of three crippling liabilities, namely, excessive rules and regulations, egregious level of corruption, and an embarrassingly hostile and irrational tax system.

Third is the loss of economic welfare caused by participants carrying out fewer transactions than they would otherwise. It might even divert business from the over-regulated sector / economy to less-regulated sector / economy. These costs are borne by the economy in reallocation of resources in response to regulations. Regulation can be distortionary and mis-allocating at times. Inappropriate design and administration of regulation could raise the costs of regulation so that the costs exceed the benefits from regulation. There could be a high opportunity loss for the market participants and for the economy resulting from inappropriate regulatory provisions, delays and constraints on innovation, efficiency and dynamism.

Fourthly, regulation acts as a barrier to change and so preserves an inefficient structure of products and their provisions. The continued existence of about 20 exchanges without any trading for two decades is a direct outcome of a regulatory requirement (since dispensed) on a company to list on regional exchange first. Further, regulation creates barrier to entry and exit. This might lessen competition, raise costs and lead to static inefficiency. Stigler [1971, Pp. 3-21] argued that regulation is acquired by the industry and designed and operated primarily for its benefit in contrast to benefits of the public at large. Regulation is a means whereby powerful coordinated interest groups often, perhaps the main established companies in the industry usually, transfer wealth from the less coordinated, usually the customers, to them. There is also a possibility of regulation stifling financial innovation and thereby causing dynamic inefficiency. Novelty is a disturbing experience for the established players including the authorities and regulators, as it upsets tidiness of life [Goodhart, 1988, Pp. 17-31].

2.6 Optimum Level of Regulations

By all accounts, regulation is not a cost-less exercise. This realisation is important to avoid excessive or unwarranted regulation. The costs of regulation increase sharply after a stage with the volume of regulation. However, the benefits from additional regulation decrease [Sahoo, 1997]. As the benefits and costs of regulation behave in diametrically opposite ways, one has to carefully balance the marginal benefits with marginal costs to determine the extent of regulation.

The volume of regulations is humungous and increasing. It is not clear if the market under the extant regulatory framework is delivering the least cost transfer of larger amount of resources for the most productive uses. It is also not clear how the regulations have impacted the behaviour of market participants and if such impact, intended and unintended, of regulations is socially desirable. In the absence of such clarity, the market may be burdened with costly, ineffective, excessive, unwarranted, inappropriate and growth hindering regulations. A heavily regulated economy may grow on average by about 2% to 3% less per annum than less heavily regulated ones [Gorgens, et al., 2003]. The world has moved to some kind of analysis of efficacy, efficiency and effectiveness of proposed regulations to ensure that the market does not end up with unwarranted or excessive regulation or regulations with unintended consequences.

2.7 A Brief on Regulatory Discourses

Some of the contemporary discourses relevant in the context of regulation of securities markets are discussed below. Income Vs. Wealth Effect

Modern economic thought believes that consumption and consequently aggregate demand depends on wealth as much on current income. The higher valuation of equities necessarily means higher wealth effect, aggregate demand and economic growth. The valuation of securities is reflected in SENSEX.[8] The market capitalisation, for example, which was Rs. 36 trillion at the end of December 2006, more than doubled to Rs. 72 trillion by the end of December 2007. The increase in market capitalisation in 2007 was almost equal to the size of the GNP in 2006-07. Add to this rise in valuation of real estate and bullion: welcome to the world of 'unearned' income with both its real and illusory effects that could trigger an age of much higher aggregate demand far in excess of the aggregate supply or income. This happens when portfolio owners perceive themselves to be richer due to an asset price boom of the kind that India experienced in 2007.[9] Consequently, they feel more comfortable and secure and tend to spend more. Since the increase in wealth is 'unearned', they may splurge a little. Or, at least the urge to add more to their portfolio reduces and they save less. A sharp decline in savings is, therefore, not uncommon in the economies where wealth is driven by higher equity valuations. The very low rate savings in G7 countries in 1990s exemplifies this. The asset price boom reduces cost of capital, which coupled with higher consumption demand, pushes up investment demand. The portfolio owners are comfortable to bet more on investment. The combined increase in consumption and investment shifts aggregate demand function upwards because of the positive 'wealth effect'.

The higher the proportion of people who depend on passive income for livelihood, the higher the average size of portfolios, the higher the proportion of market linked assets (securities, real estate, bullion, etc.,) in the portfolios, the higher the elasticity of demand to changes in wealth, the higher is the magnitude of wealth effect. A sharp and lasting change in asset valuation could cause sharp and lasting wealth effect on the level of demand. Assume an economy which consumes 65% and saves 35% of its GNP and where investment is equal to savings. If it has an 'unearned' income (increase in wealth from equity valuation) equal to GNP, it may consume about 5% of this leading to consumption rate of 70%. Probably this explains a part of recent 'consumerism' in India. It may also invest about 5% of the increase in wealth leading to investment rate of 40%. This sets the beginning of disequilibrium where aggregate demand (investment) exceeds GNP (savings) and inevitably drives up the economy through the 'multipliers' and 'accelerators'. While these happen, the prices of other assets (non-equities) also go up, creating ripple wealth effect from those assets also. As the movement approaches equilibrium, the resultant economic growth propels further higher valuations of equities putting a virtuous circle in motion.

The wealth effect is a double-edged sword. The poor equity valuations in bear markets can hurt economic growth particularly if the erosion in equity valuation in a year is as high as 50% of GNP: the market capitalisation reduced to less than half in 2008 from Rs. 72 trillion to Rs. 31 trillion. The SENSEX declined to less than half in a year from 20287 to 9647 in 2008. This may even lead to withdrawal of public issues and consequently lower investment. In such cases, the aggregate demand would be much less than the supply to onset the disequilibrium. This would inevitably drive down the economy through 'multipliers' and 'accelerators' [Sahoo & Nair, 2008]. The stock market crash of 1929 and 2008 caused sharp decline in wealth, reduced consumption sharply and contributed to depth of the Great Depression and Great Recession. While the macroeconomic managers have to worry about the demand and the economy if the stock prices fall sharply from the exalted levels, the regulation should ensure non-manipulated demand for and supply of securities to avoid unwarranted over-valuation or undervaluation of securities.

With globalisation, the economic agents of one economy hold assets in other economies. The variations in asset valuations in other economies have significant wealth effect in the host economy. Further, since the markets are linked globally, the valuations in one market have ripple effect on others. It is even possible to manipulate market on one jurisdiction by manipulating market in another jurisdiction. Times are not far off when the sharp gyrations in valuations of equity or other assets in any part of the world would contribute to divergence between aggregate demand and supply and can move the economies up or down depending on the degree of integration with the global economy and the direction and size of valuations. As more people invest in market linked assets and depend on markets for their income and wealth, asset price volatility anywhere in the world could have severe macroeconomic consequences and implications for monetary policy. A substantial rise in asset prices will increase 'unearned' incomes and consequently aggregate demand and *vice versa.* This will amplify macroeconomic swings. Besides, sharp fluctuations in asset prices can fuel expectations in a rather irrational way which can cause systemic risks. This increases demand for effective regulation, backed by sound macro policies. This forms the basis for regulations relating to systemic risk, such as circuit breaker, unfair trade practice, risk management, etc.

Merit Vs. Disclosure Based Regulation

The securities markets in India followed merit -based regulations till 1992, when the Capital Issues (Control) Act, 1957 was repealed and SEBI was established. Till 1992, Government used to take decisions on behalf of investors and issuers based on its perception of the merits of a transaction. It was believed that it is better equipped than investors / issuers and can better decide the merits of a transaction on their behalf. However, on realising the severe limitations of this approach in the securities market which suffers from moral hazard and adverse selection associated with information asymmetry, SEBI adopted Disclosure-based Regulation (DBR) regime. This regime believes that the market rather than the regulator is best equipped to determine the merits of a transaction. Under this approach, the regulator ensures disclosure of full and accurate information, based on which investors / issuers take informed decisions and also assume responsibility for their own decisions. It believes that the regulator cannot take decisions for investors / issuers, but it can protect them by arming them with the information they need to take decisions. An important element of investor protection is the disclosure of information by issuers and intermediaries [Glaeser et al., 2001, Pp. 853-899]. Disclosure of information enables an investor to decide if, at all, to undertake transactions in securities market, and if so, in which securities and at what prices and through which intermediary. It similarly enables an issuer to decide if, at all, to raise resources through securities market and if so, through what instruments and which intermediary. This fits in well in the today's anti-establishment climate, when there is increasing deference to private decision making. The investors / issuers like it because it gives them the freedom to take their own decisions. The regulators like it because they are reluctant to be accountable for the decisions they take for or on behalf of issuers / investors. The issuers / intermediaries like it because it is not as ideologically threatening or as costly to comply with, particularly with the availability of technology, as substantive mandates [Sahoo, 2005b, Pp. 3-24].

The DBR removes information asymmetry and thereby (a) improves allocative efficiency, as the investors and issuers get perfect information about the market and can make more informed and socially optimal decisions; (b) enhances equity as all the investors and issuers have equal access to the information necessary for making decision and no one benefits exclusively or at the cost of others from the information; (c) promotes democratic governance and prevents fraud and corruption, and (d) improves performance of the disclosing parties as they know that their performance is being watched and evaluated. It changes the behavior of the disclosers (issuers / intermediaries), and the users (issuers / investors), or both. First, the disclosers provide, either on their own volition or in compliance to some regulatory mandate, certain information about them, their activities and their products. The users gather the information, and if warranted, change their conduct / behavior in respect of the discloser or his product. As a result of the change in the behavior of the users, the behavior of the discloser also changes. The discloser also reveals his changed behaviour which, in turn, induces further changes in the behaviour of the user. The process continues ad infinitum and the market benefits from the combined changes in the behavior of the users and the disclosers in the desired policy direction.

The success of DBR hinges on the presence of a very congenial market environment. First is the faith in the DBR. The disclosers must believe that the disclosure is in the interest of the market and hence in their own interest. Otherwise they make a number of warning statements and a lengthy, but largely meaningless section on risk factors with a view to hide more than to reveal. The second is the financial literacy. A disclosure-based regulatory regime presumes that users will make sensible choices or at least that they should have no one to blame for their foolishness but themselves. For example, the securities laws in theory permit issuers with no reasonable prospects of profitability to sell securities to the public, as long as their poor quality is fully disclosed. Further, the marketplace often offers products with diverse features to meet specific preferences of investors. In such cases, if investors are not discerning, the DBR will not achieve much. Third, the disclosures should be such that everyone across the globe derives the same meaning. This means that discloser must use standard conventions of accounting and practices to produce the information for disclosure. Fourth, the cost of disclosure on the part of the discloser and the cost of using information disclosed should be minimum and should be less than the benefits that accrue to the system. Fifth is a strong enforcement mechanism. DBR is only as effective as the liability that the disclosers have to bear for breaching the requirements. Moreover, the liability has to outweigh the potential gain from non-disclosure. This requires the regulator to have the ability to detect and establish non-disclosure and powers to impose deterrent sanctions.

The disclosers have reasons to voluntarily disclose information about them and their products that the users want. They do not, however, have an incentive to disclose everything, because disclosure is costly. Hence, the voluntary disclosure may fall short of the level required by the users. There can be a gap between what the disclosers are willing to disclose on their own volition and what the users need to take informed decisions. Similarly, there can be a gap in the quality (form, time, frequency, medium, standard, etc.,) of the disclosure. This happens because of uneven power of the interest groups -

disclosers and users. The disclosers are small in number and are better organised. The users are large in number and are generally not organised. This inevitably reduces the quality and quantity of disclosure. This calls for intervention from the regulator to bridge the gap. This forms the basis for regulations relating to initial, continuous and event specific disclosures.

2.8 Regulation Vs. Development

Development and regulation are two sides of the same coin - one does not exist independent of the other. Unless market develops, it cannot be regulated. In the absence of regulation, the market cannot develop. Regulation is necessary to develop the market and once the market develops, it needs to be regulated. For example, the Securities Contracts (Regulation) Act, 1956 (SCRA) was amended in 1995 to lift the ban on options in securities. But trading in derivatives did not take off, as there was no regulatory framework to govern these trades. Once the regulatory framework was put in place in 2000, trading in derivatives took off. This is so because the market develops in a regulated environment, as it gets protective shield of regulation. The same logic does not hold good when derivatives emerged for the first time in the world. The market for derivatives emerged as a few enterprising innovative participants felt a need and designed a new product to meet the need. As people found the product useful, the market developed. With development of market, the participants and regulators understood the nuances of the new market and developed regulations to deal with the nuisances and provide an environment, which promoted the market. As market developed further, a variety of derivatives emerged to meet demand of each niche segment and instances of market abuse were also noticed. This made the regulator fine-tune the regulatory framework to deal with the possible abuses. This facilitated proliferation of the market. Thus, development and regulation fed on each other in a virtuous circle for an orderly growth of the market. As other jurisdictions noticed the new product, they imported the regulatory framework and indigenised it to suit to their local environment so that market could develop in their jurisdiction also. Thus, if there is market for a product elsewhere, the regulation comes first at a different place. If there is no market at all anywhere, the development comes first and regulation follows.

A major objective of regulation has been development of the market. Regulations signal minimum standards of quality and hence enhance confidence in markets. They minimise, at least disclose, the insecurities associated with products and transactions, and penalise the manipulators. In the absence of regulations, the risk averse investors may exit the market altogether. In its extreme form the market breaks down completely as potential investors know there are high- and low-quality products but they cannot distinguish them ex-ante, while the issuers can make the distinction but are unable or unwilling to communicate the distinction with credibility. In such a case, by signaling minimum standard, regulations remove the bad products from the market and develop market for good products. They are deeper determinants of development of securities markets and of economic growth [Rodrik and Subramanian, 2003]. However, they act as a barrier to development when it preserves an inefficient structure of products and their provisions. They occasionally stifle financial innovation and thereby cause dynamic inefficiency.

Given the inter-linkages between development and regulation, SEBI has been assigned both the responsibilities in respect of securities market. The preamble to the SEBI Act, 1992 that established SEBI states that SEBI would protect the interests of investors in securities and promote the development of and regulate the securities market. SEBI noted in its first annual report immediately after it became statutory body in January 1992 that regulatory and developmental functions are strongly interlinked and have the same objectives in the long run, and very often, rapid and healthy development is an outcome of well-regulated structures. Whilst the preamble puts both regulatory and developmental roles on the same pedestal, the regulatory role is sub-servient to the developmental role and should be just enough to enforce the required degree of discipline and foster high standards of fairness and integrity of the markets.

There is some disagreement about import of the word 'development' in the context of regulation. Some believe that a regulator should develop the market by inviting people to participate in the market, while others believe that regulator should improve the structures and processes so that people feel comfortable to participate in the market. Some regulators seek and occasionally succeed in securing incentives or benefits for the products in their domain. This occasionally distorts choice of people and hence contributes to market failure. There is also a debate as to whether both the roles should be assigned to the same agency. A recent report [MOF, 2013a] has recommended that regulator should not have entire responsibility of development of the market. It divides developmental initiatives into two categories, namely, (i) initiatives that impose cost on the society as a whole and yield gains to a particular group of citizens such as financial inclusion (priority sector lending), and (ii) initiatives that foster the development of market infrastructure or market process (modernisation of market infrastructure, strengthening consumer protection, adopting international best practices, etc.). Government and regulator should have responsibility for the first and second category, respectively. Assigning both the developmental responsibilities to a regulator creates conflicts and inefficiency. If the developmental mandate is passed on to the regulated, which is often the case, it adds to the cost of service provided by them.

2.9 Market Failure Vs. State[10] Failure

Economic development in India initially depended on Government and Government enterprises as the private sector then lacked trust as well as the capacity. On failure of the Government to meet all the economic needs efficiently, private sector was allowed to undertake business under severe constraints. Gradually constraints were liberalised, but market was promoted to discipline the private enterprises. However, market occasionally failed to yield the best allocation of resources. An example of market failure was the payment crisis of approximately Rs. 5,600 crore at the National Spot Exchange Limited (NSEL) involving about 13,000 investors [MCA, 2014]. The genesis of this was a Government notification that exempted all forward contracts of one day duration for the sale and purchase of commodities traded on the NSEL from operation of the provisions of the Forward Contract (Regulation) Act, 1952 (FCRA) subject to certain conditions. NSEL was neither recognised nor registered under the FCRA nor were the contracts traded on NSEL approved by any authority. The market failed as there was no regulatory oversight over NSEL and the contracts traded on NSEL. The contemporary thought and approach to regulation and design of financial markets emphasise that market failure is the only legitimate rationale for regulation [Planning Commission, 2008a; MOF, 2007, 2010, 2013a, 2013b, and 2014].

Liberalisation does not mean scrapping of all codes and statutes, as some market participants may wish. It rather means replacement of one set by another set of more liberal code / statute, which allows full freedom to economic agents, but influence or prescribe the way they should exercise their freedom, so that the liberalised markets operate in an efficient and fair manner and the risks are minimised. The reforms aimed at liberalisation (reducing regulation) have only increased the volume of regulations. In fact, freer markets often call for more regulations as experience with liberalisation and regulatory reforms in advanced countries indicate [Vogel, 1996]. But there is no guarantee that regulations would not fail. It has, in fact, failed occasionally. It fails for the very same reason as the market fails. For example, regulator does not have the same level of information about the market as the regulated have. Often regulators come from the industry or end up there, which introduces bias in regulatory decision. Sector-specific regulation is a perilous task which, at worst, can be captured by the regulated industry; regulation may end up benefitting producers rather than consumers [Stigler, 1971].

A growing body of empirical studies have supported this by documenting various regulatory dysfunctions [Dal Bó, 2006, Pp. 203-225]. Wolf [1978] has raised doubts about effectiveness of government interventions and even felt that government failure may be of the same order of importance as market failure. He lists out four sources and types of non-market failure, namely, internalities, redundant and rising costs, derived externalities, and distributional inequity. Government failure arises when Government creates inefficiencies because (a) it intervenes where it should not, that is, there is no evidence of a market failure to correct, (b) it does not use an intervention which could have corrected the market failure at a significantly lower cost, (c) the intervention is not implementable and hence does not yield the expected outcome, or (d) the intervention, not properly calibrated, results in unintended consequences.

The strategy changed to market discipline tampered with Government intervention. Unfortunately, both the Government and the market have failed simultaneously on many occasions. The continued existence of a dozen exchanges in India without any business over decades is a classic example of government failure and market failure. The 2008 financial crisis presents a bright example of failure of both the market and the Government. There were four primary failures contributing to the 2008 crisis: excessive risk-taking in the financial sector due to mispriced government guarantees; regulatory focus on individual institution risk rather than systemic risk; opacity of positions in financial derivatives that produced externalities from individual firm failures; and runs on the unregulated banking sector [Acharya et. al., 2011]. People generally have a love and hate relationship with regulation: demand for regulation rises when something goes wrong, while people complain of regulation in normal times. Davies [2004, Pp. 12-20] beautifully summed up: "Politicians complain about the cost of regulations, and apologise for it to their business supporters, but of course as soon as the company fails, the politician’s language shifts 180 degrees and questions are immediately asked about where the light-touch regulator was when this dastardly plot was being hatched. Why did the regulator not prevent the failure?" (p. 14)

Sidgwik, [1901] argued that it does not follow that whenever laissez faire falls short, government interference is expedient, since the inevitable drawbacks of the latter, may in any particular case, be worse than the shortcomings of the private enterprise. When administrative capacity of the Government is severely limited, that is, the law and order environment is weak, it is better to accept the market failure and not intervene [Glaeser & Shleifer, 2003, Pp. 401-425]. In either case, harmful conduct is not punished, but with laissez faire, at least corruption and other forms of subversion are avoided. Wolf [1978] reiterates that market failure is only a necessary, but not a sufficient condition, for state intervention. Regulation is not a virtue by itself and may not always succeed in correcting/arresting market failure. OECD [1995] asked ten questions at the time of making regulatory decisions: (a) Is the problem correctly defined?; (b) Is Government action justified?; (c) Is regulation the best form of Government action?; (d) Is there a legal basis for regulation?; (e) What is the appropriate level (or levels) of Government for this action?; (f) Do the benefits of regulation justify the costs?; (g) Is the distribution of effects across society transparent?; (h) Is the regulation clear, consistent, comprehensible, and accessible to users?; (i) Have all interested parties had the opportunity to present their views?; and (j) How will compliance be achieved?. Box 3 presents the 12 recommendations of OECD on regulatory policy and governance.

Box No. 3. OECD Recommendations on Regulatory Policy and Governance

1. Commit at the highest political level to an explicit whole-of-government policy for regulatory quality. The policy should have clear objectives and frameworks for implementation to ensure that, if regulation is used, the economic, social and environmental benefits justify the costs, the distributional effects are considered and the net benefits are maximised.
2. Adhere to principles of open government, including transparency and participation in the regulatory process to ensure that regulation serves the public interest and is informed by the legitimate needs of those interested in and affected by regulation. This includes providing meaningful opportunities (including online) for the public to contribute to the process of preparing draft regulatory proposals and to the quality of the supporting analysis. Governments should ensure that regulations are comprehensible and clear and that parties can easily understand their rights and obligations.
3. Establish mechanisms and institutions to actively provide oversight of regulatory policy procedures and goals, support and implement regulatory policy, and thereby foster regulatory quality.
4. Integrate Regulatory Impact Assessment (RIA) into the early stages of the policy process for the formulation of new regulatory proposals. Clearly identify policy goals, and evaluate if regulation is necessary and how it can be most effective and efficient in achieving those goals. Consider means other than regulation and identify the trade-offs of the different approaches analysed to identify the best approach.

5. Conduct systematic programme reviews of the stock of significant regulation against clearly defined policy goals, including consideration of costs and benefits, to ensure that regulations remain up to date, cost justified, cost effective and consistent, and deliver the intended policy objectives.
6. Regularly publish reports on the performance of regulatory policy and reform programmes and the public authorities applying the regulations. Such reports should also include information on how regulatory tools such as Regulatory Impact Assessment (RIA), public consultation practices and reviews of existing regulations are functioning in practice.
7. Develop a consistent policy covering the role and functions of regulatory agencies in order to provide greater confidence that regulatory decisions are made on an objective, impartial and consistent basis, without conflict of interest, bias or improper influence.
8. Ensure the effectiveness of systems for the review of the legality and procedural fairness of regulations and of decisions made by bodies empowered to issue regulatory sanctions. Ensure that citizens and businesses have access to these systems of review at reasonable cost and receive decisions in a timely manner.
9. As appropriate apply risk assessment, risk management, and risk communication strategies to the design and implementation of regulations to ensure that regulation is targeted and effective. Regulators should assess how regulations will be given effect and should design responsive implementation and enforcement strategies.
10. Where appropriate promote regulatory coherence through co-ordination mechanisms between the supranational, the national and sub-national levels of government. Identify cross-cutting regulatory issues at all levels of government, to promote coherence between regulatory approaches and avoid duplication or conflict of regulations.
11. Foster the development of regulatory management capacity and performance at sub-national levels of government.
12. In developing regulatory measures, give consideration to all relevant international standards and frameworks for co-operation in the same field and, where appropriate, their likely effects on parties outside the jurisdiction.

Source: OECD [2012].

Hence, each piece of existing and proposed regulation and supervision should be tested by trying to answer a few questions, namely, (a) Is there evidence or strong likelihood of any market failure?, (b) Can the regulation really correct for the likely market failures?; (c) Is the regulation justified by the optimising principle that seeks to equate the benefits and costs at the margin, that is, is the intervention the most cost effective?; (d) Is the regulation designed to ensure that it addresses the market failure and does no more, that is, it does not have any unintended consequences?; and (e) Can the regulation be implemented and not subverted? At any point of time, these tests should be applied to find out which regulatory provision needs to be introduced, modified or removed. However, the tests would often result in controversial findings as these depend substantially on subjective assessment of people carrying out the tests. As far as possible, efforts should be made to make the tests objective and be supported by credible researches. Further, a good policy entails right mix of State and markets that has to be crafted with intelligence [Basu, 2006]. Where market signals alone are not effective guides to desirable action, appropriate non-market institutions are required to be created [Datta-Chaudhuri, 1990].

2.10 Self-Regulation Vs. Statutory Regulation

There are broadly three institutional forms of regulation, namely, self-regulation (regulations made by the users themselves voluntarily), statutory regulation (regulations made under the statute or by a statutory regulator), and co-regulation or two-tier regulation (mix of self-regulation and statutory regulation). Every industry generally starts with self-regulation; it comes up with its own regulations and standards to govern the transactions in the industry and conduct of its participants. Such regulation is generally forward looking and embedded on the ground and carries the legitimacy and commitment of implementation. It works well where the competition is vigorous, structure of firms is relatively simple, goods/services are well-defined and information is largely available in public domain [Doyle, 1997]. However, it fails as industry becomes impersonal, large and complicated and thereby fails to address inherent conflict of interest. On failure of self-regulation in certain circumstances, statutory regulation comes in. For example, the accounting profession in the United States shifted from self-regulation to statutory regulation by the Public Company Accounting Oversight Board[11] (PCAOB) set up under the Sarbanes-Oxley Act, 2002. The statutory regulation is carried on by a statutorily empowered regulator with detailed arrangements of accountability. The regulator usually does not have any conflict of interest as it pursues only public interest except when it is captured by the regulated. However, the functionaries with regulators are quite sensitive to criticism in media and fearful of actions by vigilance agencies. Hence, they have a tendency to avoid firm, prompt decisive actions. Therefore, given its advantages of self-regulation and disadvantages of statutory regulation, self-regulation continues to co-exist with statutory regulation. A two-tier model is usually superior to a system wholly reliant either on self-regulation or statutory regulation.

There is a trend of decline of self-regulation and growth of statutory regulators [Davies, 2004]. Three developments have contributed to declining role of SROs in securities market. First, the stock exchanges used to be association of individuals and not-for-profit organisations. Individuals were governors of the exchange and users of its services. There was occasional conflict of interest as the governors and users championed public interest and private interest simultaneously. When there was tension between public interest and private interest, the latter got precedence over the former, self-regulation broke down and the market witnessed misconduct which shook the confidence of investors. It also suffered from several other limitations, such as under regulation, lenient enforcement, free riders, collusion, etc., as any other club. By a regulatory fiat,[12] the exchanges were demutualised and dominance of users in governance was reduced. In the process, the exchanges became corporate, for profit entities. This has given rise to another kind of conflict of interests between commercial aspirations and regulatory tasks of an exchange which undermines its regulatory role.

Second is the emergence of empowered statutory regulators who are continuously in search of new turf. They have a tendency to take over well-established institutions and practices from SROs. For example, SEBI has taken over substantial part of regulation of markets as well as regulation of listed companies and brokers, not for without a valid reason. It has recently decided to have listing regulations to deal with matters such as corporate governance and disclosures by listed companies, which was governed so far through a listing agreement between a listed company and the stock exchange concerned. The third is the limited reach of SROs. The members of the SRO started undertaking several activities not regulated by the SRO. For example, a stock broker took up services relating to commodity broking or deposit participant, which is not regulated by a stock exchange. Further, as industry became globalised and practices and regulations differed over geography, an SRO failed in terms of authority and competence to rule outside the country of its origin. In contrast, the statutory regulators are empowered to have some kind of extra-territorial jurisdiction. For example, the Securities Laws (Amendment) Act, 2014 explicitly empowers SEBI to call for information from or furnish information to an agency outside India, which has functions similar to those of SEBI. The State has the authority to apply and enforce the laws of this country against the persons and things beyond its territory when its 'legitimate interests' are affected.[13]

The IOSCO Principles recognise that self-regulation may be an appropriate tool of regulation, but they do not recommend that SROs be necessarily a part of the regulatory structure in every jurisdiction. Nevertheless, securities market generally uses a two-tier model. For example, the UK uses statutory authorities [Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA)] in combination with a number of SROs [Investment Management Regulatory Organisation (IMRO), Securities and Futures Agency (SFA), Personal Investment Authority (PIA), Life Assurance and Unit Trust Regulatory Organisation (LAUTRO), Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA), Association of Futures Brokers and Dealers Limited (AFBD) and The Securities Association Limited (TSA)]. The USA combines statutory authorities [Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC)] with a number of SROs [Financial Industry Regulatory Authority, Inc. (FINRA), National Futures Association (NFA), clearing corporations, depository companies, securities exchanges, etc.] India uses statutory regulator SEBI in conjunction with SROs like stock exchanges. The SEBI Act, 1992 obliges SEBI to promote SROs. It has come up with regulations to register and regulate SROs, though as on date no SRO, except stock exchanges, is registered. The SROs require registration or recognition of the regulator, approval of rules by the regulator, regular filings, etc. The statutory regulator has strong oversight over SROs and has been refining ownership and governance structures to address conflict of interest inherent in SROs that serve the commercial interests of its members or users and regulate them. The trend is rather regulated self-regulation.

2.11 Rule Vs. Principle Based Regulation

Under the rule-based approach, the regulator prescribes in great detail exactly what the regulated must do and what they must not. Most regulatory systems contain a mixture of rules and principles. Rules may become more principle-like through the addition of qualifications and exceptions, whereas principles may become more rule-like by the addition of best-practices and requirements [Ford, 2008, Pp. 1-60]. No market is solely governed by principle-based regulations or by rule-based regulations and the dichotomy between the two is over blown. Nelson [2003, Pp. 91-104] believed "One reason why relatively younger standard setting regimes like IAS (International Accounting Standards) appear more principles-based is that they have not had as much time to accrete rules" (p. 92). Quite often the context and culture determine the kind of regulatory approach. For example, UK is more principle based because it has more institutional investors while USA is more rule based because it has more retail investors. Walsh [2008, Pp. 381-412] has come up with an approach called "institution-based" regulation, which contains both principles and rules, but adopts a fundamentally different regulatory strategy. Under this approach, regulator requires regulated entities to create certain internal institutions.[14] It communicates its expectations through interpretations, guidance, and personal statements. Once regulated entities have established the mandatory institutions, they have considerable discretion in determining how those institutions will actually function within the context of each particular firm.

FSLRC [MOF, 2013a] has argued in favour of legislations with very high level, timeless principles, on the lines of Indian Contract Act, 1872 and the Indian Evidence Act, 1872 which have stood the test of time. These principles should, however, be linked to the continuously evolving world of technology, institutional arrangements and financial sector processes through continuous revision of subordinated legislation, and interpretation by the judiciary. The subordinated legislation could either be in the form of detailed prescriptive rules or be principles-based, depending on the situation and the judgment of the regulator. This would substantially improve compliance culture. However, Dr. P. J. Nayak, a member of the FSLRC dissented on the ground that this is not pragmatic in the Indian context, particularly as most financial sector law has hitherto been rules-based. He observed [MOF, 2013a]: "Where rules-based law has achieved adequate comprehensiveness, it provides greater certainty to financial sector participants in understanding whether contracts and behaviour are lawful. Principles based law does not provide such certainty, but by focusing on more generalised principles, covers the gaps by providing meaning to situations not presently contemplated but which could arise in future" (p. 151). He further believed that in the Indian context, with an accumulating backlog of cases with courts, it is more problematic.

India has been following rule-based approach. Of late, it is adopting principles in certain cases while retaining the rules. The recent years witnessed a variety of innovative fund-raising schemes which did not fit into any of the description of products / schemes regulated by any regulator. The schemes were so designed that no regulator could claim jurisdiction over such scheme. As a consequence, investors in such schemes did not get regulatory protection. To address this, the Securities Laws (Amendment) Act, 2014 lays down that any pooling of resources, if it is not regulated otherwise, would be deemed to be a CIS and regulated by SEBI accordingly. Now any innovative design of scheme cannot keep it out of regulatory ambit. Similarly, SEBI board decided to convert listing agreement into listing regulations. These regulations, in addition to specifying specific obligations, would incorporate the overarching principles for making disclosures and obligations. The extant rule-based regulations are getting tampered with principle-based regulations.

With this understanding of the securities regulations, we now turn to a profile of the Indian securities market in Section 3.

SECTION 3
AN OVERVIEW OF INDIAN SECURITIES MARKETS- A PROFILE

The law defines ‘securities’ to include shares, scrips, stocks, bonds, debentures, debenture stock, or other marketable securities of like nature in or of any incorporated company or body corporate, government securities, derivatives of securities, units issued by any collective investment scheme, units of mutual funds (MFs), security receipts, securitisation instruments, such other instruments so declared by the Central Government and rights and interest in securities. An instrument which is not ‘securities’ today under the law can be treated as ‘securities’ if the Government so deems in the changed market environment. These instruments do not have any thing in common except a bundle of ‘insecurities’. This Section[15] presents an overview of the market design and market outcome in the organised market for ‘securities’ in India. It does not cover such details in respect of government securities as these do not come under the jurisdiction of SEBI,[16] which is the focus of this study.

The securities market in India dates back to the 18th century when the securities of the East India Company were traded in Mumbai and Kolkata. The brokers used to gather under a Banyan tree in Mumbai and under a Neem tree in Kolkata for the purpose. However, the real beginning came in 1850s with the emergence of joint stock companies with limited liability. The 1860s witnessed feverish dealings in securities and reckless speculation which culminated in the ‘black day’ on July 1, 1865. This brought brokers in Mumbai together on 9th July, 1875 to form the first formally organised stock exchange in the country, "The Native Share and Stockbrokers’ Association" [SEBI, 2013] which has morphed to BSE Ltd. This was given permanent recognition under the Securities Contract Regulation Act (SCRA) in 1957.

The securities market attracted heightened attention from policy-makers in the aftermath of the scam of 1992 [Shah, 1999, Pp. 183-194] and as a part of pro-market reforms of the 1990s [Subramanian, 2007]. This led to several state initiatives, including establishment of SEBI, in the securities markets in the following years. Along with reforms comprising liberalisation, development and regulation, the securities market has been growing exponentially as measured in terms of amount raised from the market, number of market participants, the number of listed stocks, number of takeover transactions, market capitalisation, turnover on stock exchanges, etc. The data in Table 1 bear testimony to this growth.

The Government and the corporate sector together raised a sum of Rs. 23,82,191 crore from the market during 2019-20. The MFs mobilised net resources of about Rs. 87,301 crore during the same period. TGhe assets at the disposal of MFs stood at Rs. 22,26,203 crore, the net cumulative investment by foreign institutional investors (FIIs) at US$ 245 billion, and the valuation of equity of companies listed on exchanges reached Rs. 1,13,48,757 crore at the end of March 2020. The exchanges reported an aggregate turnover of Rs. 96,59,735 crore in the equity cash segments and Rs. 34,47,95,160 crore in equity derivative segments in 2019-20, while the subsidiary general ledger reported a total turnover (outright transactions) of Rs. 94,33,829 crore in government securities in 2018-19. The open interest in equity derivatives at the end of March, 2020 reached Rs. 1,63,160 crore. The depositories were having a total of 4.1 crore investor accounts at the end of March, 2020. The MFs together had 8.97 crore folios on the same date. At the end of March, 2020, there were 5.42 crore investors registered with BSE for undertaking transactions. An estimated 3.4 crore households participate in Indian securities market in 2015.

Table 1. A Profile of Indian Securities Markets

Parameter	Unit	1991-92	1995-96	2000-01	2007-08	2013-14	2019-20
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Amount Raised by Government	Rs. crore	12,284	46,783	1,28,483	2,22,883	8,97,119	15,62,191
Amount Raised Domestically by Corporate Sector	Rs. crore	16,366	37,490	74,199	2,96,432	4,68,606	8,20,000
Amount Raised through Euro Issues	Rs. crore	NA	1,297	4,197	26,556	116	0
Amount (Net) Raised by Mutual Funds	Rs. crore	11,253	-5,833	11,135	1,53,802	53,782	87,301
Assets Under Management of MFs at the end of year	Rs. crore	37,973	74,315	90,587	5,05,152	8,25,240	22,26,203
No. of Folios with MFs	Crore	NA	NA	NA	4.76	3.96	8.97
Sensex at end of the year	Index	4285	3367	3604	15644	22386	29,468
Market Capitalisation at the end of year	Rs. crore	3,54,106	5,72,257	7,68,863	51,54,368	74,15,296	1,13,48,757
Turnover in Equity Cash Segment	Rs. crore	NA	2,27,368	28,80,990	51,30,816	33,41,338	96,59,735
Open Offers under Takeover Code	Rs. crore	NA	NA	NA	28,706	45,411	20,530
Turnover (Out-right) in Government Securities	Rs. crore	NA	NA	5,12,084	16,53,851	89,56,689	94,33,829*
Turnover in Equity Derivatives Segment	Rs. crore	NA	NA	4,018	1,33,32,787	4,75,75,571	34,47,95,160
Open Interest in Equity Derivatives at the end of year	Rs. crore	NA	NA	46.42	48,974	1,25,078	1,63,160
Turnover in currency derivatives	Rs. crore	NA	NA	NA	NA	69,80,795	1,63,37,668
No. of Investors registered with BSE for trading	Crore	NA	NA	NA	NA	2.69	5.42
Net Cumulative Investment by FIIs/FPIs at the end of Year	US $ bn	NA	5.2	13.5	68.9	180.4	245.1
Amount of Demat Settlement	Rs. crore	NA	NA	2,68,736	16,12,307	16,61,653	40,54,692
No. of Investor Accounts with Depositories at the end of year	Crore	NA	NA	0.38	1.0	2.18	4.1
Estimated no. of Investors participating in securities market	Crore	NA	NA	NA	NA	3.2	NA

* For 2018-19
Source: RBI (Several years) and SEBI ((Several years)

3.1 Market Segments

The securities market has three interdependent and inseparable segments, the new issues (primary) market, the stock (secondary) market and the derivatives (tertiary) market. The primary market provides the channel for sale of new securities while the secondary market deals in securities previously issued. The price signals, which subsume all information about the issuer and his business including associated risk, generated in the secondary market, help the primary market in allocation of resources. The issuers of securities issue (create and sell) new securities in the primary market to raise funds for investment and/or to discharge some obligation. They do so either through public issues or private placement. It is a public issue if anybody and everybody can subscribe for the securities. If the issue is made to select people, it is called private placement. In terms of the Companies Act, 2013, an issue becomes public if the offer or invitation to subscribe to securities is made to such number of persons exceeding 50 or such higher number as may be prescribed. This means that an issue offered to less than 50 persons is a private placement.[17] If the securities are issued exclusively to the existing shareholders, it is called 'rights' issue. It is a public issue if the offer is made to public at large. The securities are issued at face value, at a discount or at a premium. There are two major types of issuers who issue securities. The corporate entities issue mainly debt and equity instruments (shares, debentures, etc.), while the Governments (Central and State Governments) issue debt securities (dated securities and treasury bills). A variant of primary market allows the existing shareholders of a company to offer securities to public for subscription through an offer document. This is called offer for sale. This route is generally used by Government for disinvestment of its shares in public sector undertakings (PSUs).

The secondary market enables participants who hold securities to adjust their holdings in response to changes in their assessment of risk and return. They also sell securities for cash to meet their liquidity needs. The secondary market has further two components, namely the Over-the-Counter (OTC) market and the exchange-traded market. OTC is different from the market place provided by the Over The Counter Exchange of India (OTCEI), which is a recognised stock exchange. OTC markets are essentially informal markets where trades are negotiated. The spot trades where securities are traded for immediate delivery and payment take place in the OTC market. The exchanges do not provide facility for spot trades in a strict sense. Closest to spot market[18] is the cash market where settlement takes place after some time. Trades taking place over a trading cycle, i.e., a day under rolling settlement, are settled together after a certain time. All the stock exchanges in the country provide facilities for trading of equities, though many of them are defunct. Trades executed on the national exchanges[19] are cleared and settled by Clearing Corporations which provide novation and settlement guarantee. Except rare exceptions, all trades settled by delivery are settled in demat[20] form.

The secondary market has a few variants which allow a person to buy securities from a large number of holders in pursuance to specified objectives. For example, a company buys back the shares from the existing holders of securities on a proportionate basis through tender offer or from the open market through book building process or stock exchanges. Another variant allows promoters to buy the outstanding shares with public with a view to delist the company. Still another variant allows a person to acquire shares / voting rights in excess of a certain percent through a public announcement / offer to do so. This is called market for corporate control which assigns the enterprises to the best managers.

The tertiary market allows trading of derivatives of securities (futures and options), where securities are traded for future delivery and payment. This enables the holders of securities to guard themselves against uncertainties arising out of fluctuations in prices of securities. They hedge their positions by locking in prices through derivative transactions. In futures market, standardised contracts are traded for future delivery of securities and settlement. These futures can be on a basket of securities like an index or an individual security. In case of options, contracts are traded for conditional future delivery of securities. There are two types of options - a put option permits the buyer to sell a security to the writer of options at a predetermined price while a call option permits the buyer to purchase a security from the writer of the option at a predetermined price. These options can also be on individual stocks or a basket of stocks like index and can follow European or American style of settlement. Stock options follow American style of settlement where the options can be exercised at any time up to the expiration date, while the index options follow European style where options can be exercised only on the expiration date. Three exchanges, namely, NSE, BSE and MCX-SX provide trading of derivatives of securities.

3.2 Dependence on Markets

Three main sets of entities depend on securities markets. While the corporate sector and Governments raise funds from the securities market to meet their needs of investment and / or to discharge their obligations, the households invest their savings in securities. The Central Government and the State Governments now-a-days finance about 80% of their respective fiscal deficits through borrowings from the securities market. The corporate sector finances about one third of its external finance requirements through the securities market (Table 2). The household sector accounted for 56% of gross domestic savings during 2017-18; 40% of their savings were in financial assets. The share of financial savings of the household sector in securities (shares, debentures, public sector bonds, units of UTI and other MFs and government securities) is estimated at at 11.1% in 2018-19.

Table 2. Dependence on Securities Markets

Year	Share (%) of Securities Markets in			
	External Finance of Corporates	Fiscal Deficit of Central Government	Fiscal Deficit of State Governments	Financial Savings of Households
(1)	(2)	(3)	(4)	(5)
1991-92	32.80	20.7	17.5	22.9
1995-96	41.54	56.4	18.7	7.7
2000-01	38.27	61.8	14.0	5.8
2007-08	53.07	73.4	71.5	10.1
2013-14	33.62	90.6	88.2	5.9
2019-20	NA	67.2	90.6*	11.1*

* Relate to 2018-19

Source: Compiled from CMIE (Several years) and RBI (Several years)

3.2.1 Investor Population

The Society for Capital Market Research and Development (SCMRD) used to carry out periodic surveys of household investors to estimate the number of investors since 1975 [Sahoo & Venkateswaran, 2005, Pp. 1143-1147]. The survey carried out in 1990 placed the total number of shareowners at 90-100 lakh. The next survey estimated the number of shareowners at around 140-150 lakh as of mid-1993. A later survey estimated the number of shareowners at around 2 crores at end 1997, after which it remained stagnant up to the end of the 1990s. The bulk of the increase in the number of investors took place during 1991-94 and the momentum tapered off thereafter.

SEBI and National Council of Applied Economic Research (NCAER) have been carrying out investor surveys at intervals. According to the first SEBI-NCAER Survey of Indian investors [SEBI, 2011], an estimated 12.8 million, or 7.6% of all Indian households representing 19 million individuals had directly invested in equity shares and / or debentures at the end of the financial year 1998-99. According to the second Survey [SEBI, 2011], 13.1 million, or 7.4% of all Indian households, representing 19.5 million individuals, had directly invested in equity shares and / or debentures in 2000-01. The third survey [SEBI, 2011] estimated that 24.5 million households had invested in equities, debts and mutual funds in 2010-11. In the fourth survey (SEBI, 2015), it was estimated that 33.7 million households invested in equities, debts and mutual funds in 2014-15. (see Table 3) It may be noted that these surveys have estimated the number of investors in listed equities, listed debentures and units of MFs. An indirect, but very authentic, source of information about distribution of investors is the database of beneficial accounts with the depositories.

Table 3. Investor Population

Investments in	1990 (SEBI / SCMRD)	1998-99 (SEBI-NCAER)			2000-01 (SEBI-NCAER)			2010-11 (SEBI-NCAER)			SEBI Investor Survey 2015		
		Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
Number of Households with investments in Equity / Debentures/ MFs (million)													
Equity (E)	3.8	8.30	3.80	12.10	4.62	1.92	6.54	5.42	3.21	8.63			19.0
Debentures (D)	2.9	2.96	0.74	3.70	5.28	4.27	9.55	3.59	1.74	5.34			7.7
$E \cap D$	2.7	2.40	0.59	2.99	2.10	0.91	3.01						
$E \cup D$	4.0	8.83	3.98	12.81	7.80	5.28	13.08						
Units of MFs (MF)				15.05	7.04	4.74	11.78	6.21	4.29	10.50			22.0
$(E \cup D) \cap MF$					2.51	1.33	3.85						
Derivatives (Equity and Currency)													3.0
Commodity Derivatives													2.1
$(E \cup D) \cup MF$					12.33	8.68	21.01	15.23	9.25	24.48	23.7	10.0	33.7
Number of Investors with Investments in Equity / Debentures/ MFs (million)													
Equity (E)	9.00	12.22	5.73	17.95	6.93	2.80	9.73						
Debentures (D)		4.36	1.12	5.49	7.92	6.23	14.15						
$E \cap D$		3.53	0.89	4.43	3.15	1.33	4.48						
$E \cup D$	10.00	13.05	5.96	19.01	11.7	7.7	19.5						
Units of MFs (MF)				23.0	11.35	7.65	19.0						
$(E \cup D) \cap MF$					4.05	2.14	6.19						
$(E \cup D) \cup MF$					19.01	13.20	32.21						

Source: SEBI-NCAER Surveys (2000, 2002 2011), SEBI (2015a)

The folios with MFs and unique client codes with exchanges also give an indication of number of investors in the country. These data taken together give an impression that the participation of retail investor is not increasing over the years, despite increase in population and per capita income. This is corroborated by the share of securities in financial savings of households. The impression also prevails that repeated market misconducts, often outside jurisdictions of regulators, are discouraging investors from participating in the securities markets.

3.2.2 Intermediaries

It is not that the investors and investees meet each other on a fine morning and exchange funds for securities. It is difficult to accomplish such double coincidence of wants. The amount of funds supplied by the investors may not be the amount needed by the investees. Similarly, the risk, liquidity and maturity characteristics of the securities may not match the preference of the investors. The intermediaries match the preferences and bring these suppliers together. They may act as agents to match the needs of the suppliers of funds / securities, help them in creation and sale of securities, or buy the securities issued by suppliers of securities and in turn, sell their own securities to suppliers of funds. It is, thus, a misnomer that securities market disintermediates by establishing a direct relationship between the suppliers of funds and the suppliers of securities. It requires services of a large variety of intermediaries to bring the suppliers of funds and the suppliers of securities together for a variety of transactions. The disintermediation in the securities market is in fact an intermediation with a difference; it is a risk-less intermediation, where the ultimate risks are borne by the suppliers of funds/securities, and not the intermediaries [Sahoo, 1997]. Table 4 presents the details of participants and institutions operating in securities market.

The quality of intermediation services determines the shape and health of the securities market, as the suppliers of funds/securities, and occasionally regulator, rely on knowledge and expertise of the intermediaries and look up to them for guidance and support. The provision of quality intermediation is necessary not only to sustain the reforms in the market, but also to maintain and enhance the confidence of investors / issuers in the market. They can have comfort if the intermediaries as well as its employees (i) are fit and proper persons, (ii) follow a certain code of conduct and behave properly, and (ii) are capable of providing professional services. All the intermediaries in the securities market are now registered and regulated by SEBI. Before authorising a person to act as an intermediary, the regulator determines if it is a fit and proper person to participate in the market. In order to do so, it takes account of financial integrity, convictions or civil liabilities, competence, reputation and character, efficiency and honesty, etc., of the person. A code of conduct has been prescribed for each intermediary as well as for their employees in the regulations; capital adequacy and other norms have been specified; a system of monitoring and inspecting their operations has been instituted to enforce compliance; and disciplinary actions are taken against them for violating any regulation. The intermediaries in the market are mandated to have a compliance officer who reports independently to SEBI about any noncompliance observed by him. Thus, a reasonably satisfactory arrangement is in place to ensure good conduct of the intermediaries. As regards the capability, the intermediaries need to have capable people who understand the market, regulations and products and can guide the investors and issuers to take appropriate decisions. This is generally ensured through a set of complementary initiatives, namely, training and certification programmes. SEBI has mandated certifications for certain categories of professionals in securities market.

Table 4. Participants / Institutions in Indian Securities Markets as on 31st March

Market Participants / Institutions	2004-05	2007-08	2013-14	2019-20
(1)	(2)	(3)	(4)	(5)
Securities Appellate Tribunal	1	1	1	1
Regulators (DEA, MCA, RBI and SEBI)	4	4	4	4
Depositories	2	2	2	2
Depository Participants	477	654	859	899
Clearing Corporations	NA	NA	NA	7
Stock Exchanges with trading of				
Equities	23	19	20	4
Debt	2	2	2	2
Equity Derivatives	2	2	3	3
Currency Derivatives	0	0	4	3
Commodity Derivatives	NA	NA	NA	5
Brokers				
Equities	9128	9487	9411	4,249
Debt	NA	NA	NA	378
Equity Derivatives	1003	1575	3051	3,460
Currency Derivatives	-	-	2395	2,708
Commodity Derivatives	NA	NA	NA	2,257
Sub-brokers*	13,684	44074	51885	NA
Investment Advisers	NA	NA	NA	1291
Research Analysts	NA	NA	NA	680
FIIs / FPIs#	685	1319	1739	9,825
Sub-accounts	-	-	6394	NA
Portfolio Managers	84	205	212	351
Custodians	11	15	19	19
Registrars to an issue & Share Transfer Agents	83	76	71	80
Merchant Bankers	128	155	197	215
Bankers to an Issue	59	50	59	66
Debenture Trustees	35	28	31	31
Underwriters	59	35	3	2
Venture Capital Funds	50	106	207	189
Foreign Venture Capital Investors	14	97	192	251
Alternative Investment Funds	-	-	101	649
Mutual Funds	39	40	50	47
Infrastructure Investment Trusts	NA	NA	NA	10
Collective Investment Schemes	0	0	1	1
Credit Rating Agencies	4	5	6	7
Approved Intermediaries (Stock Lending)	3	2	2	2
Investment Advisers	-	-	129	1,291
KYC Registration Agency	-	-	5	5

* The number of sub-brokers declined as SEBI allowed access to market through authorized persons. Subsequently, registration of sub-brokers was discontinued with effect from 1st April, 2019 and existing sub-brokers were advised to migrate to act as an authorized person of trading member.
# With the commencement of FPI Regime from June 1, 2014, the erstwhile FIIs, Sub Accounts and QFIs are merged into a new investor class termed as "Foreign Portfolio Investors" (FPIs).
Source: SEBI (Several years)

3.2.3 Institutions

The intermediaries, investees and investors use services provided by a host of MIIs, namely, stock exchanges, depositories, and clearing corporations. The regulator ensures fair conduct of these institutions, intermediaries and investees, and lays down and enforces the rules of the game. A tribunal ensures that the actions of the regulator are fair and equitable. Brief details of these institutions[21] are provided here.

3.2.3.1 Stock Exchanges:

The stock exchanges occupy a prime and elitist position amongst the varied institutions of capitalism. These provide organised marketplace where trading members, commonly known as 'brokers' gather around a trading pit or access an electronic trading platform to trade in stocks and other securities either as agents for clients, or as principals on their own accounts. The core activities of an exchange, therefore, are: maintaining an orderly trading platform, permitting the securities that can be traded on the platform, admitting the brokers who can trade on the platform, clearing and settling trades executed on the platform, and maintaining discipline on the issuers of securities and on the brokers and thereby on the whole market. The law does not require trading of securities to take place only on exchanges. However, for obvious reasons, most of the trades in listed securities take place on exchanges.

For the past few years, the exchanges have been losing a substantial part of their turf [Nair & Sahoo, 2008a]. Market innovations, such as electronic communication networks (that facilitate trading of securities among its subscribers), crossing networks (that match orders for execution without first routing to an exchange), negotiated dealing system (which match orders in government securities in India), etc., challenge the core functions of the exchange. Specialised service providers such as securities settlement systems have come up the world over to handle post-trading activities. The exchanges are losing part of their self-regulatory status because of the perceived conflict of interest between commercial aspirations and regulatory tasks as well as the search for new turfs by the empowered statutory regulators who have taken over substantial part of regulation of markets as well as of listed companies and brokers. Brokers' Associations and other interest groups are trying to adorn the angel's role of SROs, often with the blessings of the regulators. Thus trading, clearing, settlement, market regulation, and administration of listing and broking are no more the exclusive prerogative of exchanges. This raises a question mark on their continued existence.

While the turnover has been increasing in leaps and bounds, the growth of turnover has not been uniform across the exchanges. The increase in turnover took place mostly at big exchanges and it was partly at the cost of small exchanges that failed to keep pace with the changes. The business moved away from small exchanges to exchanges which adopted technologically superior trading and settlement systems. The huge liquidity and order depth of big exchanges further sucked liquidity of other exchanges. Over a dozen exchanges are reporting nil turnover for nearly two decades. The continued existence of these defunct exchanges presents a classic case of market failure and State failure [Sahoo and Rath, 2004, Pp. 1667-1676]. It is market failure because the exchanges have failed to receive the signal emanating from the changes in the environment. The State has also failed because it has not yet withdrawn recognition of these exchanges.

3.2.3.2 Clearing Corporations

The Securities Contracts (Regulation) Act, enacted in 1956, dealt with trading of securities and governance of exchanges. It considered Clearing and Settlement (C&S) as an integral part of trading. The members of the exchanges, called brokers, acted as trading-cum-clearing members. They knew each other and traded and settled trades among themselves. The SCRA did not explicitly provide for C&S, which was left to be dealt with in the byelaws of the exchanges. The byelaws generally provided for clearing houses and the exchanges traditionally set up departmental clearing houses to facilitate settlement. However, with the advent of the Anonymous Screen Based Trading System (SBTS), which does not allow participants to assess the counter party risks of others, and in the interest of better risk management through novation and central counter party guarantee, the modern markets started using the services of a CC for C&S. Besides, unbundling of activities made economic sense with the exchanges and CC specialising in trading and C&S respectively. The exchanges modified the structural design of the clearing house to address the emerging concerns and subsequently all exchanges used services of a CC for C&S of trades. The CC today provides novation and central counter party guarantee for every trade executed on a stock exchange and guarantee settlement of trades.

3.2.3.3 Depositories

There is a well-developed depository system backed by a modern legislation. The depositories maintain ownership records of demat securities and record transfer of ownership electronically by book entry without making the securities move from person to person. In order to promote dematerialisation, the regulator mandated trading and settlement in demat form in an ever-increasing number of securities in a phased manner. The stamp duty on transfer of demat securities was waived. Two depositories, viz., National Securities Depository Limited and Central Depository Services (India) Limited, have come up to provide instantaneous electronic transfer of securities. This has eliminated the bad deliveries and other ills associated with paper-based securities system. To prevent physical certificates from sneaking into circulation, it has been mandatory for all initial public offers (IPOs) to be compulsorily traded in demat form. The admission to a depository for dematerialisation of securities has been made a prerequisite for making a public or rights issue or an offer for sale. It has also been made compulsory for public listed companies making IPOs of any security for Rs. 10 crore or more to do the same only in demat form. The investors, however, have the option of subscribing to securities in either physical form or demat form.

3.3 Governance of Market Infrastructure Institutions (MIIs)

The MIIs not only provide various infrastructure services in the market, but also share regulation of the securities market with the regulator and others. Particularly, the exchanges constitute the sixth step of delegation [Braun & Gilardi, 2006, Pp. 1-22] in the hierarchy of principals and agents. They pursue broadly two sets of interests: public interests, such as market integrity encompassing the interests of investors, the market and the society, and private interests, such as turnover encompassing the interests of trading members, shareholders and employees [Sahoo, 2012a]. A measure - commercial or regulatory - undertaken by an exchange may not always further both the interests simultaneously. Or, an exchange may adopt measures that give precedence to one interest over the other. Keeping in view their regulatory responsibilities and their occasional failure to discharge the same, the stock exchanges were demutualised in 2005. Other two institutions came up as demutual organisations. The influence of the members, who use the services of MIIs, has been limited by limiting their role in general body and governing body of the respective MIIs. The influence of shareholders, individually or in aggregate, who may pursue commercial interests more, has also been limited by limiting their shares in shareholding and voting. Only a fit and proper person can have significant shareholding in a MII. Public interest directors constitute half of the governing bodies of these institutions.

3.3.1 Associations of Intermediaries

The exchanges were earlier association of persons formed by brokers. Hence, they acted as Self Regulatory Organisations (SROs) for brokers. Even after their demutualisation and corporatisation, the exchanges continue to regulate the conduct of brokers and sub-brokers. However, the SEBI Act, 1992 mandates SEBI to promote (SROs). It has been taking steps to promote the development of SROs in the Indian securities market. In pursuance to this, it has framed regulations for SROs. There is no SRO as such in the market. MFs, merchant bankers, share transfer agents, debenture trustees, depository participants have associations which are currently acting as trade bodies and promoting the interests of their respective members. SEBI has been encouraging trade bodies/intermediaries' associations of stock brokers (Association of National Exchanges Members of India - ANMI), MFs (Association of Mutual Funds in India - AMFI), merchant bankers (Association of Merchant Bankers in India - AMBI), and depository participants (Depository Participants Association of India - DPAI), etc., to develop SROs.

3.3.2 Securities and Exchange Bonds of India (SEBI)

India embraced economic liberalisation in a meaningful sense from the early 1990s. It essentially meant freedom for the market to 'discover' the quantity and price. However, in order to avoid market failure, a strong possibility in the face of information asymmetry and externalities, it was considered necessary to create a statutory agency, which would ensure fair play in the market, develop fair market practices, prescribe and monitor conduct of issuers and intermediaries so that the securities market enables efficient allocation of resources necessary for economic development and where the investor and issuers enjoy undertaking transactions. The SEBI Act, 1992 established SEBI and assigned it with the responsibility for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. The Act has been amended a number of times subsequently to empower SEBI adequately and expand its jurisdiction to meet the emerging needs. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with the securities market and certain matters outside India. It also extends[22] over any pooling of funds exceeding Rs. 100 crore under any scheme or arrangement if such pooling is not regulated by any other regulator. All market intermediaries are registered with and regulated by SEBI. They are also required to appoint a compliance officer who is responsible for monitoring compliance with the securities laws and for redressal of investor grievances. The courts have upheld the powers of SEBI to levy fees from market intermediaries and to impose various penalties.

3.3.3 Securities Appellate Tribunal (SAT)

Any person aggrieved by an order of SEBI and stock exchanges can prefer an appeal to the Securities Appellate Tribunal (SAT).[23] The scrutiny of orders by SAT ensures that SEBI is fair and equitable to the parties before it in quasi-judicial matters. In fact, this scrutiny is mainly responsible for improving the quality of orders of SEBI. A person aggrieved by an order of SAT may prefer an appeal to the Hon'ble Supreme Court on any question of law.

3.4 Market Design and Outcome

We discuss here only two segments,[24] namely, primary market and secondary market, to have a flavour of the securities market.

3.4.1 Primary Market

Market Design: The major part of the liberalisation process was the repeal of the Capital Issues (Control) Act, 1947 in May 1992. With this, Government's control over issue of capital, pricing of the issues, fixing of premia and rates of interest on debentures etc. ceased and the market was allowed to allocate resources to competing uses. The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009[25] (ICDR) govern issue of capital to public by Indian companies. These prescribe norms relating to eligibility for companies to issue securities, pricing of issues, listing and disclosure requirements, lock-in period for promoters' contribution, contents of offer documents, pre and post issue obligations, etc. These contain a substantial body of requirements for issuers/intermediaries, the broad intention being to ensure that all concerned observe high standards of integrity and fair dealing, comply with all the requirements with due skill, diligence and care, and disclose the truth, whole truth and nothing but truth. These aim to secure full disclosure of relevant information about the issuer and the nature of the securities to be issued so that investors can take informed decisions. For example, issuers are required to disclose any material 'risk factors' and give justification for pricing in their prospectus. These regulations have the following key elements:

a. Disclosures: SEBI has mandated disclosure[26] of full and accurate information about the products, namely, the securities and the services of the intermediaries, and their suppliers, namely, the issuers of securities and the intermediaries. The investors / issuers take informed decisions based on the disclosures, and also assume responsibility for their own decisions. It believes that the regulator cannot take decisions for investors / issuers, but it can protect them by arming them with the information they need to take decisions.

b. Eligibility: A company meeting certain requirements in terms of profitability, net worth and assets can access public market to raise resources up to five times of its pre-issue net worth. Otherwise, it needs to make the issue through book building[27] where a certain percentage of the issue is allotted to qualified institutional buyers (QIBs).[28] The objective is that the QIBs being sophisticated can evaluate and price the issue better and if they find it reasonable, the issue should go through.

c. Promoters' contribution: There is a requirement that the promoters must contribute a minimum percentage of the proposed issue or the post issue capital and hold the shares allotted in pursuance to this for a minimum period. This ensures that the promoters have substantial stake in the fortune of the company and are not fly-by-night[29] operators.

d. Obligations: The lead merchant banker discharges most of the pre-issue and post-issue obligations. It satisfies itself about all aspects of the offering and adequacy of the disclosures in the offer document. It issues a due diligence certificate stating that it has examined the prospectus, it finds it in order and that it brings out all the facts and does not contain anything wrong or misleading. It also takes care of allotment, refund and despatch of certificates.

e. Listing: A company cannot make a public issue of securities unless it has made an application for listing of those securities with the stock exchange(s). The SCRA requires a company seeking listing on a stock exchange to offer at least 25% of each class or kind of securities to the public for subscription. This requirement seeks to ensure the availability of a minimum percentage / number of shares (floating stock) of the listed securities with the public so that there is a reasonable depth in the market and the prices of the securities are not susceptible to manipulation. The listing agreement[30] requires the listed companies to make ongoing disclosures and comply with corporate governance norms. SEBI has been enhancing the norms of corporate governance over time.

f. Dematerialisation: The admission to a depository for dematerialisation of securities is a prerequisite for making a public or rights issue or an offer for sale. All new IPOs are compulsorily traded in dematerialised form. This allows quick and efficient allotment of securities and liquidity immediately on listing.

g. Process: SEBI has mandated time line for every activity in the issue chain and has been prompting use of technology and process simplification to ensure a quick turnaround time. For example, it is coaxing investors to use ASBA[31] that obviates the need for refund in case an applicant does not get allotment in a public issue.

Market Outcome: The average annual capital mobilisation by non-government public companies from the primary market, which used to be about Rs. 70 crore in the 1960s and about Rs. 90 crore in the 1970s, increased manifold during the 1980s. It received a further boost following liberalisation during the 1990s. The market dried up for about a decade since 1995-96 as many investors who were lured into the market during 1992-94 adopted a very cautious approach because of their frustration with some of the issuers and intermediaries associated with those issuers. They withdrew from the market for a while, and looked for quality issues the availability of which declined due to stricter eligibility criteria for public issues imposed by SEBI and the general slowdown in the economic activity. Simultaneously, issuers shifted attention to alternate avenues for raising resources like private placement where compliance is much less and to overseas market which is cost effective. The amounts raised by Government and corporate sector through public issues and private placement is presented in Table 5. The amount raised through public issues, which is defacto jurisdiction of SEBI, is presented in Table 6.

Table 5. Resource Mobilisation from the Primary Market

(Rs. crore)

Issues	1991-92	1995-96	2000-01	2007-08	2013-14	2019-20
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Corporate Securities	16,366	37,490	78,396	3,22,988	4,68,606	820000
Domestic Issues	16,366	36,193	74,199	2,96,432	4,68,490	820000
Public / Rights Issues	11,903	22,832	6,362	83,707	55,650	90000
Private Sector	6,193	16,075	4,890	63,638	11,680	80000
Public Sector	5,710	6,757	1,472	20,069	43,970	10000
Private Placement	4,463	13,361	67,837	2,12,725	3,99,180	680000
Private Sector		4070	23,106	1,29,677	1,21,327	330000
Public Sector		9,291	44,731	83,048	2,77,854	350000
Qualified Institutional Placement					13660	50000
Euro Issues	0	1,297	4,197	26,556	116	00
Government Securities	12,283	46,783	1,28,483	2,22,883	8,97,119	15,62,191
Central Government	8,919	40,509	1,15,183	1,87,769	7,00,456	9,27,670
State Governments	3,364	6,274	13,300	35,114	1,96,663	6,34,521
Total	28,649	84,273	2,06,879	5,45,871	13,65,725	23,82,191
Mutual Funds	11,253	-5,833	11,135	1,53,802	53,782	87,301

Source: RBI, (Several years)

The authorities have been taking measures to encourage retail investors to participate in securities market through MFs. These include enhancing the reach of MF fund products and financial inclusion, preferential tax treatment, etc. A MF is a kind of collective investment vehicle which pools the resources of small investors, who generally lack expertise to invest on their own, invests in securities and distributes the returns their form among them on cooperative principles. It is set up in the form of a trust which has sponsor, trustees, asset management company, and custodian. The 1990s witnessed emergence of a large variety of funds. There are funds which invest in growth stocks, funds which specialise in the stocks of a particular sector, funds which assure returns to investors, funds which invest in debt instruments, funds which invest aggressively and funds which do not do any of these. Thus, there are income funds, growth funds, balanced funds, liquid funds, gilt funds, index funds, sectoral funds, and there are open ended, close ended and assured return (now extinct) funds - there is a fund for everybody and also fund of funds.

At the end of March 2020, there were 47 MFs - with 1916 schemes. These had a total assets of Rs. 22,26,203 crore under their belt on the same date. (Table 6 here)

Table 6. Capital Mobilised by Corporates from the Capital Market

(Rs. crore)

Year	Equity							Bonds			Total (Equity + Bonds)
	IPOs	FPOs	Rights Issue	OFS (SE)	QIPs	Preferential Allotments	Total	Public Issue	Private Placement	Total	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
2010-11	33,391	13,044	6,058	0	24,294	31,710	1,08,497	2,495	2,18,785	2,21,280	3,29,777
2011-12	4,870	4,578	7,029	4,762	520	24,626	46,386	26,984	2,61,283	2,88,267	3,34,654
2012-13	6,430	0	5,556	27,657	10,488	45,632	95,762	17,242	3,61,462	3,78,704	4,74,466
2013-14	1,548	7,457	3,063	6,956	13,391	55,792	88,207	28,735	2,76,054	3,04,789	3,92,995
2014-15	1,647	0	7,787	26,887	27,670	22,160	86,151	9,413	4,04,137	4,13,550	4,99,702
2015-16	15,677	0	10,755	19,816	14,438	50,533	1,11,218	34,112	4,58,073	4,92,185	6,03,403
2016-17	29,200	10	3,274	7,843	8,464	44,240	93,030	29,093	6,40,716	6,69,809	7,62,839
2017-18	78,493	4	21,268	17,082	71,033	59,542	2,47,422	5,173	5,99,147	6,04,320	8,51,742
2018-19	21,720	0	2,001	21,901	8,678	2,10,163	2,64,464	36,679	6,10,318	6,46,997	9,11,462
2019-20	10,938	37	55,642	17,009	54,389	1,74,875	3,12,890	14,984	6,74,702	6,89,686	10,02,576

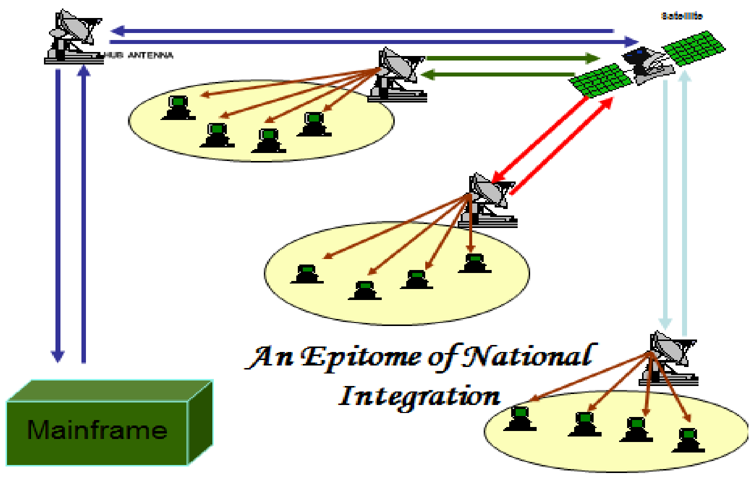
Source: BSE, NSE, MSEI (Several years)

3.4.2 Secondary Market

Market Design: There are 20 stock exchanges at the end of March 2014 of which eight have permanent recognition. Except NSE, BSE, MCX-SX and USE, the other 16 exchanges practically defunct. They provide online, anonymous, order driven screen-based trading system (Figure 2) where an order becomes a trade in fraction of a second and gets settled on T+2 day. A single market with equal access to everybody, big and small, irrespective of his location and status in the society presents one of the best examples of national integration. The main elements of the secondary market are:

a. *Trading Mechanism:* The exchanges provide an on-line fully-automated SBTS where a member can punch into the computer quantities of securities and the prices at which he likes to transact and the transaction is executed as soon as it finds a matching order from a counter party. SBTS electronically matches orders on a strict price/time priority and hence cuts down on time, cost and risk of error, as well as on fraud thereby resulting in improved operational efficiency. It allows faster incorporation of price sensitive information into prevailing prices, thus increasing the informational efficiency of markets. It enables market participants to see the full market on real-time basis, making the market transparent. It allows a large number of participants, irrespective of their geographical locations, to trade with one another simultaneously, improving the depth and liquidity of the market. It provides full anonymity by accepting orders, big or small, from members without revealing their identity, thus providing equal access to everybody. Trading platform is also accessible to an investor through the Internet and mobile devices. It provides a perfect audit trail, which helps to resolve disputes by logging in the trade execution process in entirety.

Figure 2: Screen Based Trading System



b. *Trading Membership:* The trading platform of an exchange is accessible only to brokers. They execute trades on exchanges either on their own account or on behalf of their clients. With demutualisation,[32] trading membership is available on tap which ensures free entry and free exit. The standards for admission of members stress on factors, such as corporate structure, capital adequacy, track record, education, experience, etc., and reflect a conscious endeavour to ensure quality broking services. No stock broker or sub-broker is allowed to buy, sell or deal in securities, unless he or she holds a certificate of registration granted by SEBI. The broker and its sub-brokers comply with the code of conduct prescribed by SEBI.

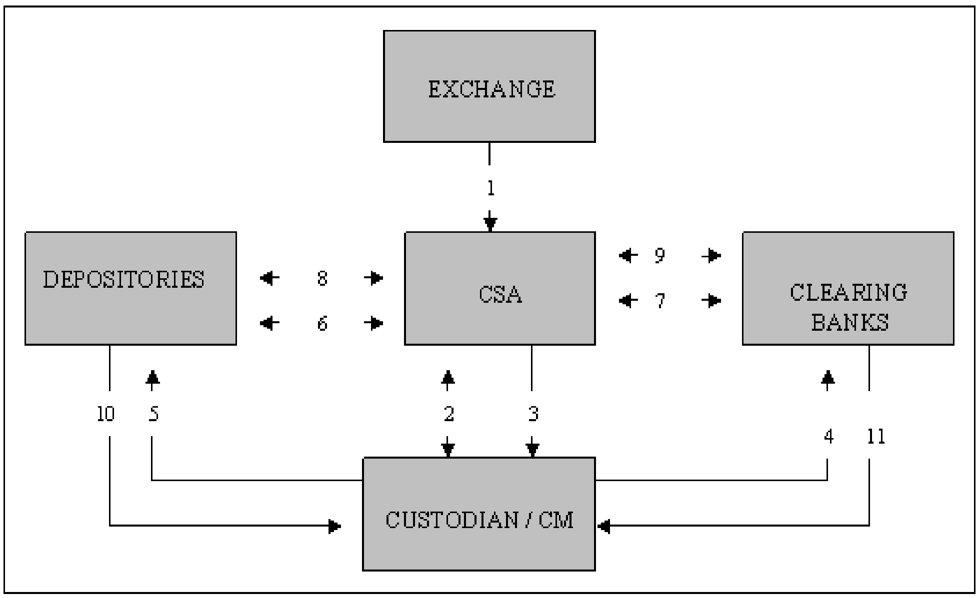
Till 1985, only individuals were allowed to become brokers. The rules, then in vogue, prohibited a company from becoming a broker of a stock exchange. This framework envisaged broking as a profession dependent on individual skills and emphasised on individual attributes. The thinking changed and the need for better broking service was felt. In June 1986, Government removed the prohibition on companies to become brokers. It initially permitted section 322 [of the Companies Act, 1956] companies[33] to become brokers of the stock exchanges. The prohibition on becoming a broker of more than one exchange was withdrawn in November 1988. However, the corporate broker ship did not take off. The legal changes were effected in November 1992 to open up the broker ship of stock exchanges to corporates with limited liability. In order to encourage existing brokers to corporatise themselves, which was considered desirable for the development of the securities market, the tax laws were amended in 1997 to exempt capital gains tax on corporatisation of a broking entity. The regulations were amended in January 1998 to provide for fee continuity benefit[34] on conversion. In response, many brokerage firms reorganised themselves into corporate entities. Over time, a number of brokers - proprietor firms and partnership firms - have converted themselves into the corporate form. A conscious effort has been made to convert broking from a profession to a business and brokerage entity from a proprietorship form to a corporate form. Given the trend, probably the day is not far off when individuals would be virtually prohibited from becoming brokers!

The corporatisation enabled brokers to invest heavily in technology. This, in turn, allowed them to undertake additional business at negligible or zero marginal cost. On the other hand, the cost of setting up systems and ensuring compliance with the ever-increasing rules and regulations of SEBI and the exchanges became too heavy for the small brokers to break even. This is because of the nature of business of broking and the technology, which provide substantial economies of scale only after a threshold level of investments. As a consequence, big brokers continue to invest in technology and human resources and grow bigger, while small brokers fail to do so and consequently fail to provide quality service to clients and to meet the emerging and increasing compliance requirements and gradually withdraw from the market. In course of time, a few brokers, with financial muscle and available technology, can probably cater to the needs of the whole market [Sahoo, 2004, Pp. 8-12]. Often an investor interacts with broker through a sub-broker. The number of sub-brokers was increasing rapidly. Many wished to access trading platform of national exchanges, but did not have the resources to do so. They became sub-brokers to brokers of these exchanges. Two major exchanges, namely NSEIL and BSE, account for 98% of the sub-brokers.

This happened because SEBI allowed authorised persons (similar to derivatives segment which does not have sub-brokers) to provide the same service as sub-brokers but with much less resources and obligations. On realising futility of regulations of sub-brokers, SEBI has recommended[35] amendment of the law to do away with the registration of sub-brokers.

c. *Settlement:* The trades accumulate over a trading cycle of one day and at the end of the day, these are clubbed together, and positions are netted and payment of cash and delivery of securities settle the balance after 2 working days. All trades executed on day ‘T’ are settled on T+2 day. Trades are executed on screen and matched trade details are linked to settlement system electronically, and hence matching and confirmation of trades for direct participants are instantaneous. All communications relating to securities settlement is fully electronic and automated. For instance, the clearing agency downloads the obligations and pay-in advices of funds / securities to members electronically through secured networks. It also sends electronic advice to clearing banks and depositories to debit the members’ accounts to the extent of their obligations. The banks and the depositories debit accounts of members and credit the account of the clearing agency electronically. The reverse happens when the funds / securities are paid out to members. The exchange is connected electronically to the C&S agency, which, in turn, is connected electronically to clearing banks, depositories, custodians and members. The depositories have electronic communication with depository participants, clearing agency, custodians, clients and exchanges. Most of these electronic communications are interactive. The typical C&S process is presented in Figure 3, followed by explanations of arrows. Except at the stage of entering orders into trading system, no data is entered manually or electronically in the entire value chain. Data flows seamlessly among the entities, viz., from exchanges to clearing agency and from clearing agency to clearing banks, depositories, member-brokers and custodians. Once a trade is executed, it has to be settled. There is no way that it can be undone. The clearing corporations / houses have been allowed to borrow and settle the trades on behalf of the brokers who fail to deliver securities.

Figure 3. Clearing and Settlement Process



Explanations for the Figure:

1. Trade details from Exchange to Clearing and Settlement Agency (CSA) (real-time and end of day trade file).
2. CSA notifies the consummated trade details to CMs/custodians who affirm back. Based on the affirmation, CSA applies multilateral netting and determines obligations.
3. Download of obligation and pay-in advice of funds/securities.
4. Instructions to clearing banks to make funds available by pay-in-time.
5. Instructions to depositories to make securities available by pay-in-time.
6. Pay-in of securities (CSA advises depository to debit pool account of custodians/CMs and credit its account and depository does it).
7. Pay-in of funds (CSA advises Clearing Banks to debit account of custodians/CMs and credit its account and clearing bank does it.) CSA transfers funds between clearing banks to meet the pay-out requirements at each bank.
8. Pay-out of securities (CSA advises depository to credit pool account of custodians/CMs and debit its account and depository does it).
9. Pay-out of funds (CSA advises Clearing Banks to credit account of custodians/CMs and debit its account and clearing bank does it).
10. Depository informs custodians/Clearing Members (CMs) through DPs.
11. Clearing Banks inform custodians/CMs.

d. Risk Management: To pre-empt market failures and protect investors, the regulator and the exchanges have put in place a comprehensive risk management system, which is continuously monitored and upgraded. It encompasses capital adequacy of members, adequate margin requirements, limits on exposure and turnover, indemnity insurance, on-line position monitoring and automatic disablement, etc. They also administer an efficient market surveillance system to curb excessive volatility and to detect and prevent price manipulations. The exchanges issue observation or caution letters where they observe *prima facie* unusual or abnormal activities, with a view to alert the brokers and clients at an early stage. They have set up trade/settlement guarantee funds for meeting shortages arising out of non-fulfilment/partial fulfilment of funds obligations by the members in a settlement. A CC assumes the counterparty risk of each member and guarantees financial settlement in respect of trades executed on exchanges.

Market Outcome: Select indicators in the secondary market are presented in Table 7. The market capitalisation grew ten-fold between 1990-91 and 1999-2000. It declined thereafter following a major market misconduct. It, however, picked up in 2003-04 to Rs. 13 trillion at the end of March 2004. It reached a high of about Rs. 75 trillion on 7th January 2008 and declined thereafter following the global crisis. It achieved an all-time peak of Rs. 100 trillion on 18th November, 2014. The market capitalisation ratio, which indicates the size of the market, increased sharply to 109% by March 2008. The turnover ratio has been increasing by leaps and bounds after the advent of the SBTS in the 1990s. One-sided turnover on all stock exchanges exceeded Rs. 10 trillion during 1998-99, Rs. 20 trillion during 1999-2000 and approached Rs. 30 trillion during 2000-01. It increased to Rs. 51 trillion in 2007-08. It declined to Rs. 33 trillion in 2013-14 but had nearly tripled to the 96 trillion in 2019-20.

Table 7. Secondary Market - Select Indicators

(Amount in Rs. crore)

At the End of Financial Year	Cash Segments of Stock Exchanges							Equity Derivatives Turnover
	No. of Brokers	No. of Listed Companies	S&P CNX Nifty	Market Capitalisation	Market Cap Ratio (%)	Turnover	Turnover Ratio (%)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1991-92	NA	6,480	1261.65	3,54,106	57.4	NA	-	0
1995-96	8,476	9,100	985.3	5,72,257	47	2,27,368	39.7	0
2000-01	9,782	9,954	1148.2	7,68,863	54.5	28,80,990	374.7	4,018
2007-08	9,487	4,887*	4734.5	51,38,014*	109.09	51,30,816	99.86	1,33,32,787
2013-14	9,411	5,624*	6704.2	74,15,296*	64.1	33,41,416	45.1	4,75,75,571
2019-20	4,249	5,377*	8,598	1,13,48,757*	55.3	96,59,735	85.12	34,47,95,160

* Relate to BSE.
Source: NSE, & BSE (Several years)

In terms of turnover on exchanges, the equity derivatives lead with a dominate share followed by currency derivatives, cash segment and corporate bonds with. The turnover on the active exchanges during 2019-20 is presented in Table 8.

Table 8. Distribution of Turnover on Stock Exchanges for 2019-20

(Rs. crore)

Exchange	Equity Cash	Equity Derivatives	Corporate Debt	Currency Derivatives	Commodity Derivatives	Interest Rate Derivatives	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
NSE	89,98,811	34,45,32,892	3,53,659	96,54,394	6362	3,60,811	36,39,06,929
BSE	6,60,896	2,62,269	7,54,510	66,83,274	46,439	1,00,045	85,07,433
MSEI	28	NA	NA	45,325	NA	0	45,353
USE	NA	NA	NA	NA	NA	NA	0
NCDEX	NA	NA	NA	NA	1	NA	1
MCX	NA	NA	NA	NA	86,89,518	NA	86,89,518
ICEX	NA	NA	NA	NA	40,511	NA	40,511
Total	96,59,735	34,47,95,160	11,08,169*	1,63,82,992	87,82,831	4,60,857	38,00,81,575

* Relate to 2018-19
Source: SEBI (Several years)

3.5 Reforms in Securities Markets

In order to improve market efficiency, enhance transparency, prevent unfair trade practices and bring the Indian market up to international standards, a package of reforms consisting of measures to liberalise, regulate and develop the securities market is being implemented since early 1990s. The practice of allocation of resources among different competing entities as well as its terms by a central authority was discontinued. The issuers complying with the eligibility criteria were allowed freedom to issue the securities at market determined rates. The market shifted formally and completely from merit-based regulation to DBR. Domestic issuers / investors were allowed choice to raise resources / invest within / across the borders. Overseas issuers and investors were granted access to Indian market. Stock exchanges were corporatised and demutualised to reduce conflict of interests. A variety of corporatised and capitalised intermediaries emerged. Service providers were allowed free entry and free exit. Institutional investment was encouraged. The secondary market overcame the geographical barriers by moving to screen based trading. The trading system is accessed through trading terminals spread across the Indian subcontinent and also through the internet and hand held mobile devices all over the world. All kinds of securities - debt and equity, government and corporate - are traded on exchanges side by side. Trades enjoy counter-party guarantee. The trading cycle shortened to a day and trades are settled within 2 working days, while all deferral products were banned. A variety of derivatives were permitted. The securities were dematerialised. The settlement system complies with the CPSS-IOSCO[36] recommendations and G30 recommendations in letter and spirit. The settlement guarantee funds have balances adequate to meet the settlement obligations, after multilateral netting, of about six settlements at a stretch if all the members fail to honour their obligations. Modern risk management practices were mandated. Corporate governance, both in law and practice, improved significantly. An empowered regulator was established to govern the securities markets. In fact, these reforms (SEBI, DBR, SBTS, dematerialisation of securities, demutualisation of stock exchanges, central counterparty and novation, multilateral netting, T+2 rolling settlement, etc.), constitute fundamental institutions of the securities market. This has made the securities market, the rules of the game in securities market, and the institution responsible for governance of securities market comparable with the best. The market design of 2015 *vis-à-vis* that in 1992 is presented in Table 9 [Ramakrishna & Sahoo, 2010, Pp. 43-120].

Table 9. Market Design in Indian Securities Market, 1992 and 2015

Features	1992	2015
(1)	(2)	(3)
Regulator	No Specific Regulator, Central Government oversight	A specialized regulator for securities market (SEBI) vested with powers to protect investors' interest and to develop and regulate securities market. SROs strengthened
Securities	Limited number of traditional instruments	Expanded to cover government securities, units of CISs and MFs, derivatives of securities, security receipts, securitisation instruments, etc.
Form of Securities	Physical	Dematerialised
Regulatory Approach	Merit based regulation	Disclosure based regulation
Intermediaries	Some intermediaries (stock brokers, authorized clerks and remisiers) regulated by the SROs	A variety of specialized intermediaries are registered with and regulated by SEBI (also by SROs).
Access to Market	Granted by Central Government	Eligible issuers access the market after complying with the issue requirements
Disclosure	Voluntary, vague, scanty and non-standardised	Standardised, systematic and at par with international standards.
Pricing of Securities	Determined by Central Government	Determined by market, either by the issuer through fixed price or by the investors through book building, reverse book building (RBB)
Access to International Market	No access	Indian firms allowed access to international markets through issue of ADRs/ GDRs and ECBs. FIIs allowed portfolio investments. Indian firms, investors and mutual funds allowed to invest overseas.
Corporate Compliance	Very little emphasis	Emphasis on disclosures, accounting standards and corporate governance
Mutual Funds	Restricted to public sector	Open to private sector and emergence of a variety of funds and schemes
Exchange Structure	Mutual, not-for-profit Exchanges	Corporate, demutual, for-profit Exchanges
Trading Mechanism	Open outcry, Available at the trading rings of the exchanges, Opaque, Auction-/negotiated deals	Screen based trading system, Orders are matched on price-time priority, Transparent, Trading platform accessible from all over country

(Contd.)

Table 9. ***(Concld.)***

Features	1992	2015
(1)	(2)	(3)
Aggregation of order flow	Fragmented market through geographical distance. Order flow unobserved.	Order flow observed. The exchanges have open electronic consolidated limit order book (OECLOB)
Anonymity in Trading	Absent	Complete
Settlement Cycle	14-day account period settlement, not adhered to always	Rolling settlement on T+2 basis
Counterparty Risk	Present	Absent
Form of Settlement	Physical	Electronic
Basis of Settlement	Bilateral Netting	Multilateral Netting
Transfer of Securities	Cumbersome. Transfer by endorsement on security and registration by issuer	Securities are freely transferable. Transfers are recorded electronically in book entry form by depositories.
Risk Management	No focus on risk management	Comprehensive risk management system encompassing capital adequacy, limits on exposure and turnover, VaR based margining, client level gross margining, on-line position monitoring, etc.
Derivatives Trading	Absent	A wide array of exchange traded derivatives such as futures and options on indices and select securities available
Research	Very little	Many market participants have full-fledged research departments.
HR Capability	No dedicated programmes to build HR capacity for securities markets.	A variety of programmes to build HR capacity in niche areas of securities markets. A specialised institute, NISM is in place

3.6 Regulatory Framework

Legislations: The four main legislations governing the securities markets are:

a. *SEBI Act, 1992:* The SEBI Act, 1992 established SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with the securities market. It can conduct enquiries, audits, inspection and investigation of all concerned and adjudicate offences under the Act. It has powers to register and regulate all market intermediaries and also to penalise them in case of violations of the provisions of the Act, Rules and Regulations made there under. It has full autonomy, including financial autonomy, and authority to develop and regulate an orderly securities market.

b. *Securities Contracts (Regulation) Act, 1956:* It provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives Central Government[37] / SEBI regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with the conditions prescribed by Central Government. Organised trading activity in securities takes place on recognised stock exchanges. The stock exchanges determine their own listing standards which have to conform to the minimum listing criteria set out in the Rules.

c. *Depositories Act, 1996:* The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by (a) making securities of public limited companies freely transferable subject to certain exceptions; (b) dematerialising the securities in the depository mode; and (c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act provides transfer of ownership of securities electronically by book entry without necessitating the securities move from person to person. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the company law have been dispensed with.

d. Companies Act, 2013: It deals with issue, allotment and transfer of securities and various aspects relating to company management. It prescribes for standard of disclosure in public issues of capital, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, supply of annual report and other information, etc.

Rules and Regulations: In order to meet exigencies of the market and to provide flexibility to regulators, they have been delegated substantial powers of subordinate legislation. Government has framed rules under the SCRA, the SEBI Act and the Depositories Act. SEBI has framed regulations under the SEBI Act, the SCRA and the Depositories Act for registration and regulation of all market intermediaries, and for prevention of unfair trade practices, insider trading, etc. The regulated and the market participants are consulted, as a matter of best practice, before framing any regulation. Under these Acts, Government and SEBI issue notifications, guidelines, and circulars which need to be complied with by the market participants. The SROs like stock exchanges have also laid down their rules and regulations. The list of the Regulations issued by SEBI is presented in Table 10.-

Table 10. Regulations under the Securities Laws

No.	Title of Regulations
(1)	(2)
1	SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992
2	SEBI (Merchant Bankers) Regulations, 1992
3	SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993
4	SEBI (Underwriters) Regulations, 1993
5	SEBI (Debenture Trustees) Regulations, 1993
6	SEBI (Bankers to an Issue) Regulations, 1994
7	SEBI (Custodian of Securities) Regulations, 1996
8	SEBI (Venture Capital Funds) Regulations, 1996
9	SEBI (Mutual Funds) Regulations, 1996
10	SEBI (Credit Rating Agencies) Regulations, 1999
11	SEBI (Collective Investment Schemes) Regulations, 1999
12	SEBI (Foreign Venture Capital Investors) Regulations, 2000
13	SEBI (Procedure for Board Meeting) Regulations, 2001
14	SEBI (Employees' Service) Regulations, 2001
15	SEBI (Issue of Sweat Equity) Regulations, 2002
16	SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003
17	SEBI (Ombudsman) Regulations, 2003
18	SEBI (Central Database of Market Participants) Regulations, 2003
19	SEBI (Self-Regulatory Organizations) Regulations, 2004
20	SEBI (Regulatory Fee on Stock Exchanges) Regulations, 2006
21	SEBI (Certification of Associated Persons in the Securities Market) Regulations, 2007
22	SEBI (Public Offer and Listing of Securitized Debt Instruments) Regulations, 2008
23	SEBI (Intermediaries) Regulations, 2008
24	SEBI (Issue and Listing of Debt Securities) Regulations, 2008
25	SEBI (Investor Protection and Education Fund) Regulations, 2009
26	SEBI (Delisting of Equity Shares) Regulations, 2009
27	SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
28	SEBI (Know Your Client Registration Agency) Regulations, 2011
29	SEBI (Alternative Investment Funds) Regulations, 2012
30	SEBI (Investment Advisors) Regulations, 2013
31	SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013
32	SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013
33	SEBI (Procedure for Search and Seizure) Regulations, 2014
34	SEBI (Research Analysts) Regulations, 2014
35	SEBI (Infrastructure Investment Trusts) Regulations 2014
36	SEBI (Real Estate Investment Trusts) Regulations, 2014
37	SEBI (Share Based Employee Benefits) Regulations, 2014
38	SEBI (Prohibition of Insider Trading) Regulations, 2015
39	SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015
40	SEBI (Issue and Listing of Municipal Debt Securities) Regulations, 2015
41	SEBI (Procedure for Search and Seizure) Regulations, 2015
42	Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018
43	SEBI (Settlement Proceedings) Regulations, 2018
44	SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018
44	SEBI (Depositories and Participants) Regulations, 2018
46	SEBI (Buy-back of Securities) Regulations, 2018
47	SEBI (Appointment of Administrator and Procedure for Refunding to the Investors) Regulations, 2018
48	SEBI (Foreign Portfolio Investors) Regulations, 2019
49	SEBI (Portfolio Managers) Regulations, 2020

Source: SEBI (Several years) Regulations under the Securities Laws, Securities and Exchange Board of India, Mumbai.

Regulators: The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Ministry of Company Affairs (MCA), SEBI and the Reserve Bank of India (RBI). FSDC coordinates the activities of these agencies and also other regulators such as RBI, FMC, (Insurance Regulatory and Development Authority of India (IRDAI), and Pension Fund Regulatory and Development Authority (PFRDA). The orders of SEBI under the securities laws are appellable before the SAT. The orders of the SAT are appellable before the Hon'ble Supreme Court on points of law.

Most of the powers under the SCRA are exercisable by DEA while others by SEBI. The powers of the DEA under the SCRA are also con-currently exercised by SEBI. The specified powers under the SCRA in respect of the contracts for sale and purchase of government securities, gold related securities, money market securities and securities derived from these securities and ready forward contracts in debt securities are exercised concurrently by RBI. The SEBI Act and the Depositories Act are mostly administered by SEBI. Government frames the rules under the securities laws while the regulations are framed by SEBI. These are administered by SEBI. The powers under the Companies Act relating to issue and transfer of securities and non-payment of dividend are administered by SEBI in case of listed public companies and public companies proposing to get their securities listed. The SROs frame and ensure compliance with their own rules as well as with the rules and regulations relevant to them under the securities laws.

Now that we have a fair understanding of the securities regulations and securities markets, we turn to the governance of the governor in our context, namely SEBI, which is commonly referred to as the regulator of the Indian securities markets, in Section 4.

SECTION 4
GOVERNING GOVERNOR

4.1 Government within Government

SEBI and SEBI-like institutions are a class of body corporates mostly created by the statutes. They provide public goods in public interest just as Government does. They have responsibilities - consumer protection, development and regulation - similar to those discharged by Government. They have powers - legislative, executive and judicial - similar to those of Government. They resemble Government in many respects, yet they are not the 'Government'. They are, in a sense, Governments within Government, imperium in imperio, and carry out governance on behalf of Government in a pre-defined framework [Nair & Sahoo, 2007]. They are epistemically known as 'regulators' as their responsibilities include regulation, though they formally described as authority, commission, board, council, etc.

It is a misnomer that SEBI is a standalone regulator; it has responsibilities that go beyond regulation. For example, it has the mandate to protect the interests of investors in securities and to promote the development of the securities market, in addition to regulating the same. However, it is mostly termed as the regulator of the securities market because it is predominantly responsible, though not exclusively, for its regulation. Many others, such as stock exchanges, depositories, SROs, and even market intermediaries, who are not called regulators as such, also undertake some amount and some kind of regulation of the securities market. Further, while SEBI undertakes extra-regulatory activities, such as investor protection and market development, these are not its exclusive domain. Government, NGOs, market participants, and even general public also often undertake activities in these areas.

The traditional statecraft has limitations in governance of securities markets which evolves continuously. To address effectively the issues of the dynamic nature in such a market, the Government has set up SEBI,[38] and equipped it with the necessary powers, expertise and processes, and resources commensurate with the requirements of the task. Being encouraged by the success of this approach, the Government has been creating and nurturing such institutions and sharing governance in various areas with them. The rise of regulators to share governance with Government is now a hard reality and the governance through regulators constitutes the most important governance reforms in the last few decades. Perhaps the establishment of independent regulators constitutes a significant change to formal institutions of governance [Westrup, 2007].

The rise of the regulatory state[39] may have been an efficient response to changing conditions [Glaeser & Shleifer, 2003]. The emergence of regulators and the regulatory state is explained primarily by interest groups' desire to establish an agency that would protect or enhance their interests [Posner, 1974]. The emergence of regulators is a response to the deterrence failure problem due to incomplete law [Chenggang & Pistor, 2001]. There are, in fact, significant advantages of governance through a regulator. It generally does not share the 'social' obligations of Government; nor is it subject to the pressures of 'interest' groups. It provides the same level playing field to all kinds of participants without fear or favour. Jaitley [2014] argues: "The State can't be a player and a decision maker. You can't be a player and a referee at the same time. And that is when Government started realising the merits of having a regulator, whether it was insurance, or it was telecom, or it was any other field". The regulator builds the expertise matching the complexities of the task and evolves processes to enforce authority rapidly and proactively. However, there are also significant concerns. The fusion of legislative, executive and judicial powers in one entity carries the tension of potential misuse. It suffers from democratic deficit as it is not directly accountable to people or their representatives. Government continues to remain accountable for the governance carried out through the regulator, which poses a classic example of the principal-agent problem. In case of exigencies, Government is called upon to explain and carry out the rescue operations. The challenge is to minimise the trade-off between the advantages of governance through regulator and the apparent threat to democratic accountability [Westrup, 2007].

4.2 Institutional Delegation

The securities market is jointly regulated by a hierarchy of agencies, namely, Government, regulators and self-regulatory organisations. Within the Government while Ministry of Finance (MOF) is primarily responsible under the Constitution and the Allocation of Business Rules, 1961, Ministry of Corporate Affairs (MCA) deals with participation of companies in securities market. Among the regulators, while SEBI is primarily responsible under the statute, RBI has certain responsibilities in respect of debt securities and Forward Markets Commission (FMC) is responsible for commodity derivatives. The stock exchanges are primarily responsible for market regulations, while depositories, CCs and a host of other self-regulatory organisations and trade associations share the responsibility of regulation of different facets of the market.

In this hierarchy, SEBI acts as both a principal and an agent. Government is the farthest from the market and has the least information. However, as the principal, it communicates its objectives such as market development, market integrity and consumer protection through policies, statutes, rules, and directions. Because of proximity, SEBI has better understanding of the markets than the Government has and has better understanding of objectives of the Government than the exchanges have. As an agent it translates the objectives set by the Government into reality within a predetermined framework. At the same time, as a principal it delegates part of its responsibility to the exchanges and others who are the closest to the market. Because of their proximity, the exchanges have better understanding of the market than SEBI has. As agents of SEBI and indirectly of the Government, they regulate conduct of their constituents. It is possible that there is transmission loss in terms of objectives or focus from one level to the other in the hierarchy. Appropriate contracts minimise the loss by holding the agents accountable while incentivising them to promote the interests of the respective principals. However, both because of the perceived conflict of interests between commercial aspirations and regulatory tasks of exchanges and the search for new turfs by statutory regulators, the importance of SEBI (fifth layer) has been increasing at the cost of exchanges (sixth layer) [Nair & Sahoo, 2008a].

Citizens are ultimate principals in parliamentary democracies. They delegate their authority to their representatives who form the Parliament; the Parliament further delegates some of its authorities to the Government which further delegates the same to ministers. The Government/minister delegates the implementation to the bureaucracy. Thus, in the normal chain of delegation there are four delegates, the Parliament, the Government, the ministers and the bureaucracy. Delegation to independent regulatory agencies, such as SEBI is the fifth layer [Braun & Gilardi, 2006, Pp. 1-22] and further delegation to exchanges and depositories constitutes the sixth layer. One wonders why politicians voluntarily weaken their position by delegating governance to agencies outside Government. They do not completely abdicate; they only delegate and retain the ultimate control. There are three important reasons: (a) It insulates the regulatory decisions from being overturned with change in public opinion or Government and thereby ensures predictability and certainty; (b) It insulates politicians from the fallout of unpopular decisions by shifting the blame to the regulator; and (c) It builds high level of expertise for regulatory decisions which is not otherwise possible within the normal public service guidelines [Westrup, 2007]. However, such a long chain of delegation and multiple principals and agents obfuscate their accountability as it is well-neigh impossible to draw up perfect contracts among them for various reasons. This gets complicated further when the regulator is considered an agent of the investors, as SEBI claims to be: 'Har Investor ki Taaqat'.

An agency away from the hierarchal institutions of Government, but with specific governance responsibilities, is essentially an American phenomenon that dates back to the end of the nineteenth century. This experiment began in India with SEBI in 1992. Governance through regulators is still evolving. Every administrative ministry is experimenting with issues such as composition of regulator, relation between the Government and the regulator, the finances of regulator, scrutiny of quasi-legislative and quasi-judicial actions of regulator, etc. There is a need for a comprehensive review of the experience so far of this mode of governance and use the learning to improve the spacing and design of the regulators within the constitutional schema to make them more effective and address the felt concerns. It is useful to do this review based on working of SEBI which is the oldest, the most prominent and the most evolved, and probably the most successful regulator in the country [Subramanian, 2007; Dhume, 2010; The Economic Times, 2013]. It is because the institutions like SEBI make a difference to a country. Acemoglu and Robinson [2012] in their highly acclaimed book "Why Nations fail?" argue that the key differentiator between countries is "institutions". Nations thrive when they develop "inclusive" political and economic institutions, and they fail when those institutions become "extractive" and concentrate power and opportunity in the hands of only a few.

Based on the review, critical overarching principles may be written into a charter[40] to guide the establishment as well as operations of the regulator irrespective of the sphere of governance. This charter should be something similar to the Constitution or the Companies Act, 1956, which provides for all aspects of the Government / company, its operations, management and governance, irrespective of the kind of business / activity it is engaged in. The governance of regulators is as much important as the governance of Government or of companies. Good governance of regulator is necessary for effective regulation. A draft charter has been attempted by Planning Commission [2013] in the context of regulators for utilities. The charter may build on four mutually reinforcing pillars of good regulatory governance, namely, independence, accountability, transparency, and integrity [Prat & Berg, 2014]. The regulator should be independent of social pressures, political influences and regulatory capture in regulatory space. It should be accountable for its actions and performance. Its actions, decision and operations should be transparent. It should have internal processes to ensure discipline and consistency in its operations.

The charter may take into account the IOSCO [2010] principles relating to the regulator: (a) The responsibilities of the regulator should be clear and objectively stated; (b) The regulator should be operationally independent and accountable in the exercise of its functions and powers; (c) The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers; (d) The regulator should adopt clear and consistent regulatory processes; (e) The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality; (f) The regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate; (g) The regulator should have or contribute to a process to review the perimeter of regulation regularly; and (h) The regulator should seek to ensure that conflicts of interests and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed. Doyle [1996, Pp. 35-40] has identified twelve criteria which make regulatory structure credible. These are independence, accountability, penalties, transparency, clarity, speed, appeal mechanism, simplicity, periodic review, consistency, commitment and fairness.

The charter should contain the thumb rules. It should ordinarily provide for: (a) a conducive legal framework to enable the regulator to enforce authority promptly and proactively, (b) appropriate level of independence in terms of resources and powers to enable the regulator to build the capability and processes commensurate with the task, (c) institutional mechanism to ensure accountability of the regulator to avoid its possible failure, (d) internal architecture of the regulator to avoid intra-institutional bargains, (e) effective partnership among Government and the regulators to work in unison for a common purpose, and (f) spacing of a regulator vis-‘-vis

Government and other regulators to avoid gaps and overlaps in coverage and shifting of responsibilities in times of crises.

4.3 Incomplete Law

There are broadly two forms of law, namely, ‘almost complete’ and ‘almost incomplete’. The former endeavours to enact the law with perfection, which can deal with all the possible circumstances for a long time. A law is complete if it unambiguously stipulates for all future contingencies; otherwise it is incomplete. An example of such form is the Indian Penal Code enacted way back in 1860. Take the definition of ‘theft’ given therein, which has not been amended yet. Any activity satisfying the ingredients specified in the said definition is construed as theft. Once the legislature lays down the definition of ‘theft’ and prescribes the penalty for it, it is for the executive to administer the law. In case of any violation, the executive or the affected party brings it before the judiciary which penalises the delinquent, if it is satisfied that it was a case of theft and there is sufficient evidence to the effect that the delinquent has committed it beyond all reasonable doubts. If any deficiency is noticed while administering or enforcing the law, the legislature amends it, though normally with a time lag. In this form of law, there is almost complete separation of powers among the governmental agencies - the legislature frames the laws; the executive administers and the judiciary enforces them. Till about a century back when the environment was somewhat dynamic, the Governments used mostly this form of law for governance.

Of late, the environment has become very dynamic. The change that used to take centuries earlier is coming about in months, or at best in years. Former Chairman of SEBI, Mr. C. B. Bhave reportedly likened governance challenge in this environment to a flight that has developed snag at 30,000 feet and it is too late to land and too dangerous to continue flying. The options being limited, we must fly and we must repair too. The governance response to this has been establishment of regulators empowered by ‘almost incomplete’ form of law. This form believes that it is not possible to visualise all the possible circumstances and provide for the same in the legislation. Here, the legislations tend to be skeletal, but have the potential to deal with all the possible circumstances, including unforeseen emergencies. The incomplete law, therefore, is not a reflection of bad drafting; most often it is a deliberate design. In fact, it tends to be more principle based and hence requires higher drafting skills.

The Securities and Exchange Board of India Act, 1992 belongs to this genre. It empowers SEBI to register and regulate not only the intermediaries listed in the Act, but also such other intermediaries who may be associated with the securities market in any manner. This allows SEBI to regulate the intermediaries who are not listed in the Act, should the need arise in future and also the new intermediaries that may emerge in future, without an amendment to the law. At the time of enactment, the legislature could not possibly visualise all intermediaries who all would need to be regulated in future. Similarly, the Act mandates SEBI to take such measures as it considers fit to protect the interests of investors with an illustrative list, as at the time of enactment, it could not visualise all possible measures that might prospectively become necessary. This enables SEBI to undertake innovative measures to respond appropriately to the circumstances at hand. For example, SEBI recently secured disgorgement of illegal gains from the fraudsters and disbursed the same among the victims. It debarred certain individuals from becoming directors of listed companies. These measures are not explicitly mentioned in the illustrative list. Another example is the definition of 'securities'. The SCRA defines 'securities' to include shares, debentures, derivatives of securities, rights or interests in securities, etc. and such other instruments as may be declared by Government. This enables the authorities to regulate any instrument which is not included in the definition, should the need arise in future and also the new instruments that may emerge in future, without an amendment to the law.

Another dimension of incomplete law is subordinate legislation. The Act confers on SEBI substantial powers of delegated legislation (quasi-legislative) to make subordinate legislation (regulations) to fill the gaps in laws and to deal with the matters of detail, which rapidly change with time. While the Act is about ten pages, SEBI has framed regulations running into thousands of pages. This enables it to strike the moving targets at the right time and at the same time, keep the laws relevant. The Act further confers on SEBI the enforcement, including quasi-judicial, powers to enforce the laws made by the legislature and also by itself. In particular, it can by regulations cast obligations on participants and dispense civil penalties for failure to discharge the said obligations. As a consequence, if SEBI considers a particular conduct undesirable, it can within no time outlaw the same through regulations and enforce such regulations. It does not have to wait for the legislature to outlaw any conduct or create an offence through legislations. Nor does it need to seek judicial concurrence for levying a variety of civil penalties on the accused. Here the separation of powers is blurred - the same entity is vested with the quasi-legislative, executive and quasi-judicial functions so that it can enforce the laws proactively and preferably before any harm has been done. This form of law is eminently suitable for markets which evolve very fast and the authority needs to respond faster with preventive and remedial measures.

As stated earlier, the raison d'être of regulators is to hit the moving targets. This is possible only if the law evolves continuously in tandem with the environment to meet the emerging deficiencies, accommodate new products and market designs, deal with innovative transactions by the market participants and improve the safety and efficiency of operations in the market by overcoming the legislative lags. The law should enable the regulator to expeditiously issue a variety of innovative - administrative and quasi-judicial - preventive, remedial and penal - measures matching the conduct of the participants. This requires an almost incomplete legal regime where the regulator, which has a better understanding of the environment, has adequate powers of subordinate legislation within the basic frame of the statute and also the powers to enforce the laws proactively and promptly. In fact, this is the modern trend. For example, the Companies Act, 2013 uses the words "as may be prescribed" 416 times. This means that Government is empowered to make subordinate legislation on at least 416 matters, in addition to any other matter for carrying out provisions of the Act.

While SEBI mostly operates under an incomplete legal regime and that explains its success to a large extent, many statutes establishing other regulators are not so much incomplete. Further, some of them need prior approval of the Government to make regulations, as SEBI was required to do till 1995. Some do not have the power to take enforcement actions against the miscreants or penalise them. Often, the regulator and the Government have powers to make subordinate legislation to carry out the purposes of the statute that has created the regulator. And Government has powers to exempt certain matters from the regulatory purview of the regulator. Occasionally, the regulator does not have complete authority over the area it governs. For example, SEBI and MOF have authority to make subordinate legislation to carry out the purposes of the SEBI Act and the SCRA. SEBI does not have full authority to make subordinate legislation on certain important aspects of the securities market such as recognition of stock exchanges, requirements of listing, grounds for delisting of securities, etc. This partly explains different standards, for example, for listing of securities of a government company and of a private sector company and distorts the level playing field and hinders the effectiveness of SEBI.

4.4 Independence of Regulator

There is an expanding empirical literature on the relationship between regulatory independence and economic outcomes [Parker and Kirkpatrick, 2012]. The economic outcomes improve where there is an independent regulatory agency. The protagonists of governance by regulators believe that the independence of regulators is the key to their effectiveness [Szapiro, 2005]. In fact, a key objective of the independent regulatory agencies is to shield market interventions from interference from 'captured' or 'partisan' politicians and bureaucrats [OECD, 2002]. It is now increasingly recognised that political meddling has consistently caused or worsened financial instability [Quintyn & Taylor, 2004]. Independence from the Government of the day is important, especially when the Government is a shareholder in one or more of the regulated enterprises. Independence from the regulated enterprises is clearly essential to containing opportunistic behaviour. It must, however, be noted that though independence means discretion, it is not unfettered discretion.

4.4.1 Co-ordinates of Independence

'Independence', as applied in the context of regulators, is often misunderstood. It certainly does not mean independence from the laws of the land. Nor does it mean independence from the standard checks and balances evolved over time for the exercise of powers. As much as one may wish, a public agency has to discharge its responsibilities within the framework of the law and be accountable for its performance. In fact, in a democratic mode of governance, no public agency is independent. Strictly speaking, a system delivers its best only if all its parts have harmonious co-existence and no part seeks independence from the others. In a sense, dependence on one another is a source of strength; vigilance by others keeps one always on toes and prevents failure. Full independence carries along with it the obvious danger of a public agency drifting away from the people and, possibly, even from the very objectives for which it is established.

In a system, only those who can shoulder accountability deserve to be independent. Hence accountability and independence go hand in hand and the mechanism to ensure these needs to be provided together. If an entity is to be held accountable for its performance, it must be independent in terms of resources and capacity and the manner of using resources towards its objectives. A related issue is credibility. Independence is not always granted; it is often earned. Great organisations aspire to earn credibility and, in the process, become institutions. In institutional parlance this is called "legitimacy" [Williamson, 1996] that institutions acquire as organic brand equity. Unless an institution establishes its credibility, it cannot claim 'real' independence even if the statute provides for it! It takes years, sometimes decades to build credibility. Central banking the world over, for example, undertook painstaking efforts for decades to earn the level of its independence that it enjoys today. This does not mean that a regulator should not have any independence to start with. Independence and credibility need to feed on each other in a virtuous circle.

Without functional independence in regulatory space, regulators would be encumbered by socio-political or legacy constraints and may not be in a position to take 'objective' decisions. Functional independence entails powers, financial resources and capacity commensurate with the regulatory responsibilities. Regulators discharge extra-regulatory functions as well where, perhaps, the nature and degree of independence sought is different, as these are not their exclusive prerogatives and these do not involve determination of rights or obligations of economic agents. Here, regulators are just one of the players (Government may have multiple arms performing these tasks) while in the regulatory space they are the umpires. The umpires must be independent - but armed with the knowledge, including the knowledge that their independence is restricted to the game on the field, and that they are accountable for the exercise of their independence.

Government shares governance with regulators. This does not make the latter the agents of the former. In fact, all over the world, the regulators are central actors in their own right in governance of markets, holding and applying major powers, engaging with other market participants [Coen and Thatcher, 2005, Pp. 329-346]. Regulator is, however, a part of the State and carries on governance in a statutory framework. The legislature and judiciary scrutinise its activities as much as they do those of the executive. In fact, the executive and the regulator carry out governance in a particular area subject to oversight / scrutiny of the legislature and the judiciary and the statute does not make explicit provision for oversight of the regulator by the executive. For example, the Government of India (Allocation of Business) Rules, 1961 assign policy relating to regulation and development of securities market and investor protection to DEA, while the SEBI Act, 1992 entrusts SEBI with the responsibilities to protect the interests of investors in securities and to promote the development of, and to regulate the securities market. Even the SCRA and the SEBI Act, 1992 empower both Department of Economic Affairs (DEA) and SEBI to make subordinate legislations to carry out the purposes of these Acts such as listing and delisting and, in fact, both of them have made rules and regulations on these matters. This kind of arrangement puts the executive and the regulator on the same side as partners in governance, and, therefore, the latter is generally considered an extension of the executive. The relationship between these two has, however, important bearing on the independence of the regulator.

Let us look at the regulatory domain of SEBI. The statute empowers SEBI to discharge most of its responsibilities without recourse to the executive or the Government. It makes subordinate legislation, issues various kinds of directions in the interests of the market and the customers; carries out executive responsibilities such as registration, inspection, investigation, etc.; determines and initiates enforcement actions appropriate to the alleged violations; raises resources to discharge its regulatory responsibilities; and builds human resources matching its tasks. Its staff enjoys immunity from suit, prosecution or other legal proceedings in respect of actions taken by them in good faith. These statutory provisions promote the independence of SEBI and leave little scope for 'interference' in the regulatory arena. Viewed in this context, most regulators in India are fairly independent, though in different degrees.

Under the democratic form of government, the legislature exercises oversight over the executive and scrutinises its quasi-legislative activities. It also exercises similar oversight over the activities of the regulators. It is, however, expected to scrutinise only the quasi-legislative and the executive activities of the regulators and the quasi-judicial activities of the regulators should be beyond its scrutiny. However, it is difficult at times to clearly classify every activity of a regulator into watertight compartments and to restrict the legislative scrutiny to the quasi-legislative and the executive activities of the regulators. Further, a particular matter may have been dealt with administratively up to a point and determined thereafter quasi-judicially. In such cases, it is difficult to demarcate the aspects of the matter which can be scrutinised by the legislature. If proper care is not exercised, the legislature may inadvertently scrutinise quasi-judicial activities which would undermine the independence of regulators.

4.4.2 Independence of Whom?

Regulators undertake quasi-legislative, executive and quasi-judicial measures - a reason why their powers, as well as image, sometimes get magnified. But given the exalted position of the legislature and the judiciary in the Indian Constitution, independence is not sought in respect of quasi-legislative and quasi-judicial activities of regulators. It is considered normal if the regulations and orders of regulators are modified or set aside by the legislature or the judiciary, as the case may be. In any case, regulation making resembles enactment of law by legislature and adjudication resembles a judicial decision by a court of law [Supreme Court, 2013b]. In fact, the statute itself provides the manner and extent of legislative and judicial intervention in the quasi-legislative and the quasi-judicial activities of regulators. However, a gentle nudging from the executive has the potential of being perceived as impinging on the independence of the regulator and, hence, the independence of the regulators essentially boils down to independence from the executive.

The Constitution assigns ‘stock exchanges and future markets’ in the union list to the union legislature. The business allocation rules assign ‘policy measures for the regulation and development of the securities market and investor protection’ to MOF. However, the legislature, by a statute, assigns regulation, development and investor protection matters related to securities, to SEBI, and clothes it with quasi-legislative, executive and quasi-judicial powers subject to the oversight of the legislature and the judiciary, without actually curtailing the responsibilities of the Ministry. The said statute, however, empowers the Ministry to constitute SEBI and supersede it if the latter fails to discharge functions to its satisfaction. It also empowers the Ministry to give directions on policy matters to SEBI and make rules to further the objectives of the statute. The Ministry responds to the legislature on all matters relating to the subject for and on behalf of SEBI. It places the activity reports - the annual report, the annual accounts, the regulations - of SEBI before the legislature for scrutiny. It is accountable to the people through the legislature on all matters relating to securities markets, even if it is governed by SEBI. In exercise of these responsibilities, it engages in constant interaction with SEBI. The interaction, if not properly calibrated, could be construed as ‘interference’. It impinges more when the secretaries of the administrative ministries interact with the chairpersons of the regulatory bodies, particularly because the secretaries are junior to chairpersons[41] in Indian civil service.

The Ministry is usually perceived to have the ability to influence the decision and policy of a regulator. One reason is that the Ministry can influence a regulator through its power to issue directions in matters of policy which the regulator is bound to comply with and to reconstitute or supersede the regulator. This power, though necessary to ensure that the regulator does not drift from its mandate, must be sparingly used. The statute should provide an objective, structured process for issuing directions to regulator, or superseding it in specified circumstances. Second reason is its presence on the governing board of the regulator. The views of the representative(s), being the nominee(s) of the Minister who is accountable to the legislature, usually carries relatively more weight in the decision-making process. Besides, Government is a market participant and is subject to pulls and pressures. It may not always be possible for the representative to take an objective position in all matters involving Government. It is better that the board of the regulator does not have any nominee from the Ministry, particularly when the latter has recourse to give directions to the regulator and throw away any member from the board. Ideally, SEBI may not have any nominee at all. At present it has nominees of MOF, MCA, and RBI. The nominees generally have a conflict of interest as they look at every proposal that comes before the board from the perspective of their organisations. They usually take extra-ordinary interest in the proposal that has some bearing on the working of their organisations and invariably espouse the interests of the organisations which have nominated them.

The board of a regulator needs to have a mix of part-time and whole- time members (WTMs). Part-time members are necessary to obtain the industry knowledge and feedback from the people who are otherwise engaged on full time basis in industry or profession and are not willing to come on full time basis on the board of the regulator. They are necessary, along with public consultation for making regulation and appearance before parliamentary committee, to bridge the democratic deficit the regulators suffer from. While the boards of sectoral regulators should have predominance of sectoral experts, these must also have representation of experts outside the sector. This is necessary to ward off the capture by the regulated. The part time members could be nominated by FSDC[42] from among the eminent citizens who may not be top-notch experts in securities markets, but must have a sound understanding of the economy and the finance. The boards also need to have a mix of WTMs from different disciplines relevant to the subject governed by regulator. For example, the board of SEBI needs to have members who have excelled in the disciplines such as securities markets, economics, finance, law or public policy and have demonstrated capacity in dealing with problems relating to securities market. The WTMs may be selected by a professional selection committee. A Regulatory Selection Board (RSB) may be set up on lines similar to Union Public Service Commission (UPSC), Public Enterprises Selection Board (PESB) or National Judicial Appointments Commission (NJAC)[43] to select WTMs for all regulatory bodies. This kind of composition of the board would promote independence of regulators, bridge the democratic deficit and avoid undue influence on the decision making from outside. However, care has to be taken to avoid any kind of conflict of interest. An individual should not be appointed as member if he has association of any kind with any regulated entity, Government of India, any State Government or any regulatory authority unless he severs that association before assuming the office.

4.4.3 Terms of Appointment

The independence critically depends on the terms (term and compensation) of appointment of functionaries (whole time members and chairman) on the board of SEBI. The terms determine the strength of the functionary to withstand the influence of articulate interest groups and the pressures of fear and favour from ‘captured’ politicians or bureaucrats. A reasonable secured term with reasonable compensation attracts the right persons on the board who have motivation to build capability rapidly to match the tasks and to discharge their responsibilities with utmost professionalism and objectivity. The terms in vogue today is debilitating to say the least.

The rules initially provided for a term up to three years subject to the condition that no one would hold position as member or chairman after he has attained the of 62 or 65 years, as the case may be. The rules were amended in 2007 to increase the maximum age for members to 65 at par with chairman. These are amended again in 2009 to increase the term up to five years for members. The current provision is that a person can have a term up to five years at one go and the said term can be extended or a person can be re-appointed for a fresh term up to five years subject to the condition that he would not hold the position after he has attained the age of 65. The ministry generally has powers to relax these rules, for example, to grant a term longer than that is provided in the rules. The rules initially provided that chairman and members would get salary as admissible to secretary and additional secretary to Government of India. However, if a person has retired from government service, his salary is reduced by the amount of pension he receives. Based on the recommendation of 6th Pay commission, the members and chairman have now been allowed an option to receive what is called ‘regulatory pay’, a lump sum amount without house and car. This lump sum amount is revised at discretion of Government unlike grant of dearness allowance every six months for government employees. Earlier a serving government employee could go on deputation to SEBI as chairman or member. However, it is now a requirement that a serving employee of Government, if selected as member or chairman, has to resign from government service before joining SEBI. The ostensible purpose is that a person should not continue to have loyalty to Government which could be a party before SEBI some time.

The outcome of this framework is obvious. There are occasions when a person has been appointed for a term of five years when the rules provided for a term up to three years and a person has been appointed for a term of three years while the rules provided for a term up to five years. Further, while some persons have been granted extension of the term, some others have been denied for no apparent reason. At least on one occasion, three members and a chairman were offered extension of service by two years but were not actually granted. Except for exceptions, people join as member or chairman when they are about to retire from government service or have already retired, which allows little time for them to work for SEBI. During initial years, no member could get to work even for two years[44] as then retirement age for a member was 62. All persons who have worked so far as chairman or a member of SEBI are from Government or public sector background.[45] Not a single person from private sector has yet joined. Thus, the outcome is that mostly retired persons, that too, with Government background join as member or chairman and are paid salary, not commensurate with the market. The term of an appointment, the termination of the appointment before the expiry of the term, the extension of the term, or even granting a second term depends solely on the subjective satisfaction of the Ministry, which is often a party before the regulator (PSUs are subject to listing discipline of SEBI), and have the potential to prevent a person from taking a position extremely unpalatable to the Ministry.

In this context, two pronouncements of the Hon'ble Supreme Court [2010b: Para 56] are instructive. In the context of a National Company Law Tribunal (NCLT), it directed as under:

"(x) The term of office of three years shall be changed to a term of seven or five years subject to eligibility for appointment for one more term. This is because considerable time is required to achieve expertise in the field concerned. A term of three years is very short and by the time the members achieve the required knowledge, expertise and efficiency, one term will be over. Further the said term of three years with the retirement age of 65 years is perceived as having been tailor-made for persons who have retired or shortly to retire and encourages these Tribunals to be treated as post-retirement havens. If these Tribunals are to function effectively and efficiently, they should be able to attract younger members who will have a reasonable period of service.

(xi) The second proviso to Section 10FE enabling the President and members to retain lien with their parent cadre/ministry/department while holding office as President or Members will not be conducive for the independence of members. Any person appointed as members should be prepared to totally disassociate himself from the Executive. The lien cannot therefore exceed a period of one year.

(xii) To maintain independence and security in service, sub-section (3) of section 10FJ and Section 10FV should provide that suspension of the President/Chairman or member of a Tribunal can be only with the concurrence of the Chief Justice of India".

In another matter, the Hon'ble Supreme Court [2014b] held that section 5 of the National Tax Tribunal Act, 2005 is not sustainable in law, as it does not ensure that the alternative adjudicatory authority is totally insulated from all forms of interference, pressure or influence from co-ordinate branches of Government. It also held section 8 of the Act invalid as a chairperson/member is appointed to the tribunal in the first instance, for a duration of 5 years and such chairperson/member is eligible for reappointment, for a further period of 5 years. A provision for reappointment would itself have the effect of undermining the independence of the chairperson/members of the national tax tribunal (NTT).

As regards compensation, it is instructive to note the observation of Subramanian [2007]: "The second major factor contributing to the decline of public institutions is its increasing inability to attract talent. This too has deeper causes, including the growing politicisation of the bureaucracy, cynicism about its role, and the fading sense of public service. But clearly one of them is the very rise of the private sector which has simply made the public sector a less attractive place to work in. The allocation of talent has become skewed. With the staggering scale of remuneration that the new economy is showering on skilled people, the public sector does not stand a chance of competing with the private sector in attracting high quality people. And, if institutions ultimately depend on the individuals manning them and the incentives they face, the prognosis is somewhat grim for public institutions" (p. 218). The compensation linked to that of the government employees reduces the catchment area of people who are willing to work for regulators.

FSLRC [MOF, 2013a] has recommended that the executive members of a regulatory board should have a fixed term of five years, subject to a retirement age which must be equivalent to the age of retirement for the equivalent senior-most Government positions. This may ensure that government servants do not come to regulatory boards after their retirement. But that is not the problem; that is a symptom of the problem. The issue is to ensure young talent coming on board to pursue a regulatory career with independence.

In the government apparatus, the elected functionaries hold office for a term of five years while the appointed functionaries hold office till their age of superannuation. An elected functionary can hold office for life if he enjoys patronage of the electorate. A member of bureaucracy or judiciary usually holds office till the age of superannuation. It is extremely difficult to remove a member of bureaucracy or judiciary from office. And there are restrictions on post-superannuation employment to avoid conflict of interest when in service. These provide security of the term, avoid conflict of interest and shield the bureaucrats or judges from fear or favour or undue influence of the Government of the day. Such provisions are much sharper and more entrenched for judiciary given their responsibilities. A protected long career in bureaucracy or judiciary till superannuation ensures development of expertise and, that too, at a younger age, and shields them from undue influence of the interest groups. In contrast, a person is appointed for a term of three or five years in board of a regulator, when the retirement age in regulatory boards is usually higher by three to five years than that in Government.

The regulator as a new institution of governance has been created to discharge certain responsibilities which could not be done efficiently within the usual statecraft in normal course. A regulator will not deliver substantially different if it is manned by people who have spent a full career in Government and are accustomed to act in a particular manner. Considerable time is required to achieve expertise in the field concerned. A person would not develop regulatory capability if he is allowed to work only for at best a term of three years. A three to five-year tenure, that too, when one is sixty, is very short and by the time he acquires the required knowledge, expertise and efficiency, the term is over and he is out. Sixty is not a very appropriate age to learn new things. The leadership position with a regulator is full of stress and tension[46] and is not very conducive for a person at sixty. A successful Advocate does not wind up his profession and join as judge for five years. A relatively young promising professional or a civil servant with proven track record in the area relevant for SEBI is eligible to be the chairman or member of SEBI, but he is reluctant to give up his flourishing profession/service and serve SEBI for a term of five years. If at all he joins, being eligible for reappointment, he would not able to discharge his duties without fear or favour, in as much as, he would always have a lurking uncertainty in his mind about his future, after the expiry of the prescribed term of five years, in the event of not being granted an extension. In fact, it would promote independence, if extension or second term is prohibited. In that case, the person would have no reason to bend as he has nothing to lose.

The solution is to attract people at young age by offering them market linked compensation and a career. Irrespective of the age at joining, they should serve up to a particular age as the members of judiciary or civil services do. The ideal age for entry could be between 45 and 55, as that would ensure reasonable maturity at joining and reasonable long time left to learn and serve. There would be no need for reappointment or extension and member / chairman once appointed must severe his relationship with past employment or profession, as the case may be. The civil servants having flair in regulation would leave Government well in time to join regulatory bodies. Once appointed, the terms of appointment should not be varied to his disadvantage. The statute should provide an objective, structured process for appointment and termination of services of persons on the boards of regulators. Ideally, these matters should be dealt with by a Ministry, which does not deal with the subject governed by the regulator. It is desirable that a new Ministry is set up to look after the establishment matters of all regulators; as such matters relating to PSUs are looked after by the Department of Public Enterprises (DPE). This may be named Department of Regulatory Affairs (DRA). A person should be appointed as full-time member on a regulatory board on the recommendation of RSB, similar to the recommendation of PESB, and his services may be terminated on the recommendation of RSB made after an inquiry. The regulator and the administrative ministry concerned must neither seek nor provide any physical facility (for comfort of the oragnisation or their employees) to each other.

4.4.4 Resources of Regulator

Independence critically depends on the provision of resources matching the responsibilities. A regulator cannot exercise its authority independently if it is dependent on somebody for its sustenance. While some regulators have adequate and independent sources of income, some others are not that fortunate. Some raise resources and use the same for meeting their objectives, while others turn the same over to the Government and depend on budgetary allocation for their expenditure. Irrespective of their potential to raise resources, regulators need financial autonomy, though there are various ways to secure it. The entities like Comptroller and Auditor General of India (C&AG) are effective because they have financial autonomy, even though they do not have adequate and independent sources of finance. The regulator should have resources from those sources which do not conflict with its professional delivery. For example, the fines levied by a regulator should not come to its coffers. Otherwise, the regulator may prefer to impose a higher monetary penalty than warranted or prefer monetary penalty to other kinds of more effective or appropriate penalties.

There are three basic approaches to fund the regulation. First is internalisation of regulatory costs, that is, the cost is recovered through fees from the regulated. This is transparent, easy to administer, and consistent with regulatory independence. The second is parliamentary appropriation from tax revenue. This approach has potential to transmit non-professional considerations in to regulatory decisions and also the danger of levying fees from the regulated or on the regulated transactions to support general obligations of the Government. An example is securities transaction tax levied on all securities transactions. The third is recovery of costs through specific fees for specific service. This is very cumbersome and has the highest transaction cost. The securities market in India uses the first approach, though the second is used in other segments of the economy such as telecommunications. The SEBI Act, 1992 empowers SEBI to levy fees or other charges for carrying out the purposes of the Act. FSLRC [MOF, 2013a] has recommended that the regulator should be funded primarily through fees, as is practice now for SEBI. It ensures that only the beneficiaries of regulated market, and not the general public, bear the cost of regulation. However, this fee should be minimum to ensure that it does act as entry barrier for firms while it is enough for the regulator to meet the regulatory needs and have a little surplus for exigencies. This should also be commensurate to the regulatory burden on the regulator. This means that the fee payable by an intermediary would depend on the kind of service it renders and its volume of service. Such fees must be levied only through regulations.

The independence depends on the availability of human resource at the disposal of the regulator. If the available human resources do not have the professional capability to determine the issues objectively, the quality of regulations would be poor as it would not be able to withstand the perceived or actual influence from various quarters, not necessarily from the Ministry. For example, if it does not have an adequate understanding of an issue, it would get carried away by noisy, often articulate, suggestions made by the vested interest groups. Unfortunately, many regulators compensate their employees at par with the government employees and often recruit employees on deputation from government sector. This often fails to attract the right talent adequate for the task and develop a cadre of professionals in the regulator who needs to upgrade themselves continuously to meet the challenges of dynamic environment. The incidence of this, which was very high in initial years, is much less now in SEBI. This happens partly due to the resource constraints. The regulator may not have budgetary freedom to engage staff as it considers necessary and to respond proactively to emerging needs. In the initial years, SEBI had to take a loan from Government to pay salary to its employees. It repaid the loan in instalments; the last instalment was paid in 2009. Additionally, the revolving door, while useful to bring in expertise, has the potential to weaken the professionalism of regulators. This needs to be handled by suitable restriction on post-regulatory employment.

4.4.5 Location of Fund

Many financial regulators like SEBI and IRDAI have, as statutorily required, constituted funds at their disposal to which all sums received by them such as fees, grants, charges, etc., are credited and all their expenses are defrayed from the said fund. However, there has been a protracted debate as to where this fund should be kept. A school believes that the regulators perform a governmental function and they do so, on behalf of the Government and, therefore, a regulator is an alter ego of the Government. Government is doing through the regulator what it could have done directly. This is clear from the fact that the powers of appointment, removal or supersession of the regulator are vested with the Government and the policy direction of the Government is binding on the regulator. Therefore, the moneys collected by a regulator are receipts for and on behalf of Government and should be deposited in the Public Accounts of India first and then withdrawn after due appropriation. This is consistent with the principle that parliamentary sanction of expenditure is hall mark of democratic form of Government. A section of this school believes that the Constitution does not require appropriation from public accounts and hence withdrawal of money should not require appropriation. Following this approach, it is argued that retention of funds by SEBI outside government public accounts is inconsistent with constitutional provisions. It has been observed by C&AG that five regulatory bodies, including SEBI, retained their surplus funds aggregating Rs. 2142 crore[47] at the end of March 2010 outside Government Accounts and, therefore, the Finance Accounts of the Union Government did not present a correct and complete picture of government finances to the extent of funds lying outside government accounts. SEBI has been established by an Act of Parliament and is to be treated as 'State'[48] within the meaning of the expression used in Article 12 of the Constitution. The moneys collected by SEBI should, therefore, be credited to government account under Article 266[49] of the Constitution. Hence, the issue is not keeping[50] of the funds as it *prima facie* appears.

The protagonists of regulatory independence believe that SEBI is a body corporate having perpetual succession and is empowered to hold property in its own name. The Hon'ble Supreme Court [2001] confirms this, "The Board (SEBI) is an autonomous body created by an Act of Parliament to control the activities of securities market in which thousands of members of gullible public will be investing huge sums of money. Therefore, there is every need for a vigilant supervision of activities of the market and for that purpose if the statute intends that the necessary funds should be met by collection of fees from the securities market itself then the said levy cannot be questioned on the ground that the monies required for capital expenditure of the Board should be met by Government of India" (p. 519). It upheld the provisions of the Act that permit SEBI to raise funds by collection of fees.

SEBI pays taxes to Government. It is allowed to receive, though never received, grants from Government. When it was acutely short of funds, it took a loan, albeit interest free, from Government and repaid the same. SEBI levies fees in its own right for carrying out the purposes of the SEBI Act. It does not receive fees as an agent or on behalf of Government. Article 266(1) deals with funds/revenues/moneys of Government. Article 266(2) deals with other moneys received by or on behalf of Government. These do not deal with moneys received by other authorities such as SEBI who are part of the 'State', and not of 'Government'. Such money is outside the purview of Article 266. The money which does not belong to SEBI, such as money realised by way of penalties, is credited to Consolidated Fund of India, as required by the statute. If the intention was to credit fees to any government account, the statute would have provided so specifically. Therefore, fees levied by SEBI is not required to be kept in government account. If all the moneys of 'State' is to be kept in government account, the moneys of municipal authorities, PSUs, and other agencies such as stock exchanges, who have been held to be 'State' by judicial pronouncements, would also need to be kept in government account. This would be absurd and impractical.

4.4.6 Perception of Independence

The regulators in India are generally independent in varying degrees, although there is scope for greater independence (not absolute independence) for all of them. What surely needs improvement is the public perception about their independence. If a regulator brings in a measure which is not liked by some market participants, they generally use their influence to seek intervention of the Government to persuade or influence the regulator to withdraw or modify the measure. During the initial and formative days of SEBI, whenever a measure was initiated, it was common for the affected market participants to seek government intervention. On one such occasion, the then SEBI Chairman Mr. G. V. Ramakrishna is stated to have once remarked that the way to Mittal Court (then SEBI office) from Dalal Street is not via North Block (the headquarters of Ministry of Finance). This happens because of the perception that the affected parties can protect their interest if they can adequately influence the Government, which is policy maker and principal of the regulator. To the extent the vested interest groups succeed in their endeavours, this perception gets reinforced.

Further, the courts in India pass thousands of orders every day or set aside the orders passed by lower judiciary. These hardly get reported in media and rarely criticised for appropriateness. These rather serve as learning tools for professionals. The losing party respects the orders even while appealing against the same before the higher judiciary. Unfortunately, the same is not true of a quasi-judicial order passed by a regulator. The affected parties at times resort to media campaigns against such orders of the regulators as well as the functionary who has passed the orders. This happens because of the perception that the orders of the judiciary cannot be influenced, while that of a regulator, which is considered an extension of the executive, can be. The judiciary has earned this kind of credibility over centuries of impartial and objective work, while the regulator is a new kid in the block. The regulators need to demonstrate objectivity and impartiality in their orders for years and the public needs to notice such objectivity and impartiality.

4.5 Accountability of Regulator

Non-accountability is most desirable when (a) the electorate is poorly informed about the optimal action, (b) acquiring decision relevant information is costly, and (c) feedback about the quality of decisions is slow. Therefore, technical decisions, in particular, may be best allocated to judges or appointed bureaucrats [Maskin and Tirole, 2004, Pp. 1034-1054]. Nevertheless, the Government is ultimately accountable to the people for governance through the regulator. Since the regulator is not directly accountable, it may not always be as sensitive to the consequences of its omissions and commissions. This calls for a well-crafted accountability mechanism to avoid possible failure of the regulator. However, this does not call for a well-crafted control mechanism over the operations and the management of the regulator. It is important to note that accountability is not synonymous with control and less of autonomy. In fact, the higher the level of autonomy, the greater is the accountability and *vice versa*. In other words, the accountability should be commensurate to the level of autonomy.

Current accountability arrangements in India focus mainly on their role as regulators, probably because they are so perceived. Through the administrative ministries, the regulators lay on the table of the Parliament subordinate legislation, annual report detailing their activities and performance, and statement of accounts audited by the C&AG. The departmental standing committees scrutinise their activities while approving their demand for grants or the demand for grants of their administrative ministries, as the case may be. They are obliged to carry out the policy directions of the Government. In the face of substantial failure, the Government has the power to reconstitute the regulators under specified circumstances by following a special procedure. Their orders are subject to appeal, generally before a tribunal, with provision of judicial review to the Hon'ble Supreme Court.

There are comparable bodies in other countries. A case in point is the Securities and Exchange Commission in the USA. It is required to consult the stakeholders and the public, and reveal the associated costs and benefits, while making subordinate legislation. Its budget as well as the subordinate legislation with important bearings needs to be pre-approved by the Congress. It appears before the Congress twice a year and gives testimony before the congressional oversight committees as often as required. The Government Accountability Office (GAO) generally assesses its performance in terms of its objectives and efficiency and reports to the Congress. It seeks administrative sanctions from an administrative law judge. It refers matters to the Justice Department for launching prosecution before the District criminal court. Another regulator, namely, the Commodity Futures Trading Commission, has to even justify its continuation every five years before the Congress. The accountability arrangements are well laid out in the UK, where a 'private limited company' acts as the Financial Services Authority (FSA).[51] It reports to the Parliament through the Treasury and the Director General of Fair Trading keeps a watch from the sidelines on the conformity of the FSA's regulatory actions. It publishes an annual performance account of the fairness and effectiveness of its own enforcement process, half-yearly performance account for service standards and customer satisfaction, quarterly performance account on business plan milestones, etc.

There are certain standard arrangements that advanced jurisdictions have adopted for ensuring the accountability of the regulators. These include: (a) ex-ante accountability such as consultation with the public and the stakeholders before taking an action, (b) ex-post accountability such as reporting actions already taken, (c) explanatory accountability such as disclosure of the rationale of the actions, (d) procedural accountability such as adhering to standards of procedural fairness and transparency, and (e) performance accountability such as achievement in terms of objectives. The accountability arrangements rest on five main planks: (a) articulation of the responsibilities, objectives and targets against which the regulators may be held accountable, (b) provision of powers, resources and capacity of the regulators matching their assigned responsibilities, (c) assignment of the affairs of the regulators to competent people who are comfortable with the accountability arrangements, (d) identification of stake holders to whom the regulators may be accountable, and (e) education of the stake holders about the manner of ensuring the accountability [IMF, 2006]. FSLRC [MOF, 2013a] has enumerated four components of accountability, namely, clarity of purpose, a well-structured regulation-making process, the rule of law, and reporting mechanisms.

With the growing reliance on the regulators for governance, it is important to follow a holistic approach to building a uniform system of accountability. As stated earlier, regulators are not averse to being accountable to the legislature and the judiciary. They, being extensions of the executive, have hesitation to be accountable to the executive, even though the Minister is accountable to the legislature for the actions and inactions of the regulator. The trend in advanced jurisdictions is to give regulators almost complete autonomy from the executive and make them accountable to the legislature and the judiciary directly as much as possible. This is all the more necessary because Government is often a party before SEBI. In a different context, the Hon'ble Supreme Court [2014b] struck down the National Tax Tribunal Act, 2005, *inter alia* on the ground that Government is a party before the NTT and has administrative powers over NTT and, therefore, NTT is not totally insulated from all forms of interference, pressure or influence from co-ordinate branches of Government. The law should clearly articulate precise objectives of the regulator. It should also spell out specific responsibilities of the regulatory board and regulatory organisation within the regulator. Currently, the SEBI Act 1992 does not make any distinction between the board of SEBI and the SEBI, which is a board. This is necessary to fix responsibility. The executive should man the regulators with capable people who value independence and are comfortable with the accountability arrangements, and make provision for resources matching their responsibilities. It must not attempt to review any action of the regulator, not even its executive actions. The judiciary may exercise oversight over the quasi-judicial activities of the regulators through dedicated specialised tribunals with provision for further appeals to the Hon'ble Supreme Court. This would help rapid review of regulatory actions, develop case laws and enforce discipline in the quasi-judicial process followed by regulators. This would enable an aggrieved party to access a quick, efficacious and inexpensive mechanism to secure justice.

Planning Commission [2008b] recommends that the regulator should be directly responsible to the legislature for the ways in which it chooses to administer the policy subject to the caveat that the legislative oversight of the minister concerned should exclude those areas where the regulator is directly accountable. The legislature may exercise general oversight over the quasi-legislative and the executive activities of regulators. Given the number of regulators across the economy and the volume of their activities, and the pressure on legislature to deliberate the various Bills brought before it, the legislature needs to set up legislative committees, each of which would exercise oversight over a few regulators on its behalf. The committee should engage professional agencies or a group of independent experts to monitor and review on an ongoing basis the working of the regulators *vis-à-vis* that of others in its peer group within the country and overseas, and submit reports for its consideration. It may examine the subordinate legislations, the reports submitted by the regulators on their working and the reports submitted by professional agencies on the working of the regulators and make its recommendations. The regulators may have opportunity to explain their conduct and performance to the said committee. The committee and the regulators should meet at regular intervals, instead of having event specific meetings which could be clouded with impressions from the event.

Government may create a new department, called Department of Regulatory Affairs (DRA), for developing standards / best practices for establishment of regulators, including accountability arrangements, developing standards for rule making and enforcement of rules by them, and for promoting the best practices across the regulators. The Regulatory Selection Board (RSB) may be housed inside DRA. This will keep away the bias of the administrative ministry which is deeply involved in the subject. The crux of the issue is to spell out ex-ante the mechanism of accountability to the legislature, the executive, the judiciary and the other stakeholders at large and to institutionalise the same along with matching resources and capability so that it does not suffer from subjectivity. The legislature and the judiciary must ensure that the executive and the regulators adhere to those standards and best practices. The regulators may disclose all relevant information to their stake holders and take their inputs for making laws and their decision-making process may be transparent to the public. They may disclose their performance in different areas on various parameters at periodic intervals, as they often require the regulated entities to do. The Government and the regulator should educate the stakeholders about the accountability mechanism pertaining to the regulators.

4.5.1 Measuring Performance

The accountability arrangement must include an objective measure to measure the effectiveness of the regulator. It is because the quality of regulation affects performance of the country. A heavily regulated economy may grow on average by about 2% to 3% less per annum than less heavily regulated ones [Parker & Kirkpatrick, 2012]. One way could be to measure the performance of the regulator in terms of market outcomes, such as performance in attracting listings, cost of equity and/or equity risk premium, market size, transaction costs, market cleanliness, and breadth of participation and ownership [City of London, 2009]. These are market-based and represent outcomes for investors and firms seeking capital, and for market participants.

SEBI has adopted a four-pronged strategy to pursue its objectives. It endeavours to ensure that (i) the investor learns investing, obtains and uses information required for investing, and takes certain precautions; (ii) the market participants reveal relevant details about themselves, the products, the market and the regulations so that the investor has full knowledge about the market; (iii) the market has systems and practices which make transactions safe, only the fit and proper persons are allowed to operate in the market, every participant has incentive to comply with the prescribed standards, and there is assurance that the miscreant will be awarded exemplary punishment; and (iv) the investor is fully indemnified, if he happens to lose money due to failure of any system or participant, malafide or otherwise [MOF, 2005]. The outcome of this strategy is reflected by the number of investors participating in the securities markets or the number of investor complaints. The regulator passes a large number of quasi-judicial orders. These are scrutinised by an appellate authority. The percentage of orders of regulator upheld by the appellate authority reflects the quality of orders and hence the performance of the regulator.

Another way could be to measure the health of securities market. In view of our obsession with prices, the immediate temptation is to use the stock index for the purpose. A stock price index hides more than it reveals. It reveals the health of the listed companies and the economy, but eclipses the health of the stock market [Nair & Sahoo, 2007a]. The sporadic attempts such as financial sector assessment programme (FSAP) take snap shots on the health of the stock market. The assessment of the health of the stock market requires a more holistic approach, involving evaluation of the structure, processes and designs of the market contributing to the fairness, integrity and credibility of the market. This calls for the development of an index to track the health of the stock market comprehensively. This would involve identification/development of performance indicators (parameters) that can capture the health of different components of the market, determination of their weights in the index, maintenance of database to capture these parameters scientifically on an ongoing basis and churning out the index at regular intervals.

The index should capture the entire market - primary market, secondary market, tertiary (derivatives) market, CISs and globalisation of the market. Their weights would vary depending on their relative importance. For example, since primary market has a predominant role in capital formation and resource allocation, which are the main objectives of the stock market, it may have a relatively larger weight in the index. The elements within each segment need to be determined based on the expectations of the country / economy, regulators, intermediaries, issuers and investors who are the stakeholders of the stock market. All of them expect that the market should be efficient, defined in the neo-classical sense of low transaction cost. Similarly, they expect the market to be safe. The elements that may be considered in each segment may, therefore, include: cost of transactions, safety of transactions, reliability of transaction infrastructure, ease of transaction, product range, quality and speed of enforcement actions, quality of intermediation services, level of investor protection, transaction volumes, etc.

Under each of these elements, there can be a few parameters. For example, safety element may have parameters like property rights, risk management mechanism, certainty of transactions, etc. The level of investor protection may be derived from the number of complaints received against issuers and intermediaries, average time taken to redress a grievance, expenditure on investor awareness and education, the size of investor protection funds, funds used from investor protection funds, incidence of class actions, etc. The level of participation may be measured by amount raised from primary market, turnover in secondary market, number of beneficial accounts with depositories, etc. However, these need to be suitably adjusted for seasonal or extraneous factors. For example, the volume of transactions may be very high because of macroeconomic fundamentals without any improvement in market design. This needs to be addressed by use of relative figures such as volume of transactions in stock market *vis-à-vis* that in banking channel or as a percentage of GDP. Thus, assuming 'm' segments in the market, 'n' elements in each segment, and 'p' parameters in each element, there would 'mnp' parameters in the index.

Many of the parameters identified may not be amenable to objective quantification. In such cases, proxies need to be used. For example, the ease of transaction is very subjective. One way to look at can be the availability of transaction front ends close to the location of participants. Another way could be the liquidity in the market so that a participant does not have to incur substantial search costs. A combination of such proxies needs to be used in case of subjective parameters. Further, some parameters may become obsolete and hence these need to be substituted by appropriate emerging parameters to remain abreast with the environment. The parameters as well as their weights also need to be fine-tuned by an iterative process keeping in view the practical constraints and need for timely availability of the index. Of course, developing such an index involves major exercises on the learning curve. This comprehensive index would reveal the health of the stock market. The contributory factors to the movement of this index will alert the authorities on hot spots and help in timely and informed policy making.

4.6 Internal Design of Regulator

The regulators are extremely powerful creations by their design and stature. They have quasi-legislative, executive and quasi-judicial powers rolled into one, while in statecraft these functions have been separated into legislative, executive and judicial functions and assigned to separate agencies to facilitate mutual checks and balances. The regulators, therefore, derive extra-ordinary powers arising from the fusion of quasi-legislative, executive and quasi-judicial powers. The Hon'ble Supreme Court made (2004) an interesting observation in the context of SEBI's powers: "The SEBI Act confers a wide jurisdiction upon the Board. Its duties and functions thereunder, run counter to the doctrine of separation of powers. Integration of power by vesting legislative, executive and judicial powers in the same body, in future, may raise a several public law concerns as the principle of control of one body over the other was the central theme underlying the doctrine of separation of powers" (Pp. 19-20). Though the Constitution of India does not envisage strict separation of powers, it does indeed make horizontal division of powers among the legislature, the executive and the judiciary. In keeping with the spirit of the constitutional provisions, every regulator must ensure that its three wings exercise quasi-legislative, executive and quasi-judicial powers with independence and without intra-institutional bargaining and, thereby, avoid potential public law concerns prognosticated by the Hon'ble Supreme Court. This requires the three wings to have disinfect able distance from one another, a system of mutual checks and balances to prevent any excess, and robust and transparent systems and processes required for judicious and professional interventions.

One critical function of regulators is making regulations. Most of the statutes creating regulators are silent about its process. For example, the SEBI Act, 1992 merely states that the regulations shall be made in the interest of investors and markets and after the notification of the regulations, the same shall be laid on the tables of the Parliament. Even though it is not a statutory requirement, many regulators have evolved a transparent and consultative process to make regulations. Another critical function is the initiation and the disposal of the enforcement actions. The Act and regulations made thereunder generally do not provide the process. Nevertheless, the regulator should ensure that the process is just and fair. This means that the accused should have adequate notice, provisions of documents / evidence relied upon by the regulator, and reasonable opportunity to defend. This could be formalised by the regulators setting up dedicated quasi-judicial units and posting officers to that department on a tenure basis. This would be akin to the process before the Administrative Law Judge where the representatives of the SEC and the accused present their case. These two functions are dealt in greater detail in Sections 4 and 5, respectively.

There must be time-lines for completion of every activity of the regulator. It must dispose of any application from market participants, such as for registration, within a specified time. It must grant approval if the application meets the requirements. If it rejects an application, it must do so by a speaking order after providing an opportunity of hearing. It must complete the various processes such as inspection, investigation, enquiry, audit, etc., in a time bound manner. It must initiate appropriate enforcement actions immediately on conclusion of the fact-finding process. It must conclude the enforcement actions expeditiously because delay defeats justice and causes hardships to the accused as well as the victims. The Government and the regulator should be held accountable if disposal of a matter is delayed beyond the specified timeline. The affected person may seek legal remedy if there is undue delay and the cost of such remedy should be borne by the Government or the regulator, as the case may be. The standards, norms and processes[52] applicable for every regulatory action (quasi-legislative, executive and quasi-judicial) must be available in public domain. The regulator must develop and publish operations manuals for each of its major activities.

We have to bear in mind that the regulators are popularly known as regulators in their respective areas. This can create perverse incentives in the sense that these agencies focus only on regulation and not so much on the other objectives formally assigned to them and the public too evaluates their performance only in the area of regulation. As a result, either they do not perform that well in extra-regulatory areas or their performance in those areas are not noticed. Further, quite often, they have apparently conflicting objectives. Most regulators have the mandate to protect the consumers and to develop the market. It is possible that a measure which promotes market development may not necessarily promote consumer protection. As a result, a regulator may not take any developmental initiative which has the potential to adversely affect the interests of the consumers. This defeats the very purpose of creation of the regulators. They need to pursue all their objectives simultaneously and manage the conflicts skillfully.

There have been sceptics of regulators from early on. Particularly relevant was the powerful argument advanced by George Stigler in the early 1970s about regulatory capture. In its simplest form, it was argued that the regulatory agencies would come to espouse the cause of the industry which they are supposed to regulate rather than the cause of the consumers whom they are supposed to protect. Dalal claims [2013] that SEBI protects everyone but the common investor it was created to protect. Generally, sector-specific regulators are more susceptible to regulatory capture than economy-wide agencies[53] for a variety of reasons. Regulatory capture and regulatory bargaining in a multi-regulatory environment provided a strong concoction for their lethargy and consequently regulatory collapse in the run up to the recent financial crisis. The regulators not only supported the conflict-of-interest-ridden organisational structures and product over-innovations of the high street but also adopted 'feather-touch' regulation and oversight of these entities and their activities. The important lesson from the financial crisis is that the regulators need to build their capability to withstand the influence of the regulated. Like a chess master who sees many moves in advance, regulators must visualise the implications of organisational structures, products and practices of market participants and 'front-run' the financial Frankensteins rather than becoming their worshippers dazzled by their innovations [Nair & Sahoo, 2008b].

They also need to build capacity that would inspire the confidence of the consumers and the regulated. Their expertise must be such that their findings enjoy deference from judiciary, something similar to the doctrine of deference in the USA. The judiciary should not disturb the professional findings of a regulator unless it is malafide. They should have professional decision-making process based on adequate research and consultation with the stakeholders. To supplement their in-house talent, they must use expertise available outside through advisory groups and public consultations. They should undertake at periodic intervals self-assessment of their own performance and disseminate the outcome of such assessment. They should disclose their performance against pre-set benchmarks quarterly, semi-annually and annually. They should continuously rebuild the oragnisation to meet the dynamism of the market they oversee. This will build credibility of the organisation.

4.7 Co-operation and Partnership

A regulator needs to recognise that it alone does not have the exclusive jurisdiction over extra-regulatory activities and that it is only a part of the governance ecosystem. It must, therefore, actively seek the support of the Government and other regulators involved as well as the market participants while pursuing extra-regulatory activities. For example, no single agency can do by itself enough in the area of financial literacy. This requires pooling of resources and promoting public-private partnership. Similarly, a regulator should seek co-operation from the Government and the other regulators while pursuing its regulatory objectives. It must, in turn, extend its support and co-operation to the Government and the other regulators whenever called upon to do so. It must establish harmonious relationship with the Government and the other regulators as it would not be able to deliver effective governance on its own.

4.7.1 Partnership with Government

As stated earlier, both DEA and SEBI have jurisdiction over the securities market. Even the SEBI Act, 1992 empowers both to make rules and regulations respectively to further the objectives of the Act. This overlap leaves scope for duplicity and inconsistency in the measures and shifting of responsibilities at the time of crisis. More importantly, this gives an impression that the market participants can pursue their objectives with either of them. In the early days of SEBI, the affected regulated entities used to take the first available flight to North Block with every significant restriction that it imposed on them. This happened because many genuinely believed that SEBI was subordinate to the Ministry, it had no option but to act the way the Ministry wished, and the Ministry had a legitimate role in the matter. In order to reinforce the independence of the regulators and to promote harmonious relationship between the Ministry and the regulator, it is useful to discourage such attempts by the regulated entities.

This is difficult to achieve in practice as the Ministry is called upon to explain the conduct and performance of the regulator before the legislature and the Government has the responsibility to deliver the governance in the area assigned to the regulator. For example, the MOF is called upon to explain to the Parliament the developments in the securities market, including the performance of SEBI, even though the Government has assigned the governance of securities market to SEBI. Further, the Ministry quite often receives complaints of citizens against economic agents regulated by regulators and also regulators themselves. In such cases, the Ministry faces a dilemma. If it does not intervene in the matter, it runs the risk of being perceived as ineffective or insensitive to citizens. If it calls for a report or seeks certain actions from the regulator, it is construed as interference. Given the precarious position of the Ministry *vis-à-vis* the regulator, the latter must never put the former in a spot.

One option is to allow the regulators to explain their quasi-legislative and the executive activities directly to a department related standing parliamentary committee, which may, after consideration of all issues, give appropriate advices, not directions, within the confines of the Act. The committee may evolve a structured mechanism to receive inputs on matters of policy from the stakeholders and intervene, in a transparent manner, in such matters after hearing the regulator. Another option is to ensure that the regulators have staff who have competence and integrity and who inspire confidence among the citizens. The Ministry can then forward the complaints to the regulator and allow it to take action as it may consider appropriate. In addition, the Ministry must abdicate / refrain from using its powers of making rules, except on the establishment matters of the regulator. This requires a well calibrated co-ordination between the Government and the regulator and understanding and mutual respect for each other.

One objective of the governance through the regulators is to improve efficiency which is not otherwise possible within the usual statecraft. It is imperative to let the regulators have their own processes and procedures, that enhance efficiency, to deal with a matter, rather than adopt the processes and procedures followed by the Government. Sometimes, however, the Government expects and the regulators follow, either on account of inertia or fear of going wrong, the processes and procedures established in the Government. For example, the circumstances may warrant an immediate advertisement in the press in the interest of the consumers. The government process requires it to be issued through Directorate of Advertising & Visual Publicity. If this process is followed, the advertisement may not appear in papers immediately and thereby defeat the very purpose of the advertisement. Therefore, the regulators need to evolve their own process, with adequate checks and balances to avoid any possible misuse, of issuing advertisements. Similarly, the regulators need to develop specialised skills matching the tasks by breaking away from the HR policies of the Government. Their effectiveness would remain a challenge if they were to compensate their staff at par with the government employees. They should have their own recruitment processes and pay structures to attract and retain the talent appropriate for their task. The agencies like C&AG, Central Vigilance Commission, Central Bureau of Investigation (CBI) should insist on adherence to the standards and the practices evolved by regulators and / or by the DRA.

The regulators have defined boundaries in terms of products, participants, and geographies and have limited powers and responsibilities. Certain situations may demand exercise of powers beyond these boundaries or exercise of more powers than those available with them. This realisation comes only with practical experience. For example, SEBI needed telephone call records of some persons to establish their involvement in a fraud. Government, which is sovereign, ensured this recently through the Securities Laws (Amendment) Act, 2014. Similarly, a regulator may need certain information from another agency, domestic or overseas, to unravel the design of the fraudsters. It may need to follow up on the activities of a certain entity overseas. It may need powers to issue interim directions pending enquiry or investigation. In such cases, the Government needs to empower the regulator to do these things. It also needs to facilitate them by bringing together the various agencies for a common purpose in the public interest. For example, the development of the corporate debt market needs support of the Central Government, the State Governments, and many regulators. In such cases, the Government needs to not only extend its support, but also garner the support of the State Governments and the concerned regulators.

Let us now turn to the conflict of interest arising from the Government's dual role of a policy maker and a market participant. Quite often, the government-owned enterprises participate in the market and compete with the private enterprises. It may not always be possible for the Government to treat the PSUs and the private enterprises at par and there is a possibility that the market would view the government policies and regulations with suspicion that they promote the interests of the PSUs. This is one of the main reasons why the Government established regulators to oversee the activities and markets where PSUs also participate. This builds the perception that both the PSUs and the private enterprises have the same level-playing field. The PSUs, who are creations of the same Government which has created the regulator and who are historically accustomed to special treatments, at times seek and secure exemption from compliance with some of the regulations of the regulators. Let us take an extreme example of how this can potentially happen. Let us say a PSU has issued a class of securities on certain terms in compliance with the securities laws. As the market conditions change, it may find such terms unfavourable. But it cannot change the terms of issue under the securities laws. However, the legislature can enact a new law to change the terms of issue applicable to the PSUs. While the legislature can enact overriding laws in public interest, such an approach undermines the governance through regulators. Another example is the implementation of corporate governance standards. SEBI is not enforcing these standards on listed companies because many PSUs do not comply with the same. There are different norms of public holding for PSUs and other companies. On the other hand, the PSUs, because of their parentage, often demonstrate a higher level of compliance with the regulations prescribed by the regulators. Once the PSUs lead the way, the others fall in line. This facilitates easy acceptance of reforms and new regulations.

4.7.2 Co-operation among the Regulators

Government has been creating regulators for every possible niche area. Let us look at the financial markets. Traditionally, businesses were clearly differentiated - banks offered banking services, insurance companies offered risk sharing, securities companies offered resource allocation and employers provided pension - an entity carried on only one kind of business. This established entity-based regulation and separated the supervisory structures along the business lines. Thus, we have RBI as the primary regulator for banking, IRDAI for insurance, SEBI for securities markets and PFRDA for pensions. Add commodity derivatives, and we have one more market regulator, namely, FMC. The number increases further if we add the administrative ministries associated with each of these regulators and the authorities responsible for the governance of each kind of market participants. To complicate the matrix, a few authorities jointly and concurrently regulate certain segments. For example, MOF, MCA, RBI and SEBI regulate different aspects of securities markets simultaneously. There are also sub-regulators, such as National Bank for Agriculture and Rural Development (NABARD) and National Housing Bank (NHB), and general regulators, like CCI as well as regulators at the central and the state level. A large number of SROs and industry bodies, who litter the regulatory canvas, share the responsibility of regulation with the primary regulators.

In the recent decades, the economies of scale and scope together with deregulation and globalisation have blurred the legal and geographic boundaries between markets in banking, securities, insurance and pension. Consequently, we now have financial supermarkets - entities that simultaneously engage in activities that come under the purview of multiple regulators. This prompted a shift to activity-based regulation: an entity carrying on three different businesses is simultaneously regulated by three different sectoral regulators as well as many administrative ministries, general regulators, sub-regulators and SROs. Thus, the regulatory architecture of the financial sector in India is as complex as it could be.

The matrix of markets, products and participants in different segments-banking, insurance, securities and pensions- at different layers-sub-national, national and supra-national- exhibit considerable overlaps, gaps and twilight zones. This overlap leaves scope for duplicity and inconsistency in regulations and shifting of responsibilities at the time of a crisis. Such overlap has often ended up in the courts, such as the dispute between the Central Electricity Regulatory Commission (CERC) and the FMC over the development and the regulation of the market for ‘power’. It occasionally leads to prescription of competing standards such as in the area of corporate governance by SEBI and the MCA. On the other hand, there are instances where no regulator takes any initiative because it is the responsibility of many regulators. For example, we do not yet have a framework for grooming and regulating investment advisers,[54] who operate in the jurisdictions of many regulators. There have been problems with regulatory gaps also. In fact, the unregulated market has been the bane of the extant regulatory structure [Sahoo, 2013a]. For example, taking advantage of the gaps, plantation schemes merrily collected thousands of crores of rupees from innocent investors in the mid-1990s and the debate on who would regulate such schemes went on till a scam of sort broke out. We have twilight zones when a market or product has many elements and these elements are under the jurisdiction of different regulators. This sometimes leads to quarrels between the regulators: in one such instance involving determination of the regulatory jurisdiction over a financial product (ULIP), the then Finance Minister, Mr. Pranab Mukherjee lamented in Parliament that the regulators were quarrelling like petulant children and the Government had to step in through an ordinance, which has since been replaced by the Securities and Insurance Laws (Amendment and Validation) Act, 2010.

Further, there is a potential for tension between the general regulators and the specialised regulators. While one deals with a particular market, another may deal with one aspect of every market. For example, the CCI deals with competition issues in all markets while SEBI deals with all aspects of the securities market. Both these regulators may wish to have independence to determine the pace and manner in which to usher in competition into the securities market. Such determination by one may amount to 'interference' in the domain of the other. The regulators need to develop inter-institutional arrangements, which are made publicly available so that the market participants are aware of the respective jurisdictions.

There are certain infrastructures, which if developed, will be useful for all the segments of the financial markets. From the perspective of each regulator, private benefits fall short of private costs resulting in under investment in such infrastructure and consequentially underdevelopment of the market. Cooperation among the regulators has the potential to overcome such problems, as it would help look at public benefits and public costs of such infrastructure more objectively and holistically. For example, every regulator in financial markets tends to under-invest in financial literacy; the problem can be addressed if they work together. Further, some activities require efforts of many regulators. We would not be having a flourishing exchange-traded currency derivatives market today but for the very fruitful co-ordination between RBI and SEBI. Similarly, we would not be able to take the proceedings relating to a financial sector scam, the tentacles of which spreads over the entire financial market and even beyond, to a successful logical end, if every regulator takes a limited view of the irregularity in its jurisdiction only.

Every regulator follows a unique approach or process. This distorts the level-playing field and creates arbitrage opportunities. For example, one regulator may develop market for a product by laying down a conducive market design, while another may develop the market for an essentially similar product by soliciting business for the same. Similarly, one regulator may cancel the registration of a market participant, while another may impose a monetary penalty for a similar kind of irregularity. One may follow judicial process to dispense penalty, while another may follow administrative process. Different regulators have laid down different standards and processes for the participants and their activities. Though the standards need to differ based on the nature of the activities, there are certain fundamental standards common to all of them. For example, a market participant has to be a fit and proper person. Unfortunately, we do not have this requirement in all segments of the financial markets. At times, similar products get different treatments in different jurisdictions because these are so permitted or so promoted by two different regulators. Similarly, we have different degrees of outsourcing, self-regulation, transparency, consumer protection, etc., which distort the landscape. A multi-layer regulatory approach to various intermediaries of the financial sector, with different regulatory prescriptions, may lead to a regulatory arbitrage [MOF, 2009].

One extreme solution is to have one regulator for the entire financial sector, another for all utilities, etc., to avoid the issues arising from multiple regulators. Keeping some of these concerns and the synergy in view, FSLRC [MOF, 2013a] has recommended creation of Unified Financial Agency (UFA)[55] to take over the responsibilities of RBI (trading related matters), SEBI, IRDAI, FMC, and PFRDA. However, if this argument is extended further, we could end up having only one regulator for all kinds of activities / markets. This would, however, deprive us of the advantages of domain expertise of the regulators. The aim should be not to have too many regulators, nor too few. There is a need for regulators for reasonably compact areas and the responsibilities among them need to be demarcated as clearly as possible. Gaps and overlaps need to be avoided to the extent possible. Despite extreme care, it would still not be possible to contain the market into water-tight compartments. The regulators as well as the Government would need to complement one another. This would require an institutionalised approach to coordination at multiple levels among the regulators and between the Government and the regulators. There is an attempt to achieve this in the financial sector through the establishment of FSDC.

4.7.3 Engagement with Institutions

There are many institutions which are not specific to securities market, but have profound bearing on securities markets. Black [2000] has listed a large number of such institutions. Even with all-round development of securities market institutions, the securities markets may not achieve much if other institutions are weak. For example, the market needs accountants to certify financial statements which form the basis of investment decisions. This onerous responsibility requires that the accountants have the capability to understand the designs of the clients, ethical standards not to succumb to pressures of clients, and fear of risk of liability for making false or misleading financial statements. If the market has accountants of the genre who certified accounts of Satyam Computer Services (Satyam), the investor would not trust the certificates of accountants and would never invest in securities. This requires a passionate agency to develop accountancy competence and discipline the accounting profession. Similarly, the market needs a judiciary that is honest, prompt and understands sophisticated web of transactions. It can't wait indefinitely for resolution of a matter just as a cricket match can't wait for a year to get a decision from the third umpire. The market would come to standstill or manipulation would continue if a decision is not given. The major issuers of securities are companies. The companies need to have certain minimum governance norms which are enforced under the company law. The market needs an efficient company law along with an efficient machinery to enforce the same. An active financial press, an active securities analysis profession, an active proxy advisory firms, etc. are required to uncover and publicise instances of misdemeanours. The regulator must make special efforts to engage with concerned agencies to develop these institutions.

4.8 End Note

Governance through the regulators is still evolving. There is yet no comprehensive review of this model of governance in India. The reviews elsewhere seem to indicate that while such agencies have been successful in securing better protection of the customers, in a few cases their work has become disconnected with the objectives of the elected Governments. The impression prevails that some of the regulators in India have earned credibility at par with constitutional bodies. In an article Dhume [2010] observed: "Unlike many developing countries, India has a record of sustaining credible institutions, among them the Supreme Court, the Election Commission and the Securities and Exchange Board of India". At the other extreme, one [Srinivasan, 2014] considers SEBI as a dragon. Nevertheless, there is a need for a comprehensive review of the experience so far of governance through the regulators and use the learning to improve the location and design of the regulators to make them more effective.

Government has not laid down the standards for the establishment and the operations of the regulators. Every administrative ministry invents a model based on its expectations from the regulator. A careful analysis of the existing legal, policy and institutional framework in India reveals a somewhat haphazard and uneven approach to regulation across and within different sectors of the economy resulting in inadequate and expensive reform [Planning Commission, 2008b]. As a result, the structure of regulators differs widely. For example, for some regulators, there are dedicated tribunals to scrutinise their orders and act as appellate authorities, while for the others, there are no such mechanisms. In some cases, the Government itself is the appellate authority against the orders of the regulators. Similarly, some regulators have their own independent budgets, while the others depend on grants from the Government. Some regulators have representatives of the Government in their governing boards, while some others do not have such representation. Some regulators have only whole-time members (WTMs); some others have mostly part-time members. While some degree of flexibility is necessary, there is a need for some overarching principles that would guide the establishment as well as the operations of the regulators. In this respect, the executive agency framework of the UK may provide some useful guidance. This format may also cover the best practices to be followed by a regulator. Department of Regulators can adopt the best provisions and practices based on the experience and incorporate those into the charter to serve as a guide for the ministries.

Regulators are the result of extended delegation: from the people to the legislature to the executive to the regulators. Given the complex issues relating to regulators as new mechanisms of governance, their design and location have to be an integral part of a larger vision and unifying goal of public interest. As rightly observed by Anant & Singh [2006, Pp. 121-127], "the central dilemma inherent in the problem of designing effective regulatory institutions... how should such decisions be taken and, notably, where should they be located in the wider structures of governance?" (p. 121). Even with a charter in place, the administrative ministry needs to be more than a visionary in designing and spacing each new regulator or in restructuring an existing regulator. However, a regulator should be created only after it is considered the most appropriate delivery mechanism based on a business review. It should cease to exist on completion of every fifth year unless it is extended by a Reauthorisation Act after a legislative evaluation of its working in the preceding five years and of the need for its continued existence in the changed environment.

The Constitution of India does not explicitly recognise the regulators as a mechanism for governance. When governance through the local self-governments was considered necessary, the Constitution was amended to explicitly recognise them and specify their responsibilities, including their autonomy and accountability arrangements. Perhaps, the time now has come when a clear Constitutional provision may be considered to explicitly recognise the regulators and provide for an appropriate and uniform autonomy-accountability framework for them. While deciding their 'space' in the constitutional schema, it would be ideal to define the 'autonomy' arrangements of the regulators *vis-à-vis* the three organs of the State - the legislature, the executive and the judiciary. Similarly, it would be useful to specify the 'accountability' arrangements for the regulators *vis-à-vis* the various stakeholders. This is necessary to clear the cobweb of the 'practical' aspects of independence, avoid the institutional tensions, and minimise the transaction costs in an increasingly information asymmetric world.

A major component of governance is how regulations are made for the securities market. The Section 5 deals with making of regulations.

SECTION 5
REGULATING REGULATIONS[56]

5.1 Subordinate Legislation

Legislation is either supreme or subordinate. The former emanates from the legislature while the latter from the executive and these together constitute the law. The latter is a statutory instrument made by the executive, which is a body subordinate to the legislature, and in exercise of power, within specific limits, conferred by the legislature. The Hon'ble Supreme Court [1974] explained its need: "Most of the modern socioeconomic legislations passed by legislature lay down the guiding principles and the legislative policy. The legislatures because of limitations imposed upon the time factor hardly go into matters of details. Provision is, therefore, made for delegated legislation to obtain flexibility, elasticity, expedition and opportunity for experimentation. The practice of empowering the executive to make subordinate legislation within a prescribed sphere has evolved out of practical necessity and pragmatic needs of a modern welfare State" (p. 1667). It [2003] reiterated: "The main justification for delegated legislation is that the legislature being overburdened and the needs of the modern-day society being complex it cannot possibly foresee every administrative difficulty that may arise after the Statute has begun to operate. Delegated legislation fills those needs. The Regulations made under power conferred by the Statute are supporting legislation and have the force and affect, if validly made, as the Act passed by the competent legislature" (p. 5).

Kaul & Shakdher [2009] elaborated: "In a modern welfare State, governmental activity has pervaded almost every field of human endeavour, thus, necessitating enactment of multifarious laws to regulate this ever-widening activity. The Legislature does not have enough time to deliberate upon, discuss and approve all the regulatory measures. Moreover, law-making has now become a complicated and technical matter, and law has to be flawless in technical details" (pp. 667-668). Thus, delegated legislations serves four purposes: (a) legislature has limited time in comparison to the number of maters to be dealt; (b) the legislature may not have detailed technical expertise relating to all matters to be dealt; (c) legislations can't be amended frequently to deal with rapidly changing or uncertain situations; and (d) legislations may not allow for swift action in the case of an emergency in all circumstances.

The ambit of subordinate legislation, which includes amendment, variation or rescission of thereof, is very limited. The Hon'ble Supreme Court [1972] observed: "The legal position as regards the limitation of this power is, however, no longer in doubt. The delegation of legislative power is permissible only when the legislative policy and principle are adequately laid down and the delegate is only empowered to carry out the subsidiary policy within the guidelines laid down by the Legislature. The Legislature, it must be borne in mind, cannot abdicate its authority and cannot pass on to some other body the obligation and the responsibility imposed on it by the Constitution. It can only utilise other bodies or authorities for the purpose of working out the details within the essential principles laid down by it. In each case, therefore, it has to be seen if there is delegation of the essential legislative function or if it is merely a case in which some authority or body other than the Legislature is empowered to work out the subsidiary and ancillary details within the essential guidelines, policy and principles, laid down by the legislative wing of the Government" (p. 1922).

Therefore, the legislation cannot abdicate the essential legislative function in favour of executive and subordinate legislation has to be in strict conformity with the legislative policy. It has to be intra vires the Act, which authorises the subordinate legislation, as well the Constitution. It has to be done in the specified manner with regard to prior consultation or publication, if any, and the final publication. It is subject to judicial scrutiny at the behest of any third party. It needs to be laid before each house of Parliament for specified period and both the houses may agree to modify or annul the same. It should be made as soon as possible and in no case later than six months from the date on which the legislation comes into force. The Committee on Subordinate Legislation looks into every subordinate legislation to satisfy itself that there has been no executive excess or trespass in the exercise of its delegated power.

Take the example of the Companies Act, 2013 [GOI, 2013]. It uses the word ‘prescribed’ 416 times where ‘prescribed’ means prescribed by rules made by the Central Government under the Act. This means that the Government would make rules over 400 matters which, the Bill claimed, are of procedure and detail and it is not practicable to provide for them in the law. It defines ‘Key Managerial Personnel (KMP)’ to mean chief executive officer, company secretary, whole-time director, chief financial officer and such other officers as may be prescribed. It further provides that the companies as may be prescribed would have KMP and KMP would have functions as may be prescribed. This would allow the authorities to deal with the KMPs who are not listed in the Act, should the need arise in future and also the new KMPs that may emerge in future, without an amendment to the law [Sahoo, 2013b]. At the time of enactment, the legislature could not possibly visualise all KMPs who all would need to be regulated in future. The import of this provisions is that KMPs are important and the law needs to deal with them in a particular manner and an officer irrespective of designation can be a KMP depending on the environment and such designation or environment can’t be specified today which would hold good for all times to come. The Government needs to be empowered to deal with a KMP that emerges any time by resorting to ‘prescribed’ without legislative intervention, particularly when this particular legislation has taken almost a decade for enactment.

5.2 Securities Regulations

The SEBI Act, 1992 is a modern socio-economic legislation. It confers on SEBI substantial powers of delegated legislation (quasi-legislative) to make subordinate legislation (regulations) to fill the gaps in laws and to deal with the matters of detail, which rapidly change with time. While the Act is about ten pages, SEBI has framed regulations running into thousands of pages. Raval [2011] rightly observed: "The securities market is regulated more through regulations than through the SEBI Act, 1992" (p. 9). This enables it to strike the moving targets at the right time and at the same time, keep the laws relevant. The Act further confers on SEBI the enforcement, including quasi-judicial, powers to enforce the laws made by the legislature and also by itself. In particular, it can by regulations cast obligations on participants and dispense civil penalties for failure to discharge the said obligations. As a consequence, if SEBI considers a particular conduct undesirable, it can within no time outlaw the same through regulations and enforce such regulations.

SEBI is empowered to make regulations subject to the conditions that the regulations: (a) carry out the purposes of the Act; (b) are consistent with the Act and the rules made thereunder; (c) are made by a notification published in the official gazette; and (d) are laid, as soon as possible, before each House of Parliament for 30 days. There was an apprehension that the Act provided for excessive subordinate legislation. The Hon'ble Delhi High Court [2002] set it at rest with an observation that the provision of parliamentary scrutiny act as a check on power of SEBI and it cannot be called to be a case of excessive delegation. Once it is laid on the table of Parliament and not rejected (affirmation is not required), it is considered as if it has been made by the Parliament. Since 1995,[57] regulations do not require prior approval of Government indicating enhanced autonomy of SEBI.

5.3 Making of Regulations

The securities laws are silent about the process of making regulations. Even though it is not a statutory requirement, SEBI has evolved a transparent and consultative process to make regulations. It has a number of standing advisory committees to deliberate on the evolving issues and their possible resolution. It also appoints ad-hoc committees on specific issues. It generally issues a concept / discussion paper before or after consultation with the standing advisory / ad-hoc committee concerned. It sometimes organizes workshops of stakeholders to elicit their feedback. It examines the feedback on concept / discussion papers internally or through the advisory committees. In exceptional cases, a revised concept / discussion paper is put out seeking another round of comments / feedback. The consultation process factors in ground reality and makes the decisions sound and acceptable by the regulated. Based on the examination of feedback, it formulates an agenda note proposing the necessary regulations. The board of SEBI considers the agenda and approves the proposed regulations with appropriate modifications. While the board agenda and minutes are made available in public domain after a while, the decisions are conveyed through a press release on conclusion of the board meeting and the necessary regulations are issued thereafter through a gazette notification. To cement the process further, SEBI has suggested[58] Central Government to amend the law to make it mandatory for SEBI to consult the public before making regulations except in urgent circumstances and in the consultation process, it shall present the economic implications of the proposed regulations.

Patnaik and Shah [2014] believed that in the current system, unelected officials with independent regulators choose to draft regulations that are the easiest to implement. The regulators are often reluctant to grant permissions for businesses to operate, perhaps because it makes their supervisory tasks more difficult. They impose several prescriptions which restrict creating new kinds of products or processes because it caters to their convenience. These hinder competition and innovation. There are also numerous regulations that stray from the economic purpose of financial regulation—identifying and addressing market failures in finance. Two elements of process make a regulation robust. They are public consultation and economic analysis.

5.3.1 Economic Analysis - A Brief

It may take the form of an analysis of costs and benefits, regulatory impact assessment (RIA) or any other structured methodology to avoid sub-optimal outcomes and subjectivity of decisions. The objective is to ensure that the cost of regulation is less than the cost of market failure which the regulation intends to address. FSLRC [MOF, 2013a] recommends publication of an analysis of costs and benefits of the proposed regulation because every regulatory intervention imposes certain costs on the regulated and the system, and regulations should minimise these costs. It is acknowledged that often pure numerical value-based cost-benefit analysis is not possible. In such cases, the best possible analysis and the reasoning for choice of intervention should be published.

OECD [2008] observed that regulatory impact assessment (RIA) helps to ensure that the regulations are as effective and as efficient as possible. Effective regulation achieves the policy objective(s) for which it is made. Efficient regulation achieves these objectives at the lowest total cost to all members of society. Inappropriate regulation can stifle growth by putting obstacles on the way of doing business and by creating perceptions of a negative environment. It is, therefore, necessary to identify as many different practical ways of addressing a particular problem or achieving a particular objective and assessing their impacts to identify the best of them. It may reveal that there is no case for a regulation. This is possible when the size of the problem is too small to justify regulation or no feasible regulation is likely to address the problem effectively and at a cost that is reasonable in relation to the expected benefits of the regulation. Regulation should be introduced only if it is expected to improve society's economic and social welfare. It keeps the 'whole of society' view in mind, rather than paying undue attention to the impact on individual groups who may be lobbying for regulation. OECD [2012] recommends RIA in the early stages of new regulatory proposals. It advises evaluation of alternatives such as 'regulation' and 'no regulation' and if regulation, which kind of regulation.

Niemyar [2001] proceeded to undertake economic analysis with three classical motives of securities regulation. These are: systemic risks, efficiency and investor protection. The assumptions underlying the concept of systemic risk are that there exists the possibility of a market failure, often in terms of an externality, and if the market fails, it would damage the securities market to such an extent that economic activity in the wider economy would suffer. Take the example of C&S. If a seller of a security is not able to deliver, it may have domino effect on many other traders. One way to address this is prudential regulation on the participants. Another could be treating C&S organizations as public utilities. Each of these solutions impacts the behavior of the participants in view of associated moral hazard or cost considerations. Similarly, the efficiency is affected, among others, by asymmetric information. This is addressed by DBR. This regulation changes the behavior of the participants who are under obligation to disclose as well as the users of disclosures. Investor protection arises, among others, from principal-agent conflict. The neglect of principal's interest can invite stern enforcement actions. The provision of prompt and fair enforcement mechanism would change the behavior of the participants. The intensity of impact would depend on the ability and motive of the agency laying down regulations and the purported costs and benefits to market participants.

Lawrence [1996] revisited the economic rationale by which the effectiveness of securities regulation can be measured. It does so by referring to both the costs and benefits -direct and indirect, explicit and implicit, tangible and intangible- to investors, intermediaries, state, economy and society- of securities regulations in the light of recent empirical research and developments in legal and economic theory. In order to evaluate if the society has adopted optimal regulatory regime, it weighs the purported benefits of regulation against the associated costs. The costs would include transactions costs, opportunity costs, compliance costs and public resource costs. The benefits would include market integrity, investor protection, enhanced competition, minimisation of systemic risk, prevention of fraud, etc. The costs of regulation are generally more direct, upfront and visible while the benefits are not. For example, it is not possible to quantify benefits of avoiding a fraud. That is why we generally have resistance to any new regulation. This requires careful identification and scientific quantification of the costs and the benefits of every proposed regulation to avoid intuitive decisions.

5.3.2 Public Consultation

Rodrik and Subramanian [2003, Pp. 31-34] argued that while economic analysis can help by identifying the incentive effects of alternative arrangements and the relevant tradeoffs, there is a very large role for public deliberation and collective choice within societies. In fact, political democracy is a meta institution that helps societies make choices about the institutions they want. The participation in the regulatory process ensures that regulation serves the public interest and is informed by the legitimate needs of those interested in and affected by regulation [OECD, 2012]. It avoids, at least reduces, the unnecessary or over-costly regulations and improves the quality of the remaining body of regulations. This is all the more necessary, as argued by Glaeser & Shleifer [2003], doing nothing is the most appropriate response to market failure in many times and circumstances. It bridges democratic deficit and ensures that the regulations are within the ‘pith and substance’ of the law. The consultation is effective if (a) it provides meaningful opportunities (including online) for the public to contribute to the process of making regulation; (b) draft regulations are comprehensible and clear and that the public can easily understand their rights and obligations, (c) draft regulations are accompanied by sound economic analysis, (d) it brings to the notice of the public the best practices prevalent globally on the subject of regulation; and (e) it brings to the notice of the public the norms set by international standard setting agencies on the subject of regulation.

The Administrative Procedure Act, 1946 (of US) prescribed fair administrative procedure for all executive branch agencies, including independent regulatory agencies. The most common procedure is notice-and-comment, that is, the agency must provide the public with adequate notice of a proposed rule followed by a reasonable and meaningful opportunity to comment on the rule’s content. The Act requires that the agency shall publish a general notice of proposed rules in the Federal Register. This notice shall include: (a) a statement of the time, place, and nature of public rule making proceedings; (2) reference to the authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved. After issue of the notice, the agency shall afford interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity to present the same orally in any manner; and, after consideration of all relevant matter presented, the agency shall incorporate in any rules adopted a concise general statement of their basis and purpose. The general statement should enable the public to obtain a general idea of the purpose of, and a statement of the basic justification for, the rules. The final rule, along with the general statement, must be published in the Federal Register not less than 30 days before the rule's effective date. There are other variants of consultation. One variant allows the party to present his case through oral hearing or documentary evidence.

There are a few statutes in India which require consultation with public before making regulations. For example, the Company Secretaries Act, 1980 provides that all regulations made under this Act shall be subject to the condition of previous publication. The Airport Economic Regulatory Authority of India Act, 2008 requires the authority to ensure transparency while exercising its powers and discharging its functions by (a) holding consultation with all the stakeholders, (b) allowing all stakeholders to make their submissions and (c) making all decisions of the authority fully documented and explained. The authority makes available in the public domain the comments of the regulator on each feedback received during consultation process[59] [AERAI, 2011] of every proposed regulation. While a regulator may provide opportunities for public consultation though required under the law, as SEBI does, it cannot be claimed as a matter of right in the absence of specific provision in the Act. Subordinate legislation cannot be questioned even on the ground of violation of principles of natural justice [Supreme Court, 1987].

There is an increasing demand to strengthen the consultation process in India. Each government organization which has the responsibility of writing regulations should undertake two rounds of consultation with stakeholders [MCA, 2013]. FSLRC [MOF, 2013a] has suggested a detailed step by step approach for making regulations. It suggests that since the board of the regulator is accountable to Parliament, regulation making process must originate from the board as this would ensure that the issues requiring regulation are deliberated at appropriate level. The draft regulations must be approved by the board before it is released to public for comments. The regulator must release for public comments: (a) draft regulations; (b) the specific provision of law that empowers the regulator to make the proposed regulations and the manner in which the proposed regulation is consistent with the principles of the law; (c) a statement of the problem or market failure that the proposed regulation seeks to address; and (d) an analysis of the costs and benefits of the proposed regulations. The regulator must provide reasonable time for public comments and an appropriate mode for widespread public participation. The board must consider the comments received from public before approving the regulations and such public comments along with its response thereon must be published. This process may be relaxed if there is an emergency, but regulation so made would have a limited life unless it is ratified by regulations made following the regular process. FSLRC advocates that the regulations made by a regulator should be struck down by the Financial Sector Appellate Tribunal (FSAT) if it strays away from objectives, powers or procedures. OECD [2012] recommends that the public should have access to a cost effective and prompt mechanism which should review the legality and procedural fairness of regulations. This is in addition to the jurisdictions of courts to review any subordinate legislation.

The consultation alerts the regulated to the likely shape of regulatory obligations and compliances. However, the regulation may not be implemented, not because of unwillingness on the part of any stakeholder, but because either the regulator, or the regulated, or both are not prepared. For example, the listing regulations have introduced certain principles of disclosure and governance by listed companies. However, regulator, regulated and the courts have not prepared themselves for administration of principle-based regulation. FSLRC proposes to have regulatory impact assessment or cost benefit analysis of every proposed regulation. But most of the regulators do not yet have the capacity to conduct cost benefit analysis. The regulator has prescribed corporate governance norms which require listed companies to have a specified number of independent directors. However, the system has not bred enough number of people to be independent directors. It is a good practice to produce ideas years before actual implementation. The regulator should research and publish studies and analyses which would have pointers for discourses and debates. Take the example of the concept paper on depositories prepared by The Stock Exchange, Mumbai in 1967. This ultimately saw the light in the form of the Depositories Ordinance, 1995. Successful implementation of regulation requires the regulator to (a) make regulations in consultation with the stakeholders, (b) facilitate implementation by providing tools and building capacity, and (c) making cost of non-compliance much higher than the cost of compliance through an effective enforcement mechanism.

5.3.3 Democratic Legitimacy

Though democratically accountable principals (read Government) can transfer policy making powers to non-majoritarian institutions (read regulators), they cannot transfer their own legitimacy [Majone, 1999, Pp. 1-24]. The delegation to independent regulatory authorities implies a net loss of legitimacy for political system [Majone, 2005]. The higher the independence of the regulators, the greater is the democratic deficit. The regulators, therefore, have apparent threat to democratic accountability [Westrup, 2007]. The endeavor is to harness the benefits of governance through regulators, but with democratic legitimacy.

There are broadly three approaches to impart democratic legitimacy. The first is ex-ante input-oriented legitimacy. This generally uses two sets of measures, namely, (a) representation of citizens / stakeholders in decision making body of the regulators - the governing board of regulator has enlightened citizens as part-time members, and (b) association or involvement of citizens / stakeholders in decision-making process - the inputs of stakeholders are taken into account while making a decision. Second is ex-post output-oriented legitimacy [Maggetti, 2010, Pp. 1-9], where regulatory outputs are evaluated by citizens. There are several difficulties in administering output-oriented legitimacy particularly because the regulatory output may be vague and hence not measurable and regulatory effort may not have any linkage with regulatory output. The third is the standard accountability arrangements to ensure that the regulator operates within the confines of its mandate and follows the procedural checks and balances. For example, it should explain its actions through reasoned orders within a time bound manner. These three approaches are not alternatives to one another.

Though not a part of structural design, these are followed largely in case of SEBI. These, however, need to be instiutionalised.

5.4 Institutional Reforms

To this researcher, the making of regulation is more of an art than a science. The regulator develops this expertise over time and with experience. A good regulation is one which effectively deals with the menace and does no more. This is like a good medicine which treats the disease without any side effects. A case in point is 'dealing' by an insider *vis-à-vis* 'trading' by an insider. The latter is a sub-set of the former, is harmful to investors and needs to be curbed. However, all dealings by an insider are not harmful. For example, dematerialisation of securities is socially desirable and has no nexus with the Unpublished Price Sensitive Information (UPSI), i.e., information asymmetry. Similarly, the regulations should focus on the substance, not the form. As every killing is not murder, every trade by an insider is not insider trading. It depends on facts and circumstances of each trade and is a mixed question of law and facts. The essence of insider trading is unfair advantage from asymmetric information [SEBI, 2015]. The regulations have recently excluded trades, which do not provide such unfair advantage, from the mischief of insider trading. Therefore, the law avoids tick box approach and requires application of mind to ascertain if a particular trade amounts to insider trading. Nevertheless, certain institutional reforms are useful.

One Authority: Both SEBI and MOF have authority to make subordinate legislations to carry out the purposes of the securities laws. And, both of them in fact have made subordinate legislations on the same subject. For example, Ministry and SEBI have made rules and regulations, respectively to govern listing and delisting. For about ten years, there were rules made by Ministry and regulations made by SEBI on certain matters relating to intermediaries. These were rescinded in 2006, as those were found redundant. Besides, MCA and SEBI have authority to make subordinate legislation impacting securities market. They have made rules and regulations respectively to deal with issue and trading of Indian Depository Receipts (IDRs). Both RBI and SEBI have been delegated authority to make regulations on certain matters. This is besides the fact that there is a separate regulator, namely FMC, which regulates trading of financial assets called commodity derivatives.

SEBI does not have full authority to make subordinate legislation on certain important aspects of the securities market such as recognition of stock exchanges, requirements of listing, delisting of securities, etc. This partly explains different standards for different participants or activities in the market. For example, a company in private sector was required by an amendment in the rules in 2010 to have at least 25% public holding for listing on a stock exchange. This requirement was applied to companies in public sector in 2014 by the Securities Contracts (Regulation) (Second Amendment) Rules, 2014. This does not provide level playing field to all listed companies and has potential to hinder the effectiveness of SEBI. Similarly, there are so many agencies competing to occupy the space of corporate governance. A public sector listed insurance company has to meet corporate governance norms prescribed by Department of Public Enterprises (DPE), MCA, Insurance Regulatory and Development Authority of India (IRDAI), and SEBI. Further, one agency comes with corporate governance norms and other agencies try to catch up in the guise of alignment.

Following corporate governance norms in the Companies Act, 2013, SEBI is aligning its corporate governance norms with those under the Companies Act. This creates confusion, duplication, inconsistency of regulations and regulatory arbitrage. It also requires co-ordination among so many agencies to deal with a particular matter. Only one agency should have exclusive responsibility on a matter.

One Instrument: Like every other agency in Government, SEBI uses a variety of instruments, in addition to regulations, to communicate and administer the norms of the market. It uses guidelines, schemes, orders, directions, circulars, agreement, and letters depending on the imperatives. The examples are: the SEBI (STP Centralised Hub and STP Service Providers) Guidelines, 2004; the SEBI (Informal Guidance) Scheme, 2003; the SEBI (Framework for Rejection of Draft Offer Documents) Order, 2012; Orders approving corporatisation and demutualisation schemes of stock exchanges, listing agreement, circular dated October 13, 2014 relating to single registration for Stock Brokers & Clearing Members, etc. Besides, there are rules, regulations, and bye-laws made by self-regulatory organisations such as stock exchanges, CCs and depositories to govern certain matters relating to market.

Take the example of SEBI (Disclosure and Investor Protection) Guidelines, 1992 which was replaced by another set of Guidelines issued in 2000. These contained the fundamental law of access to securities market as a substitute for Capital Issues (Control) Act, 1947 which was repealed in 1992. The Guidelines of 2000 contained 384 pages of law at the time of its repeal in 2009. For all practical purposes the Guidelines were regulations and had statutory force. These Guidelines together served the market for about 18 years before these were repealed in 2009 by the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR). Similar is the case of listing and delisting. Listing is being governed by a listing agreement between the listed company and stock exchange since 1956. It has recently been decided[60] to replace the listing agreement by listing regulations. The delisting circulars issued in 1979 were converted to guidelines and then to regulations only in 2009. Thus, several instruments are being used as substitutes for regulations. These do not go through the same rigour as the regulations do. It is not surprising that we are at the bottom of the pyramid in ease of doing business. Nevertheless, the non-compliance of the norms prescribed through these instruments invite penal consequences. FSLRC [MOF, 2013a] has suggested that the regulator should be empowered to issue only two types of instruments, namely, regulations and guidelines.

It is necessary to ensure that simplicity and clarity should inform the content of regulation, leaving no part of it open to different interpretations by different persons [MCA, 2013]. SEBI must endeavor to write regulations in plain English. Despite this, different people would derive different meanings from the same provisions. The economic agents would be taking huge risks if they take decisions based on their understanding of law, even if, most often, their understanding turns out to be correct. They can have some comfort if they can get some kind of guidance or advance ruling from the regulator where there is not enough legal certainty about the applicability of the particular provisions or the obligations thereunder. Every organization tasked with writing regulations should have a provision for an advance authority for rulings [MCA, 2013]. Though not a perfect one, the SEBI (Informal Guidance) Scheme, 2003 provides some comfort to market participants in this regard. FSLRC [MOF, 2013a] has recommended that the regulator should issue guidelines. The guidelines are particularly useful to reduce uncertainty when the regulations are more principle based. However, the guidelines are the interpretation of the regulator of the laws and regulations and not enforceable on standalone basis.

Review and Scavenging: The SEBI Act, 1992 states that the regulations shall be made in the interest of investors and markets and after the notification of the regulations, the same shall be laid on the tables of the Parliament which has power to modify or annul the regulations. Both the Houses of Parliament have constituted Committees on Subordinate Legislations to scrutinize and report to the House whether the powers delegated by the Parliament have been properly exercised. However, the examination of subordinate legislation by the Committee has been rare and hardly any regulation[61] made by SEBI has been modified or annulled. The regulations made by SEBI have been occasionally challenged before the courts of law. Wherever challenged, the courts have generally been supportive of regulations as long as SEBI is able to demonstrate that the regulations have been made in the interests of investors.

Ideally, every organization which writes regulations or other forms of supporting legislations should have a Regulation Review Authority to continuously examine the stock of existing regulations and to weed out those that do not have any continuing use [MCA, 2013]. FSLRC [MOF, 2013a] requires an ex-post analysis of every regulation, with the same rigour as applicable to making regulations at the first instance. This would, keeping in view the objectives of a regulation, examine the outcome to determine the extent to which the stated objectives have been achieved and review enforcement experience and litigation that has been undertaken in relation to the regulation.

In India, legislative scavenging is a periodic exercise to cleanse the statute book. It has never happened in a systematic manner in case of subordinate legislations for securities market. In a recommendation, the Parliamentary Standing Committee [2014] observed: "Government should lay more emphasis on identifying such laws and take early steps for identification and repeal of such laws to provide real relief to people from obsolete and archaic laws. As regards amending Acts, Government should examine feasibility of providing in such amending Acts a sunset clause for their automatic repeal so that these do not remain on statute book after their purpose is achieved. Such a provision will do away with the need of bringing a repealing Act every now and then to repeal amending Acts" (p. 15). It felt that simple periodic scavenging of statute book would not suffice the need of the globalised economy. The need of the hour is to have easy and understandable codification of the law. The Government should endeavor in that direction to make the laws simple while reviewing the existing enactments on the statute book. A Committee [PMO, 2014] identified a total of 1741 Central Acts for repeal out of total 2781 Central Acts existing as on 15th October, 2014 on the Statutes Book.

Review or scavenging requires appreciation of the objectives of subordinate legislation. Coupled with increasing dependence on subordinate legislation, it is necessary that every regulation is accompanied by objects and purpose clause, something similar to 'Statement of Object and Reasons' appended to Bills placed before Parliament, to ease understanding and interpretation of the same. The Supreme Court [2010a] observed: "In this case, it was quite apparent that the 1997 Takeover Code and the later amendments introduced in it were intended to give effect to the recommendations of the two Committees headed by Justice Bhagwati. We were, thus, in a position to refer to the relevant portions of the two reports that provided us with the raison d'être for the amendment(s) or the introduction of a new provision and thus helped us in understanding the correct import of certain provisions. But this is not the case with many other regulations framed under different Acts. Regulations are brought in and later subjected to amendments without being preceded by any reports of any expert committees. Now that we have more and more of the regulatory regime where highly important and complex and specialised spheres of human activity are governed by regulatory mechanisms framed under delegated legislation it is high time to change the old practice and to add at the beginning the "object and purpose" clause to the delegated legislations as in the case of the primary legislations" (p. 47). SEBI has made a beginning with insider trading regulations based on the recommendations of Justice Sodhi Committee.[62] The Committee has recommended that the regulations must contain specific notes on each provision setting out the legislative intent for which that provision has been formulated. These notes should be an integral and operative part of the regulations and aim at telling society what role the regulatory system expects the provision of the regulation to perform and help in their interpretation.

5.5 Implementation of Regulations

Regulations need to be implemented in most objective and equitable manner. The regulator has many tools to implement the regulations. The section gives a flavour of the implementation through two prominent activities, namely, registration and investigation.

A market participant needs a permission to provide services in the market. It required a license earlier and now it requires a registration. This approach ensures that an eligible person wishing to be a service provider can't be denied registration. And if it wishes, it can surrender the registration. Hence there is a free entry and free exit to the market. In order to ensure that there is hassle free and seamless entry and exit, the regulations provide norms of entry and exit and the regulator needs to administer it in letter and spirit. This means that a person eligible under the law and desirous of registering itself as a service provider should apply to the regulator seeking registration. The regulator may require the applicant to furnish such further information or clarification as may be necessary for considering the application. If it is satisfied that the applicant is eligible, it must grant registration. If it forms a *prima facie* opinion that registration ought not be granted or granted with specific conditions to an applicant, it must hear the applicant and take the decision by a reasoned order and that order should be appellable to a tribunal. The entire process should be completed in a time bound manner.

The registration usually carries a number of obligations and compliances. The regulator must have a mechanism to ensure that the service provider is providing services with due care and diligence and in compliance with applicable laws. It uses many tools such as inspection, audit, inquiry, surveillance, investigation, etc., to verify the extent of due diligence and compliance. Investigation carries some amount of coercion and disruption of business hence it should be used as the first option. Whenever the regulator has reasons to believe that the transactions in securities market are being dealt with in a manner detrimental to the investors or the securities market; or any service provider or any person associated with the securities market has violated any provision of the law, it may appoint an investigating authority to investigate the affairs of such service provider or persons associated with the securities market and to report thereon to the regulator. The order of investigation should contain (a) the need for investigation; (b) the scope of investigation in terms of records, activities, places, persons, etc.; (c) the date of commencement of investigation; (d) the time within which the investigation shall be completed; (e) the mechanism of reporting about the progress in investigation and on completion of investigation; (f) the particulars of investigating authority. The regulator as well as the investigation authority must make every effort to keep investigation confidential and to cause the least burden on or disruption of the business of the persons being investigated. In extreme cases, it may with the approval of Magistrate search and seize books and records relevant for the investigation. The regulator should consider the investigation report and take a view, depending on the findings, to issue a Show Cause Notice (SCN) to delinquents. The SCN should be disposed of following quasi-judicial process. The Section 6 deals with this further.

SECTION 6
DISCIPLINING DISCIPLINE

6.1 Enforcement

The rule of law requires that the regulator must compel observance of or compliance with a law, rule, regulation or obligation, if it is not voluntarily done, to induce the desired conduct of participants in the market place. This usually includes four elements, namely, facilitation, supervision (inspection, investigation, surveillance, inquiry, and audit), adjudication and prosecution. While the first two activities are administrative actions to encourage compliance of regulations and detect possible violations of law, the adjudication is a quasi-judicial action of the regulator to penalise the delinquent for violation of law, and the prosecution is a judicial action initiated by the regulator against the delinquent before a court of law. This chapter deals with adjudication of violations of law and levy of civil penalties by SEBI without recourse to judiciary, i.e., the discipline of disciplinary mechanism which respects rights of persons under the constitution. It may be noted that adjudication used in this chapter includes ‘adjudication proceeding’ before the adjudicating officer (AO), enquiry and other quasi-judicial proceedings envisaged under the securities laws.

The Hon’ble Supreme Court [2013a] summarised the objectives of adjudication: "SEBI, the market regulator, has to deal sternly with companies and their Directors indulging in manipulative and deceptive devices, insider trading, etc., or else they will be failing in their duty to promote orderly and healthy growth of the Securities market. Economic offence, people of this country should know, is a serious crime which, if not properly dealt with, as it should be, will affect not only country’s economic growth, but also slow the inflow of foreign investment by genuine investors and also casts a slur on India’s securities market. Message should go that our country will not tolerate "market abuse" and that we are governed by the "Rule of Law". Fraud, deceit, artificiality, SEBI should ensure, have no place in the securities market of this country and ‘market security’ is our motto. "People with power and money and in management of the companies, unfortunately often command more respect in our society than the subscribers and investors in their companies. Companies are thriving with investors' contributions but they are a divided lot. SEBI has, therefore, a duty to protect investors, individual and collective, against opportunistic behavior of Directors and Insiders of the listed companies so as to safeguard market's integrity" (Para 43).

It is important to note that SEBI is duty bound to protect investors in securities irrespective of the end use of investment. This defines the scope of jurisdiction for enforcement action. It was contended that the sale and purchase of agricultural land and/or development of agricultural land cannot be regulated as CIS under the SEBI Act, 1992, as agricultural land is a matter covered under the state list of the Constitution. The Hon'ble Punjab and Haryana High Court [2004] declined to accept this contention relying on the pith and substance rule. It held: "while examining the issue of legislative jurisdiction, it is the pith and substance of the legislation, and not the pith and substance of the activities of a party, which are relevant. ..., whether the pith and substance of the legislation under challenge is "investor protection", and sale and purchase of agricultural land is an activity ancillary thereto; or whether, the pith and substance of the legislation under challenge, is sale and purchase of agricultural land and 'investor protection' is ancillary thereto. In answering the aforesaid quarry, the conclusion undoubtedly is in favour of the former, i.e., the pith and substance of the legislation in question is "investor protection", whereas sale and purchase of agricultural land and/or development of agricultural land is incidental thereto" (Para. 90). The Hon'ble Supreme Court also concurred[63] with this subsequently.

6.1.1 *Enforcement Strategy*

A law is as good as its enforcement. The best-designed law is useless without compliance, whether voluntary or coercive. The participants would comply with the law only if the cost of non-compliance exceeds the cost of compliance.[64] The endeavor should be to decrease the cost of compliance and or increase the cost of non-compliance. The authorities should ideally facilitate compliance by making available cost effective and reliable tools of compliance. The cost of non-compliance comprises two elements: (a) the risk to the business of the offender itself, and (b) the punishment that may be meted to him, arising from non-compliance. The authorities have control over the second and hence can enhance it. However, it depends on the possibility of apprehension and conviction. If this possibility is real, it discourages potential offenders from committing the offence. It is real if (a) the authority has adequate capacity, powers and motivation to detect the violations and gather impeccable evidence establishing the violation, and (b) there is a credible mechanism to award appropriate deterrent sanctions against the guilty, which cannot be subverted. The probability of detection and the severity of punishment are two important variables that the authorities can play with for enhancing the cost of non-compliance and thereby effectiveness of enforcement. The higher probability of detection of violation of regulations can assure compliance even at lower levels of sanction and vice versa. If the law enforcement is costly, the optimal penalty system should exhibit low probabilities of detection and conviction with very high penalties [Becker, 1968, Pp. 169-217]. The optimal enforcement strategy depends on, among other things, the cost of catching and convicting offenders, the nature of punishments (fines or imprisonment), including execution of punishment, and the responses of offenders to changes in enforcement.

There are four alternative strategies, namely, private litigation (read judiciary), government regulation (read regulator), a combination of both, and neither of the two, to establish the rule of law. Glaeser, et al., [2001] observe a tight relationship between the 'law and order' the society is in and the optimality of alternate law enforcement schemes. Where the law and order are weak, the optimal government policy is to do nothing, as it would not address market failure while resources would be wasted on implementing intervention and on subversion of justice. In societies with intermediate level of law and order, regulation alone, or more likely in combination with litigation, is efficient. They illustrate this with the examples of financial markets in Poland and the Czech Republic in the 1990s, when their per capita incomes were roughly comparable. Czech adopted a laissez-faire approach to securities regulation, expecting the judiciary to fill the necessary gaps. This hands-off regulation was associated with a moribund stock market. In contrast, Poland created an independent regulatory commission to enforce the regulations. This was associated with a rapidly developing stock market. The societies with highest levels of law and order should rely on private litigation. They further argue that there are three reasons why regulation may supplement or replace private litigation. The regulator (a) has stronger incentives than do judges to pursue costly investigation necessary to establish that a violation of a rule has occurred; (b) can either simplify private litigation or solve the free-rider problem among the private plaintiffs by representing their mutual interest; and (c) deals with ex-ante precautions while courts deal with damages after the harm is done. If the offence attracts lower penalty, it is unlikely to be subverted. In a weak law and order environment which has potential for subversion, it is better to have lower penalty. However, compliance in such cases would require higher probability of detection of violation of regulations which is possible only with a motivated regulator. In a weak law and order environment, a regulator with high ability of detection and a mechanism of low penalty works better. Glaeser, et al., [2001] also argued that enforcement by regulators may be more effective than enforcement by courts when the enforcement requires investment in costly evidence collection, because it is easier to design incentives for regulators than for courts to optimize their law enforcement activities. Regulators may be more robust than courts in the face of activities aimed at subverting justice [Glaeser & Shleifer, 2003].

As stated earlier, the countries generally use incomplete legal regime to deal with an ever-evolving securities market. Chenggang & Pistor [2001] believed that under incomplete law, law enforcement by courts may suffer from deterrence failure. This is because courts enforce law reactively, that is, only when others have initiated law enforcement procedures. By design, they do not initiate investigations themselves as it would undermine their neutrality and impartiality and their strength lies in interpretation of law.[65] This often results in acquittal (under enforcement), even though the identified actions are widely regarded as wrongful. On the other hand, regulators enforce law mostly proactively. They monitor behavior, launch investigations, and enjoin or punish actions on their own initiative. They initiate enforcement proceedings when they find that the level of expected harm is sufficiently high and change rules in response to socioeconomic or technological change they observe and thereby enhance their ability to enforce the law at optimal levels. Regulators exercise their law-making rights more flexibly than the legislatures do, albeit within the confines of the statute, which is democratically legitimised. The countries have, therefore, generally allocated law making and law enforcement from courts to regulators under incomplete legal regime [Pistor & Chenggang, 2003]. For example, SEBI has been allowed to mandate obligations through regulations, and adjudicate non-compliance of regulations. It may, however, be noted that establishing a regulator involves costs of establishment and maintenance, possible errors in law enforcement, and problems of corruption and regulatory capture. Courts may sometimes be superior to regulators even when is highly incomplete, where the expected harm is contained, and the cost of regulation is substantial [Chenggang & Pistor, 2001].

There are generally five principles of enforcement. These are: (a) fair and non-discriminatory, (b) efficient and effective, (c) transparent, (d) proportionate, and (e) consistent across the organisation. IOSCO [2010] have laid down three principles for the enforcement of securities regulation, namely, (a) The regulator should have comprehensive inspection, investigation and surveillance powers; (b) The regulator should have comprehensive enforcement powers; and (c) The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance programme. Ayres and Braithwaite [1992] recommended responsive regulation on the belief that human beings are borne with a sense of responsibility and they respond to signals emitted by the authorities. This suggests a Regulatory Enforcement Pyramid of Sanctions (REPS) in order of (a) Education and persuasion, (b) Warning letter, (c) Civil penalty, (d) Criminal penalty, (e) License suspension, and (f) License revocation. Regulatory stance should be neither solely deterrent nor entirely persuasive. A completely deterrent approach spoils the relationship between the regulator and the regulated, while a solely persuasive approach results in excessive contraventions.

6.1.2 Monetary Penalty

If regulators enforce law better than the courts do in an incomplete legal regime, it necessarily follows that administrative penalties through civil proceedings are better than punishment through criminal prosecution. The prosecution is not always efficient for violations of securities laws as (a) it takes unduly long time for conclusion; (b) it requires proof beyond all reasonable doubts which reduces the incidence of conviction; (c) conviction, even though late and rare, results in a nominal amount of monetary penalty; (d) conviction in rare cases results in imprisonment, the implementation of which is costly as it involves costs of establishment and maintenance of jails; (e) the courts may not have the capacity (technical knowledge as well as number of judges or courts) to deal with a large number of technical or minor violations; and (f) such large number of technical or minor violations do not warrant a rigorous trial by judiciary. The data in Table 11 presents effectiveness of prosecutions of securities market violations in India. During 2013-14, 269 new cases were initiated while only 10 were disposed of. In 2019-20 86 were disposed of. Probably, disposal rate will improve if dedicated courts are set up as envisaged by the Securities Laws (Amendment) Act, 2014.

Table 11. Initiation and Disposal of Prosecutions

(No. of Prosecutions)

Year	Opening	Initiated	Disposed of	Pending
(1)	(2)	(3)	(4)	(5)
≤03-04	891			891
04-05	891	86	6	971
05-06	971	30	6	995
06-07	995	23	43	975
07-08	975	40	65	950
08-09	950	29	19	960
09-10	960	30	24	966
10-11	966	17	25	958
11-12	958	29	43	944
12-13	944	75	22	997
13-14	997	269	10	1256
14-15	1256	67	30	1293
15-16	1293	46	50	1289
16-17	1289	33	87	1235
17-18	1235	56	96	1195
18-19	1195	65	85	1175
19-20	1175	38	86	1127
Total	NA	1824	697	1127

Source: SEBI (Several years) Prosecutions Situation

One variant of administrative penalty is suspension or cancellation of registration. However, this is not always efficient as (a) it results in cessation of business and affects innocent third parties, often adversely, who were dealing with the intermediary; (b) cancellation of registration is not possible in certain cases such as depositories and exchanges which are in a sense systemically important financial institutions (SIFIs); (c) cancellation is not warranted for many technical and minor violations, and (d) there are many persons other than intermediaries associated with the securities market on whom the penalty of suspension/cancellation has no bearing [Sahoo, 2005b]. Monetary penalty, on the other hand, has several advantages over other punishments: it conserves resources, compensates society as well as punishes the offenders [Becker, 1968]. It addresses all the concerns of prosecution and cancellation of registration. It is, however, necessary in certain cases to have prosecution as well as cancellation of registration, in addition to or in lieu of monetary penalty.

The violations of securities laws all over the world attract three main kinds of punishment, namely, criminal prosecution, suspension or cancellation of registration, and monetary penalty, in addition to directions carrying remedial or preventive measures. Of late, monetary penalty has become the most preferred penalty both from the perspective of the guilty and the authority as it allows life to go on. The statistics relating to proceedings initiated and disposed by SEBI till 31st March 2020 presented in Table 12 which indicates preference for monetary penalties, particularly in recent years, where disposal rate is much higher. SEBI is likely to rely further more on adjudication because the law has now enabled recovery of penalties by coercion and it can easily increase adjudication capacity by putting more officers on the job.

Table 12. Initiation and Disposal of Enforcement Proceedings, 2010-19

Year	Section 11B		Enquiry		Adjudication		Prosecution	
	Initiated	Disposed	Initiated	Disposed	Initiated	Disposed	Initiated	Disposed
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
2009-10	376	260	23	11	644	593	30	24
2010-11	346	182	24	20	571	571	17	25
2011-12	348	103	8	0	609	383	29	43
2012-13	184	53	27	3	1548	361	75	22
2013-14	612	65	12	0	1095	226	269	10
2014-15	Na	Na	23	1	Na	Na	67	111
2015-16	223	257	17	11	249	425	46	30
2016-17	82	140	19	7	278	83	33	87
2017-18	171	183	16	23	594	888	56	96
2018-19	78	121	309	103	822	811	65	85
2019-20	218	151	19	196	257	684	38	86
Pending	376		101		637		1127	

Note: 'Initiated' means initiated during the year and 'Disposed' means disposed till 31st March 2020 out of those initiated in a year.
Source: SEBI (Several years) Enforcement Proceedings

The history of monetary penalty in Indian securities market is interesting. The SCRA originally provided for prosecution which could lead to imprisonment up to one year and in some cases, a penalty of Rs. 1000. The SEBI Act, 1992, as enacted in 1992, provided for penalty of suspension and cancellation of a certificate of registration of an intermediary, in addition to prosecution. On realising severe limitations of cancellation and prosecution, the Securities Laws (Amendment) Act, 1995 amended the SEBI Act, 1992 to provide for monetary penalties as an alternative mechanism to deal with violations. SEBI was empowered to adjudicate a wide range of violations and impose monetary penalties on any intermediary or other participants in the securities market. The amendment Act listed out a wide range of violations along with the maximum penalties leviable. It provided for three types of monetary penalties, namely, (a) a lump sum penalty for a specific violation of the law, (b) a penalty for every day during which the violation continued, and (c) a multiple of the amount involved in the violation. The amount of penalty was determined, subject to the ceiling, by the AO who would be guided by the factors, including (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default; (b) the amount of loss caused to an investor or any group of investors as a result of default, and (c) the repetitive nature of the default. To ensure fair enquiry and penalty, the amendment Act established SAT to consider appeals against the orders of AOs.

The SEBI (Amendment) Act, 2002, which was a response to the major market misconduct in 2001, prescribed a few more offences along with associated penalties and enhanced penalties for the offences substantially. It prescribed that a violator shall be liable to a penalty of the prescribed amount for most of the contraventions. For example, the amended section 15G prescribed that the person shall be liable to a penalty of Rs. 25 crore or three times the amount of profit made out of the insider trading, whichever is higher. This kind of fixed penalties was replicated in the SCRA and the Depositories Act, 1996 by the Securities Laws (Amendment) Act, 2004. It, therefore, appeared that the AO has no discretion but to levy the prescribed penalty irrespective of the gravity of the contravention and intention behind it. However, since AO was still required to consider certain factors for determining the amount of penalty, he could impose a lower penalty taking into account the factors. From a practical perspective, the AOs levied penalties as they considered appropriate and the SAT upheld the same while reducing in some cases. Nevertheless, there was no confusion about the amount of penalty that should be imposed by an AO. Further, SEBI used to pass different kinds of orders requiring payment of monetary penalty, disgorgement of unlawful gains, etc. At times, the indicted person did not pay the amount. To address these concerns, SEBI requested[66] Government to expressly enable it to impose monetary penalty up to the maximum permissible under the relevant provisions, while the maximum monetary penalty then prescribed in the Act could be doubled, and recover the amounts due to SEBI as arrears of land revenue. The Securities Laws (Amendment) Act, 2014 has now rationalized the penalty structure (floor and cap on penalty for each violation) and enabled SEBI to appoint recovery officers to recover the amounts by attachment or sale of person's movable and immovable property, attachment of bank accounts, arrest of the person, etc. It empowers the board of SEBI to enhance the penalty if it considers that the order passed by an AO is erroneous to the extent that it is not in the interests of the securities market.

6.1.3 Consent Settlement

In the past, Indian laws and courts used to be quite cagey about consent settlement. A new chapter was, however, incorporated in the Code of Criminal Procedure, 1973 in 2006 to facilitate some sort of consent settlement offences, which attract imprisonment of up to seven years. The advantages of this kind of settlement are many in the Indian context. It frees up the scarce resources of the authorities and the judicial system which are already saddled with a very large number of enforcement actions awaiting disposal for years. It allows the authorities to have innovative deterrents on the accused while achieving equitable remedies for the victims. Most importantly, it achieves something in days or months, which decades of trial may fail to, and avoids the risk of the accused being scot free after prolonged, expensive and valiant legal battle for some technical reason(s). In short, it achieves the public good, that is, an end of litigation, *Expedit reipublicae ut sit finis litium.*

SEBI commenced settlement of proceedings, under a circular issued in 2007, through the consent procedure to achieve appropriate sanction without lengthy and costly legal proceedings. It used to settle then all kinds of defaults as long as the terms of settlement were appropriate. In view of criticism on certain aspects of settlement, the circular was modified in 2012 to disallow settlement in grievous violations and to determine the amount of settlement through an objective formula. However, there was a question mark on the legal validity of the consent mechanism as it was not explicitly provided in the Act. SEBI recommended[67] Government to amend law to explicitly enable it to settle administrative and civil proceedings on payment of such sum by the defaulter as may be determined by SEBI in accordance with the procedure prescribed in the regulations. This may be allowed, at the request of the defaulter, in respect of administrative and civil proceedings initiated or about to be initiated under the securities laws. The amendment in this regard may be clarificatory and no appeal may be allowed from these proceedings as these are administrative in nature. The Securities Laws (Amendment) Act 2014 has addressed these concerns. In pursuance to the amendment, SEBI has framed the SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014. The details of settlements undertaken so far are, which was (replaced in 2018) presented in Table 13.

Table 13. Receipt and Disposal of Applications for Settlement

Year	No. of applications received	No. of applications settled	Amount (Rs. lakh)			
			Settlement charges	Legal / Admn charges	Disgorgement	Total
(1)	(2)	(3)	(4)	(5)	(7)	(8)
2007-08	698	101	269.08	40.01	0.00	309.09
2008-09	692	440	3729.31	54.90	827.85	4612.06
2009-10	702	363	4917.40	45.70	1898.33	6861.42
2010-11	359	177	7044.97	4.76	171.21	7220.94
2011-12	272	105	1649.05	0.97	0.00	1650.02
2012-13	193	65	1244.71	3.00	225.73	1473.44
2013-14	121	46	421.53	0.60	0.00	422.13
2014-15	108	41	357.95	NA	NA	357.95
2015-16	177	24	NA	NA	NA	442.26
2016-17	171	103	NA	NA	NA	1350.83
2017-18	241	200	NA	NA	NA	3086.71
2018-19	419	137	4510.05	9.07	92.19	4611.31
2019-20	249	100	5181.04	0	0	5181.04

Source: SEBI (Several years) Settlement

The new framework of consent settlement has ushered in some good practices, bringing to an end many ills of the past, but has made it unworkable. The earlier framework allowed settlement of all kinds of defaults as long as the terms of settlement were appropriate. The new framework debars settlement of insider trading; Fraudulent and Unfair Trade Practices (FUTP) which are serious and have a market wide impact or have caused substantial losses to investors; failure to make open offer; defaults or manipulative practices by MFs, alternative investment funds, CISs and their sponsors or asset management companies, collective investment management company, managers, trustees that result in substantial losses to investors; failure to redress investor grievances; failure to make material disclosures in offer documents; etc. However, these can be settled if the applicant has compensated or willing to compensate the loss of investors or makes adequate grounds for settlement. The words ‘serious’, ‘material’ ‘substantial’, ‘adequate’, etc., being subjective, legitimatise discretion of the SEBI. The new framework practically allows settlement of all kinds of defaults, but requires invocation of discretion. The delinquents have no clue whether a particular default is consentable. And, whether a particular default is consentable would be contestable.

The new framework prescribes a formula to arrive at the terms of settlement. This robs the consent mechanism of its soul. A formula, howsoever, robust and comprehensive it be, can’t capture all possible factors having a bearing on the terms of settlement. For example, it can’t capture the strength of evidence and consequently the probability of conviction. Take the case of a default, which warrants a consent settlement of Rs. 1 crore according to the formula. If, however, the evidence available is such that the probability of conviction is negligible, the delinquent would never settle the default for the amount derived by the formula. Thus, the option to settle a default under the consent route is limited. It may not mind settling it for Rs. 10 lakh if the strength of evidence is factored in. This explains why a few defaults[68] were not settled earlier under consent even though the delinquents offered handsome amounts, but it was completely exonerated subsequently on adjudication on merits. Its unintended consequence is that only the defaults with substantial evidence would be settled under consent while the defaults with inadequate evidence would be adjudicated on merits. Further, a formula-driven approach delivers if the settlement is in monetary terms only. However, the framework rightly allows, wherever necessary, suitable directives under the consent order. These directives, such as cancellation of registration, debarment from market, compensation to investors and disgorgement of unlawful gains could often be more effective and equitable. But, since it would be difficult to establish equivalence between monetary terms and such directives, the new framework would encourage settlement of defaults mostly in monetary terms, which may not always achieve the objectives of enforcement actions. A formula has laudable objectives to ensure that the consent terms are commensurate with the default and uniform for similar defaults. However, since it can’t factor in all possible factors, it would occasionally overestimate the terms of settlement and deny settlement in an otherwise deserving case and vice versa. If no formula is used in adjudication where there is application of mind by one person only, it is not necessary to use a formula in consent settlement, which passes through three committees and application of mind by at least nine persons, including a justice and two whole-time members.

Ideally, any default, irrespective of its nature and gravity, should be settled through consent, subject, however, to the condition that the settlement terms are appropriate to the alleged default, that is, at least the same or equivalent outcomes, as would have been obtained if the proceedings were adjudicated on merits, are achieved. For example, if a default warrants a penalty of Rs. 1 lakh on adjudication, it should be settled under consent only if the delinquent either admits the guilt and pays Rs. 1 lakh, or does not admit or deny the guilt and pays Rs. 2 lakh. If the terms are not appropriate, the consent application should be rejected. While the authorities should have no discretion as to which defaults can be settled under consent, they should have full discretion to determine the terms of settlement keeping in view all the relevant factors.

It is believed in some circles that a person can violate any provision of the securities laws and settle the violation, if at all caught, through the consent procedure. The statistics, however, do not support this. Consent settlement is not a matter of right. The three layers in SEBI have to be satisfied that the settlement terms are appropriate to the alleged violation. During 2013-14, 46 consent applications were disposed by passing orders whereas 58 applications were rejected. Even assuming for the sake of argument that a proceeding could be settled through the consent procedure, it is not a cause for concern as long as the objectives of enforcement actions are fully realized [Sahoo & Kumar, 2011]. At least the same outcomes, as would have been obtained if the proceedings were adjudicated on merits, must be achieved through the consent settlement. At times, the consent settlement achieves more than the adjudication on merits simply because the terms of settlement could be more innovative. They are more effective because these orders are passed only after compliance with the terms of settlement. The disposal of proceedings on merits directs the party to pay the penalty which may not be realized always.[69] Since Consent Guidelines were issued in 2007, SEBI has recovered about Rs. 225 crore through consent settlement. It is also believed that SEBI settles the enforcement actions only in monetary terms signaling that a person can do all illegal activities and get away by paying some amount of money. It is thus perceived as an escape mechanism for anyone who is caught violating securities laws. This is not borne out by facts. As stated earlier, all applications are not approved for settlement under the consent procedure. Besides, the enforcement actions are settled not only in monetary terms. In appropriate cases, the terms of settlement are in kind in the sense that these include debarment from trading or accessing securities market, disgorgement, suspension of certificate of registration, etc. A potential violator of law cannot take a chance that his violation would be settled by SEBI through the consent procedure and, that too, at best, by payment of money.

6.1.4 Disgorgement

It is worth noting three major facts. First, the powers of SEBI under section 11B are extremely open-ended. It allows SEBI to pass any kind of directions in the interest of investors. SEBI has used this power to issue a variety of innovative directions, including disgorgement, which was not explicitly provided in the law. SAT and the Hon'ble Supreme Court have upheld a number of orders of SEBI in the matter of IPO irregularity[70] seeking disgorgement of illegal gains from fraudsters. SAT [2010b] observed: "Since disgorgement is not a punishment but only a monetary equitable remedy meant to prevent a wrongdoer from unjustly enriching himself as a result of his illegal conduct, we are of the view that there need be no specific provision in the Act in this regard and this power to order disgorge inheres in the Board" (p. 9). SEBI has distributed the disgorgement proceeds among the victims of the misdemeanour. What was implicit so far has been made explicit by the Securities Laws (Amendment) Act, 2014. All three pieces of securities laws now clarify that the power to issue direction includes the power to direct any person, who has made profit or averted loss by indulging in any transaction or activity in contravention of the law, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention. However, it further provides that the disgorged amount shall be credited to Investor Protection Fund (IPF) of SEBI and such amount shall be utilised in accordance with the regulations.

SEBI has an excellent track record of quasi-judicial orders, thanks to scrutiny of its orders by the SAT. The quality of its orders has earned widespread appreciation. To a large extent, its orders enjoy judicial deference.[71] About 10% of the orders of SEBI are appealed before the SAT. Of the appeals, about 20% are allowed. These ratios are quite commendable. and these are declining. Data in Table 14 below bear testimony to this. Raval [2011] carried out a similar study of the outcomes of appeals before the SAT and divided those into two categories, 'For' and 'Against'. She concluded that if the cases had fallen unilaterally either in the category of 'For' or 'Against', it ought to be treated as a cause for concern: an appeals process against the regulator ought to be capable of taking an independent view of the order. This only proves that SEBI has a reasonable system of penalizing the mischief makers, if they are caught. Do the victims of mischief get any relief?

Table 14. Disposal of Appeals by SAT

Year	No. of Appeals disposed of by SAT					Appeals allowed (%)
	Dismissed	Modified	Withdrawn	Allowed	Total	
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1998-99	1	0	0	1	2	50
1999-00	2	0	0	2	4	50
2000-01	7	1	0	6	14	42.9
2001-02	20	7	3	8	38	21.1
2002-03	15	NA	2	23	40	57.5
2003-04	16	10	1	13	40	32.5
2004-05	29	58	8	19	114	16.7
2005-06	46	101	NA	72	219	32.9
2006-07	139	16	NA	71	226	31.4
2007-08	40	27	NA	32	99	32.3
2008-09	81	1	17	39	138	28.3
2009-10	86	19	19	30	154	19.5
2010-11	134	45	29	77	285	27.0
2011-12	90	51	16	44	201	21.9
2012-13	62	49	28	58	193	30.1
2013-14	117	25	12	23	188	12.1
2014-15#	103	16	32	18	169	10.7
2015-16#	261	5	142	33	441	7.5
2016-17#	185	50	92	7	334	2.1
2017-18#	306	37	112	17	472	3.6
2018-19#	138	21	29	25	213	11.7
2019-20#	217	96	18	121	452	26.8

exclude the number Appeals remanded by SAT
Source: SEBI (Several years) Disposal of Appeals

Third, SEBI used to issue directions imposing monetary penalties, seeking disgorgement or directing refund of money to investors. It was not in a position to recover these amounts. Only option it had was to launch prosecution which was not very fruitful. As consequence, most of the amounts were not realized. The Securities Laws (Amendment) Act, 2014 now enables SEBI to recover these amounts by coercion. The early indications are that SEBI has been reasonable successful in exercise of this power.

It is now clear that SEBI can direct disgorgement, such disgorgement can be recovered by coercion, if required, and most of the directions of SEBI are being upheld. However, the victims of the mischief do not get any relief. The law may oblige SEBI to make all out efforts to seek disgorgement of unlawful gains from the miscreants, in addition to other possible penal actions, and endeavour to identify victims in all cases of misdemeanor and disburse the disgorged amount among them. If any penalty is also imposed in cases where disgorgement is sought, the penalty amount may be added[72] to disgorgement fund for benefit of victims of the misdemeanor. Only if the victims can't be identified, the disgorged amount may be credited to IPF. This money in IPF may be used[73] for building institutions in securities market such as promotion of professional education in the area of securities market and investor awareness. An investor may lose money on account of: (a) his fault, (b) adverse market movements, or (c) fraud / failure in the system. If she loses money for the third reason, she needs to be indemnified, to the extent possible, from disgorgement. SEBI may explore also other means of indemnifying the investors if disgorgement amount is not adequate. In the absence of such an arrangement, it is unlikely that investors who suffer on account of fraud will continue to participate in the securities market.

6.1.5 Associated Persons

The Securities Laws (Amendment) Act, 1995 (a) enlarged jurisdiction of SEBI to register and regulate a few more intermediaries, (b) conferred on SEBI regulatory jurisdiction over corporates in the issuance of capital, transfer of securities and other related matters, and (c) empowered SEBI to issue directions to all intermediaries and other persons associated with the securities market in the interests of investors or orderly development of the securities market. The 'other persons associated with the securities market' has been the bone of contention. It was contended that an investor is not a person associated with the securities market. This has now been settled with a catena of judgements. The Hon'ble Gujarat High Court [1996] has held that 'persons associated with' denotes a person having connection or having intercourse with the other and that 'other' is the securities market. The SAT [2003b] has also held that the phrase would cover a company, its directors, its shareholders / investors, etc., for without them there is no securities market.

It has been argued that a professional rendering services in securities market is not covered and hence outside the jurisdiction of SEBI. It was contended on behalf of the delinquents that SEBI had no jurisdiction to take the action proposed in the SCNs as it would amount to regulating the profession of Chartered Accountants, which was the exclusive domain of the Institute of Chartered Accountants of India (ICAI).[74] It is instructive to quote the Hon'ble Bombay High Court [2010]: "...it is true that the petitioners may not have any direct association with the securities market since they were performing their duties as Auditors of the Company and were associated with the preparation of the balance-sheets of the Company. It is however required to be noted that normally an investor would like to invest his money in the shares of a Company on the basis of reflection of Company's financial health as disclosed in the balance-sheet of the Company and he may consider that it is safe to invest money in a particular company, if the balance-sheets have been certified by reputed Chartered Accountants and it reflects that the financial position of the Company is sound. An investor is likely to be guided by the audited balance-sheet of the Company and would presume that the facts incorporated in the balance-sheet are true and correct. Considering the said aspect, even though the petitioners may not have direct association in the share market activities, yet the statutory duty regarding auditing the accounts of the Company and preparation of balance-sheets may have a direct bearing in connection with the interest of the investors and the stability of the securities market. In our view, the petitioners in their capacity as auditors of the Company Satyam, which was at one point of time considered to be a blue chip company, who had a defining influence on the securities market, can be said to be persons associated with the securities market within the meaning of the provisions of the said Act" (Para 27).

It may be worthwhile to note the treatment meted out by the US authorities for the same misdemeanour by auditors in respect of Satyam. Public Company Accounting Oversight Board (PCAOB) of the US settled the disciplinary proceedings against five PricewaterhouseCoopers International firms based in India, which included a $1.5 million penalty against two of those firms for violations of PCAOB rules and standards in connection with the audit of Satyam. The SEC also settled the proceedings against them for a $6 million penalty. They imposed, in addition to the penalty, significant limitations and undertakings related to the firms' audit activities, required the appointment of an independent monitor, and censured the firms. While settling the matter, the SEC observed that the auditors violated its most fundamental duty as a public watchdog by failing to comply with some of the most elementary auditing standards and procedures in conducting the Satyam audits and the result of this failure was very harmful to Satyam shareholders, employees and vendors. This also demonstrates the co-operation between the regulator of the audit profession and the regulator of the securities markets to secure the interests of investors.

A large variety of professionals render services in the securities market. For example, company secretaries are compliance officers under the listing regulations. Company secretaries, chartered accountants and cost accountants carry out regulatory internal audit of market intermediaries. These professionals constitute critical institutions of the securities market. If the professionals render regulatory services, i.e., when a specified professional is required under the securities regulations to render professional services, such professional must be subject to regulatory discipline. Black [2000] suggested that the professionals must have enough risk of liability to investors if they endorse false and misleading statements so that they would resist their clients' pressure for favourable treatment. Since the securities laws assign the responsibility to a professional, it must ensure that the said professional renders service with full diligence and care. It is all the more the necessary as professionals are being increasingly called upon to take up second order state functions[75] on behalf of the authorities. This should not cover the professional who renders services in securities market, not because of a regulatory requirement, but because his profession allows him to render the service anywhere. This service is, in any case, regulated by the regulator in charge of the profession. For example, SEBI should not discipline Advocates who are representing clients before SEBI. This service of Advocates is regulated by the Bar Council of India. This explains why a restraint order issued by SEBI against an Advocate was withdrawn.[76]

6.2 Enforcement Actions by SEBI

On noticing any prima facie contravention of any provision of the securities laws, pending or on completion of the fact finding process, if the WTM of SEBI considers it necessary, he issues immediately, an ad-interim, often ex-parte, order directing certain preventive measure(s) to contain further damage. On completion of the fact-finding process such as investigation, he decides the enforcement action(s) appropriate for the alleged contravention, if any. If the contravention has been committed by an intermediary, he may initiate an enquiry proceeding, appoint an enquiry officer (EO) to conduct an enquiry and submit a report to him. Based on the recommendation of the EO, he may suspend/ cancel the registration of the intermediary concerned. He may initiate an adjudication proceeding and appoint an AO to impose monetary penalty on the delinquent. He may also initiate section 11B proceeding and issue an order directing a wide variety of preventive / remedial measures. In addition, he may initiate prosecution before the competent court. In fact, where ever he considers appropriate, he initiates a combination of these proceedings. While most of the proceedings are closed on merits with appropriate directions, quite a few are settled by a panel of WTMs under the consent procedure. Table 15 presents an outline of these proceedings [Sahoo, 2012b].

Table 15. Outline of the Proceedings

Proceeding	Authority	Delinquent	Outcome
(1)	(2)	(3)	(4)
Section 11(4)-Interim	WTM	Any person	Preventive measures
Enquiry	EO followed by WTM	Intermediaries	Suspension or cancellation of registration
Adjudication	AO	Any person	Monetary penalty
Section 11(4) & 11B	WTM	Any person	Preventive and remedial measures
Prosecution	Court*	Any person	Imprisonment and / or monetary penalty
Consent Settlement	ED	Any person	As per the terms of settlement

* In earlier years, it was a panel of WTMs on recommendations of HPAC.

The SEBI Act, 1992 allows SEBI to issue such directions as are necessary in the interests of investors or orderly development of the securities market. The nature of direction is left to imagination of the WTM issuing directions, and the law does not put any fetters on his imagination except that it is in the interest of investors or the securities market. The imagination of the WTM has resulted in many innovative directions matching the circumstance. For example, SEBI routinely directs the delinquents to disgorge the unlawful gains made by them from contravention of law. This has been upheld by the Hon'ble Supreme Court and recently made explicit by the Securities Laws (Amendment) Act, 2014. SEBI restrains them from holding the position of director of any listed company. It directs them to pay interest to investors who received the payment late in public offers. It also directs them to make a public offer to acquire shares from public shareholders at a price to be determined by the stock exchange and acquire the shares offered in response thereto. It has illustrious examples of directing refunds worth billions of dollars to investors in a few cases.[77] It even declares them as persons not fit and proper for any trade or profession in the securities market. All these directions though operate as punishment occasionally have been upheld by the higher authorities. The case laws make it clear that only remedial / preventive measures / directions can be issued under section 11B. It can't be used to impose penalties, though some of the preventive / remedial directions may operate as penalty on the delinquent. The SAT [2008b] observed that the directions may result in penal consequences to the entity to whom those are issued but that would be only incidental. The object of directions issued under section 11B is not to punish the delinquent but to protect and safeguard the market and the interest of the investors.

Section 24 of the SEBI Act, 1992 provides that without prejudice to any award of penalty by the AO, if any person contravenes the provisions of the Act or of any rules or regulations made thereunder, he shall be punishable with imprisonment for a term up to ten years, or with fine up to Rs. 25 crore or with both. This provision allows both adjudication and prosecution for the very same offence, though it is open if this provision is violative of Article 20(2) of the Constitution. There have been cases where SAT has upheld multiple actions by SEBI provided these are initiated under different regulations. For example, the SAT [2003c] held that adjudication under section 15-I for insider trading does not preclude SEBI from holding inquiry under section 11B of the Act for fraudulent trades. This is because the same act may amount to insider trading as well as fraudulent trade and it is possible that contravention of the latter is established where the former is not. If SEBI is not conscientious, every contravention could attract multiplicity of proceedings and imposition of multiple penalties against the same person for the same offence, though it is not uncommon for these multiple proceedings resulting in conflicting outcomes.

The law allows enquiry and adjudication proceeding for the same violation. Two issues are relevant here. First, mind is made up about the type of punishment (not quantity of punishment) to be imposed on the delinquent when the alleged contravention is referred to an AO for adjudication or to an EO for enquiry, that is, at a stage when the nature and gravity of the contravention has not been fully ascertained. If a contravention is assigned to an EO, monetary penalty cannot be imposed even if the enquiry findings justify imposition of monetary penalty. Similarly, if a contravention is assigned to an AO, the registration cannot be cancelled even if he comes to the conclusion that the contravention warrants cancellation of registration. Even the SAT can't rectify this situation by converting one kind of penalty to another as has been held by the Hon'ble Supreme Court [2009]. Second, as argued by SAT [2008a], even though the two sets of proceedings are independent of each other, there has not been an instance where the AO has taken a view contrary to the one taken by the WTM. Further, the possibility of conflicting views on the same set of facts cannot be ruled out which would not be in public interest. SAT, therefore, recommended that if only one inquiry is held in such cases and on the basis of that inquiry the same body is given the power to impose penalties under both sets of proceedings, it would not only expedite matters but also avoid conflicting opinions.

This is in addition to penalties levied by SROs such as stock exchanges against the brokers. For example, the SAT [2003a] held that the fact that NSE had deactivated the trading terminal of the appellant and that a sum of Rs. 29 lakh was debited towards "fines and penalties" does not in any way preclude SEBI exercising its powers under the regulations under the Act. It observed that it is not material as to whether the facts relied on by SEBI and NSE are one and the same. It is even possible for SEBI as well as the exchange concerned to initiate enforcement action for the contravention of the same law, such as contravention of the listing agreement. And, such multiplicity of actions does not constitute double jeopardy and it is perfectly in order to initiate more than one proceeding against the same delinquent for the same irregularity or contravention of the same law. Further, since the securities laws are in addition to and not in derogation of any other law, a delinquent may be subjected to enforcement actions simultaneously under the securities laws as well as other laws such as the Indian Penal Code.

Ideally, on completion of the fact-finding process, the executive unit of SEBI should file a charge sheet and present its case, through a Presenting Officer or an Advocate, before the quasi-judicial unit, which would follow the principles of natural justice and pass reasoned orders with appropriate sanctions. These orders may provide for private warning or public warning; direction requiring the person to correct the violation; preventive/ remedial measures; monetary penalties; direction to disgorge unlawful gain made or lawful loss avoided; variation, suspension, or cancellation of an authorization, permission or registration; and or launch of prosecution before appropriate court of law. The order shall state the manner of implementation of the order as well as provide for management of the consequences of such implementation. SEBI has, in fact, recommended Government to amend the securities laws to empower SEBI to appoint any of its officers not below the rank of Chief General Manager as Enquiry and Adjudication Officer (E&AO) to conduct an enquiry and impose punishment in accordance with regulations. If any person is aggrieved by an Order of E&AO, it may file a review petition to the Board, which will be disposed by chairman or a member. The appeals from the order of Board will be made to SAT. Besides, if considered necessary, SEBI may approach appropriate courts for criminal sanctions. This could be in addition to any action that SROs may take as well as actions by any authority under any other law.

6.3 Public Law Concerns

Generally, there is a broad separation of powers among the agencies associated with law - the legislature makes the law; the executive and the judiciary respectively administer and enforce it. This provides a system of checks and balances for one another to prevent misuse of power. The securities laws, in contrast, do not follow the strict separation of powers to a large extent. These confer on SEBI and self-regulatory organisations (SROs) substantial quasi-legislative and quasi-judicial powers, in addition to full executive powers to enable them to make and enforce the laws proactively, and preferably, before the harm is done. These agencies, therefore, simultaneously make, administer, and enforce laws. For example, section 15HB of the SEBI Act, 1992 prescribes a penalty range of Rs. 1 lakh to Rs. 100 lakh through adjudication for failure to comply with any provision of the regulations. Similarly, section 24(1) prescribes a penalty of imprisonment up to ten years, or a fine up to Rs. 25 crore, or both through prosecution for contravention of any provision of the regulations. The regulations are, however, made by SEBI. If SEBI prescribes certain norms through the regulations, non-compliance of the same would attract penalty under section 15HB as well as section 24(1). Thus, for all practical purposes, SEBI prescribes the norms to be followed through regulations, and the penalty for failure to comply with the same. Besides, SEBI creates obligations under the regulations and prescribes the penalties for non-compliance with the same. For example, it has, through the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, listed a variety of penalties that can be levied for different failures under the said regulations. Similarly, the stock exchanges, through their regulations, prescribe norms as well as the corresponding penalties for failure to comply with the same. As a consequence, if SEBI / an exchange considers a particular conduct undesirable, it can within no time outlaw the same through regulations and enforce such regulations. While enabling the authorities to deal swiftly with any emerging misdemeanour in the market, this arrangement empowers them to create new offences under the law and adjudicate the same.

As stated earlier, the securities laws belong to a genre which has the potential to deal with all possible circumstances. For example, the SEBI Act, 1992 allows SEBI to regulate the intermediaries, that are not listed in the Act, in future should the need arise and also the new intermediaries that may emerge in future, without any amendment to the Act. The Depositories Act, 1996 allows SEBI to prescribe a large variety of instruments to be 'security', whether these are 'securities' or not under the SCRA. Such provisions enable SEBI to bring within its jurisdiction such intermediaries and such securities as it considers appropriate and thereby expand and define its jurisdiction, and adjudicate violations in respect of such intermediaries and market for such instruments. Further, a large number of plantation schemes came up in 1990s and raised huge amounts from public. SEBI, which had authority to register and regulate CIS, stretched the scope of CIS to include plantation schemes within its ambit and started regulating them. The scope of listing agreement (under conversion to regulations) is being continuously expanded by SEBI and exchanges to cast additional obligations on the listed companies. Thus, the securities laws enable the authorities to expand their jurisdictions to a large extent, and enforce their authority over the expanded jurisdiction.

The Hon'ble Supreme Court made [2004] an interesting observation in the context of SEBI's powers: "Integration of power by vesting legislative, executive and judicial powers in the same body (SEBI), in future, may raise a several public law concerns as the principle of control of one body over the other was the central theme underlying the doctrine of separation of powers" (p. 19-20). Though the Constitution of India does not envisage strict separation of powers, it does indeed make horizontal division of powers among the legislature, the executive and the judiciary. In keeping with the spirit of the constitutional provisions, every regulator must ensure that its three wings exercise quasi-legislative, executive and quasi-judicial powers with independence and without intra-institutional bargaining and, thereby, avoid potential public law concerns prognosticated by the Hon'ble Supreme Court. This requires the three wings to have disinfectable distance from one another, a system of mutual checks and balances to prevent any excess.

6.3.1 Quasi-judicial Process

The SEBI Act, 1992 and regulations made thereunder generally do not provide the enforcement process. Nevertheless, SEBI ensures that the process is just and fair. It ensures that the delinquent has adequate notice, access to documents / evidence relied upon by the regulator, and reasonable opportunity to defend. If a delinquent believes that the authority may be biased or interested, he has the option to seek a change of the authority. The Code of Ethics for Chairman and Members of SEBI board provides this facility to the delinquent. The authority disposing of the enforcement action should be free from bias, including official bias. An authority, which has ordered or supervised the investigation into the matter, may be tempted to punish the delinquent even if there is not enough evidence. This bias is avoided in SEBI where an authority, other than the one who has initiated the proceeding, disposes of the proceeding. The case of the authority, who has initiated the proceeding, is presented by an Advocate or a Presenting Officer before another authority who disposes of the proceeding, after hearing the delinquent.

This could be formalized by SEBI by setting up dedicated quasi-judicial units and posting officers to that department on a tenure basis. These officers must have a long experience in dealing with the problems relating to the area and undergo intensive training to deal with quasi-judicial matters. During the said tenure, they would do only quasi-judicial work, in addition to participating in board matters, as may be required and would not have any operational responsibilities of the authority. They must not have been associated with the fact finding process - investigation, inspection or otherwise, based on which the proceeding has commenced. They should adopt an adversial system, i.e., would hear both the operational department(s) who have alleged the irregularity and the delinquent(s) and, then, pass appropriate orders. This would be akin to the process before the Administrative Law Judge where the representatives of the SEC and the delinquent present their case. These officers would move back to operational departments after the expiry of the said tenure. This would ensure that quasi-judicial officers do not carry any official bias while they remain abreast with the technical knowledge.

FSLRC [MOF, 2013a] studied the enforcement process in financial markets in great detail. It has recommended that the quasi-judicial responsibilities be held separate from the legislative and executive functions in the internal working of the regulator. Based on its recommendations, MOF [2014a] is encouraging financial market regulators to improve the process. It requires issue of a SCN to initiate any enforcement proceeding. The SCN must be in writing and must state the provisions of law under which it is issued; a detailed explanation of the alleged facts; details of evidence in support of the alleged facts; the laws allegedly contravened; the action(s) / directions that the regulator proposes to take / issue; the reasons for the proposed action / directions; whether the alleged violations may be settled by consent and the procedure for the same; what the notice is required to do and the timeline for and the manner of doing the same; the rights of the notice; the consequences of failure to respond adequately to the notice; the timelines for various stages for disposal of the notice; the procedure to be followed for disposal of the notice; and the details of the officer authorised to dispose of the notice. Such notice must annex copies of documents and reports and extracts of relevant portions of documents and reports containing the findings arrived at in an investigation or inspection, if any, and other material as may be relied on by the regulator in support of the alleged contravention. The notice shall have the right to make a written submission by the specified date; avail an opportunity of personal hearing before the concerned officer, seek inspection and or copies of relevant documents, records or material from the authority as he consider necessary in support of his defence; cross examine the witnesses relied on by the regulator in support of the contraventions; represent himself personally or through an authorised representative before the officer; and prefer an appeal before the tribunal if he is aggrieved by the order issued in disposal of the notice.

The officer shall follow an adversarial system where the regulator as well as the notice shall have the right to be represented at the hearing. He shall dispose of the SCN by a reasoned order. The order shall contain such actions / directions as are warranted by the nature and extent of the contravention of law and while determining such actions / directions, the officer shall take into consideration, among others, (a) the nature and seriousness of the contraventions, including whether it was deliberate, reckless or negligent; (b) the consequences and impact of the contravention, including the extent of unfair benefit or unfair advantage gained by the notice, and loss caused or likely to be caused, to customers or any other person; (c) the conduct of the notice after the occurrence of the contravention; and (d) prior contraventions or offences committed by the notice. The order, and not the SCN, shall be available in public domain. A person who has received such an order may seek a review of order by a member of the board, who may set aside the order if there is an apparent order. Ideally, the process from initiation to disposal of a proceeding should be governed by statutory regulations.

FSLRC has recommended creation of a separate department called administrative law department comprising ALOs under the oversight of an ALM who is a member of the board. This department will not have any operational responsibilities. The ALOs will adjudicate every matter and impose appropriate sanctions by reasoned orders. Such orders are appellable before a tribunal. These may be reviewed by the ALM for apparent errors. Given the urgency, all interim orders would be issued by the ALM. While the above recommendations of FSLRC are reasonable, it is useful to provide a filter before the orders are appealed to a tribunal. This is necessary not to overburden a tribunal which is a three-member body under the chairmanship of a Justice. The burden would be less if the quality of order is better or the orders undergo a review before attaining finality. As of now, the Securities Laws (Amendment) Act, 2014 enables SEBI to examine the records of any proceeding before AO, and then modify the order of the AO to enhance the penalty. FSLRC has also recommended a review in limited cases. Since it may not be possible to allow review of all orders, the other option is to improve application of mind by putting two minds together. The ALOs may work in benches of two. This will reduce the probability of error and hence probability of appeal. This would also conserve resources of the regulator and of the delinquents.

6.4 Timelines

There may be situations where a contravention does not come to notice of SEBI immediately or the delinquent manages to hide the contravention for a long time. If general law of limitation applies, the delinquent goes scot free if the enforcement action is not initiated within the period of limitation. In order to ensure that the delinquent is penalised sooner or later, SEBI is not barred from launching investigation / enquiry and initiating enforcement action against the delinquent for contravention of the securities laws even after lapse of several years. This does not mean that a proceeding can be initiated after 'n' years. SAT lamented [2008b]: "Before concluding, we cannot resist observing that there has been an inordinate delay in initiating action against the appellant. It is alleged to have committed the irregularities in the earlier part of the year 1996 and the show cause notice was admittedly issued in June 2004. How could anyone file a proper reply after a lapse of more than eight years. This long delay itself causes grave injustice to the delinquent and results in the violation of the principles of natural justice. Such delays defeat the very purpose of the proceedings" (Last Para).

The delinquent is under a strict time frame for its response(s) as and when called upon under the proceeding. Failure to respond to summons from SEBI within the specified time invites additional penal consequences. However, there is no time limit on the authorities to conclude a particular enforcement action initiated under the securities laws. There are quite a few proceedings initiated more than a decade back waiting for conclusion. While noting that it had taken SEBI twelve years to complete the proceeding relating to a case of market manipulation, the SAT [2012a] observed that inordinate delay in conducting inquiries and in punishing the delinquent has demoralizing effect on the market players who are ultimately 'not found guilty'. The SAT [2012b] observed: "We fully appreciate the fact that no time limit is provided for finalisation of proceedings in the Act or regulations. However, delay defeats justice and causes undue hardship to the delinquent in putting forth timely defence" (p. 6). As a result, the Damocles' sword hangs on the delinquent for years together, he is looked down with suspicion and practically ostracised from the market till conclusion of the proceeding. The waiting for conclusion of the proceeding occasionally becomes more painful than the worst penalty the proceeding may warrant. There are even a few proceedings where the matter has reached the penultimate stage, that is, it has been heard by the WTM, but orders are yet to be passed for years. While disposing of a matter on July 19, 2012, the SAT [2012c] noted that though the appellant was heard by SEBI on August 11, 2009, no order had yet been passed. The Table 16 presents pendency of proceedings with SEBI and courts as on 31st March 2014. It appears that quite a few proceedings initiated a decade back are still waiting for disposal. This is harmful to the accused as well as the market. 100 section 11B proceedings initiated in or before 2003-04 are yet to be concluded.

Table 16. Pendency of Enforcement Proceedings at the end of March

Year of Initiation	No. of Pending Proceedings				
	Enquiry	Section 11B	Adjudication	Prosecution	Total
(1)	(2)	(3)	(4)	(5)	(6)
2003-04	0	100	13	891	1004
2004-05	0	12	11	971	994
2005-06	0	0	25	995	1020
2006-07	7	47	111	975	1140
2007-08	36	58	307	950	1351
2008-09	10	0	27	960	997
2009-10	12	116	51	966	1145
2010-11	4	164	0	958	1126
2011-12	8	245	226	944	1423
2012-13	24	131	1187	997	2339
2013-14	12	547	869	1256	2684
2014-15	53	456	1381	1293	3183
2015-16	59	422	1205	1289	2975
2016-17	71	364	1400	1235	3070
2017-18	72	352	1053	1195	2672
2018-19	278	309	1064	1175	2826
2019-20	101	376	637	1127	2241

Source : SEBI (Several years) Pendency of Proceedings

The SEBI Act, 1992 allows SEBI to issue a large variety of directions, either pending or on completion of fact finding process, in the interest of investors or the securities market. Most often directions under this section restrain the delinquent from accessing the securities market or from dealing in securities. Such restraint is not violative of Article 19 (1) (g) of the Constitution, which guarantees freedom of occupation, trade or business, as held by the Hon'ble Rajasthan High Court [2010]. Most often, such directions are issued by ad-interim ex-parte orders without hearing the parties concerned upfront. The Hon'ble Rajasthan High Court also held in the same matter that the provisions of post decisional hearing are consistent with Article 14 of the Constitution. The fact, however, is that the interim order often debars a delinquent from participating in market and it practically operates as a penalty on him. He suffers this penalty till the conclusion of the fact finding process and also the enforcement actions emanating therefrom. And, there is no time limit by which these have to be concluded. Many have sought intervention of the SAT to stay the operations of interim orders particularly when there is inordinate delay in completion of investigation. However, the SAT has generally refused to do so, though it has advised SEBI on occasions to complete the investigations expeditiously or within a specified time. In one matter, the SAT [2012d] observed that it cannot bind SEBI to complete investigations by a timeframe, but this time has to be a reasonable one, more so when the entities are debarred from dealing in the market which adversely affects their business. It has occasionally directed that if SEBI does not complete the investigation / pass an order within the specified time, the interim order shall stand vacated.

A cardinal principle of law is that an accused must be deemed innocent until such time as his guilt has been proved conclusively and the punishment can follow only thereafter. It is so because punishment before conviction does irreversible and irreparable damage to the person. He could well be found innocent ultimately or the punishment suffered before conviction could be more than warranted. However, the interim orders issued by SEBI imply that the accused *is deemed guilty until proven innocent through the fact finding process and the resultant quasi-judicial proceeding(s). The loss of reputation, opportunity, livelihood, and freedom of the accused cannot be made good even if the process ultimately finds that it was innocent.* For example, on completion of investigation, SEBI closed the proceedings which were initiated by issue of interim order dated December 2, 2010,[78] vide its order dated March 16, 2012,[79] without any directions in respect of a large number of accused, after they had suffered for 16 months, as no charge was made out against them by the investigation. In a different context, the Hon'ble Supreme Court [2011] has recently reiterated that every person is deemed innocent until found guilty after due trial and that the punishment begins only after conviction. It felt that the detention of under trial persons in jail for an indefinite period amounted to punishment before conviction and, therefore, violation of Article 21 of the Constitution. It also reiterated that every person, detained or arrested, is entitled to speedy trial lest the accused may end up in jail longer than the period of sentence, if ultimately found guilty. That is why the saying, bail is the rule and jail an exception.

Let us see another dimension of timeline. Vide an order dated June 24, 2002, SEBI held that the schemes floated by PACL Limited (then PACL India Ltd.) were CIS.[80] However, the Hon'ble High Court of Rajasthan, vide its order dated November 28, 2003 held that the schemes of PACL India were not CIS as they did not possess the characteristics of a CIS. SEBI preferred an appeal before the Hon'ble Supreme Court of India against the said order of the Hon'ble High Court. The Hon'ble Supreme Court of India, vide order dated February 26, 2013, set aside the order of the Hon'ble High Court and directed SEBI to pass fresh orders as to whether the schemes of PACL Limited are CIS and if CIS, take further appropriate action. On completing the processes as required by the Hon'ble Supreme Court, SEBI, vide order[81] dated August 22, 2014, held the schemes of PACL Limited to be CIS and directed the company, promoters and directors to refund the moneys, the company has collected over the years, with returns to the investors. It had collected Rs. 49,100 crore. The matter is now before the SAT. 15 years have passed and the matter is still unresolved. As the saying goes, a stitch in time saves nine. As per the said order, PACL Ltd. had collected money from 59 million investors. If the authorities had taken a view at the relevant time, 59 million investors would not have been victims of the misdemeanour. If it is not clear what a person does is legal or not, a view must be taken without any loss of time. The person should be allowed to carry on business if it is legal. It should be prohibited from carrying on business if it is illegal. It harms everybody if it carries on business for ten years and then the business is considered illegal. That amounts to locking the stable door after the horse is stolen.

SEBI must initiate appropriate enforcement proceeding immediately on conclusion of the fact-finding process. It must conclude the enforcement proceeding expeditiously because delay defeats justice and causes hardships to the delinquent as well as the victims. Interim orders must be avoided to the extent possible and such orders must cease to have effect after the passage of a certain time. The authority should dispose of the enforcement actions by issuing speaking orders which should be disseminated on the web-site. The judiciary must have a separate window to take a view expeditiously on matters relating to legal permissibility of any business or activity. If a game is on and the first two umpires have two different views, the third umpire must give his views immediately to settle the matter and the game to continue. Appeal mechanism should not compromise the speed of decision making [Doyle, 1997]. It is all the more important when some litigants are bent upon deferring a decision indefinitely. In a matter involving another CIS, the Hon'ble Supreme Court [2013c] upheld the order of the Hon'ble Punjab and Haryana High Court with several directions against the appellant, including CBI investigation and a cost of Rs. 50 lakh with an observation: "... in that process prolonged this litigation for more than a decade and thereby provided scope for defrauding its customers who invested their hard-earned money in the scheme of sale of land and its development and since we have found that the appellants had not approached the court with clean hands.... should be mulcted with the exemplary costs" (Para 54).

6.5 Mens Rea

The securities laws provide for imposition of various civil penalties. It was doubtful for a while if imposition of monetary penalty under the securities laws required evidence of mens rea. It got clarity when the Hon'ble Bombay High Court [2004] held that for breaches of provisions of SEBI Act and regulations, which are civil in nature, mens rea is not essential. It is now conclusively settled with a ruling from the Supreme Court that the adjudication proceedings are not criminal or quasi-criminal proceedings. These deal with failures to comply with the statutory civil obligations. Penalty is attracted as soon as the non-compliance with the statutory obligation is established even if there is no mens rea. While upholding imposition of monetary penalty, the Supreme Court [2006] held: "Therefore, there is no question of proof of intention or any mens rea by the appellants and it is not essential element for imposing penalty under SEBI Act and the Regulations. ..... In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the regulations is established and hence the intention of the parties committing such contravention becomes wholly irrelevant..." (p. 4 and p. 11). A three judge bench of the Hon'ble Supreme Court [2008] endorsed this view. And, when the state of mind is relevant, what is material is what one does or omits to do and not what he says. In another matter, the Hon'ble Supreme Court [2012b] observed that a person's inner intentions are to be read and understood from his acts and omissions. '*acta exterior indicant interiora secreta*' (external action reveals inner secrets). SAT carried [2010a] further the ratio, which was in the context of adjudication proceedings, to all kinds of proceedings except prosecution.

The criminal offence requires proof beyond all reasonable doubts. Since the offences under the securities laws are generally civil in nature and it is very hard to have evidence for certain offences like unfair trade practice or insider trading, the preponderance of probability is considered the required level of evidence. Its implication is that if it is in all likelihood that a person has committed a contravention of law, even if there is no clear evidence to establish it, he will be deemed to have violated the law and shall be liable to the prescribed penalty. However, there can be degrees of probability; the higher the gravity of the alleged contravention, the higher must be the preponderance of probabilities required for establishing the same. But it can't be that high as warranted in criminal offences. As a consequence, the available evidence may be adequate to establish fraud if it is tried as a civil offence, but may fail to establish it as a criminal offence. In such cases, SEBI would be tempted to initiate adjudication rather than prosecution. This makes the probability of an offence being established higher in securities laws. The provision of scrutiny of orders by the SAT encourages SEBI to be absolutely fair and equitable to the delinquents while initiating, processing and disposing of enforcement actions.

6.6 End Note

The judicial job is stressful. There is fear of retribution also. In a recent judgment, Hon'ble Supreme Court had this to say [2014a]: "One wonders, what is it, that a Judge should be made of, to deal with such litigants, who have nothing to lose. What is the level of merit, grit and composure required, to stand up to the pressures of today's litigants? What is it, that is needed to bear the affront, scorn and ridicule hurled at officers presiding over Courts? Surely one would need super-humans to handle the emerging pressures on the judicial system. The resultant duress is grueling" (Para 147). A Supreme Court Justice recently observed: "There are matters pending with the court, but the pressure, tension and strain both of us have undergone is unimaginable. I can't explain.[82] He added that the pressure was even felt by his family.

If this is the experience of a Hon'ble Judge of the highest court of the land, what to speak of regulators having quasi-judicial responsibilities, who serve for a term of 3-5 years, whose orders are subject to layers of judicial scrutiny and often second guess by investigative agencies. It is not unusual to see advertisements in press putting SEBI in bad light when SEBI comes up with an adverse order against a mighty person. While most of these can be considered as professional hazard, the second guess by investigative agency affects the integrity of the quasi-judicial process. The Hon'ble Supreme Court [2013b] recognizes that quasi-judicial orders come from adjudication which is a part of administrative process resembling a judicial decision by a court of law. Therefore, it hesitates to disturb the finding of a quasi-judicial body. It observed [2012b]: "These aspects demand serious deliberation at the hands of the technical experts. It will not be appropriate for this Court to examine these technical aspects, as such matters are better left in the domain of the statutory or expert bodies created for that purpose. The concept of 'regulatory regime' has to be understood and applied by the courts, within the framework of law, but not by substituting their own views, for the views of the expert bodies like an appellate court. The regulatory regime is expected to fully regulate and control activities in all spheres to which the particular law relates" (Para 16).

Keeping in view the quasi-judicial responsibility, discharge of which requires substantial technical expertise and independent application of mind, it is not appropriate for investigative agencies to examine any matter disposed of through quasi-judicial process. There have been a few news reports [The Times of India, 2015a][83] in the recent past about the investigating agencies suspecting that the regulatory authorities have let off the accused with inadequate sanction. This would amount to an administrative review of quasi-judicial decision which is not permissible. Further, the possibility that an investigating agency may examine the inadequacy of sanction would induce the adjudicating authority to impose sanctions invariably in all cases even if sanction is not warranted, or impose a higher sanction than warranted. They must, however, be free to look into if anybody has got illegal gratification or has disproportionate assets without attempting to examine in any manner merits of a quasi-judicial matter. If there is anything erroneous, it would be rectified by SAT and then by the Hon'ble Supreme Court. As observed by the Hon'ble Supreme Court [1995], imputation of motives of corruption to the judicial officer/authority is a serious inroad into the efficacy of judicial process and threat to judicial independence. For the sake of rule of law, the authority of the court or a statutory authority and the confidence of the public in them should not be allowed to be undermined by the second guess of an administrative agency. Ideally the same protection as available to judges and others acting judicially under the Judges (Protection) Act, 1985 should be available to members and officers of regulatory bodies in respect of their quasi-judicial actions.

We now move to Section 7 for our concluding remarks.

SECTION 7
CONCLUDING REMARKS

7.1 A Model Legislation

Based on the analysis, findings, principles in the previous Sections, we have attempted a model legislation, which is superior to the SEBI Act, 1992 and vastly superior to many other legislations which have established regulators in the country. This model (a Draft) is presented in an Annexure to the paper.

This would improve structural design of SEBI and the manner it discharges its quasi-legislative, executive and quasi-judicial responsibilities. This would hopefully improve the efficiency of the securities regulations and the efficiency of securities markets and thereby capital formation and economic development. Some of the suggestions made in this study would help in improving India's ranking in ease of doing business. The model legislation could serve as a charter for setting up any regulatory agency in the country and, if implemented, would improve governance through regulators.

The model legislation is a unique contribution of this study. It precisely implements the measures emanating from the study. It must be noted that the model legislation is based on contemporary thought to meet needs of today and the foreseeable future. Every law has its limitations and the best law does not ensure the best regulator. It is only enabling and the people in charge of implementing the law make the difference. For example, the law can empower the regulator to intervene through regulations, but it cannot dictate the appropriate mix of market, self-regulation and statutory regulation to address a specific problem. It must also be noted that the building a regulator would always remain a work-in-progress.

7.2 Useful Areas for Further Research

To begin with, it would be useful find the association between institutions and economic development in Indian context and identify critical institutions for improvement. Also, in case of a regulator, it would be required to develop measures to examine the level of independence of the regulator, the level of accountability of the regulator, the efficiency of securities regulations, effectiveness of different kinds of sanctions for contraventions, the effectiveness of regulators, the effectiveness of governance through regulators, the strength and quality of other institutions in the securities market and then find the relation between these measures and the economic development. There is also need to start using the standard cost benefit analysis used for project appraisals and refine the same for cost benefit analysis of regulations in course of time. Another issue would be to explore the options to hold the regulators accountable to people without compromising their independence and measures to bridge the democratic deficit while, at the same time, develop a strategy to improve level of compliance of regulations and compliance culture and reduce the cost of compliance and increase cost of non-compliance. There is need to examine ways to develop harmonious relationship between executive wing of Government and the regulator.

ANNEXURE

Bill No. ---- of 2020

THE SECURITIES AUTHORITY OF INDIA ACT, 2015

A Bill to provide for the establishment of an Authority to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto.

BE it enacted by Parliament in the Sixty-Sixth Year of the Republic of India as follows: -

CHAPTER I

PRELIMINARY

Short title, extent and commencement.

1. (1) This Act may be called the Securities Authority of India Act, 2015.

(2) It extends to the whole of India and also the persons and things beyond her territory when her legitimate interests are affected.

(3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint in this behalf.

(4) It shall cease to be in force on 31st March of every fifth year from the day of its coming into force, unless it is extended by a Reauthorisation Act after an evaluation by a parliamentary committee, in the manner prescribed, of its working in the preceding five years.

Definitions.

2. (1) In this Act, unless the context otherwise requires, -

a) "Act" means the Securities Authority of India Act, 2015;

b) "administrative law member" means an individual who is appointed as such in the Board under section 5(1)(b);
c) "administrative law officer" means an officer who is designated as such in the Authority under section 11(3);
d) "administrative law department" means a department named as such in the authority under section 11(2) and comprises only administrative law member(s), administrative law officer(s) and officers and employees supporting them;
e) "advisory council" means an advisory council constituted by the Board of the Authority under section 12(1);
f) "associated person" includes:
   a. a professional,
   b. a company,
   c. an investor in securities,
   d. a promoter, director, key managerial personnel of a company or service provider, and
   e. any other person whose activities have substantial bearing on the integrity of the securities markets;
g) "Authority" means the Securities Authority of India established under section 3(1);
h) "Board" means the Board of the Securities Authority of India constituted under section 4(1);
i) "bench" means a bench of two administrative law officers or a bench of presiding officer and members of the Tribunal, as the case may be;
j) "Central Government" means -
   a. the Department of the Central Government which is responsible for securities markets, (i.e., Department of Economic Affairs), or

b. the Department of the Central Government which is responsible for establishment matters of regulators, (i.e., Department of Regulatory Affairs), as the case may be, under the Business Allocation Rules, 1961.

k) "chairperson" means chairperson of the Authority;

l) "cognate Acts" mean and include:
   i. the Securities Contracts (Regulation) Act, 1956 (42 of 1956);
   ii. the Depositories Act, 1996 (22 of 1996);
   iii. the Companies Act, 2013 (18 of 2013)
   iv. any statutory modification or re-enactment thereof;

m) "company" means a listed public company or a public company, not being a service provider, which intends to get its securities listed on a recognised stock exchange;

n) "contravention" means contravention of the Act, rules, regulations or orders issued under chapter V.

o) "executive member" means a member of the Authority who has responsibility of managing day-to-day affairs of the Authority and includes administrative law member(s) and chairperson;

p) "investigating authority" means an officer or group of officers directed by the Authority to undertake an investigation and include persons authorised by the investigation authority in this behalf.

q) "investors" include clients of service providers;

r) "legislative notes" means the intent or rationale for making a specific regulation.

s) "member" means a member of the Authority and includes chairperson;

t) "non-executive member" means a member who is not an executive member.

u) "notice" is a person who has been issued a show cause notice;

v) "notification" means a notification published in the Gazette and the terms ‘notify’ and ‘notified’ shall be construed accordingly;

w) "operation Manual" means a manual of operations for a task or activity of the Authority;

x) "prescribed" means prescribed by rules made under this Act;

y) "professional" means an individual who is a member of a statutory body or firm of such individuals who provide professional services in securities market, pursuant to a requirement under the Act;

Example: The Listing Regulations requires a Company Secretary to be Compliance Officer of a listed company. A Company Secretary acting as Compliance Officer shall be considered as a professional and regulated by the Authority in respect his role as Compliance Officer.

z) "public domain" means any platform, such as web site, electronic or otherwise, which is accessible to public without any cost.

aa) "publish" means publish in public domain unless specifically stated;

bb) "register" means the register of service providers maintained under section 31(6);

cc) "regulations" means the regulations made by the Authority under section 22;

dd) "rules" means rules made by the Central Government under section 21;

ee) "secretary" means secretary to the Board;

ff) "securities" has the same meaning as assigned to it in section 2(h) of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

gg) "service provider" includes:
   i. stock exchanges, clearing corporations, and depositories;
   ii. bankers to an issue, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers, custodians, credit rating agencies, stock brokers, depository participants;
   iii. collective investment schemes, including venture capital funds and mutual funds, their fund managers and asset management companies;
   iv. self-regulatory organisations; and
   v. other intermediaries or persons, who may be associated with securities markets in any manner, as may be specified by the Authority;

hh) "specified" means specified by regulations made under the Act and the term ‘specify’ shall be construed accordingly;

ii) "Tribunal" means the Securities Appellate Tribunal established under section 49.

(2) Words and expressions not defined in this Act, but defined in or under the cognate Acts, shall have the same meanings as have been assigned to them by or under those Acts.

CHAPTER II
ESTABLISHMENT, GOVERNANCE AND MANAGEMENT OF THE AUTHORITY

Establishment of Authority.

3. (1) With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purposes of this Act, an Authority by the name of the Securities Authority of India.

(2) Subject to section 1(4), the Authority shall have perpetual succession and a common seal and shall have power to acquire, hold and dispose of property, movable or immovable, and to contract, and shall by its name sue or be sued.

(3) In the event of this Act not being extended under section 1(4), the Authority shall be wound up and all property and legal rights and liabilities of the Authority on the date of winding up shall vest in the Central Government.

(4) The head office of the Authority shall be at Mumbai.

(5) The Authority may establish offices at other places in and outside India as may be necessary.

Functions of Board.

4. (1) The general superintendence, direction and management of the affairs and business of the Authority shall vest in a Board, which may exercise all powers and do all acts and things which may be exercised or done by the Authority.

(2) Save as otherwise determined by regulations, the chairperson shall also have powers of general superintendence and direction of the affairs and business of the Authority and may also exercise all powers and do all acts and things which may be exercised or done by that Authority.

(3) The Board shall:
(a) ensure the functioning of the Authority in accordance with the provisions of this Act; and
(b) undertake any activity as may be necessary to carry out the purposes of this Act.

(4) The Board shall facilitate, approve and review:
(a) the annual budget and accounts of the Authority;
(b) the annual report of the Authority;
(c) the regulations under the Act;
(d) the operations manuals of the Authority;
(e) the code of conduct and ethics for members; and
(f) the performance of the Authority keeping in view objectives, functions, responsibilities, powers and resources of the Authority under the Act.

Composition of Board.

5. (1) The Board shall consist of not less than 10 and not more than 12 members appointed by the Central Government as under:
(a) a chairperson;
(b) at least one administrative law member;
(c) as many other executive members as may be necessary; and
(d) as many non-executive members as may be necessary to ensure that they constitute not less than 50% of the Board at any point of time.

(2) The Central Government must ensure that the Board has not less than 10 members at any point of time irrespective of resignation by or removal of any member(s).

(3) No act or proceeding of the Board shall be invalid merely by reason of any vacancy or any defect in constitution of the Board or appointment of any member.

Appointment of members.

6 (1) A member shall be appointed by Central Government by a notification.

(2) An executive member shall be appointed on the recommendation of the Regulatory Selection Board.

(3) A non-executive member shall be appointed on the recommendations of the Financial Stability and Development Council.

(4) An individual is eligible for appointment as an executive member, if he: -

(a) is a citizen of India;

(b) is at least 45 years of age and not more than 55 years of age;

(c) has an advanced degree in economics, finance, law, public policy or securities market; and

(d) has professional experience of not less than twenty years in dealing with matters relating to economics, finance, law, securities market or public policy in the area of finance; Provided that an individual must have an advanced degree in law as well as professional experience in law for being eligible to be an administrative law member.

(5) An individual is not eligible for appointment as a member if he has association: -

(a) of any kind with any service provider; or

(b) with Government of India, any State Government or any regulatory authority as an employee, a judge or a legislator at any level unless he severs that association before assuming the office.

(6) An individual is not eligible for appointment as a member if he is not a fit and proper person. Explanation: An individual is not fit and proper person if he

(a) is not a person of ability, integrity and standing;

(b) has any conflict of interest with the objectives of the Authority;

(c) has been adjudicated as insolvent;

d) is of unsound mind and stands so declared by a competent court;

(e) has been convicted of an offence involving moral turpitude;

(f) has been sentenced to imprisonment for 180 days or more and five years have not passed since suffering the punishment; or

(g) is otherwise not fit and proper in the facts and circumstances.

Term of office.

7. (1) No executive member shall hold office after he has attained the age of sixty-five years.

(2) The term of a non-executive member shall be five years subject to the condition that he shall not hold office after he has attained the age of seventy years.

(3) The Central Government may terminate the services of a member at any time before the expiry of the term by giving him notice of not less than three months in writing or three months' salary and allowances in lieu thereof.

(4) A member may relinquish his office, at any time before the expiry of the term by giving to the Central Government notice of not less than three months in writing.

(5) The Central Government may remove a member by a notification from office on a finding by the Regulatory Selection Board on a reference made to it to the effect that he has

(a) attracted any of the disqualifications under sections 6(5) and 6(6);

(b) has acquired such financial or other interest as is likely to affect prejudicially his functions as a member;

(c) abused his position so as to render his continuance in office prejudicial to the objectives or interests of the Authority;

(d) violated any of the terms of appointment;

(e) made any misleading statement at the time of selection; or

(f) failed to disclose material interest.

(6) The Regulatory Selection Board, on a reference from Central Government, must expeditiously conduct an inquiry following the principles of natural justice to arrive at the finding and submit its findings to Central Government.

(7) A member shall cease to hold office under sub-sections (3), (4) and (5) from the date as may be specified in the notification.

Conditions of service of members.

8. (1) The terms of office and other conditions of service of members shall be such as may be prescribed keeping in view relevant factors including the talent required for the office.

(2) The terms of office of a particular member shall not be varied to his disadvantage during his term.

Meetings of the Board.

9. (1) The Board shall meet at such frequency, and shall observe such rules of procedure in regard to transaction of business at its meetings as may be prescribed.

(2) The chairperson or, if for any reason, he is unable to attend a meeting of the Board, any other member chosen by the members present from amongst themselves at the meeting shall preside at the meeting.

(3) The quorum for any meeting of the Board or any of its sub-committees shall be three fourth of the subsisting members.

(4) All questions which come up before any meeting of the Board shall be decided by a majority votes of the members present and voting, and, in the event of an equality of votes, the chairperson, or in his absence, the member presiding, shall have a second vote.

(5) Any member, who has any direct or indirect personal interest in a matter coming up for consideration at a meeting of the Board, shall, as soon as possible after relevant circumstances have come to his knowledge, disclose the nature of his interest at such meeting and such disclosure shall be recorded in the proceedings of the Board and the member shall not take part in any deliberation or decision of the Board with respect to that matter.

(6) The provisions of this section shall apply, mutatis mutandis, to meetings of a committee of the Board.

Audit Committee.

10. (1) The Board shall constitute an Audit Committee comprising three non-executive members.

(2) A member shall ordinarily be a member of the Audit Committee for a term of three years.

(3) The responsibilities of the Audit Committee include:

(a) Monitoring compliance with laws applicable to the Authority;

(b) Monitoring adherence to regulations and operations manual(s) made by the Authority;

(c) Monitoring compliance with the decisions of the Board;

(d) Monitoring utilisation of resources of the Authority;

(e) Appraisal of performance of the Board;

(f) Oversight over risk management by the Authority;

(g) Oversight over vigil mechanism of the Authority;

(h) Any other as may be assigned by the Board.

Administrative law department.

11. (1) The Authority shall set up an appropriate organisational structure to effectively discharge its responsibilities.

(2) It shall have an administrative law department under the oversight of the administrative law member(s). Provided that if the Board does not have any administrative law member, any other member of the Board may be authorised to officiate as an administrative law member.

(3) The Authority shall designate as many officers as required as administrative law officers and post them to administrative law department for a term of five years at a time.

(4) An officer shall be eligible to be designated as administrative law officer if he has at least five years of experience in operations of the Authority, a professional degree in law and holds a position in either of the two grades immediately below the Board.

(5) The administrative law member(s) and administrative law officers shall discharge only quasi-judicial functions under chapter V and must not have any responsibility that may conflict with their independence and neutrality.

(6) The administrative law member shall also exercise the functions of a member of the Board as such.

Advisory council.

12. (1) The Board may set up subject specific or standing advisory council(s) as it considers expedient.

(2) An advisory council shall have eminent academicians and practitioners in the concerned subject, subject to the condition that no person becomes a member of more than one council at any point of time.

(3) The council shall advise the Authority on any matter under its purview either and shall advise on any matter on a request from the Authority.

(4) The council shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings, as may be specified.

(5) A member of the council shall be paid such fees and allowances as may be specified.

Secretary to the Board.

13. (1) The secretary to the Board shall:

(a) manage the affairs and record the proceedings relating to the meetings of the Board and its committees in compliance with the rules; and

(b) ensure compliance with laws applicable to the Authority.

(2) Subject to sub-section (3), the secretary shall publish the following in public domain:

(a) the minutes and agenda of meetings of the Board and its committees in the manner as may be prescribed;

(b) the minutes and agenda of meetings of the council(s) in the manner as may be specified;

(c) the annual accounts under section 15(6) as soon as it is laid before the Parliament;

(d) the annual report under section 16(4) as soon as it is laid before the Parliament;

(e) operations manual(s) made under section 23 as soon as it is approved by the Board;

(f) regulations made under section 24 as soon as it is notified;

(g) register of service providers maintained under section 31(6);

(h) report of the review under section 28 within 30 days of the review;

(i) orders issued under sections 38, 39, 40 and 41 on the day of issue; and

(j) any other as may be considered appropriate to meet the needs of transparency.

(3) Any exception sub-section (2) shall be in accordance with the policy made by the Board.

Employees of the Authority.

14. (1) The Authority shall appoint such officers and employees as it considers necessary for the efficient discharge of its functions under this Act.

(2) The Authority shall designate one of its senior officers as secretary to board.

(3) The term, terms and other conditions of service of officers and employees of the Authority shall be such as may be specified by regulations.

(4) The members, officers and other employees of the Authority shall be deemed, when acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860).

(5) No suit, prosecution or other legal proceedings shall lie against the Central Government or any officer of the Central Government or any member, officer or other employee of the Authority for anything which is in good faith done or intended to be done under this Act or the rules or regulations made thereunder: Provided that nothing in this Act shall exempt any person from any suit or other proceedings which might, apart from this Act, be brought against him.

(6) The protection available to Judges under the Judges (Protection) Act, 1985 shall be available to administrative law member(s) and administrative law officer(s) in respect their functions under chapter V.

15. Finances and accounts of the Authority.

(1) There shall be established a fund called "The Securities Authority of India General Fund" under the management, custody and control of the Authority into which shall be paid all moneys, including donations, grants, fees, charges and borrowing received by the Authority and out of which shall be met all expenses, including donations, grants and repayment of loans, and liabilities properly incurred by the Authority.

(2) The Authority may invest any money for the time being standing to the credit of the Fund in any government security or in any other security approved by the Board.

(3) The Authority shall prepare in the manner prescribed and approve, prior to the start of the financial year, an annual budget indicating all its anticipated revenues as well as all proposed expenditures for the forthcoming year.

(4) The Authority shall keep proper accounts of the fund distinguishing capital from revenue in the manner prescribed.

(5) The annual accounts of the Authority shall be prepared in such manner as may be prescribed and be subject to audit by a Chartered Accountant in practice to be appointed annually by the Board.

(6) The Authority shall forward a copy of the audited accounts together with audit report thereon annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

Returns and reports.

16. (1) The Authority shall furnish to the Central Government at such time and in such form and manner such returns and statements as the Central Government may, from time to time, require.

(2) The Authority shall also, within 90 days after the end of each financial year, submit to the Central Government an annual report, in the prescribed format.

(3) The annual report shall carry:

(a) a true and full account of its policies, activities, programmes, and

(b) an assessment of the effectiveness and the efficiency of the Authority in terms of its objectives, functions, and activities during the previous financial year.

(4) A copy of the annual report shall be laid, as soon as may be after it is received, before each House of Parliament.

Power of Central Government to issue directions.

17. (1) The Authority shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy as the Central Government may give in writing to it from time to time: Provided that the Board shall be given an opportunity to express its views before any direction is given.

(2) The decision of the Central Government whether a question is one of policy shall be final.

(3) The Central Government shall cause a copy each of the direction issued under sub-section (1) and a statement carrying the rationale for the same before each House of Parliament at the earliest.

Power of Central Government to supersede the Board.

18. (1) If, at any time the Central Government is of the opinion that the Authority is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act, it may, by notification and for reasons to be stated therein, supersede the Board for such period, not exceeding six months, as may be stated in the notification: Provided that before issuing any such notification, the Central Government shall give a reasonable opportunity to the Board to make representations against the proposed supersession and shall consider the representations, if any, of the Board.

(2) Upon the publication of a notification, -
   (a) the members shall, as from the date of supersession, cease to discharge their functions; and
   (b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Board shall be exercised and discharged by such person or persons as the Central Government may direct.

(3) On or before the expiration of the period of supersession specified in the notification, the Central Government shall reinstate the Board by a notification.

(4) The Central Government shall cause a copy each of the notifications issued for supersession and reinstatement and a full report of any action taken during the period of supersession and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

Functions of the Authority

19. (1) It shall be the duty of the Authority to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit.

(2) (2) Without prejudice to the generality of the foregoing provisions, the measures referred to therein may provide for-
   (a) registering the service providers and regulating their business, affairs, conduct and operations;
   (b) regulating the matters relating to issue of capital, transfer of securities and related corporate actions;
   (c) regulating listing, delisting, trading and settlement of trades in securities;
   (d) regulating conduct and performance of professionals in respect of their services required under the securities laws;
   (e) prohibiting fraudulent and unfair trade practices relating to securities markets;
   (f) prohibiting insider trading in securities;
   (g) regulating substantial acquisition of shares and takeover of companies;
   (h) promoting investors' education and training of service providers of securities markets;
   (i) promoting best practices in securities markets;
   (j) calling for information from, undertaking inspection, conducting inquiries and audits of the service providers;
   (k) calling for information and records from any person or any authority which, in the opinion of the Board, shall be relevant to any investigation or inquiry by the Board in respect of any transaction in securities;
   (l) calling for information from, or furnishing information to, other authorities, whether in India or outside India, having functions similar to those of the Authority, in the matters relating to the prevention or detection of violations in respect of securities laws, subject to the provisions of other laws for the time being in force in this regard:
   (m) calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions;
   (n) performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956 (42 of 1956), as may be delegated to it by the Central Government;
   (o) levying fees or other charges for carrying out the purposes of this Act;
   (p) conducting research and maintaining databases for the above purposes; and
   (q) such other measures as may be prescribed.

(3) The Authority may take measures to undertake inspection of any book, or register, or other document or record of a company where the Authority has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.

(4) Notwithstanding anything contained in any other law for the time being in force, while exercising the powers under sub-section (2)(j), 2(k) or (3), the Authority shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit in respect of the following matters, namely:-
   (i) the discovery and production of records and documents at such place and such time as may be required by the Authority;
   (ii) summoning and enforcing attendance of persons and examining them on oath;
   (iii) inspection of any books, registers, records and documents of a service provider or a company referred to in sub-section (3); and
   (iv) issuing commissions for the examination of witnesses or documents.

Delegation.

20. The Authority may, by notification, delegate to the chairperson or any other member or a committee of members or an officer or a committee of officers of the Authority subject to such conditions, if any, as may be specified in the notification, such of its powers and functions under this Act, except the functions of the Board under chapter III and functions of administrative law member(s) and administrative law officers under chapter IV, as it may deem necessary.

CHAPTER III
QUASI-LEGISLATIVE FUNCTIONS AND RELATED MATTERS

Rules.

21. (1) The Central Government may, by notification, make rules for carrying out the purposes of this Act.
(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely: -
   (a) the manner of evaluation of the working of this Act;
   (b) the terms and conditions of service of members;
   (c) the manner of preparation and maintenance of accounts of the Authority;
   (d) the format of annual report to be submitted by the Authority;
   (e) the frequency of and the procedure to be followed at meetings of the Authority, including the quorum necessary for the transaction of business;
   (f) the manner of filing of appeal before the Tribunal;
   (g) the manner of analysis of costs and benefits of regulations; and
   (h) any other matter which is required to be, or may be, prescribed, or in respect of which provision is to be or may be made by rules.

Regulations.

22. (1) The Authority may, by notification, make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act.
(2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely: -
   a) the time and places of meetings of the advisory council(s) and the procedure to be followed at such meetings including the quorum necessary for the transaction of business;
   b) the terms and other conditions of appointment of members on advisory council(s);
   c) the service matters, including selection, appointment, and terms and conditions of service of officers and other employees of the Authority;
   d) the powers and functions which may be delegated to chairperson, other members or committees of members, or officers or committee of officers;

e) matters relating to service providers, including the manner of seeking certificate of registration; eligibility, capital adequacy and other requirements for registration; fees payable on registration and periodically thereafter; process of registration and surrender of registration; the condition for grant of registration; obligations and code of conduct; the manner of inspection, inquiries and audit; the manner of preparation and disclosure of accounts; the manner of preparation and filing of returns of activities; the relationship between a service provider and a client; and the grounds and manner of suspension or cancellation of registration;
f) terms and conditions of engagement of professionals in securities markets;
g) the fees and charges to be levied for any of its services;
h) the terms and manner of settlement of contraventions of the provisions of the Act; and
i) any other matter which is required to be, or may be, specified by regulations or in respect of which provision is to be or may be made by regulations.

(3) The Authority shall endeavor, wherever appropriate, to include in regulation:
 (a) the principles;
 (b) the legislative notes; and
 (c) timelines for various activities.

Operations manual.

23. (1) The Authority shall make operations manual(s) consistent with this Act and the rules and regulations made thereunder to guide disposal of major tasks, including activities, under the Act.
(2) In particular, and without prejudice to the generality of the foregoing power, such operations manual(s) shall provide for all or any of the following matters, namely: -
 (a) process of initiation and conclusion of a task;
 (b) stages and sequence of stages in the task;
 (c) time lines for completion of each stage in the task;
 (d) level of officers entitled to determine matters at various stages of the task,
 (e) any other matter relevant to the task in respect of following tasks, namely,
  (i) making regulations;
  (ii) grant of registration to a service provider;
  (iii) surrender of registration of a service provider;
  (iv) calling for information or providing information;
  (v) recovery of fees and penalties;
  (vi) guidance on the provisions of the Act and regulations made thereunder;
  (vii) fact finding such as investigation, inspection, inquiry, audit, etc.;
  (viii) prosecution;
  (ix) orders by administrative law department, and
  (x) any other task the Board considers necessary.

Making regulations.

24. (1) For the purpose of making regulations, the Authority must publish the following for public comments:
 (a) draft of proposed regulations approved by the Board;
 (b) the specific provision of the Act empowering the Authority to make the said regulations;
 (c) a statement of the problem or market failure that the said regulation seeks to address;
 (d) an analysis of the costs and benefits of the proposed regulations in the manner as may be prescribed;
 (e) a statement carrying norms advocated by international standard setting agencies and the international best practices, if any, relevant to the said regulation;
 (f) the manner of implementation of the regulations; and

(g) the manner, process and timelines for receiving comments from the public.

(2) The Authority shall consider the public comments received and publish the same along with a general statement of its response on the comments, not later than the notification of regulations.

(3) If the Authority decides to approve regulations in a form substantially different from what was published earlier, it shall repeat the process under this section.

(4) The regulations shall be notified immediately after it is approved by the Board and shall come into force after 30 days from the date of notification unless a different date is specified along with the reasons for the same.

Making rules.

25. The provisions of sections 24, except 24(1)(d), shall, mutatius mutandis, apply to making of rules.

Emergency regulations.

26. (1) The Authority may, in emergency, make regulations, by notification, with the approval of chairperson, without following the provisions under sections 24, if it considers that time required for compliance with those provisions is detrimental to the objectives of the Act.

(2) The regulations made under this section shall remain in force for six months from the date of notification.

Guidance on law.

27. The Authority may have an arrangement for providing a general or specific clarification or guidance, either on a request by a person or on its own, on the provisions of the Act and regulations made thereunder subject to the condition that the violation of such clarification or guidance will not ipso facto be a violation of the Act.

Review of regulations.

28. (1) The Authority shall review every regulation and operation manual in force every three years unless a review is warranted earlier keeping in view:

(a) its objectives;
(b) its outcome;
(c) experience of its implementation;
(d) experience of its enforcement and the related litigation;
(e) its relevance in the changed environment; and
(f) any other factor considered relevant by the Board.

Parliamentary consideration.

29. (1) Every rule and every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days, which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

(2) A Parliamentary Committee shall have interaction with the Authority at least once in a year to appreciate the thrust of the regulations and the operations of the Authority, and after consideration of all facts and issues, including the annual reports and annual accounts, may make recommendations as it considers appropriate for consideration of the Authority.

CHAPTER IV
EXECUTIVE FUNCTIONS AND RELATED MATTERS

Certificate of registration.

30. On and from the commencement of this Act, no person shall act as a service provider or hold itself out as a service provider except under, and in accordance with, the conditions of a certificate of registration obtained from the Authority in accordance with the regulations made under this Act.

Application for registration.

31. (1) A person eligible under this Act and the regulations and desirous of registering itself as a service provider shall apply to the Authority seeking a certificate of registration.

(2) Every application for registration shall be in such manner and on payment of such fees as may be specified.

(3) The Authority may require the applicant to furnish such further information or clarification as may be necessary for considering the application for grant of certificate.

(4) The Authority, on being satisfied that the applicant is eligible, shall grant a certificate in the specified format and enter its name in the register.

(5) Where the Authority is of the *prima facie* opinion that a certificate ought not be granted or granted with specific conditions to an applicant, it shall refer the matter along with its recommendation to an administrative law officer for further action under chapter V.

(6) The Authority shall enter the names of service providers who have been granted registration under the Act.

Conditions of registration.

32. A registration granted under the Act shall be subject to the conditions that the service provider:

(a) remains a fit and proper person;
(b) remains eligible under the Act and regulations;
(c) takes adequate steps for the redressal of grievances of clients;
(d) pays the specified fees in time;
(e) undertakes specified continuing professional education programmes;
(f) abides by the provisions of this Act and the regulations made thereunder; and
(g) satisfies any specific condition as may be specified.

General obligations.

33. (1) A service provider shall-

(a) always act in the best interest of its clients;
(b) disclose to all its clients concerned the conflicts of interests as and when they arise or seem likely;
(c) disclose to clients all commissions, rewards, or incentives by whatever name called, if any, from any source, that it may receive if the client chooses to transact through it;
(d) disclose, in public domain, all material information about itself, its business, its disciplinary history, the terms and conditions on which it offers services, and such other information as is necessary for the clients to take informed decisions;
(e) sign an agreement with the clients describing its terms of engagement with him;
(f) redress the grievances of clients within 15 days of the receipt of the same;
(g) maintain the records as may be specified;
(h) comply with conditions of registration; and
(i) comply with the provisions of this Act, and the rules, the regulations made and orders issued thereunder.

(2) A service provider shall not-

(a) provide any service either as principal on its own account or as agent;
(b) disclose to anybody, either orally or in writing, directly or indirectly, any confidential information about its clients, which has come to its knowledge, without taking prior permission of its clients

except where such disclosures are required to be made in compliance with any law for the time being in force;
(c) employ any device, scheme, or artifice to defraud any client;
(d) engage in any transaction, practice, or course of business which operates as fraud or deceit upon any client;
(e) engage in any act, practice or course of business which is fraudulent, deceptive or manipulative; or
(f) adopt any coercive measure for recovery of any money from clients.

Fees and charges

34. (1) The Authority must specify, by regulation, the fees and charges payable by service providers and others to the Authority and the manner of such payment.
(2) The Authority must endeavour to fix the rates of fees and charges in equitable manner keeping in view:
(a) its resource needs, and
(b) effort involved in providing a service or regulating a service provider.

Investigations.

35. (1) Whenever the Authority has reasons to believe that -
(a) the transactions in securities market are being dealt with in a manner detrimental to the investors or the securities market; or
(b) any service provider or any associated person has violated any provision of the Act or direction issued thereunder, it may, at any time by order in writing, direct an officer or group of officers (hereafter referred to as the investigating authority) specified in the order to investigate the affairs of such service provider or associated person and to report thereon to the Authority.
(2) The order shall contain the following particulars:
a) the need for investigation;
b) the scope of investigation in terms of records, activities, places, persons, etc.;
c) the date of commencement of investigation;
d) the time within which the investigation shall be completed;
e) the manner of reporting about the progress in investigation and completion of investigation, and
f) the particulars of investigating authority: Provided the persons to be investigated must have at least 15 days' notice of the commencement of investigation; Provided further that investigations may be commenced with shorter notice if the Authority has approved the same with the reason for such shorter notice.

(3) The Authority and the investigation authority shall make every effort to keep investigation confidential and to cause the least burden on or disruption of the business of the persons being investigated.
(4) Without prejudice to the provisions of any other law, it shall be the duty of every manager, managing director, officer and other employee of the service provider and every other person under investigation and any person having knowledge or custody of material relevant to the investigation, to produce to the investigating authority, all the books, registers, other documents and record of, or relating to, the organisation or, as the case may be, of or relating to, the person.
(5) The investigating authority may require any such person to furnish such information to, or produce such books, or registers, or other documents, or record before him or any person authorised by it in this behalf as it may consider necessary if the furnishing of such information or the production of such books, or registers, or other documents, or record is relevant or necessary for the purposes of the investigation.
(6) The investigating authority may keep in its custody any books, registers, other documents and record produced to it up to six months and thereafter shall return the same to the person by whom or on whose behalf the books, registers,

other documents and record were produced: Provided that it may call for these records and documents again if it considers necessary and shall give certified copies of these to the person by whom or on whose behalf these were produced, if required by him.

(7) The investigating authority may examine on oath, any manager, managing director, officer and other employee of any service provider or associated person in any manner, in relation to the affairs of his business and may administer an oath accordingly and for that purpose may require any of those persons to appear before it personally.

(8) Notes of any examination under sub-section (7) shall be taken down in writing and shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.

(9) If any person fails without reasonable cause or refuses -

(a) to produce to the investigating authority; any book, register, other document and record which is his duty to produce; or

(b) to furnish any information which is his duty to furnish; or

(c) to appear before the investigating authority personally when required to do so under or to answer any question which is put to him by the investigating authority; or

(d) to sign the notes of any examination, he shall be punishable under section 44 of the Act.

(10) Where in the course of investigation, the investigating authority has reasonable ground to believe that the books, registers, other documents and record of, or relating to, any service provider or associated person in any manner, may be destroyed, mutilated, altered, falsified or secreted, the investigating authority may make an application to the Magistrate or Judge of such Designated Court in Mumbai, as may be notified by the Central Government for an order for the seizure of such books, registers, other documents and record.

(11) After considering the application and hearing the investigating authority, if necessary, the Magistrate or Judge of the Designated Court may, by order, authorise the investigating authority -

(a) to enter, with such assistance, as may be required, the place or places where such books, registers, other documents and record are kept;

(b) to search that place or those places in the manner specified in the order; and

(c) to seize books, registers, other documents and record, it considers necessary for the purposes of the investigation:

Provided that the Magistrate or Judge of the Designated Court shall not authorise seizure of books, registers, other documents and record, of any listed public company or a public company, not being a service provider, which intends to get its securities listed on any recognised stock exchange unless such company has prima facie indulged in insider trading or market manipulation.

(12) The investigating authority may requisition the services of any police officer or any officer of the Central Government, or of both, to assist him for in search and seizure under the order under sub-section (11) and it shall be the duty of every such officer to comply with such requisition.

(13) The investigating authority shall keep in its custody the books, registers, other documents and record seized under this section for such period not later than the conclusion of the investigation as it considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person, from whose custody or power they were seized and inform the Magistrate or Judge of the Designated Court of such return.

Provided that the investigating authority may, before returning such books, registers, other documents and record as aforesaid, place identification marks on them or any part thereof.

(14) Save as otherwise provided in this section, every search or seizure made under this section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973 (2 of 1974) relating to searches or seizures made under that Code.

(15) The Authority shall, by an order conclude, the investigation only if it is satisfied that the investigating authority has conducted the investigation and submitted the report of investigation as per the order.

(16) If the Authority is not satisfied of the progress in investigation or with the investigation report, it may direct the investigating authority to address the deficiencies in the investigation or may direct another officer or group of officers as investigating authority to conduct investigation.

Consideration of investigation report.

36. (1) If the Authority or the investigating authority is of prima facie of the opinion that certain measures need to be taken in the interests of investors or securities market, pending completion of investigations, it shall refer the matter along with a statement of its recommendations and reason for the same, to an administrative law member for further action under chapter V.

(2) The Authority shall consider the investigation report within 30 days of the submission of the report and approve show cause notice if it finds that there has been any contravention of any provision of the Act.

(3) While considering the investigation report, the Authority shall take into the following factors, among others:

(a) the nature and seriousness of the contraventions, including whether it was deliberate, reckless or negligent on the part of the notice;

(b) the consequences and impact of the contravention, including the extent of-

i. unfair advantage gained by the notice as a result of the contravention, and

ii. loss caused, or likely to be caused, to investors or any other person as a result of the contravention; and

(c) the conduct of the notice after the occurrence of the contravention, and prior contraventions committed by the notice.

(4) The show cause notice must state:

(a) the provisions of law under which it is issued;

(b) a detailed explanation of the alleged facts;

(c) details of evidence in support of the alleged facts;

(d) the specific provisions of law allegedly contravened;

(e) the action(s) / directions that the Authority proposes to take / issue;

(f) the procedure for seeking settlement of contravention;

(g) what the notice is required to do and the timeline for and the manner of doing the same;

(h) the rights of the notice;

(i) the consequences of failure to respond adequately to the notice;

(j) the timelines for various stages for disposal of the notice; and

(k) the procedure to be followed for disposal of the notice.

(5) The show cause notice must annexe copies of documents and reports and extracts of relevant portions of documents and reports containing the findings arrived at in an investigation, if any, and other material as may be relied on by the Authority in support of the alleged contravention.

(6) The Authority shall refer the show cause notice to the administrative law department for further action under chapter V.

Fact finding.

37. (1) The Authority may use any means of fact finding, such as inspection, enquiry, surveillance, audit or any other to ensure that the service providers and professionals comply with the provisions of the Act or to find the non-compliance by any of them.

(2) The Authority must adopt fair practices in conduct of fact finding and ensure least burden on or disruption of business of persons concerned.

(3) The provisions of section 36 shall, mutatis mutandis, apply to consideration of any fact finding report and if there is any contravention of any provision of Act, the show cause notice shall be issued accordingly.

CHAPTER V
QUASI-JUDICIAL FUNCTIONS AND RELATED MATTERS

Registration order.

38. An administrative law officer, on a reference under section 31(5), shall hear the applicant and the Authority and pass a reasoned order disposing of the application.

Order pending fact finding.

39. (1) An administrative law member, on a reference from the Authority under section 36(1), in the interests of investors or the securities markets, pending fact finding, may, by a reasoned order, take any of the following measures, namely: -

(a) suspend the trading of any security on a recognised stock exchange;

(b) restrain any person from accessing the securities market;

(c) prohibit any service provider or associated person to buy, sell or deal in securities;

(d) suspend any office-bearer of any service provider from holding such position;

(e) impound and retain the proceeds or securities in respect of any transaction which is under investigation or any fact-finding process;

(f) attach, after passing of an order on an application made for approval by the Judicial Magistrate of the first class having jurisdiction, for a period not exceeding one month, one or more bank account or accounts of any service provider or associated person in any manner involved in violation of any of the provisions of this Act, or the rules or the regulations made thereunder; and

(g) direct any service provider or associated person in any manner not to dispose of or alienate an asset forming part of any transaction which is under the fact-finding process.

(2) The administrative law member shall give a hearing to the person(s) concerned within 30 days of the issue of interim order and confirm the same if it is to continue remain in force.

(3) The interim order shall remain in force for not more than six months unless it is extended on consideration of circumstances, after hearing the persons concerned and no such extension can be for more than six months at a time.

Order on completion of fact finding.

40 (1) A bench shall, on a reference from the Authority under section 36(6), follow an adversarial system where the Authority as well as the notice shall have the right to be represented at the hearing.

(2) The bench may give a preliminary ruling on the issue of jurisdiction of the authority, if sought by the notice.

(3) The bench shall facilitate cross examination of witnesses, if required and relevant in disposal of the show cause notice.

(4) The bench shall have the power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in his opinion, may be useful for or relevant to the subject matter of the show cause notice.

(5) In the event the notice fails, neglects or refuses to make written submission or fails, neglects or refuses to appear before the bench, the bench shall proceed ex-parte the notice after recording the reasons for doing so.

(6) The bench shall, after considering the written and oral submission(s), if any, of the notice and of the Authority and the relevant material facts and circumstances and material on record, dispose of the show cause notice by a reasoned order.

(7) The order shall contain such measures and directions as are warranted by the nature and extent of the contravention of the Act and while determining the measures and directions, the bench shall take into consideration, among others,
  (a) the factors enumerated under section 36(3); and
  (b) the sanctions indicated against the contraventions listed in Schedule 1.

(8) The order may contain any or all of the following measures and directions:
  (a) public warning;
  (b) direction requiring the notice to remedy the contravention;
  (c) direction requiring the notice to cease and desist from committing contravention;
  (d) direction to prevent recurrence of contravention;
  (e) direction to disgorge unlawful gain made or lawful loss avoided;
  (f) imposition of monetary penalty;
  (g) variation, suspension, or cancellation of registration granted by the Authority;
  (h) direction not to participate in the securities market in any manner;
  (i) launch of prosecution before appropriate court of law; and
  (j) any other as may be warranted to meet the ends of justice.

(9) It will be endeavour of the bench, wherever possible and meaningful, to direct disgorgement of the unlawful gain made or lawful loss avoided by the notice.

(10) The order shall state the manner of its implementation as well as provide for management of the consequences of such implementation

(11) The order shall not become effective until thirty days have elapsed from the date of issue of the order unless the bench states otherwise in the said order along with the reason for the same.

Review of order.

41. (1) Any person aggrieved an order under section 39 or 40 may apply for a review of the same by an administrative law member.

(2) The administrative law member may, by a review order, set aside or modify the order if he finds an apparent error in the said order on review.

Recovery of amounts.

42. (1) If a person fails to pay the penalty, refund or disgorge monies as directed under an order of the Authority, the Recovery Officer shall recover from such person the amount due by one or more of the following modes, namely: -
  (a) attachment and sale of the person's movable property;
  (b) attachment of the person's bank accounts;
  (c) attachment and sale of the person's immovable property;
  (d) arrest of the person and his detention in prison; and
  (e) appointing a receiver for the management of the person's movable and immovable properties.

(2) The provisions of the Income-tax Act, 1961 and the rules thereunder as in force from time to time shall, mutatis mutandis, apply to recovery of the amounts by the Recovery Officer.

(3) The Recovery Officer may seek the assistance of the local district administration while exercising the powers under sub-section (1) and it shall be the duty of district administration to extend such assistance.

(4) Notwithstanding anything contained in any other law for the time being in force, the amounts due under an order of the Authority shall have precedence over any other claim against such person.

(5) For the purposes of recovery of the amounts, the Authority shall designate any officer of the Authority, by general or a special order in writing, to exercise the powers of a Recovery Officer.

Contraventions

43. (1) Without prejudice to any award of penalty by the Authority under this Act, if any person contravenes, or attempts to contravene, or abets the contravention of the provisions of this Act or regulations made thereunder, he shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to rupees one crore, or with both.

(2) If a person fails to pay the monetary penalty imposed by the Authority or fails to comply with any of its orders or directions, he shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to rupees one crore, or with both.

Establishment of Special Courts.

44. (1) The Central Government may, for the purpose of providing speedy trial of contraventions under this Act, by notification, establish or designate as many Special Courts as may be necessary.

(2) A Special Court shall consist of a single judge who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.

(3) A person shall not be qualified for appointment as a judge of a Special Court unless he is, immediately before such appointment, holding the office of a Sessions Judge or an Additional Sessions Judge, as the case may be.

(4) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, all contraventions under this Act shall be taken cognizance of and tried by the Special Court established for the area in which the contravention is committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned.

Appeal and revision.

45. The High Court may exercise, so far as may be applicable, all the powers conferred by Chapters XXIX and XXX of the Code of Criminal Procedure, 1973 on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

Application of Code to proceedings before Special Court.

46. (1) Save as otherwise provided in this Act, the provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court and for the purposes of the said provisions, the Special Court shall be deemed to be a Court of Session and the person conducting prosecution before a Special Court shall be deemed to be a Public Prosecutor within the meaning of clause (u) of section 2 of the Code of Criminal Procedure, 1973.

(2) The person conducting prosecution referred to in sub-section (1) should have been in practice as an advocate for not less than seven years or should have held a post, for a period of not less than seven years, under the Union or a State, requiring special knowledge of law.

Settlement of contraventions.

47. (1) Notwithstanding anything contained in any other law for the time being in force, any person, against whom any show cause notice has been issued or likely to be issued for any alleged contravention listed in schedule 1, may file an application in writing to the Authority proposing settlement of the alleged contravention. Clarification: There is no contravention which shall not be settled. Every contravention can be settled only if the terms of settlement are appropriate.

(2) The Authority may, after taking into consideration the nature, gravity and impact of contravention(s), agree to the proposal for settlement, on payment of such sum of money or on such other terms as may be considered equitable by the Authority.

(3) If the matter is pending before a Court or the Tribunal, the terms of settlement agreed between the Authority and the applicant shall be submitted before the Court or the Tribunal, as the case may be, for is consideration.

(4) The settlement under this section shall be conducted in accordance with the procedure specified in the regulations made under this Act.

(5) No appeal shall lie against any order passed by the Authority under this section.

Credit to penalties, etc.

48. The following amount shall be credited to the disgorgement fund:

(a) the amount received towards disgorgement under settlement of any contravention under section 47(1);

(b) the amount received towards disgorgement under an order under section 40; and

(c) the amount of monetary penalty received from the person who has disgorged under an order under section 40 for the same contravention.

(2) The Authority, wherever possible and meaningful, shall disburse the disgorged amount to the victims of the related contraventions.

(3) Any surplus in disgorgement fund shall be used for investor education and awareness.

(4) All sums realied by way of monetary penalties and settlement of contraventions under this Act, subject to sub-section (1), shall be credited to the Consolidated Fund of India.

Establishment of Securities Appellate Tribunal.

49. (1) The Central Government shall by notification, establish a Tribunal by the name the Securities Appellate Tribunal to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act or any other law for the time being in force.

(2) The Tribunal shall have its main bench at Mumbai and may establish as many benches as required at any other place in India.

(3) The Tribunal shall be headed by a Presiding Officer and shall have as many technical or judicial members as may be necessary.

(4) The main bench shall consist of the Presiding Officer and two members.

(5) Any other bench shall consist of two members, one of whom must be a judicial member who will preside over the bench.

(6) The eligibility, term and terms of appointment and resignation and removal of the Presiding Officer and members of the Tribunal and other establishment matters of the Tribunal shall be as applicable to Appellate Tribunals under the Tribunals, Appellate Tribunals and other Authorities (Conditions of Service) Bill, 2014.

Appeal to Securities Appellate Tribunal.

50. (1) A person aggrieved by an order under sections 38, 39, 40 or 41(2) may prefer an appeal before the Tribunal.

(2) An appeal shall be filed within a period of forty-five days from the date on which a copy of the order or decision is received by the appellant. Provided that the Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

(3) On receipt of an appeal, the Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(4) The Tribunal shall send a copy of every order made by it to the parties to the appeal and to the Authority.

(5) The appeal filed before the Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal within six months from the date of receipt of the appeal.

Procedure and powers of Securities Appellate Tribunal.

51. (1) The Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908), but shall be guided by the principles of natural justice and, subject to the other provisions of this Act, the Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings.

(2) The Tribunal shall have, for the purpose of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908), while trying a suit, in respect of the following matters, namely: -

(a) summoning and enforcing the attendance of any person and examining him on oath;
(b) requiring the discovery and production of documents;
(c) receiving evidence on affidavits;
(d) issuing commissions for the examination of witnesses or documents;
(e) reviewing its decisions;
(f) dismissing an application for default or deciding it ex parte;
(g) setting aside any order of dismissal of any application for default or any order passed by it ex parte.

(3) Every proceeding before the Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code (45 of 1860) and the Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974).

Right to legal representation.

52. The appellant may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Tribunal.

Limitation.

53. The provisions of the Limitation Act, 1963 (36 of 1963) shall, as far as may be, apply to an appeal made to a Tribunal.

Civil court not to have jurisdiction.

54 No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Appeal to Supreme Court.

55. A person aggrieved by any decision or order of the Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Tribunal to him on any question of law arising out of such order:

Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Legal permissibility

56. If subject matter of a dispute before the Authority, the Tribunal, any High Court or the Supreme Court requires determination of legal permissibility of an activity, service or business of a service provider, it must be decided forthwith and, in any case, not later than 90 days from receipt of matter.

CHAPTER VI
MISCELLANEOUS

Exemption from income tax, etc.

57. Notwithstanding anything contained in any law for the time being in force, the Authority shall not be liable to tax on its wealth, income, expenditure, gift, profits or gains.

Application of other laws not barred.

58. The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

Obligations.

59. (1) The Central Government and the Authority shall discharge their obligations within the timelines specified in the Act, the rules, the regulations and the operations manuals, as the case may be.

(2) A person aggrieved by non-discharge of obligations by the Central Government or the Authority under the Act may seek intervention of Special Court and the cost of seeking such intervention shall be borne by the Central Government or the Authority, as the case may be, if it is found by that Court that the Central Government or the Authority was at fault.

Repeal and savings.

60. (1) The Securities and Exchange Board of India Act, 1992 is hereby repealed.

(2) Notwithstanding such repeal, anything done or any action taken under the said Act(s) shall be deemed to have done or taken under the corresponding provisions of this Act.

Transfer of assets, liabilities, etc.

61. (1) On and from the date of establishment of the Authority, -

(a) any reference to the existing Securities and Exchange Board of India in any law other than this Act or in any contract or other instrument shall be deemed as a reference to the Authority;

(b) all properties and assets, movable and immovable, of, or belonging to, the existing Securities and Exchange Board of India shall vest in the Authority;

(c) all rights and liabilities of the existing Securities and Exchange Board of India shall be transferred to, and be the rights and liabilities of, the Authority;

(d) without prejudice to the provisions of clause (c), all debts, obligations and liabilities incurred, all contracts entered into and all matters and things engaged to be done by, with or for the existing Securities and Exchange Board of India immediately before that date, for or in connection with the purpose of the said existing Board shall be deemed to have been incurred, entered into, or engaged to be done by, with or for, the Authority;

(e) all sums of money due to the existing Securities and Exchange Board of India immediately before that date shall be deemed to be due to the Authority;

(f) all suits and other legal proceedings instituted or which could have been instituted by or against the existing Securities and Exchange Board of India immediately before that date may be continued or may be instituted by or against the Authority; and

(g) every employee holding any office under the existing Securities and Exchange Board of India immediately before that date shall hold his office in the Authority by the same tenure and upon the same terms and conditions of service as respects remuneration, leave, provident fund, retirement and other terminal benefits as he would have held such office if the Authority had not been established and shall continue to do so as an employee of the Authority or until the expiry of the period of six months from that date if such employee opts not to be the employee of the Authority within such period.

(2) Notwithstanding anything contained in the Industrial Disputes Act, 1947 (14 of 1947), or in any other law for the time being in force, absorption of any employee by the Authority in its regular service under this section shall not entitle such employee to any compensation under that Act or other law and no such claim shall be entertained by any court, tribunal or other authority.

Power to remove difficulties.

62. (1) If any difficulty arises in giving effect to provisions of this Act, the Central Government may, by order, published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear to be necessary for removing the difficulty. Provided that no order shall be made under this section after the expiry of five years from the commencement of this Act.

(2) Every order shall be laid, as soon as may be after it is made, before each House of Parliament.

Schedule 1
(Under section 40 (7)
(This is only an illustrative format.)

The contraventions under the Act and the sanctions warranted are as under:

Class of Contravention	Contraventions covered in the class	Sanctions (one or any combination of sanctions in the class)
(1)	(2)	(3)
A	a.	a. Prosecution leading to an imprisonment of 3 - 7 years and or a fine of Rs. 5 crore to three times of the amount involved in contravention; b. Cancellation of registration; c. Monetary penalty of Rs. 5 crore to three times of the amount involved in contravention; d. Disgorgement of unlawful gain made or unlawful loss avoided; e. Debarment to access market and deal in securities for at least ten years; f. Debarment not to work as key managerial personnel in any listed company for at least ten years; g. Preventive or remedial measures of appropriate scale; and h. Any other as considered appropriate.
B	a. .... b. .... c. .... d.	a. Prosecution leading to an imprisonment of 3 months to three years and or a fine of Rs. 5 lakh to three times of the amount involved in contravention;

(Contd.)

Schedule 1 ***(Concld.)***

Class of Contravention	Contraventions covered in the class	Sanctions (one or any combination of sanctions in the class)
(1)	(2)	(3)
		b. Suspension of registration beyond six months;
		c. Monetary penalty of Rs. 5 lakh to three times of the amount involved in contravention;
		d. Disgorgement of unlawful gain made or unlawful loss avoided;
		e. Debarment to access market and deal in securities for at least five years;
		f. Debarment not to work as key managerial personnel in any listed company for at least five years;
		g. Preventive or remedial measures of appropriate scale;
		h. Cease and desist; and
		i. Any other as considered appropriate.
C	a.	a. Suspension of registration up to six months;
	b. .... c.	b. Monetary penalty of Rs. 1 lakh to three times of the amount involved in contravention;
	d.	c. Disgorgement of unlawful gain made or unlawful loss avoided;
		d. Debarment to access market and deal in securities for at least three years;
		e. Debarment not to work as key managerial personnel in any listed company for at least three years;
		f. Preventive or remedial measures of appropriate scale;
		g. Cease and desist;
		h. Restriction on taking new clients;
		i. Warning and censure; and j. Any other as considered appropriate.
E (continuing	a.	a. Warning and censure;
contraventions and	b.	b. Rs. 1 lakh per day;
technical contraventions)	c.	c. Monetary penalty of Rs. 1 lakh;
	d.	d. Any other as considered appropriate.

NOTES

1. Includes any other synonym such as development, growth, prosperity, progress, quality of life, etc.

2. NIFTY is an index of prices of fifty major companies listed on NSEIL(National Stock Exchange of India Limited).

3. The six fully-compliant jurisdictions are Australia, Brazil, Japan, Hong Kong SAR, India and Singapore. Overtaking global giants like the US and China, India scored top rankings when it comes to putting in place necessary regulations to ensure soundness of the financial market infrastructure.

4. The Council is chaired by Finance Minister. Its predecessor was HLCCFM (High Level Committee on Capital and Financial Markets), which was chaired by Governor, RBI.

5. Canada issued in August 2014 a draft Capital Markets Stability Act for public comments at: http://www.fin.gc.ca/drleg-apl/2014/cmsa-lsmc-l-eng.pdf

6. Please see order of CCI at: http://www.cci.gov.in/May2011/OrderOfCommission/MCXMainOrder240611.pdf

7. It was initially contemplated that there would be only one depository which would store physical securities in a safe vault, maintain records of ownership of securities, and transfer securities from one person to another. The idea was to immobilize the securities rather than to dematerialise them.

8. SENSEX is an index of prices of thirty major companies listed on Bombay Stock Exchange (BSE) Ltd.

9. Market capitaliation almost doubled during 2009 from Rs. 31 trillion at the end of December 2008 to Rs. 60 trillion by the end of December 2009. It increased by more than 40% in 2014.

10 Alternative terms are government failure, regulatory failure, non-market failure, etc.

11. The PCAOB is a nonprofit corporation that oversees the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. It also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.

12. See the Securities Laws (Amendment) Act, 2004 following extreme volatility in the stock markets in 2001.

13. Please see Justice J. Chelameswar [2013], in Republic of India & Ors v. Union of India & Ors at http://judis.nic.in/supremecourt/ imgs1.aspx?filename=39941.

14. In the US regulatory context, these typically include a chief compliance officer (CCO), written compliance policies and procedures, annual self-assessments, mandatory access for the CCO to the entity's senior executives, and written codes of ethics.

15. This section heavily borrows from a number of publications, namely, Sahoo, 2005c; Ramkrishna & Sahoo, 2010; Sabarinathan G., 2010; SEBI, 2014; and NSEIL, 2014.

16. SEBI, which is statutorily responsible for protection of investors in securities and promotion of development of and regulation of securities market, curiously has no role in the market for government securities.

17. If a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public.

18. The trades on exchange platform are now as good as spot trades as the settlement happens within two days.

19. BSE Ltd., NSEIL, and MCX-SX.

20. The term 'demat' is an Indian usage for dematerialisation.

21. We do not discuss here institutions, such as venture capital funds, credit rating agencies, mutual funds, etc., as these do not have much regulatory role, though these are otherwise important institutions of securities market.

22. Please see the Securities Laws (Amendment) Act, 2014.

23. The SAT is the appellate authority for orders issued by SEBI, PFRDA and IRDAI. FSLRC has recommended that it be converted to Financial Sector Appellate Tribunal for the entire financial sector.

24. Please see Sahoo [2005c]; Ramakrishna & Sahoo [2010]; NSEIL [2014].

25. In its earlier incarnations, this was known as the Disclosure and Investor Protection Guidelines, 1992 / 2000.

26. Three kinds of disclosures, namely, initial disclosures while making a public issue, continuous disclosures as long as the securities remain listed, and transaction / event specific disclosures.

27. It is a process where investors bid to buy the shares at prices they consider appropriate.

28. These are institutional investors who are generally perceived to possess expertise and the financial muscle to evaluate and invest in the capital markets.

29. During initial days of liberaliation (1992-95), quite a few issuers raised resources and vanished.

30. This is an agreement between a listed company and the stock exchange. This is being converted into regulations by SEBI.

31. ASBA (Applications Supported by Blocked Amount) enables an applicant to apply for shares in public issues. His account does not get debited until the shares are allotted to him.

32. Separation of ownership rights from trading rights. NSEIL and OTCEI were born as demutalised exchanges, while all other exchanges were demutualised in 2005 as a regulatory requirement.

33. These were unlimited companies under the Companies Act, 1956.

34. A broker was required to pay turnover based fees for five years from the date of registration and pay a nominal fee thereafter. A broker who has already paid turnover based fees for three years and converts to corporate form thereafter for which it takes a fresh registration, it would not be charged fees afresh for five years. The new registration would be considered as continuation and it would pay turnover based fees for the balance two years.

35. Please see SEBI Board agenda at: http://www.sebi.gov.in/cms/sebi_data/boardmeeting/1299216814348-a.pdf.

36. CPSS since renamed as Committee on Payments and Market Infrastructures (CPMI).

37. Most of the powers under the SCRA have been delegated to SEBI and a few to RBI.

38. SEBI was coined by borrowing parts of names from different jurisdictions. 'Securities and Exchange' was borrowed from 'Securities and Exchange Commission' of USA, 'Board' was borrowed from 'Securities and Investments Board' of UK and 'India' came from 'Made in India'.

39. Planning Commission [2008b] also used the word 'regulatory state'.

40. Something similar to "Executive Agencies: A Guide for Departments" of Cabinet Office (UK), 2006.

41. Chairpersons are mostly retired civil servants, while secretaries are serving civil servants.

42. Till FSDC becomes a statutory body, the Joint Committee under section 45Y of the RBI Act, 1935 may discharge this responsibility.

43. To be established under the National Judicial Appointment Commission Bill, 2014. The NJAC will recommend names for appointment as Chief Justice and other Judges of High Courts and the Supreme Court.

44. Two members got a term of about 13 months. Incidentally, except one exception, no person got to work even two years as a member of the Securities Appellate Tribunal.

45. Only two of them had a stint in private sector after long career in Government.

46. Many members and chairman have admitted privately.

47. Please see para 2.5 of chapter 2 (Comments on Accounts) of Report No. -1 of 2010-11 for the period ended March 2010- Union Government (Civil) - Accounts of the Union Governments at: http://www.saiindia.gov.in/english/home/Our_Products/Audit_Report/Government_Wise/union_audit/recent_reports/union_compliance/2010_2011/Civil/Report_no_1/chap2.pdf

48. "the State" includes the Government and Parliament of India and the Government and the Legislature of each of the States and all local or other authorities within the territory of India or under the control of the Government of India.

49. Article 266 reads as under: (1) Subject to the provisions of article 267 and to the provisions of this Chapter with respect to the assignment of the whole or part of the net proceeds of certain taxes and duties to States, all revenues received by the Government of India, all loans raised by that Government by the issue of treasury bills, loans or ways and means advances and all moneys received by that Government in repayment of loans shall form one consolidated fund to be entitled "the Consolidated Fund of India", ...
(2) All other public moneys received by or on behalf of the Government of India or the Government of a State shall be credited to the public account of India or the public account of the State, as the case may be.
(3) No moneys out of the Consolidated Fund of India or the Consolidated Fund of a State shall be appropriated except in accordance with law and for the purposes and in the manner provided in this Constitution.

50. 'Keeping' does not mean only custody. Otherwise, it would not be argued that the Finance Accounts of the Union Government does not present a correct and complete picture of government finances because these funds are kept outside government accounts.

51. It has been renamed as FCA under the Financial Services Act, 2012.

52. Something similar to the Federal Administrative Procedure Act of 1946 (US).

53. Government is most immune to capture by an interest group. General regulator like CCI is less susceptible.

54. There are nearly 3 million financial advisors plus banking staff selling non-banking financial products. They serve about 188 million investors holding financial assets [MOF, 2009].

55. Incidentally, this consolidation will harness the economies of scope and scale in the financial system while reducing the potential of regulatory capture.

56. The theoretical underpinning of this chapter was provided in Section 2 (Part 1).

57. The Securities Laws (Amendment) Ordinance promulgated on 25th January 2005 dispensed with the requirement of prior approval of Government.

58. See agenda no. 13 of the SEBI Board meeting held on 18th June 2009 at: http://www.sebi.gov.in/cms/sebi_data/boardmeeting/1299216814348-a.pdf

59. The consultation process followed by AERAI is probably the best in India and could be emulated by others.

60. Please see agenda no. 4 of the SEBI Board meeting held on 19th November 2014 at http://www.sebi.gov.in/cms/sebi_data/boardmeeting/1417500933558-a.pdf

61. Only instance, I am given to understand, where the parliamentary committee had sought some change was in 2003 in respect of the SEBI (Ombudsman) Regulations, 2003. This regulation is yet to be operationalised.

62. Please see the SEBI (Prohibition of Insider Trading) Regulations, 2015 which has been prepared through an expert committee and which has undergone an extensive consultation process. Though it did not carry an analysis of costs and benefits, each proposed provision carried the rationale for the same. Also see agenda no. 17 of the SEBI Board meeting held on 19th November 2014 at http://www.sebi.gov.in/cms/sebi _data/boardmeeting/1417514515705-a.pdf.

63. Please see order at: http://www.sebi.gov.in/cms/sebi _data/attachdocs/1310556344733.pdf

64. Every piece of regulation potentially entails three sets of costs: one borne by regulators in monitoring and enforcing regulations, the second borne by the economy in reallocation of resources in response to regulations, and the third borne by the participants in meeting the obligations imposed by regulations. The third set is called compliance costs which every economic agent incurs and, being unavoidable, is often called 'regulatory tax'. It includes expenses to set up systems, engage specialists and commit resources to maintain records, make timely filings and disclosures, undertake due diligence, abide by code of conduct, sustain capital adequacy and other prudential norms, and discharge other obligations under the applicable laws.

65. In common law countries judges make law through legally binding precedents.

66. Please see SEBI Board agenda at: http://www.sebi.g ov.in/cms/sebi_data/boardmeeting/1299216814348-a.pdf

67. Ibidem.

68. For an example, please see order at http://www.sebi. gov.in/cms/sebi_data/attachdocs/1291022006876.pdf. Reportedly (http://www.moneylife.in/article/tc-nair-right-m an-right-place-right-time/34648.html), the party had offered to settle the alleged contravention for Rs. 5 crore which was not accepted. Ultimately the party was let off with a warning.

69. The Securities Laws (Amendment) Act, 2014 now enables SEBI to recover the monetary penalties by coercion. Most of the penalties levied so far were not realied.

70. For the details of IPO irregularity, visit: http://www. sebi.gov.in/cms/sebi_data/commondocs/IPO1_p.pdf.

71. Judicial deference to agency interpretation of law. The courts generally accept an agency's reasonable interpretation of the ambiguous terms of a statute that the agency administers.

72. Section 308(a) of the Sarbanes-Oxley Act, 2002 provides monetary penalties in certain circumstances to be added to disgorgement fund for the benefit of victims of the violation.

73. Section 109(c)(2) of the Sarbanes-Oxley Act, 2002 requires the money collected by penalties to be used to fund merit scholarships for undergraduate and graduate students in accredited accounting degree programmes.

74. Please see at http://www.sebi.gov.in/cms/sebi_data/a ttachdocs/1293602129668.pdf:

75. These include compliance, audit (statutory, secretarial, internal), inspection, investigation, due diligence, etc.

76. Please see at: http://www.sebi.gov.in/cms/sebi_data/ attachdocs/1288001059498.pdf.

77. Please see orders in respect of: a. PACL Limited at http://www.sebi.gov.in/cms/sebi_data/attachdocs/13105563 44733.pdf, and b. Sahara India Real Estate Corpn Ltd at htt p://www.sebi.gov.in/cms/sebi_data/attachdocs/1408704987 673.pdf.

78. Please see order at: http://www.sebi.gov.in/cms/sebi _data/attachdocs/1293604032124.pdf.

79. Please see order at: http://www.sebi.gov.in/cms/sebi _data/attachdocs/1331897274867.pdf.

80. Please see order at: http://www.sebi.gov.in/cms/sebi _data/attachdocs/1321599470068.pdf.

81. Please see order at: http://www.sebi.gov.in/cms/sebi _data/attachdocs/1408704987673.pdf.

82. Please see: http://ibnlive.in.com/news/sahara-case-sc -judge-recuses-himself/471965-7.html.

83. A leading industrialist [The Time of India, 2015b] claims that government officials are avoiding quick decisions as they are wary of CBI, CVC and CAG.

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