Securities Laws (Amendment) Acts, 1999

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Several important amendments have been brought about in the laws relating to securities by the two Amendment Acts of 1999. This article explains these changes.

TWO Acts seeking far-reaching amendments in the securities laws were enacted on 16th December 1999. The first Act, namely, the Securities Laws (Amendment) Act 1999 (No. 31 of 1999) has expanded the definition of "securities" under the Securities Contracts (Regulation) Act, 1956 (SCRA) to include derivatives of securities and instruments of collective investment schemes (CIS) with a view to developing and regulating markets for them. The Act also authorises Central Government to delegate powers under the SCRA to the Reserve Bank of India (RBI) with a view to enabling the latter to regulate transactions in securities as may be specified by the Government from time to time. This Act came into force on 22nd February 2000, the date appointed by the Central Government for the purpose. The second Act, namely, the Securities Laws (Second Amendment) Act 1999 (Act No. 32 of 1999) has transferred appellate functions of the Central Government under the securities laws to the Securities Appellate Tribunal (SAT) with a view to bringing greater transparency and impartiality in disposal of appeals. This Act came into force on 16th December 1999 when it was assented to by the President. In addition to rationalising allocation of powers under the securities laws among the Securities and Exchange Board of India (SEBI), RBI, Government and the SAT, these Acts would help to develop and regulate markets for derivatives as well as units of CIS and protect the interests of investors therein.

THE SECURITIES LAWS (AMENDMENT) ACT, 1999

This Act has inserted provisions relating to derivatives, units of CIS and delegation of powers under the SCRA to RBI.

Derivatives

In the last few years there have seen substantial improvements in the functioning of the securities market. Requirements of adequate capitalisation, margining and establishment of clearing corporations have reduced market and credit risks. Systematic improvements have been effected by introduction of screen based trading system and electronic transfer and maintenance of ownership records of securities. However there are inadequate advanced risk management tools. In order to provide such tools and to deepen and strengthen cash market, a need was felt for trading of derivatives like futures and options.

But it was not possible in view of prohibitions in the SCRA. Its preamble stated that the Act was to prevent undesirable transactions in securities by regulating business of dealing therein, by prohibiting options and by providing for certain other matters connected therewith. Section 20 of the Act explicitly prohibited all options in securities. Section 16 of the Act empowered Central Government to prohibit by notification any type of transaction in any security. In exercise of this power, Government by its notification in 1969 prohibited all forward trading in securities. Introduction of trading in derivatives required withdrawal of these prohibitions. The Securities Laws (Amendment) Ordinance, 1995, promulgated on 25th January 1995, withdrew the prohibitions by repealing section 20 of the SCRA and amending its preamble.

The market for derivatives, however, did not take off, as there was no regulatory framework to govern trading of derivatives. SEBI set up a 24 member Committee under the Chairmanship of Dr. L. C. Gupta on 18th November 1996 to develop appropriate regulatory framework for derivatives trading in India. The Committee submitted its report on March 17, 1998 recommending, among others, that the derivatives may be declared as securities under section 2(h)(iia) of the SCRA, so that the regulatory framework applicable to trading of securities could govern trading of derivatives also. Section 2(h) of the SCRA which defines 'securities' to include shares, scrips, stocks, bonds, debentures, debenture stock, or other marketable securities of a like nature in or of any incorporated company or other body corporate, government securities, etc., empowers Central Government to declare "such other" instruments as "securities". Government, however, did not declare derivatives to be securities, rather amended the SCRA to explicitly define securities to include derivatives, probably because it's power to declare any instrument as "securities" was limited by the words "such other".

The Securities Contracts (Regulation) Amendment Bill, 1998 was introduced in the Lok Sabha on 4th July 1998 proposing to expand the definition of "securities" to include derivatives within its ambit so that trading in derivatives could be introduced and regulated under the SCRA. The Bill was referred to the Standing Committee on Finance (SCF) on 10th July 1998 for examination and report thereon. The Committee submitted its report on 17th March 1999. The committee was of the opinion that the introduction of derivatives, if implemented with proper safeguards and risk containment measures, will certainly give a fillip to the sagging

** The views/interpretations expressed in this article are of the author and not necessarily of his employer.*

of the above stated notification provides, as a condition precedent for availing the SSI exemption, that the manufacturer shall not avail the credit of duty under rule 57A of rule 57B of the Central Excise Rules, 1944. If you look at CENVAT Rules Credit is not available under Rule 57A. Rule 57A, in a sense is a definition section of CENVAT and reference to rule 57A is unwarranted in the notification. Under CENVAT credit is available under Rule 57B.

In para (iv) of the Clause (2) it is provided that the manufacturer also shall not use credit of duty under rule 57Q of the said rules paid on capital goods. Purpose of this particular provision is not understandable as the rule 57Q will not be in the statute from 1st April, 2000 and the aforesaid notification will also be operative from 1st April, 2000.

Even if it is presumed, as pointed out earlier, that there is error in drafting rule 57H of CENVAT rules and if on correction, credit remaining unutilised under rule 57Q will be allowed to be carried forward on 1st April, 2000, then it will be called as CENVAT CREDIT and will cease to be a credit under Rule 57Q. Thus, the provision contained in para (iv) will be redundant.

RULE 173 *VIS A VIS* CENVAT

As explained earlier RG23A and RG23C Part I and Part II registers have been dispensed with under CENVAT. However, it seems that the Government has missed to amend sub-rules (2A) and (3) of Rule 173, which continue to require the manufacturer, submission of copies of RG23A & RG23C registers to the Department.

EXISTING MODVAT PROVISIONS FOR WHICH THERE ARE NO CORRESPONDING PROVISIONS UNDER CENVAT

In the process of simplification and cutting down the size of MODVAT Rules, it seems that the Government has opened the Pandoras box. The existing MODVAT rules, though sizeable in number are explicit in most of the cases. Now the explicit rules will be replaced by the implicit CENVAT Rules. It is most likely that the assessee will go by a maxim 'What is not prohibited by law is permitted' and the department, on the other hand, will go by the maxim, 'What is not permitted by law is prohibited' and these diametrically opposite views are going to open floodgates of disputes under the CENVAT. Under the CENVAT one can not get answers to the number of real life situations, for which there are answers under the MODVAT Scheme. These situations are as under:-

1. There is no restriction under CENVAT, as under Rule 57C of MODVAT Rules which bars MODVAT Credit in case the final product is exempted from whole of duty of excise or chargeable to Nil rate of duty. Thus, under CENVAT, if a manufacturer of exempted goods takes credit of duty and accumulates it without using (except in case of exemption under Notification No. 8/2000 dated 01-03-2000) for use in future, it seems that it will not be violation of CENVAT Rules but definitely department will not allow it and will raise demand.
2. There is no corresponding provision to Rule 57D of MODVAT Rules which provides that credit of duty shall not be denied or varied on the ground that part of the inputs is contained in any waste, by product, refuse or etc.

   Does it mean that credit in respect of inputs going as waste, refuse etc. will not be allowed? Assessee may say 'No' but the department will say Yes. This lacuna may give rise to the disputes between the assessee and the department.

   Even there is no provision under CENVAT Rules corresponding to the existing rule 57E for adjustment in duty credit. Under the existing Rule 57E the manufacturer of the final product is in position to pay the additional duty of excise under Rule 57E(2) or 57R(5) in case of price rise given or price escalation allowed by the customer and pass on the duty so paid to this customer on the strength of a Certificate of the Range Superintendent. Under CENVAT Scheme there is no such provision. Hence, the manufacturer may face difficulties as in case of price rise in absence of a provision mentioned above he may have to bear the duty in case of price rise, particularly during the period from 01-04-2000 to 30-06-2000 on the valuation based on the transaction value concept will be effective from 01-07-2000.
3. Whether inputs can be removed as such is also going to be ticklish poser under the CENVAT Rules. It seems that if the inputs are removed as such, certainly credit will not be allowed under the new rules. There is no provision under the new rules as to the utilisation of credit in the respect of removal of inputs as such.
4. There is also no provision under CENVAT Rules in respect of scrap generated by the job workers and in processing of inputs in the line with existing rule 57F(5). So whether to reverse credit on scrap or not to do anything, will be dilemma for the assessee.
5. Under the existing rules there is very good provision under rule 57F(13) providing that in case of credit on inputs contained in the final products exported under bond can not be utilised then cash refund of credit is allowed. This is a kind of export incentive, which do not find place in CENVAT.
6. There is no corresponding provision to existing rule 57H. So at the time of opting out of CENVAT Scheme, in case of SSI exemption with nil rate of duty upto first clearances of Rs. 50 lacks (Notification No. 8/2000-CE dated 1-3-2000 or the like Notification), it seems that, at the time of opting out of CENVAT at time of commencement of new financial year reversal of duty in respect of inputs, WIP and finished goods in stock will not be required, Similarly manufacturer may not be in position to take credit on stock of inputs or duty paid inputs contained in WIP or finished goods when he will start paying full rate of duty after crossing the clearances of Rs. 100 lacks.
7. There is also no provision in line with existing rule 57J under which credit of duty paid on inputs which are utilised for manufacture of intermediate products at the job workers end or in the another factory of the said manufacturer is allowed.
8. Under the existing rule 57S(2) capital goods can be removed as such subject to allowance of credit at the rate of 2.5% per quarter from the date of taking capital goods credit. There is no such provision under CENVAT. Does it mean in such case there will not be any disallowance of CENVAT Credit on Capital goods?
9. There is no provision for removal of dies/moulds to a job worker for manufacture of final products. Under existing sub-rules (8), (9) & (10) of Rule 57-S there is a provision to that effect.

Thus, it can be concluded that only the time will decide whether the new rule are simple or whether there will be full stop to the disputes between the assessee and the department as per the wishful thinking of the Finance Minister and whether the CENVAT is going to be 'SANE VAT'. ❑

market, result in enhanced investment activity and instill greater confidence among the investors/participants. The committee after having examined the Bill and being convinced of the needs and objectives of the Bill approved the same for enactment by Parliament with certain modifications. The Bill, however, lapsed following the dissolution of 12th Lok Sabha. A fresh Bill, the Securities Laws (Amendment) Bill, 1999 was introduced in the Lok Sabha on 28th October 1999 incorporating the amendments proposed in the Securities Contracts Regulation (Amendment) Bill, 1998 as well as the modifications suggested by the SCF. This Bill was converted into an Act on 16th December 1999.

The Act has inserted clause (aa) in section 2 to define derivatives to include: **(a)** a security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security, and (b) a contract which derives its value from the prices, or index of prices, of underlying securities. It has also inserted sub-clause (ia) in section 2(h) to include derivatives within the ambit of securities. Since derivative contracts are generally cash settled, these may be classified as wagers. The trading in wagers being null and void under section 30 of the Indian Contracts Act 1872, it may be difficult to enforce derivative contracts. In order to avoid such legal uncertainties, a new section 18A has been inserted to provide that notwithstanding anything contained in any other law for the time being in force, contracts in derivatives shall be legal and valid if such contracts are traded on a recognised stock exchange and settled on its clearing house in accordance with rules and bye-laws of such stock exchange. Section 23 has been amended to provide that any body who enters into contract in contravention of section 18A shall be punishable.

By a notification issued on 1st March 2000, Government lifted the three-decade-old prohibition on forward trading in securities by rescinding 1969 notification. This prohibition was imposed by Government in exercise of its powers under section 16 of the SCRA by a notification issued on 27th June 1969 in order to curb certain unhealthy trends that had developed in the securities markets at that time and to prevent undesirable speculation. In the changed financial environment, the relevance of this prohibition had vastly reduced. Through appropriate amendments in the byelaws of the stock exchanges, carry-forward transactions in securities were permitted. Similarly, periodic amendments to the aforesaid notification were made to permit repo transactions in government securities by authorised intermediaries. Even though the notification of 1969 was in force, exceptions had been carved out in course of time as market needs changed and some form of forward trading (carry forward/ready forward) was prevalent. The L.C. Gupta Committee recommended its amendment to enable trading in futures and options.

The provisions in the SCRA and the regulatory framework developed thereunder govern the trading in securities. The amendments of the SCRA to include derivatives within the ambit of "securities" in the SCRA would make trading in derivatives possible within the framework of that Act. The repeal of the 1969 notification would permit development of the derivatives markets in accordance with the rules and guidelines of the relevant regulatory authorities.

The Amendment Act freezed section 22 of the SCRA and inserted a new section 22A to provide for right of appeal before SAT against refusal, omission or failure by a stock exchange to list the securities of any public company within 15 days of such refusal, omission or failure. An obligation has been cast on SAT to dispose off appeals as expeditiously as possible, and shall endeavour to dispose of finally within six months. Section 23 has been amended to provide penalty for failure to comply with the orders of SAT.

Similar amendments have been effected in the SEBI Act, 1992 and the Depositories Act 1996. Section 15K of the SEBI Act has been amended to expand jurisdiction of SAT to deal with appeals also under any other law. Section 15T has been amended to empower SAT to deal with appeals from any person aggrieved by an order of SEBI as well as of an adjudicating officer under the SEBI Act. Section 20 of the Act, which provided for appeals to Central Government, has been freezed. Section 23 of the Depositories Act, 1996, which provided for appeals to the Central Government, has been freezed. A new section 23A has been inserted to provide for appeals to SAT under the Act.

Provisions have been made in all the three Acts to provide for appearance of the appellant in person or through one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers before the SAT. The jurisdiction of civil courts has been barred over any matter which a SAT is empowered by or under any of the three Acts. It has been further provided that any person aggrieved by the order of SAT may prefer appeal to High Court within 60 days. Central Government has been empowered to make rules to provide for the form in which an appeal may be filed before the SAT and the fees payable in respect of such appeals.

Consequent on enactment of the Securities Laws (Second Amendment) Act, 1999; the SEBI (Appeal to the Central Government) Rules, 1993 and the Depositories (Appeal to the Central Government) Rules, 1998 have been repealed. Government notified on 18th February 2000 three Appeal Rules, Viz. (a) Securities Appellate Tribunal (Procedure) Rules, 2000 under the Securities and Exchange Board of India Act, 1992; (b) The Depositories (Appeal to Securities Appellate Tribunal) Rules, 2000 under the Depositories Act, 1996, and (c) The Securities Contracts (Regulation) (Appeal to Securities Appellate Tribunal Rules, 2000 under the Securities Contracts (Regulation) Act, 1956. These rules provide for fees, form and procedure for filing appeal and the process of their disposal by the SAT. The appeals (except appeals against adjudication orders under the SEBI Act) under all three Acts need to be accompanied by a fee of Rs. 5,000 only. The appeals against the adjudication orders need to be accompanied by a fee of Rs. 500 if the penalty imposed is less than Rs. 10,000, Rs. 1200 if the penalty imposed is more than Rs. 10,000 but less than Rs. 1,00,000, and an additional Rs. 1000 for every additional one lakh of penalty or fraction thereof.

THE SECURITIES LAWS (SECOND AMENDMENT) ACT, 1999

Section 22 of the SCRA provides the right of appeal before the Central Government against refusal, omission or failure by a Stock exchange to list the securities of any public company. The SEBI Act, 1992 provides for two kinds of appeals. Under section 20 of the Act, any person aggrieved by any order of the SEBI under the Act or rules or regulations made thereunder may prefer an appeal to the Central Government. Accordingly, the Central Government has notified the SEBI (Appeal to the Central Government) Rules, 1993 and constituted an Appellate Authority for disposal of appeals. Section 15 K of the Act provides for establishment of one or more SATs to hear appeals from orders of adjudicating officer of SEBI imposing monetary penalty as per Rules framed by the Central Government. Government has accordingly established a SAT at Mumbai to hear appeals from the orders of adjudicating officers. Under section 23 of the

Depositories Act, 1996, any person aggrieved by an order of SEBI under the Depositories Act, 1996 or Rules and Regulations made thereunder may prefer an appeal to the Central Government. Accordingly, the Central Government has notified the Depositories (Appeal to the Central Government) Rules, 1998 and constituted an Appellate Authority for disposal of appeals. Thus, the Central Government is conferred with powers to dispose of appeals in respect of all matters (except disposal of appeals against the orders of adjudicating officer under the SEBI Act 1992) under all the three Acts.

In addition, the Central Government is empowered to issue directions to SEBI and make rules under these Acts. Central Government is empowered to approve/amend/make rules/bye-laws/regulations of the stock exchanges. Further, Central Government is represented on the management of SEBI as well as of the stock exchanges. The powers of the Central Government to issue directions and to make rules and appoint members of the SEBI as well as all on governing bodies of the stock exchanges are perceived as compromising on its appellate powers. The Appellate Authorities appointed by the Government under the SEBI Act and the Depositories Act have been receiving and disposing of appeals in accordance with the Rules. However, since Government constitutes these, their orders are perceived at times as orders of the Government. When an order of SEBI is struck down, even on merits, there is a feeling that SEBI's autonomy as the regulator has been compromised. In order to remove such misgivings and impart transparency and impartiality to the process of disposal of appeals, the Securities Laws (Second Amendment) Act, 1999 amended all the three Acts to transfer appellate functions from the Central Government to an independent body, SAT.

Collective Investment Scheme

Recently many companies especially plantation companies have been raising capital from investors through schemes, which are in the form of CIS. Though SEBI is authorised under the SEBI Act, 1992 to register and regulate CIS, there was no suitable regulatory framework to allow an orderly development of market for units/instruments by them. In order to allow for this and to strengthen the hands of SEBI to protect interests of investors in plantation companies, the Act has amended the definition of "securities" to include within its ambit the units or any other instruments issued by any CIS to the investors in such schemes. The Act empowers the Central Government to make rules to provide for the requirements, which shall be complied with by CIS for the purpose of getting their units listed on any stock exchange. This is aimed at an orderly development of market for these units while protecting the interest of investors therein. The Act also inserts a definition of the CIS in the SEBI Act, 1992. The CIS has been defined to mean any scheme or arrangement made or offered by any company under which— **(a)** the contributions, or payments made by the investors, by whatever name called, are pooled and utilised solely for the purposes of the scheme or arrangement; **(b)** the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement; **(c)** the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors; and **(d)** the investors do not have day to day control over the management and operation of the scheme or arrangement. The CIS, however, does not include any scheme or arrangement— **(a)** made or offered by a cooperative society, **(b)** under which deposits are accepted by non-banking financial companies, **(c)** being a contract of insurance, **(d)** providing for any Scheme, Pension Scheme or the Insurance Scheme framed under the Employees Provident Fund and Miscellaneous Provision Act, 1952, **(e)** under which deposits are accepted under section 58A of the Companies Act, 1956, **(f)** under which deposits are accepted by a company declared as Nidhi or a mutual benefit society under section 620A of the Companies Act,1956, **(g)** falling within the meaning of Chit business as defined in clause (d) of section 2 of Chit Fund Act,1982, and **(h)** under which contributions made are in the nature of subscription to a mutual fund.

Delegation of Powers to RBI

The Government had power to delegate regulatory authority to SEBI. To provide additional flexibility, the Act has amended section 29A of the SCRA so as to empower the Central Government to delegate powers to RBI also along with SEBI, to enable the former to regulate transactions under the SCRA as may be necessary. Now the Central Government, the SEBI and the RBI depending on their jurisdiction as may be mutually agreed upon can exercise the powers under the Act.

With the repeal of the 1969 notification, the existing regulatory framework, which governed repo transactions, disappeared. It was, therefore, necessary to work out an arrangement whereby the regulators could regulate such transactions. In pursuance to this and in exercise of its newly acquired power, Government issued a notification on 2nd March 2000 delineating the areas of responsibility between RBI and SEBI. In terms of this notification, the powers exercisable by Central Government under section 16 of the SCRA in relation to the contracts in government securities, gold related securities, money market securities and in securities derived from these securities and in relation to ready forward contracts in bonds, debentures, debenture stock, securitised debt and other debt securities shall also be exercised by RBI. Such contracts, if executed on stock exchanges, shall, however, be regulated by— **(i)** the rules and regulations or the byelaws made under the SCRA, or the SEBI Act or the directions issued by SEBI under these Acts, **(ii)** the provisions contained in the notifications issued by RBI under the SCRA, and **(iii)** the rules or regulations or directions issued under the RBI Act, 1934; the Banking Regulation Act, 1949 or the Foreign Exchange Regulation Act, 1973 by RBI.

RBI and SEBI have also issued consequential notifications on 2nd March 2000 specifying the regulatory framework in their respective areas. In terms of RBI notification, no person can enter into any— **(a)** contract for the sale or purchase of government securities, gold related securities and money market securities other than spot delivery contract or such other contract traded on a recognised stock exchange as is permissible under the SCRA, rules and byelaws of such stock exchange, and **(b)** ready forward contracts in bonds, debentures, debenture stock, securitised debt, and other debt securities. Ready forward contracts may, however, be entered into by permitted persons in all government securities put through the Subsidiary General Ledger Account held with RBI in accordance with the terms and conditions as may be specified by RBI. SEBI by its notification has prohibited all contracts in securities other than such spot delivery contract or contract for cash or hand delivery or special delivery or contract in derivatives as is permissible under the SCRA or the SEBI Act and rules and regulations made thereunder and rules, regulations and byelaws of a recognised stock exchange. ❑