Chapter – ii

Legal Frame Work of the Capital Market and Investor Protection
2.1 Introduction

Of all the modern service institutions, stock exchanges are perhaps the most crucial agents and facilitators of entrepreneurial progress. After the industrial revolution, as the size of business enterprises grew, it was no longer possible for proprietors or even partnerships to raise colossal amounts of money required for undertaking large entrepreneurial ventures. Such huge requirement of capital could only be met by the participation of a very large number of individuals, their number running into hundreds, thousands and even millions, depending on the size of the business venture.

These investors could be expected to invest actively in a productive enterprise only if there was some mechanism by which they could sell a part of their stake in the business whenever they wished to generate cash. This need for making the investment 'liquid' was necessary to attract participation from individuals. Therefore, the stakes of individuals in a business, whether of ownership or of lending, had to be 'broken up' into a large number of small units, so that each unit could be, independently and easily, bought and sold. This was achieved through shares and debentures (or bonds) (together referred to as securities) representing smallest units of ownership and lending, respectively, by the public. Such breaking up of the stake into smaller denominations also helped in channeling small savings in the economy into entrepreneurial ventures. The institution where these are traded is known as the Stock Exchange\(^1\). The buying and selling of securities leads only to changes in the set of individuals who have stakes in a specific business at a point in time, without affecting the funds available to the business. Traditionally, a stock exchange has been an association of individual members called member brokers (or simply members or brokers), formed for the express purpose of regulating and facilitating the buying and selling of securities by the public and the institutions at large.

\[^1\text{Barua&Raghunathan, Portfolio Management, Tata McGraw Hill, 2003.}\]
A stock exchange in India operates with due recognition from the government under the Securities & Contracts (Regulations) Act, 1956. The member brokers are essentially the middlemen, who transact in securities on behalf of the public for a commission or on their own behalf. Corporate membership of stock exchanges has also been introduced lately. At present 19 stock exchanges in India. The largest among them is the Bombay Stock Exchange (BSE). It alone accounts for over 80 percent of the total volume of transactions in shares in the country.

A stock exchange was typically governed by a board consisting of directors, a majority of whom were elected by the member brokers. The other members of the board were nominated by the government. The Government nominees include representatives of the Ministry of Finance, as well as some public representatives, who were expected to safeguard the interest of investors in the functioning of the exchanges. The board was headed by a President, who was an elected member, usually nominated by the government, from among the elected members. The Executive Director, who was appointed by the stock exchange with government approval, was the operational chief of the stock exchange. His duty was to ensure that the day-to-day operations of the stock exchange are carried out in accordance with the rules and regulations governing its functioning. Securities and Exchanges Board of India (SEBI) has been set up in Bombay by the Government to oversee the orderly development of stock exchanges in the country. All companies wishing to raise capital from the public are required to list their securities on at least one stock exchange. Thus, all ordinary shares, preference shares and debentures of publicly held companies are listed in one or more stock exchanges. Stock exchanges also facilitate trading in the securities of the public sector companies as well as government securities.

Primary and Secondary Capital Markets

We mentioned earlier that a company cannot easily attract investors to invest in its securities (shares or debentures) if the investors cannot subsequently trade these securities at will. In other words, a security cannot have a good primary market unless it is ensured of an active secondary market.

Primary Market

Primary market is the market for issue of new securities. It, therefore, essentially consists of the companies issuing securities, the public subscribing to these securities, the regulatory agencies like the SEBI and the government, and the intermediaries such as brokers, merchant bankers and banks who underwrite the issues and help in collecting subscription money from the public.

Secondary Market

Secondary market is the market for trading in existing securities after they have been created in the primary market. It essentially consists of the public who were buyers and sellers of securities, brokers, mutual funds and most importantly, the stock exchanges where the trading takes place.

The two markets mentioned above are not to be understood as two physically segregated institutions. The same parties are generally involved in both the markets. The major difference is in the fact that a security born in the primary market but it matures in the secondary market.

Buying and Selling Securities

Securities can be bought either from the primary or from the secondary market. Bonds or debentures can be sold either in the secondary market or redeemed in the primary market at the time of maturity. However, shares can be sold only in the secondary market.

We have already learnt that firms raise money by issuing new securities in the primary market. Investors acquire these securities by applying for the
securities being issued by the firm. The application form, along with application money, has to be submitted to designated banks. In case the issue was oversubscribed, the company, in consultation with a stock exchange, draws up a scheme for allotment of the securities being issued. An investor may or may not get the number of shares he applied for. Generally, when the market was booming, the new issues were heavily oversubscribed, and investors, more often not receive only a small fraction of the number of securities applied for.

While shares can be bought and sold like any other commodity by individuals, it is advisable to route all transactions through a broker. That not only reduces the risk of fraud, but also makes it easier for investors to complete the formalities of transferring the securities from the seller to the buyer.

2.2 Legal framework of the Indian capital markets

Various Acts, rules, regulations, ordinance, guidelines, clarifications, press releases and bye-laws of self regulatory organizations constitute the legal framework of the Indian Capital Markets. The Indian Securities Laws, Rules and Regulations enacted for its capital markets include the following:

- The Companies Act, 1956
- The Securities Contracts (Regulation) Act, 1956
- The Securities Contracts (Regulation) Rules, 1957
- The Securities and Exchange Board of India Act, 1992
- The SEBI (Insider Trading) Regulations, 1992
- The SEBI (Merchant Bankers) Rules, 1992
- The SEBI (Merchant Bankers) Regulations, 1992
- The SEBI (Stock Brokers and Sub-Brokers) Rules, 1992

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The SEBI (Stock Brokers and Sub-Brokers) Regulation, 1992
The SEBI (Debenture Trustees) Rules, 1993
The SEBI (Debenture Trustees) Regulations, 1993
The SEBI (Portfolio Managers) Rules, 1993
The SEBI (Portfolio Managers) Regulations, 1993
The SEBI (Registrars to Issue and Share Transfer Agents) Rules, 1993
The SEBI (Registrars to Issue and Share Transfer Agents) Regulations, 1993
The SEBI (Underwriters) Rules, 1993
The SEBI (Underwriters) Regulations, 1993
The SEBI (Appeal to Central Government) Rules, 1993
The SEBI (Bankers to an Issue) Rules, 1994.
The SEBI (Bankers to an Issue) Regulations, 1994.
The SEBI Appellate Tribunal (Procedure) Rules, 1994
The SEBI (Foreign Institutional Investors) Regulations, 1995
The SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to
Depositories Act, 1996
The SEBI (Depositories & Participants) Regulations, 1996
The SEBI (Mutual Funds) Regulations, 1996.
The SEBI (Venture Capital Funds) Regulation 1996.
The SEBI (Custodian) Regulations, 1994.
The SEBI (Substantial Acquisition of Shares and Take Over) Regulation,
1997.

The Companies Act, Securities Contracts (Regulation) Act, 1956, Securities and
Exchange Board of India Act, 1992 and Depository Act, 1996 are the statutory laws.

2.2.1 Rules and regulations

Securities Contracts (Regulation) Rules, 1957 and such other rules referred to hereinabove are made by the Central Government under the provisions of the relevant Act and the SEBI (Depositories and Participants) Regulations, 1996 and such other regulations referred to hereinabove are made by SEBI also under the provisions of the relevant Act. Both the rules and regulations are made for carrying out the purposes of the Act. They have the force of an Act.

2.2.2 Bye-laws

Self regulatory organizations, such as, different Stock Exchanges in India, enact their own Bye-laws setting forth the rules of the administration of their respective stock exchanges. They cover the hours of trade and clearing, method of operations, the collection and publication of market data, trading and listing rules, the scale of brokerage and other matters. In the case of bye-laws of stock exchanges in India under the SEBI Act, 1992 the SEBI has the authority to approve, make or amend the bye-laws.

2.2.3 Ordinances

These are promulgated by the President of the Republic of India in accordance with the Constitution of India when Parliament is not in session and when it is necessary for the President to take immediate action.

2.2.4 Guidelines & clarifications

The SEBI issues guidelines and their clarification on specific and technical subjects such as development of "Finance Institutions", "flexibility on pricing of the issue", "bonus issues", "preferential disclosure and investor protection", etc. At times a clarifications leads to further clarification. In the case of "disclosure and investor protection", SEBI had to issue as many as 17 clarifications.
2.2.5 Press releases

As a means of informing the public on SEBI's tentative administrative stands or criteria for a particular subject, press releases are frequently issued by SEBI. They are extremely effectual and serve practical purposes.

2.3 The Securities Contracts (Regulation) Act; 1956

The Act imposes strict government control over the stock exchanges. It provides the framework within which the Central Government tries to achieve the objective of regulation of securities contract and their trading. The main provisions of the Act relate to:

❖ Recognition of Stock Exchange

Any stock exchange, which was desirous of being recognized has to make an application in the prescribed manner to the Central Government. The application should be accompanied by the bye-laws of the stock exchange for regulation and control of the contracts and also copy of the rules relating in general to the constitution of the stock exchange and, in particular, to:-

1. The governing body of such stock exchanges, its constitutions and powers of the management and the manner in which its business is to be transacted;
2. The powers and duties of the office-bearers of the stock exchange;
3. The admission into the stock exchange of the various classes of members, the qualification and eligibility of members and the exclusion, suspension, readmission of members there from; and
4. The procedure of registration of partnerships as members of the stock exchange where rules permit for such membership.5

5. The Securities Contract (Regulation) Act, 1956, Govt. of India Publications, Section 3 (1).
Grant of reorganization to Stock Exchange

The Central Government may grant recognition to the stock exchange if it was satisfied after making necessary enquiries and obtaining such further information, if any, as it may require that:-

a) Rules and by laws of the stock exchanges were in conformity with such conditions as may be prescribed with a view to ensure fair dealings. The conditions which the government may impose, may, interalia, relate to :-

i. The qualifications for membership;

ii. The manner in which contracts between members were entered into;

iii. The representation of the Central Government in the governing body; and

iv. The maintenance of accounts of the members and their audit.

b) The stock exchange was willing to comply with another condition which may be prescribed by the Central Government after consultation with the governing body of the stock exchange; and

c) It was in the interest of trade and also in the public interest to grant recognition to the stock exchange.

The recognition to the stock exchanges were to be granted subject to the condition that:-

i. The recognition shall be either on permanent basis or for such period not less than one year as may be prescribed in the recognition and

ii. The stock exchange shall apply before three months of expiry of the Period of recognition for renewal.

8. Ibid., Section 4 (2).
9. Ibid., Section 4 (1) (b).
 Withdrawal of Recognition

The Central Government has the power to withdraw the recognition granted to a particular stock exchange. The Government gives a written notice to the governing body of the stock exchange, in which it mentions all reasons of withdrawal of the recognition and, after giving an opportunity to the governing body to be heard in the matter, the Government may withdraw the recognition granted to the stock exchange by notifications in the official Gazette. However, such withdrawal shall not affect the validity of any contract entered into or made before the date of notification, and the government may, in consultation with the stock exchanges, make such provisions as it deems fit in the notification similarly published for the due performance of any contract outstanding on the date.  

 Power of Central Government to call for Periodical Returns or Direct Inquiries.

The Central Government, if satisfied that it was in the interest of trade or in the public interest to do so, may order the appointment of one or more persons to make an inquiry in the prescribed manner in relation to the affairs of the governing body in relation thereof and submit a report of the result of such inquiry to the Central Government within specified time or in case of inquiry in relation to the affair of any of the members of stock exchange, direct the governing body to make the inquiry and submit its report to the Central Government. 

In case the inquiry in relation to the affairs of recognized stock exchange or any of its members has been undertaken, then:-

a) Every director, manager, secretary or other officer of such stock exchange;

b) Every member of such stock exchange and;

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c) If the member of the stock exchange was a firm, every partner, manager, secretary or other officer; and

Every other, person or body person who had dealings in the course of business, whether directly or indirectly, are bound to appear before the inquiring authority and furnish the required information. 13

The manner of inquiring authority will be governed by the following rules:-

a) The inquiring authority consists of two or more persons. One of them shall be appointed as chairman or senior member thereof; 14

b) The inquiring authority shall hand over the statement of issues to be inquired to the governing body or the member concerned who will be given reasonable opportunity to state their or his side of the case ; 15

c) If any witness was called for examination, an opportunity will be provided to the governing body or the member whose affairs were being inquired into, to cross-examine such witness ; 16 and

d) When the inquiring authority consist of more than one person, the views of the majority will be taken into consideration and the chairman will have the casting vote. 17

The inquiring authority was required to submit a report in writing to the Central Government within a specified period. Every stock exchange has to furnish a copy of the annual report containing the prescribed particulars to the


15. The Securities Contract (Regulation) Rules, 1957, Rule 16 (i) (b).

16. Ibid., Rules 16 (i) (c).

17. Ibid., Rules 16 (i) (d).
Central Government. The annual report shall be furnished within one month of the date of holding of its general meetings.

Power of the Central Government to direct rules to be made in consultation with the governing body of a stock exchange in general or with Government may direct to make rules or to amend any rules already made within a period of six months from the date of order. In case any recognized stock exchange fails or neglects to comply with any order, then Central Government may make the rules for or amend the rules made by the recognized stock exchange either in the form proposed in the order or with such notification thereof as may be agreed to between the stock exchange and the Central Government.

2.3.1 Power of recognized stock exchange to make and amend bye-laws

Any recognized stock exchange may, subject to the prior approval of the Central Government, make bye-laws for regulation and control of contracts such bye-law may provide for:-

a) The opening and closing of markets, and the regulation of the hours of trade;

b) The regulation, or prohibition of badlas or carry over facilities;

c) The fixing, altering or postponing the days for settlement;

d) The determination and declaration of market rates, including the opening, closing, highest and lowest rates for securities;

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18. Ibid., Rules 16 (i) (e).
19. Ibid., Rules 16 (i) (f).
20. The Securities Contract (Regulation) Act, 1956, Govt. of India Publications, Section 8 (1).
21. Ibid., Section 8 (2).
22. Ibid., Section 9 (1).
23. Ibid., Section 9 (2) (a).
24. Ibid., Section 9 (2) (g).
e) The terms, conditions and incidents of contracts, including the prescription of margin requirements;  

f) The regulation of the entering into, making, performance, rescission and termination of contracts;  

g) The regulation of tawarni business including the placing of limitation thereon;  

h) The listing of securities on the stock exchange;  

i) The method and procedure for the settlement of claims or disputes;  

j) The fixing of a scale of brokerage and other charges;  

k) The making, comparing, settling and closing of bargains;  

l) The regulation of dealing by members for their own account;  

m) The separation of the function of jobbers and brokers;  

n) The limitation on the volume of trade by any individual member in exceptional circumstances.

The bye-laws made under this section may provide that the contravention of any of the bye-laws shall render the member concerned liable to one or more of the following punishments, namely:

27. Ibid., Section 9 (2) (j).  
28. Ibid., Section 9 (2) (k).  
29. Ibid., Section 9 (2) (l).  
30. Ibid., Section 9 (2) (m).  
31. Ibid., Section 9 (2) (n).  
32. Ibid., Section 9 (2) (q).  
33. Ibid., Section 9 (2) (r).  
34. Ibid., Section 9 (2) (t).  
35. The Securities Contract (Regulation) Act, 1956, Govt. of India Publications, Section 9 (2) (u).  
36. Ibid., Section 9 (2) (v).
i. Fine;
ii. Expulsion from membership for specified period; and
iii. Suspension from membership for specified period;
iv. Any other penalty of a like nature not involving the payment of money.  

The Central Government may, either on a request in writing from the governing body or on its own in consultation with the governing body, make bye-laws or amend any bye-laws made by a stock exchange.

Super session of the governing body; in case the Central Government was of the opinion that the governing body of a recognized stock exchange should be superseded, then it may serve a written notice to the governing body stating reasons and after giving an opportunity to the governing body to be heard in the matter. The Government, by notification in the official gazette, declares the governing body superseded and may appoint any person to exercise and perform the powers and duties of the governing body.

2.3.2 Power of the Central Government to suspend business of a stock exchange

If, in the opinion of the Central Government an emergency has arisen, it may, by notification, direct a recognized stock exchange to suspend such of its business for such a period not exceeding seven days and subject to such conditions as specified in the notification. Similarly in case, in the opinion of the Central Government, the interest of trade or the public interest so requires, the period can be extended by a like notification from time to time. Where the period of suspension was to be extended beyond the first period, an opportunity was to be given to the governing body of stock exchange to decide the issue.

37. Ibid., Section 9 (3).
38. Ibid., Section 10 (1).
39. Ibid, Section 11 (1).
40. Ibid., Section 20 (1).
Contracts in notified areas illegal;

In case Central Government was satisfied, having regard to the nature of the volume of transactions in securities in any state or area, may, by notification, declare to apply to such state or area, and thereupon, every contract between members of a recognized stock exchange in such state or area with such member shall be illegal. All contracts for sale or purchase of specified securities in any state or area which the Central Government has, shall be regarded as illegal by notification in the official Gazette, prohibited with a view to prevent undesirable speculations. All options in securities entered into after the commencement of the Act, i.e. after 20.2.1957, shall be illegal.41

Contracts in Notified Areas to be Void;

All contracts entered into in the notified area may be declared void by Central Government under section 13 of the Act, in contravention of any of the bye-laws of the stock exchange under section 9 (3) (a) of the Act. This will affect the rights of any member of the stock exchange who has entered into such contract in contravention of such bye-laws and also the rights of any other person who knowingly participated in the transaction entailing such contravention. However, the right of any person, other than a member of recognized stock exchange, to enforce any such contract as to recover any sum under or in respect of such contravention of any such bye-law, will not be affected. All options in securities, which have been entered into before the commencement of Act viz. before 20-2-1957, and which remain to be performed, whether wholly or in part, after such commencement, to the extent, become void. 42

Licensing of dealers in securities;

Any person dealing in securities in areas other than those notified under

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42. Ibid., Section 14 (2).
section 13 was required to obtain licence from the Central Government for dealing in securities, if so required by the Central Government, by notification. However, dealing in securities by or on behalf of member of any recognized stock exchange does not come within the purview of the restriction. 43

Even though the provisions relating to licensing do not normally apply to spot delivery contract, the Central Government may by notification in the official Gazette, make the provisions applicable in respect of spot delivery for sale and purchase of such securities. 44

Members may not act as principals;

A member of a recognized stock exchange was not permitted to enter into any contract in respect of any securities as a principal with any person other than a member of stock exchange unless he has secured the consent or authority of such person and discloses in note, memorandum or agreement of sale or purchase that he was acting as principal. In case such consent or authority has not been received by the member in writing, he shall secure written confirmation of such consent or authority within 3 days from the date of the contract. However, no such written consent or authority from such a person shall be necessary for closing out any outstanding contract entered into by such person in accordance with the bye-laws, if the member discloses in the note, memorandum of sale or purchase in respect of such closing out that he was acting as a principal. 45

Stock Exchange other than Recognized Stock Exchange Prohibited;

Any person shall not organize or assist in organizing or be a member of any stock exchange (other than recognized stock exchange) without permission the Central Government, for the purpose of assisting in, entering into or performing any contracts in securities. 46

43. Ibid., Section 20 (2)
44. Ibid., Section 17 (2)
45. The Securities Contract (Regulation) Act, 1956. Govt. of India Publications, Section 18 (2).
46. Ibid., Section 15.
Power to compel listing of securities by public companies;

In case the Central Government was of the opinion, having regard to the nature of the securities issued by any public companies, that it was necessary or expedient in the interest of trade or in public interest to get the security of any public limited company listed, on a recognized stock exchange, it may issue a notification to that effect. However, an opportunity of being heard was to be given to the concerned company before issuing the notification.  

Right to appeal against refusal by stock exchange to enlist securities of public companies;

In case a recognized stock exchange, acting in pursuance of any power given to it by bye-laws to enlist the securities of any public limited company, refuses to enlist the same or fails to dispose of an application within 15 days from the date on which the reason for such refusal are furnished to it, the company can make appeal to the Central Government against this refusal, failure or omission as the case may be.  

Offences by companies;

In case an offence has been committed by a company, every person who at the time when the offence was committed, was in charge of, and was responsible to the company, for the conduct of the business of the company, shall be deemed to be guilty of the offence, and shall be liable to be proceeded against and published.  

In case an offence under the Act was been committed with the consent or connivance of, or was attributable to any gross negligence on the part of, any director, manager, secretary or other officer of the company, shall also be

47. *Ibid*, Section 19 (i).
deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly. 50

Jurisdictions to Try Offences under this Act;

No court, inferior to that of a presidency magistrate or a magistrate of the first class shall take congruance of or try any offence punishable under this Act. 51

2.3.3 Power of Central Government to make rules

The Central Government was empowered to make the rules for the purpose of carrying into effect the objectives of this Act. 52

Such rules may provide for:

i. The manner in which application may be made, the particulars which they should contain and The procedure of paying the fees; 53

ii. The manner in which inquiry for the purpose of recognizing stock exchange may be made, the conditions which may be imposed for the grant of recognition including conditions as to the admission of members in the stock exchange and the form in which such recognition shall be granted; 54

iii. The contents of the periodical returns and annual reports to be furnished to the Central Government; 55

50. Ibid., Section 24 (1).
51. Ibid., Section 25 (2).
52. Ibid., Section 26.
54. Ibid., Section 30 (2) (a).
55. Ibid., Section 30 (2) (b).
iv. The documents which should be maintained and the period for which they should be preserved;  

v. The manner in which any inquiry by the governing body was to be made;  

vi. The manner in which the bye-laws to be made or amended under this Act shall, before being so made or amended, be published for criticism;  

vii. The requirements which shall be complied with by the public limited company for the purpose of getting its securities listed on any stock exchange. The rules any, made, shall be laid before both the Houses of Parliament, after their publication in the official gazette.

The Act not to apply;

The provision of the Act should not apply to the government, the Reserve Bank of India, any local authority or any corporation set up by a special law or any person who has effected any transaction with or through the agency of any such authority.

Maintenance of Books of Accounts by Stock Exchange;

Minute books of the meeting of members, governing body or any standing committee, register of members, details of name and address, register of authorized clerks, register of remisiers or authorized assistants, record of security deposits, margin deposit books, ledgers, journals, cash book and bank pass book shall be maintained and preserved for a period of five years.

56. Ibid., Section 30 (2) (c).  
57. Ibid., Section 30 (2) (d).  
58. Ibid., Section 30 (2) (e).  
59. Ibid., Section 30 (2) (f).  
60. Ibid., Section 30 (2) (h).  
61. The Securities Contract (Regulation) rules, 1956, Govt. of India Publications, Section 30 (3).
Maintenance of Books of Accounts by members;

Every member of a recognized stock exchange shall maintain and preserve register of transactions (SAUDA Books), clients’ ledger, General ledger, journals, cash book, bank pass book and documents register showing full particulars of shares and securities received and delivered for a period of five years. 62

Every members of a recognized stock exchange shall maintain and preserve:

i. Member’s contract book showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members;

ii. Counterfoils or duplicates of contracts notes issued to clients ; and

iii. Written consent of clients in respect of contracts entered into principals for a period of two years. 63

Every member shall get his accounts audited by a chartered accountant.

105 The audit of accounts of active members of the stock exchange may be made effective in respect of the financial year, of accounts of member concerned beginning after 31st March. Only one copy of the audited accounts is submitted to the stock exchange. The stock exchange should preserve the same for a period of six year.64

2.4 Securities Exchange Board of India

The Controller of Capital Issues (CCI) controls on issue of capital by the companies have been substituted by the transparent and simplified guidelines issued by the Securities Exchange Board of India under (SEBI), Act 1992. 65

62. Ibid., Section 28 (1) (a).
64. Ibid., rules 15 (a).
65. Notification No. 1/5/se/83 dt. 4.3.83 Stock Exchange Division of Finance Ministry
Functions of the Board

A. Subject to the provisions of this Act, it shall be duty of the Board to protect the interests of the investors in securities and to promote and development of, and to regulate the securities market by such measures as it thinks fit.

B. Without prejudice to the generality of the foregoing provisions, the measures referred to therein may provide for –
   a. Regulating the business in stock exchanges and any other securities markets;
   b. Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner.
   (ba) registering and regulating the working of the depositories, [participants,] custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf.
   c. Registering and regulating the working of [venture capital funds and collective investment schemes] including mutual funds;
   d. Promoting and regulating self-regulatory organisations;
   e. Prohibiting fraudulent and unfair trade practices relating to securities markets;
   f. Promoting investors’ education and training of intermediaries of securities markets;
   g. Prohibiting insider trading in securities;

h. Regulating substantial acquisition of shares and take-over of companies;

i. Calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, [mutual funds] and other persons associated with the securities market and intermediaries and self-regulatory organizations in the securities market;

j. Performing such functions and exercising such powers under the provisions of [...] Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;

k. Levying fees or other charges for carrying out the purpose of this section;

l. Conducting research for the above purposes;

m. Performing such other functions as may be prescribed.

C. Notwithstanding anything contained in any other law for the time being in force while exercising the powers under clause (i) of sub-section (2), the Board shall have the same powers as are vested in a civil court under the [Code of Civil Procedure, 1908 (5 of 1908)] while trying a suit, in respect of the following matters, namely:-

   i. The discovery and production of books of account and other documents, at such place and such time as may be specified by the Board;

   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 section 12, at any place  

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67. Ibid, Act 15, 1992 (c)
2.4.2 Matters to be disclosed by the companies

Without prejudice to the provisions of [the Companies Act, 1956, (1 of 1956)](#) the Board may, for the protection of investors, specify, by regulations,-

a. The matters relating to issue of capital, transfer of securities and other matters incidental thereto; and

b. The manner in which such matters, shall be disclosed by the companies.\(^{68}\)

2.4.3 Collective investment scheme

A. Any scheme or arrangement which satisfies the conditions referred to in sub-section (2) shall be a collective investment scheme.

B. Any scheme or arrangement made or offered by any company under which,—

i. The contributions or payments made by the investors, by whatever name called, are pooled and utilized solely for the purposes of the scheme or arrangement;

ii. The contributions or payments are made to such scheme or arrangement by the investors with a view to receive the profits, income, produce or property, whether movable or immovable from such scheme or arrangement;

iii. The property, the contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors;

iv. The investors do not have day to day control over the management and operation of the scheme or arrangement.

C. Notwithstanding anything contained in sub-section (2), any scheme or arrangement:\(^{69}\)

i. Made or offered by a co-operative society registered under the co-operative societies Act, 1912 or a society being a society

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\(^{68}\) Ibid., Act 15 of 1992, (11AA)

\(^{69}\) Ibid., Act 15 of 1992, (Collective investment scheme)
registered or deemed to be registered under any law relating to cooperative societies for the time being in force in any state;

ii. Under which deposits are accepted by non-banking financial companies as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934;

iii. Being a contract of issuance to which the Insurance Act, 1938, applies;

iv. Providing for any scheme, Pension Scheme or the Insurance Scheme framed under the Employees Provident Fund and Miscellaneous Provisions Act, 1952;

v. Under which deposits are accepted under section 58A of the Companies Act, 1956;

vi. Under which deposits are accepted by a company declared as a Nidhi or a mutual benefit society under section 620A of the Companies Act, 1956;

vii. Falling within the meaning of Chit business as defined in clause (d) of section 2 of the Chit Fund Act, 1982;

viii. Under which contributions made are in the nature of subscription to a mutual fund;

Shall not be a collective investment scheme

2.4.4 Power to issue directions

Save as otherwise provided in section 11, if after making or causing to be made an enquiry, the Board is satisfied that it is necessary:70

i. In the interest of investors, or orderly development of securities market; or

ii. To prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interests of investors or securities market; or

70. The Security Exchange Board of India, Act 15 of 1992, Power to Issue Direction Chapter iv
iii. To secure the proper management of any such intermediary or person, it may issue such directions,

a. To any person or class of persons referred to in section 12, or associated with the securities market; or

b. To any company in respect of matters specified in section 11A.
as may be appropriate in the interests of investors in securities and the securities market.

2.5 Guidelines for investor protection

An issue advertisement shall be truthful, fair and clear and shall not contain any statement which was untrue or misleading.71 Any advertisement reproducing or purporting to reproduce any information contained in an offer document shall reproduce such information in full and disclose all relevant facts and not be restricted to select extracts relating to that item.72 An issue advertisement shall be considered to be misleading, if it contains:

a) Statements made about the performance or activities of the company in the absence of necessary explanatory or qualifying statements, which may give an exaggerated picture of the performance or activities, than what it really was;
b) An inaccurate portrayal of past performance or its portrayal in a manner which implies that past gains or income will be repeated in the future;73
c) An advertisement shall be set forth in a clear, concise and understandable language; and
d) Extensive use of technical, legal terminology or complex language and the inclusion of excessive details which may distract the investor, shall be avoided.74 An issue advertisement shall not contain statements which

71. Security Exchange Board of India, Disclosure and Investor Protection Guidelines, Chapter – IX Para 9.1.1
72. Ibid., Para – 9.1.2
73. Ibid., Para – 9.1.3
74. Ibid., Para – 9.1.4
promise or guarantee rapid increase in profits.\textsuperscript{75} An issue advertisement shall not contain any information that was not contained in the offer document.\textsuperscript{76} No models, celebrities, fictional characters, landmarks or caricatures or the likes shall be displayed on or form part of the offer documents or issue advertisements.\textsuperscript{77} Issue advertisements shall not appear in the form of crawlers (the advertisements which run simultaneously with the programme in a narrow strip at the bottom of the television screen) on television.\textsuperscript{78}

No advertisement shall include any issue slogans or brand names for the issue except the normal commercial name of the company or commercial brand names of its products already in use.\textsuperscript{79} No slogans, expletives or non-factual and unsubstantiated titles shall appear in the issue advertisements or offer documents.\textsuperscript{80} If any advertisement carries any financial data, it shall also contain data for the past three years and shall include particulars relating to sales, gross profit, net profit, share capital, reserves, earnings per share, dividends and the book values.\textsuperscript{81}

a) All issue advertisements in newspapers, magazines, brochures and pamphlets containing highlights relating to any issue shall also contain risk factors giving equal importance the following aspects including the print size;

b) The print size of highlights and risk factors in issue advertisements shall not be Less than point(7) size; and

c) It shall contain the names of Issuer company, address of its Registered Office, names of the main Lead Merchant Bankers and Registrars to the Issue.\textsuperscript{82}

\textsuperscript{75} Ibid., Para - 9.1.5
\textsuperscript{76} Ibid., Para - 9.1.6
\textsuperscript{77} Security Exchange Board of India, Disclosure and Investor Protection Guidelines, Chapter – IX Para 9.1.7
\textsuperscript{78} Ibid., Para - 9.1.8
\textsuperscript{79} Ibid., Para - 9.1.9
\textsuperscript{80} Ibid., Para - 9.1.10
\textsuperscript{81} Ibid., Para - 9.1.11
\textsuperscript{82} Ibid., Para - 9.1.12
d) No issue advertisement shall be released without giving "Risk Factors" in respect of the concerned issue.\textsuperscript{83} No corporate advertisement of issuer company shall be issued after 21 days of the filing of the offer document with the Board till the closure of the issue unless the risk factors, were required to be mentioned in the offer document, were mentioned in such advertisement.\textsuperscript{84}

Roll over of Non Convertible Portions of Partly Convertible Debentures (PCDs)/ Non Convertible Debentures (NCDs), by company not being in default:
The non-convertible portions of PCDs or the NCDs issued by a listed company, the value of which exceeds Rs.50 lakh, can be rolled over without change in the interest rate subject to section 121 of the Companies Act, 1956 and subject to the following conditions, if the company was not in default:-

a) A resolution to this effect was passed by postal ballot, having the assent from not less than 75% of the debenture-holders;

b) The company shall redeem the debentures of the entire dissenting debenture holders, who have not assented to the resolution;

c) Before roll over of any NCDs or non-convertible portion of the PCDs, at least two credit ratings of not less than investment grade, shall be obtained within a period of six months prior to the due date of redemption and communicated to debenture holders before roll over;

d) Fresh trust deed shall be executed at the time of such roll over; and

e) Fresh security shall be created in respect of such debentures to be rolled over. Provided that if the existing trust deed or the security documents make a provision for continuance of the security till redemption of debentures, fresh trust deed or fresh security need not be created.\textsuperscript{85}

\textsuperscript{83} Ibid., Para – 9.1.13
\textsuperscript{84} Security Exchange Board of India, Disclosure and Investor Protection Guidelines, Chapter – IX Para 9.1.14
\textsuperscript{85} Security Exchange Board of India, Disclosure and Investor Protection Guidelines, Debt Instruments, Chapter – X
Roll over of Non Convertible portions of Partly Convertible Debentures (PCDs)/ Non Convertible Debentures (NCDs), by the company being in default; The non-convertible portions of PCDs and the NCDs issued by a listed company, the value of which exceeds Rs.50 lakh, can be rolled over without change in the interest rate subject to section 121 of the Companies Act, 1956 and subject to the following conditions, where the company is in default:

a) A resolution to this effect is passed by postal ballot, having the assent from not less than 75% of the debenture-holders;

b) The company shall send an Auditors’ certificate on the cash flow of the company with comments on the liquidity position of the company to all debenture holders, along with the notice for passing the said resolution;

c) The company shall redeem the debentures of the entire dissenting debenture holders, who have not assented to the resolution; and

d) The debenture trustee shall decide on whether the company was required to create fresh security and execute fresh trust deed in respect of such debentures to be rolled over Provided that if the existing trust deed or the security documents provide for continuance of the security till redemption of debentures, fresh security and fresh trust deed need not be created.\[86\]

In case of conversion of instruments (PCDs/FCDs, etc.) into equity capital:-

i. In case, the convertible portion of any instrument such as PCDs, FCDs etc. issued by a listed company, value of which exceeds Rs.50 Lakh and whose conversion price was not fixed at the time of issue, holders of such instruments shall be given a compulsory option of not converting into equity capital;

ii. Conversion shall be done only in cases where instrument holders have sent their positive consent and not on the basis of the non-receipt of their negative reply;

\[86\] Security Exchange Board of India, Disclosure and Investor Protection Guidelines, Debt Instruments, Chapter –X, Para – 10.7.1.1A
Provided that where issues were made and cap price with justification thereon, was fixed beforehand in respect of any instruments by the issuer and disclosed to the investors before issue, it will not be necessary to give option to the instrument holder for converting the instruments into equity capital within the cap price;

iii. In cases where an option was to be given to such instrument holders and if any instrument holder does not exercise the option to convert the debentures into equity at a price determined in the general meeting of the shareholders, the company shall redeem that part of debenture at a price which shall not be less than its face value, within one month from the last date by which option is to be exercised; and

iv. The provision of sub-clause above shall not apply if such redemption was to be made in accordance with the terms of the issue originally stated.\(^87\)

Additional Disclosures in respect of debentures;
The offer document shall contain:

a) Premium amount on conversion, time of conversion;
b) In case of PCDs/NCDs, redemption amount, period of maturity, yield on redemption of the PCDs/NCDs;
c) Full information relating to the terms of offer or purchase including the name(s) of the party offering to purchase the khokhas (non-convertible portion of PCDs);
d) The discount at which such offer was made and the effective price for the investor as a result of such discount;
e) The existing and future equity and long term debt ratio;

\(^87\). Security Exchange Board of India, \textit{Disclosure and Investor Protection Guidelines. Debt Instruments, Chapter -X, Para – 10.7.1.2}
f) Servicing behaviour on existing debentures, payment of due interest on due
dates on term loans and debentures; and
g) That the certificate from a financial institution or bankers about their no
objection for a second or pari passu charge being created in favour of the
trustees to the proposed debenture issues has been obtained.88

2.5.1 Guidelines for preferential issues

The preferential issue of equity shares/ Fully Convertible Debentures
(FCDs) Partly Convertible Debentures (PCDs) or any other financial instruments
which would be converted into or exchanged with equity shares at a later date,
by listed companies whose equity share capital was listed on any stock
exchange, to any select group of persons under section 81(1A) of the Companies
Act 1956 on private placement basis shall be governed by these guidelines.89

Such preferential issues by listed companies by way of equity shares/
Fully convertible Debentures (FCDs) / Partly Convertible Debentures (PCDs) or
any other financial instruments which would be converted into / exchanged with
equity shares at a later date, shall be made in accordance with the pricing
provisions mentioned below.90

2.5.2 Pricing of the issue

The issue of shares on a preferential basis can be made at a price not
less than the higher of the following:
i. The average of the weekly high and low of the closing prices of the related
   shares quoted on the stock exchange during the six months preceding the
   relevant date;
   Or

   ii. The average of the weekly high and low of the closing prices of the related
   shares quoted on a stock exchange during the two weeks preceding the
   relevant date.91

89. Ibid., Para – 10.7.1.2
90. Ibid., Para – 13.1
2.5.3 Pricing of shares on conversion

Where PCDs/FCDs/other convertible instruments, were issued on a preferential basis, providing for the issuer to allot shares at a future date, the issuer shall determine the price at which the shares could be allotted in the same manner as specified for pricing of shares allotted in lieu of warrants. The explanatory statement to the notice for the general meeting in terms of section 173 of the Companies Act, 1956 shall contain –

i. The object/s of the issue through preferential offer;
ii. Intention of promoters/ directors/ key management persons to subscribe to the offer;
iii. Shareholding pattern before and after the offer;
iv. Proposed time within which the allotment shall be complete; and
v. The identity of the proposed allottees and the percentage of post preferential issue capital that may be held by them.

(13.1A A listed company shall not make any preferential issue of equity shares, Fully Convertible Debentures, Partly Convertible Debentures or any other instrument which may be converted into or exchanged with equity shares at a later date if the same was not in compliance with the conditions for Continuous listing.)

2.5.4 Currency of financial instruments

In case of Warrants/PCDs/FCDs/or any other financial instruments with a provision for the allotment of equity shares at a future date, either through conversion or otherwise, the currency of the instruments shall not exceed beyond 18 months from the date of issue of the relevant instrument.

92 Ibid., Para – 13.1.1
2.5.4.1 Non-transferability of financial instruments

a) The instruments allotted on a preferential basis to the promoter / promoter group as defined in Chapter VI in Clause [6.4.2 (m)] of these guidelines, shall be subject to lock-in of 3 years from the date of their allotment;

b) In any case, not more than 20 percent of the total capital of the company, including capital brought in by way of preferential issue, shall be subject to lock-in of three years from the date of allotment;

c) In addition to the requirements for lock in of instruments allotted on preferential basis to promoters/promoter group as per clause 13.3.1 (a) and (b), the instruments allotted on preferential basis to any person including promoters/promoters group shall be locked-in for a period of one year from the date of their allotment except for such allotments on preferential basis which involve swap of equity shares/securities convertible into equity shares at a later date, for acquisition; and

d) The lock-in on shares acquired by conversion of the convertible instrument/exercise of warrants, shall be reduced to the extent the convertible instrument warrants have already been locked-in. 94

2.5.5 Currency of shareholders resolutions

Allotment pursuant to any resolution passed at a meeting of shareholders of a (company) granting consent for preferential issues of any financial instrument, shall be completed within a period of three months from the date of passing of the resolution. The equity shares and securities convertible into equity shares at a later date, allotted in terms of the above said resolution shall be made fully paid up at the time of their allotment. 95

Other Requirements

a) In case of every issue of shares/warrants/FCDs/PCDs/ or other financial instruments having conversion option, the statutory auditors of the issuer (company) shall certify that the issue of said instruments is being made in accordance with the requirements contained in these guidelines ;

94. Ibid., Para – 13.2.1
95. Ibid., Para – 13.3.1
b) Copies of the auditors' certificate shall also be laid before the meeting of the shareholders convened to consider the proposed issue; and

c) In case of preferential allotment of shares to promoters, their relatives, associates, and related entities, for consideration other than cash, valuation of the assets in consideration for which the shares are proposed to be issued shall be done by an independent qualified valuer and the valuation report shall be submitted to the exchanges on which shares of the issuer company are listed. Explanation – For the purpose of this clause the word valuer shall have the same meaning as assigned to the term under clause (r) of sub-regulation (1) of Regulation 2 of the SEBI (Issue of Sweat Equity) Regulations, 2002)

(13.5A The details of all monies utilized out of the preferential issue proceeds shall be disclosed under an appropriate head in the balance sheet of the company indicating the purpose for which such monies have been utilised. The details of unutilized monies shall also be disclosed under a separate head in the balance sheet of the company indicating the form in which such unutilised monies have been invested.96

2.6 Rights/Responsibilities of investors in securities market and risk in securities investment

The risks that investors encounter while investing in the Securities Market; An investors expectations of income and/or growth may not materialize. Realization of values of the investment of an equity holder was in the share market only. Thus this investment may not be easily liquid. Disinvestment may result in capital losses also. An investor may run into problems while trading in or transferring securities.

2.6.1 The rights of a shareholder

A shareholder has a right to receive the share certificates, on allotment or transfer (if opted for transaction in physical mode) as the case may be, in due

96. Ibid, Para – 13.4.1
time; to receive copies of the Annual Report containing the Balance Sheet, the Profit & Loss account and the Auditor’s Report; to participate and vote in general meetings either personally or through proxy; to receive dividends in due time once approved in general meetings; to receive corporate benefits like rights, bonus etc. once approved; to apply to Company Law Board (CLB) to call or direct the Annual General Meeting; to inspect the minute books of the general meetings and to receive copies thereof; to proceed against the company by way of civil or criminal proceedings, if need be. To apply for the winding up of the company (as provided in the law); and to receive the residual proceeds, in case if a company was wound up. Besides the above rights, which the shareholders enjoys as an individual shareholder, he also enjoy the following rights as a group. To requisition an Extra-ordinary General meeting; to demand a poll on any resolution. To apply to CLB to investigate the affairs of the company; and to apply to CLB for relief in cases of oppression and/or mismanagement.2.6.2 The rights of a debenture holder

A debenture holder has the right to receive interest/redemption in due time; to receive a copy of the trust deed on request. To apply for winding up of the company if the company fails to pay its debt and to approach the Debenture Trustee with your grievance, if any. It may be note that the above mentioned rights may not necessarily be absolute. For example, the right to transfer securities (in physical form) is subject to the company’s right to refuse transfer as per statutory provisions.

2.6.3 The responsibilities of a share/debenture holder

While the investors may be happy to note that he has so many rights as a stakeholder in the company that should not lead to complacency; because you have also certain responsibilities to discharge like the responsibilities, to be specific, to remain informed, to be vigilant, to participate and vote in general meetings and to exercise his rights on his own or as a group

97. Security Exchange Board of India, Disclosure and Investor Protection Guidelines, Pricing of Shares and Conversion, Chapter – XIII, Para – 13.5.1
2.6.4 The advantages investor gets if deal through a recognized Stock Exchange

If the investor chooses to deal (buy or sell) directly with another person, he is exposed to counter party risk, i.e. the risk of non-performance by that party. However, if he deals through a stock exchange,

2.6.5 Investors action in case of company objection

When investors receive a company objection for transfer, they should proceed to get corrected the errors/discrepancies mentioned by the company. Investors may have to contact the transferor (the seller) either directly or through their broker for rectification or replacement with good securities. Then investor can resubmit the securities and the transfer deed to the company for affecting the transfer. In case investors are unable to get the errors rectified or get them replaced, they have recourse to the seller and his broker through the stock exchange to get back their money. However, if investor had transacted directly with the seller originally, he has to settle the matter with the seller directly.

2.6.6 Investors action in case if securities get lost or misplaced

If investor's securities are lost or misplaced, he should immediately request the company to record a 'stop transfer' of the securities and he should simultaneously apply for issue of duplicate securities. For effecting stop transfer, the company may require him to produce a court order or the copy of the FIR filed by him with the Police. Further, to issue duplicate securities to the investors, the company may require him to submit indemnity bonds, affidavit, sureties etc. besides issue of a public notice. He has to comply with these requirements in order to protect his own interest.

2.6.7 Investors action in case if securities gets lost or misplaced in transit

Sometimes, it may so happen that the securities in physical form were lost in transit either from the investor to the company or from the company to the investors. He has to be on his guard to write to the company within a month of his sending the securities to the company. The moment it comes to his notice
that either the company has not received the securities that he sent or he did not receive the securities that the company claims to have sent to him, he should immediately request the company to record stop transfer and proceed to apply for duplicate securities. 

Summary

Huge requirement of capital for business ventures could only be met by the participation of a very large number of individuals, their number running in to millions. So, there is a need to control and regulate the investment market for proper functioning of the stock market and to protect the interest of the investors. SEBI was constituted by the government in April 1988 and given legal status in 1992 as a supervisory body to regulate and promote the securities in order to promote fair dealings, to provide degree of protection to investors, to regulate and develop a code of conduct and fair practices by intermediaries in the capital market. The investor may be happy to note that he has many rights as a stockholder of the company. That should not lead to complacency, because he has certain responsibilities to discharge like the responsibility to be specific, to remain informed, to be vigilant, to participate and vote in general meeting and to exercise his rights on his own or as a group.

98 www.sebi.gov.in