CHAPTER-VI
LEGISLATIONS AND REGULATORY BODIES FOR PREVENTION OF CORPORATE FRAUDS IN INDIA

The existence of sound and healthy financial system is a pre requisite for the economic development of a nation. Capital market facilities mobilization of saving of individuals and pool them into reservoir of capital which can be used for the economic development of country unless the interest of investors are protected, the smooth flow of capital by corporate is not possible. An efficient and healthy capital market provides for mechanism for raising of capital and also for protecting the interest of investors. In the last two decade, far reaching development has taken place in the working of capital market.

Several legislations were made in Indian capital market to create a healthy and efficient atmosphere and to protect the interest of investors. The primary object of these legislations is to protect the interest of investors and to inspire the confidence in the mind of those who actively involved it by controlling fraudulently and unfair trade practices. The legislation also regulated various financial intermediaries like mutual funds, venture capital, underwriters, merchant banker etc.

The capital issues Act, 1947 was the first piece of legislation passed in India to control the capital market. The Act originally came into being in the year 1943, with the objectives of channelizing resources to support the second world war. It was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channelized for desirable purposes to serve the goals and priorities of government and to protect the interest of investors. Under the act, any firm intending to issue securities had to obtain approval from the central government, which fixed the amount, type and price of issues. As a part of liberalization process the act was repealed in 1992 which paved the way for
market determined allocation of resources. Other regulation governing security Market are following-

- The Companies Act, 2013
- The Security Exchange Board of India, 1992
- The Security Contract (Regulation) Act, 1956
- The Depositories Act, 1996.
- The Insurance Regulation and Development Act, 1999
- Reserve Bank of India Act, 1935.
- Foreign Exchange Management Act, 1999
- The Securities Law (Amendments) Act, 2014

6.1 The Companies Act 2013

The Companies Act, 1956, which was enacted with the object to consolidate and amend the law relating to companies and certain other associations, had been in force for about 55 years and had undergone several amendments. However a need was felt to enact a new legislation to meet the changed national and international economic environment and to further accelerate the expansion and growth of economy. For this purpose The Companies Bill, 2009 was introduced in the parliament. Subsequent to it central government introduced a lot of suggestions for amendments in the said Bill. The parliament standing committee on finance and suggestions of various stakeholders, the Central Government withdrew the Companies Bill, 2009. Incorporating the recommendation of the Parliament Standing Committee on Finance and suggestions of all stakeholders The Companies Bill, 2012 was introduced in Parliament and received the assent of the President on the 29th August, 2013. The Companies Act, 2013 makes provision for E-Governance. It provides for one Man Company. Section 211 makes provision for serious fraud investigation office. In the earlier Act no such office was created. Section 29 provides that the securities offered to public shall be in dematerlised form by complying with the provisions of the
Depositories Act, 1996 and the regulations made there under. And it further lays down that Any company, other than a company mentioned in sub-section (1), may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialised form in accordance with the provisions of the Depositories Act, 1996 and the regulations made there under. The Companies Act, 1956, incorporated this provision in Sect 66 B. This provision is incorporated to ensure transparency and liquidity in market. Earlier peoples avoided to invest their money in capital market as in case of urgent matters it was not possible to sell it and take money. So they consider it safe to deposit it in bank. For the protection of interest of investors Section 36 makes further provision for punishment for fraudently inducing person to invest money. It provides that any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into,—

(a) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or

(b) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or

(c) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution, shall be liable for action under section 447.

Section 40 further lays down that every company making public offer shall, before making such offer, make an application to one or more recognized stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges. Sect 41 provides for Issuance of depository receipt. It lays down that a company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country in such manner, and subject to such conditions, as may be
prescribed. This provision was also not contained in earlier Act. Section 74 makes provision for repayment of deposits, etc, accepted before the commencement of the act makes provision for punishment in case of default. It provides that where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall—

(a) file, within a period of three months from such commencement or from the date on which such payments, are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and

(b) repay within one year from such commencement or from the date on which such payments are due, whichever is earlier.

(2) The Tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.

(3) If a company fails to repay the deposit or part thereof or any interest thereon within the time specified in sub-section (1) or such further time as may be allowed by the Tribunal under sub-section (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.
Section 75 provides for damages for fraud. If a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified in sub-section (1) of that section or such further time as may be allowed by the Tribunal under sub-section (2) of that section, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in subsection (3) of that section and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors. Both these provisions were not have any place in earlier Act. Section 120 requires the maintains and inspection of document in electronic form. Section 121 Every listed public company shall prepare in the prescribed manner a report on each annual general meeting including the confirmation to the effect that the meeting was convened, held and conducted as per the provisions of this Act and the rules made. Section 135 makes mandatory responsibility toward society. Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee. The Committee shall formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company and also recommend the amount of expenditure to be incurred on the activities and monitor the Corporate Social Responsibility Policy of the company from time to time. The Board of every company after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company. The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the
company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy: Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility. Section 195 of companies Act prohibits insider trading of securities. It provides that no person including any director or key managerial personnel of a company shall enter into insider trading: Provided that nothing contained in this sub-section shall apply to any communication required in the ordinary course of business or profession or employment or under any law and if any person engages in insider trading he shall be punished. Insider Trading has been defined as-

(i) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or

(ii) an act of counselling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person;

(b) “price-sensitive information” means any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company.

Section 211 provides for establishment of the Serious Fraud Investigation Office to investigate frauds relating to a company by central government and section 212 provides procedure for investigation and also bars the investigation by other agency. Sect 229 provides that if a person who is required to provide an explanation or make a statement during the course of inspection, inquiry or investigation, or an officer or other employee of a company or other body corporate which is also under investigation destroys, mutilates or falsifies, or conceals or tampers or unauthorisedly removes, or is
a party to the destruction, mutilation or falsification or concealment or tampering or unauthorised removal of, documents relating to the property, assets or affairs of the company or the body corporate or makes, or is a party to the making of, a false entry in any document concerning the company or body corporate; or provides an explanation which is false or which he knows to be false, he shall be punishable for fraud under Sect 447. The punishment provided under Section 447 is without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force. If any person is found to be guilty of fraud he shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

The Companies Act, 2013 has also made mandatory for a company to have independent director. Sect 149 lays down that every company shall have at least one third of total number of directors as independent directors and Central Government may prescribe the minimum number of independent directors in case of any public companies. Clause 6 of Sect 149 defines independent director as:

An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;

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1. “fraud” in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.

2. Section 149 of The Companies Act 2013
(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(e) who, neither himself nor any of his relatives—

(i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

(iii) holds together with his relatives two per cent. or more of the total voting power of the company; or
(iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or who possesses such other qualifications as may be prescribed.

The companies Act 2013 has incorporated a lot of reform in order to protect the interest of investors and to ensure transparency and accountability in Companies. Now it is mandatory for the companies to have independent director. Independent director are mandatory for protecting the interest of investors. If there would not be independent director then in that case the director (who is not independent) would act for the benefit of himself and not for the company. Other major reform is Sect 211 which provides for establishment of serious fraud investigation. This provision was not incorporated in earlier Act. This provision is incorporated to investigate the corporate fraud and Sect 75 makes the personal liability of a person who fails to repay the deposit or commit fraud which cause damage. The Act also includes the provision of corporate Socio Responsibility i.e. responsibility of corporate world toward society.

6.1.1 Various Authorities Constituted under the Act

6.1.2 National Financial Reporting Authority (NFRA)

Sect 132 empowers the Central Government may constitute NFRA for accounting and auditing standards under this Act. It shall consist of a chairperson, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law to be appointed by the Central Government and such other members not exceeding fifteen consisting of part-time and full-time members as may be prescribed.

6.1.3 Functions of National Financial Reporting Authority

It shall (a) make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and
standards for adoption by companies or class of companies or their auditors, as the case may be;

(b) monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed;

(c) oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and (d) perform such other functions relating to clauses (a), (b) and (c) as may be prescribed.

6.1.4 Power of NFRA

- Power to investigate, either *suo motu* or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949. Provision to it further provide that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the National Financial Reporting Authority has initiated an investigation under this section;

- Powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:—

(i) discovery and production of books of account and other documents, at such place and at such time as may be specified by the National Financial Reporting Authority;

(ii) summoning and enforcing the attendance of persons and examining them on oath;

(iii) inspection of any books, registers and other documents of any person referred to in clause (b) at any place;
(iv) issuing commissions for examination of witnesses or documents;

- where professional or other misconduct is proved, have the power to make order for imposing penalty of not less than one lakh rupees, but which may extend to five times of the fees received, in case of individuals; and not less than ten lakh rupees, but which may extend to ten times of the fees received, in case of firms;
- Debarring the member or the firm from engaging himself or itself from practice as member of the Institute of Chartered Accountant of India referred to in clause (e) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 for a minimum period of six months or for such higher period not exceeding ten years as may be decided by the National Financial Reporting Authority.

6.1.5 The Nomination and Remuneration Committee

Sect 178 lays down the Board of Directors of every listed company and such other class or classes of companies, as may be prescribed shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors out of which not less than one-half shall be independent directors Provided that the chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

6.1.6 Functions of Committee

- The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director’s performance.
- The Nomination and Remuneration Committee shall formulate the criteria for determining qualifications, positive attributes and independence of a
director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.

6.1.7 The Serious Fraud Investigation Office

Sect 211 empowers the Central Government to establish an office to be called the Serious Fraud Investigation Office to investigate frauds relating to a company. The Serious Fraud Investigation Office shall be headed by a Director and consist of such number of experts from the following fields to be appointed by the Central Government from amongst persons of ability, integrity and experience in,—

- banking;
- corporate affairs;
- taxation;
- forensic audit;
- capital market;
- information technology;
- law; or such other fields as may be prescribed.

Where any case has been assigned by the Central Government to the Serious Fraud Investigation Office for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under this Act and in case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to Serious Fraud Investigation Office. Where the investigation into the affairs of a company has been assigned by the Central Government to Serious Fraud Investigation Office, it shall conduct the investigation in the manner and
follow the procedure provided in this Chapter; and submit its report to the Central Government within such period as may be specified in the order.

6.1.8 National Company Law Tribunal

Sect 408 provides for constitution of National Company Law Tribunal consisting of a President and such number of Judicial and Technical members, as the Central Government may deem necessary

Sect 409 prescribes qualification of member. The President shall be a person who is or has been a Judge of a High Court for five years. A person shall not be qualified for appointment as a Judicial Member unless he—

- is, or has been, a judge of a High Court; or
- is, or has been, a District Judge for at least five years; or
- has, for at least ten years been an advocate of a court.

A person shall not be qualified for appointment as a Technical Member unless he-

1. has, for at least fifteen years been a member of the Indian Corporate Law Service or Indian Legal Service out of which at least three years shall be in the pay scale of Joint Secretary to the Government of India or equivalent or above in that service; or
2. is, or has been, in practice as a chartered accountant for at least fifteen years;
3. is, or has been, in practice as a cost accountant for at least fifteen years; or
4. is, or has been, in practice as a company secretary for at least fifteen years; or
5. is a person of proven ability, integrity and standing having special knowledge and experience, of not less than fifteen years, in law, industrial finance, industrial management or administration, industrial reconstruction, investment, accountancy, Labour matters, or such other disciplines related to management, conduct of affairs, revival, rehabilitation and winding up of companies; or
6. is, or has been, for at least five years, a presiding officer of a Labour Court, Tribunal or National Tribunal constituted under the Industrial Disputes Act, 1947.

6.1.9 National Company Law Appellate Tribunal

Sect 410 lays down that the Central Government shall, constitute an Appellate Tribunal to be known as the National Company Law Appellate Tribunal consisting of a chairperson and such number of Judicial and Technical Members, not exceeding eleven for hearing appeals against the orders of the Tribunal. Sect 411 further provides the qualification of chairperson and member of the tribunal. It lays down that the chairperson shall be a person who is or has been a Judge of the Supreme Court or the Chief Justice of a High Court and a Judicial Member shall be a person who is or has been a Judge of a High Court or is a Judicial Member of the Tribunal for five years. And a Technical Member shall be a person of proven ability, integrity and standing having special knowledge and experience, of not less than twenty-five years, in law, industrial finance, industrial management or administration, industrial reconstruction, investment, accountancy, labour matters, or such other disciplines related to management, conduct of affairs, revival, rehabilitation and winding up of companies.

Sect 423 further lays down that any person aggrieved by any order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of receipt of the order of the Appellate Tribunal to him on any question of law arising out of such order:

6.2 Security Exchange Board of India Act, 1992

It was officially established by The Government of India in the year 1988 and given statutory powers in 1992 with SEBI Act 1992 being passed by the Indian Parliament. The Securities and Exchange Board of India (SEBI) was constituted on 12 April 1988 as a non statutory body through an administrative Resolution of the Government for dealing with all matters
relating to development and regulation of the Securities market and investor protection and to advise the government on all these matters. SEBI was given statutory status and powers through and ordinance promulgated on January 30, 1992. SEBI was established as a statutory body on 21 February 1992. The ordinance was replaced by an Act of Parliament as 4th April 1992. The Preamble of SEBI Act, 1992 enshrines the objectives of SEBI - to protect the interest of investor in securities market and to promote the development of and to regulate the securities market. The statutory powers and functions of SEBI were strengthened through the promulgation of the Securities Laws (Amendment) Ordinance on 25th January 1995, which was subsequently replaced by an Act of Parliament. Before SEBI Act, 1992, the three principal Acts governing the securities market were: (a) the Capital Issues (Control) Act, 1947, which restricted issuer's access to the securities market and controlled the pricing of issues; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; and (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges. The Capital Issues (Control) Act, 1947 had its origin during the war in 1943 when the objective was to channel resources to support the war effort. The Act was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channelled into proper lines for desirable purposes to serve goals and priorities of the government, and to protect the interests of investors. Under the Act, any firm wishing to issue securities had to obtain approval from the Central Government, which also determined the amount, type and price of the issue. Major part of the liberalisation process was the repeal of the Capital Issues (Control) Act, 1947 in May 1992. With this, Government's control over issue of capital, pricing of the issues, fixing of premia and rates of interest on debentures etc. ceased. The office which administered the Act was abolished and the market was allowed to allocate resources to competing uses. However

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3 www.wikipedia.com visited on 26th March 2014
4 http://shodhganga.inflibnet.ac.in visited on 26th March 2014
to ensure effective regulation of the market, SEBI Act, 1992 was enacted to empower SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporate in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. SEBI can specify the matters to be disclosed and the standards of disclosure required for the protection of investors in respect of issues; can issue directions to all intermediaries and other persons associated with the securities market in the interest of investors or of orderly development for securities market; and can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. In short, it has been given necessary autonomy and authority to regulate and develop an orderly securities market.

The SEBI is managed by its members, which consists of following: a) The chairman who is nominated by Union Government of India. b) Two members, i.e. Officers from Union Finance Ministry. c) One member from The Reserve Bank of India. d) The remaining 5 members are nominated by Union Government of India; out of them at least 3 shall be whole-time members.

6.2.1 Establishment and Incorporation of Board\(^5\)

The SEBI Act provide that the central government may be notification establish for the purpose of this Act, a board by the name of the Securities Exchange Board of India.

Sub Section (2) of Section 3 further provide that the board shall be a body corporate having perpetual succession and a common seal with power subject to provisions of the SEBI Act.

6.2.2 Offices of SEBI

The head office of the board shall be at Bombay; but it may establish office at other place in India; and its other offices are located at Delhi, Kolkatta and Chennai.

\(^5\) Section 3 of the SEBI Act 1992
6.2.3 Management of SEBI\textsuperscript{6}

The general superintendence, direction and management of the affairs of SEBI vests in a board of members, which exercises all powers and do all acts and things, which may be exercised or done by SEBI.

Section 4 of the Act lays down the constitution of the management of SEBI. The board of members of SEBI shall consist of a chairman, two members from amongst the official of the ministries of the central government, dealing with finance and law; one member from amongst the officials of RBI; two other member to be appointed by the central government who shall be professionals and inter-alia have experience or special knowledge relating to securities market.

6.2.4 Removal of Member from Office\textsuperscript{7}

Section 6 provides that the central government shall remove a member from office if he –

- is, or at any time has been adjudicated as insolvent.
- is, of unsound mind and stands so declared by a competent court.
- has been convicted of an offence which in the opinion of the central government, involves a moral turpitude.

Every member who is removed from his office shall be given a reasonable opportunity of being heard.

6.2.5 Meetings of SEBI\textsuperscript{8}

All questions which come up before any meeting of SEBI shall be decided by a majority votes of the members present and voting, and, in the event of an equality of votes, the chairman or, in his absence, the person presiding, shall have a second or casting vote.

\textsuperscript{6} Section 4 of SEBI Act 1992
\textsuperscript{7} Section 6 of SEBI Act 1992
\textsuperscript{8} Section 7 and 7A of SEBI Act 1992.
An interested party, like a company director can be a member of SEBI. But if he has any direct or indirect, pecuniary interest in any matter coming up for consideration at a meeting of SEBI, he shall disclose the nature of his interest and shall not take part in deliberations or decision of SEBI in respect of that matter.

6.2.6 Functions of SEBI

The principal function of SEBI are:

- Protecting the interest of investors in securities.
- Promoting and development of securities market.
- Regulating the securities market.

Section 11(1) of the Act casts upon SEBI the duty to protect the interest of investors in securities and to promote development of and to regulate the securities market through appropriate measures.

These measures provided for:

- Regulating the business in stock exchange and any other securities market.
- Registering and regulating the working of stock brokers, sub-brokers, share Transfer agents, bankers to an issue, trustee of trust deed, underwriters, port folio manager and such other intermediaries who may be associated with securities market in any manner.
- Registering and regulating the working of collective investment scheme including mutual funds, venture capital funds.
- Promoting and regulating self-regulating organizations.
- Prohibiting fraudulent and unfair trade practice in securities market.
- Promoting investors education and training to intermediaries in securities market.
- Prohibiting insider trading in securities.
- Regulating substantial acquisition of shares and take over of companies;

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9 Section 11 of SEBI Act 1992
• Registration and regulating the work of depositories and depositories participants.
• Registration and regulating the work of foreign institutional investors, credit rating agencies etc.
• Undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds and other persons associated with the securities market.
• Performing such functions and exercising such powers under the provisions of [The Capital Issues Control Act 1947] and SCRA Act 1956 as may be delegate to it by the central government.
• Conducting research for the above purpose.

6.2.7 Powers of SEBI

SEBI may take any of the following measures in the interest of investors or securities market:

• Suspends the trading of any security in a stock exchange.
• Retrain or prohibit any person from accessing the securities market.
• Suspends any office – bearer of any stock exchange.
• Impound and retain the proceeds or securities in respect of any transaction under investigation.
• Attach bank account(s) of any intermediary or any person associated with the securities market, for a period not exceeding one month.

SEBI is vested with powers to take action against practices relating to securities market manipulation and misleading statements to include sale/purchase of securities.

SEBI has the powers of civil court in respect of discovery and production of books, documents, records, accounts, summoning and enforcing attendance of person/company and examining them under oath. SEBI can levy fines for violations relating to failure to submit information to SEBI/to enter in to agreements with clients/to redress grievances of investors, violation by mutual fund. Issuing commissions for the examination of witnesses or documents.
6.2.8 Securities Appellate Tribunal [SAT]

Establishment of SAT\(^{10}\) :- The central government shall by notification, establish one or more appellate tribunals to be known as SAT to exercise the jurisdiction, powers and authority conferred on such tribunal by or under this Act or any other law for the time being in force.

The central government shall also specify in the notification referred to sub-section (1) the matters and places in relation to which the SAT may exercise jurisdiction.

Composition of SAT\(^{11}\) :- SAT shall comprise of the following:-

- one presiding officer
- two other members

The presiding officer and two other members, to be appointed, by notification by the central government. Provided that SAT used to comprise of only one person i.e. presiding officer before SEBI [Amendment] Act, 2002 came in to effect from 29\(^{th}\) October, 2002, shall continue to exercise the jurisdiction, powers and authority conferred on it by or under this Act or any other law for the time being in force till two other members are appointed under this section.

6.2.9 Presiding Officer

The presiding officer of SAT shall be appointed by the central government in consultation with the Chief Justice of India. The person to be appointed as the presiding officer must be a sitting or retired judge of the Supreme Court or a sitting or a retired Chief Justice of a High Court. The presiding officer shall hold his office for a period of five years or up to the age of 68 years, whichever is earlier.

6.2.10 Members

The two members of SAT shall be appointed by the central government. The members shall hold their office for a period of five years or up to the age of 62 years, whichever is earlier.

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\(^{10}\) Section 15 K of SEBI Act 1992

\(^{11}\) Section 15 L of SEBI Act 1992
6.2.11 Disqualification for Member\textsuperscript{12}

A person shall not be qualified for appointment as member of SAT unless he is a person of ability, integrity and Standing who has shown capacity in dealings with problems relating to securities market and has qualification and experience of corporate law, securities laws, finance and economics or accountancy.

6.2.12 Appeal to SAT\textsuperscript{13}

Any person aggrieved:

- by an order of the SEBI, made under
- by an order made by an adjudicating officer under SEBI Act, 1992,

May prefer an appeal to SAT. However, no appeal shall lie to SAT from an order made by SEBI or adjudicating officer, with the consent of parties. The appeal to SAT shall be filed within a period of 45 days from 100. The date of receiving the copy of the order of SEBI or adjudicating officer, as the case may be. However, SAT may entertain an appeal after the expiry of 45 days, if it is satisfied that there was sufficient cause for not filing it within that period. On receipt of an appeal, SAT may confirm, modify or set aside the order appealed against, after giving an opportunity of being heard. It shall send a copy of every order made by it to the following persons:-(1) SEBI (2) Concerned Adjudicating Officer (3) Parties to Appeal

6.2.13 Powers of SAT\textsuperscript{14}

The SAT shall have, for the purpose of discharging their functions under SEBI Act, 1992 the same powers as are vested in a civil court Under the Code of Civil Procedure, 1908 while trying a suit, in respect of the following matters, namely:

- Summoning and enforcing the attendance of any person and examining him on oath.

\textsuperscript{12} Section 15 (m) of SEBI Act 1992
\textsuperscript{13} Section 15 T of SEBI Act, 1992.
\textsuperscript{14} Section 15 U of SEBI Act, 1992
• Requiring the discovery and production of documents.
• Receiving evidence on affidavits.
• Issuing commissions for the examination of witnesses or documents.
• Reviewing its decisions; it can review only when law has given this power.
• Dismissing an application for default or deciding it ex-parte.
• Setting aside any order of dismissal of any application for default or any order passed by it ex-parte.
• Any other matter, which may be prescribed.

6.2.14 Appeal against the Orders of SAT\textsuperscript{15}

Any person aggrieved by any decision or order of SAT may file an appeal to the Supreme Court. It may be noted that the appeal can be made only on any question of law and not on the questions of fact. The appeal shall be filed within 60 days from the date of receiving a copy of decision or order of SAT. However, the Supreme Court may allow a further period of 60 days for making an appeal, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the first 60 days. Thus, SEBI is a statutory body, was formed in January 1992 as a single agency to look after control over capital market and ensure its orderly growth. Investor’s protection is one of its major objectives.

6.2.15 Analysis of Judgments of SAT

\textit{In Sterlite Industries Vs. Union of India}\textsuperscript{16}

It was held that SEBI has wide discretionary powers to regulate the securities market and protect the interest of investors.

\textit{In BSE Brokers Forum Vs. SEBI}\textsuperscript{17}

It was held that SEBI cannot grant registration certificate with retrospective effect. Registration will be valid from date of issue of

\textsuperscript{15} Section 15 Z of SEBI Act, 1992
\textsuperscript{16} Sterlite Industries Vs. Union of India ( 2002) 38 SCL 592
\textsuperscript{17} BSE Brokers Forum Vs. SEBI (2003) 48 SCL 266 [SAT]
registration certificate and not from date of application to SEBI for registration.

*In LKP Securities Ltd. Vs. SEBI*\(^1\)

In this case, it was held that violation of code of conduct by intermediary [broker in this case] itself is violation of regulation and if violation is established, certificate of registration can be suspended.

*In Dalmia Securities Vs. G.S. Reddy*\(^2\)

It was held that SEBI can put some conditions while granting registration or its renewal. However, such conditions should be fair and reasonable, as SEBI is a public authority.

*In Chintamani Shares and Broking Ltd. Vs. Securities and Exchange Board of India. Appeal No.203 of 2009*

In this case the scrip of a company namely BSEL and MSL are listed on the Bombay Stock Exchange and also on the National Stock Exchange. The primary charge that is leveled against the appellants is that they along with some others formed a group and executed trades within that group which were circular.

It was held by the adjudicating officer that the appellants guilty of the charges leveled against them and held that they violated the Provisions of Regulation 4 of the SEBI. [Prohibition of fraudulent and unfair trade practice relating to securities market]. Regulations, 2003 and also the code of conduct prescribed for the brokers. A penalty of Rs.5 lacs has been imposed on shelter which traded in its proprietary account while executing the offending trades\(^3\).

*In Mukesh Dokania and Co. Vs. Securities and Exchange Board of India*\(^4\)

\(^{18}\) *LKP Securities Ltd. Vs. SEBI* (2003)41 SCL 1 [sat]  
\(^{19}\) *Dalmia Securities Vs. G.S. Reddy* (2003) 42SCL 500 [sat]  
\(^{20}\) [www.sebi.gov.in](http://www.sebi.gov.in) visited on 15\(^{th}\) august 2012  
\(^{21}\) Appeal no 159 of 2009
The appellant is a registered stock broker and a member of the Calcutta stock exchange. It is the sole proprietorship concern of Mukesh Dokania. He was been found to have executed manipulative trades in the scrip of Minolta finance Ltd. On behalf of his clients and the adjudicating officer by his order dated July 9, 2009 has imposed on him a monetary penalty of Rs 6 lacs for violating regulations 3 and 4 of the SEBI [Prohibition of Fraudulent and Unfair Trade Practices relating to securities market] Regulations, 2003 and also the code of conduct prescribed for the stock brokers

All modern economies, therefore, recognize the need for sound regulation of securities markets. This is needed not just for proper functioning of these markets, but also for their very survival. It will ensure that markets are safe and perceived to be safe by the public at large and necessary information is available to the public so that they can take informed decisions about investments. It will further ensure that while engines of growth are allowed to move at full speed, there is no space for manipulators in the system. Today securities market regulation has evolved to include three principal objectives: (a) Fair, efficient and transparent markets; (b) Investor protection; (c) Reduction of systemic risk. I am happy to say that SEBI shouldering the responsibility in all these three areas with great deal of efficiency and commitment. Thus the SEBI has issued various regulations in respect of each of the intermediaries such as stock brokers and sub broker, share transfer agents and registrars to an issue, banker to an issue, debenture trustees, merchants bankers, underwriters portfolio manager, depositaries, participants, custodian of securities, foreign institutional investors, credit rating agencies, venture capital funds, collective investment schemes including mutual funds, etc to regulate and ensure fair play by these intermediaries. SEBI has also issued regulations to prohibit insider trading and to regulate substantial acquisition of shares and take over of companies. All these rules and regulations, circulars and guidelines serve the objective of affording necessary protection to the investors. Over and above this, various
penalties and adjudications which could be imposed on persons including the various intermediaries who are held to have contravened provisions of the enactment and committed defaults. The Act thus provides sufficient deterrents to those who may indulge in defaults and illegalities and malpractices on the market to the detriment of the investors.

6.3 The Depositories Act, 1996

The Depositories Act ,1996 has introduced the system of depositories in India. It has come in to force with effect from 20th September, 1995.

A depository is organizations where the securities of an investor are held in the electronic form at his request through the medium of a depository participate[DP]. If the investor wants to utilize the services offered by a Depository, the investor has to open a beneficiary account with the Depository through a DP. DP is the representative or agent in the system and it maintains the investor’s securities account balances and intimates to holdings from time. The investor can open account with one or more DPs when a person buys any security e.g. shares and debentures already in the depository mode, the buyer will become owner of the said security in the depository within a day of settlement being made / completed. The buyer is not required to apply to the company for registering the security in his name.

Dematerialization is the process by which physical share certificates are converted in to electronic entries. Rematerialization is the process by which electronic holdings are converted back into certificates. The investor has to pay charges to the depository and the DP for opening of account and also for every transaction in the account.

Thus, a depository is an organization like a central bank where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a depository participant, [DP] To utilize

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22 [www.google.com](http://www.google.com) visited on 27th Sept 2013
23 [www.legalserviceindia.com](http://www.legalserviceindia.com) visited on 27th Sept 2013
the services offered by a depository, the investor has to open an account with the depository through a DP.

“Depository means a company formed and registered under the companies Act, 1956 and which has been granted a certificate of registration under section 12(IA) of the SEBI Act 1992”

A depository cannot act as a depository unless it obtains a certificate of commencement of business from SEBI. There are two depositories players in the market i.e. national securities depository limited [NSDL] and central depository service [India] Limited [CDSL], all the securities held by a depository shall be dematerialized and shall be in a fungible form. Depository and DP both are regulated by SEBI.

6.3.1 Advantages of Depository System

The depository system gives a less risky settlement with implementation of collateral bases payment systems and greater profits from increased trading volume which are made possible by NCDS systems with reduced operational costs per transaction and reduced risk. There is an improved cash flow from not having funds tied up for long periods. Further forgery and counterfeit have been eliminated with attendant reduction in settlement risk from bad deliveries. The system has led to an opportunity for development of retail brokerage business and for development of more sophisticated custodial services which can be offered to the smaller investor. There are now standardised communications between NCDS, registrars and other intermediaries. Also, there is an ability to arrange pledges without movement of physical scrip and further increase overall level of trading activity, liquidity and profits.

Although India had a vibrant capital market which is more than a century old, the paper-based settlement of trades caused substantial problems like bad delivery and delayed transfer of title till recently. The enactment of Depositories Act in August 1996 paved the way for establishment of NSDL, the first depository in India. This depository promoted by institutions of

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24 Section 2(e) of Depository Act. 1996
national stature responsible for economic development of the country has since established a national infrastructure of international standard that handles most of the trading and settlement in dematerialised form in Indian capital market. The procedure relating to depositories is mainly governed by the regulations and bye laws that are framed by the SEBI and the depositories under the power provided by the Depositories Act.

There are immense advantage to the public by reduction of risks associated with loss, mutilation, theft and forgery of physical scrip\textsuperscript{26}. Further there is an elimination of financial loss owing to loss of physical scrip and greater liquidity from speedier settlements and reduction in delays in registration. There will be greater opportunities for investment offered by new instrument and services that can be provided only when NCDS is implemented and faster receipt of benefits and rights resulting from corporate actions. There is also an improved protection of shareholder’s rights resulting from more time communications from the issuer and reduced transaction costs through greater efficiency.

The system provides Up-to-date knowledge of shareholder’s names and addresses. And there will be savings in costs of new issues from reduction in printing and distribution costs. It may also lead to increased efficiency of registrar and transfer agent functions and better facilities for communication with shareholders, conveying benefits of corporate actions and information notices. Furthermore there will be an improved ability to attract international investors without having to incur the expenditure of issuance in overseas markets. Immobilisation of securities is done by storing or lodging the physical security certificates with an organisation that acts as a custodian – a securities depository. All subsequent transactions in such immobilised securities take place through book entries. The actual owners have the right to withdraw the physical securities from the custodial agent whenever required by them. In short we can say depository system has following advantages:-

- It eliminates bad deliveries.
- It eliminates all kinds if risks associated with physical certificates.

\textsuperscript{26} \texttt{http://rna-cs.com} visited on 31\textsuperscript{st} March 2014
• It provides immediate transfer and registration of securities.
• It provides faster disbursement of non-cash corporate benefits like rights, bonus etc.
• It provides reduction in handling of huge volumes of paper and periodic status report.
• It eliminates the problems which related with change of address of investor, transmission etc.
• It further eliminates the problems related to selling of securities on behalf of a minor.

6.3.2 Depository Participant

Depository participant [DP] is the agent of the depository and is the interface between the depository and the investor. Just as a broker act an agent of the investor at the stock exchange; a DP is the representative [agent] of the investor in the depository system providing the link between the company and investor through the depository. The DP maintains securities account balances and intimate the status of holding to the account holder from time to time, according to SEBI guidelines; financial institutions like banks, custodians, stocks brokers etc. can become participants in the depositor.

The main characteristics of a depository participant are as under:

• Acts as an agent of depository
• Customer interface of depository
• Functions like securities Bank
• Account opening
• Facilitates dematerialization
• Instant transfer on pay – out
• Credits to investor in IPO, rights, bonus
• Settles trades in electronic segment

Stocking Holding Corporation of India Limited [SHCIL] is the first depository participant in India registered with NSDL. Besides SHCIL, a number of new and private and foreign banks like times Bank, HDFC Bank, ICICI Bank, IDBI Bank, Hong Kong Bank, Standard chartered Bank are
providing shares depository services to its customers from its various branches. There are some private depository participants like Alankit and Aphibra also.

6.3.3 Dematerialisation

It is a process by which the physical share certificates of an investor is taken back by the company and an equivalent number of securities are created his account in electronic form at the request of the investor. An investor will have to first open an account with a D.P and then, request for the dematerialisation of his share certificates through DP so that the dematerialised holdings can be credited into that account. This is very similar to opening a bank account.

Thus, it may conclude that the dematerialisation of shares is optional and an investor can still hold shares in physical form. However, he / she has demat the shares if he / she wishes to sell the same through stocks exchanges. Similarly, if an investor purchases shares from the stock exchanges, he / she will get delivery of the shares in demat form.

6.3.4 Fungibility

The act envisages that all securities held in depository shall be fungible i.e. all certificates of the same security shall become interchangeable in the same sense that investor loses the right to obtain the exact certificate he surrenders at the time of entry in to depository27.

6.3.5 Legal Framework

The legal framework for a depository system has been laid down by the depositories Act 1996 and is regulated by SEBI. The depository business in India is regulated by:-

- The depositories Act 1996
- The SEBI [Depositories and Participants] Regulations, 1996

27 Section 9 of the depositories Act 1996.
• Bye – laws of depository
• Business rules of depository.

A part from the above, depositories are also governed by the certain provisions of the companies Act, 1956, the India stamp Act, 1899, SEBI Ac, 1992; SCRA 1956, Income tax Act, 1961, benami Transaction [Prohibition] Act, 1988. Banker’s books evidence Act, 1891.

6.3.6 Right and Obligation of Depository, Depository Participants, Issuers and Beneficial Owner

1. Depository shall enter in to an agreement with one or more DP as its agents.

2. Any person, through a DP, may enter in to an agreement with any depository for availing its services.

3. The depository shall be deemed to be the registered owner for the purpose of effecting transfer of ownership of a security on behalf of beneficial owner.

4. A beneficial owner may with the previous approval of depository, create a pledge/hypothecation in respect of security owned by him through its depository.

Any loss caused to beneficial owner due to the negligence of depository or DP the depository shall indemnify such loss to the beneficial owner.

There are two depositories functioning in India, namely NSDL and CDSL are as follows:

6.3.7 National Securities Depository Limited [NSDL]

NSDL, the first and largest depository in India, established in August 1996 and promoted by institutions of national stature responsible for economic development of the country has since established a national infrastructure of international standards that handles most of the securities
held and settled in dematerialized form in the Indian Capital Market. NSDL crosses one crore demat accounts.

6.3.8 Basic Services

Under the provisions of the Depositories Act, NSDL provides various services to investors and other participants in the capital market like, clearing members, stock exchanges, banks and issuers of securities. These include basic facilities like account maintenance, dematerialization, rematerialization, settlement of traders through market transfers, off market transfers and inter-depository transfers, distribution of non-cash corporate actions and nomination transmission.28

6.3.9 Central Depository Service (India) Limited [CDSL]

CDSL was promoted by Bombay Stock Exchange Limited [BSEL]; jointly with leading banks such as State Bank of India, Bank of India, Bank of Baroda, HDFC Bank, Standard Chartered Bank, Union Bank of India and Centurion Bank.

CDSL was set up with the objective of providing convenient, dependable and secure depository services at affordable cost to all market participants. Some of the important milestones of CDSL system are:-

CDSL received the certificate of Commencement of business from SEBI in February, 1999.

All leading stock exchanges like the National Stock Exchange, Calcutta Stock Exchange, Delhi Stock Exchange, The Stock Exchange, Ahmedabad, etc. have established connectivity with CDSL.

CDSL’s demat service are extended through its agent called DP. The DP is the link between the investor and CDSL. An investor who opens a demat account with DP can utilize the services offered by CDSL.29

28 http://nsdl.co.in
29 http://www.cdslindia.com
Depository facilities holding of securities in the electronic form and enables securities transactions to be processed by book entry by a DP, who as an agent of the Depository, offers Depository services to investors. The investor who is known as beneficial owner [BO] has to open a demat account through any DP for dematerialization of his holdings and transferring securities.

The balances in the investors account recorded and maintained with CDSL can be obtained through the DP. The DP is required to provide the investor, at regular intervals, a statement of account, which gives the details of the securities holdings and transactions. The depository system has effectively eliminated paper-based certificates, which were prone to be fake, forged, counterfeit resulting in bad deliveries. CDSL offers an efficient and instantaneous transfer of securities.

The Depository Act which provides for the establishment of depositories like NSDL and CDSL to curb the irregularities in the capital market and protect the interests of the investors and paved a way for an orderly conduct of the financial markets through the free transferability of securities with speed, accuracy and transparency.

6.4 The Securities Contract (Regulation) Act, 1956

The security laws in India are governed by the broad Parameters of Contracts (Regulation) Act 1956. The main purpose of securities law is both facilitatory as well as regulatory. The Securities Contracts (Regulation) Act 1956 was enacted with a view to regulate the market; mainly the secondary market i.e. the stock exchanges. Stock exchanges require greater degree of control since most of the transaction with regard to securities may tend to be speculative in the nature unless tightly regulated. There are various modes by which securities in the market are transacted. If the market, therefore, is not controlled, it would lead to only large scale gambling. The act endows the central government with sweeping power in respect of supervision and control of securities market. It extends to whole of India.
6.4.1 Historical Perspective\textsuperscript{30}

In order to appreciate the intricate details and the need for the Securities Contracts (Regulation) Act 1956, it is necessary to outline the history behind the Act. The earliest legislative measure was undertaken in Bombay by the enactment of the Bombay Securities Contracts Control Act 1925. The main purpose of that Act was to control and regulate certain contracts for the purchase and sale of securities in the city of Bombay, and Bombay Presidency. The most important provision was Section 6 of the Act which provided that any contract for purchase or sale of securities other than a ready delivery contract, be void unless it was subject to and accordance with the rules of the recognized stock exchange.

The bill drafted on the suggestion of Gorwala Committee Report and came out on 1954 and was enacted as an Act in 1956.

6.4.2 Objects of the Act

The object of this legislation could be clearly explained by reference to the decision of the Supreme Court in Madhubhai Amathlal Gandhi Vs. Union of India\textsuperscript{31}. It was observed that shares were transacted in the stock exchanges in three ways:-

(1) Spot delivery: A contract providing for delivery of securities on payment of a price on the day of the contract or the next day.

(2) Ready delivery contract:

This is a contract for purchase or sale of securities for the performance of which no time is specified and which is to be performed immediately or within a reasonable time.

(3) Forward contracts: A contract by which parties agree for their performance at a future date.

\textsuperscript{30} \url{www.vakilno1.com} visited on 23\textsuperscript{rd} March 2013.
\textsuperscript{31} Madhubhai Amathlal Gandhi Vs. Union of India AIR1961 SC 21.
Thus, the main object of the SCRA was to regulate speculations in shares on the stock exchange and also at the same time regulate the stock exchange itself. However the Act is not envisaged to apply to shares of private companies as the investing public do not have any substantial interest. This was so held in *Norman Hamilton Vs. Amedhbhai Patel*\(^\text{32}\).

The Act empowered the central government to call for periodical returns from stock exchanges. The act stipulates that annual reports have to be furnished to central government by stock exchanges. The act thus provides for direct and indirect control over security trading and running of stock exchange and aims to prevent undesirable transaction in securities.

Important terms in the statute:

(1) Securities\(^\text{33}\):

“Securities” include:-

a. Shares

b. Scrips

c. Stock

d. Bonds

e. Debentures

f. Debentures Stock or

g. Other marketable securities of a like nature in or of any incorporated company or other body corporate.

h. Derivative

i. Units or any other instruments issued by any collective investment scheme to the investors in such scheme.

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\(^{32}\) *Norman Hamilton Vs. Amedhbhai Patel* [(1979) 49 Com. (as 1 (Bom)]

\(^{33}\) Section 2(h) of SCRA; 1956

k. Units or any other such instruments issued to investors under any mutual fund scheme.

l. Any certificate or instrument [by whatever name called] issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity and acknowledging beneficial interest of such investor in such debt or receivable including mortgage debt.

m. Government securities.

n. Such other instruments as may be declared by the Central Government to be securities.

o. Rights or interests in securities.

In Sudhir Shantilal Mehta vs. Central Bureau of Investigation\(^{34}\) commenting on the scope of securities encompassed by the definition of the term in Section 2(h) of the Securities Contracts (Regulation) Act, 1956, the Hon’ble Supreme Court of India, at paragraphs 41 and 42, observed as follows:

"41. The definition of `securities' is an inclusive one. It is not exhaustive. It takes within its purview not only the matters specified therein but also all other types of securities as commonly understood. The term `securities', thus, should be given an expansive meaning.

(2) Contract: Contract means a contract for or relating to the purchase or sale of securities\(^{35}\).

3. Corporatisation: - Corporatisation means the succession of a recognized stock exchange, being a body of individuals or a society registered under the

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\(^{35}\) Section 2(a) of SCRA 1956
Societies Registration Act 1860 [21 of 1860], by another stock exchange, being a company incorporated for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in Securities carried on by such individuals or society\(^{36}\).

Thus, corporatisation is the process of converting the organizational structure of the stock exchange from a non-corporate structure to a capital structure. Traditionally, some of the stock exchange in India were established as associations of persons such as BSE. Corporatisation of such exchanges is the process of converting them into incorporated companies.

4. “Demutualization”:

Demutualization means the segregation of ownership and management from the trading rights of the members of a recognized stock exchange in accordance with a scheme approved by the Securities and Exchange Board of India\(^{37}\).

Thus, Demutualization of stock exchange refers to transition process of an exchange from a mutually owned association to a company owned by shareholders. In other words, transforming the legal structure of an exchange from a mutual form to a business corporation. The above in effect means that after demutualization the ownership the management and the trading rights at the exchange are segregated from one another. Demutualization refers to the legal structure of an exchange where by the ownership, the management and the trading rights at the exchange are segregated from one another currently, two stock exchanges in India, the National Stock Exchange [NSE] and over the counter Exchange of India [OTCEI] are demutualised\(^ {38}\). The government through an ordinance has amended the Securities and Contract [Regulations] Act to make of stock exchanges mandatory. Recently, the SCRA was amended through the promulgation of an ordinance to make corporatisation and demutualization of stock exchanges mandatory. The amendment not only

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36 Section 2(aa) of SCRA 1956
37 Section 2(ab) of SCRA 1956.
38 \[www.hindu.com\] visited on 26\(^{th}\) March 2010
requires separation of ownership and trading right, it also requires that the majority ownership rests with the public and those without any trading rights.

Though the social desirability of such external regulation and supervision in a liberalized environment is debatable, it may assume that there is a genuine reason for the Government to believe that such a move is socially desirable. However, there are several difficulties and practical issues when the exchanges are forced to comply with the provisions of the ordinance.

The process of demutalising all the broker run exchanges in India actually started with the Bombay Stock Exchange which was demutualised in August 2005.

6.4.3 Recognized Stock Exchanges

Recognized Stock Exchange means a stock exchange, which is for the time being recognized by the central government.

6.4.4 Application for Recognition

Any stock exchange desirous of being recognized may apply to the central government in the prescribed manner.\(^{39}\).

6.4.5 Grant of Recognition\(^{40}\)

The central government may make such enquiry as may be necessary in this behalf and if it is satisfied in all the respects; it may grant recognition to the stock exchange.

The central government should be satisfied that the following requirements are fulfilled:

1. That the rules and byelaws of the stock exchange are such that they ensure fair dealing and investor protection.

2. That the stock exchange is willing to comply with any conditions, which the central government may impose.

\(^{39}\) Section 3 of SCRA 1956

\(^{40}\) Section 4 of SCRA 1956
3. That the grant of recognition of stock exchange is in the interest of securities trade and public interest.

The grant of recognition shall be published in the Gazette of India and also the official Gazette of the state in which the principal office of the stock exchange is situated.

Section 5 of SCRA provides the withdrawal of recognition.

6.4.6 Power of Recognized Stock Exchange to Make Byelaws

Any recognized stock exchange may make byelaws for the regulation and control of contracts. Such power of recognized stock exchange is subject to the approval of SEBI. Such bye-laws may provide for the following:

1. Opening and closing of markets and regulations of trade hours.

2. Periodical settlement of contracts and differences there under by a clearinghouse.

3. Submission of certain particulars to SEBI by a clearinghouse after each such settlement period.

4. Prohibition of blank transfers

5. Class of contracts in respect of which settlement shall be made through the clearinghouse.

6. Prohibition to badlas or carry-over facilities.

7. Regulations of days for settlement.

8. Listing of securities on the stock exchange.

9. Method and procedure for settlement of claims or disputes.

10. Levy and recovery of fees, fines and penalties.

11. Regulation of brokerage.

Section 9 of SCRA 1956.
12. Regulation of dealings by members for their own accounts.

The securities amendment Act passed in May 2007 amended the securities Contract Act of 1956 and it is a legal frame work for trading in securitized debt including mortgage backed debt. It also provides provisions for contracts and options in securities, listing of securities, penalties and procedures and various miscellaneous aspects. This act is administered by the union ministry of finance and department of Economic affairs of the government of India. Most of functions and powers under Securities Contract Regulation Act, which brought stock exchanges, their members as well as contract in securities which could be traded under the regulation of Ministry of finance, has been entrusted to SEBI.

Sect 23JB is recently added in the Act which provides for recovery of money. It lays down that If a person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any direction of the Board for refund of monies or fails to comply with a direction of disgorgement order issued under Section 12A or fails to pay any fees due to the Board, the Recovery Officer may draw up under his signature a statement in the specified form specifying the amount due from the person (such statement being hereafter in this Chapter referred to as certificate) and shall proceed to recover from such person the amount specified in the certificate by one or more of the following modes, namely:

- attachment and sale of the person’s movable property;
- attachment of the person’s bank accounts;
- attachment and sale of the person’s immovable property;
- arrest of the person and his detention in prison;
- appointing a receiver for the management of the person’s movable and immovable properties,
6.4.7 Establishment of Special Courts under Securities Contract (Regulation) Act, 1956

Sect 26A lays down that the Central Government for the purpose of providing speedy trial of offences under this Act establish or designate as many Special Courts as may be necessary. And it further lays down that a Special Court shall consist of a single judge who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working. A person shall not be qualified for appointment as a judge of a Special Court unless he is, immediately before such appointment, holding the office of a Sessions Judge or an Additional Sessions Judge, as the case may be.

6.4.8 Offences Triable by Special Courts

Sect 26 B further provides that all offences under this Act committed prior to the date of commencement of the Securities Laws (Amendment) Second Ordinance, 2013 or on or after the date of such commencement, shall be taken cognizance of and triable by the Special Court established for the area in which the offence is committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned. Sect 26 D lays down that Code of criminal procedure shall apply to proceedings before Special Court.

Sect 26 E lays down that any offence committed under this Act, which is triable by a Special Court shall, until a Special Court is established, be taken cognizance of and tried by a Court of Session exercising jurisdiction over the area.

The objective of SCRA is to regulate the working of stock exchanges or secondary market with a view to prevent undesirable transactions or speculation in securities, and thereby to build up a healthy and strong investment market in which public could invest with confidence. It empowers

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43 Inserted by The Securities Laws (Amendment) Second Ordinance, 2013 w.e.f. 18-07-2013
44 Ibid.
the Government of India to recognize and derecognize the stock exchanges, to stipulate laws and bye-laws for their functioning, and to make the listing of securities on stock exchanges by public limited companies [PULCOS] mandatory. It prohibits securities transactions outside the recognized stock exchanges. It is administered by the Ministry of Finance, Department of Economic Affairs, Government of India. The provision of segregation of management from trading would ensure sound decision.

6.5 Insurance Regulatory Authority Act, 1999

The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector. Before that, the industry consisted of only two state insurers: Life Insurers (Life Insurance Corporation of India, LIC) and General Insurers (General Insurance Corporation of India, GIC). GIC had four subsidiary companies. With effect from December 2000, these subsidiaries have been de-linked from the parent company and were set up as independent insurance companies: Oriental Insurance Company Limited, New India Assurance Company Limited, National Insurance Company Limited and United India Insurance Company Limited. The insurance sector went through a full circle of phases from being unregulated to completely regulated and then currently being partly deregulated. It is governed by a number of acts.

The Insurance Act of 1938 was the first legislation governing all forms of insurance to provide strict state control over insurance business. Life insurance in India was completely nationalized on 19 January 1956, through the Life Insurance Corporation Act. All 245 insurance companies operating then in the country were merged into one entity, the Life Insurance Corporation of India.

The General Insurance Business Act of 1972 was enacted to nationalize the about 100 general insurance companies then and subsequently merging them into four companies. All the companies were amalgamated into National Insurance, New India Assurance, Oriental Insurance and United India Insurance, which were headquartered in each of the four metropolitan
cities. Until 1999, there were no private insurance companies in India. The government then introduced the Insurance Regulatory and Development Authority Act in 1999, thereby de-regulating the insurance sector and allowing private companies. Furthermore, foreign investment was also allowed and capped at 26% holding in the Indian insurance companies.

In 2006, the Actuaries Act was passed by parliament to give the profession statutory status on par with Chartered Accountants, Notaries, Cost & Works Accountants, Advocates, Architects and Company Secretaries.

The IRDA Act, 1999 was passed as per the major recommendation of the Malhotra Committee report (1994) which recommended establishment of an independent regulatory authority for insurance sector in India. Later, It was incorporated as a statutory body in April, 2000. The IRDA Act, 1999 also allows private players to enter the insurance sector in India besides a maximum foreign equity of 26 per cent in a private insurance company having operations in India. The FDI limit in insurance sector was raised to 49% in July 2013. It serves as an Authority to protect the interests of holders of insurance policies, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith. IRDA role is to protect rights of policy holders & they provide registration certification to life insurance companies & responsible for renewal, modification, cancellation & suspension of this registered certificate. Recently the Finance Minister of India announced the setting of insurance repository system. An Insurance Repository is a facility to help policy holders buy and keep insurance policies in electronic form, rather than as a paper document. Insurance Repositories, like Share Depositories or Mutual Fund Transfer Agencies, will hold electronic records of insurance policies issued to individuals and such policies are called “electronic policies” or “e Policies.”

The Insurance Regulatory and Development Authority (IRDA) is a national agency run by the Government of India and was formed by an act of

46 [[en.wikipedia.org](http://en.wikipedia.org)] visited on 31st March 2014
48 Ibid
49 Ibid
Indian Parliament called as IRDA Act of 1999. The act is enacted "to protect the interests of the policyholders, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto." Indian insurance industry is regulated by the terms and conditions of the IRDA.

Indian law has certain expectations from the IRDA to perform in the Indian insurance industry. IRDA should protect the interest of policyholders by ensuring fair treatment by the insurance companies. The growth of insurance companies in a speedy and orderly manner should be taken care by the IRDA. It should monitor and implement quality competence and fair dealing of the insurance companies in the industry. IRDA should make sure that the insurers are providing precise and correct information about the products offered by them for the insurance customers. IRDA should also ensure speedy settlement of genuine claims of the policyholders and prevent malpractices in the process of claims settlement.

Section 14 of IRDA Act of 1999 lays that there are certain duties, powers and functions laid down for the IRDA and they are as following-

The Act lays down that the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business. It further provides that-

- Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include-
  - Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
  - protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
  - Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;
  - Specifying the code of conduct for surveyors and loss assessors;
• Promoting efficiency in the conduct of insurance business;
• Promoting and regulating professional organizations connected with the insurance and re-insurance business;
• Levying fees and other charges for carrying out the purposes of this Act;
• calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business;
• control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
• Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
• Regulating investment of funds by insurance companies;
• Regulating maintenance of margin of solvency;
• Adjudication of disputes between insurers and intermediaries or insurance intermediaries;
• Supervising the functioning of the Tariff Advisory Committee;
• Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations
• Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
• Exercising such other powers as may be prescribed

Insurance Regulatory and Development Authority (IRDA) in India consists a Chairman and some permanent and part time members in the administration. IRDA regulates private insurance companies in India.

○ The Insurance Sector is now opened to private companies. IRDA act by amending Insurance Act 1938 prescribes that no person start
a new business, after the commencement of IRDA Act 1999 unless he has obtained a certificate of registration for the particular class of insurance business he purposes to carry out and that existing insurance are giving breathing space of three months. The Act also provides for cancellation and suspension of Certification as a penalty if it has issued a person for commencing the insurance business. The ground for cancellation and suspension are following-

- If the Insurance company conducts its business in a manner prejudicial to the interest of policy holders
- Fails to furnish any information as required by authority
- Does not submit periodical Return
- Does not cooperate in inquiry conducted by authority
- Indulges in manipulating the insurance business
- Indulges in unfair trade practice
- Fails to make investment in the infrastructure or social sector specified in Sect 27 (d) of the Act.

IRDA in consultation with insurance advisory committee passed a separate regulation prescribing the procedure for conducting its own meeting called IRDA (meeting) Regulation 2000 and the meeting of insurance advisory committee called Insurance Advisory Committee Regulation, 2000 Which lays down that-

Every insurer doing the life business must appoint a qualified actuary exclusively for himself to advise him on matter relating to tariff, investments and manner of maintain accounts.

The IRDA acts not only a watchdog but also an advisor and with reference particularly to erring companies by constantly committing act of

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Section 3 of Insurance Act 1938.
malfeasance and misfeasance to act as a bloodhound\textsuperscript{51}. It is also to act as an advisory board to develop healthy and prosperous trends in insurance market. To have a constant vigil over their activities, registration is made renewable every year. The Registration only serve as visiting card and make the IRDA only to know about its existence and the fact that it is doing insurance.

Schedule C of the above Regulation deals with the Auditor’s report that the report of the auditors on the financial statements of every insurer shall deal with the matters specified herein:

1. (a) That they have obtained all the information and explanations which, to the best of their knowledge and belief were necessary for the purposes of their audit and whether they have found them satisfactory;

(b) Whether proper books of account have been maintained by the insurer so far as appears from an examination of those books;

(c) Whether proper returns, audited or unaudited, from branches and other offices have been received and whether they were adequate for the purpose of audit;

(d) Whether the Balance sheet, Revenue account and Profit and Loss account dealt with by the report and the Receipts and Payments Account are in agreement with the books of account and returns;

(e) Whether the actuarial valuation of liabilities is duly certified by the appointed actuary including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the Authority, and/or the Actuarial Society of India in concurrence with the Authority.

2. The auditors shall express their opinion on:

(a)(i) Whether the balance sheet gives a true and fair view of the insurer’s affairs as at the end of the financial year/period;

(ii) Whether the revenue account gives a true and fair view of the surplus or
the deficit for the financial year/period;

(iii) Whether the profit and loss account gives a true and fair view of the
profit or loss for the financial year/period;

(iv) Whether the receipts and payments account gives a true and fair view of
the receipts and payments for the financial year/period;

(b) The financial statements stated at (a) above are prepared in accordance
with the requirements of the Insurance Act, 1938 (4 of 1938), the Insurance
Regulatory and Development Act, 1999 (41 of 1999) and the Companies Act,
1956 (1 of 1956), to the extent applicable and in the manner so required.

(C) Investments have been valued in accordance with the provisions of the
Act and these Regulations.

(d) The accounting policies selected by the insurer are appropriate and are in
compliance with the applicable accounting standards and with the accounting
principles, as prescribed in these Regulations or any order or direction issued
by the Authority in this behalf.

3. The auditors shall further certify that:

(a) they have reviewed the management report and there is no apparent
mistake or material inconsistencies with the financial statements;

(b) the insurer has complied with the terms and conditions of the registration
stipulated by the Authority.

4. A certificate signed by the auditors [which shall be in addition to any other
certificate or report which is required by law to be given with respect to the
balance sheet] certifying that:–

(a) they have verified the cash balances and the securities relating to the
insurer’s loans, reversions and life interests (in the case of life insurers) and
investments;
(b) to what extent, if any, they have verified the investments and transactions relating to any trusts undertaken by the insurer as trustee; and

(c) no part of the assets of the policyholders’ funds has been directly or indirectly applied in contravention of the provisions of the Insurance Act, 1938 (4 of 1938) relating to the application and investments of the policyholders’ funds.

A commercial company can make its investment in available assets of secured method but the insurance sector owes an obligation to national interest, a new phase developed due to nationalization of insurance market. LIC and GIC shall act in consonance with the principle laid down in Directive Principle of State Policy.

6.6 Reserve Bank of India, 1935

The Reserve Bank of India was founded on 1 April 1935 to respond to economic troubles after the War. The bank was set up based on the recommendations of the 1926 Royal Commission on Indian Currency and Finance, also known as the Hilton–Young Commission. The original choice for the seal of RBI was The East India Company Double Mohur, with the sketch of the Lion and Palm Tree. However it was decided to replace the lion with the tiger, the national animal of India. The Preamble of the RBI describes its basic functions to regulate the issue of bank notes, keep reserves to secure monetary stability in India, and generally to operate the currency and credit system in the best interests of the country. The Central Office of the RBI initially established in Calcutta (now Kolkata), but was permanently moved to Bombay (now Mumbai) in 1937. The RBI also acted as Burma's central bank, except during the years of the Japanese occupation of Burma (1942–45), until April 1947, even though Burma seceded from the Indian Union in 1937. After the Partition of India in 1947, the Bank served as the central bank for Pakistan until June 1948 when the State Bank of Pakistan commenced operations. Though originally set up as a shareholders’

53 Ibid.
bank, the RBI has been fully owned by the Government of India since its nationalization in 1949\textsuperscript{54}.

The institution is also the regulator and supervisor of the financial system and prescribes broad parameters of banking operations within which the country's banking and financial system functions. Its objectives are to maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public. The \textit{Banking Ombudsman Scheme} has been formulated by the Reserve Bank of India (RBI) for effective addressing of complaints by bank customers. The RBI controls the monetary supply, monitors economic indicators like the gross domestic product and has to decide the design of the rupee banknotes as well as coins.

The central bank manages to reach the goals of the Foreign Exchange Management Act, 1999 i.e. to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

Every commercial bank has to keep certain minimum cash reserves with RBI. Consequent upon amendment to sub-Section 42(1), the Reserve Bank, having regard to the needs of securing the monetary stability in the country, RBI can prescribe Cash Reserve Ratio (CRR) for scheduled banks without any floor rate or ceiling rate.

Apart from the CRR, banks are required to maintain liquid assets in the form of gold, cash and approved securities. Higher liquidity ratio forces commercial banks to maintain a larger proportion of their resources in liquid form and thus reduces their capacity to grant loans and advances, thus it is an anti-inflationary impact. A higher liquidity ratio diverts the bank funds from loans and advances to investment in government and approved securities. The latest SLR as on 14 December 2013 is 23%.

In well-developed economies, central banks use open market operations—buying and selling of eligible securities by central bank in the

\textsuperscript{54} Ibid.
money market—to influence the volume of cash reserves with commercial banks and thus influence the volume of loans and advances they can make to the commercial and industrial sectors. In the open money market, government securities are traded at market related rates of interest. The RBI is resorting more to open market operations in the more recent years.

The Reserve Bank of India is entrusted with the responsibility of regulating and supervising the Non-Banking Financial Companies by virtue of powers vested in Chapter III B of the Reserve Bank of India Act, 1934. A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

6.6.1 Types of Non Banking Financial Company

Asset Finance Company (AFC): An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathes, machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines. Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising there from is not less than 60% of its total assets and total income respectively.

56 Ibid.
**Investment Company (IC):** IC means any company which is a financial institution carrying on as its principal business the acquisition of securities.

**Loan Company (LC):** LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

**Infrastructure Finance Company (IFC):** IFC is a non-banking finance company a) which deploys at least 75 per cent of its total assets in infrastructure loans, b) has a minimum Net Owned Funds of Rs. 300 crore, c) has a minimum credit rating of ‘A ‘or equivalent d) and a CRAR of 15%.

**Systemically Important Core Investment Company (CIC-ND-SI):** CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:-

- it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;
- its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;
- it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
- it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.
- Its asset size is Rs 100 crore or above and
- It accepts public funds
**Infrastructure Debt Fund:** Non-Banking Financial Company (IDF-NBFC):

IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

**Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI):** NBFC-MFI is a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets which satisfy the following criteria:

- loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding Rs. 60,000 or urban and semi-urban household income not exceeding Rs. 1,20,000;
- loan amount does not exceed Rs. 35,000 in the first cycle and Rs. 50,000 in subsequent cycles;
- total indebtedness of the borrower does not exceed Rs. 50,000;
- tenure of the loan not to be less than 24 months for loan amount in excess of Rs. 15,000 with prepayment without penalty;
- loan to be extended without collateral;
- aggregate amount of loans, given for income generation, is not less than 75 per cent of the total loans given by the MFIs;
- loan is repayable on weekly, fortnightly or monthly instalments at the choice of the borrower

**Non-Banking Financial Company – Factors (NBFC-Factors):** NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 75 percent of its total assets and its income derived from factoring business should not be less than 75 percent of its gross income.

A company incorporated under the Companies Act, 1956 and desirous of commencing business of non-banking financial institution as defined under Section 45 (I) (a) of the RBI Act, 1934 requires registration compulsory. The NBFCs accepting public deposits should furnish to RBI
Audited balance sheet of each financial year and an audited profit and loss account in respect of that year as passed in the annual general meeting together with a copy of the report of the Board of Directors and a copy of the report and the notes on accounts furnished by its Auditors;

6.6.2 Companies which are non Banking Financial Institution but still Exempt from Registration under Reserve Bank of India Act\textsuperscript{57}

Housing Finance Companies, Merchant Banking Companies, Stock Exchanges, Companies engaged in the business of stock-broking/sub-broking, Venture Capital Fund Companies, Nidhi Companies, Insurance companies and Chit Fund Companies are NBFCs but they have been exempted from the requirement of registration under Section 45-IA of the RBI Act, 1934 subject to certain conditions. Housing Finance Companies are regulated by National Housing Bank, Merchant Banker/Venture Capital Fund Company/stock-exchanges/stock brokers/sub-brokers are regulated by Securities and Exchange Board of India, and Insurance companies are regulated by Insurance Regulatory and Development Authority. Similarly, Chit Fund Companies are regulated by the respective State Governments and Nidhi Companies are regulated by Ministry of Corporate Affairs, Government of India.

RBI is the highest Authority for regulating the financial market in India. It control inflation and regulate NBFC.

6.7 Foreign Exchange Management Act, 1999

FERA (Foreign Exchange Regulation Act) was passed in 1947 which was amended in 1973. The new FERA came into force from 1.1.1974. The objective was the conservation of India’s Foreign Exchange reserves, judicious use of foreign exchange, using mainly in these sector which require foreign technology. Transactions in foreign exchange were absolutely

\textsuperscript{57} Ibid.
prohibited excepting in certain selected sectors. Every foreign company had to maintain Indian share of 26 percent.

FERA was repealed in 1998 and Foreign Exchange Management Act (FEMA) was enacted to facilitate external trade and payments and for promoting the orderly development and maintenance of foreign exchange market\(^{58}\) in India No unauthorised person would be allowed to deal in foreign exchange. The authorised person could sell; draw foreign exchange from any authorised person on current Account transaction, subject to approval of R.B.I.

RBI has exclusive authority to regulate supply; use of foreign exchange, R.B.I, if thinks fit at the compelling situation can prohibit use of foreign exchange\(^{59}\) for any specific purpose. R.B.I.’s decision on borrowing, lending, issue, deposit, export of foreign exchange is final.

Section 3 of the FEMA lays down that No person shall-

(a) deal in or transfer any foreign exchange or foreign security\(^{60}\) to any person not being an authorised person;

(b) make any payment to or for the credit of any person resident outside India in any manner;

(c) receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner.

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58 Foreign exchange market is market where money in one currency is exchanged for another currency

59 "foreign exchange" means foreign currency and includes,- (i) deposits, credits and balances payable in any foreign currency, (ii) drafts, traveler cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency, (iii) drafts, traveler cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency;

60 "foreign security” means any security, in the form of shares, stocks, bonds, debentures or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency, but where redemption or any form of return such as interest or dividends is payable in Indian currency
(d) enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

Section 5 of the Act lays down that any person may sell or draw foreign exchange to or from an authorized person if such sale or drawl is a current account transaction. However the central government may impose reasonable restriction, in public interest and in consultation with the Reserve Bank, impose such for current account transaction. Further Section 6 provides that Subject to the provisions of sub-section (2), any person may sell or draw foreign exchange to or from an authorized person for a capital account transaction.

(2) The Reserve Bank may, in consultation with the Central Government, specify-

(a) any class or classes of capital account transactions which are permissible;

(b) the limit up to which foreign exchange shall be admissible for such transactions: Provided that the Reserve Bank shall not impose any restriction on the drawl of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary courts of business.

(3) Without prejudice to the generality of the provisions of sub-section (2), the Reserve Bank may, by regulations, prohibit, restrict or regulate the following-

(a) transfer or issue of any foreign security by a person resident in India;

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61 "current account transaction" means a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes:- (i) payments due in connection with foreign trade, other current business, services, and short term banking and credit facilities in the ordinary course of business, (ii) payments due as interest on loans and as net income from investments, (iii) remittances for living expenses of parents, spouse and children residing abroad, and (iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children;
(b) transfer or issue of any security by a person resident outside India;

(c) transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;

(d) any borrowing or lending in rupees in whatever form or by whatever name called;

(e) any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;

(f) deposits between persons resident in India and persons resident outside India;

(g) export, import or holding of currency or currency notes;

(h) transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;

(i) acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;

(j) giving of a guarantee or surety in respect of any debt, obligation or other liability incurred-

(i) by a person resident in India and owed to a person resident outside India; or

(ii) by a person resident outside India.

(4) A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.
(5) A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

Section 7 of the Act requires that every exporter of goods shall-

(a) Furnish to the Reserve Bank or to such other authority a declaration containing true and correct material particulars, including the amount representing the full export value or, if the full export value of the goods is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India; (b) furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realization of the export proceeds by such exporter.

Section 8 makes provision relating to realization and repatriation of foreign exchange. It lays down that where any amount of foreign exchange is due or has accrued to any person resident in India, such person shall take all reasonable steps to realize and repatriate to India such foreign exchange within such period and in such manner as may be specified by the Reserve Bank.

6.8 Difference between FERA and FEMA

<table>
<thead>
<tr>
<th>DIFFERENCES</th>
<th>FERA</th>
<th>FEMA</th>
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<tbody>
<tr>
<td>PROVISIONS</td>
<td>FERA consisted of 81 sections, and was more</td>
<td>FEMA is much simple, and consist of only 49</td>
</tr>
</tbody>
</table>

62 Repatriate to India" means bringing into India the realized foreign exchange and the selling of such foreign exchange to an authorized person in India in exchange for rupees, or the holding of realized amount in an account with an authorized person in India to the extent notified by the Reserve Bank, and includes use of the realized amount for discharge of a debt or liability denominated in foreign exchange and the expression "repatriation" shall be construed accordingly

63 http://www.advocatekhoj.com visited on 8th April 2014
<table>
<thead>
<tr>
<th>FEATURES</th>
<th>Presumption of negative intention (Mens Rea) and joining hands in offence (abatement) existed in FEMA</th>
<th>These presumptions of Mens Rea and abatement have been excluded in FEMA</th>
</tr>
</thead>
<tbody>
<tr>
<td>NEW TERMS IN FEMA</td>
<td>Terms like Capital Account Transaction, current Account Transaction, person, service etc. were not defined in FERA.</td>
<td>Terms like Capital Account Transaction, current account Transaction person, service etc., have been defined in detail in FEMA</td>
</tr>
<tr>
<td>DEFINITION OF AUTHORIZED PERSON</td>
<td>Definition of &quot;Authorized Person&quot; in FERA was a narrow one (2(b))</td>
<td>The definition of Authorized person has been widened to include banks, money changes, off shore banking Units etc. (2(c))</td>
</tr>
<tr>
<td>MEANING OF &quot;RESIDENT&quot; AS COMPARED WITH INCOME TAX ACT.</td>
<td>There was a big difference in the definition of &quot;Resident&quot;, under FERA, and Income Tax Act</td>
<td>The provision of FEMA, are in consistent with income Tax Act, in respect to the definition of term &quot;Resident&quot;. Now the criteria of &quot;In India for 182 days&quot; to make a person resident has been brought under FEMA. Therefore a</td>
</tr>
</tbody>
</table>
A person who qualifies to be a non-resident under the Income Tax Act, 1961 will also be considered a non-resident for the purposes of application of FEMA, but a person who is considered to be non-resident under FEMA may not necessarily be a non-resident under the Income Tax Act, for instance a business man going abroad and staying therefore a period of 182 days or more in a financial year will become a non-resident under FEMA.

<table>
<thead>
<tr>
<th>PUNISHMENT</th>
<th>Any offence under FERA, was a criminal offence, punishable with imprisonment as per code of criminal procedure, 1973</th>
<th>Here, the offence is considered to be a civil offence only punishable with some amount of money as a penalty. Imprisonment is prescribed only when one fails to pay the penalty.</th>
</tr>
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<tr>
<td>QUANTUM OF</td>
<td>The monetary penalty</td>
<td>Under FEMA the</td>
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</table>

Here, the offence is considered to be a civil offence only punishable with some amount of money as a penalty. Imprisonment is prescribed only when one fails to pay the penalty.
<table>
<thead>
<tr>
<th>PENALTY.</th>
<th>payable under FERA, was nearly the five times the amount involved.</th>
<th>quantum of penalty has been considerably decreased to three times the amount involved.</th>
</tr>
</thead>
<tbody>
<tr>
<td>APPEAL</td>
<td>An appeal against the order of &quot;Adjudicating office&quot;, before &quot;Foreign Exchange Regulation Appellate Board went before High Court</td>
<td>The appellate authority under FEMA is the special Director (Appeals). Appeal against the order of Adjudicating Authorities and special Director (appeals) lies before &quot;Appellate Tribunal for Foreign Exchange.&quot; An appeal from an order of Appellate Tribunal would lie to the High Court. (sec 17,18,35)</td>
</tr>
<tr>
<td>RIGHT OF ASSISTANCE DURING LEGAL PROCEEDINGS.</td>
<td>FERA did not contain any express provision on the right of an impleaded person to take legal assistance</td>
<td>FEMA expressly recognizes the right of appellant to take assistance of legal practitioner or chartered accountant (32)</td>
</tr>
<tr>
<td>POWER OF SEARCH AND SEIZE</td>
<td>FERA conferred wide powers on a police officer not below the rank of a Deputy Superintendent of</td>
<td>The scope and power of search and seizure has been curtailed to a great extent</td>
</tr>
</tbody>
</table>
6.8.1 Similarities

The similarities between FERA and FEMA are as follows:

- The Reserve Bank of India and central government would continue to be the regulatory bodies.
- Presumption of extra territorial jurisdiction as envisaged in section (1) of FERA has been retained.
- The Directorate of Enforcement continues to be the agency for enforcement of the provisions of the law such as conducting search and seizure.

6.9 Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

With an aim to provide a structured platform to the Banking sector for managing its mounting NPA stocks and keep pace with international financial institutions, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act was put in place to allow banks and FIs to take possession of securities and sell them. As stated in the Act, it has “enabled banks and FIs to realise long-term assets, manage problems of liquidity, asset-liability mismatches and improve recovery by taking possession of securities, sell them and reduce non performing assets (NPAs) by adopting measures for recovery or reconstruction.” Prior to the Act, the legal framework relating to commercial transactions lagged behind the rapidly changing commercial practices and financial sector reforms, which led to slow recovery of defaulting loans and mounting levels of NPAs of banks and financial institutions.

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64 Ibid.
65 Non performing Assets.
66 [www.dnb.co.in](http://www.dnb.co.in) visited on 8th April 2014
67 Ibid.
The SARFAESI Act has been largely perceived as facilitating asset recovery and reconstruction. Since Independence, the Government has adopted several ad-hoc measures to tackle sickness among financial institutions, foremost through nationalisation of banks and relief measures. Over the course of time, the Government has put in place various mechanisms for cleaning the banking system from the menace of NPAs and revival of a healthy financial and banking sector. Some of the notable measures in this regard include:\(^{68}\):

6.9.1 Sick Industrial Companies (Special Provisions) Act, 1985

To examine and recommend remedy for high industrial sickness in the eighties, the Tiwari committee was set up by the Government. It was to suggest a comprehensive legislation to deal with the problem of industrial sickness. The committee suggested the need for special legislation for speedy revival of sick units or winding up of unviable ones and setting up of quasi-judicial body namely; Board for Industrial and Financial Reconstruction (BIFR) and The Appellate Authority for Industrial and Financial Reconstruction (AAIRFR) and their benches. Thus in 1985, the SICA came into existence and BIFR started functioning from 1987.

The objective of SICA was to proactively determine or identify the sick/potentially sick companies and enforcement of preventive, remedial or other measures with respect to these companies. Measures adopted included legal, financial restructuring as well as management overhaul. However, An Assessment process was cumbersome and unmanageable to some extent. The system was not favourable for the banking sector as it provided a sort of shield to the defaulting companies.

\(^{68}\) Ibid.
6.9.2 Recoveries of Debts due to Banks and Financial Institutions (RDDBFI) Act, 1993

The procedure for recovery of debts to the banks and financial institutions resulted in significant portions of funds getting locked. The need for a speedy recovery mechanism through which dues to the banks and financial institutions could be realised was felt. Different committees set up to look into this, suggested formation of Special Tribunals for recovery of overdue debts of the banks and financial institutions by following a summary procedure. For the effective and speedy recovery of bad loans, the RDDBFI Act was passed suggesting a special Debt Recovery Tribunal to be set up for the recovery of NPA. However, this act also could not speed up the recovery of bad loans, and the stringent requirements rendered the attachment and foreclosure of the assets given as security for the loan as ineffective.

6.9.3 Corporate Debt Restructuring (CDR) System

Companies sometimes are found to be in financial troubles for factors beyond their control and also due to certain internal reasons. For the revival of such businesses, as well as, for the security of the funds lent by the banks and FIs, timely support through restructuring in genuine cases was required. With this view, a CDR system was established with the objective to ensure timely and transparent restructuring of corporate debts of viable entities facing problems, which are outside the purview of BIFR, DRT and other legal proceedings. In particular, the system aimed at preserving viable corporate/businesses that are impacted by certain internal and external factors, thus minimising the losses to the creditors and other stakeholders. The system has addressed the problems due to the rise of NPAs. Although CDR has been effective, it largely takes care of the interest of bankers and ignores (to some extent) the interests of borrower’s stakeholders. The secured lenders like banks and FIs, through CDR merely, address the financial structure of the company by deferring the loan repayment and aligning interest rate payments
to suit company’s cash flows. The banks do not go for a one time large write-off of loans in initial stages.

6.9.4 SARFAESI ACT, 2002

By the late 1990s, rising level of Bank NPAs raised concerns and Committees like the Narasimham Committee II and Andhyarujina Committee which were constituted for examining banking sector reforms considered the need for changes in the legal system to address the issue of NPAs. These committees suggested a new legislation for securitisation, and empowering banks and FIs to take possession of the securities and sell them without the intervention of the court and without allowing borrowers to take shelter under provisions of SICA/BIFR. Acting on these suggestions, the SARFAESI Act, was passed in 2002 to legalise securitisation and reconstruction of financial assets and enforcement of security interest. The act envisaged the formation of asset reconstruction companies (ARCs)/Securitisation Companies (SCs).

6.9.5 Provisions of the SARFAESI Act

The Act has made provisions for registration and regulation of securitisation companies or reconstruction companies by the RBI, facilitate securitisation of financial assets of banks, empower SCs/ARCs to raise funds by issuing security receipts to qualified institutional buyers (QIBs), empowering banks and FIs to take possession of securities given for financial assistance and sell or lease the same to take over management in the event of default.

The Act provides three alternative methods for recovery of NPAs, namely:

Securitisation: It means issue of security by raising of receipts or funds by SCs/ARCs. A securitisation company or reconstruction company

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69 "non-performing asset" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset.--
(a) in case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body;
(b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank;
may raise funds from the QIBs\textsuperscript{70} by forming schemes for acquiring financial assets. The SC/ARC shall keep and maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired, out of investments made by a QIB and ensure that realisations of such financial asset is held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.

Asset Reconstruction\textsuperscript{71}: The SCs/ARCs for the purpose of asset reconstruction should provide for any one or more of the following measures:

- the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower
- the sale or lease of a part or whole of the business of the borrower
- rescheduling of payment of debts payable by the borrower
- enforcement of security interest in accordance with the provisions of this Act
- settlement of dues payable by the borrower
- taking possession of secured assets in accordance with the provisions of this Act.

Sect 3 lays down that No securitisation company or reconstruction company shall commence or carry on the business of securitisation or asset reconstruction without obtaining a certificate of registration from RBI.

The Reserve Bank may take into consideration following factor while issuing certificate of registration-

\textsuperscript{70} "qualified institutional buyer" means a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or securitisation company or reconstruction company which has been granted a certificate of registration under sub-section (4) of Section 3 or any asset management company making investment on behalf of mutual fund or pension fund or a foreign institutional investor registered under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or regulations made thereunder, or any other body corporate as may be specified by the Board.

\textsuperscript{71} "asset reconstruction" means acquisition by any securitisation company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance;
that the securitisation company or reconstruction company has not incurred losses in any of the three preceding financial years;
• that such securitisation company or reconstruction company has made adequate arrangements for realisation of the financial assets acquired for the purpose of securitisation or asset reconstruction and shall be able to pay periodical returns and redeem on respective due dates on the investments made in the company by the qualified institutional buyers or other persons;
• that the directors of securitisation company or reconstruction company have adequate professional experience in matters related to finance, securitisation and reconstruction;
• that the board of directors of such securitisation company or reconstruction company does not consist of more than half of its total number of directors who are either nominees of any sponsor or associated in any manner with the sponsor or any of its subsidiaries;
• that any of its directors has not been convicted of any offence involving moral turpitude;
• that a sponsor, is not a holding company of the securitisation company or reconstruction company, as the case may be, or, does not otherwise hold any controlling interest in such securitisation company or reconstruction company;
• that securitisation company or reconstruction company has complied with or is in a position to comply with prudential norms specified by the Reserve Bank.
• that securitisation company or reconstruction company has complied with one or more conditions specified in the guidelines issued by the Reserve Bank for the said purpose.

Sect 4 empowers the Reserve Bank of India to cancel the certificate if the securitisation company fail to comply with any rule or on any ground as it thinks fit.
Sect 12 of the Act provides that If the Reserve Bank is satisfied that it is in the public interest or to regulate financial system of the country or to prevent the affairs of any securitisation company or reconstruction company from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such securitisation company or reconstruction company it may determine the policy and give directions to all or any securitisation company or reconstruction company in matters relating to income recognition, accounting standards, making provisions for bad and doubtful debts, capital adequacy based on risk weights for assets and also relating to deployment of funds by the securitisation company or reconstruction company, as the case may be, and such company shall be bound to follow the policy so determined and the directions so issued.

Section 13 lays down that any security interest created in favour of any secured creditor may be enforced, without the intervention of court or tribunal, by such creditor in accordance with the provisions of this Act. Where any borrower makes any default in repayment of secured debt or any installment is under a liability to a secured creditor under a security agreement, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under clause 4. The measure provided are following-

1. take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
2. take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
3. appoint any person to manage the secured assets the possession of which has been taken over by the secured creditor;
4. require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

Sect 17 provides that any person (including borrower), aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorised officer under this Chapter, may make an application alongwith such fee, as may be prescribed to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measure had been taken. The Debts Recovery Tribunal shall consider whether any of the measures taken under section 13 (4) by the secured creditor for enforcement of security are in accordance with the provisions of this Act or not. If, the Debts Recovery Tribunal, after comes to the conclusion that any of the measures referred taken by the secured creditor are not in accordance with the provisions of this Act and the rules it shall require restoration of the management of the business to the borrower or restoration of possession of the secured assets to the borrower, it may by order, declare the recourse taken by the secured creditors as invalid and restore the possession of the secured assets to the borrower or restore the management of the business to the borrower, as the case may be, and pass such order as it may consider appropriate.

In the case of a borrower residing in the State of Jammu and Kashmir, the application under section 17 shall be made to the Court of District Judge in that State having jurisdiction over the borrower which shall pass an order on such application.

Any person aggrieved, by any order made by the Debts Recovery Tribunal under section 17, may prefer an appeal to the Appellate Tribunal within thirty days from the date of receipt of the order of Debts Recovery Tribunal.

72 "Appellate Tribunal" means a Debts Recovery Appellate Tribunal established under sub-section (1) of section 8 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.
Any borrower residing in the State of Jammu and Kashmir and aggrieved by any order made by the Court of District Judge under section 17A may prefer an appeal, to the High Court having jurisdiction over such Court, within thirty days from the date of receipt of the order of the Court of District Judge.

The act would help in reducing the NPA by financial institution. As when a financial institution gave loan earlier on security then in many cases there were no chances of recovery as they have limited power. But now they can recover it speedily. However the act doesn’t deal protection of investors interest.

6.9.6 The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003

The Reserve Bank of India issued guidelines in 2003 to regulate the financial system, to the advantage of the country and to prevent the affairs of any Securitisation Company or Reconstruction Company from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such Securitisation Company or Reconstruction Company relating to registration, measures of asset reconstruction, functions of the company, prudential norms, acquisition of financial assets and matters related thereto.

Every Securitisation Company or Reconstruction Company shall apply for registration in the form of application specified vide Notification and obtain a certificate of registration from the Bank as provided under Section 3 of the Act.

(ii) A Securitisation Company or Reconstruction Company, which has obtained a certificate of registration issued by the Bank under Section 3 of the Act, can undertake both securitisation and asset reconstruction activities.

(iii) Any entity not registered with the Bank under Section 3 of the Act may conduct the business of securitisation or asset reconstruction outside the purview of the Act.
Further Sect (7)(3) deals with rescheduling of Debts it lays down that Every Securitisation Company or Reconstruction Company shall frame a policy, duly approved by the Board of Directors, laying down the broad parameters for rescheduling of debts due from borrowers; All proposals should be in line with and supported by an acceptable business plan, projected earnings and cash flows of the borrower; The proposals should not materially affect the asset liability management of the Securitisation Company or Reconstruction Company or the commitments given to investors.

These guidelines were issued as the SERFASI ACT does not deal with the protection of investor’s interest.

6.9.7 RBI is Regulator for Determine time Limit to NPA

The Gujarat high court on 25th April 2014 has held an amendment in securitization laws as unconstitutional and restored the Reserve Bank of India (RBI) as the regulator of banks and non-banking financial institutes across the country as far as their non-performing assets (NPA) period is concerned. Various defaulters questioned an amendment made in November 2004 in the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002. Before this amendment in Section 2(1)(o) of the Act, the RBI was the regulator for banking, non-banking firms and securitization agencies for deciding the period after which the loans could be treated as NPAs. Earlier, the NPA period for all such finance institutions - banks, NBFCs and other agencies - was 180 days. Later in 2004, the RBI kept the NPA period for banks at 90 days and 180 days for NBFCs. However, with the amendment in the law, the finance institutions were free to have their own regulators, and the RBI ceased to be the regulator for the purpose. With this, the NPA period was decided separately by all finance firms, which differed in each of the cases. Aggrieved with the discrepancy, some defaulters of banks and NBFCs moved the HC.

73 The Times of India.
questioning the reason for the difference of NPA periods among finance firms. Their counsel Vishwas and Masoom Shah contended that this difference was in violation of the right to equality as guaranteed by the Constitution. The HC upheld this argument, declared the amendment as unconstitutional with observation that the Parliament was wrong in snatching the power from the RBI to set NPA guidelines.

However The Delhi high court has upheld this 2004 amendment in the securitization law.

6.10 The Securities Laws (Amendment) Act, 2014

This Act provides market Regulator SEBI with new power. Earlier the judicial powers were not given to SEBI. But after the passing of this act SEBI has also judicial power. The Act provides for establishment of Special fast Trial Court. The Act has 57 Sections. This act gave the power to search and obtain information, including Call records about any suspected entity from within or outside the firm. The act has amended the SEBI Act 1992, Security Contract (Regulation), Act 1956 and Depository Act. Now The SEBI, which is the regulator of capital market or securities in India Can ask for any information from any authority which it consider necessary for any matter of investigation or inquiry by the board in respect of any transaction in securities. Now even the SEBI can require furnishing of information to other authorities even outside India, having similar functions to the Board in the matter relating to the prevention or detection of violation of securities laws and for that purpose the Board may enter into agreement with such authority outside India with the prior approval of central government. The punishment has been increased. The law has been made stricter. Sect 28A has been Added which provides for attachment of property movable or immovable, arrest and detention and appointment of receiver in case of failure to comply with any of direction Of SEBI. In Section 19 of The Depository Act, 1996 a explanation has been added which provides that power to issue directions include the power to direct any person, who made profit or loss by indulging in any
transaction or activity in contravention of provision of this Act. The other thing which has been amended is related to punishment. Now the punishment provided under the act would be deterrent. These amendments has been introduced after the Shardha chit fund fraud as these fraud has affected the whole of nation and especially the investors’ confidence. The Government has realized that there are so many loopholes in the existing law and there is need to overcome these loopholes. So the government has passed this bill on 6th August by Lok Sabha and on 12th August in Rajya Sabha. Now the act is in force.

In short we can say that this act has empowered the SEBI. And strict punishment has been provided in order to prevent frauds in market. However time will tell whether it would be able to achieve it object or not i.e. would be able to maintain investor’s interest in capital market or not.

So a lot of legislation has been enacted for the prevention and control of frauds in corporate world and regulatory authority has been established for ensuring the compliance with the legislation and take action whenever required. When in 1992 SEBI was established after Harshad Mehta Fraud it was thought there would hardly be any fraud capital market. But it was only 3 year of its establishment that Ketan Parekh fraud was committed. At that time question on the efficiency of SEBI was raised and power of the SEBI was increased. The Security Contract (Regulation) Act, 1956 also prevents undesirable transaction in security market. The Highest Authority under the act is Central Government. However some of the power which was earlier conferred on Central Government was transferred to SEBI with amendment so that SEBI can discharge its function efficiently. Then Depository Act, 1996 was enacted with a view to ensure Transparency and accountability and to provide liquidity in market and to introduce paperless security which would reduce the burden of their keeping. Other Act which were also there was IRDA, RBI, FEMA and SERFAESI Act. Recently some amendment has been made in Companies Act, 1956 like concept of Independent Director was
introduced, Serious Fraud Investigation Office was created, it also makes provision for E- Governance and also makes provision for punishment fraudently inducing person to invest money. Various Authorities has been constituted to ensure effective implementation of these legislation Like SAT[^74], SFIO[^75], NCLT[^76], NCLAT[^77], NFRA[^78] etc. These are some of authority. However these authorities have failed to discharge its duty as fraud is rampant. Some scholars are of view that now the problem of corporate fraud has been solved and now there would not be any case after the amendment of Companies act, 2013. But this fact also cannot be denied that Implementation of Act is one thing and its Enactment is another thing. Indian Penal Code was enacted in 1860 and many offences were created. Murder is one of such offence in IPC. Punishment which was provided was death sentence which is deterrent punishment. However everyone knows that our newspapers are full of incident of Murder. So the contention of Scholar that the topic has become outdated is not sustainable. So Today we need not more law but their effective implementation as the cases discussed in chapter 4 itself lays down that fraud could have been prevented if the Authorities would not have negligent. So Authorities should alert.

[^74]: Security Appellate Tribunal.
[^75]: Serious Fraud Investigation Office
[^76]: National Company Law Tribunal.
[^77]: National Company Law Appellate Tribunal
[^78]: National Financial Reporting Authority.