Reforms in the Corporate Securities Market in India

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Reforms in the 1990s

With the objectives of improving market efficiency, enhancing transparency, preventing unfair trade practices and bringing the Indian market up to international standards, a package of reforms consisting of measures to liberalise, regulate and develop the securities market was introduced. The practice of allocation of resources among different competing entities as well as its terms by a central authority was discontinued. The secondary market overcame the geographical barriers by moving to screen based trading. Trades enjoyed counter-party guarantee. Physical security certificates almost disappeared. The settlement period shortened to one week and is approaching to one day. The following paragraphs discuss the principal reform measures undertaken since 1992.

SEBI Act, 1992: It created a regulator (SEBI), empowered it adequately 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. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. All market intermediaries are registered and regulated by SEBI. They are also required to appoint a compliance officer who is responsible for monitoring compliance with securities laws and for redressal of investor grievances. The courts have upheld the powers of SEBI to impose monetary penalties and to levy fees from market intermediaries.

Enactment of SEBI Act is the first attempt towards integrated regulation of the securities market. SEBI was given full authority and jurisdiction over the securities market under the Act, and was given concurrent/ delegated powers for various provisions under the Companies Act and the Securities Contracts Regulation Act, 1956 [SC(R)A]. Many provisions in the Companies Act having a bearing on securities market are administered by SEBI. The Depositories Act, 1996 is also administered by SEBI. A high level committee on capital markets has been set up to ensure co-ordination among the regulatory agencies in capital markets.

DIP Guidelines: 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. In the interest of investors, SEBI issued Disclosure and Investor Protection (DIP) guidelines. The guidelines 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. The guidelines aim to secure fuller 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. The guidelines cast a responsibility on the lead managers to issue a due diligence certificate, stating that they have examined the prospectus, they find it in order and that it brings out all the facts and does not contain anything wrong or misleading. Issuers are now required to comply with the guidelines and then access the market. The companies can access the market only if they fulfil minimum eligibility norms such as track record of distributable profits and net worth. In case they do not do so, they can access the market only through book building with minimum offer of 60% to qualified institutional buyers. The norms for continued disclosure by listed companies also improved availability of information. The information technology helped in easy dissemination of information about listed companies and market intermediaries. Equity research and analysis and credit rating improved the quality of information about issues.

Screen Based Trading: The trading on stock exchanges

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in India used to take place through open outcry without use of information technology for immediate matching or recording of trades. This was time consuming and inefficient. This imposed limits on trading volumes and efficiency. In order to provide efficiency, liquidity and transparency, NSE introduced a nation-wide on-line fully-automated screen based trading system (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 sale or buy 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 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, 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. It also provides a perfect audit trail, which helps to resolve disputes by logging in the trade execution process in entirety. This sucked liquidity from other exchanges and in the very first year of its operation, NSE became the leading stock exchange in the country, impacting the fortunes of other exchanges and forcing them to adopt SBTS also.

Technology was used to carry the trading platform to the premises of brokers. NSE carried the trading platform further to the PCs in the residences of investors through the Internet and to hand-held devices through Wireless Application Protocol (WAP) for convenience of mobile investors. This made a huge difference in terms of equal access to investors in a geographically vast country like India.

Trading Cycle: The trades accumulated over a trading cycle and at the end of the cycle, these were clubbed together, and positions were netted out and payment of cash and delivery of securities settled the balance. This trading cycle varied from 14 days for specified securities to 30 days for others and settlement took another fortnight. Often this cycle was not adhered to. Many things could happen between entering into a trade and its performance providing incentives for either of the parties to go back on its promise. This had on several occasions led to defaults and risks in settlement. In order to reduce large open positions, the trading cycle was reduced over a period of time to a week. The exchanges, however, continued to have different weekly trading cycles, which enabled shifting of positions from one exchange to another. It has now been made mandatory for all exchanges to follow a uniform weekly trading cycle. In respect of about 400 major securities, which are traded and settled under rolling settlement, the trading cycle has been reduced to a day and transactions in these securities are settled after 5 days from the trade date w.e.f. July 2001. The balance securities are traded and settled under uniform weekly settlement cycle. These would also be traded under rolling settlement from January 2001. The market also had a variety of deferral products like modified carry forward system, which encouraged leveraged trading by enabling postponement of settlement. The deferral products have been banned. The market has moved close to spot/cash market.

Derivatives Trading: To assist market participants to manage risks better through hedging, speculation and arbitrage, SC(R)A was amended in 1995 to lift the ban on options in securities. However, trading in derivatives did not take off, as there was no suitable legal and regulatory framework to govern these trades. Besides, it needed a lot of preparatory work- the underlying cash markets strengthened with the assistance of the automation of trading and of the settlement system; the exchanges developed adequate infrastructure and the information systems required to implement trading discipline in derivative instruments. The SC(R)A was amended further in December 1999 to expand the definition of securities to include derivatives so that the whole regulatory framework governing trading of securities could apply to trading of derivatives also. A three-decade old ban on forward trading, which had lost its relevance and was hindering introduction of derivatives trading, was withdrawn. Derivative trading took off in June 2000 on two exchanges. The market presently offers index futures, index options and stock options and would soon offer stock futures.

Demutualisation: Historically, brokers owned, controlled and managed stock exchanges. In case of disputes, the self often got precedence over regulations leading inevitably to conflict of interest. The regulators, therefore, focussed on reducing dominance of members in the management of stock exchanges and advised them to reconstitute their governing councils to provide for at least 50% non-broker representation. This did not materially alter the situation. In face of extreme volatility in the securities market, Government proposed in March

2001 to corporatise the stock exchanges by which ownership, management and trading membership would be segregated from one another. A few exchanges have already initiated demutualisation process.

NSE, however, adopted a pure demutualised governance structure where ownership, management and trading are with three different sets of people. This completely eliminated any conflict of interest and helped NSE to aggressively pursue policies and practices within a public interest (market efficiency and investor interest) framework.

Depositories Act: Settlement system on Indian stock exchanges gave rise to settlement risk due to the time that elapsed before trades are settled. Trades were settled by physical movement of paper. This had two aspects. First, the settlement of trade in stock exchanges by delivery of shares by the seller and payment by the purchaser. The stock exchange aggregated trades over a period of time to carry out net settlement through the physical delivery of securities. The process of physically moving the securities from the seller to the ultimate buyer through the seller's broker and buyer's broker took time with the risk of delay somewhere along the chain. The second aspect related to transfer of shares in favour of the purchaser by the company. The system of transfer of ownership was grossly inefficient as every transfer involved physical movement of paper securities to the issuer for registration, with the change of ownership being evidenced by an endorsement on the security certificate. In many cases the process of transfer took much longer, and a significant proportion of transactions ended up as bad delivery due to faulty compliance of paper work. Theft, forgery, mutilation of certificates and other irregularities were rampant, and in addition the issuer had the right to refuse the transfer of a security. All this added to costs, and delays in settlement, restricted liquidity and made investor grievance redressal time consuming and at times intractable.

To obviate these problems, the Depositories Act, 1996 was passed to provide 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 both the stages of settlement process, the Act envisages transfer of ownership of securities 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.* NSDL and CDSL, have come up to provide instantaneous electronic transfer of securities. At the end of June 2001, 39,948 million securities worth Rs. 3,265 billion have been dematerialised with NSDL. The market capitalisation of the companies that have joined NSDL has reached Rs. 5,398 billion at the end of June 2001. 202 depository participants are rendering depository services at 2,639 locations all over the country serving 4 million investors who have opened beneficial accounts with NSDL. The securities of 3,154 companies are available for demat trading. Demat settlement accounts for over 99% of turnover settled by delivery. This has almost eliminated the bad deliveries and associated problems.

To prevent physical certificates from sneaking into circulation, it has been mandatory for all new IPOs to be compulsorily traded in dematerialised 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 IPO of any security for Rs. 10 crore or more to do the same only in dematerialised form.

Risk Management: Market integrity is the essence of any financial market. To pre-empt market failures and protect investors, the regulator/exchanges have developed a comprehensive risk management system, which is constantly 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, detect and prevent price manipulations. Exchanges have set up trade/settlement guarantee funds for meeting shortages arising out of non-fulfillment/partial fulfillment of funds obligations by the members in a settlement.

The fact that an anonymous electronic order book ushered in by the NSE does not allow members to assess credit risk of the counter-party necessitated some innovation in this area. To effectively address this issue, NSE introduced the concept of a novation, and set up the first clearing corporation, *viz.* National Securities

Clearing Corporation Ltd. (NSCCL), which commenced operations in April 1996. The NSCCL assures the counterparty risk of each member and guarantees financial settlement. Counterparty risk is guaranteed through a fine tuned risk management system and an innovative method of on-line position monitoring and automatic disablement. A large Settlement Guarantee Fund, which stood at Rs. 2,916 crore at NSCCL as on31st March 2001, provides the cushion for any residual risk. The market has now full confidence that settlements will take place in time and will be completed irrespective of default by isolated trading members. In fact such confidence is driving volumes on exchanges.

Traditionally, brokerage firms in India have been proprietary or partnership concerns with unlimited liabilities. This restricted the amount of capital that such firms can raise. The growing volume of transactions made it imperative for such firms to be well capitalised and professional. The necessary legal changes were effected to open up the membership of stock exchanges to corporates with limited liability, so that brokerage firms may be able to raise capital and retain earnings. In order to boost the process of corporatisation, capital gains tax payable on the difference between the cost of the individual's initial acquisition of membership and the market value of that membership on the date of transfer to the corporate entity was waived. In response, many brokerage firms reorganised themselves into corporate entities. At the end of March 2001, 3,808 brokers out of 9,782 were corporate bodies.

Investor Protection: The SEBI Act establishes SEBI with the primary objective of protecting the interests of investors in securities and empowers it to achieve this objective. SEBI specifies the matters to be disclosed and the standards of disclosure required for the protection of investors in respect of issues and issues directions to all intermediaries and other persons associated with the securities market in the interest of investors or of orderly development of the securities market.

DEA, DCA, SEBI and exchanges have set up investor grievance cells for redressal of investor grievance. The exchanges maintain investor protection funds to take care of investor claims, which may arise out of non-settlement of obligations by a trading member for trades executed on the exchange. DCA has also set up an investor education and protection fund for the promotion of investors' awareness and protection of interest of investors. All these agencies and investor associations are organising investor education and awareness programmes. Government is considering the report of N. L. Mitra committee, which has, among others, recommended that there should be a specific Act for protecting investors' interest.

Globalisation: Indian securities market is getting increasingly integrated with the rest of the world. Indian companies have been permitted to raise resources from abroad through issue of ADRs, GDRs, FCCBs and ECBs. ADRs/GDRs have two-way fungibility. Indian companies are permitted to list their securities on foreign stock exchanges by sponsoring ADR/GDR issues against block shareholding. NRIs and OCBS are allowed to invest in Indian companies. FIIs have been permitted to invest in all types of securities, including government securities. The investments by FIIs enjoy full capital account convertibility. They can invest in a company under portfolio investment route upto 24% of the paid up capital of the company. This can be increased to 49% with the approval of the shareholders. Indian Stock Exchanges have been permitted to set up trading terminals abroad. The trading platform of Indian exchanges is now accessed through the Internet from anywhere in the world. Mutual Funds have been permitted to set up off-shore funds to invest in equities of other countries. They can also invest in ADRs/GDRs of Indian companies.

Research in Securities Market: In order to deepen the understanding and knowledge about Indian capital market, and to assist in policy-making, SEBI has been promoting high quality research in capital market. It has set up an in-house research department, which brings out working papers on a regular basis. In collaboration with NCAER, SEBI brought out a 'Survey of Indian Investors', which estimates investor population in India and their investment preferences. SEBI has also tied up with reputed national and international academic and research institutions for conducting research studies/ projects on various issues related to the capital market. In order to improve market efficiency further and to set international benchmarks in the securities industry, NSE administers a scheme called the NSE Research Initiative with a view to develop an information base and a better insight into the working of securities market in India. The objective of this initiative is to foster research, which can support and facilitate (a) stock exchanges to better design market micro-structure, (b) participants to frame their strategies in the market place, (c) regulators to frame regulations, (d) policy makers to formulate policies, and (e) expand the horizon of knowledge. The Initiative has received tremendous response.

Testing and Certification: The intermediaries, of all shapes and sizes, who package and sell securities, compete with one another for the chance to handle investors/ issuers' money. The quality of their services determines the shape and health of the securities market. In developed markets and in some of the developing markets, this is ensured through a system of testing and certification of persons joining market intermediaries in the securities market.

A testing and certification mechanism that has become extremely popular and is sought after by the candidates as well as employers is an unique on-line testing and certification programme called National Stock Exchange's Certification in Financial Markets (NCFM). It is an on-line fully automated nation-wide testing and certification system where the entire process from generation of question paper, invigilation, testing, assessing, scores reporting and certifying is fully automated - there is absolutely no scope for human intervention. It allows tremendous flexibility in terms of testing centres, dates and timing and provides easy accessibility and convenience to candidates as he can be tested at any time and from any location. It tests practical knowledge and skills, that are required to operate in financial markets, in a very secure and unbiased manner, and certifies personnel who have a proper understanding of the market and business and skills to service different constituents of the market. It offers eight securities market related modules. About 15, 000 personnel have been certified in these modules.

Further Reforms

The above reforms have come in stages. As some deficiency is noted or some malpractice surfaces in the working of the market, the authorities initiate further reforms and corrective steps. Most of the reforms have gained wide acceptance among market participants and yielded desirable results. A few of them like clearing corporation, demutualised exchange governance need to permeate the whole of the market. A few more fresh initiatives are called for to provide a more peaceful life to investors, broaden the choice for market participants, and further improve efficiency and transparency of the market place. Some of these have been discussed in the following paragraphs.

Exchange Related

***Exchange Governance*:** Reforms focussed on reducing dominance of trading members in the management of stock exchanges by prescribing composition of governing council and strengthening the position of executive director. Such attempts made for decades to improve the working of the exchanges while retaining the basic structure has not yielded any appreciable result. The broker-managed exchanges continue to witness different types of malaise from time to time. The post-mortem of these has generally revealed complicity of elected directors. It has now been realised that there is no alternative to demutualisation. A complete overhaul – not just corporatisation, but also demutualisation - of the exchanges has been announced. This needs to operationalised soon.

***Regional Exchanges*:** There was a time when we needed a large number of exchanges spread across the length and breadth of the country. In the changed on-line environment, while one large exchange could possibly be adequate to meet the demand for securities transactions in India, at least two or three would be essential to ensure competition. Clearly there is not enough space for 24 of them. Other could explore mergers, alliances or other niche markets, which they can profitably serve. They could also consider providing non-exchange intermediation services.

***Business Continuity Plan*:** NSE has established a disaster back-up site at Pune alongwith its entire infrastructure including the satellite earth station and the high speed optical fibre link with its main site at Mumbai. The site at Pune is a mirror replica of the complete production environment at Mumbai. The transaction data is backed up on near real time basis from the main site to the disaster back-up site through the 2 mbps high-speed link to keep both the sites all the time synchronised with each other. Such business continuity plans need to be replicated by all stock exchanges and depositories to provide uninterrupted service to investors.

Central Listing Agency: A security not found suitable for listing on an exchange gets listed on a different exchange, as they follow different criteria for listing securities. This creates an anomalous situation that a security, which is not found suitable for investors in one locality, is suitable for investors in another locality. It is, therefore, desirable that there is only one central agency, which considers all requests for listing and grants listing if it finds a security suitable for investors across the country. A security granted listing by the agency is available for trading on all exchanges that do not waste resources in terms of duplication of efforts on listing and monitoring compliance. The security is monitored, and suspended and withdrawn from trading centrally by the listing agency. The investors and market participants get all the company related information, which are mandatorily required to be filed by companies with stock exchanges or any other agency, at one central location preferably a web-site. This is all the more necessary as the exchanges get demutualised and in turn seek listing on exchanges.

Trading Related

Derivatives Trading: The derivatives trading in India has so far been introduced in a fairly limited range of products. Index futures and options are available only on two indices. Stock options have been introduced on a few securities. In order to provide wider option to market participants, new derivative products, such as stock futures, index futures/options on other popular indices, derivatives on exchange rate, interest rate or gold as the underlying could be introduced.

In the absence of a specific provision regarding taxability of income from derivatives, since derivative contracts are essentially cash settled, it is possible that these may be termed as speculative transactions and if so, any loss arising out of these trades will not be eligible for set off against any other income. Since derivatives are essentially hedging instruments used by the investors to hedge against the potential loss, these must not be considered speculative transactions. These must, however, be taxed as normal business income.

Accounting issues relating to all types of derivatives need to be finalised. All types of market participants like mutual funds, FIIs should be permitted to trade in all types of derivatives. All securities should be traded in the cash segment only under rolling settlement.

Trading of MF Units: The market for units of MFs has not developed appreciably. The easiest way to develop the market for units of MFs is to consider them to be securities explicitly under the SC(R)A so that the regulatory framework applicable to trading of securities would also apply to trading of units of MFs and SEBI which has mandate to protect the interest of investors in securities, can protect the interest of holders of units of MFs.

Margin Trading: Margin trading is purchasing securities by borrowing a portion of the transaction value and using the securities in the portfolio as collateral. It is a form leveraged trading in the sense that backed by the collateral, one can buy assets, which are far greater in value than the value of the collateral. It thus leads to an increase in the purchasing/selling power of the participants and hence enables them to magnify their gains if the stock market moves on expected lines. In the absence of any leveraged trading, like MCFS and ALBM/BLESS, margin trading can address the liquidity concerns in the market.

Settlement Related

Clearing Corporation:: The anonymous order book does not allow participants to assess the counter party risk. It is, therefore, necessary that the exchanges use a clearing corporation to provide novation and settlement guarantee. NSCCL provides such novation for all trades executed on NSE. Similar facility should be provided for trades on other exchanges. It is not necessary that each stock exchange must have its own exclusive clearing corporation. It may be better if the stock exchanges use the services of a clearing corporation or a few clearing corporations, as they share the depository services. Such an arrangement allows the clearing corporation to have an overall view of gross exposure position of traders across the stock exchanges and is much better geared to manage the risk. However, to provide for necessary competition, it is essential that there are at least two clearing corporations, just as this has been ensured in the case of depositories.

The clearing corporation ensures financial settlement of trades on the appointed day and time irrespective of default by members to bring in the required funds and/or securities, with the help of a 'Settlement Guarantee Fund'. This has revolutionised the volumes in the secondary market. It is important to keep improving the value of the Settlement Guarantee Fund by adding back all the accruals to the fund, subject to administrative expenses, to retain and build up the faith that the retail and foreign investment have reposed in the settlement mechanism. For this purpose, it is necessary to exempt the income of the Clearing Corporation from the purview of income tax.

As the clearing corporation guarantees financial settlement, it is necessary that it has first lien over the assets of insolvent clearing members.

It is meaningful for a clearing corporation to net all liabilities falling due on any given day for all types of settlement. As long as the clearing corporation is a centralised legal counter-party, risk management would dictate that it nets all obligations vis-à-vis each counter-party to itself.

Continuous Net Settlement (CNS): A migration from account period settlement to rolling settlement is inevitable, as was from floor trading to electronic screen trading. SEBI has mandated rolling settlement for about 400 major scrips from July 2001 and for all scrips from January 2001.

In the rolling settlement environment where the obligations are to be performed in a shorter period, there is greater likelihood of non-performance/ inadequate performance in terms of delivery on the appointed day and time. CNS offers a facility to a member having a deliverable obligation and going short in delivery of securities on the pre-determined day and time, to make an alternate arrangement of obtaining delivery of securities so as to meet the obligation on the succeeding settlement. Alternatively, a member may take a counter position on the succeeding trading day to create a receivable obligation in the succeeding settlement. This ensures that the unsettled obligation is added or merged with the settlement obligations of the succeeding day where on account of multilateral netting, there will be benefit of offsetting of deliverable obligations and thereby no settlement obligation on the succeeding day.

Funds Clearing: Settlement of trades requires smooth, preferably instantaneous, movement of securities and funds in accordance with the prescribed schedule of pay-in and pay-out. The securities can now move instantaneously since all the participants have accounts with either of the two depositories, which are connected to each other and are connected to the Exchanges. The movement of funds is not so instantaneous as only a few banks empanelled as clearing banks have the facility to transfer funds electronically. As participants have accounts in different banks at different places, movement of funds among participants invariably requires clearance through RBI's payment system. Further, the funds coming in and the funds going out of a clearing bank for settlement purposes rarely match requiring movement of funds from one clearing bank to another by using the RBI clearing system. This constrains same day pay-in and pay-out. The funds do not reach the accounts of investors on the pay-out day from the accounts of the trading members. This can be facilitated if the clearing corporation directly participates in the RBI's clearing.

A radical, but enduring solution would be to provide for movement of funds related to securities transactions directly between clearing banks without recourse to RBI subject to prudential checks and balances. As inter-depository transfer of securities does not need to be cleared by any regulator/central depository/any other third entity, inter-bank transfer of funds related to securities transactions need not also be cleared through RBI. The movement of funds and securities would be synchronised if funds move among the clearing banks as securities move among the depositories.

Straight Through Processing (STP): It is necessary to introduce STP to eliminate settlement risks. Under this system, the selling client's DP account is checked as soon as broker gets sale order through the Internet for securities balances and, similarly, buying client's bank account is checked for cash balances. Only if this check confirms availability of adequate balances of either stock or cash, the order is routed by the broker's trading terminal for trade execution.

Cross Margining: The optimum utilisation of resource dictates that a member/client is allowed to take an aggregate position across products / market segments / exchanges. The clearing corporation should allow a member/client to take positions in different products/ markets/exchanges as long as he does not exceed the permitted aggregate exposure. It should also compute and levy a single net margin amount after netting positions of a member/client in different products/ segments/exchanges.

VaR based Margin: A 99% VaR based margin system is followed for trades in rolling settlement. Margins for each trading member is arrived at by summing up scrip-wise margins based on scrip-wise VaRs multiplied by their positions in each stock. This approach treats the risk of a portfolio as equal to the sum of risks of each scrip in the portfolio. This ignores the fact a portfolio is a diverse set of correlated positions and the risk of well-diversified portfolios is expected to be less than that of the sum of the risks of individual parts. Therefore the current approach levies a higher margin which adversely affects the market activity.

Regulatory Issues

Regulatory Jurisdiction: There are several statutes regulating different aspects of the securities market. These cause a lot of confusion not only in the minds of investors, but also among the various agencies who administer these legislations. The greater the number of laws, the greater is the scope for inconsistency among them and greater is the possibility for regulatory overlaps and gaps.

There are also as many regulators as the number of laws. As a result the responsibility for supervision and development of the securities market is fragmented among different agencies. As the roles of various agencies overlap, there is scope for duplicate and inconsistent regulations.

The interest of investors requires a consolidation of all laws relating to securities market into a single piece of legislation, preferably called the Securities Act and assigning its administration to one agency. And it should prevail over general laws like the Companies Act, the UTI Act, the Consumer Protection Act, the Contracts Act, etc and the agency responsible for its administration works in close coordination with regulators for other areas of financial market.

The securities market has the potential to destabilise other sectors of the economy. It is therefore necessary that the penalty for offences in the securities market is deterrent. The first step in this regard is to make all the offences in the securities market cognisable, as a few offences under the SC(R)A are. It is desirable that all offences under the securities laws are tried by an adjudicating officer who should award any type of punishment, while the regulator concentrates on developmental and regulatory work. In addition to rationalising the rates of penalty, these needs to be increased substantially.

Private Placement: The convenience of structuring of the issues to match the needs of issuers with those of investors coupled with savings in terms of time and cost has contributed to rapid growth of market for private placement. The issues by private placement do not require prospectus, disclosures, or a rating. This route accounted for 91.3% of resources mobilised domestically by corporate sector during 2000-01. This development reflects regulatory arbitrage. If this route is to continue as a major source of resources, this requires to be subjected to regulatory discipline.

Asset Based Securitisation: The market for securitisation has not appreciably developed in India because of lack of legal clarity and conducive regulatory environment. A RBI Working Group has identified various impediments, *viz.*, lack of investor base, capital market infrastructure, regulatory framework, legal provisions, accounting and taxation issues and standardisation and recommended a number of measures for securitisation to take off in the country. The recommendations include rationalisation/reduction of stamp duties, inclusion of securitised instruments in the definition of "securities" under the SC(R)A, removal of prohibition on investment in mortgage backed securities by mutual fund schemes, tax neutrality of SPV, etc. These recommendations need to be quickly translated into policy and regulations.

Quality Intermediation: The confidence of the investors can be maintained and enhanced by making provision for professional intermediation services through a system of certification. Industry/SROs/ Regulators have made a modest beginning, but not adequate given the dimensions of the market. SEBI regulations, which lay down various requirements for registration as an intermediary, should specify certification as a mandatory requirement for persons joining market intermediaries. While this requirement should apply at the entry point for all new employees joining the intermediaries and all intermediaries joining the market, regulation may allow a breathing time for the existing intermediaries and employees to qualify the certification. These people should also be required to update their skills and expertise by seeking certification at intervals of five years. There should be an arrangement to maintain a database of certified professionals and enforce a code of conduct for them so as to enable the prospective employers access the database to meet their personnel requirements.

Corporate Governance: Listing agreement is being used as the only means available for bringing about discipline in corporate sector, particularly when non-compliance with listing agreement can at best invite a penalty up to Rs. 1, 000. Trading of securities can be suspended or withdrawn, but this becomes a penalty on the investor. If the corporate governance norms are to be implemented in all seriousness, the coercive mechanism needs to be strengthened.

Market Misconduct: Despite vast improvements in market design and consequently the operational efficiency, the market is still plagued by high volatility and price manipulations. The 1990s witnessed a series of episodes which included Harshad (1992), M.S.Shoes (1991), Sesa Goa (1995), Rupangi Impex and Magan Industries Limited (1995), CRB (1997), BPL& Videocon (1998), Ketan (2001). Of the 68 cases taken up by SEBI for investigation during 2000-01, 47 related to price manipulation and price rigging. The regulators and SROs need to strengthen their capability to detect unfair trade practices, investigate them expeditiously and award exemplary punishment to the miscreants. They need to have right quality and quantity of people to enforce securities laws.

Investor Protection: An investor normally deals with securities through an intermediary, whose acts of omission and commission can cause loss to him. In order for the investor to choose the right intermediary through whom he may transact business, it may be useful to help him in taking informed decision by making details of intermediaries available to him. One way to do so would be to display details of SEBI-registered intermediaries on a web-site. The details may include the form of organisation, management, capital adequacy, liabilities, defaults and penal actions taken by regulator and self-regulatory organisations against the intermediary in the past. Similarly, issuer related information should also be available at one central web site. They should be under obligation to file all the information electronically. They may also be rated in terms of corporate governance and such rating is displayed in the web site.

The law may provide a special mechanism, like consumer forum, to dispose of all investor grievances summarily. There may also be a mechanism to compensate investors upto say Rs.10,00,000 from a central investor protection fund as the depositors in the banks are protected by DIGC.

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