Chapter 6
INVESTORS' PROTECTION AND EDUCATION –
REGULATORY FRAMEWORK

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Chapter 6

INVESTORS’ PROTECTION AND EDUCATION –
REGULATORY FRAMEWORK

6.1 Introduction

Capital market plays a key role in the economy as the source of investible funds for the corporate sector. During the past two decades particularly since initiation of the financial sector reforms in 1992, the Indian Capital Market has witnessed metamorphic changes with respect to products, participants, market microstructure, regulation and enforcement. These reforms have been introduced in order to ensure wide participation of household investors particularly small investors, to enhance transparency in operations and to develop Indian capital market in line with the international standards. Though these reforms have really helped the Indian capital market to attain a new high, the small investors have really been left on their own.

The idiom ‘Investor protection and education’ is being discussed since the beginning of the capital market i.e. since 1850. In order to protect investors a system of regulatory network has been developed by the Government of India. This chapter presents a detailed probe in the various regulations, legislations enacted and organizations set up by the government to promote and protect the interest of investors. The chapter also takes a review of the various non-government agencies working in Mumbai for the cause of investors.

6.2 The Securities and Exchange Board of India

The burgeoning growth of the stock market has necessitated the establishment of a separate regulatory agency for the securities market. Accordingly the government has passed the Securities and Exchange Board
of India Act, 1992 (SEBI Act) to provide for the establishment of the Securities and Exchange Board of India (SEBI) on the pattern of Securities Exchange Commission of the U.S.A. to protect the interest of investors in securities and to promote the development of and to regulate the securities market. The Board of members of SEBI consists of a Chairman, two members from the officials of the ministries of the Central Government dealing with finance and law, one member from amongst the officials of Reserve Bank of India, two other members appointed by Central Government, who would be professional with adequate knowledge of securities market. The Board insures that the interest of investors is protected and the development of the securities market is well promoted.

The objective of a stable market is sought to be achieved by two agencies at two levels. First, at the exchange level, the Board of governors and at the national level the Securities and Exchange Board of India. The activities of the stock brokers are regulated by the Board of Governors of the stock exchange. Stock exchanges are designed to be self regulatory. In fact, no stock exchange is granted recognition by the Government of India unless its rules and bye-laws are in conformity with such conditions as may be prescribed with a view to protecting the interest of investors. At the national level is he Securities and Exchange Board of India exercising a supervisory role over the functioning of the capital market and stock exchanges.

The following model indicates vividly the objectives of the SEBI
Model 6.1

Objectives of SEBI

- Investor Protection
- Steady Flow of Savings
- Fair practices by the Issuers
- Promotion of Efficient Services
- Transparency in Work

Model 6.1 gives a brief idea of the objectives of SEBI. Thus, the prime objective of SEBI is to protect and promote the interest of the investors and thereby achieve overall development of the securities market.

The functions of SEBI include registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustee of trust deeds, registrar to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and mutual funds. The functions of SEBI also include promoting investors’ education and training of intermediaries of securities market, prohibiting fraudulent and unfair trade practices relating to dealing in securities, prohibiting insider trading in securities, regulating substantial acquisition of shares and take-over of companies, etc. The following model gives a quick glance at the SEBI functions.
Model 6.2
Functions of SEBI

1) Registration of brokers and sub-brokers and other players in the market.
2) Registration of collective investment schemes and mutual funds.
3) Regulation of stock exchanges and other S.R.O.s, merchant banks, portfolio managers, etc.
4) Prohibition of all fraudulent and unfair trade practices.
5) Controlling Insider trading and takeover bids and imposing penalties for such practices.

1) Investor Education
2) Training of Intermediaries
3) Promotion of fair practices and a code of conduct for all S.R.O.s.
4) Conducting research and publishing information useful to all market participants.

6.2.1 Features of the SEBI Act, 1992:-

The salient features of SEBI Act, 1992 are as given below.

1) The SEBI shall be a corporate body by the name having perpetual succession and a common seal with a power to acquire, hold and dispose of property both movable and immovable, and to contract, and shall, by the said name sue or be sued.

2) The head office of the board shall be at Bombay. The board may establish offices at other places in India. In Bombay, the board is situated at Mittal Court, B-Wing, 224, Nariman Point, Bombay- 400021.
3) The chairman and the members of the board are appointed by the central government.

4) The general superintendence, direction and management of the affairs of the board are in a Board of members, which may exercise all powers and do all the acts and things which may be exercised or done by that board.

5) The government can prescribe terms of office and other conditions of service of the chairman and members of the board. The members can be removed under section 6 of the SEBI Act under specified circumstances.

6) It is the primary duty of the board to protect the interest of the investors in securities and to promote the development of and to regulate the securities market by such measures as it thinks fit.

6.2.2 Powers of SEBI under the SCRA:-

In addition to the powers that have been granted to be exercised by the SEBI under its own law, following are the powers granted to it under the Securities Contract (Regulation) Act (SCRA):

1) Information:-

SEBI calls for periodical returns from stock exchanges. It would also prescribe maintenance of certain documents by the exchanges. In addition, SEBI calls upon the exchange/ any members(s) to furnish explanation/ information relating to the affairs of the exchange/ any member(s) to appoint any person to conduct an inquiry into the affairs of the governing body of any exchange/ any member of the exchange.

2) Stock exchange regulation:-

SEBI commands following powers as relating to the regulation of stock exchanges:-

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a) Approval of byelaws of the exchange(s) for regulation and control of contracts.
b) Licensing of dealers in securities in certain areas.
c) Compel a public company to list its shares.
d) Furnishing of annual report by recognized stock exchanges.
e) Issuing direction to stock exchanges in general or a stock exchange in particular to make rules or to amend rules.
f) Superseding the governing body of a recognized stock exchange.
g) Suspension of business of recognized stock exchange.
h) Submission of application for the recognition of stock exchanges.
i) Grant of recognition to stock exchanges.
k) Making or amending rules or articles of association of stock exchange regarding voting rights of members of a stock exchange at any meeting.
l) Regulation and control of the business of dealing in spot delivery contracts.
m) Hearing appeals submitted by companies against refusal of a stock exchange to list their securities, etc.

3) Registration of intermediaries:-

All intermediaries dealing in securities are compulsorily registered with the SEBI in accordance with the regulation made under the SEBI Act. The certificate of registration contains the conditions/rules and regulations for the conduct of business by the security market intermediaries. The SEBI prescribes regulations for the application form and the manner of making an application as well as the fee payable. The SEBI can suspend/cancel certificate of registration granted to the
intermediaries in accordance with the regulations made by it in this behalf.

4) Directions from Government:-

The government of India can issue directions to SEBI on question of policy in writing from time to time. It is bound to follow and observe such directions in the exercise of its powers/ the performance of its functions. The government has absolute discretion to determine whether a question is one of policy or not. Its inability to discharge its functions/ duties, or non-compliance to follow and act upon any direction given by the government or requirement in the public interest may lead to its suspension by the government.

5) Power to make rules:-

The government is authorized to make rules for carrying out the purposes of the SEBI Act. The important matters for which rules may be framed, include, the additional functions to be performed by it, its constitution, maintenance of its accounts, manner of inquiry to impose penalty for defaults, constitution of the Securities Appellate Tribunal (SAT), and the form in which reports have to be submitted to the government. The government was also empowered to frame rules regarding the conditions for certificate of registration for intermediaries. With effect from 1995, this power was withdrawn from the government and rests with the SEBI now.

6) Power to make regulations:-

To carry out its functions SEBI is empowered to make regulations. Every regulation made by it must have the prior approval of the government. All such regulations must be published as notification in the official gazette. The matters for which regulation(s) may be framed include-
a) The conditions for registration certificate, fee for registration, cancellation/suspension of registration of intermediaries and
b) Matters relating to issue of capital; transfer of securities and so on.
7) imposing Penalties:-

With effect from 1995, the SEBI has been empowered to impose penalties on different intermediaries for defaults such as the following-

a) Failure to furnish information and return- The SEBI can impose penalties as detailed below:-

i) For failure to furnish any document, return, report – not exceeding Rs. 150000 for each such failure.

ii) For failure to file any return/ furnish any information, books or documents within the specified time- not exceeding Rs. 50000 for each day.

iii) Failure to maintain books of accounts/ records – not exceeding Rs. 10000 for each day.

b) Failure to enter into agreement with clients – not to exceed Rs. five lakh for every failure.

c) Failure to redress investors’ grievances – not to exceed Rs. 10000 for each such failure.

d) Defaults in case of mutual funds –

i) Default in not obtaining certificate of registration – not to exceed Rs. 10000 for each day or Rs. 10 lakhs whichever is higher.

ii) Default in not complying with the terms and conditions of the certificate of registration – not to exceed Rs. 10000 for each day or Rs. 10 lakh whichever is higher.

iii) Default in making to make an application for listing of schemes – not to exceed Rs. 5000 per day or Rs. five lakhs, whichever is higher.
iv) Default in not dispatching unit certificates – not to exceed Rs. 5000 for each day of default.

v) Default in failing to refund application money – not to exceed Rs. 1000 for each day of default and

vi) Default in failing to invest collected money not to exceed Rs. five lakhs for each such default.

e) Failure by an AMC – not to exceed Rs. five lakhs for each such failure.

f) Default in case of stock brokers –

   i) For failure to issue contract notes in the form and manner prescribed by the stock exchange – not to exceed five times the amount for which the contract note was required to be issued.

   ii) For failure to deliver any security/payments the amount due to the investor in the manner and within the period specified in the regulations – not to exceed Rs. 5000 for each day of default.

   iii) For charging brokerage in excess of that prescribed by the regulation not to exceed Rs. 5000 or five times the excess charge, whichever is higher.

   g) Penalty for insider trading – If an insider a) deals in securities on his behalf or on behalf of others on the basis of an unpublished price sensitive information or b) communicates any unpublished price sensitive information except as required in the course of business or under any law, or c) counsel or procures for any person to deal in such securities on the basis of unpublished price sensitive information, he is liable to a penalty not exceeding Rs. five lakhs.

h) Non-disclosure of acquisition of shares and takeovers – Failure to disclose the aggregate of shareholding in a company before acquiring any share of that company, and also to make a public announcement
for acquiring shares at a minimum price is liable to penalty not exceeding Rs. five lakhs

8) Power to adjudicate:–

The SEBI is empowered since 1995, to appoint any of its officers of the rank of a division chief as the adjudicating officer, to hold an enquiry in the manner prescribed for determining the amount of penalty on any intermediary. The quantum of penalty is to be fixed with due regard to a) the amount of disproportionate gain or unfair advantage made as result of the default, b) the amount of loss caused to an investor/group of investors as a result of the default and c) the repetitive nature of default.

6.2.3 Role and Relevance of SEBI:–

The role of SEBI in the realm of development and regulation of the securities market in India is discussed hereunder–

1) Regulatory role:–

Since its inception in 1992, the SEBI as a capital market regulator has been making tremendous efforts towards achieving its twin objectives of investor protection and capital market development as mandated by the SEBI Act. SEBI has initiated a number of policy initiatives. The focus of attention of SEBI’s activities is as follows:–

a) Increasing market transparency through further improvement of disclosure standards.
b) Improving the standards of corporate governance.
c) Improving market efficiency by speeding up the process of dematerialization and introducing rolling settlement in a phased manner.
d) Reduced transaction costs by refining the margin system.
e) Enhancing the market safety through an efficient margin system and stepping up surveillance.

2) Credible regulatory structure:-

SEBI has been responsible for successfully creating a credible regulatory structure for the securities market. It acts as a major catalyst for the development of the securities market in India. For this purpose it brings about far reaching changes in market practices, introduces the internationally acclaimed best practices and procedures in the realm of trading and engages it in periodical modernization of the market infrastructure by enforcing regulations taking advantage of technology. SEBI introduced a package of measures of liberalization, regulation and development for the healthy promotion of the securities market in India, keeping in mind the necessity of contributing to the industrial and economic growth of the country.

3) Market surveillance:-

In order to bring about orderliness in the working of the stock exchanges all over India, market surveillance is an important key used by the SEBI. This assumes relevance in the context of the growing incidence of scams taking place in the capital market. SEBI set up a Market Surveillance Division as early as in July 1995, with a view to keep a pro-active surveillance on the activities of the stock exchanges.

4) Disclosure standards:-

SEBI appointed an expert committee in 1995 under the chairmanship of Y. H, Melgam to suggest measures for improving the disclosure standards. Another committee was appointed under the chairmanship of C. B. Bhave to recommend measures for improving the continuing disclosure standards by corporates and timely dissemination of price sensitive information to the public. On the basis of the
recommendations of the above committees, SEBI initiated such steps as the imposition of a set of entry barriers on new issues specifying the minimum issue size requirements for companies that seek listing. A reinforcing step was initiated by the SEBI by issuing the compendium of SEBI (Disclosure and Investor Protection) Guidelines, 2000 effective from January 27, 2000. This was the consolidation of all earlier guidelines encompassing entry norms, lock-in-period, promoters’ contribution, etc. This was done in order to streamline the current procedure and smoothen out the aberrations in initial offerings.

5) Best governing practices:-

Based on the recommendations of Kumar Manglam Birla Report, SEBI put into vigorous practice, the code of corporate governance in listed companies for the purpose of affording protection to investors through the mechanism of enhanced standards of corporate management.

To secure corporate governance in companies, the SEBI issued directives to stock exchanges to amend the listing agreement to include a new clause (clause 49) on corporate governance to be adhered to, by the listed companies. The board areas of corporate governance were composition of board of directors, disclosure requirements, compliance report on corporate governance and compliance certificate. Such a measure was designed to instill investor confidence in the capital market through better corporate governance.

6) Building investor confidence:-

SEBI took a number of steps in order to allow for better investor protection and market development so as to usher in an active primary market. Safety measures introduced by the SEBI for safeguarding the interests of millions of investors and also building their confidence were as follows-
a) Appointment of compliance officer.

b) Prudent corporate governance norms for all listed companies to ensure transparency and better disclosure practices.

c) Service centers set up by stock exchanges for investors to enable them to have a forum for recording and counseling their grievances as well as access to financial and other information of companies and government policies, rules, regulations, etc.

d) Better monitoring and market surveillance systems.

e) Directions to stock exchanges to take stern action against companies not complying with listing agreement.

f) Standardization of investor complaints lodged with SEBI against companies.

7) Global Outlook:-

Rapid developments in the realm of global financial markets has prompted the SEBI to initiate steps for the faster integration of the Indian securities market with the rest of the world. Accordingly, FIIs have been permitted to invest in all types of securities including government securities. Similarly, Indian companies have been permitted to raise resources from abroad through the issue of ADRs, GDRs, FCCBs and ECBs. In the same manner, Indian stock have been permitted to set up trading terminals abroad and trading platform of Indian exchanges are now accessed through internet from anywhere in the world.

As an active and leading member of the International Organisation of Securities Commission (IOSCO), the SEBI has been making all efforts to harmonize SEBI regulations and guidelines with IOSCO’s principles securities’ regulations. This was designed to conform to global standards. On the basis of the IOSCO’s 30 principles
of securities' regulations, the SEBI has devised its own principles aimed at protection of investors, ensuring the markets are fair, efficient and transparent, and reduction of systematic risk. The eight categories of principles formulated by the SEBI are as follows-

i. Principles relating to the regulator  
ii. Principles of self regulation  
iii. Principles for the enforcement of securities regulations  
iv. Principles for co-operation in regulation  
v. Principles of issue  
vi. Principles for market intermediaries  
vii. Principles for the secondary market

8) Improving operational efficiency:-

An important requirement for the efficient functioning of the capital market is the efficient functioning of the market participants. In this regard, SEBI has undertaken number of measures aimed at improving the operational and informational efficiency in the market. This has helped the participants to carry out transactions in a cost effective manner by providing full, relevant, accurate and timely information.

A number checks and balances have been built to ensure the desired level of investor protection, enhance their confidence and avoid systematic failure of the market. Allowing contestability of the market and imposing entry criteria for issuers and intermediaries have ensured stability of the system as a whole. Prudential controls on intermediaries have facilitated the financial integrity of the market.

9) Screen based trading:-

A landmark development that took place in the history of the SEBI was the initiative taken by it to constitute the OTCEI (Over the
Counter Exchange of India) in the year 1992 and the National Stock Exchange (NSE) in the year 1994. The exchange allowed for transparency in the securities dealings made possible through the screen based trading. Under this mechanism, information regarding quotations for securities, the prices of transactions and volume of those transactions is made publicly available promptly after each transaction or quotation.

6.2.4 SEBI and investor education:-

Investor awareness and investor education go hand in hand with investor protection. An educated investor feels more protected. An informed investor feels safer and is further encouraged to invest in the capital market. Investors therefore need proper and accurate education so that they can make informed decisions.

To educate the investors, SEBI issues series of advertisements in various vernacular newspapers about investors rights, their responsibilities, key terms used in capital market as well as the risks involved in the capital market. Also SEBI has broadcast educative message for the investors through national and regional stations of Vividh Bharati as well as on television channels. Further, over a crore of booklets ‘A quick Reference Guide for Investors’ have been circulated through various companies and making it available on complementary basis to investors who visit SEBI offices. SEBI’s Annual Report 2006-07 clearly shows that SEBI conducted the investor awareness campaign in the following manner-

Securities Market Awareness Campaign:

SEBI launched a comprehensive education campaign for the investors in the securities market called as ‘Securities Market Awareness Campaign’ (SMAC). The motto of the campaign was ‘An educated
investor is a protected investor.' The table given below shows the details of the SMAC launched and conducted by the SEBI.

**Table 6.1**

**Securities Market Awareness Campaign**

<table>
<thead>
<tr>
<th>Item</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Level Seminars</td>
<td>States covered</td>
</tr>
<tr>
<td>Workshops</td>
<td>Number held</td>
</tr>
<tr>
<td></td>
<td>Cities/ Towns covered</td>
</tr>
<tr>
<td>Educational material</td>
<td>Copies distributed</td>
</tr>
<tr>
<td>Media-print</td>
<td>Total appeared</td>
</tr>
<tr>
<td>Advertisements/ Announcements</td>
<td>Languages covered</td>
</tr>
<tr>
<td></td>
<td>Cities covered</td>
</tr>
</tbody>
</table>

Source: SEBI Annual Report 2007

Table 6.1 given above presents the details of the SMAC held by SEBI during the year 2006-07. It shows that the program was spread over 12 states. In total 374 workshops were held which covered 235 cities/towns. 240000 copies of educational material was distributed. SEBI addressed investors through media print by making a total appearance for 721 times. Finally the advertisement issued by SEBI with respect to investor protection and education was made public in 11 different languages which covered 111 cities.

**6.2.5 The Road Ahead:**

Indian securities markets have undergone dramatic changes over the last several years. SEBI has been continuously endeavoring to make the Indian capital market efficient, transparent and investors’ friendly. Though a significant amount of work has been done over the couple of
years, SEBI recognizes that it still has a long way to go. Some major priorities from its immediate agenda are given below-

- Setting up of Central Listing Authority (CLA).
- Corporatization and demutualization of stock exchanges.
- Strengthening of corporate governance through evaluation of form and measurement of wealth creation, wealth management and wealth sharing.
- Improving liquidity through increased use of margin trading facility and securities lending.
- Setting up of investor Protection Corporation.
- Educating the investors about the securities market.
- Strengthening risk management system of mutual funds.
- Expansion of product portfolio in derivative segment.
- Improving the quality of intermediaries and corporate governance at intermediaries.
- Strengthening regulatory transparency.
- Creation of market intelligence network and strengthening surveillance enforcement.
- Development of active corporate bond market.
- Use of digital signatures in securities transactions.
- Development of self regulatory organizations (SROs) in securities market.

6.3 The Securities Contracts (Regulation) Act, 1956

The securities Contracts (Regulation) Act, 1956 was legislated to prevent undesirable transactions in securities by regulating the business of dealing therein. The Act, which extends to the whole of India, came into effect from 20th February, 1957. The passing of this Act marks an important
milestone in the history of Indian securities market. The Act seeks to accomplish this objective by prohibiting options (options are however, now allowed trading) and by providing for certain other matters connected therewith. The Act also seeks to regulate the buying and selling of securities outside the limits of stock exchange, through the licensing of securities dealers.

6.3.1 Provisions of the Act:

The important provisions of the Act as it relates to the regulation of the working of stock exchanges and matters related thereto are as follows-

a) Exemptions (Section 28)-

The Act will not be applicable to such organizations and agencies as the government, the Reserve Bank of India, any local authority, any corporation set up by a special law, any person who has effected any transaction with or through the agency of government or institutions mentioned above. Similarly the provisions of the Act will also not apply to any convertible bond or share warrant or any option or right in relation thereto.

b) Rules –

The rules under the Act were framed in 1957, to provide for the procedure to be followed for recognition of stock exchanges, submission of periodical returns and annual reports by recognized stock exchanges and their members, and requirements for listing of securities. The rules are statutory and they constitute a code of standardized regulations uniformly applicable to all the recognized stock exchanges in India.

According to this Act, stock exchange has been defined as
“Any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.”

c) Recognized stock exchanges-

There are at present 24 recognized stock exchanges functioning at various places in the country. While the recognition granted to some of the exchanges are on permanent basis, in respect of others it is temporary, which can be extended. Within the city/town limits wherever stock exchanges are located contracts entered into otherwise than between members of recognized stock exchanges or through or with such members will be illegal. Following are the recognized stock exchanges in India.

1) The Bombay Stock Exchange (BSE).
2) The Ahmedabad Stock Exchange Association Ltd.
3) Bangalore Stock Exchange Ltd.
4) Bhubaneshwar Stock Exchange.
5) The Calcutta Stock Exchange Association Ltd.
6) The Cochin Stock Exchange Ltd.
7) The Delhi Stock Exchange Association Ltd.
8) The Guwahati Stock Exchange Ltd.
9) The Hyderabad Stock Exchange Ltd.
10) The Jaipur Stock Exchange Ltd.
11) The Kanara Stock Exchange Ltd.
12) The Ludhiana Stock Exchange Association Ltd.
13) The Madras Stock Exchange Ltd.
14) The Madhya Pradesh Stock Exchange Ltd.
15) The Magadh Stock Exchange Ltd.
16) The Mangalore Stock Exchange Ltd.
17) The Pune Stock Exchange Ltd.
18) The Saurashtra Kutch Stock Exchange Ltd.
19) The Vadodara Stock Exchange Ltd.
21) The Meerut Stock Exchange Ltd.
22) The Over The Counter Exchange of India (OTCEI).
23) The National Stock Exchange of India (NSE).
24) The Interconnected Stock Exchange of India Ltd.

Thus, the Act provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives the central government regulatory jurisdiction over a) stock exchange through the process of recognition and continued supervision, b) contracts in securities, and c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with conditions prescribed by the central government.

6.4 Capital Issues (Control) Act

The Act had its origin during the war in 1943 when the objective was to channel the resources to support the war efforts. It was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channeled into proper lines, i.e. for the desirable purposes to serve goals and priorities of the government, and to protect the interest of investors. Under the Act any firm wanting to issue securities had to obtain approval from the central government, who also determined the amount, type and price of the issue. As a part of the liberalization process, the Act was repealed in 1992 paving a way for market determined allocation of resources.
6.5 Depositories Act, 1996

The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by a) making securities of public limited companies freely transferable subject to certain exceptions; b) dematerializing the securities in the depository mode; c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of ownership of securities electronically by book entry without making the securities move from person to person. The Act has made the securities of all public company freely transferable, restricting the company’s right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the Companies Act have been dispensed with.

6.6 Companies Act, 1956

One of the principle objectives of the Companies Act is investor protection. This is needed in view of the fact that investors put their hard earned savings in the purchase of securities floated by the companies. The company being a juristic person it functions through its management in order to ensure that they do not misuse their position to enrich themselves at the cost of the company; there are various safeguards and restrictions on company.

The Companies can collect savings from small investors in various ways:
- Equity capital
- Company Fixed Deposits
- Convertible Debentures
Non-convertible Debentures, etc.

The Companies Act, 1956 has made several provisions to protect small investors for all the above financial instruments. One of the major segments of the capital markets is the primary market. Companies raise money from capital market through IPO and public issues. With a view to ensure that small investors of securities get the information for taking the investment decision, the Act inter-alia provided that every application to subscribe for the shares and debentures sent by the company must be accompanied by the prospectus. The company is obliged to file a copy of prospectus duly signed by all the directors with the Registrar of Companies. No company can proceed to issue and allot the shares unless the prospectus or statement in lieu of prospectus is filed with the Registrar.

The allotment of shares before receiving minimum subscription was prohibited under section 69 of the Act. The Directors were free to declare any amount as the minimum subscription, which was not less than five percent of the issue amount. It is only after SEBI announced Disclosure and Investor Protection Guidelines in 1992 that receiving 90 percent of the issue amount was made as a minimum subscription amount.

To protect the interest of investors in the secondary market the Act provided that the shares must be transferred within a period of two months from lodgment. The Companies Act did allow the Board of Directors of the company a right of refusal to effect the transfer of shares. However, Section 111 of the Act allows the transferor and transferee to prefer an appeal against such refusal to the National Company Law Tribunal.

The Act has made elaborate provisions to protect the interests of depositors placing their deposits with the companies. Firstly such deposits can be taken for an amount not exceeding 25 percent of the aggregate of the
paid up capital and free reserves from the public and additional 10 percent of the aggregate paid up capital and free reserves could be taken from the shareholders of the company. In order to ensure that investors know the minimum financial details of the company the Companies’ Acceptance of Deposit Rules provide that no company shall invite or accept the deposits from the public unless the company has filed particulars of advertisement in the prescribed form with the Registrar of Companies and such particulars are required to be signed by the majority of the directors as on the date on which such particulars were provided.

Further, where the company fails to repay the deposit or to pay interest thereon as per the terms of such deposit, the investor has been given a right to file petition to the National Company Law Tribunal (Company Law Board). In respect of non-payment to the small depositors keeping the deposit upto Rs. 20000 the responsibility is cast on the company itself to inform the said Tribunal. Failure to do so is made a cognizable offence. The Company Law Board (now National Company Law Tribunal) has the jurisdiction to hear the case against non-banking finance companies.

In order to protect the interests of the existing shareholders the Companies Act Section 81 gave pre-emptive rights to the shareholders in further issue of capital by the companies. The Act compels the companies to issue the existing shareholder new shares in the same proportion to their present holding in the share capital of the company. Thus, the Directors can not increase their holding percentage by issuing shares to themselves disproportionately.

6.7 **BSE on investor protection and education**

BSE has taken various measures with respect to investor protection and education which are as follows-
a) Surveillance department of BSE:-

The surveillance department of BSE has three main sections, viz. i) position monitoring, ii) Price monitoring and iii) investigation.

Position monitoring- monitors exposure of member-brokers on a daily basis. Price monitoring monitors the trading of scrips having large variation in prices as well as volumes. The trading in scrips which reach new high or new low are watched. Also the prices and volumes in newly listed scrips are watched. Based on the findings, appropriate actions are taken. In case certain abnormalities are noticed, then circuit filters are reduced to make it difficult for the price manipulators to increase or push down prices of a scrip within a short period of time. The exchange also imposes special margin in the scrips where it is suspected that there is an attempt to manipulate prices by creating artificial volumes. In cases, where there is excessive volatility or sudden spurt in volumes or where the net deliverable quantity is insignificant the settlement of the trades in the scrip as a surveillance measure may be shifted on ‘trade to trade’ basis.

Detailed investigations are conducted by the investigation section in cases where price manipulation is suspected a disciplinary action is taken against the member-brokers concerned, if warranted. Where any scrip has been suspended for more than three days, a detailed investigation report is required to be prepared and sent to SEBI for further investigation, if any.

The BSE has also developed an On-Line Real Time (OLRT) surveillance system known as BSE On-Line Surveillance (BOSS) which was commissioned from July 15, 1999 with the main objective of detecting potential market abuses at nascent stage to reduce the ability of market participants to influence the price and volumes of scrips traded at
the exchange, improve the risk management system and to strengthen the self regulatory mechanism at the exchange. The system generates on-line alerts on real time and also generates on-line and off-line exception reports for settlement related information.

b) BSE and Investor Protection Fund:-

In accordance with the guidelines issued by the Ministry of Finance, Government of India, the Bombay Stock Exchange (BSE) has set up an Investors Protection Fund (IPF) on July 10, 1987 to meet the claims of investors against defaulter members. The fund is managed by the trustees appointed by the exchange. The member-brokers at present contribute to this fund Rs. 0.05 per Rs. 1 lakh of gross turnover which is debited to their settlement account.

The BSE contributes on a quarterly basis 2.5 percent of the listing fees collected by it from the companies listed with it. Also the entire interest earned by the BSE on 1 percent security deposit kept with it by the companies making public/ rights issues is credited to the Fund. The corpus of the fund, as at the end of March 31, 2003 was Rs. 178.57 crores.

The maximum amount presently payable to an investor from the fund in event of default by a member is Rs. 10 lakhs. This has been progressively raised by the exchange from Rs. 5000 in 1998 to the present level and is highest among the stock exchanges in the country.

c) BSE and Trade Guarantee Fund (TGF):

The TGF has come into force with effect from May 12, 1997. This scheme is managed by the Defaulters Committee which is a standing committee constituted by the BSE. Temporary refundable advances for a stipulated period are given by the Defaulters Committee from the Trade Guarantee Fund to the member-brokers who fail to meet
their settlement obligations subject to certain conditions and payment of interest at 0.07 percent per day on the outstanding amount. During the period of advance the BOLT TWSs of the member-brokers to whom the advance has been granted from TGF are kept de-activated.

d) BSE and grievances handling:

An Investors’ Service Cell (ISC) was set up in 1986 by BSE. The purpose of setting up such a department was to cater to the needs of investors and also to resolve complaints against listed companies/members of the exchange. The grievances of investors against listed companies and members of the stock exchange are redressed by the exchange.

The ISC also takes many pro-active measures to resolve the investors’ grievances like-

- Calling the company representative to the exchange to interact with the investors/members to resolve the complaints.
- Calling major registrars and transfer agents to the exchange for interaction with investors/members.
- Issuing monthly press release listing 25 companies against whom maximum complaints are pending for resolution. The list is also released on the website of the Exchange. A brief sketch on grievances would give one an idea as to how the ISC has effectively succeeded in resolving complaints. The total pending complaints against various companies under various heads such as non-receipt of shares/debentures sent for transfer/interest/dividend/bonus, etc. was as high as 54000 in 1996. The table given below presents the details of grievances received and resolved by the Investor Service Cell of BSE for the month of April 2008.
Table 6.2
Complaints received and resolved by Investor Service Cell of BSE
(For the month of April 2008)

<table>
<thead>
<tr>
<th>Type of complaints</th>
<th>Complaints received</th>
<th>Complaints resolved</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Against Active Companies</td>
<td>Against Suspended Companies</td>
</tr>
<tr>
<td>I</td>
<td>452</td>
<td>1</td>
</tr>
<tr>
<td>II</td>
<td>73</td>
<td>4</td>
</tr>
<tr>
<td>III</td>
<td>116</td>
<td>12</td>
</tr>
<tr>
<td>IV</td>
<td>140</td>
<td>36</td>
</tr>
<tr>
<td>V</td>
<td>38</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>819</strong></td>
<td><strong>62</strong></td>
</tr>
</tbody>
</table>

Source: www.bseindia.com

Table 6.2 given above shows that the ISC of BSE received a total of 881 complaints for the month of April 2008 of which 888 complaints were resolved which also includes the complaints carry forward of the previous month. The table also gives the bifurcation of complaints received of various types. The details of the types of complaints/grievance received by BSE have been given hereunder.

i) Investors’ grievances against companies-

These complaints received by BSE against companies are categorized into five categories-

- Type 1- Non-receipt of refund orders/ allotment letters/ stock investment, etc.
- Type 2- Non receipt of dividend/ interest.
Type 3- Non-receipt of share/ debenture certificates after transfer/ endorsement and bonus shares.

Type 4- Non-receipt of annual reports, right forms/ interest on delayed receipt of refund order/ dividend, etc.

Type 5- Non-receipt of credit with depository participants.

ISC forwards the complaints to the concerned companies and directs them to resolve the same within a period of 15 days. A copy of the letter sent to the company is also forwarded to the complainant. If the concerned company fails to resolve the complaints of investors and the total number of pending complaints exceed 25 and if the complaints are pending for more than 45 days, a show cause notice is issued to the company. If not taken care of then the trading of the scrip is shifted to “Z” group and in case of further non-resolution the trading may be suspended till the grievances are resolved. By transferring the shares to the “Z” category group, the exchange tries to caution the investors to be more careful in their investments in scrips of such companies. The Exchange attempts to put pressure on the companies to ensure compliance with various requirements of the Listing Agreement, redress grievances of investors and arrange for dematerialization of their securities.

ii) Investors’ grievances against member-brokers of the exchange-

As regards to complaints against members, these complaints are forwarded to concerned members to reply/ settle within 7 days from the receipt of letter. If no reply is received, the matter is placed before the Investors’ Grievances Redressal Committee (IGRC) headed by the retired High Court judge. The
IGRC tries to solve the matter amicably but in the absence of co-operation from the concerned member-broker the matter is referred for arbitration to the arbitration committee. In case a member fails to implement the decision of the IGRC, then the matter is considered for taking further action against the concerned member-broker including referring the matter to the Disciplinary Action Committee.

iii) Complaints of members inter-se-

In order to resolve the complaints of members’ inter-se, a Brokers’ Consultative Committee has been appointed by the Governing Board. This committee consists of two-member brokers of the exchange. The committee after hearing both the member-brokers give an award and if a member against whom the award has been given fails to implement the same then a show-cause notice is issued to him. Inspite of this if the member does not implement the award then the Department of Investor Service directly debits the settlement account of the concerned member-broker in the Clearing House and credits the other member-broker’s account with the amount of the arbitration award.

For the cases which are not resolved an arbitration mechanism is also put in place. The non-member arbitration panel consists of retired High Court and City Civil Court Judges, Chartered Accountants, Company Secretaries, Solicitors and other professionals having an in-depth knowledge of the capital market. For claims less than 10 lakhs, the applicant has to propose name of three arbitrators and the respondent(s) have to consent to one of them. For claims above Rs. 10 lakhs, a panel of three arbitrators, one each to be appointed by the applicant and respondent and the presiding
arbitrator has to be appointed by the Exchange to adjudicate the matter.

If the applicant is not satisfied with the award, he can appeal against the same to the Exchange within 15 days. The appeal bench of five arbitrators hears the matter and gives the award. Cases of non-implementation of arbitration awards by member-brokers are placed before the Disciplinary Action Committee of the Exchange for action against the member-broker concerned after issuing a show cause notice to them. An award by the arbitrators is forwarded to the Defaulters’ Committee. After satisfying itself about the genuineness of the claim, the Defaulters Committee pays the same from the assets of the defaulter lying with the Exchange or recommends to the Trustee of the Investors’ Protection Fund (IPF) to release the award amount of Rs. 10 lakhs, whichever is lower form the Fund. After the approval of the trustee of IPF, the amount is disbursed to the clients, who have obtained award against the defaulters.

e) Role of BSE in investors’ education-

Investor Awareness Programmes are being regularly conducted by BSE to educate the investors and to create awareness among the investors regarding the working of the capital market and in particular the working of the Stock Exchanges. These programmes have been conducted in Gujarat, Kerala, Tamilnadu, Uttar Pradesh, Rajasthan, Punjab, Haryana and within Maharashtra.

The Investor Awareness Programmes covers extensive topics like instruments of investment, portfolio approach, mutual funds, tax provisions, trading, clearing and settlement, rolling settlement, Investors’ Protection Fund, Trade Guarantee Fund, dematerialization of shares, information of debt market, investors’ grievances redressal system.
available with SEBI, BSE and Company Law Board, information on sensex and other indices, workshops on derivatives, futures, and options, etc. BSE’s official website www.bseindia.com which is the focal point for information dissemination, updates investors with the latest information on stock markets on a daily basis through real time updation of statistical data on market activity, corporate information and results. Educative articles on various products and processes are also available on the site. Also BSE regularly comes out with various publications for investor education.

f) BSE and investor awareness and Investor Protection Fund-

The Bombay Stock Exchange has also earmarked an amount of Rs. one crore for assistance to investor associations for conducting investor awareness and educational seminars, etc. During the year 2006-07 an amount of Rs. 20 lakhs has been disbursed to the SEBI recognized investors associations.

g) BSE Training Institute-

BSE believes that investors as well as various intermediaries associated with the capital market must learn about the available financial products, system of trading and settlements of financial products traded on the Exchange, managing risks arising therefrom, details of procedures and documentation, etc. so as to equip themselves to deal in the primary and secondary debt and derivatives market. With these objectives in view, the Exchange has established BSE Training Institute (BTI) on January 3, 1989.

BTI has emerged as the premier training institute in India conducting quality programmes for investors, various capital market intermediaries, members of stock exchanges and their staff and commerce and management students, etc. So far more than 30000
investors and working professionals have been trained at BTI. BTI regularly conducts programmes on the following topics-

- Programme on Investor Awareness.
- Programme on Stock Market Operations.
- Basic Programme on Derivatives.
- Programme on Index and Stock Futures
- Workshop on Options.
- Programme on Fundamental and Technical Analysis.
- Programme on Debt Market.
- Programme on Mergers and Acquisitions.
- Certificate Course on Stock Market.
- Programme on Corporate Governance.
- Programme on Interest Rate Futures.
- Programme on Commodity Trading.
- Programme on Mutual Funds.
- Programme on Exchange Traded Funds (ETFs).
- Programme on Retail Debt Market, etc.

The faculties drawn from the officials of the Exchange as well as external professionals and experts from the respective fields; conduct sessions at BTI. Apart from classroom sessions and hands on training on computers, etc. comprehensive study material is supplied to the participants for reference.

For bringing an international perspective to its programmes for the participants, BTI collaborated with the highly reputed New York Institute of Finance (NYIF) in November 2000 and conducted training programmes on the emerging and crucial topics of corporate governance, exchange traded derivatives and risk management. Further in March
2003 BTI conducted a five day training programme on derivatives for the members of South Asian Federation of Exchanges (SAFE) where participants from the stock exchanges in six countries in South East Asia attended the programme. BTI has also in the year 2002 affiliated itself with the Jamnalal Bajaj Institute of Management Studies, Mumbai for conducting a 3 month duration comprehensive programme on capital market and a certificate to the passing candidates after test is issued by the University of Mumbai.

6.8 NSE on investor protection and education

NSE has taken various measures with respect to investor protection and education which are as follows-

a) Role of NSE in investor protection and grievances handling-

In order to attend to investor grievances, NSE has put in place a system for redressal of investor grievances for matters/ issues related to/ against trading members/ listed companies. The Investor Grievance Cell (IGC) of NSE is manned by a team of professionals possessing relevant experience in the areas of securities markets, company and legal affairs and specially trained to identify the problems faced by the investors and to find and effect a solution quickly. It takes up complaints in respect of trades executed on the NSE through its NEAT terminal routed through the NSE trading member and trades pertaining to companies traded on NSE.

The status of pending investor grievances is given in the following table.
Table 6.3
Pending investor grievances at NSE

<table>
<thead>
<tr>
<th>Year</th>
<th>Pending against members</th>
<th>Pending against companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994-95</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>1995-96</td>
<td>13</td>
<td>24</td>
</tr>
<tr>
<td>1996-97</td>
<td>72</td>
<td>337</td>
</tr>
<tr>
<td>1997-98</td>
<td>439</td>
<td>197</td>
</tr>
<tr>
<td>1998-99</td>
<td>347</td>
<td>409</td>
</tr>
<tr>
<td>1999-00</td>
<td>298</td>
<td>375</td>
</tr>
<tr>
<td>2000-01</td>
<td>201</td>
<td>359</td>
</tr>
<tr>
<td>2001-02</td>
<td>710</td>
<td>299</td>
</tr>
<tr>
<td>2002-03</td>
<td>418</td>
<td>260</td>
</tr>
<tr>
<td>2003-04</td>
<td>253</td>
<td>229</td>
</tr>
<tr>
<td>Total</td>
<td>2751</td>
<td>2491</td>
</tr>
<tr>
<td>Average</td>
<td>275.1</td>
<td>249.1</td>
</tr>
</tbody>
</table>

Source: WWW.nseindia.com.

Table 6.3 given above shows the number of pending investor grievances at NSE. As given in the table the average cases pending against members were 275 whereas the cases pending against companies averages at 249. The average has got affected due to the extreme frequencies like the number of cases pending against members in the year 1994-95 was zero whereas in the year 2001-02 the number of cases pending against members was 710.

Some cushion to the interest of investors has been provided by the Investor Protection Fund (IPF) set up by the NSE. The exchange maintains an IPF to take care of investor claims which may arise out of non-settlement of obligations by the trading member who has been
declared a defaulter in respect of trades executed on the exchange. The maximum amount of claim payable from the IPF to the investor is Rs. 10 lakhs. An arbitration mechanism has also been put in place by the NSE to resolve disputes between the trading members and between a trading member and his client in respect to trades done on the exchange.

b) NSE and investor education-

NSE has put in place system to ensure that proper, up-to-date and correct information is available to the investors to enable them to take informed decisions and to ensure that their interests are protected. NSE has made attempts to ensure that all class of investors including the small investors receive critical and time-sensitive information at the same point of time.

NSE conducts various seminars and programmes for the investors all over the country with a view to educating them on their rights and obligations and precautions they should take while dealing in the securities market. NSE also makes an audit trial available on request, viz. price, time, etc. for the trades executed on his behalf by the broker.

In order to improve market efficiency further and to set up international benchmarks in securities industry, NSE administers a scheme called the NSE Research Institute. The initiative fosters research which can support and facilitate stock exchanges to design market microstructure, its participants to frame their strategies in the market, regulators in framing regulations, policy makers to frame policy and broaden the horizon of knowledge about the securities market. The initiative has received tremendous response from the academics as well as the market participants from within the country.

NSE also publishes monthly the NSE NEWS. It brings out articles in order to educate the market participants and also investors in
securities about latest developments in industry. These articles analyze market developments familiarize the professionals with the working of the market and innovations and provide theoretical and empirical inputs for policy initiatives.

6.9 Investor Associations and investor education

Investor Associations play an important role in investor education. They are the organizations which work at the grass-root level constantly interacting with the retail investors. There are seven investor associations recognized by SEBI of which only two of them IGF and GIWA are in Mumbai hence, have been studied in detail hereunder.

6.9.1 Investor Grievances Forum (IGF):

Investor Grievances Forum (IGF) is a non-government organization registered as an Investor Association based in Mumbai. It is a social non-profit organization established in 1994. The objective of IGF is to protect and educate small investors. It also helps and guides the investor in recovering his lost/stuck fixed deposits from companies. It's responsibilities include receiving, forwarding, co-coordinating and monitoring the status of such complaints to the agencies concerned.

The track record of the initiatives of the IGF is as follows-

a) Successfully took up the cause of investors for firm allotment in SBI public issue.

b) Enabled investors to recover fraudulently encashed dividend warrants/ refund orders through legal recourse.

c) Filed writ petition against CRB along with RBI, SEBI, and CBI in high court at Mumbai.
d) Has been helping investors to recover their deposits from NBFCs such as Prudential, NITL group and many others.

e) Agitated for protection of investors’ money in plantation companies and demanded control on plantation companies by a regulatory authority.

f) Filled suits against some NBFCs in consumer courts and Company Law Board for the recovery of investors’ money.

g) It conducts regular seminars, public meetings to educate and keep investors alert about frauds in capital market.

h) Continuous follow-up to set up the ‘Investor Education and Protection Fund’ to educate and create awareness amongst small investors.

i) IGF moved Investors Protection Bill in Maharashtra State Assembly which has now become Investors’ Protection Act, 1999.

j) It publishes a monthly newsletter called ‘Alert Investors’ and also periodic topical booklets to educate the small investors.

6.9.2 Ghatkopar Investors Welfare Association (GIWA):

Ghatkopar Investors Welfare Association (GIWA) was formed in the era of liberalized economic policies of the Government of India in 1992.

GIWA is a non-profit organization and got registered as a society under the Societies Registraation Act, 1860 in 1994.

The main objectives of GIWA includes the following-

a) to create awareness about investment in shares and securities,

b) spread equity cult,

c) educate members about their rights and responsibilities,

d) make available investment information including methods of evaluating securities,

e) to conduct seminars and conferences,

f) provide a forum for exchange of views on stock market operations,
g) represent to any authority on matters of investors interest, and
h) secure recognition for the Association from various authorities.

As a part of its activities, GIWA organizes from time to time public lecture meetings where stock market experts, merchant bankers, consumer activists, registrars and other professional address the participants and answer their queries related to their investment in shares, debentures and other securities. Public meetings on Union Budget have become an annual feature of the Association. Such meetings are held jointly with Forum of Free Enterprise and other social, professional and trade organizations. Since its inception the Association has held more than hundred seminars, meetings, classes for special groups which were largely attended by keen investors.

6.10 Conclusion

Thus, the smooth operations of the securities market and its healthy growth and development, depends to a large extent the quality and integrity of the market. Unfair practices like insider trading, market manipulation and other securities related fraud affect the integrity, fairness and efficiency of the securities market, thereby reducing the confidence of the investors. The various legislations enacted as discussed above attempts to restore the confidence of the investors in the securities market. There are various non government associations as discussed above which work for the protection of investors interest and their education.