CHAPTER-IV

SEBI GUIDELINES FOR MERCHANT BANKERS IN INDIA
4.1 Introduction

The preceding chapter deals with the several functions of merchant bankers in India. In this chapter, an attempt has been made to discuss the historical perspective of Securities and Exchange Board of India (SEBI) regulations, the powers and functions of SEBI in relation to capital issue management. It is also intended to explain the organizations of SEBI and SEBI guidelines on merchant banking activities. Responsibilities of merchant bankers and procedure for inspection by SEBI and steps to be taken in case of default by merchant bankers as per the rules of the relevant period are highlighted here.

4.2 Historical Perspective of SEBI regulations

The Indian security market, which has a long history spanning over a century, was largely unregulated before independence. In 1947, the Capital Issues (Control) Act was formed and it played an important and leading role in the functioning of the Indian capital market. This Act was administered by the office of the Controller of Capital Issues (CCI) under the Ministry of Finance, Department of Company Affairs, Central Government of India. Up to 1992, the companies had to obtain prior permission from the CCI to issue shares to the public beyond Rs. 1 crore or any amount at a premium. The CCI used to fix premium for existing companies to tap the capital market or to allow new companies to issues shares at par. The main purpose of control on capital issues was to prevent the diversion of investible resources to non-essential projects, capital reorganization and the capital structure of companies with a view to discouraging issue of shares with disproportionate voting rights and encouraging the adaptation of sound methods and techniques in company flotation.

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In 1956, the Securities Contract (Regulation) Act, 1956 (SCRA) was enacted to regulate the workings of stock exchanges and also the secondary market as well. The intention was not only to prevent undesirable transactions or speculative trading in securities, but also to build up a healthy and strong investment market for establishing investor confidence. In India, companies are incorporated and regulated by the Companies Act, 1956, which is administered by the Department of Company Affairs in the Ministry of Law, justice and Company Affairs of the Central Government. Both the financial and non-financial performance of the corporate sector are governed by this Act. It makes an integrated relationship between promoters, investors and company management and also specifies the form and contents of the prospectus as is required for the issues of corporate securities.

For three decades after independence the capital market was not accessed effectively by many companies and the quantum of funds mobilized through the capital market was meagre. In early 1980's a large number of corporate entities raised a huge amount of capital, especially through debt instruments from the capital market. The year 1991 witnessed a radical change in the Indian economic scenario as there was a fillip to liberalization and reforms in the Indian financial sector by the Government. For some time thereafter, the volume of business in the primary and secondary securities markets have increased significantly. However, there was a major halt when the multi-crore securities scam rocked the Indian financial system in 1992. The investors' confidence in the capital market was totally shattered and this forced the authorities to rethink the overall situation and the need of an independent regulatory body was seriously felt. Moreover, the Government guidelines and the protective provisions in the legal framework regulating the capital market were not adequately strict enough to safeguard the interest of the investors. It was also realized

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that the then regulatory framework was fragmented, ill co-coordinated and inadequate and that there was a need for an autonomous, statutory, integrated organization to ensure the smooth functioning of the Indian financial sector and thus to have an effective and efficient watchdog on their functioning\(^4\). The Government, as a consequence, was bogged down with numerous complaints from different corners about the malpractices adopted by the issuer companies, merchant bankers, brokers, investment consultants and others associated with capital issue management. The glaring examples of these malpractices in the primary market were: (i) too many self styled investment advisers and consultants, (ii) grey market or unofficial premiums on new issues, (iii) manipulation of market prices before new issues are floated, (iv) delay in sending allotment letters or refund orders or dispatching of share certificates, (v) delay in listing and commencement of trading in shares, etc\(^5\). Issues involved in the secondary markets were: (i) lack of transparency in the trading operations and prices charged to clients, (ii) poor services due to delay in passing contract notes or not passing contract notes at all, (iii) delay in making refunds to clients or in delivery of shares, (iv) insider trading by agents of companies or brokers, rigging and manipulating prices, etc\(^6\).

The Government had no other alternatives but to take stringent actions against such malpractices and with a view to bringing all round reforms in the capital market. Moreover, a high power Committee under the Chairmanship of G.S.Patel, former chairman of Unit Trust of India (UTI) was appointed to intensely go after the situation. It was one of the recommendations of the above Committee to constitute Securities and Exchange Board of India (SEBI) to regulate the business relating to securities market\(^7\).

\(^6\) Ibid.p.54.
The SEBI was established on 12th April, 1988 through an administrative order, but it became a statutory organization only since 1992. The Capital Issues (Control) Act, 1947 was repealed and office of the Controller of Capital Issues (CCI) was abolished in 1992 and SEBI was set up as a statutory body on 21st February, 1992 through an ordinance issued on 30th January, 1992. The ordinance was replaced by the SEBI Act on 4th April, 1992 and certain powers under certain sections of the Companies Act, 1956 and also the Securities Contracts (Regulation) Act, 1956 have been delegated to the SEBI. The guidelines issued by SEBI allow free pricing of a new issue and gives unrestricted freedom to the existing listed companies to announce rights issue of shares. Since its formation, SEBI, a vigilant watchdog, has been instrumental in bringing greater transparency in the capital issue management of corporate securities. In this respect, companies issuing shares are free to fix the premium provided requisite and adequate disclosures are made in the offer documents. In other words, with the abolition of the Capital Issues (Control) Act, 1947, companies are now free to enter into the capital markets for raising funds subject to adherence to the procedures framed in the guidelines issued by SEBI on 11th June, 1992 on free pricing and investors' protection.

4.3 Objectives of SEBI

The overall objective of the SEBI as enshrined in the preamble of the SEBI Act, 1992 is “to protect the interest of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto”. To elaborate, the SEBI regulates stock exchanges and securities industry to promote their orderly functioning. It protects the rights and interests of investors, particularly individual investors, and guides / educates them. It prevents trading malpractices and aims at achieving a balance between self-regulation by securities industry and its statutory regulation.

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Having regard to the emerging nature of the securities markets in India, the SEBI necessarily has the twin task of regulation and development. Its regulatory measures are always meant to be subservient to the needs of the market development. Thus underlying these measures refers to the logic and the rapid and healthy market development is the outcome of well-regulated structures. In this spirit, the SEBI endeavors to create an effective surveillance mechanism and encourage responsible and accountable autonomy on the part of all players in the market, who are expected and required to discipline themselves and observe the rules of the market. The self-regulation and regulation by exception are thus the cornerstones of its regulatory framework. The SEBI believes that self-regulation can work only if there is an effective regulatory body overseeing the activities of self-regulatory organizations.

The SEBI also aims at facilitating an efficient mobilization and allocation of resources through the securities market, stimulating competition, and encouraging innovations. Its regulation is expected to be flexible, cost-effective and confidence-inspiring. To investors, the SEBI provides a high degree of protection of their rights and interest through adequate, accurate and authentic information and disclosures of such information on a continuous basis. To issuers, it provides a market place in which they can confidently look forward to raise all the finance in an easy, efficient and fair manner. To the market intermediaries, it offers a competitive, professionalized and expanding market with adequate and efficient infrastructure so that they can render better and more responsible service to the investors and issuers.

4.4 Powers and functions of SEBI

According to section 11(1) of the SEBI Act, 1992, SEBI is empowered to:

(i) regulate the business in stock exchanges and in any other securities market,

(ii) register and regulate 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,

(iii) register and regulate the workings of collective investment schemes, including mutual funds,

(iv) promote and regulate self-regulatory organizations,

(v) prohibit fraudulent and unfair trade practices in securities market,

(vi) educate investor and train intermediaries in securities market,

(vii) prohibit insider trading in securities,

(viii) regulate substantial acquisition of shares and takeovers of companies,

(ix) call for information, to undertake inspection, to conduct enquiries and audits of stock exchanges, intermediaries and other self-regulatory organizations in securities market,

(x) perform such functions and exercise such powers under the provision of the Capital Issues (Control) Act, 1947, (subsequently repealed) and the Securities Contracts (Regulations) Act, 1956, which have now been delegated to SEBI by the Central Government,

(xi) levy fees or other charges for carrying out the purposes levied under section 11 of the Act,

(xii) conduct research in support of above purposes,

(xiii) perform such other functions as may be prescribed by the Government from time to time.

4.5 Organizations of SEBI

The head office of SEBI is situated at Mumbai and it has three regional offices, located at New Delhi, Kolkata and Chennai. It has two non-statutory advisory committees namely, the Primary Market Advisory
Committee and Secondary Market Advisory Committee. These Committees are set up from amongst market players, recognized investor associations, and other eminent persons associated with capital markets for providing advisory inputs in framing policies and regulations. SEBI is a permanent member of International Organization of Securities Commissions (IOSCO), a body comprised of security regulators from over 100 countries. The overall activities of SEBI are controlled by five departments and each one of them is headed by an executive director who is authorized to report to the Chairman. The other departments include legal department and the investigation department which are divided into different divisions10. The scope of activities of various departments of SEBI can be highlighted in the following lines:

(i) **Primary Market Policy, Intermediaries, Self-Regulatory Organizations (SROs), and Investor Grievance and Guidance Department**

It looks after the overall policy matters and regulatory issues in respect of primary market, registration, merchant bankers, portfolio management services, investment advisors, debenture trustees, underwriters, self-regulatory organizations (SRO) and investor grievance, guidance, education, and association.

(ii) **Issue Management and Intermediaries Department**

It is responsible for vetting of all prospectuses and letters of offer for public and rights issues, for coordinating with the primary market policy, for registration, regulation and monitoring of issues related intermediaries.

(iii) **The Secondary Market Policy, Operations and Exchange Administration, New Investment Products and Insider Trading Department**

It is responsible for all policy and regulatory issues for secondary market and new investment products, registration and monitoring of members of stock exchanges, administration of some of the stock exchanges, market

surveillance, monitoring of price movements and insider trading, and EDP and SEBI’s data base.

(iv) **Secondary Market Exchange Administration and Inspection Department and Non-member Intermediaries Department**

It looks after the smaller stock exchanges of Guwahati, Magadh, Indore, Mangalore, Hyderabad, Bhubaneshwar, Ludhiana and Cochin. It is also responsible for inspection of all stock exchanges, and registration, regulation and monitoring of non-member intermediaries like sub-brokers.

(v) **Institutional Investment (Mutual Funds and Foreign Institutional Investment), Mergers and Acquisitions, Research and Publications, and International Relations and IOSCO Department**

It looks after policy matters, registration, regulation and monitoring of Foreign Institutional Investors (FIIs) and domestic mutual funds, mergers and substantial acquisitions of shares, and International Organization of Securities Commissions (IOSCO) membership, international relations, research and publication and Annual Report of SEBI.

(vi) **Legal Department**

It looks after all legal matters under the supervision of the General Counsel.

(vii) **Investigation Department**

It carries out inspection and investigation under the supervision of the chief of Investigation.

### 4.6 Compendium of Circulars to Merchant Bankers

In terms of the Ministry of Finance, Government of India guidelines dated April 6, 1990, SEBI had authorized certain merchant bankers and issued from time to time operational guidelines to them, governing issue management and other activities. With the passing of the Securities and Exchange Board of India Act, 1992 and notification of the Merchant Bankers Rules and Regulations, such of the authorized merchant bankers as also others who desire to carry on merchant banking
activities are required to register themselves with SEBI under section 12 of the Act.

As regards the general instructions so far issued by SEBI to authorized Merchant Bankers, they have been consolidated and codified in this GI Series (Covering general instructions issued by SEBI from time to time) circular which commences a new series and accordingly bears the number RMB (GI Series) Circular No. 1 (92-93). All Registered Merchant Bankers should ensure compliance with the instructions contained in this circular.\(^\text{11}\)

### 4.6.1 Registration

1. The registration granted pursuant to Chapter II of the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992, (hereinafter referred to as the “Regulations”) will be for the principal as well as for all the branch offices in India of the Merchant Bankers.

2. The certificate of registration will contain registration code No. granted to the Merchant Banker. This code number should be quoted in all the correspondence with SEBI, Government authorities, Stock Exchanges and its clients.

### 4.6.2 Pre-Issue Obligations

1. **Memorandum of Understanding**

   In terms of Regulations 18(2), before taking up any issue management, every merchant banker (lead manager) must invariably enter into a Memorandum of Understanding (MOU) with the company making the issue (issuer) clearly setting out their mutual rights, liabilities and obligations relating to the issue. While considering the rights, and obligations, it must be ensured that neither party should reserve for themselves any rights, which would have the effect of diminishing in any way their liabilities and obligations under the Companies Act, 1956 and SEBI (Merchant Bankers) Rules and Regulations, 1992.

2. Inter-se allocation of responsibilities
Where an issue is managed by more than one lead manager, the responsibility of each lead manager shall be clearly delineated, preferably as indicated in Annexure “B”.

3. Submission of draft offer documents
3.1 The Lead Manager responsible for drafting of the offer documents shall ensure that—
(i) the terms of the issue and the offer documents, namely, prospectus or letter of offer are in conformity with the Guidelines for Disclosure and Investor Protection and other statutory requirements;
(ii) the Due Diligence Certificate as specified in Regulation 23 as per Form C (Annexure “C”) accompanies each draft offer document submitted to SEBI for vetting;
(iii) the format of prospectus conforms to the format prescribed by the Department of Company Affairs, Ministry of Law, Justice and Company Affairs, vide GSR 614 (E), dated October 3, 1991;
(iv) the format of letter of offer conforms to disclosures prescribed in the Memorandum in Form 2A under section 56(3) of the Companies Act, 1956.

3.2 Every draft offer document submitted to SEBI shall be accompanied by the undertakings/ certificates.

3.3 Making the Draft Prospectus public
(1) The lead manager while submitting the Draft Prospectus to SEBI for vetting shall also hand over not less than 25 copies of the draft to SEBI and also to the Stock Exchange(s) where the issue is proposed to be listed.
(2) SEBI will issue Press Releases on weekly basis listing out the Draft Prospectus submitted to it for vetting.
(3) The lead manager and the Stock Exchange(s) may charge such reasonable change as they deem fit for providing a copy of the Draft Prospectus.
(4). After a period of 21 days from the date the draft prospectus is made available to public.

4. Disclosures
Lead manager should ensure proper disclosures to the investors, keeping in mind their increased responsibility consequent upon the notification of the Merchant Bankers Rules and Regulations. The lead manager should, therefore, not only furnish adequate disclosures but also ensure due compliance with the Guidelines for Disclosure and Investor Protection issued by SEBI, both in letter and in spirit.

5. Application form
On Guidelines for Disclosure and Investor Protection, it has been stated that the application form should contain necessary instructions/provisions for the following:

a) Instructions to applicants to mention the number of application form on the reverse of the instruments to avoid misuse of instruments submitted along with the applications for shares/debentures in public issues.

b) Provision in the application form for inserting particulars relating to savings bank/current account number and the name of the bank with whom such account is held, to enable the Registrars to print the said details in the refund orders after the names of the payees.

c) Suitable instructions to investors in this behalf in the application form under the head “how to apply” should be incorporated.

In order to bring the salient features of the prospectus to the attention of every applicant, the lead manager shall ensure the following:

a) Every application form distributed by the company or any one else is accompanied by a copy of the memorandum in the manner prescribed in Form 2A under section 56(3) of the Companies Act, 1956.

b) The application form may be stapled to form part of the Memorandum; alternatively, it may be perforated part of the Memorandum.
c) The Memorandum in Form 2A does not contain matters which are extraneous to the contents of the prospectus.

d) The Memorandum in Form 2A shall be printed at least in point 7 size with proper spacing.

e) The Disclaimer Clause in Form 2A shall be printed prominently, immediately after "Issue Details".

f) The Risk Factors in Form 2A shall be printed along with Issue Highlights just preceding the para on "Capital Structure", with equal treatment in printing in all respects.

g) In the application form meant for Indian Public, the declaration relating to Nationality and Residentship shall be amended and shown prominently.

4.6.3 Underwriting

1. In respect of every issue under his management, the lead manager shall accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lacs whichever is less.

2. The outstanding underwriting commitment of a merchant banker shall not exceed 5 times his networth at any point of time.

3. The lead manager shall ensure that the issue to the public is fully underwritten and details of underwriters included in the prospectus. He shall also satisfy himself about the worth of the underwriters to fulfil their respective underwriting commitments.

4. The lead manager shall satisfy himself that the issue is fully subscribed before announcing closure of the issue. In case, there is no definite information about subscription figures, the issue should be kept open for the required number of days to take care of the underwriters' interests and to avoid any dispute, at a later date, by the underwriters over their liability.

5. In case there is a development on underwriters, the lead manager shall ensure that the underwriters give a letter of acceptance for the amount of devolvement within 60 days from the date of closure of the issue and pay the amount of devolvement within 90 days from the date of
closure of the issue. Any dispute relating to acceptance of underwriting commitment shall immediately be brought to the notice of SEBI.

4.6.4 Post-Issue Obligations

1. Within 7 days from the date of closure of the issue, lead manager shall confirm to us that the issue is subscribed to the extent of at least 90%.

2. The lead manager shall ensure that the 45 days Compliance Report (Annexure “J”) is submitted to SEBI before the close of the next working day, without fail.

3. Lead manager responsible for post-issue activities shall maintain close co-ordination with the registrars to the Issue, and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue to monitor the flow of application from collecting bank branches, processing of the applications including those accompanied by stockinvest and other matters till the basis of allotment is finalized, dispatch completed and listing done. Any act of omission or commission on the part of any such intermediaries noticed during such visits should be duly reported to SEBI.

4.6.5 Activities that merchant bankers can undertake

With effect from 1st July, 1998, a merchant banker shall undertake only those activities which are relating to securities market and which do not require registration have been granted exemption from registration as an NBFC from RBI. In particular, a merchant banker may undertake the following activities:

a) Managing of public issue of securities;

b) Underwriting connected with the aforesaid public issue management business;

c) Managing / advising on international offerings of debt / equity, i.e., GDR, ADR, bonds and other instruments;

d) Private placement of securities;

e) Primary or satellite dealership of government securities;
f) Corporate advisory services related to securities market, e.g.,
takeovers, acquisition, disinvestment;
g) Stock-broking;
h) Advisory services for projects;
i) Syndication of rupee term loans;
j) International financial advisory services.

Registered Category-I merchant bankers who were permitted under the
SEBI (Merchant Bankers) Regulations, 1992 to carry on underwriting
and portfolio management activities may continue to carry on these
activities till the expiry of their existing certificate of registration.
Similarly Categories-II, III, IV merchant bankers may continue to carry
on the activities which the certificate of registration authorized them to
do, till the validity of the existing registration.

4.6.6 Reporting requirements in respect of merchant banking
dates

In terms of regulation 28 of SEBI (Merchant Bankers) Regulations, 1992,
the merchant bankers are advised to send half yearly report in the
enclosed format relating to their merchant banking activities. The report
is to be submitted twice a year, as on March 31 and September 30 and it
should reach the authority within three months from the close of the
period to which it relates. The first report will pertain to the six months
period ending March 31, 1995. Failure to submit the report within
stipulated time will be viewed seriously.

4.7 Securities and Exchange Board of India (Merchant Bankers)
Rules, 1992

In exercise of the powers conferred by Section 29 of the Securities and
Exchange Board of India Act, 1992 (15 of 1992), the Central Government
hereby makes the following rules, namely:—

1. Short title and commencement

(i) These regulations may be called the Securities and Exchange
Board of India (Merchant Bankers) Rules, 1992.

2. **Definitions**

Merchant bankers means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory services in relation to such issue management.

3. **No person to act as merchant banker without registration**

No person shall carry on any activity as a merchant banker unless he holds a certificate granted by the Board under the regulations:

Provided that such person, who was engaged as merchant banker prior to the coming into force of the Act, may continue to carry on activity as merchant banker if he has made an application for such registration till the disposal of such application.

4. **Conditions of grant or renewal of certificate to merchant banker**

The Board may grant or renew a certificate to a merchant banker subject to the following conditions, namely:

(a) the merchant banker, in case of any change in its status and constitution, shall obtain the prior permission of the Board to carry on its activities as a merchant banker;

(b) he shall pay the amount of fees for registration or renewal, as the case may be, in the manner provided in the regulations;

(c) he shall take adequate steps for redressal of grievances of the investors within one month of the date of the receipt of the complaint and keep the Board informed about the number, nature and other particulars of the complaints received;

(d) he shall abide by the rules and regulations made under the Act in respect of the activities carried on by the merchant banker.
5. **Period of validity of the certificate**

The certificate of registration or its renewal, as the case may be, issued under rule 4 shall be valid for a period of three years from the date of its issue to the applicant.

4.8 **Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992**

According to section 30 of the SEBI Act, 1992 (15 of 1992), the Board with the previous approval of the Central Government, hereby makes the following regulations:

4.8.1. **Registration of Merchant Bankers**

(A) **Application for grant of certificate**

(1) An application by a person for grant of a certificate shall be made to the Board in Form A.

(2) The application under sub-regulation (1) shall be made for any one of the following categories of the merchant banker namely:-

(a) Category I, that is –

(i) to carry on any activity of the issue management, which will inter-alia consist of preparation of prospectus and other information relating to the issue, determining financial structure, tie-up of financiers and final allotment and refund of the subscription; and

(ii) to act as adviser, consultant, manager, underwriter, portfolio manager.

(b) Category II, that is, to act as adviser, consultant, co-manager, underwriter, portfolio manager;

(c) Category III, that is to act as underwriter, adviser, consultant to an issue;

(d) Category IV, that is to act only as adviser or consultant to an issue.

(2A) Notwithstanding anything contained in this regulation, with effect from 9th December, 1997,

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(i) an application under sub-regulation (2) can be made only for carrying on the activities mentioned in clause (a) therein, and
(ii) an applicant can carry on the activity as underwriter only if he obtains separate certificate of registration under the provisions of Securities and Exchange Board of India (Underwriters) Regulations, 1993, and
(iii) an applicant can carry on the activity as portfolio manager only if he obtains separate certificate of registration under the provisions of Securities and Exchange Board of India (Portfolio Manager) Regulations, 1993.

(3) Notwithstanding anything contained in sub-regulation (1), any application made by a merchant banker prior to coming into force of these regulations containing such particulars or as near thereto as mentioned in Form A shall be treated as an application made in pursuance of sub-regulation (1) and dealt with accordingly.

**(B) Application to conform to the requirements**

Subject to the provisions of sub-regulation (3) of regulation on Application for grant of certificate, any application, which is not complete in all respects and does not conform to the instructions specified in the form, shall be rejected:

Provided that, before rejecting any such application, the applicant shall be given an opportunity to remove within the time specified such objections as may be indicated by the Board.

**(C) Furnishing of information, clarification and personal representation**

(1) The Board may require the applicant to furnish further information or clarification regarding matters relevant to the activity of a merchant banker for the purpose of disposal of the application.

(2) The applicant or its principal officer shall, if so required, appear before the Board for personal representation.
(D) Consideration of application

The Board shall take into account for considering the grant of a certificate, all matters, which are relevant to the activities relating to merchant banker and in particular the applicant complies with the following requirements, namely:

(a) the applicant shall be a body corporate other than a non-banking financial company as defined under clause (f) of section 45-1 of the Reserve Bank of India Act, 1934, (2 of 1934) as amended from time to time:

Provided that the merchant banker who has been granted registration by the Reserve Bank of India to act as a Primary or Satellite Dealer may carry on such activity subject to the condition that it shall not accept or hold public deposit.

(aa) the applicant has the necessary infrastructure like adequate office space, equipments, and manpower to effectively discharge his activities;

(b) the applicant has in his employment minimum of two persons who have the experience to conduct the business of the merchant banker;

(c) a person directly or indirectly connected with the applicant has not been granted registration by the Board;

Explanation: For the purposes of this clause the expression "directly or indirectly connected" means any person being an associate, subsidiary, inter-connected or group Company of the applicant in case of the applicant being a body corporate.

(d) the applicant fulfils the capital adequacy requirement as specified below;

(e) the applicant, his partner, director or principal officer is not involved in any litigation connected with the securities market which has an adverse bearing on the business of the applicant;

(f) the applicant, his director, partner or principal officer has not at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;
(g) the applicant has the professional qualification from an institution recognised by the Government in finance, law or business management;

(gg) the applicant is a fit and proper person,

(h) grant of certificate to the applicant is in the interest of investors.

(E) Capital Adequacy Requirement

(1) The capital adequacy requirement referred to in sub- regulation (d) of regulation on Consideration of application shall not be less than the net worth of the person making the application for grant of registration.

(2) For the purposes of sub- regulation (1), the networth shall be as follows, namely:

<table>
<thead>
<tr>
<th>Category</th>
<th>Minimum Amount</th>
</tr>
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<tbody>
<tr>
<td>Category I</td>
<td>Rs. 5,00,00,000</td>
</tr>
<tr>
<td>Category II</td>
<td>Rs. 50,00,000</td>
</tr>
<tr>
<td>Category III</td>
<td>Rs. 20,00,000</td>
</tr>
<tr>
<td>Category IV</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Explanation: For the purposes of this regulation "net worth" means in the case of an applicant which is a partnership firm or a body corporate, the value of the capital contributed to the business of such firm or the paid up capital of such body corporate plus free reserves as the case may be at the time of making application under sub-regulation (1) of regulation on Application for grant of certificate.

(F) Procedure for Registration

(1) The Board on being satisfied that the applicant is eligible shall grant a certificate in Form B.

(2) On the grant of a certificate the applicant shall be liable to pay the fees in accordance with Schedule II.

(G) Renewal of certificate

(1) Three months before expiry of the period of certificate, the merchant banker, may if he so desires, make an application for renewal in Form A.

14 Substituted by the SEBI(Merchant Bankers) (Amendment) Regulations,1995, w.e.f 7-9-1995 for Rs. 1,00,00,000

15 Omitted by the SEBI (Merchant Bankers) (Amendment) Regulations, 1997, w.e.f 9-12-1997.
(2) The application for renewal, under sub-regulation (1) shall be dealt with in the same manner as if it were a fresh application for grant of a certificate.

Provided that in case of an application for renewal of certificate of registration, the provisions of clause (a) of regulation on consideration of application shall not be applicable upto June 30th, 1998.

(3) The Board on being satisfied that the applicant is eligible for renewal of certificate shall grant a certificate in Form B and send an intimation to the applicant.

(4) On the grant of a certificate the applicant shall be liable to pay the fees in accordance with Schedule II.

(H) Procedure where registration is not granted

(1) Where an application for grant of a certificate under regulation on Application for grant of certificate or of renewal under regulation on Renewal of certificate, does not satisfy the criteria set out in regulation on Consideration of application, the Board may reject the application after giving an opportunity of being heard.

(2) The refusal to grant registration shall be communicated by the Board within thirty days of such refusal to the applicant stating therein the grounds on which the application has been rejected.

(3) Any applicant may, being aggrieved by the decision of the Board, under sub-regulation (1), apply within a period of thirty days from the date of receipt of such intimation to the Board for reconsideration of its decision.

(4) The Board shall reconsider an application made under sub-regulation (3) and communicate its decision as soon as possible in writing to the applicant.

17 Omitted by the SEBI (Merchant Bankers) (Amendment) Regulations, 1997, w.e.f 9-12-1997
(I) **Effect of refusal to grant certificate**

Any merchant banker whose application for a certificate has been refused by the Board shall on and from the date of the receipt of the communication under sub-regulation (2) of regulation on Procedure where registration is not granted cease to carry on any activity as merchant banker.

(J) **Payment of fees and the consequences of failure to pay fees**

(1) Every applicant eligible for grant of a certificate shall pay such fees in such manner and within the period specified in Schedule II.

(2) Where a merchant banker fails to pay the Annual fees as provided in sub-regulation (1), read with Schedule II, the Board may suspend the registration certificate, whereupon the merchant banker shall cease to carry on any activity as a merchant banker for the period during which the suspension subsists.

4.8.2. **General Obligations and Responsibilities**

(A) **Code of Conduct**

Every merchant banker shall abide by the Code of Conduct as specified in Schedule III. No merchant banker, other than a bank or a public financial institution, who has been granted a certificate of registration under these regulations, shall after June 30th, 1998 carry on any business other than that in the securities market.

Notwithstanding anything contained above, a merchant banker who prior to the date of notification of the securities and exchange board of India (Merchant Bankers) Amendment Regulations, 1997, has entered into a contract in respect of a business other than that of the securities market, may, if he so desires, discharge his obligations under such contract.

Provided that a merchant banker who has been granted certificate of registration to act as primary or satellite dealer by Reserve Bank of India, may carry on such business as may be permitted by Reserve Bank of India.
(B) Maintenance of books of accounts, records etc.

(1) Every merchant banker shall keep and maintain the following books of accounts, records and documents namely: - (a) a copy of balance sheet as at the end of each accounting period; (b) a copy of profit and loss account for that period; (c) a copy of the auditor's report on the accounts for that period; and (d) a statement of financial position.

(2) Every merchant banker shall intimate to the Board the place where the books of accounts, records and documents are maintained.

(3) Without prejudice to sub- regulation (1), every merchant banker shall, after the end of each accounting period furnish to the Board copies of the balance sheet, profit and loss account and such other documents for any other preceding five accounting years when required by the Board.

(C) Submission of Half-yearly results

Every merchant banker shall furnish to the Board half-yearly unaudited financial results when required by the Board with a view to monitor the capital adequacy of the merchant banker.

(D) Maintenance of books of account, records and other documents

The merchant banker shall preserve the books of accounts and other records and documents maintained under regulation 14 for a minimum period of five years.

(E) Report on steps taken on Auditor's report

Every merchant banker shall within two months from the date of the auditors' report take steps to rectify the deficiencies, made out in the auditor's report.

(F) Appointment of lead merchant bankers

(1) All issues should be managed by at least one merchant banker functioning as the lead merchant banker:

Provided that, in an issue of offer of rights to the existing members with or without the right of renunciation the amount of the issue of the body corporate does not exceed rupees fifty lacs, the appointment of a lead merchant banker shall not be essential.
(2) Every lead merchant banker shall before taking up the assignment relating to an issue, enter into an agreement with such body corporate setting out their mutual rights, liabilities and obligations relating to such issue and in particular to disclosures, allotment and refund.

(G) Restriction on appointment of lead managers
The number of lead merchant bankers may not exceed in case of any issue of—

<table>
<thead>
<tr>
<th>Size of issue</th>
<th>Number of Lead Merchant Bankers</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Less then rupees 50 crores.</td>
<td>2</td>
</tr>
<tr>
<td>(b) Rupees 50 crores but less then rupees 100 crores.</td>
<td>3</td>
</tr>
<tr>
<td>(c) Rupees 100 crores but less then rupees 200 crores.</td>
<td>4</td>
</tr>
<tr>
<td>(d) Rupees 200 crores but less then rupees 400 crores.</td>
<td>5</td>
</tr>
<tr>
<td>(e) Above rupees 400 crores.</td>
<td>5 or more as may be agreed by the SEBI</td>
</tr>
</tbody>
</table>

(H) Responsibilities of lead managers
(1) No lead manager shall agree to manage or be associated with any issue unless his responsibilities relating to the issue mainly, those of disclosures, allotment and refund are clearly defined, allocated and determined and a statement specifying such responsibilities is furnished to the Board at least one month before the opening of the issue for subscription:

Provided that, where there are more than one lead merchant bankers to the issue the responsibilities of each of such lead merchant banker shall clearly be demarcated and a statement specifying such responsibilities shall be furnished to the Board at least one month before the opening of the issue for subscription.

(2) No lead merchant banker shall, agree to manage the issue made by any body corporate, if such body corporate is an associate of the lead merchant banker.
(I) Lead merchant banker not to associate with a merchant banker without registration
A lead merchant banker shall not be associated with any issue if a merchant banker who is not holding a certificate is associated with the issue.

(J) Underwriting obligations
(1) In respect of every issue to be managed, the lead merchant banker holding a certificate under Category I shall accept a minimum underwriting obligation of five percent of the total underwriting commitment or rupees twenty-five lacs, whichever is less:

Provided that, if the lead merchant banker is unable to accept the minimum underwriting obligation, that lead merchant banker shall make arrangement for having the issue underwritten to that extent by a merchant banker associated with the issue and shall keep the Board informed of such arrangement.

(K) Submission of due diligence certificate
The lead merchant banker, who is responsible for verification of the contents of a prospectus or the Letter of Offer in respect of an issue and the reasonableness of the views expressed therein, shall submit to the Board at least two weeks prior to the opening of the issue for subscription, a due diligence certificate in Form C.

(L) Documents to be furnished to the Board
(1) The lead manager responsible for the issue shall furnish to the Board, the following documents, namely:

(i) particulars of the issue;
(ii) draft prospectus or where there is an offer to the existing shareholders, the draft letter of offer;
(iii) any other literature intended to be circulated to the investors, including the shareholders; and
(iv) such other documents relating to prospectus or letter of offer as the case may be.

(2) The documents referred to in sub-regulation (1) shall be furnished at least two weeks prior to date of filing of the draft prospectus or the letter
of offer, as the case may be, with the Registrar of Companies or with the Regional Stock Exchanges, or with both.

(3) The lead manager shall ensure that the modifications and suggestions, if any, made by the Board on the draft prospectus or the Letter of Offer as the case may be, with respect to information to be given to the investors are incorporated therein.

(M) Continuance of association of lead manager with an issue
The lead manager undertaking the responsibility for refunds or allotment of securities in respect of any issue shall continue to be associated with the issue till the subscribers have received the share or debenture certificates or refund of excess application money:

Provided that where a person other than the lead manager is entrusted with the refund or allotment of securities in respect of any issue, the lead manager shall continue to be responsible for ensuring that such other person discharges the requisite responsibilities in accordance with the provisions of the Companies Act and the listing agreement entered into by the body corporate with the stock-exchange.

(N) Acquisition of shares prohibited
No merchant banker or any of its directors, partner or manager or principal officer shall either on their respective accounts or through their associates or relatives enter into any transaction in securities of bodies corporate on the basis of unpublished price sensitive information obtained by them during the course of any professional assignment either from the clients or otherwise.

(O) Information to the Board
Every merchant banker shall submit to the Board complete particulars of any transaction for acquisition of securities of any body corporate whose issue is being managed by that merchant banker within fifteen days from the date of entering into such transaction.

(P) Disclosures to the Board
A merchant banker shall disclose to the Board as and when required, the following information, namely:

(i) his responsibilities with regard to the management of the issue;
(ii) any change in the information or particulars previously furnished, which have a bearing on the certificate granted to it;
(iii) the names of the body corporate whose issues he has managed or has been associated with;
(iv) the particulars relating to breach of the capital adequacy requirement as specified in regulation on Capital adequacy requirement;
(v) relating to his activities as a manager, underwriter, consultant or adviser to an issue as the case may be.

4.8.3. Procedure for Inspection

(A) Board's right to inspect

(1) The Board may appoint one or more persons as inspecting authority to undertake inspection of the books of accounts, records and documents of the merchant banker for any of the purposes specified in sub-regulation (2).

(2) The purposes referred to in sub-regulation (1) may be as follows namely: -
(a) to ensure that the books of account are being maintained in the manner required;
(b) that the provisions of the Act, rules, regulations are being complied with;
(c) to investigate into the complaints received from investors, other merchant bankers or any other person on any matter having a bearing on the activities of the merchant banker; and
(d) to investigate *suo-moto* in the interest of securities business or investors interest into the affairs of the merchant banker.

(B) Notice before inspection

(1) Before undertaking an inspection under regulation on Board's right to inspect the Board shall give a reasonable notice to the merchant banker for that purpose.

(2) Notwithstanding anything contained in sub-regulation (1), where the Board is satisfied that in the interest of the investors no such notice
should be given, it may by an order in writing direct that the inspection
of the affairs of the merchant banker be taken up without such notice.

(3) During the course of inspection, the merchant banker against whom
an inspection is being carried out shall be bound to discharge his
obligations as provided under regulation on obligations of merchant
banker on inspection by the Board.

(C) Obligations of merchant banker on inspection by the Board
(1) It shall be the duty of every director, proprietor, partner, officer and
employee of the merchant banker, who is being inspected, to produce to
the inspecting authority such books, accounts and other documents in
his custody or control and furnish him with the statements and
information relating to his activities as a merchant banker within such
time as the inspecting authority may require.

(2) The merchant banker shall allow the inspecting authority to have
reasonable access to the premises occupied by such merchant banker or
by any other person on his behalf and also extend reasonable facility for
examining any books, records, documents and computer data in the
possession of the merchant banker or any such other person and also
provide copies of documents or other materials which, in the opinion of
the inspecting authority are relevant for the purposes of the inspection.

(3) The inspecting authority, in the course of inspection, shall be entitled
to examine or record statements of any principal officer, director,
partner, proprietor and employee of the merchant banker.

(4) It shall be the duty of every director, proprietor, partner, officer or
employee of the merchant banker to give to the inspecting authority all
assistance in connection with the inspection which the merchant banker
may reasonably be expected to give.

(D) Submission of Report to the Board
The inspecting authority shall, as soon as may be possible submit, an
inspection report to the Board.

(E) Communication of findings etc. to the merchant banker
The Board shall after consideration of the inspection report communicate the findings to the merchant banker to give him an opportunity of being heard before any action is taken by the Board on the findings of the inspecting authority.

On receipt of the explanation if any, from the merchant banker, the Board may call upon the merchant banker to take such measures as the Board may deem fit in the interest of the securities market and for due compliance with the provisions of the Act, rules and regulations.

**Appointment of Auditor**

The Board may appoint a qualified auditor to investigate into the books of account or the affairs of the merchant banker:

Provided that the auditor so appointed shall have the same powers of the inspecting authority as are mentioned above and the obligations of the merchant banker as also mentioned above shall be applicable to the investigation under this regulation.

Explanation: For the purposes of this regulation the expression "qualified auditor" shall have the same meaning as given in Section 226 of the Companies Act, 1956 (1 of 1956).

**4.8.4. Procedure for action in case of default**

**(A) Liability for action in case of default**

(1) A merchant banker who:

(a) fails to comply with any conditions subject to which certificate has been granted;

(b) contravenes any of the provisions of the Act, rules or regulations;

shall be liable to any of the penalties specified in sub-regulation (2).

(2) The penalties referred to in sub-regulation (1) may be either:

(a) suspension of registration; or (b) cancellation of registration.

**(B) Suspension of registration**

(1) A penalty of suspension of registration of a merchant banker may be imposed where---
(i) the merchant banker violates the provisions of the Act, rules or regulations;
(ii) the merchant banker ---
(a) fails to furnish any information relating to his activity as merchant banker as required by the Board;
(b) furnishes wrong or false information;
(c) does not submit periodical returns as required by the Board;
(d) does not co-operate in any enquiry conducted by the Board;
(iii) the merchant banker fails to resolve the complaints of the investors or fails to give a satisfactory reply to the Board in this behalf;
(iv) the merchant banker indulges in manipulating or price rigging or cornering activities;
(v) the merchant banker is guilty of misconduct or improper or unbusiness-like or unprofessional conduct which is not in accordance with the Code of Conduct specified in Schedule III;
(vi) the merchant banker fails to maintain the capital adequacy requirement in accordance with the provisions of regulation on Capital adequacy requirement;
(vii) the merchant banker fails to pay the fees;
(viii) the merchant banker violates the conditions of registration;
(ix) the merchant banker does not carry out his obligations as specified in the regulations.

(C) Cancellation of registration

A penalty of cancellation of registration of a merchant banker may be imposed where--

(i) the merchant banker indulges in deliberate manipulation or price rigging or cornering activities affecting the securities market and the investors interest;
(ii) the financial position of the merchant banker deteriorates to such an extent that the Board is of the opinion that his continuance as merchant banker is not in the interest of investors;
(iii) the merchant banker is guilty of fraud, or is convicted of a criminal offence;
(iv) in case of repeated defaults of the nature mentioned in regulation on Suspension of registration provided that the Board furnishes reasons for cancellation in writing.

(D) Manner of making order of suspension and cancellation
No order of penalty of suspension or cancellation as the case may be, shall be imposed except after holding an enquiry in accordance with the procedure specified in regulation on Manner of holding enquiry before suspension or cancellation.

(E) Manner of holding enquiry before suspension or cancellation
(1) For the purpose of holding an enquiry under regulation on Manner of making order of suspension and cancellation, the Board may appoint an enquiry officer.

(2) The enquiry officer shall issue to the merchant banker a notice at the registered office or the principal place of business of the merchant banker.

(3) The merchant banker may, within thirty days from the date of receipt of such notice, furnish to the enquiry officer a reply together with copies of documentary or other evidence relied on by him or sought by the Board from the merchant banker.

(4) The enquiry officer shall, give a reasonable opportunity of hearing to the merchant banker to enable him to make submissions in support of his reply made under sub-regulation (3).

(5) Before the enquiry officer, the merchant banker may either appear in person or through any person duly authorized by the merchant banker:

Provided that no lawyer or advocate shall be permitted to represent the merchant banker at the enquiry:

Provided further that where a lawyer or an advocate has been appointed by the Board as a presenting officer under sub-regulation (6), it shall be
lawful for the merchant banker to present its case through a lawyer or advocate.

(6) If it is considered necessary, the enquiry officer may ask the Board to appoint a presenting officer to present its case.

(7) The enquiry officer shall, after taking into account all relevant facts and submissions made by the merchant banker, submit a report to the Board and recommend the penalty to be imposed as also the grounds on the basis of which the proposed penalty is justified.

(F) Show-cause notice and order
(1) On receipt of the report from the enquiry officer, the Board shall consider the same and issue a show-cause notice as to why the penalty as proposed by the enquiry officer should not be imposed.

(2) The merchant banker shall within twenty-one days of the date of the receipt of the show-cause send a reply to the Board.

(3) The Board after considering the reply to the show-cause notice, if received, shall as soon as possible but not later than thirty days from the receipt of the reply, if any, pass such order as it deems fit.

(4) Every order passed under sub-regulation (3) shall be self-contained and give reasons for the conclusions stated therein including justification of the penalty imposed by that order.

(5) The Board shall send a copy of the order under sub-regulation (3) to the merchant banker.

(G) Effect of suspension and cancellation of registration of merchant banker
(1) On and from the date of the suspension of the merchant banker he shall cease to carry on any activity as a merchant banker during the period of suspension.

(2) On and from the date of cancellation the merchant banker shall with immediate effect cease to carry on any activity as a merchant banker.
(H) Publication of order of suspension

The order of suspension or cancellation of certificate passed under sub-regulation (3) of regulation on Show-cause notice and order shall be published in at least two daily newspapers by the Board.

(I) Appeal to the Securities Appellate Tribunal

Any person aggrieved by an order of the Board made, on and after the commencement of the Securities Laws (Second Amendment) Act, 1999, (i.e., after 16th December 1999), under these regulations may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

4.8.5. Code of Conduct for Merchant Bankers

1. A merchant banker in the conduct of his business shall observe high standards of integrity and fairness in all his dealings with his clients and other merchant bankers.

2. A merchant banker shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment. He shall wherever necessary, disclose to the clients, possible sources of conflict of duties and interests, while providing unbiased services.

3. A merchant banker shall not make any statement or become privy to any act, practice or unfair competition, which is likely to be harmful to the interests of other merchant bankers or is likely to place such other merchant bankers in a disadvantageous position in relation to the merchant banker, while competing for or executing any assignment.

4. A merchant banker shall not make any exaggerated statement, whether oral or written, to the client either about the qualification or the capability to render certain services or his achievements in regard to services rendered to other clients.

5. A merchant banker shall always endeavor to -
   a. render the best possible advice to the clients having regard to the clients' needs and the environments and his own professional skill; and
   b. ensure that all professional dealings are effected in a prompt, efficient and cost effective manner.
6. A merchant banker shall not -
a. divulge to other clients, press or any other party any confidential information about his client, which has come to his knowledge; and
b. deal in securities of any client company without making disclosure to the Board as required under the regulations and also to the Board of Directors of the client company.

7. A merchant banker shall endeavour to ensure that -
a. the investors are provided with true and adequate information without making any misleading or exaggerated claims and are made aware of attendant risks before any investment decision is taken by them;
b. copies of prospectus, memorandum and related literature are made to the investors;
c. adequate steps are taken for fair allotment of securities and refund of application money without delay; and d. complaints from investors are adequately dealt with.

8. The merchant bankers shall not generally and particularly in respect of issue of any securities be party to - (a) creation of false market; (b) price rigging or manipulation; (c) passing of price sensitive information to brokers, members of the stock exchanges and other players in the capital market or take any other action which is unethical or unfair to the investors.

9. A merchant banker shall abide by the provisions of the Act, rules and regulations and which may be applicable and relevant to the activities carried on by the merchant banker.

4.8.6. Payment of Fees to the Board

Every merchant banker shall pay fees as set out below:

<table>
<thead>
<tr>
<th>Size of the issue including premium and intended retention of oversubscription (Rs.)</th>
<th>Proposed Fee per document (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 5 crores</td>
<td>10000</td>
</tr>
<tr>
<td>More than 5 crores and upto 10 crores</td>
<td>15000</td>
</tr>
<tr>
<td>More than 10 crores and upto 50 crores</td>
<td>25000</td>
</tr>
<tr>
<td>More than 50 crores and upto 100 crores</td>
<td>50000</td>
</tr>
<tr>
<td>More than 100 crores and upto 500 crores</td>
<td>250000</td>
</tr>
<tr>
<td>More than 500 crores</td>
<td>500000</td>
</tr>
</tbody>
</table>
4.9 **SEBI's role in the present context**

Once the Securities and Exchange Board of India (SEBI) comes into the fray, Indian primary capital market as well as stock market is exposed to a new era of regulation. It's intentions have by and large been positive and optimistic. However, it becomes handicapped by excess of the bureaucratic mindset, lack of understanding of the markets and an incurable suspicion of market intermediaries. SEBI has also failed to protect investors from “fly-by-night” operators in the primary market, who float companies and public issues in rapid succession, garner money from the public and then 'vanish' without a trace. More than 4,000 such companies have defrauded investors of billions of rupees\(^{18}\). The slow down in the Indian economy and the successive scams have affected the sentiments of the investors badly. The revival of the market sentiments depends on the economic growth as well as the global economic recovery\(^{19}\).

4.10 **Conclusion**

SEBI guidelines, rules and regulations are meant for monitoring the security related activities in India. But such activities do not occur in isolation. Actually, these activities are the outcome of economic activities within the country and across the world. Hence, enquires are to be made to reveal the relationship among the issue of securities (which is supposed to reflect the corporate growth), economic growth and the activities of the merchant bankers. A humble attempt has been made in the subsequent chapters to study these problems.


\(^{19}\) “Capital market”, http://www.directories-today.com / i_capital_mkt.htm