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Policy challenge in capital markets

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Modernising regulations, providing clarifications on circulars, and strengthening cybersecurity practices are essential to foster economic growth

THE EVOLUTION OF capital markets in India has closely reflected the progress and transformation of the Indian economy over time. Economic liberalisation in 1991 opened up capital markets, allowing foreign institutional investors to invest in India. This influx of capital brought a change in industry dynamics, marked by rapid economic growth and improved financial literacy. The introduction of electronic trading platforms like the National Stock Exchange (NSE) in 1994 further fuelled retail and institutional participation, aiding the development of capital markets.

The wave of digitisation, especially in the late 1990s and early 2000s, transformed domestic capital markets and the stockbroking industry. It brought much-needed changes to archaic processes — for instance, electronic Know Your Customer and Digital Know Your Customer were game-changers. It led to a dramatic reduction in the cost of acquisition by removing the need for extensive physical infrastructure and greatly reduced entry barriers.

The use of digital platforms and mobile applications democratised access to capital markets, enabling companies to reach a broader audience from lower-tier cities and rural areas. It also significantly increased competition in the space. Stockbrokers offering no-commission models or lower transaction costs have resulted in a reduction in margins for traditional stockbroking players, forcing them to explore other revenue streams.

Modern consumers prioritise convenience in managing investments. They seek platforms that integrate diverse financial services in one place. The emergence of tech-driven business models has enabled stockbrokers to provide comprehensive solutions, offering a broad range of products.

This diversification is further substantiated by numbers, highlighting the steady growth of non-broking revenue among major players. For instance, a prominent stockbroking firm's non-broking revenue contributed to nearly half of its revenue from operations as of FY24, while another industry leader's non-broking revenue contributed 64% of the overall revenue as of Q3FY23. While this may indicate a plateauing trend in broking revenues, it reflects the industry's ongoing evolution, with a potential for renewed growth through strategic policy interventions.

> **Provisions of the Securities Contracts (Regulation) Rules may no longer align with operational realities**

Factors such as digital innovation, evolving customer needs, and rising competition have transformed India's capital markets. Hence, regulations must evolve to ensure fair practices, foster innovation, and support stockbroking firms in diversifying into non-broking services to meet these changing market dynamics.

The Securities Contracts (Regulation) Rules (SCRR) were drafted in 1957, at a time when stockbroking firms primarily served as intermediaries. The industry landscape has since evolved significantly, with stockbroking firms now acting as comprehensive service providers. Thus, the SCRR's provisions may no longer align with the industry's operational realities.

To account for this new era, restrictions placed on stockbroking firms must be reconsidered. These include allowing stockbrokers to engage in business outside the securities domain. This will help expand revenue streams and align with the Make in India initiative by fostering domestic innovation. Similar rules in other jurisdictions (like the US, UK, and Singapore) allow brokerage firms to diversify, enhancing flexibility while maintaining market integrity.

Similarly, Regulation 16A within the Securities and Exchange Board of India Intermediaries Regulations requires regulated entities to steer clear of direct or indirect associations with those providing investment advice or making claims about returns without appropriate licences. While the goal is to prevent unauthorised advice and promote accountability, the term "indirect associations" could unfairly hold platforms responsible for activities beyond their control. For example, if a regulated entity enters into a business contract with third-party platforms like WhatsApp or Telegram for communicating with their clients, it isn't practical to require the regulated entity to monitor all activities on these platforms unless victims come forward to report issues.

Additionally, an NSE circular issued in August 2024 requires individuals referring clients to register as authorised persons (APs) to curb unauthorised activities like guaranteed returns. While well-intentioned, this creates challenges for stockbrokers who rely on referrals to acquire clients. It includes platforms all businesses use to advertise products and services. Allowing referrals without AP registration but supported by safeguards for compliance could strike a better balance.

Lastly, the rapid digital transformation makes the stockbroking sector, like any other reliant on digital platforms, increasingly vulnerable to sophisticated cyber threats. With sensitive client data and financial transactions at stake, any breach can have severe implications. While the regulator has come up with apt regulations, it must conduct regular sessions with stockbrokers to discuss the emerging challenges.

Thus, modernising regulations like the SCRR, providing additional clarifications on circulars, and strengthening cybersecurity practices are essential for fostering economic growth and creating homegrown financial giants. This will not only help stockbroking firms meet the evolving customer needs but also strengthen India's financial ecosystem, positioning it as a leader in capital market innovation.