Financial Institutions and Markets
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Lecture – 20
SEBI, IRDA and PFRDA: Structure and Function

So, in the previous class we discussed about the functions and the operations of Reserve Bank of India, who is the one of the most important regulators operating in the Indian market or Indian economy. And, the basic job of the RBI is to conduct the monetary policy and to ensure that the price stability can be maintained. And, as well as the growth rate of the total output or the GDP also can be enhanced. So, then we have another major three regulators which work in this particular economy.

These are Securities and Exchange Board of India: SEBI, Insurance Regulatory Development Authority: IRDA and the Pension Fund Regulatory Development Authority that is the PFRDA. These are relatively new regulators which operate or which work in the Indian context. But, today we will be discussing that what are the structure of that particular regulatory bodies and what are the major functions and how they basically work in the Indian context.

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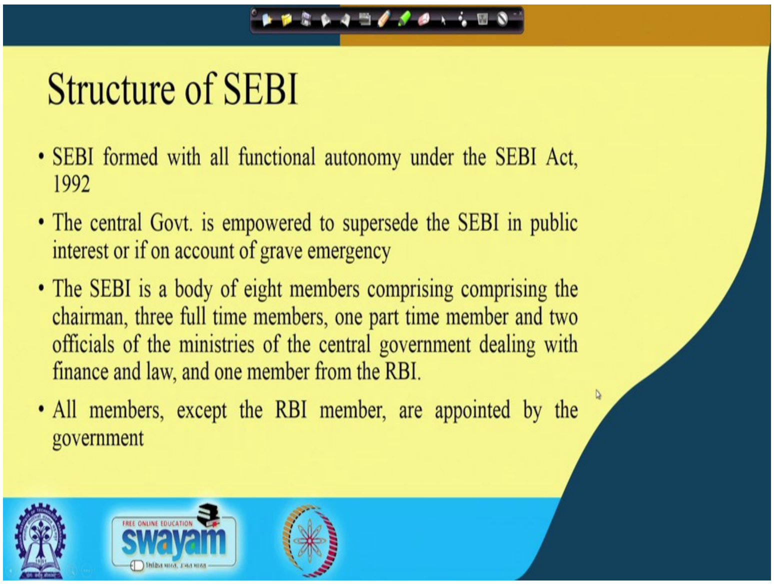

So, if you see first of all the SEBI already what I told you that this is relatively a new regulatory body which is working in the Indian market which was started after the liberalization. When the stock market was developed or there was an urge to make this capital market more developed in comparison to other emerging economies. So, in that context the government has established the SEBI under the SEBI Act, 1992. So, here there are certain things if you talk about the structure.

The SEBI is a body of eight members comprising the chairman, three full time members, one part time member and two officials of the ministries of the central government. And, they all deal with the finance and law, who are basically the members from the ministry and one member from the RBI. One nominated member from the Reserve Bank of India because, as you know there is a link between the capital market and the money market. And, the money markets are mostly controlled by the RBI and the capital market, the stock market which is mainly controlled by the securities and exchange board of India.

So, because of that to make this kind of arrangement there is a plan that or there is some kind of necessity that one member from RBI also should be there in the SEBIs bodies. So, this is what basically this governing body of SEBI is comprised or formed. And all those members who are basically this part of the SEBI, they are basically selected or nominated by the government except the member which is coming from RBI. Because, RBI nominates that person and the other persons who are the members of the SEBIs governing body they are basically appointed by the Government of India. So, this is the way the structure of SEBI is designed in the Indian context.

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So, what is the major functions what basically SEBI does, but what is the necessity that the one regulatory body was formed to control the capital market in Indian economy. So, the first job of SEBI is basically or the foremost important job of the SEBI is to protect the interest of the investors and to promote the development and to regulate the securities market. Basically, the participants whether they are the institutional investors or the retail investors, they basically work or they take the positions in the equity market for their maximization of the return.

So, SEBI ensures that their interest should be protected or whatever positions they are taking whatever monetary transactions are happening; so, all those transactions are well protected. And, the all kind of transactions which they supposed to make those are made through proper rules and regulations. Those kinds of things were over basically totally governed by or may be regulated by the securities and exchange board of India. And, next thing is to promote the development the infrastructural development.

And as well as other development activities which should happen both administrative and as well as infrastructural which should take place in the Indian equity market that is totally looked by the SEBI in the Indian context. And, they regulate the securities market in the sense they basically make the rules and regulations norms and period to period they see that whether the market is functioning in the better way. So, these are the major functions of SEBI in the Indian equity market.

And, another function of SEBI is to regulate the business in the stock exchanges. So, this would ensure that whatever business the stock exchanges are doing or whatever transactions in the stock exchanges are made they are fair. So, all kind of transactions are basically is in the interest of the shareholders or the equity holders who are investing in this. And, stock exchange is transparent providing all kind of information or stock exchange is really working in a clean manner for the investors, where the investors take their positions to maximize the return.

Then, the third thing and another function is to register and regulate the working of the stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisors etcetera. Because, you see all these agents participate in the pricing of the equity particularly in the IPO process and as well as also they participate whenever the transactions of a particular positions are taken place. When the settlement of any positions basically take place all the settlements are taken care of by some of the economic agents.

So, SEBI ensures that all these economic agents who are the major participants in the equity market they should register themselves. They should be authorized by the SEBI that they are allowed to participate in the equity market. They should act as an economic agents in the equity market and also the rules and regulations related to those kind of economic agents also should be time to time can be revised for the interest of the equity holders or for the interest of the share holders.

And, also another things SEBI basically regulate the foreign institutional investors and credit rating agencies. Because, you see where credit rating agencies is also working as a company in the Indian equity market or Indian capital market what we can say. And, because the Indian market is highly dominated by the FIIs or the Foreign Institutional Investors, SEBI ensures that all these FIIs which are coming to India they have registered themselves with the SEBI and as well as they are functioning.

And their operations and their positions they are all basically can be regulated by the security the exchange board of India. They also regulate the venture capital funds, mutual funds, collective investment schemes. These are all regulated by the SEBI and also they make the arrangements to promote and regulate the self regulatory organizations. If you remember I was discussing about the self regulatory bodies like AMFI: Association of the Mutual Funds.

So, those are basically promoted by the SEBI to ensure that the market is working in a right direction or all kind of or any kind of unethical practices are not happening. And, whatever disclosure norms and everything should be reported to the market everything is done by the companies. And, because of that what is happening SEBI also ensures that those kinds of self regulatory bodies can be developed or should come to the market. Because, once the market is matured maybe they are able to control the market in that way.

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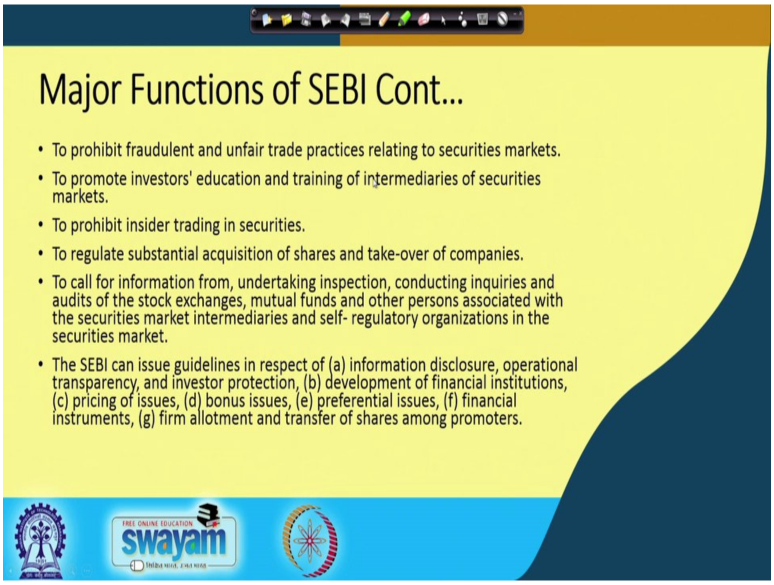

So, these are the major functions and some other functions are already I told you it is a part of that to prohibit the frauds and unfair trade practices relating to the securities market. Any kind of trade practices which are happening; any kind of frauds which are happening in the equity market that should be always controlled by the SEBI. SEBIs major job is to control that and to ensure that those kind of unfair practices are not happening in the market. And today's time because the equity holder's participation is very less in terms of the retail investment point of view SEBI also started this investors education schemes.

So, the basic job of SEBI is to promote this investors education and training that how they can participate in the equity market or they can take their positions in the equity market. Because equity market is also one of the most important markets to maximize the return or to make their portfolio in such a way; it can be considered as one of the assets in their total portfolio. To prohibit the insider trading because, the insider trading is unethical practice which may happen inside the companies. So, the SEBI basically makes the rules and regulations in such a way that also the stringent rule, policies, norms basically always try to prohibit the possibility of an insider trading within the companies.

And, SEBI is much more vigilant for this kind of thing. To regulate the substantial acquisitions of shares and takeover of the companies, the SEBI should always ensure that whatever acquisitions and takeovers are happening in the market; they are basically following the rules and regulations which is already drafted by SEBI or all the guide lines which are basically made by the SEBI. So, those things basically are very important because that has lot of implication on other investors which are investing in that stocks which are taken over or with the company which is taking over.

To call for information, conducting enquiries, audits of the stock exchange and mutual funds all are basically the major responsibility of the SEBI. Because, SEBI ensures that all the firms which are operating they are doing their business ethically. And, all kind of financial frauds and all these things are not happening in the market. And, as well as those kind of bodies are basically working in the interest of the share holders. The SEBI also can issue the guidelines in respect of information disclosure, what kind of information the companies should reveal. Those kind of guidelines SEBI can give: operational transparency and investor protection.

So, all those guidelines are always coming from the SEBI that what are those things the companies should follow by that all this information can come to the investor, whenever they take their position in the company, in the equity market. And as well as all those guidelines also they provide to protect the investors whenever they participate in the equity market. They are also provided the guidelines for the development of the financial institutions, pricing of issues. Pricing of issues in the sense of we are talking about the initial public offerings and all, because all those guidelines rules and regulations of IPO pricing are basically done by the SEBI.

So, in this particular subject we will be discuss more on this pricing part, but the pricing part is very important. Because, whenever any company comes to the market for the first time they should ensure that the pricing of that security is fair. And, whatever price they are paying for to invest in that particular security that also should be the equilibrium price in the market. So, because of that all those book building process and all those things which are already in its guidelines and all these things are drafted by the SEBI and every company has to follow that.

What are those? All those guideline related to the bonus issue, the preferential issues. Preference shares basically whenever any company gives then what are the policies or what are those steps the company should follow. So, all these things are should be given by the SEBI or SEBI provides all those kind of guidelines by that any kind of unethical practices will not happen. Firm allotment and transfer of shares among promoters, then how the shares can transfer from one promoter to another promoter.

Then, when these particular shares should be transferred and what are the particular guidelines should be followed. All kinds of regulations and guidelines are basically formulated by the SEBI for the better functioning of the equity market and as well as they would ensure that the market is working smoothly. So, these are the major things or major functions of SEBI always what we see.

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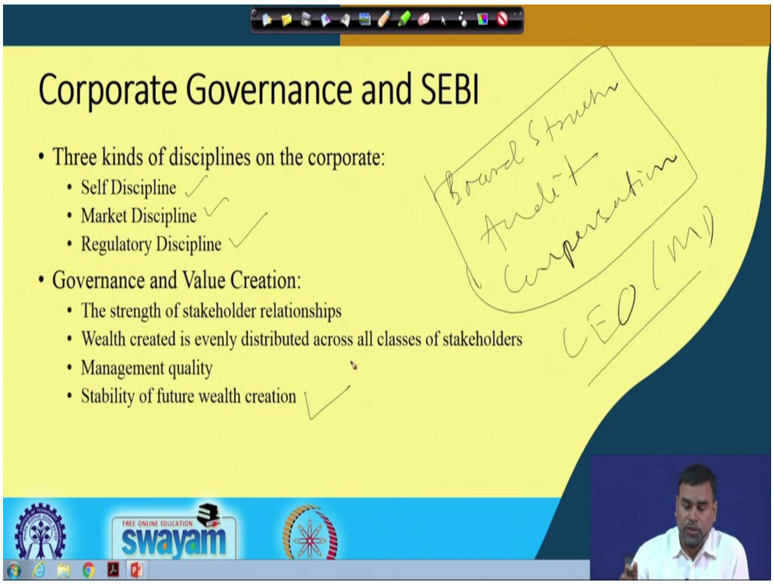

And, another major function what SEBI does, that is basically this would ensure that the governance system in the company is adequate enough to attract the investor to invest in that particular market. So, whenever we talk about corporate governance, through corporate governance basically what we are trying to make. We are trying to make the particular company more discipline, whether the company is basically working in a disciplined manner or not, whether the transparency about the company is existing or not. Those things are basically drawn by the different type of discipline: one is self discipline, market discipline, and regulatory discipline.

So, all kind of discipline whatever is imposed by the regulatory bodies all those things are basically followed by the companies or not, that basically we have to ensure. So, that is basically overall corporate governance means what; the corporate governance means that whenever the company works in a particular system, the governance system of the company should be in such a way that it can take care of the interest of all the stakeholders of the company. So, it can be equity holder, it can be debt holder, it can be suppliers, it can be government, it can be customers, it can be employees. So, everybody's interest or it can be investors so, whoever it may be all those interest should be taken care.

So, to take care of the interest of all kind of stake holder who are the parts, who are basically the major participant with respect to or major stake holders with respect to the company; the corporate governance system should be strong. Because, corporate governance system should ensure that the company is a good company for investment. And, SEBI is ensuring that the governance system of that particular company is good. So, that is why the governance has a lot of role in terms of the value creations, the strength of the stake holder relationship, it has the relationship. Wealth created is evenly distributed across all classes of stake holders that can be ensured by the governance system.

What kind of management quality we have, management quality in the sense who should be the CEO and whether the CEO follows this criteria whatever we should have, what is the board structure of the company. And, whatever rules and regulations the companies act is making and whether the company is following those rules and regulations or not. What kind of audit practices they have, what kind of remuneration policies they have. So, all those are the components of the corporate governance. So, SEBI ensures that all kind of issues are taken care of by the company and then only we can say that the company is transparent.

So, mostly if we are talking about the governance system already I told you this is related to your board structure. Then we have the audit, then we have the compensation policy. These are the major issues which comes under the corporate governance part and the CEO or the managing directors. What should be the composition of the board and whether the company is following the audit practices properly or not? What kind of compensation policy they have, everything should be transparent and should be according to the guidelines of the securities exchange board of India and as well as the Companies Act.

So, this is responsibility of SEBI to ensure that the governance practices of that particular company is fair enough. And, whatever information they are providing to the different stake holder, there they have the authenticity and they have the right information. Because, of that the investors can take the right position whenever they go to the market for investing in that particular share, that also ensures that the stability of the future wealth creation. Because, once people will be looking at that kind of governance practices and come to the market for the investment, that can help that whether the future wealth creation can be made by the company or the cash flow of that particular company can be positive or not.

So, these are the different ways the governance system helps for the betterment of the company. And, SEBI ensures that all those governance characteristics are made by the company in such a way that it can give a better idea about the company itself and the management quality also and as well as the stability of the future wealth creation. So, these are the different issues related to the corporate governance where the SEBI has a strong role to decide that whether the particular thing are happening with that particular company or not.

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Then, here whenever the SEBI ensures that whether the governance practices are happening in the company or not; this should ensure the timely disclosure of the relevant information, providing an efficient and effective market system, demonstrating a reliable and effective enforcement and enabling the highest standard of the governance. So, SEBIs major policy aim is that whether the companies should have a better standard or high standard governor system.

By that the information which is coming from that particular company, it has some kind of authenticity and the information are relevant for the investors whenever they go to the market for investing in that particular shares. So, these are the different issues what basically related the corporate governance in the context of India and as well also other countries. What SEBI is ensuring that governance practices is really followed in the Indian market.

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In this context different communities were established, there are many committees, but here we are highlighting the committees which are set up by SEBI. But, there are other committees also government has established there is a J. J. Irani committee in 2005. There are other communities, but there are major three committees what SEBI has established to increase the corporate governance system in the companies in India. The first committee was established under the chairmanship of Kumar Mangalam Birla in 2000.

So, on the recommendations of that particular community that is introduction of clause 49 of the listing agreement was to be complied by all the listed companies that was started in 2000. And, another major recommendation is that although the committee has given a long recommendations as summarized here some of the major issues what the committee has recommended. And, another recommendation the committee has given that the board of a company should have an optimum combination of executive and non-executive directors with not less than 50 percent of the board comprising the non-executive directors.

And, the disclosure should be made in the section on the corporate governance of the annual report. The annual report should have a corporate governance section then all those board structure, audit issues, remuneration issues all kind of things, we just discussed now. So, all these things will be reported in annual report, all the information should come through the annual report. And, shareholder and other investors or the market participants should have the fair idea that what kind of governance practices the company has. And, what kind of governance structure the company has. Then after that in 2003 another committee was set up under the chairmanship of Narayana Murthy, the then chairman of Infosys.

So, here what basically here we are talking about according to that recommendation there are certain issues were installed or may be included in that. The person should be eligible for the office of the non-executive director so, long as the term of office did not exceed nine years. It is basically we are talking about to make that particular policy in such a way that some kind of relevancy or the authenticity. Or, maybe we can say that the executive directors should not be there for a long period of time. Some kind of time limit should be there by that we can say that the maximum efficiency of that particular person can be used for that particular company.

Or can devote to the company to make the company more efficient and more profitable. Then the age limit of therefore, the directors to retired should be decided by the company themselves. It should not be decided by the government or any other body or by the regulator; it should be decided by the companies itself. The audit committee members shall be non-executive director because if your own employee will be in the audit committee may be there is the possibility of fraud.

Or, there is some kind of unethical practices may happen because if all the audit committee members will be the non-executive directors then, the probability of fraud and probability of unethical practices will be less. They should be financially literate and at least one member should have accounting and related financial management expertise. So, you should have those members who have the expertise in that particular area and there should be the outsiders or the non-executive directors.

They should not be the employee's regular employees of that particular company. Audit committee of listed companies shall review mandatorily the information on financial statements, risk management practices. The IPO issues or the process followed for the IPOs etcetera or the party transfers or stocks transfers and everything.

All kinds of things are basically taken care of by the audit committee and audit committee then power to see all kind of transactions financial transaction whatever the company has made in that particular financial year. So, these are the major recommendation what the Narayana Murthy committee has given.

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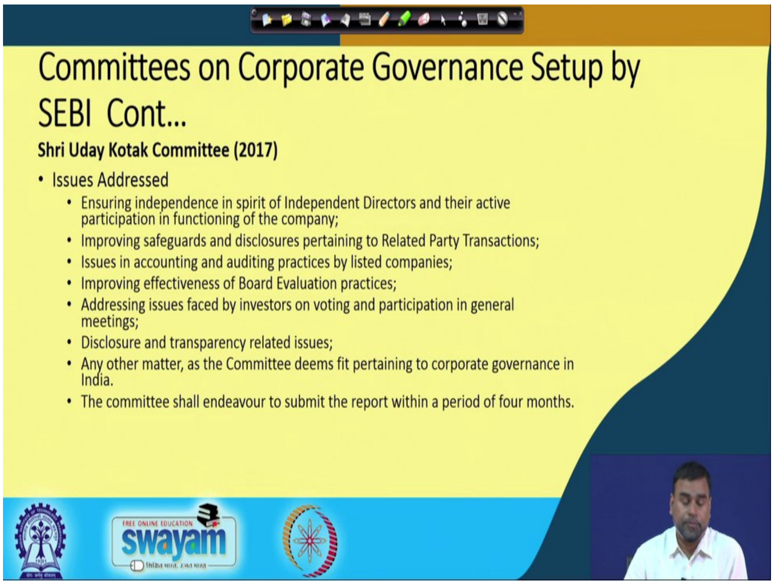

Then recently in 2017 they have established another committee under the chairmanship of Uday Kotak. Here there are different issues the committee has addressed. The issues are like ensuring the independence in spirit of independent directors and their active participation in functioning of the company, improving the safe guards and discloser pertaining to the related party transaction.

Issues in accounting and auditing practices followed by the listed companies; improving the effectiveness of the board evaluation practices, addressing the issues faced by the investor on voting rights or the participation in the general meetings. Disclosure and transparency related issues and any other matter as the committee deems fit pertaining to the corporate governance in India.

Almost all those and the committee has to submit the report, but the final recommendation has to be given. But, almost all those issues which are addressed under this corporate governance norms; this should be addressed by this committee in a comprehensive manner. And, by that if it is required then some of the changes can be carried out with the regulatory or existing norms whatever the SEBI has in terms of the corporate governance.

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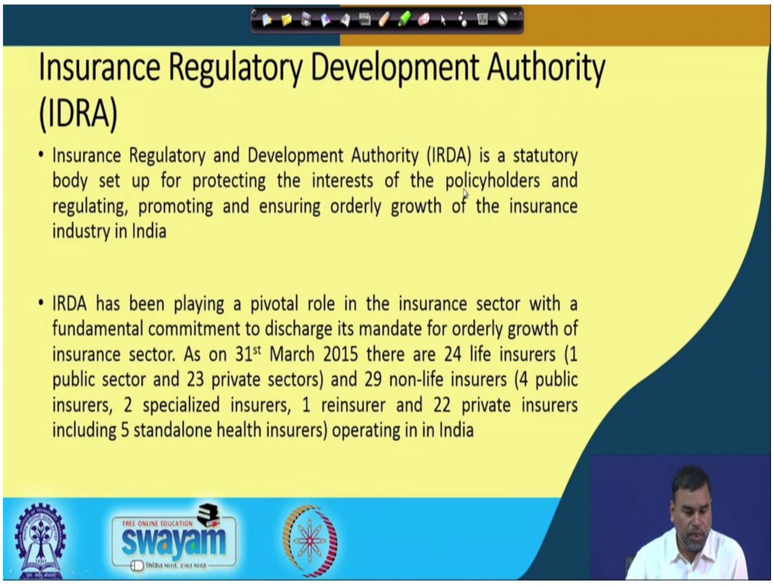

So, then we have another regulatory bodies. We have IRDA, IRDA was set of little bit late once to make this insurance sector more developed. So, this basic objective of IRDA was to protect the interest of the policyholders and to promote and regulate this insurance industry in India. Here if you see as on 31st March there are 24 life insurance companies out of them 1 is public sector like LIC and 23 private sector companies.

And 29 non-life insurance like 4 public insures and 2 specialized insures and 1 reinsure and, 22 private insures including 5 standalone health insurance companies which are operating in India. And, the major job of IRDA is to regulate them and to see that these policy holders interest is taken care of by this particular companies.

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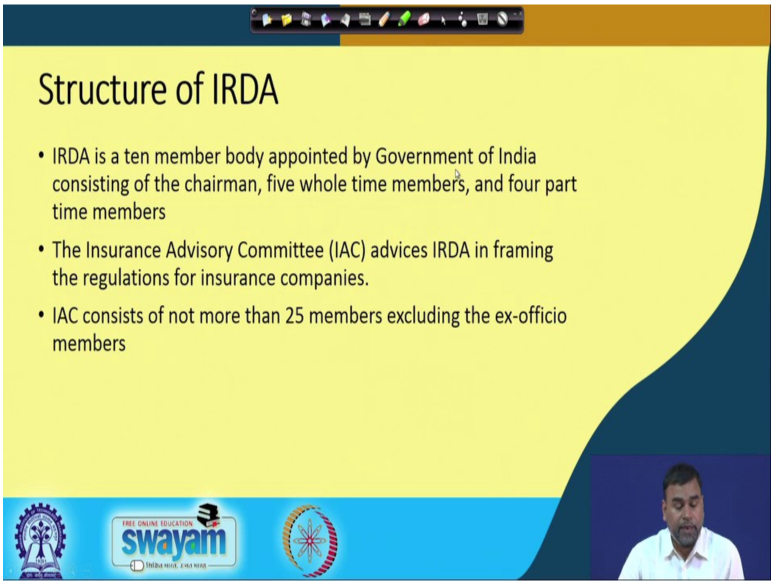

Then, whenever we talk about the structure of IRDA, the IRDA has a ten member body appointed by Government of India consisting of the chairman, five whole time members and four part time members. There is the insurance advisory committee, they advice IRDA in framing the regulations of the insurance companies. And, the IAC that Insurance Advisory Committee consists of not more than 25 members excluding the ex-officio members who are the part of the IRDA. So, their basic job is to provide this advice for the regulation and functioning of the insurance companies in India time to time.

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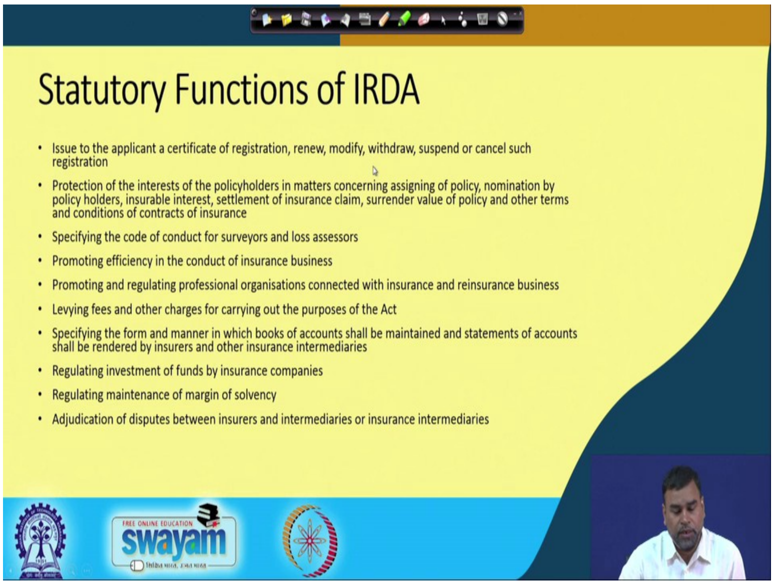

Then, if you see the functions of IRDA, already I told you this basic job of the IRDA is to regulate and to protect the interest of the insurance policy holders. But to the issue the applicant a certificate of registration, renew, modify, withdrawal, suspend, cancel such registration if they want. Protection of the interest of the policyholders in the concerning matter are the issues related to policy, nomination of the policyholders, insurable interest, settlement, surrender value of the policy or any kind of conditions which are there in the contract of the insurance. All these things will be taken care of by IRDA.

Specifying the code of conduct for the surveyors and the loss assessor, the people who are coming to assess the loss they make of code of conduct for them. Promoting efficiency in the conduct of insurance business, regulating the professional organization connected to the insurance and reinsurance business. Generally, levying the fees and other charges for carrying out a particular business in the market. Regulating the investment of the funds by the insurance companies, whenever the insurance companies invests the money on whatever they take as the premium. They should ensure that whether the money is properly invested and what are the different instruments they are using for the investment.

Maintenance of the margin of solvency, whether the insurance companies are solvent or not? Or, they are going towards any kind of insolvency that is the job of the IRDA to check whether the insurance companies are solvent or not. And, also they tried to go for making any kind of policies related to or any kind of interventions they always make for the dispute between the insurers and intermediaries at the time of requirements. So, these are the major functions of IRDA.

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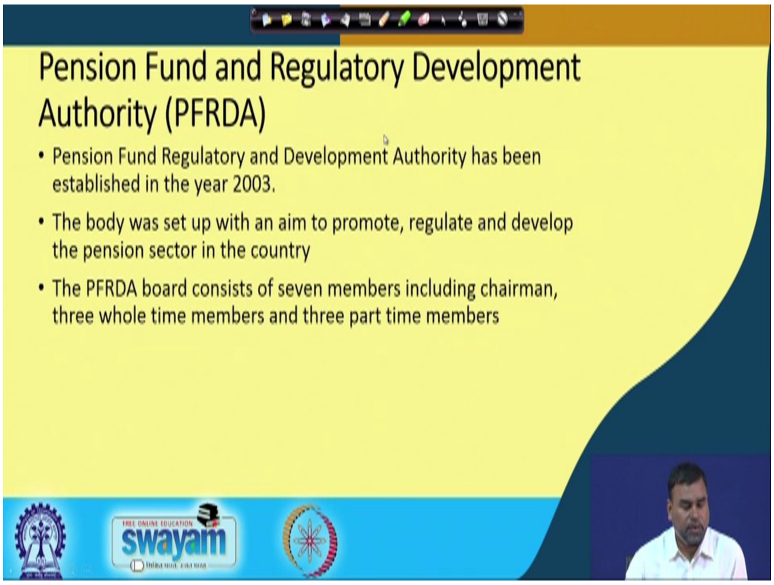

But, then we have another regulatory body we have that is PFRDA which was established in the year 2003. The basic job of PFRDA was to promote, to regulate the develop the pension sector in India after the establishment or emergence of non NPS that New Pension Scheme and the major job of PFRDA is to regulate that. The PFRDA board consists of seven members including chairman, three whole time members and three part time members.

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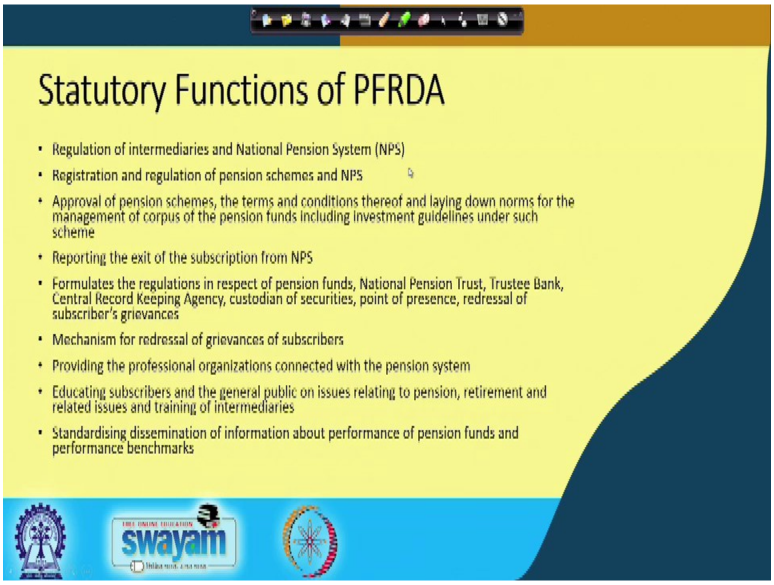

And, if you see the functions it is basically the regulation of intermediaries and national pension system; just now I was talking about that is the NPS. Registration and regulation of pension schemes, approval of the pension schemes and reporting the exit of the subscription form of the NPS. Formulate the regulations in respect of pension funds, national pension trust, trustee bank, recordkeeping agency, point of presence. All those parties which are part of the pension scheme or pension fund they are all regulated by the PFRDA.

So, these are all the point of presence, then you have central record keeping agency, custodian of securities. So, these are basically all regulations related to insurance made by them. All the grievances of subscribers should be addressed by the pension funds and all for those the mechanism is created by PFRDA. And, educating the subscribers and the general public on the issues related to pension, retirement and related issues; and they also provide the information about the performance of the pension funds.

And performance benchmarks from time to time which attracts the investors or the people to go for the pension schemes and to invest their fund in the pension sector. Because, the amount of only 23 percent of the people who are participating in the pension sector in India or they have this pension policies. So, to ensure that more people can come to participate in this process, the basic job of the PFRDA is basically to aware them, to provide them certain information by that this particular sector can be developed over the period.

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Please go through these particular references for this particular session.

Thank you.