SECURITIES LAWS

SECURITIES LAWS - LOOKING FORWARD

M. S. Sahoo*

Securities laws are dynamic in terms of their changing nature. Such dynamism is required to improve the safety and efficiency of operations, to accommodate new products and market designs and to adopt the best practices and to implement international standards. Besides amendments and several ordinances, a number of legislations having a bearing on securities market have been amended to complement the amendments in securities laws. The author has made an indepth analysis of the reforms in the legislative framework under three broad heads : Regulators, Enforcement Actions and Investors Protection and concluded that the regulatory framework needs complete overhauling to meet the emerging challenges and address existing deficiencies.

EXTANT LEGISLATIVE FRAMEWORK

1. The securities laws have been evolving over time to meet the emerging deficiencies, improve the safety and efficiency of operations, accommodate new products and market designs, and adopt the best practices from the best jurisdictions and to implement international standards. The post liberalization period has witnessed ten special legislative interventions, including three new enactments, namely, the Securities and Exchange Board of India (SEBI) Act, 1992, the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992, and the Depositories Act, 1996. The Securities Contracts (Regulation) Act, 1956 (SCRA), the SEBI Act and the Depositories Act were amended six, five and three times, respectively, during the same period. The developmental need was so urgent at times that the said period witnessed six ordinances relating to securities laws. Besides, a number of other legislations having a bearing on the securities markets have been amended to complement the amendments in securities laws.

The securities laws, comprising of five main legislations, namely, the SEBI Act, 1992, the SCRA, the Depositories Act, 1996, the Public Debt Act, 1944, and the Companies Act, 1956, govern the securities market. The SEBI Act, 1992 establishes SEBI to (*a*) protect the interests of investors in securities, (*b*) promote the development of the securities market, and (*c*) regulate the securities market. With a view to prevent undesirable transactions in securities, the SCRA gives the Central Government/SEBI regulatory jurisdiction over (*a*) stock exchanges through a process of recognition and

---

*The author is Chief General Manager, SEBI.

The views expressed in this paper are of the author and not necessarily of his Employer.

continued supervision, (*b*) contracts in securities, and (*c*) listing of securities on stock exchanges. 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. The Public Debt Act, 1944 contains the laws relating to Government securities and management of Government debt by the RBI. The Companies Act, 1956 deals with issue, allotment and transfer of securities and various aspects relating to company management. It prescribes the standards 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, management perception of risk factors, etc. All these Acts also provide a mechanism for determination and imposition of penalties for violation of securities laws.

RESPONSIBILITY FOR REGULATING SECURITIES MARKET

2. The responsibility for regulating the securities market is shared by the Department of Economic Affairs (DEA), Ministry of Company Affairs (MCA), SEBI and RBI. Most of the powers under the SCRA are exercisable by DEA while a few others by SEBI. The powers of the DEA under the SCRA are also concurrently 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. The Rules and the Regulations framed under the securities laws are generally 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. RBI administers the Public Debt Act. A High Level Committee on Capital and Financial Markets co-ordinates the activities of these agencies. The orders of SEBI under the securities laws are appealable before the Securities Appellate Tribunal (SAT). The orders of the SAT are appealable before the Supreme Court on points of law.

This paper suggests reforms in the legislative framework under the three broad sections: (*a*) Regulators, (*b*) Enforcement Actions, and (*c*) Investor Protection.

3. REFORMS RELATED TO REGULATORS

(*i*) *Regulatory Jurisdiction* - There are several statutes regulating different aspects of the securities market. The larger the number of laws, the higher is the scope for inconsistency among them and the possibility of regulatory overlaps and gaps. The protection of the interests of investors requires consolidation of all laws relating to securities market into a single piece of legislation, preferably called the Securities Act which should prevail over the general laws. The administration of the Act may be assigned to one agency with clearly defined regulatory jurisdiction and accountability. And the agency must work in close co-ordination with other regulators, domestic or foreign.

There are also as many regulators as the number of laws. Their responsibilities are not very clearly defined. For example, the SEBI Act provides that the Central Government may make rules for carrying out the purposes of the Act. It also provides that SEBI may make regulations for carrying out the purposes of the Act. To make the matter worse, some powers are exercised concurrently by more than one regulator. For example, the powers under many provisions under the SCRA are concurrently exercisable by the Central Government and SEBI. The larger the number of regulators, the higher is the scope for confusion among them, between the regulators and the regulated and duplicity and inconsistency in regulations. The respective responsibilities of each regulator and the responsibilities of the Government *vis-à-vis* the regulators need to be clearly demarcated in the interest of harmonious relation between them and to avoid shifting of responsibilities between them, particularly at the time of crisis. The law should clearly authorize the regulators to issue rules, regulations, circulars, guidelines, orders, etc., and indicate the purpose for which these instruments can be used and by which regulator.

The companies and Governments are major issuers of securities in the securities market. While SEBI is regulator for securities market and has responsibility of protection of interests of investors in securities, many aspects relating to corporate securities and Government securities are governed by MCA and RBI under the Companies Act and the Public Debt Act, respectively. This has potential to create disharmony among the regulators and confusion for the market participants. The securities laws need to be harmonized with the Companies Act and the Public Debt Act. For example, the Companies Act could prescribe the base level of standards for all companies while SEBI should be at liberty to prescribe additional requirements, if warranted, for the companies participating in the securities market. It should enable SEBI to prescribe and administer any requirement in respect of listed companies with respect to matters related to securities market and in the areas having a bearing on securities market such as private placement, public issues, rights issues, buy back, sweat equity, ADR/GDR, bonus issues, etc. These matters could be prescribed by SEBI through Regulations made under the SEBI Act read with the Companies Act. Similar empowerment of

SEBI in respect of Government securities is necessary. If the authorities find it difficult for any reason, the Government securities could be taken out of the ambit of 'securities' so that the regulators are clear about their jurisdictions and responsibilities.

A significant challenge to the regulators is the convergence of the opportunity zones. Traditionally, businesses were clearly differentiated; banks offered banking, insurance companies offered risk covers and securities companies offered services related to investments. This resulted in separation of supervisory structures along business lines. The economies of scale and economies of scope coupled with financial deregulations have, however, ushered in an era of mergers and acquisitions, leading to emergence of universal financial power houses which are one stop shops for all financial products/services. This has the danger of risk of one activity/segment spilling over to the other activities/segments of the markets. If there are different regulators for different activities, there is a potential problem of shifting responsibilities among them. This calls for single regulator. There are arguments for and against single regulator. Even if there is a single regulator, different departments dealing with different segments of the market may act at cross purposes which warrants a co-ordination mechanism among the departments. The regulators, therefore, need to co-operate more frequently than ever before and, that too, at multiple levels. The statute must provide for such regulatory co-operation/sharing of information among them.

While business is borderless, the regulation is not. Investors, issuers and intermediaries increasingly see the benefits of internationalization, while national regulators avoid taking responsibility beyond their jurisdiction. This causes a growing mismatch between the limited authority of national regulators and the global reach of the intermediaries. This increases the chances of systemic risks in one country spilling over to other countries. The regulators must have powers to assist/seek assistance from overseas regulators or to enter into MOUs or other co-operation arrangements with them to deal with cross border misconduct.

With the investor in country A, the broker in country B, the exchange in country C and the issuer in country D, the legal basis of a transaction involving them may be ambiguous. The differences in legal background and regulatory tradition complicate matters further. Harmonising the market Regulations may simplify the problems and reduce the compliance costs for participants who do not have to comply with different regulations in each country. Given the differences in legal system and regulatory tradition, such harmonization may be difficult. It may not be desirable also as it would reduce competition between different regulatory regimes. In the nonharmonised regulatory system, one can compare and learn how different regulatory systems handle different problems and every jurisdiction learns from another. Thus, there is a need for striking a balance, which could standardize the fundamental aspects and allow flexibility in other aspects. This process must ensure that international investors enjoy at least the same, if not better, rights and guarantees as local investors do and are assured of non-discretionary treatment from the State.

(ii) *Non-interested Regulator* - The regulator must not be an interested party. It must not have any interest other than the protection of interests of investors and orderly development of the market. This principle is not followed in case of Government securities. RBI, which is the manager of the monetary policy, acts as the regulator for Government securities market, and also participates in the market simultaneously as the manager of Government debt, issuer of securities, merchant banker to issue, registrar and transfer agent, clearing and settlement agent, depository, provider of trading platform, and subscriber to securities. In such a case, it may not always be possible to avoid conflict of interests. The decisions relating to debt management, interest rate and regulation of market should be taken independently to avoid perceived conflict of interests.

A related issue is equal treatment for all kinds of securities. The same regulatory framework as applicable to corporate securities or other securities, as defined in the SCRA, must apply to Government securities unless differential treatment is justified in some respects. The issue, allotment, trading and settlement of Government securities should be subject to broadly the same regulatory discipline as the corporate securities are. The different securities cannot be treated differently in all respects, as they compete in the same market place for funds. If differential treatment is justified in all respects, they should not be grouped together under 'securities'.

(iii) *Autonomy and Accountability of the Regulator* - Under the market determined decision-making regime, it is difficult to have complete law as the market evolves everyday and the market participants undertake innovative transactions. In order to deal with such evolving market on a continuous basis, it is necessary to assign legislative, executive and judicial powers to the regulator who is expected to act proactively, even though it is contrary to the doctrine of separation of powers. However, to avoid misuse, the statute generally circumscribes the exercise of such power. SEBI has substantial legislative, executive and judicial powers commensurate with its responsibilities. It does not depend on the Government for its sustenance, and it has freedom to frame regulations and initiate enforcement actions without any recourse to the Government. The power of the Government is limited to giving directions on questions of policy and superseding the regulator for a period not exceeding six months in case of grave emergencies. However, to ensure its accountability, the law requires that all the regulations made by the regulator are laid before the Parliament for scrutiny and enforcement orders can be appealed before the SAT. There is, however, a growing feeling that it does not have full autonomy necessary to discharge its duties and that there is no adequate mechanism in place to hold it fully accountable for its activities. The autonomy can be enhanced by providing for similar protection as available to constitutional functionaries such as the Election Commission, CAG or UPSC. Similarly the accountability can be enhanced by providing for time-bound disposal of regulatory approvals and periodic disclosures by the Regulator, performance audit by a specialized agency and review of conduct and performance by a parliamentary committee. This is similar to the parliamentary committee reviewing the performance of PSUs which perform only commercial functions.

(*iv*) *Self Regulatory Organisations* - The SROs are expected to share the responsibility with the regulator in framing as well as administering regulations. However, the SROs have not been developed appreciably in India. Though SEBI has framed an exclusive regulation for regulation of SROs, no SRO is registered with SEBI. Most of the associations of intermediaries, like AMFI and AMBI, promote the activities of their members, though hesitate to regulate them. It may be desirable to mandate SROs for all kinds of market participants. A market participant should be registered by SEBI only if it is a member of an SRO, just as a stock broker is registered only if he is a member of a stock exchange. The SRO must do certain amount of supervision over the activities of its members. For example, it should enforce disclosures of their performance and financial position in the interests of investors. It must provide a mechanism to upgrade the capability of the personnel working with its members. This will bring in all the attendant benefits of self-regulation. The stock exchanges, clearing corporations and depositories are not association of intermediaries and, hence, SROs in strict sense of the term. Their regulatory capacity needs to be strengthened to enable them to regulate the conduct of their constituents such as brokers, sub-brokers, clearing members and depository participants. They must act as first level regulators and their orders should be appealable to SAT.

4. REFORMS RELATED TO ENFORCEMENT ACTIONS

(*i*) *Adjudicating Authority* - The securities laws provide for two broad types of punishment: (*a*) suspension or cancellation of certificates of registration to be granted by SEBI on the recommendation of an enquiry officer, or (*b*) monetary penalty to be imposed by an adjudicating officer. If a contravention is assigned to an adjudicating officer for adjudication, it is not referred to enquiry officer and *vice-versa*. A corollary of this is that mind is made up about the type of punishment (not quantity of punishment) to be imposed on the erring party when the alleged contravention is referred to an adjudicating officer for adjudication or to an enquiry officer for imposition of suspension or cancellation of registration, 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 enquiry officer, monetary penalty cannot be imposed even if the enquiry findings justify imposition of monetary penalty. Similarly if a contravention is assigned to an adjudication officer, the registration cannot be cancelled even if the adjudicating officer comes to the conclusion that the contravention warrants cancellation of registration. It would, therefore, be desirable to allow adjudicating officer to try all contraventions under the securities laws, and award appropriate combination of penalties, while SEBI retains the powers to issue directions in the interests of investors and launch criminal prosecutions. This would enable SEBI to concentrate on developmental and regulatory work.

In a recent pronouncement, the Supreme Court has expressed discomfort with the current arrangement which vests executive, legislative and judicial powers in the Regulator as it runs counter to the doctrine of separation of powers. It also stated that integration of powers, by vesting legislative, executive and judicial powers in the same body, may raise in future several public law concerns. In order to deal with such concerns, it is desirable to create an adjudicating authority outside and independent of SEBI, probably under the administrative control of SAT to adjudicate all kinds of violations under the securities laws. SEBI should confine itself to carrying out inspection and investigation to detect possible violations and approach such adjudicating authority with its findings seeking appropriate punishment.

An Adjudicating Officer is a Division Chief appointed by SEBI to adjudicate a violation detected by another Division Chief through inspection/investigation. Both the Division Chiefs are employees of SEBI and appointed by SEBI to undertake inspection/investigation and adjudication. It may not always be possible for the adjudicating Division Chief to take a view different from that of the inspecting/investigating Division Chief of SEBI. A dedicated adjudicating authority independent of SEBI will impart more impartiality and bring in necessary professionalism and specialization to the adjudication process.

The orders of SEBI or of Adjudicating Officers are appealable before the SAT and the orders of SAT are appealable before the Supreme Court. The provision of appeal assumes that the lower authority could pass an inappropriate order which need to be rectified by the appellate authority. At the current level of maturity, the Society does not take kindly if an order of a regulator is set aside or modified by the appellate authority, while it could not careless if the judgment of a High Court is set aside by the Supreme Court. The modification of an order of SEBI by SAT casts SEBI in a poor light. A separate adjudicating authority will avoid such embarrassment to the regulator.

The securities laws empower SEBI to resort to a number of penal actions simultaneously. For example, an intermediary found guilty of market manipulation can be penalized by suspending or cancelling its certificate of registration. The directors or partners of the intermediary can be directed not to deal in securities for a specified period. The violation can be adjudicated and monetary penalty imposed. Further, the intermediary and its officers can be prosecuted for the same offence. If SEBI is not conscientious, every violation could attract multiplicity of proceedings and imposition of multiple penalties against the same person for the same offence. This is a matter of concern even though this does not constitute double jeopardy. The creation of a unified adjudication authority will reduce multiple enforcement actions.

(ii) *Plea Bargaining* - Most of the enforcement actions of SEC, US are resolved by settlement with accused, who generally consent to the entry of judicial or administrative orders without admitting or denying the allegations against them. These orders usually require the accused to agree to be censured, to a cease and desist order, to be barred from appearing/practising/dealing in a certain manner/ before an authority, to a permanent injunction, to pay a civil monetary penalty, to the disgorgement of illegal gains or illegally avoided losses, or to comply with numerous other undertakings. The SEC lets off the accused who simply pay up without admitting to an offence. This prevents every case being locked up in a court.

Though not formally recognised, plea bargaining pervades Indian criminal justice system. Compromise, it is most common variant, where there is a question of doubt, and the parties agree not to try it out but to settle it between them by a give and take agreement, is widely prevalent in the countryside in India. Some other variants have found place in statutes also. For example, the Motor Vehicles Act, 1988 empowers police to discharge a person who has violated traffic rules by paying up a prescribed amount. The Foreign Exchange Management Act, 1999 authorises Enforcement Directorate and also RBI to compound any specified contravention on an application made by the person committing such contravention. The Code of Criminal Procedure, 1973 provides for compounding of certain offences with the permission of the court and certain others even without the permission of the court. The statutes have enumerated types of offences, which can be compounded/granted immunity, who can do so and at what stage of prosecution. The authority normally has no discretion to refuse compounding/immunity in case the accused desires it. These statutory provisions aim at avoiding lengthy and costly litigation, while conserving judicial resources.

The securities laws allow SAT or Court to compound any offence punishable under the Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine. Since no offence under the securities laws is punishable with fine only, this provision has not been used so far. What would be desirable is to allow compounding of all offences, civil or criminal, and by the adjudicating authority proposed in earlier paragraphs under the administrative control of SAT. Similarly, the power of the Government to grant immunity from prosecution or monetary penalty may be transferred to the said adjudication authority. This will add to autonomy of SEBI, while enhancing the efficiency of the immunity/compounding process.

It may be noted that though SEBI/adjudicating officer can make orders with the consent of the parties, SAT/Court can compound an offence and Central Government can grant immunity, there is no provision for plea bargaining. Given the number of cases pending in the Indian courts and intangible nature of securities market offences, SEBI requires similar facilities if the offenders are to be punished on priority. This would help to bring all the co-accused to book or solve difficult cases if one accused provides lead by agreeing to plea bargaining in exchange of a lenient sentence. This requires explicit statutory provisions.

(iii) *Amount of Penalty* - The SEBI Act, as amended in 1995, provided a ceiling on the amount of monetary penalty. For example, section 15A of the Act provided that a person who fails to maintain the books shall be liable to a penalty not exceeding Rs. 10,000 for every day during which the failure continues. Section 15J of the Act, however, provided that the amount of penalty would be determined, subject to the ceiling, by the Adjudicating Officer who would be guided by the factors including amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default, the amount of loss caused to an investor or any group of investors as a result of default, and the repetitive nature of the default. The amendment Act of 2002 prescribed that the violator shall be liable to a penalty of the specified amount. For example, the amended section 15A now prescribes that the person shall be liable to a penalty of Rs. 1 lakh for each day during which the failure continues or Rs. 1 crore, whichever is less. It, therefore, appears that the Adjudicating Officer has no discretion but to levy the prescribed penalty irrespective of the gravity of the violation. Thus, there is an anomaly that the penal sections prescribe minimum penalty while section 15J requires the Adjudicating Officer to have due regard to the factors while determining the quantum of penalty. Though it is not clear if the penalty prescribed in the securities law is minimum or maximum, a series of recent pronouncements by SAT has reduced the amount of penalty imposed by the Adjudicating Officers. It is, therefore, necessary to clarify the position.

(iv) *Law of Limitation* - There may be situations where the violation does not come to notice immediately or the culprit manages to hide the violation for a long time. If general law of limitation applies, the culprit goes scot free if the enforcement action is not initiated within the period of limitation. In order to ensure that the culprit is penalised sooner or later, SEBI is not barred from launching investigation/ enquiry and initiating enforcement action against the culprit for violation of the securities laws even after lapse of several years. This facility has a potential danger that the Regulator may not be in a hurry to detect a violation or initiate enforcement action. Passing an order against a culprit after a lapse of, say, 20 years of the violation may not be adequate in the interest of investors. Criminal cases involving violation of securities laws launched by SEBI may not be disposed of on priority. It may, therefore, be desirable to bring in the law of limitation on initiation of the process to detect violation, completion of the process of detection, and issue of final enforcement order. In very exceptional circumstances, SEBI may be allowed to initiate process after the period of limitation with the approval of Court. This would expedite investigations and enforcement action.

(v) *Unique Identity* - There is no obligation on a person - natural or artificial - to have a unique identification number (UIN) and there is no system to ensure this. A person has a variety of identification numbers such as PAN from CBDT, Depository Account Numbers from respective depositories, Bank Account Numbers from respective banks, MAPIN from SEBI, Unique Client Code from Exchanges, Director Identification number from MCA, etc. and there is no arrangement to link these numbers. In the interest of enforcement action, each market participant in the financial sector (banking, insurance, pension, securities, post office instruments, etc.) must be identified by a UIN. The PAN deserves to be the UIN. A PAN could identify all participants and the account managers (Depositories, Banks, Exchanges, Insurance Companies, Pension Fund Managers, Post Offices, Intermediaries, etc.) must use these numbers. The account managers could add 1 or 2 digit prefix and/or suffix to PAN to distinguish the accounts of a person with different depositories or banks. There should be an obligation on every person not to have more than one account with one account manager and not to have more than one PAN. Similar opposite obligation may be imposed on

PAN and the account managers. This would help to retrieve the details of transactions and transaction balances of a participant by push of a button.

5. REFORMS RELATED TO INVESTOR PROTECTION

(i) *Client Assets* - The intermediaries hold in their custody, and handle, the money and the securities on behalf of clients. However, there is an apprehension that the assets of the clients can be attached in case of insolvency of the intermediaries or can be misused by them. In order to dispel this apprehension, it is necessary to provide in law that an investor can entrust the money or securities to any intermediary who shall hold such assets in trust and shall not have any right, title or interest of any nature therein. He shall deal with such assets as directed by the investor and shall be accountable for the same. Such assets shall not form part of assets of the intermediary and no authority can attach or seize such assets.

(ii) *Investment Advisers* - Many investors do not have the expertise on their own to make investment decisions. They depend on the advice from others who may not be competent to render such advice and be accountable for the same. All kinds of people, irrespective of their competence, sell financial products to, and advise, the investors on various products. SEBI Act empowers SEBI to register and regulate investment advisors in securities. While SEBI should frame regulations for investment advisers in securities, it may be desirable to lay down a set of comprehensive regulations to groom and govern the profession of Financial Planners/Investment Advisers across the financial market. This is akin to the provisions in the Investment Advisers Act, 1940 in the US.

(iii) *Compensation to Investors* - It is not enough that the culprit is punished. The culprit needs to be punished in an exemplary manner, while investor should have means to recover his loss caused by the culprit. The law should empower the authorities not only to levy penalties, but also award compensation to investor and enforce disgorgement of illegal gains made by the accused. The orders to compensate investors could be passed by a statutory ombudsman who should hear the parties and pass appropriate orders including about compensation to the investor either from the defrauding/negligent party or from an insurance fund. A group insurance policy may be considered under which an investor, losing any money for whatever reason except for market loss or his own negligence and not compensated by the negligent or defrauding party, is compensated up to a specified amount. This is akin to compensation to depositors in banks by the Deposit Insurance and Credit Guarantee Corporation. In the US, an organisation called Securities Investor Protection Corporation under the Securities Investor Protection Act, 1970, operates a similar insurance mechanism to compensate up to US $ 5,00,000 per investor in securities.

(iv) *Investor Protection Fund* - SEBI has been established with the prime objective of protection of the interests of investors in securities. However, it does not have access to public funds to discharge this responsibility adequately. There is an investor education and protection fund with MCA which is not available to SEBI. The penalties levied by SEBI are credited to the Consolidated Fund of India. The similar penalties levied by the PFRDA under Ordinance are credited to the subscriber education and protection fund. In order to strengthen the hands of SEBI, it may be desirable to allow SEBI to set up a fund for investor protection which could be credited by penalties levied by SEBI and unpaid amounts of investors/clients lying with listed companies/mutual funds and intermediaries beyond a specified period. Besides, there is a lot of float money in the public issue process which remains with banks till allotment process is over and refund is made. 1% of the issue amount is currently deposited with the exchange. This float money can be kept with a third entity and the interest therefrom can be used for investor education and protection.

(v) *Disclosure* - There are intermediaries and intermediaries of all shapes and sizes and even hues and colours operating in the market. Their acts of omission and commission can cause loss to issuers and investors and even contribute to market failure. In order to enable an issuer or 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. The details may include the form of organization, management, capital adequacy, liabilities, defaults and penal actions taken by the regulator and SROs against the intermediary in the past and other relevant information. Even, the intermediaries may be rated and their ratings be disseminated. The intermediaries may be mandated to make continuous disclosures about its performance and financial positions through a central website. For example, if an intermediary fails to comply with the prescribed eligibility criteria, particularly the capital requirements, it should come to the notice of the regulator and the investors instantly. Disclosures change the behaviour of the intermediaries. The investors and issuers gather the information from disclosures, and if warranted, change their behaviour *vis-à-vis* the intermediaries. As a result, the behaviour of the intermediaries also changes. The intermediary also discloses his changed behaviour which, in turn, induces further changes in the behaviour of the investor. The process continues *ad infinitum* and the market benefits from the combined changes in the behaviour of the investors and the intermediaries in the desired policy direction.

(*vi*) *Quality Intermediation Service* - The confidence of the investors can be maintained and enhanced by making provision for professional intermediation services. In developed markets, quality of intermediation services is ensured through a system of testing and certification of persons working with market intermediaries. In the US, for example, any securities professional associated with a member firm, including partners, officers, directors, branch managers, department supervisors, and salespersons, are required to be registered with the NASD. As part of the registration process, securities professionals must pass an examination administered by the NASD Regulation to demonstrate their competence in the areas in which they would work. This sort of arrangement ensures that a person dealing with financial products has a minimum standard of knowledge about them, market and regulations so as to assist the customers in their dealings, and bars ill-equipped personnel from providing intermediation services in the securities market. In India, Industry/SROs/Regulators have made a modest beginning, but not adequate, given the dimensions of the market. A central agency, as may be accredited by SEBI, may offer a certification for each type of intermediation service. The certified people may be required to update their skills and expertise by seeking certification at periodic intervals. While this requirement should apply at the entry point for all new employees joining the intermediaries, the existing agents/employees may be allowed, say, about a year, to obtain the certification.

(*vii*) *Agreements* - A lot of substantive law has been prescribed through agreements, which mostly aim at investor protection. In fact, the listing agreement, which is quintessence of the Sarbanes-Oxley Act, 2002 is the best example of this category of law. These agreements are not really agreements among the participants on their own volition and they generally do not have any flexibility to amend any of the terms of the agreement. In fact, the agreements are standardized and amended unilaterally by the regulators and the parties are directed to enter the standard agreement as amended from time to time. In such a case, there is no need to have agreements signed among the parties. It would be better if the law enables the regulators to regulate certain aspects by the agreements, the terms of which can be varied by the parties to agreement. The parties must be deemed to have agreed to the agreement, as may be amended from time to time by the regulators. This would avoid signing of the agreements with every amendment and costs associated with such agreements. This would be in the interest of investors as the parties cannot alter any of the terms prescribed by the regulator to the disadvantage of the investor and an investor would not suffer just because a fresh agreement has not been signed by the parties after a particular amendment.

(*viii*) *Special Agency and Statute* - An investor invests in a range of financial products such as securities (corporate and Government), fixed deposits (with banks and companies), insurance products, pension funds, mutual funds, small savings instruments, etc. He approaches a wrong regulator for his problems, as neither does he know nor the regulators always know which regulator is concerned with a particular type of problem. Besides, SEBI has been assigned the responsibility to protect interests of investors in securities. There is no such arrangement in respect of other financial instruments. It is desirable that there is only one statute which establishes a single agency to deal with all kinds of grievances of investors across financial products. It could provide for specialised ombudsman who can award compensation to the investors (across markets/products) who has lost money for whatever reason except for market loss or his own negligence. In such a case an investor, irrespective of the kind of problem, will knock only at one door.

CONCLUSION

6. The regulatory framework needs complete overhauling not only to meet the changes in law proposed in this paper, but also to meet the emerging challenges and address several existing deficiencies. These aspects have not been covered in this paper.

171-S

SECURITIES MARKET

INDEX FUNDS : PRODUCTS OF THE FUTURE

Ekta Tyagi

Index funds are perceived as poor mode of maximizing returns from equities in developing markets because of the lower return they offer. But in the course of time, as markets mature and pricing inefficiencies reduce, index funds with their negligible expenses and constant alignments to the markets will present themselves as better options. This article takes an overview of the mutual fund industry in India and endeavours to analyse why index funds will soon emerge as the most preferred mutual fund investment option. In this context, types of mutual funds and risk factors involved have been scanned here. According to the author, for investors who are content with market returns, are risk averse and do not want to depend on the skill of fund manager, index funds are least risky and most convenient options for investment.