

Legislative Brief

The Securities and Insurance Laws (Amendment and Validation) Bill, 2010

The Bill was introduced on July 27th, 2010 in the Lok Sabha by the Finance Minister Shri Pranab Mukherjee. It replaces an Ordinance promulgated on June 18th.

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Highlights of the Bill

- ◆ The Bill replaces an Ordinance which clarifies that Unit Linked Insurance Policies (ULIPs) shall be regulated by the Insurance Regulatory and Development Authority (IRDA), and not by the Securities Exchange Board of India (SEBI).
- ◆ A joint committee, chaired by the finance minister, has been established to resolve disputes over 'hybrid' instruments. The committee will consist of the governor of the Reserve Bank of India, and the heads of SEBI, IRDA and the pension fund regulator.

Key Issues and Analysis

- ◆ The law was issued as an ordinance and not through a bill. It is not clear whether there was an urgent and emergent situation that necessitated an Ordinance.
- ◆ The Government has offered no reasons why ULIPs should be regulated by IRDA rather than SEBI.

PART A: HIGHLIGHTS OF THE BILL¹

Context

On April 9 this year, the Securities and Exchange Board of India (SEBI), which regulates securities markets, directed 14 insurance companies to stop soliciting funds from investors for investment in Unit Linked Insurance Plans (ULIPs).²

Funds raised under a ULIP plan are invested in two ways. A part of the investment is treated as a premium towards a life insurance policy. The remaining amount is pooled with funds from other investors, and invested in the securities markets (shares or bonds). Investors are issued 'units' (similar to that in a mutual fund) and returns to investors depend on changes in the value of such units over the term of the plan.

ULIPs are currently regulated by the Insurance Regulatory and Development Authority (IRDA), under the Insurance Act, 1938. According to SEBI, ULIPs have a number of features which make them similar to other products offered to investors such as mutual funds. Given that such products are regulated by SEBI, ULIPs, to the extent they have similar features, must be regulated by it as well. Also, insurers who offer such schemes must be registered with SEBI if they wish to sell ULIPs as a product. Insurers are currently registered under the IRDA Act.

IRDA disputed SEBI's order and the matter was referred to the Supreme Court. Before the case was decided, the Ordinance was issued and the case was withdrawn. This Bill replaces the Ordinance.

Key Features

Regulation of ULIPs

- The Ordinance specifies that unit linked insurance policies will be covered by provisions of the Insurance Act, 1938. Such policies are no longer 'securities' or 'collective investment schemes', as defined under the Securities Contracts (Regulation) Act, 1956 or the SEBI Act, 1992.

Joint Mechanism

- The Bill provides for a joint committee, chaired by the Finance Minister, to resolve disputes between regulators over 'hybrid' or composite instruments. Such instruments are those which involve investments in the money market or the securities market, or have a component of insurance and which fall within the ambit of (a) Reserve Bank of India (b) SEBI (c) IRDA or (d) Pension Fund Regulatory and Development Authority.
- In addition to the Finance Minister, the committee shall consist of the heads of each the regulators specified above, as well as the Secretary (Department of Economic Affairs), and the Secretary (Financial Services) of the government.
- Differences of opinion over hybrid instruments can be referred to the committee by any of the regulators on it. The committee must reach a decision in three months and is binding on all the regulators.

PART B: KEY ISSUES AND ANALYSIS

Unit linked insurance policies

Regulation of ULIPs

Clause 3

ULIPs contain components of both insurance and investment. According to the SEBI order of April 9th, in some ULIPs products, the share of premium used to buy insurance is as low as 2% of the total, with the balance being invested in the securities markets. Given this, neither the Statement of Objects and Reasons of the Bill, nor the explanatory statement accompanying the Ordinance, justify the reasons why ULIPs should be regulated by IRDA rather than SEBI.

Need for Legislative Amendments

The Bill clarifies that unit linked insurance policies will be regulated by IRDA, rather than SEBI. It is unclear why the government chose to resolve the dispute between SEBI and IRDA through legislative amendments, rather than allowing for the matter to be resolved through the Joint Mechanism which has been established.

Need for an Ordinance

Under the Constitution, the power to make laws rests with the legislature. However, in cases where Parliament is not in session, and 'immediate action' is needed, the President can promulgate an Ordinance, which has the force of law, making the necessary legislative changes. The Supreme Court has clarified that the legislative power to issue Ordinances is "in the nature of an emergency power" given to the executive only "to meet an emergent situation".³

According to an explanatory statement tabled by the government in Parliament on July 27th explaining the need to promulgate the Ordinance, the SEBI order would have had the force of law and any violation of it would have attracted penalties under the SEBI Act. Therefore (according to the statement), "in order to clear uncertainties on the differences of opinion" between SEBI and IRDA, it had become necessary to clarify the ULIPs issue.

There are three issues. (a) Parliament was in session till May 7th, almost a month after the SEBI order was issued. The government has not explained why it did not make the necessary legislative changes by introducing a Bill in Parliament at the time. (b) While the original order prohibited insurers from raising further funds under existing schemes (which could have created uncertainty for investors, thus requiring quick action), SEBI subsequently clarified that its earlier order applied only to new schemes, leaving existing products untouched.⁴ This would have gone some way towards mitigating the 'uncertainties' referred to by the government in its statement. (c) On May 4th, more than three weeks after the SEBI order, the Minister of State for Finance told the Rajya Sabha that the government itself had asked the two regulators to get a legal opinion on the issue, following which the dispute was referred to the Supreme Court.⁵ It was while the matter was before the Supreme Court that the Ordinance was promulgated. Thus, the circumstances which made it necessary for the President to take 'immediate action' may not have existed.

Notes

1. This Brief has been written on the basis of the Securities and Insurance Laws (Amendment and Validation) Bill, 2010, which was introduced in the Lok Sabha by the Finance Minister Shri Pranab Mukherjee on July 27th, 2010.

2 SEBI order, 9th April 2010, see www.sebi.gov.in/cmorder/ULIPOrder.pdf

³ Article 123 of the Constitution. See *Dr DC Wadhwa v. State of Bihar*, 1987 AIR 579, 1987(1)SCR 798, 1987(1)SCC 378.

4 See <http://www.sebi.gov.in/press/2010/962010.html>

5 See Rajya Sabha Unstarred Question No. 4202, answered on 4th May, 2010

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