CHAPTER - 4
REGULATORY FRAMEWORK OF INDIAN STOCK MARKET

The growth of security market of a country is influenced by the legislative measures taken by that country from time to time. The policy change has great impact on the minds of public which ultimately affects their saving habits. For effective mobilization of funds, it is necessary that the interest of the potential investors should be protected adequately.

In the pre-independence, the earliest legislation relating to stock market was introduced in the 19th Century. This legislation was passed in 1865 but it lost its impact due to outbreak of the American Civil War. Thereafter, the Atly Stock Exchange Enquiry Committee was set-up in 1923. This committee in its report, emphasized on necessity of the Stock Exchanges’ framing and maintaining a systematic set of rules and regulations in the interest of the general investing public and of the trade itself. The next step towards special legislation for controlling stock markets was Bombay Securities Contracts Control Act, 1925. This Act gave certain powers to government in regard to recognition of Stock exchanges etc. but this act proved ineffective-in regulating security trading and government control there under was nominal, practically. The Bombay Security Contracts Control Act remained in force till the Securities Contract (Regulation) Act, 1956 enacted by the Central Government. The main Acts which effect the Securities markets are Companies Act, 1956, Capital Issues Control Act, 1947, Securities Contract (Regulation) Act, 1956, Securities Contract (Regulation) Rules 1957 and Securities and Exchange Board of India Act, 1992, which was set up as a Securities and Exchange Board of India (SEBI) on April 1988. It took almost four years for the government to bring about a separate
legislation in the name of Securities and Exchange Board of India Act, 1992 conferring statutory powers. The Act charged to SEBI with comprehensive powers over practically all aspects of capital market operations. The Securities and Exchange Board of India (SEBI), has emerged as an important constituent of the system that now exists to regulate, control and monitor the Indian Financial System (IFS) as certain powers of some other constituents of this system have been delegated to the SEBI.¹

4.1 Companies Act, 1956

After Independence, the Government of India passed various legislations so that investors can have confidence while investing their savings. With a view to protect the interest of a large number of shareholders and creditors on healthy lines and to help the attainment of the ultimate ends of social and economic policy of the Government, the Companies Act, 1956 was passed. It was not enacted purely from legalistic point of view but it was also passed on the changing social needs of the country.

The Companies Act, 1956 which together with its amendments, is the substantive law in our country today and contains a large number of new and startling provisions for public control over the functioning of joint stock companies. The following are the basic objectives of the Companies Act, 1956:

(a) Minimum assured standard of business integrity and conduct in the promotion and management of companies;
(b) Full and fair disclosure of all reasonable information relating to the affairs of the company;
(c) Effective participation and control by shareholders and the protection of their legitimate interests;
(d) Enforcement of proper performance of their duties by the company management; and

(e) Power of intervention and investigation into the affairs of companies when they are managed in a manner prejudicial to the interest of the shareholders or to the public interest.

A company has to operate within the legal framework prevailing in the country. The Companies Act deals with the formation and management of new companies. With the growth of joint stock companies, the capital market has taken a new turn in the development of the country.2

4.2 The Capital Issues (Control) Act, 1947

Another ingredient of regulatory legislation is the Capital Issues (Control) Act, 1947, 3 which prescribes the approval of the Controller of Capital Issues for all issues of capital. It is one of the major instruments through which the Government regulates the working of the capital market, particularly the new issues. Capital issues control was first introduced under the Defence of India Rule 94-A which was promulgated on 17th May, 1943 under the Defence of India Act, 1939, Capital Issue Control was retained after the War and Defence Rule 94-A was replaced by the Capital Issues (Continuance of Control) Act, in April, 1947. The main objective of this pragmatic step was to ensure those investments in the country in the various sectors of economy which takes place in a planned manner and in accordance with the priorities laid down in the plans. Despite of it, this legislation had the following objectives:

a) To protect the investing public;

b) To ensure that investments by the corporate sector were in accordance with the plans and that they were not wasteful and in non-essential channels;
c) To ensure that the capital structure of companies was sound and in the public interest;
d) To ensure that there was no undue congestion of public issues in any part of the year; and
e) To regulate the volume, terms and conditions for foreign investment.

For the purpose of achieving the above objectives, an office of the Controller of Capital Issues (CCI) was set-up. It was entrusted with the responsibility of regulating the capital issues in the Country. The CCI was vested with the powers to approve the kinds of instruments, size, timing and premium of issues.

The Capital Issues (Control) Act, (CICA) is only of historical interest now as it was repealed by the Capital Issues (Control) Repeal Act 1992. It played an important part in the functioning of the Indian capital market for as many as 45 years since 1947, and its provisions have now become the powers and functions of the SEBI. It was administered by the Controller of Capital Issues (CCI) in the Ministry of Finance, Department of Economic Affairs, Government of India. While the Securities (Control) Repeal Act, (SCRA) mainly regulates the secondary market. The CICA mostly regulates the primary or new issue market for securities.

The Act required companies to obtain prior approval or consent for issues of capital to the public, and for pricing of public and right issues. It empowered the Government of India (GOI) to regulate the timing of new issues by private sector companies, the composition of securities to be issued, interest (dividend) rates, which can be offered on debentures and preference shares, the timing and frequency of bonus issues, the amount of prior allotment to promoters, floatation costs, and the premium to be charged on securities.⁴
4.3 The Securities Contract (Regulation) Act, 1956

It was proved over time that the provision in Capital Issues (Control) Act were totally inadequate to regulate the growing dimensions of capital market activity. The government realized the necessity of creating a broad based and a more secure environment for the business to grow. This led to the enactment of Companies Act and Securities Contracts (Regulation) Act in 1956. These legislations contained several provisions relating to the issue of prospectus, disclosure of accounting and financial information and listing of securities etc.

The Securities Control (Regulation) Act, 1956 came into force throughout India on 20th Feb, 1957. This Act permits only those exchanges which have been recognized by the Central Government to function in any notified state or area. It prescribes the requirements which a company must comply with before its shares can be listed on any recognized stock exchange in the country.5

There is no statutory obligation that every public limited company should get its shares listed on a recognized stock exchange. However, a company declaring in the prospectus, its intention of applying for enlistment, is bound Under Section 73 of the Companies Act, to make a listing application to the stock exchange concerned. It is also bound to abide by the prescribed requirements in order to have its shares admitted to dealings failing which; it has to refund the application money to those who have subscribed for the share capital. Further, the Government reserves the powers under section 21 of the Securities Contracts (Regulation) Act, 1956 to compel a Public Limited Company when it is so necessary or expedient, in the interest of the trade or of the public to comply with the prescribed requirements and list its shares on a recognized stock exchange.
The objective of the Securities Contracts (Regulation) Act (SCRA) is to regulate the working of stock exchanges or secondary market with a view to prevent undesirable transactions or speculation in securities, and thereby, to build up a healthy and strong investment market in which the public could invest with confidence. It empowers the GOI to recognize and derecognize the stock exchanges, to stipulate laws and by-laws for their functioning, and to make the listing of securities mandatory on stock exchanges by Public Limited Companies (PULCOs). It prohibits securities transactions outside the recognized stock exchanges. It lays down that all contracts in securities except short delivery contracts, can be entered only between and through the members of recognized stock exchanges. It prescribes conditions or requirements for listing of securities on recognized stock exchanges. It empowers the GOI to supercede the governing bodies of stock exchanges, to suspend business on recognized stock exchanges, to declare certain contracts illegal and void under certain circumstances, to prohibit contracts in certain cases, to license the security dealers, and to lay down penalties for contravention of the provision of the Act. It is administered by the Ministry of Finance, Department of Economic Affairs, GOI.6

This Act aims at having a strong and healthy investment market so that members of the public may invest their savings with full confidence.

4.4 The Reserve Bank of India (RBI)

The financial system deals in other people's money and, therefore, their confidence, trust and faith in it is crucially important for its smooth functioning. Financial regulation is necessary to generate, maintain and promote this trust. One reason why the public trust may be lost is that some of the savers or investors or intermediaries may imprudently take too much risk, which could engender defaults, bankruptcies, and insolvencies. A regulation is needed to check prudence in the system.
The modern trading technology and the possibility of high leveraging enable market participants to take large stakes which are disproportionate with their own investments. There are frequent instances of dishonest, unfair, fraudulent, and unethical practices or activities of the market intermediaries or agencies such as brokers, merchant bankers, custodians, trustees, etc. The regulation becomes necessary to ensure that the investors are protected; that disclosure and access to information are adequate, timely, and equal; that the participants measure up to the rules of the market place; and that the markets are both fair and efficient. To regulate financial system, RBI has special role and responsibility.
The RBI, as the central bank of the Country, is the centre of Indian financial and monetary system. As the apex institution, it has been guiding, monitoring, regulating, controlling, and promoting the destiny of the Indian Financial System (IFS) since its inception. It started functioning from April 1, 1935 on the terms of the Reserve Bank of India Act, 1934. It was a private shareholders' institution till January, 1949, after which, it became a State-owned institution under the Reserve Bank (Transfer to Public Ownership) of India Act, 1948. This Act empowers the Central Government, in consultation with the Governor of the Bank, to issue such directions to it as they might consider necessary in the public interest. Further, the Governor and all the Deputy Governors of the Bank are appointed by the Central Government.

The Bank is managed by a Central Board of Directors; four Local Boards are to advise the Central Board on matters referred to them. They are also required to perform duties as are delegated to them. The final control of the Bank vests in the Central Board which comprises the Governor, four Deputy Governors, and fifteen Directors nominated by the Central Government. The committee of the Central Board consists of the Governor, the Deputy Governor and such other Directors as may be present at a given meeting.

**Functions of RBI**

The RBI functions with in the framework of mixed economic system. With regard to framing various policies, it is necessary to maintain close and continuous collaboration between the government and the RBI. The main functions of the Reserve Bank are as follows;

i) To maintain monetary satiability so that the business and economic life can deliver welfare gains of a properly functioning mixed economy;
ii) To maintain financial stability and ensure sound financial institutions so that monetary stability can be safely pursued and economic units can conduct their business with confidence;

iii) To maintain stable payments system so that financial transactions can be safely and efficiently executed;

iv) To promote the development of financial infrastructure of markets and systems, and to enable it to operate efficiently i.e., to play a leading role in developing a sound financial system so that it can discharge its regulatory function efficiently;

v) To ensure that credit allocation by the financial system broadly reflects the national economic priorities and social concerns;

vi) To regulate the overall volume of money and credit in the economy with a view to ensure a reasonable degree of price stability.

The Reserve Bank is entrusted with the function of the development and regulation of money, foreign exchange, and government securities markets. The RBI undertakes this function as it is a monetary authority as well as debt manager to the government and is responsible for the stability of the financial system. To preserve and enhance the stability of the banking and financial system, there is an important part of the “promotional” role of the RBI. In fact, financial stability has now assumed relatively greater importance as one of the tasks of the RBI. This is evident in its work to formulate prudential norms for banks and financial institutions, its intervention in the foreign exchange market, and its participation in the operation of “safety nets” i.e., the legal and organizational structure for overseeing the safety and soundness of the banking and financial system. It plays an important role in building-up and maintaining confidence in the underlying stability of the IFS. In short, the RBI helps to create and maintain a stable, efficient, and well functioning financial system in India.7
4.5 Securities and Exchanges Board of India (SEBI) Act, 1992

The year 1991 witnessed a big push being given to liberalization and reforms in the Indian financial sector. For sometime thereafter, the volume of business in the primary and secondary securities markets increased significantly. As part of the same reform process, the globalization or internationalization of the Indian financial system made it vulnerable to external shocks. The multi-crore securities scam rocked the IFS in 1992. All these developments impressed on the authorities the need to have in place a vigilant regulatory body or an effective and efficient watchdog. It was felt that the then existing regulatory framework was fragmented, ill-coordinated, and inadequate and that there was a need for an autonomous, statutory, integrated organization to ensure the smooth functioning of the IFS. The SEBI came into being as a response to these requirements.

SEBI: THE REGULATOR OF SECURITIES MARKET

The SEBI was established on April 12, 1988 through an administrative order, but it became a statutory and really powerful
organization only since 1992. The CICA was repealed and the office of the CCI was abolished in 1992, and SEBI was set-up on 21 February, 1992 through an ordinance issued on 30 January, 1992. The ordinance was replaced by the SEBI Act on 4 April, 1992. Certain powers under certain sections of SCRA and CA have been delegated to the SEBI. The regulatory powers of the SEBI were increased through the Securities Laws (Amendment) Ordinance of January, 1995 which were subsequently replaced by an Act of Parliament. The SEBI is under the overall control of the Ministry of Finance, and has its head office at Mumbai. It has become now a very important constituent of the financial regulatory framework in India.

The philosophy underlying the creation of the SEBI is that multiple regulatory bodies for securities industry i.e. the regulatory systems get divided, causing confusion among market participants as to who is really in command. In a multiple regulatory structure, there is also an overlap of functions of different regulatory bodies. Through the SEBI, the regulation model which is sought to be put in place in India, is one in which every aspect of securities market regulation is entrusted to a single highly visible and independent organization, which is backed by a statute, and which is accountable to the Parliament and in which investors can have trust.

4.5.1 Constitution and Organization

Chapter II of the SEBI Act deals with establishment, incorporation, administration and management of the Board of Directors etc. The SEBI is a body of six members comprising the Chairman, two members from amongst the officials of the ministers of the Central Government dealing with finance and law, two members who are professionals and have experience or special knowledge relating to security market, and one member from the RBI. All members, except the RBI members, are
appointed by the government, who also lay down their terms of office, tenure, and conditions of service, and who can also remove any member from office under certain circumstances. The Central Government is empowered to supersede the SEBI in public interest, on account of grave emergency when it is unable to discharge its functions or duties, or if its financial position and administration deteriorates.

The work of the SEBI has been organized into five operational departments each of which is headed by an executive director who reports to the chairman. Besides, there is a legal department and the investigation department. The departments have been divided into divisions. The various departments and scope of their activities are as follows:

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

It looks after all policy matters and regulatory issues in respect of primary market, registration, merchant bankers, portfolio management services, investment advisers, debenture trustees, underwriters, SROs and investor grievance, guidance, education and association.

- **The Issue Management and Intermediaries Department**

It is responsible for vetting of all prospectuses and letters of offer for public and right issues, for co-ordinating with the primary market policy, for registration and regulating and monitoring of issues related intermediaries.

- **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 and monitoring of price movements and insider trading, and Electronic Data Processing (EDP) and SEBI's data base.

The Secondary Market Exchange Administration, Inspection and Non-member Intermediaries Department

It looks after the smaller stock exchanges of Guwahati, Magadh, Indore, Manglore, Hyderabad, Bhubaneshwar, Kanpur, Ludhiana and Chochin. It is responsible for inspection of all stock exchanges, and registration, regulation and monitoring of non-member intermediaries such as sub-brokers.

- **Institutional Investment (Mutual Funds and Foreign Institutional Investment), Mergers and Acquisition, Research and Publications, and International Relations and IOSCO Department.**

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

- **Legal Department**

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

- **Investigation Department**

This department carries out inspection and investigation under the supervision of Chief Investigator. The SEBI has regional offices at
Calcutta, Chennai and Delhi. It has also formed two non-statutory advisory committees namely—the Primary Market Advisory Committee and Secondary Market Advisory Committee with members from market players, recognized investors associations, and other eminent persons.

SEBI is a member of IOSCO, an international body comprising of security regulators from over 100 countries. It participates in the Development Committee of IOSCO which provides a platform for regulators from emerging markets to share their views and experience.

4.5.2 Objective and Regulatory Approach

The overall objective of the SEBI, as enshrined in the Preamble of the SEBI Act, 1992 is “to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected there with or incidental thereto”. The objectives of SEBI are as follows:

• To protect the interest of investors so that there is a steady flow of savings into the capital market.

• To regulate the securities market and ensue fair practices by the issuers of securities so that they can raise resources at minimum cost.

• To promote efficient services by brokers, merchant bankers and other intermediaries so that they become competitive and professional.

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. Underlying those measures is the logic that 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 encourages 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 coroner stones 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 markets, 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 interests through adequate, accurate, and authentic information and disclosure of such information on a continuous basis. To issuers, it provides a market place in which they can confidently raise all the finance they need in an easy, fair, and efficient 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.

4.5.3 Powers, Scope, and Functions

The scope of operations of the SEBI is very wide. It can frame or issue rules, regulations, directives, guidelines, norms in respect of both the primary and secondary markets, intermediaries operating in these markets, and certain financial institutions. SEBI has been vested with the following powers:

1) Power to call periodical return from recognized stock exchanges.
2) Power to call any information or explanation from recognized stock exchanges or their members.

3) Power to direct enquiries to be made in relation to affairs of stock exchanges or their members.

4) Power to grant approval to bye-laws of recognized stock exchanges.

5) Power to make or amend bye-laws of recognized stock exchanges.

6) Power to control listing of securities by public companies.

7) Power to control and regulate stock exchanges.

8) Power to grant registration to market intermediaries.

9) Power to levy fees or other charges for carrying-out the purpose of regulation.

10) Power to declare applicability of Section 17 of Securities Contract (Regulation) Act in any state or area to grant licenses to dealers in securities.

Functions

Section 11 of the SEBI Act specifies the functions as follows:

1. **Regulatory Functions**

   The regulatory functions are as under:

   a) Regulation of stock exchanges and self-regulatory organizations.
b) Registration and regulation of stock brokers, sub-brokers, Registrars to all issues, merchant bankers, underwriters, portfolio managers and such other intermediaries who are associated with securities market.

c) Registration and regulation of the working of collective investment schemes including mutual funds.

d) Prohibition of fraudulent and unfair trade practices relating to securities market.

e) Prohibition of insider trading in securities.

f) Regulating substantial acquisitions of shares and take over of companies.

2. Development Functions

a) Promoting investor's education

b) Training of intermediaries

c) Conducting research and published information useful to all market participations.


e) Promoting self-regulatory organizations.

The SEBI is empowered to register any agency or intermediary who may be associated with the securities market and one of them shall buy, sell or deal in securities except under and in accordance with the conditions of certificate of registration issued by the SEBI. However, the GOI is empowered to exempt any person or class of persons from
registration with the SEBI. The SEBI can suspend or cancel a certificate or registration issued by it to anyone, after giving him a reasonable opportunity of being heard. The SEBI Act lays down the civil and criminal penalties for contravention of the Act. Anyone who contravenes or abets contravention of the provisions of the Act or of any rules or regulations made thereunder, is punishable with imprisonment or fine or both.

With the repeal of the CICA, all matters related to the issue of capital are now governed by the guidelines issued by the SEBI. Similarly, as a result of the delegation of certain powers under the SCRA to the SEBI, the latter can conduct inquiries into the working of the stock exchanges which have to submit their annual reports to it and seek its approval for amending their rules and buy-laws. It can direct them to amend their buy-laws and rules including reconstitution of their governing boards, councils, and it is empowered to license security dealers operating outside their jurisdiction.

Consequent upon the amendments to the SEBI Act in 1995, the regulatory powers over corporates in the issuance of capital, transfer of securities and other related matters are now vested in the SEBI. The amendments also provide for the deletion of the existing provision relating to disqualification of a member of the SEBI Board on his being appointed as a director of a company. The SEBI has also been empowered to demand explanation, to summon the attendance and call for documents from all categories of market intermediaries in order to enable it to investigate irregularities, impose penalties, and initiate prosecution. The SEBI has also been empowered now to notify its regulations and file complaints in courts without the prior approval of GOI.
However, in the exercise of its powers and in performing its functions, the SEBI is bound by such directions on questions of policy as the GOI may give in writing from time to time. Although, it has the opportunity to express its view before any direction is given, the decision of GOI is final in every case.

4.5.4 SEBI and Central Government

The Central Government has the powers to issue directions to the SEBI Board, to supersede the Board, if necessary and to call for return and report etc. as and when it finds necessary. The Central Government has also powers to give any guidelines or to make regulations and rules for SEBI and its operations.

The activities of the SEBI are financed by grants from the Government in addition to fees, charges etc. collected by SEBI. The fund called the SEBI General Fund, is set-up to which all grants, fees, charges etc. are credited. The fund is used to meet the expenses of the Board and to pay salaries of staff and remuneration to officers and members of the Board etc.

4.6 SEBI Guidelines for Primary Market and Secondary Market

SEBI has brought out a number of guidelines separately, from time to time, for primary market and secondary market. These are:

4.6.1 Guidelines for Primary Market

**New Company:** A new company is one (a) which has not completed 12 months of commercial production and does not have audited results and (b) where the promoters do not have a track record. These companies have to issue shares only at par.
**New Company Set-up by Existing Company:** When a new company is being set-up by existing companies with a five year track record of consistent profitability and a contribution of at least 50 percent in the equity of new company, it is free to price its issues, i.e., it can issue its shares at premium.

**Private and Closely Held Companies:** The private and closely held companies having a track record of consistent profitability for at least three years, are permitted to price their issues freely. The issue price is determined only by the issue in consultation with lead managers to the issue.

**Existing Listed Companies:** The exiting listed companies are allowed to raise fresh capital by freely pricing expanded capital provided the promoters’ contribution is 50 percent first Rs.100 crores of issue, 40 percent on next Rs. 200 crores, 30 percent on the next Rs. 300 crores and 15 percent on balance issue amount.

**Reservation of Issues**

Reservation under public subscription for various categories of persons is made in the following manner:

1. Permanent employees 10%
2. Indian Mutual Funds 20%
3. Foreign Institutional Investors 15%
4. Development Financial Institutions 20%
5. Shareholders of group of companies 10%
Composite Issues

In the case of composite issue, i.e., right cum public issue by existing listed companies, differential pricing is allowed. In other words, issue to the public can be priced differentially as compared to issue to right shareholders. However, justification for the price difference is required to be given in the offer document.

Lock-in-period

Lock-in-period is five years for promoters' contribution from the date of allotment or from the commencement of commercial production whichever is late. At present, the lock-in period has been reduced to one year.

Guidelines for Public Issue

1. Abridged prospectus has to be attached with every application.
2. A company has to highlight the risk factors in the prospectus.
3. Objectives of the issue and cost of project is required to be mentioned in the prospectus.
4. Company's management, past history and present business of firm is to be highlighted in the prospectus.
5. Particulars in regard to company and their listed companies under the same management which made any capital issues during the last three years are to be stated in the prospectus.
6. Justification for premiums, in the case of premium is to be stated.
7. Subscription list for public issues is to be kept open for a minimum of three days and a maximum of 10 working days.
8. The collection centres are required to be at least 30 which include all centres with stock exchanges.

9. Collection agents are not collect application money in cash.

10. The quantum of issue, whether through a right or public issue, shall not exceed the amount specified in the prospectus. No retention of over subscription is permissible under any circumstances.

11. A compliance report in the prescribed form is required to be submitted to SEBI within 45 days from the date of closure of issue.

12. Minimum number of shares per application has been fixed at 500 shares of face value of Rs. 100.

13. The allotments have to be made in multiples of tradable lot of 100 shares of Rs. 10 each.

14. Issues by bonus, rights etc. are to be made in appropriate lots to minimize odd lots.

15. If minimum subscription of 9% has not been received, the entire amount is to be refunded to investors with in 120 days.

16. The capital issue should be fully paid-up within 120 days.

17. Underwriting has been made mandatory.

18. Limit of listing of companies issue in the stock exchange has been increased from Rs. 3 crores to Rs. 5 crores.

19. The gap between the closure dates of various issues viz. rights and public should not exceed 30 days.

20. Issues should make adequate disclosure regarding the terms and conditions of redemption, securing conversion and other relevant features of the new instrument so that an investor can
make reasonable determination of risks, returns, safety and liquidity of the instrument.

4.6.2 Guidelines for Secondary Market

Stock Exchange

1. Board of Directors of stock exchange has to be reconstituted so as to include non-members, public representatives, government representatives to the extent of 50 percent of total number of members.

2. Capital adequacy norms have been laid down for members of various stock exchanges depending upon their turnover of trade and other factors.

3. Working hours of all stock exchanges have been fixed uniformly.

4. All the recognized stock exchanges have to inform about the transaction within 24 hours.

5. Guidelines have been issued for introducing the system of market making in less liquid scrips in a phased manner in all stock exchanges.

Brokers

1. Registration of brokers and sub-brokers is made compulsory.

2. In order to ensure that brokers are professionally qualified and financially solvent, capital adequacy norms for registration of brokers have been evolved.

3. Compulsory audit of broker's book and filing of audit report with SEBI have been made mandatory.

4. To bring about greater transparency and accountability in the broker-client relationship, SEBI has made it mandatory for
brokers to disclose transaction price and brokerage separately in the contract notes issued to the client.

5. No broker is allowed to underwrite more than 5 percent of public issue.\footnote{10}

4.7 SEBI's Recent Regulatory Developments

The board has taken various measures in the interest of investors in securities market and for development of the securities market and various regulations have been notified in this regard. These regulations are as follows:

4.7.1 Amendments to the Existing Regulations

i) The SEBI (Mutual Funds) Regulations, 1996 have been amended on April 16, 2008 to permit mutual funds to launch Real Estate Mutual Funds. Existing Mutual Funds shall become eligible to launch real estate mutual funds if they have adequate number of experienced key personal directors.

ii) The SEBI (Foreign Institutional Investors) Regulations, 1995 have been amended on May 22, 2008. The main features of the captioned amendment regulations were as follows:

a) The FIIs who are currently issuing Offshore Derivatives Instruments (ODIs) with total value of PNs outstanding (excluding derivatives) as percentage of their AUC in India, of less than 40 percent, shall be allowed to issue further ODIs only at the incremental rate of 5 percent of their Assets Under Custody (AUC) in India. The 5 percent incremental issuance allowed to such FIIS would be applicable on an annual basis, till such time that the percentage reaches 40 percent, after which the entity will abide by the proposal applicable to entities above the 40 percent limit.
b) FIIs and sub-account registration will be perpetual, subject to payment of fees.

iii) The SEBI (Custodian of Securities) Regulations, 1996 have been amended on July 4, 2008 to enable a Custodian of Securities holding certificate of registration at the commencement of these amendment regulations to provide custodian services in respect of title deeds of real estate assets held by a real estate mutual fund scheme with the prior approval of the Board.

iv) The SEBI (Depositories and Participants) Regulations, 1996 have been amended on August 8, 2008. Earlier regulation 32 envisaged that the depository shall satisfy the Board that it has a mechanism in place to ensure that the interest of the persons buying and selling securities held in the depository is adequately protected and shall register the transfer of security in the name of the transferee only after the depository is satisfied that payment for such transfer has been made. Amendment to regulation 32 of the Depositories and Participants Regulations has done away with the requirement of the Depositories Act and it does not cast an obligation on the depositories to ensure that payment has been made in respect of transfer of security. However, depository is expected to effect the transfer of securities diligently.

v) The SEBI (Portfolio Managers) Regulations, 1993 have been amended on August 11, 2008. The main feature of the amended regulation is to ensure that portfolio management activities do not partake the character of a mutual fund. The Amendment has further clarified that portfolio managers shall hold the securities of clients in their own names either by virtue of contracts or otherwise. The word 'scheme' wherever occurring in the regulation has also been deleted to ensure the aforesaid.
vi) The SEBI (Prohibition of Insider Trading) Regulations, 1992 have been amended on November 19, 2008. The main feature of the amended regulation is that, an obligation has been imposed on directors or officers of a listed company to disclose the position, if any, taken by them and their dependents, in derivatives. The dependents whose positions in derivatives are required to be disclosed, will have to be determined by the company.

vii) The SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 have been amended on August 11, 2008 for facilitating the trading in currency derivatives on the platform of stock exchanges.

viii) The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 have been amended on October 30, 2008. The amended regulations provide that no acquire, who together with persons acting in concert with him, holds 55 percent or more but less than 75 percent of the shares or voting rights in a target company, can acquire either by himself or through persons acting in concert with him any additional shares entitling him to exercise voting rights unless he makes public announcement.

ix) The SEBI (Foreign Institutional Investors) Regulations, 1995 were again amended on October 30, 2008. The aforementioned amended regulations removed some of the restrictions that were imposed upon FIIs for the issuance of overseas derivatives instruments by the SEBI (Foreign Institutional Investors) (Amendment) Regulation, 2008.

x) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2009 were notified on January 28, 2009. Some of the major policy changes taken by these amendment regulations are as follows:
a) Disclosure of details of creation of pledge of shares of the company by promoters/promoter groups within 7 working days from the date of creation of such pledge to that company.

b) Disclosure of details of invocation of pledge of shares of the company by promoters groups within 7 working days from the date of invocation of such pledge to that company.¹¹

4.7.2 Development of New Regulations

i) The Securities Laws (Amendment) Act, 2004 amended the Securities Contracts (Regulation) Act, 1956 [SC(R) A] to enable SEBI to provide for disclosure-based regulation for public issue of listing of securities debt instruments on the recognized stock exchanges with a view to develop market for securitized debt instruments. Accordingly, on May 26, 2008, SEBI notified the regulations, inter-alia, covering cost of transactions, competition policy, the professional expertise of credit rating agencies, disclosures and obligations of the parties involved in the transaction and the interest of investors in such instruments.

ii) In order to facilitate development of a vibrant primary market for corporate bonds in India, SEBI has notified Regulations for Issue and Listing for Debt Securities to provide for simplified regulatory framework for issuance and listing of non-convertible debt securities (excluding bonds issued by Governments) issued by any company, public sector understanding or statutory corporations. The regulations do not apply to issue and listing of, securities, debt instruments and security receipts for which separate regulatory regime is in place. The Regulations provide for rationalized disclosure requirements for public issues and flexibility to issuers to structure their instruments and decide on the mode of offering.
iii) SEBI has notified the new Regulations for the Securities Exchange Board of India (Intermediaries) Regulations, 2008, on May 26, 2008. The main features of the Regulations are as under:

a) The Regulations put in place a comprehensive framework which applies to all intermediaries. The common requirements such as grant of registration, general obligations, common code of conduct, common procedure for action in case of default and miscellaneous provisions have been provided in the approved Intermediaries Regulations.

b) The registration granted to intermediaries has been made permanent subject to the compliance of the SEBI Act, regulations, updation of relevant disclosures and payment of fees.12

4.7.3 Other Recent Reforms

The capital market reforms of SEBI are a continuing process of giving guidelines both; mandatory and advisory. Many of such measures were announced by the SEBI time to time, the more important of which are listed below:

a) The Stock Exchanges have been directed to follow the Demutualization process, for their organization and a central listing authority was set-up in 2003 for pursuit of a uniform policy for listing on all stock exchanges.

b) The SEBI has also streamlined the guidelines under Disclosure and Investor Protection (DIP) for IPOs through Book Building Process by unlisted companies and strengthened the disclosure norms for bulk deals. The clause 49 of the listing agreement was amended to improve the system of corporate governance of listed companies.
c) The stock exchanges were directed to inspect every year, at least 20 percent of active brokers, instead of 10 percent as used earlier.

d) Now the securities brokers are permitted to trade in commodity markets, but they have to set-up separate units for this purpose and follow the requirements of the Fast Moving Commodities (FMC). The RBI has also permitted some banks, on a selected basis to participate in commodity exchanges subject to some guidelines and limitations.\textsuperscript{13}

4.8 Trends of Investigation Taken and Prosecutions Launched by SEBI

Trends of investigation taken and Prosecutions launched by SEBI are as follows:

Investigation

Investigations are undertaken to examine alleged or suspected violations, to gather evidence, and to identify persons, entities behind irregularities and violations, viz., price manipulation, creation of artificial market, insider trading, capital issue related irregularities, takeover violations, manipulation of financial results, non-compliance of disclosure requirements and any other misconduct in the securities market.

i) Trends in Investigation Cases

A total of 1,288 investigations have been undertaken by SEBI since 1992-93 and investigations have been completed in 1,223 cases. During 2008-09, 76 new cases were taken up for investigation and 16 cases were completed (Table and Figure 4.1). The investigation process has been expedited as during 2005 to 2008, the pending cases were also cleared. It deficits that SEBI has increased its efficiency in respect of completion of pending cases which was just 26 percent in 2001-02 increased to 676 percent.
Table 4.1
Trends of Investigation by SEBI

<table>
<thead>
<tr>
<th>Year</th>
<th>Cases Taken up for Investigation</th>
<th>Cases Completed</th>
<th>Percentage of numbers of cases completed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-93</td>
<td>2</td>
<td>2</td>
<td>100</td>
</tr>
<tr>
<td>1993-94</td>
<td>3</td>
<td>3</td>
<td>100</td>
</tr>
<tr>
<td>1994-95</td>
<td>2</td>
<td>2</td>
<td>100</td>
</tr>
<tr>
<td>1995-96</td>
<td>60</td>
<td>18</td>
<td>30</td>
</tr>
<tr>
<td>1996-97</td>
<td>122</td>
<td>55</td>
<td>45</td>
</tr>
<tr>
<td>1997-98</td>
<td>53</td>
<td>46</td>
<td>87</td>
</tr>
<tr>
<td>1998-99</td>
<td>55</td>
<td>60</td>
<td>109</td>
</tr>
<tr>
<td>1999-00</td>
<td>56</td>
<td>57</td>
<td>102</td>
</tr>
<tr>
<td>2000-01</td>
<td>68</td>
<td>46</td>
<td>68</td>
</tr>
<tr>
<td>2001-02</td>
<td>111</td>
<td>29</td>
<td>26</td>
</tr>
<tr>
<td>2002-03</td>
<td>125</td>
<td>106</td>
<td>85</td>
</tr>
<tr>
<td>2003-04</td>
<td>121</td>
<td>152</td>
<td>126</td>
</tr>
<tr>
<td>2004-05</td>
<td>130</td>
<td>179</td>
<td>138</td>
</tr>
<tr>
<td>2005-06</td>
<td>159</td>
<td>81</td>
<td>51</td>
</tr>
<tr>
<td>2006-07</td>
<td>120</td>
<td>102</td>
<td>85</td>
</tr>
<tr>
<td>2007-08</td>
<td>25</td>
<td>169</td>
<td>676</td>
</tr>
<tr>
<td>2008-09</td>
<td>76</td>
<td>116</td>
<td>153</td>
</tr>
<tr>
<td>Total</td>
<td>1288</td>
<td>1223</td>
<td>95</td>
</tr>
</tbody>
</table>

Source: SEBI Annual Report, 2007-08

Figure 4.1: Investigation of Cases by SEBI

- Cases Taken up for Investigation
- Cases Completed

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The trends of investigation of cases by SEBI have also been represented by diagram in fig. 4.1 which shows the performance of SEBI regarding investigation of cases.

ii) Trend in Prosecution

The process of prosecution has declined since 2000 to 2006 as 28 prosecutions were launched against 127 persons/entities during 2008-09 as compared to 39 in 2007-08 (Table 4.2) shows the decreasing trends of the number cases in which prosecution has been launched.

Table 4.2
Prosecutions Launched by SEBI

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of cases in which prosecution has been launched</th>
<th>No. of persons/entities against whom prosecution has been launched</th>
<th>No. of Persons Per Case Launched</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto and including 1995-96</td>
<td>10</td>
<td>58</td>
<td>6</td>
</tr>
<tr>
<td>1996-97</td>
<td>13</td>
<td>63</td>
<td>5</td>
</tr>
<tr>
<td>1997-98</td>
<td>11</td>
<td>81</td>
<td>7</td>
</tr>
<tr>
<td>1998-99</td>
<td>15</td>
<td>145</td>
<td>10</td>
</tr>
<tr>
<td>1999-00</td>
<td>23</td>
<td>121</td>
<td>5</td>
</tr>
<tr>
<td>2000-01</td>
<td>20</td>
<td>98</td>
<td>5</td>
</tr>
<tr>
<td>2001-02</td>
<td>115</td>
<td>613</td>
<td>5</td>
</tr>
<tr>
<td>2002-03</td>
<td>229</td>
<td>848</td>
<td>4</td>
</tr>
<tr>
<td>2003-04</td>
<td>458</td>
<td>2377</td>
<td>5</td>
</tr>
<tr>
<td>2004-05</td>
<td>84</td>
<td>410</td>
<td>5</td>
</tr>
<tr>
<td>2005-06</td>
<td>27</td>
<td>81</td>
<td>3</td>
</tr>
<tr>
<td>2006-07</td>
<td>21</td>
<td>149</td>
<td>7</td>
</tr>
<tr>
<td>2007-08</td>
<td>39</td>
<td>188</td>
<td>5</td>
</tr>
<tr>
<td>2008-09</td>
<td>28</td>
<td>127</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: SEBI Annual Report, 2007-08
But the number of persons/entities against whom prosecution has been launched, predict an increasing trend in the year 2003-04 which shows that maximum number of prosecutions were launched in this year in respect of person and entities. However, the above trend of investigations and prosecution launched by SEBI, showed its determination to ensure investors protection in security market.

4.9 Trends of Investor's Grievances Redressed by SEBI

The SEBI has established a comprehensive investor grievances Redressal mechanism. The Investor Grievances Redressal and Guidance Division of the SEBI assists investors who prefer to make complaints to the SEBI against listed companies. A standardized complaint format is available at all SEBI offices and on the SEBI website for the convenience of investors. Each complaint is taken-up with the company and if the complaint is not resolved with in a reasonable time, a periodical follow-up is also made with the company. Errant companies are warned of stern action, to redress grievances. Recalcitrant companies are referred for prosecution. Table and Figure 4.3 show the SEBI's performance regarding redressal of investors' grievances. Trends of receipt and redressed of investors grievances shows that during the year 1991-92, SEBI received 1,8,794 grievances from investors, out of which only 4,061 grievances were redressed. In 1991-92, its performance was only 21.6 percent in respect of redressal of investors grievances. After 1993-94, SEBI's performance regarding redressed of investor's grievances showed increasing trends. In the year, 2007-08, its performance was 93.6 percent in comparison to the year 2006-07, when it was 94.3 percent. The position of investors' grievances and their redressal since 1991-92 by SEBI is depicted in the following table 4.3
Table 4.3

Trends of Investor’s Grievances Received and Redressed by SEBI

<table>
<thead>
<tr>
<th>Year</th>
<th>Grievances Received</th>
<th>Grievances Redressed</th>
<th>Cumulative Redressal Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>During the Period</td>
<td>Cumulative</td>
<td>During the Period</td>
</tr>
<tr>
<td>1991-92</td>
<td>18794</td>
<td>18794</td>
<td>4061</td>
</tr>
<tr>
<td>1992-93</td>
<td>110317</td>
<td>129111</td>
<td>22946</td>
</tr>
<tr>
<td>1993-94</td>
<td>584662</td>
<td>713773</td>
<td>339517</td>
</tr>
<tr>
<td>1994-95</td>
<td>516080</td>
<td>1229853</td>
<td>351842</td>
</tr>
<tr>
<td>1995-96</td>
<td>376478</td>
<td>1606331</td>
<td>315652</td>
</tr>
<tr>
<td>1996-97</td>
<td>217394</td>
<td>1823725</td>
<td>431865</td>
</tr>
<tr>
<td>1997-98</td>
<td>511507</td>
<td>2335232</td>
<td>676555</td>
</tr>
<tr>
<td>1998-99</td>
<td>99132</td>
<td>2434364</td>
<td>127227</td>
</tr>
<tr>
<td>1999-00</td>
<td>98605</td>
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<td>2000-01</td>
<td>96913</td>
<td>2629882</td>
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<tr>
<td>2001-02</td>
<td>81600</td>
<td>2711482</td>
<td>70328</td>
</tr>
<tr>
<td>2002-03</td>
<td>37434</td>
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<td>38972</td>
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<td>2003-04</td>
<td>36744</td>
<td>2785660</td>
<td>21531</td>
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<tr>
<td>2004-05</td>
<td>54435</td>
<td>2840095</td>
<td>53361</td>
</tr>
<tr>
<td>2005-06</td>
<td>40485</td>
<td>2880580</td>
<td>37067</td>
</tr>
<tr>
<td>2006-07</td>
<td>26473</td>
<td>2907053</td>
<td>17899</td>
</tr>
<tr>
<td>2007-08</td>
<td>54933</td>
<td>2961986</td>
<td>31618</td>
</tr>
</tbody>
</table>

Source: SEBI Annual Report, 2007-08

The trend of investors’ grievances received and redressed by SEBI has also been represented by graph in fig. 4.2 which shows the performance of SEBI regarding redressal of investors’ grievance.
In the year 1991-92, the number of grievances received by SEBI which was just 18,794, increased to 3,76,478 in the year 1995-96, but dropped down to 2,6,473 in the year 2006-07. In the year, 2007-08, 5, 4,933 grievances were received and 31,618 were redressed. The above trends show that SEBI's has improved its grievances redressal procedure to protect investor and to ensure development of security market by enhancing investors' confidence.

It has been concluded that for protecting the interest of investors, the Government of India passed various legislations like Companies Act, 1956, Capital Issues (Control) Act, 1947 and Securities Contracts (Regulation) Act, 1956. These legislations have brought many changes in the working of stock market in India till 1991. The year 1991, witnessed a big push being given to liberalization and reforms in the Indian financial sector. For sometime thereafter, the volume of business in the primary and secondary securities market increased significantly. As a part of the same reform process, the globalization or internationalization of Indian financial system made it vulnerable to external shocks. The multi-crore securities scam rocked the IFS in 1992. All these
developments impressed on the authorities the need to have in place a vigilant regulatory body or an effective and efficient watch dog. It was felt that the then existing regulatory framework was fragmented, ill-coordinated, and inadequate and that there was a need for an autonomous, statutory, integrated organization to ensure the smooth functioning of the IFS. The SEBI came into being as a response to these requirements.

The SEBI was established on April 12, 1988 through an administrative order, but it become a statutory and really powerful organization only since 1992. The CICA was repealed and the office of the CCI was abolished in 1992, and the SEBI was set-up on 21 February 1992 through an ordinance issued on 30 January, 1992. The ordinance was replaced by the SEBI Act on 4 April, 1992. Certain powers under certain sections of SCRA and Companies Act, 1956 have been delegated to the SEBI. The regulatory powers of the SEBI were increased through the Securities Laws (Amendment) Ordinance of January, 1995 which was subsequently replaced by an Act of Parliament. The SEBI is under the overall control of the Ministry of Finance, and has its head office at Mumbai. It has now become a very important constituent of the financial regulatory framework in India.

SEBI has wide powers to issue rules, regulations and guidelines in respect of both primary and secondary securities markets. A wide variety of intermediaries are operating in these, markets, viz. brokers, merchant bankers, underwriters, bankers to issues and certain financial institutions such as mutual funds etc. It is empowered to summon all categories of market intermediaries, to investigate their working, to impose penalty, and to initiate prosecution against them. But the GOI can supersede the SEBI under certain circumstances, and in respect of
all policy matters, the GOI can give directions to the SEBI. The GOI’s decision is final in every case.

The SEBI introduced an array of reforms in the primary and secondary markets and catalyzed modernization of the market infrastructure to prepare the market for the twenty-first century. India is probably the only country where stock exchanges have screen-based trading. Computerized trading has lead to reduction in the scope for price-rigging.

References


6. L. M. Bhole, ... op. cit., pp. 7.1.

7. Ibid ... pp. 6.1-6.4.

8. Ibid ... pp. 7.2-7.5.


12. Ibid ... pp. 91-93.

13. V. A. Avadhani, ... op, cit., p. 58.