Bar and Bench

God is in the Details: SEBI and RBI Powers in Finance Bill 2019

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In the recent Budget Speech, the Hon'ble Finance Minister proposed various measures including those to further increase foreign investor participation in Indian capital markets and to open up the economy by additional FDI in aviation, insurance, animation visual effects, gaming and comics (AVGC) and media.

On a macro level, some of the proposed measures include easing KYC norms for FPIs, forming a Social Stock Exchange under SEBI for listing and electronically fund-raising by social enterprises & voluntary organisations (the likes of ones in Singapore and London), seeking inter-operability of RBI & SEBI depositories, increasing MPS requirements to 35% from current 25% (perhaps an indirect disinvestment and privatisation programme), deepening of corporate bond markets, merging NRI portfolio route with FPI route, breather from usual income tax scrutiny on valuation of shares issued by Category II AIFs, doing away with Debenture Redemption Reserve (DRR) to enable NBFCs to tap into fund raising, levying of

Securities Transaction Tax (STT) only on the difference between settlement and strike price in case of exercise of options etc. These are immensely positive announcements and right dimensional efforts if India wishes to be a matured capital market akin to the U.S. and Singapore financial markets.

Along with this Budget Speech, an interesting aspect is the Finance (No. 2) Bill, 2019 tabled with it. Over the last few years, crucial amendments to laws governing the financial regulatory landscape have been brought in through the Finance Bill. My analysis of the Finance Bill 2018 is available here.

While some High Courts (such as challenge to merger of 8 Tribunals through Finance Act, 2017 at Bombay HC) and the Supreme Court (SC had provided an interim stay to NGT appointment rules; and amendments in PMLA through the Finance Acts of 2015, 2016 and 2018 are under challenge) are already tasked with judicial review of decision of the Speaker on inclusion of 'incidental' or 'non-financial matter' in the Finance Bill, the interpretation of Article 110 and determining constitutionality of the amendments to Acts – the SEBI Act and RBI Act are sought to be amended yet again through a "*Miscellaneous*" Chapter therein.

If not devil, God is in the detail.

Amendments to RBI Act

More Powers to regulate NBFCs: RBI has been provided greater powers to regulate Non-Banking Finance Companies (NBFCs) including powers to seek financial and related information about the group companies, seen as a fall-out of recent NBFC crisis starting with IL&FS.

Regulation of HFCs moved from NHB to RBI: The National Housing Bank Act, 1987 has been amended to take away regulation authority over the housing finance sector from National Housing Bank (NHB) and to move it under the ambit of RBI. RBI Act has been amended to increase the quantum of penalties if the regulations are not followed.

Removal of Directors & Supersession of board: New sections have been added (Section 45-ID and 45-IE) to the RBI Act, 1934 which empowers RBI to remove one director or supersede the entire board of directors, if the regulator believes it to be in the public interest or financial stability or securing 'proper' management or prevent affairs of a NBFC being conducted in a manner detrimental to depositors /creditors. In case of supersession of board of directors (other than in a Government Company), the period of such control, however, shall not exceed 5 years without permission and RBI can appoint an administrator to manage the affairs of NBFC.

Resolution of NBFCs: Under newly inserted section 45MBA, RBI is empowered to frame schemes to amalgamate an NBFC with any other NBFC or reconstruct it, or split the NBFC into different units. To ensure efficient resolutions, RBI can now establish bridge institutions which are temporary institutional arrangements for the transition and preservation. In such schemes, RBI can also reduce the pay and allowances of CEO, MD, Chairman or other officers of an NBFC and can even 'cancel' all or some shares held by them or their relatives. This

provision leaves unanswered questions, which are likely to be raised in lawsuits, as and when these provisions are enforced.

Non-uniform approach and a missed opportunity: Such provisions (section 34B, 34C, 52A) exist in Insurance Act, 1938 empowering insurance regulator IRDAI in case of resolution of insurance companies or intermediaries. SEBI, as a securities market regulator too, administers such provisions for securing management of an intermediary under (section 11B of) SEBI Act, 1992; stock exchanges under (section 11 of) Securities Contracts Regulation Act, 1956 and depositories (section 19 of) under Depositories Act, 1996.

Such provisions are extreme provisions empowering the governments/regulators to interfere in legitimate businesses in an emergency, and that is why the respective regulatory laws have made every step in that direction, appealable to an expert tribunal in the form of Securities Appellate Tribunal (SAT).

While the powers now being granted to the RBI are similar to those already wielded by SEBI and IRDAI, the Finance Bill, 2019 seems to have missed the opportunity in also making RBI judicially accountable for exercise of those powers, as is the case with SEBI and IRDAI, whose orders are appealable before the Securities Appellate Tribunal (SAT).

Debarment of Auditors: While SEBI's debarment of PWC and its network entities for 2 years from issuing audit certificates to any listed company in India for its role in the Satyam Scam is under judicial challenge, for the first time in India, a regulator, RBI, has been provided an explicit power *to "remove or debar the auditor from exercising the duties as auditor"* of any RBI regulated entities for a "maximum period of three years, at a time." This is indicative of a tight noose on auditors and such debarment may in future become routine.

However, this power may come in conflict with those of the NFRA, which was constituted under the Companies Act, 2013 for the purpose of regulating auditors.

Amendments to Securities Contracts (Regulation) Act, 1956

Penalty on failure to furnish information to SEBI. A technical issue in section 23A of SCRA has been plugged. The penalty under it was leviable if the listed entity failed to report to the stock exchange only. This has been amended to let the penalty on failure to furnish information, return, etc. to the SEBI as well or as required under rules made under SCRA.

While this clears the gap, cherry-picking one particular section for amendment through the Finance Bill, when SEBI board has recommended detailed proposals is perplexing.

Amendments to SEBI Act, 1992

All sums realised by way of penalties under SEBI Act are credited to the Consolidated Fund of India (CFI). Similarly, all settlement amounts, excluding the disgorgement amount and legal costs are also credited to CFI.

Checks and Balances on SEBI's Expenses: For salaries, allowances and other remuneration of the members, officers and other employees, SEBI has a SEBI General Fund. All grants, fees and charges received by it (such as for registrations, processing public issues, applications etc.) are credited to SEBI General Fund. Whether SEBI General Fund should be mixed with the accounts of government or should be maintained separately is more a question of policy than law, as it touches the autonomy of the regulatory institution. On the other hand, successive governments and reports of Comptroller and Auditor General (CAG) have been advocating a merger of SEBI General Fund with CFI or Public Accounts of India, as regulators are not-for-profit organisations. From the publicly available figures, SEBI has more than 3000 Crores in its General Fund as of FY 2017-18.

Balancing the interests of the regulator and the Government while also bringing some accountability, Finance Bill amends section 14 of the SEBI Act and constitutes a Reserve Fund. SEBI General Fund can now be utilized for capital expenditure as per annual capital expenditure plan approved by the SEBI board and the Central Government. 25% of the annual surplus of the General Fund is now required to be credited to this Reserve Fund and SEBI has to transfer the rest 75% of its annual surplus from the General Fund every year to CFI.

Notably, such provision has not been introduced for other regulators. Is it that some regulators are accountable, some more accountable and some non-accountable?

Clarification on Electronic Communication & penalty on broker: SEBI under section 15C of SEBI Act, can now ask a listed company or any person who is registered as an intermediary, to redress the grievances of investors. This is only a clarificatory amendment that 'in writing' will include by way of 'electronic communication'. Similarly, an error in section 15F of SEBI Act, brought by an earlier amendment, where the maximum range of penalty for default in case of stock brokers was left out, has now been specified as 1 Crore.

Alteration, Destruction etc. of records and failure to protect electronic database: A widely worded section 15HAA has been inserted whereby any alteration, destruction, etc., of records done knowingly so as to impede, obstruct, or influence the investigation, inquiry, audit, inspection or proper administration of any matter under SEBI will be penalised with minimum 1 lakh extendable upto 10 crore rupees or 3 times the profits made out of such act, whichever is higher.

While SEBI and SAT are dealing with cases involving allegations of unauthorised Colocation, broker-Exchange nexus in placing Dark Fibre, tick-by-tick data broadcast and High-Frequency Trades (HFT) at National Stock Exchange (NSE), this newly inserted section, penalises unauthorised action or omission in detriment to regulatory data and system databases. Data leakage, introducing any computer virus or other computer contaminant into the system database or their abetment has also been included for penalty.

SEBI maintains Integrated Market Surveillance System (IMSS) and Data Warehousing and Business Intelligence System (DWBIS) which has its feed from Stock Exchanges. SEBI

through inquiries, inspections and complaints also receives voluminous data in addition to the data received from other domestic and international regulators under its MOUs.

It is unclear if 'regulatory data' and 'database' used in the Section is limited to SEBI or it is meant to cover all the data at system database maintained by SEBI, Stock Exchanges, Depositories and Clearing Corporations. It is also not explicit if non-maintenance of the databases such as those required by FPIs and other intermediaries for finding ultimate beneficiaries through KYCs, or the digital database of persons having inside information (UPSI) under recent amendments to SEBI (Prohibition of Insider Trading) Regulations, 2015 will be covered under it.

Interestingly, section 15HA of SEBI Act separately provides a penalty for fraudulent and unfair trade practices, with a higher quantum than the one introduced now under section 15HHA.

Conclusion

SEBI Act and RBI Act are frequently amended by route of a 'miscellaneous item' in Finance Bills wherein important provisions are tucked in and are brought in without any debate in Parliament at all. Every successive year new powers are being provided to the Regulators, in the backdrop of one crisis or other, and perhaps without even an analysis if regulators are even using the wide powers already available with them.

I hope when the Ministry of Finance brings a notification to put into effect the above amendments to RBI Act and SEBI Act, it also makes subordinate rules for disclosure of exercise of each power provided to them, for future assessment.

Be that as it may, these amendments are an indication of mounting enforcement of financial regulatory laws.

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