# Market policy prerogative of the Executive, SEBI

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M S Sahoo and Pratik Datta April 6, 2023

Hindenburg Research's report and the subsequent volatility in share prices of Adani group companies triggered multiple writ petitions before the Supreme Court of India. The petitioners prayed for various reliefs, including a direction to the Centre to set up a committee to investigate the report's contents.

In its order dated February 10, 2023, the SC rightly noted a need to review existing financial regulatory mechanisms to ensure they are strengthened to protect Indian investors from market volatility. It even suggested to the Solicitor General to seek instructions from the Union of India on the constitution and remit of an expert committee.

In a subsequent order dated March 2, 2023, the SC noted that SEBI had already started investigating the allegations. It directed SEBI to investigate a few additional aspects raised by the petitioners without constraining the ongoing investigation. However, the court went further and constituted an expert committee.

The wide mandate of this committee includes (a) providing an overall assessment of the situation, including the relevant causal factors which have led to the volatility in the securities market in the recent past; and (b) suggesting measures to strengthen investor awareness and the statutory and/or regulatory framework, and to secure compliance with the existing framework for the protection of investors.

This judicial order constituting an expert committee to recommend policy matters is problematic. First, a writ petition typically seeks a direction from a public authority to do or refrain from doing something. In this matter, nothing indicates that any authority refused to or refrained from doing something, warranting action from the SC. The petitioners also do not appear to have prayed for a court-appointed committee.

Neither does the order specify the legal provision under which the expert committee is constituted. Assuming the court used its powers under Article 142 of the Constitution to achieve 'complete justice', the order does not explain why a committee with such a broad mandate was necessary in the facts of the case.

This contrasts with the SC order dated January 12, 2021, in *Rakesh Vaishnav v. Union of India*, where it had set up an expert committee on farm laws. The court had categorically observed that the negotiations between the government and farmers' bodies had not yielded any results. That is why it constituted the expert committee to facilitate the negotiation process.

Second, this order marks an unprecedented step towards judicial policymaking in the financial sector. Price volatility is an everyday affair. Courts usually do not intervene, though there are instances of parliamentary committees looking into major stock market crashes. Volatility is the essence of markets. Fluctuation in prices provides a system for aggregating information from numerous sources. This price system, along with volatility, is essential for the efficient allocation of resources in a market economy. Curbing volatility at the cost of price discovery would be antithetical to the securities market.

Potential systemic concerns associated with abnormal volatility in financial markets are already addressed through sophisticated laws and institutions. Circuit breakers in the stock exchanges are one prime example. Capital controls seek to reduce exchange rate volatility by restricting the free convertibility of currency.

Such laws and legal institutions result from deliberative policymaking across advanced economies over decades and keep evolving. Designing such laws and institutions involves numerous policy choices and tradeoffs, affecting many market players and stakeholders directly or indirectly. Such polycentric matters are best left to the wisdom of the legislature, executive, and regulators.

Third, market regulators like the SEBI deserve more judicial deference than guarantor institutions such as election commissions or anti-corruption bodies. Unlike market regulators, guarantor institutions are meant to provide credible and enduring guarantees to specific non-self-enforcing constitutional norms.

Powerful actors may not always have the will as well as the ability to effectuate such norms. The judiciary may, therefore, have legitimate reasons to be more demanding with respect to guarantor institutions to help them preserve such non-self-enforcing norms.

Protection of investors in the securities market, however, is a self-enforcing norm. The executive has strong incentives to maintain confidence in the integrity of the securities market. If investors lost faith in the securities market due to abnormal volatility, it would reflect in the broader market indices and have swift electoral ramifications for the ruling power.

Therefore, the incentives of both the executive and the securities regulator are sufficiently aligned to promote investor protection in the securities market. The judiciary need not expend its judicial capital on this front. It may instead defer to SEBI on this matter.

Fourth, the practical utility of forming the expert committee remains doubtful. The legislature and the executive may now prefer to wait on investor protection reforms until the court takes a view on the committee's findings. Stakeholders may seek similar relief from the SC in every other similar matter.

If the expert committee suggests certain statutory or regulatory changes, it is unclear if the court would go on to direct the legislature or the SEBI to implement those suggestions through appropriate legislation or regulations. That would encroach into the policy domain of the legislature and the executive, undermining the delicate institutional harmony.

It is an accepted norm that the judiciary does not venture into the policy domain. Promoting investor protection and awareness in the securities market involves deeper policy choices. These are best left to the wisdom of the legislature, the executive, and the SEBI. Judicial capital has better uses elsewhere.

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