

ROLE OF CAPITAL MARKET REGULATOR IN DEVELOPMENT OF CAPITAL MARKET IN AN EMERGING ECONOMY LIKE INDIA

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Abstract

Capital market is a place where companies issue securities for raising capital. The big institutional investor and smaller retail investors are involved in buying and selling of securities to gain profit. However, this market of profit, is not free of frauds, malpractices and manipulation. Before 1992, the capital market was hugely manipulated because of the absence of strict regulations governing capital market and inadequacy of the Capital Issues Control Act. After major scams and manipulations, there was an urgent need of a centralized board which could monitor and oversee the functioning of the market. The paper focuses on Security and Exchange Board of India (SEBI) and related laws which affect the capital market. In the paper, the meaning and history of capital market and SEBI has been outlined. It has also highlighted the reforms which took place after the 1992 scam and shaped SEBI into a regulatory body which is now highly efficient in preventing the frauds in the capital market. The technology which has helped the capital market grow and has facilitated a transparent system has also been discussed. The paper has recognised different regulations under SEBI which helps in protecting the interest of the innocent investors. SEBI has a platform called SCORES which is concerned with the grievance redressal and has attempted to educate the investors. Along with it the regulations like SEBI (Insider Trading) Regulations, SEBI (Prohibition of Unfair Trade) Regulations, SEBI (Underwriters) Regulations, SEBI (Depository) Regulations etc have also been looked at as to know how SEBI and its regulations affects economy. The different laws like Companies Act, 2013, FEMA regulations have been examined to know the affect of the Acts on the market. And finally, the paper has also recognized loopholes and has suggested recommendations for improvement.

KEY WORDS: Capital Market, SEBI, Investors, Regulations, Economy

CHAPTER 1: INTRODUCTION

The performance of capital markets has always been seen as an indicator of economic prosperity in India. Financial inter-mediation is a *sine qua non* in determining a country's stabilized economic growth. Walter Bagehot in his classic *Lombard Street : A Description of the Money Market* (1873) argued that it was England's efficient capital market that made the industrial revolution possible. Bagehot was the first to define the two primary roles of financial markets. One, they facilitate the accumulation of capital. Two, they manage risk inherent in particular investment projects and industries. The primary role of financial markets, broadly interpreted, is to intermediate resources from savers to investors, and allocate them in an efficient manner among competing uses in the economy, thereby contributing to growth, both through increased investment and through enhanced efficiency in resource use (Mohan, 2007). India's Economy is classified as a developing market economy. It's progress towards liberalisation coupled with development of capital markets has entailed channelization and savings in the financial system by smooth facilitation of transaction of equity and debt instruments. The GDP of India stood at 2875.14 billion US dollars in 2019 and represents 2.39 percent of the world economy.¹ GDP in India is expected to reach 2610.00 USD Billion by the end of 2020, according to Trading Economics global macro models and analysts expectations. In the long-term, the India GDP is projected to trend around 2850.00 USD Billion in 2021 and 3000.00 USD Billion in 2022, according to our econometric models.² With the growth of entrepreneurship, the growth of startups have been immense. India has the third largest startup ecosystem in the world³ which has encouraged foreign investment. Over the last 5 years, India has witnessed launch of more than 55,000 startups to date with more than 3,200 startups raising \$63 Bn in funding.⁴ Fundraising reported by SEBI-registered (Category 1) venture capital funds grew from INR 326 Cr in 2014 to over INR 2,703 Cr in 2019 — an 8x surge in five years. Also, the share of actual

¹ <https://tradingeconomics.com/india/gdp>

² <https://tradingeconomics.com/india/gdp>

³ <https://www.startupindia.gov.in/content/sih/en/international/go-to-market-guide/indian-startup-ecosystem.html#1497938344123>

⁴ <https://inc42.com/datalab/presenting-the-state-of-indian-startup-ecosystem-report-2020/>

capital raised to commitments in 2014 was 35% compared to 61% in 2019, indicating the growing investor interest towards investment opportunities in India⁵. India's Foreign Direct Investment (FDI) equity inflow reached US\$ 469.99 billion between April 2000 to March 2020, with maximum contribution from services, computer software and hardware, telecommunications, construction, trading, and automobiles.⁶ India improved its ranking in World Bank's Doing Business Report by 14 spots over last year and was ranked 63 among 190 countries in the 2020 edition of the report.⁷ With rapid expansion of economy, the imperative need to regulate and enhance capital market strategies has grown manifold. This paper attempts to assess the role of a capital market regulator in developing capital markets and come forward with suggestions to cater to the challenges of modern day. A wave of reforms in the capital markets regulation will boost the country's GDP growth and perhaps, touch a milestone if done in the right direction.

CHAPTER 2: RESEARCH METHODOLOGY

2.1 Research methodology of this study consists of following procedures:-

Research Design :- The study being descriptive in nature, our paper is based on theoretical data collection, and its analysis.

Data Collection Method :- In this study, data collection method is primary and secondary in nature from existing theoretical data available in public domain various sources like journals, newspaper, websites, magazines, bare acts, brochure, SEBI handbooks, Financial press reports etc., so as to get insights about the role of regulatory bodies on Indian Capital Market. Many secondary sources do not clearly define the issue and purpose of a study. However, the data has been gathered, analyzed, and interpreted for research.

Doctrine applied:- For this research paper we have used Theoretical Research Project.

2.2 Research Question

1. Examine the role of capital market regulator in developing capital market.
2. Examine the role, objective, significance of SEBI over the recent years in primary and secondary capital market.

⁵ <https://inc42.com/datalab/presenting-the-state-of-indian-startup-ecosystem-report-2020/>

⁶ <https://www.ibef.org/economy/indian-economy-overview>

⁷ <https://www.ibef.org/economy/indian-economy-overview>

3. To examine the role significance of a well developed capital market in the growth process of an economy.

CHAPTER 3: LITERATURE REVIEW

Francis (1991b), Barua (1993)). Dhillon (1993), in his doctoral thesis studies the regulatory policies of the Bombay Stock Exchange (BSE) for a period of four years (July 1986 -June 1990). Its results show that regulators decide on changes in their margin policy on the basis of market activity. The results of Granger's causality show that it exists limited causality in the opposite direction: changes in margins do not affect returns and only have a limited impact on price volatility, trading volume and open positions. Event study methodology applied to daily margins show similar results, except that daily margin on sellers does not appear to be influenced by market variables. Furthermore, there is also evidence of insufficient margination leading to excessively indebted positions, thus increasing the risk of default. The above results reveal this regulations through these tools had only a marginal impact on the dual objectives of control market activity and the risk of default.

Pandya (1992) notes that as a regulatory and development body, SEBI's efforts in the direction of investor protection is varied and unlimited. The measures introduced by SEBI cover extensively measures for allocative efficiency in the primary market with a fair degree of transparency, reforms in the secondary market of visible and mutual funds, the regulation of the various market intermediaries especially for the protection of the public investor.

CHAPTER 4: CAPITAL MARKET IN INDIA

4.1 Brief Introduction of Capital Market

The capital market is a market for financial investments that are direct or indirect claims to capital⁸. It plays a major role in regulating savings and investments in the financial system. It tries to establish a balance between the forces of demand and supply along with the diverse

⁸Gart A; Handbook of the money and capital market quorum Books New York 1988

market participants who are the stakeholders. The capital Market also encompasses the process by which securities already outstanding are transferred⁹. They provide a platform to raise capital for companies by bridging the gap between investors and companies. In simple words, capital markets facilitate the buying and selling of debt as well as equity instruments, both in the primary and secondary markets.¹⁰ The capital market can be further classified into two segments, namely, the primary market and the secondary market. While the primary market deals with the issue of fresh securities, the secondary market deals with securities that are already traded in the primary market. Primary market focuses primarily on issue of securities issued by companies to investors to raise capital for the purposes of expansion and modernisation. The mechanisms through which new issues are floated by the company to the investors include offer through prospectus, offer for sale, private placement, Initial Public Offerings, Rights Issue to the shareholders, bonus issue, etc. Secondary Market is comprised of equity and debt market. It involves trading of the existing shares between investors where prices are determined based on demand and supply which is highly based on the market sentiments.

The emergence of Capital Market can be dated back in the eighteenth century where long-term negotiable securities were first issued¹¹. Companies Act came in 1850 and the first stock exchange was established in Bombay in the year 1875 which is currently known as the Bombay Stock Exchange. Three other stock exchanges were established in Ahmedabad, Calcutta and Madras. The Bombay Stock Exchange was recognized in May 1927 under the Bombay Securities Contracts Control Act, 1925. The development of financial markets was very minimal in the British era as the British regime focused more on exploiting resources than developing them. The major reforms saw light in in the 1990s after the 1991 economic crisis. Prior to that phase, the financial market regime was heavily under the control of the Government. Capital Issues Control Act controlled the IPOs and the Controller of Capital Issues regulated the price and quantity. The only trust fund was the Unit Trust of India which enjoyed monopoly in the mutual fund business. The Banking system was nationalised in 1969

⁹Dougall, He and Jace E. Gauminitz; capital market and institutions, prentice Hall, new jersey, 1986

¹⁰<https://www.vikasacapital.com/emerging-markets-a-new-approach/emerging-markets-alpha/the-market/capital-markets/>

¹¹Financial Markets - ncertncert.nic.in > textbook > pdf > lebs202

and 1980 giving immense power in the hands of the Government. The infamous Harshad Mehta scam of 1992 had shook the country. It made the country realize that there were many loopholes that were being misused for personal benefits. The stock exchange was inaccessible by common people as the trading was conducted directly on the trading floor. There was monopoly in the market and many entry barriers had been created. The trading price and the price asked from the investors to pay was hugely manipulated by the stock brokers.¹² In the next few years after the scam, the stock market saw remarkable reforms to trim down the manipulation and to create a transparent as well as efficient market.

The emergence of Security and Exchange Board of India Act, 1992 gave rise to the establishment of SEBI which aimed at providing the investors with security by regulating the stock exchange and the primary market.¹³ The National Stock Exchange (NSE) was incorporated in the year 1992, was recognised as a stock exchange by SEBI in 1993 and commenced its operation in the year 1994¹⁴ which replaced the concept of trading on floor by a digitalised stock market system. The inception of depository came to be as the building block of an efficient and a fast market. The establishment of NSDL and CDSL replaced the inconvenient older way of handing over the physical shares. The physical shares carried with it the risk of getting damaged or lost. The transfer of shares was a matter of hardship and caused delays but the recourse of depository system accelerated the whole process by converting the physical shares into digitalised ones. Liberalisation acted as a huge market driver in increasing the inflow of foreign capital in India.¹⁵ The inadequacies were attempted to be done away with by SEBI through strengthening public issues norms. Transparency and accountability was sought to be achieved in the world of trading.

4.2 Recent Major Trends

There have been many recent developments which has made the capital market and the economy easily accessible and transparent. The prices of the shares in the stock market are displayed on a real-time basis which creates a hurdle for speculation and blocks the way for

¹² Ajay Shah, Institutional Change in India's Capital Markets, Economic and Political Weekly 183, 187 (1999)

¹³ George, Thusara, Impact of foreign portfolio investment on Indian Capital Market 112, 123, (2013)

¹⁴ History and Milestones, [NSE - National Stock Exchange of India Ltd. www.nseindia.com](http://www.nseindia.com)

¹⁵ George, Thusara, Impact of foreign portfolio investment on Indian Capital Market 112, 123, (2013)

manipulation. Sensitive Index, popularly known as SENSEX indicates 30 companies for Bombay Stock Exchange and NIFTY for National Stock Exchange, are the two well known market indices.¹⁶ The digital payment system which includes, UPI, NEFT, RTGS, IMPS and mobile wallets has incredibly reduced the transactional time and has enhanced the accessibility by the common mass. Before 2016, the start ups could enter the market but leaving the same was a tedious task. The merchant bankers have also transformed the capital market by rendering advisory services and buying, selling, subscribing of securities.¹⁷ The Insolvency Code, paved the way for the easy exit from the market as well. The SEBI (Issue of Capital and Disclosure Requirement) Regulation, 2009 was enforced for simplification of the language, increase readability and structure the regulation.¹⁸ Before the scam of 1992 insider trading was heavily misused to gain wrongful profit but the SEBI Act of 1992 sternly prohibited the use of insider information to trade.¹⁹

The current unprecedented situation of Cov Virus (Covid 19) pandemic has affected the capital market significantly. Even before the pandemic the markets around the world was slow.²⁰ The virus mushroomed and pushed the country into lockdown which gave a massive setback to the economy as a whole and a remarkable slowdown in capital market.”

CHAPTER 5. Capital Market Regulator in developing Capital Market

5.1 History, Meaning, Emergence of SEBI

SEBI was officially established by Government of India in 1988 and bestowed with statutory powers in 1992 with SEBI Act 1992 passed by the Parliament. Initially, SEBI had no

¹⁶Aditya Bhardwaj, Yogendra Narayanb , Vanrajc , Pawana , Maitreyee Duttaa, Analysis for Indian Stock Market Prediction Using Sensex and Nifty, 4th International Conference on Eco-friendly Computing and Communication Systems Sentiment 85, 86 (2015)

¹⁷SEBI (Merchant Bankers) Regulations, 1992

Section 2(cb)—*merchant banker means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management;*

¹⁸Sub: Review of the SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2009, https://www.sebi.gov.in/sebi_data/meetingfiles/jul-2018/1530875281608_1.pdf

¹⁹25 Recent changes in Indian Capital Market, <https://accountlearning.com/25-recent-changes-in-indian-capital-market/>

²⁰ D.N. Rao, Kriti Gulati Mehta, Seema Bushra, Interest Free Financing and its Relevance to Indian Economy in post Covid Virus Pandemic, SSRN, 1, 2 (2020)

statutory power but was given statutory status and powers through an ordinance promulgated on January 30, 1992. In 1995, the SEBI was given additional statutory power through an amendment to the Securities and Exchange Board of India Act, 1992. In April, 1988 SEBI was the sole regulator of capital markets in India under a resolution of the Government. During its establishment in 1988, it had more limited powers. It took place of the Controller of Capital Issues, which regulated the securities markets under the Capital Issues (Control) Act of 1947, passed just months before India gained independence from the British.

In 1988 SEBI's initial capital was Rs 7.5 million, provided by its promoters (IDBI, ICICI, IFCI). This amount was invested and the amount of interest covers SEBI's day-to-day expenses. All the legal powers to regulate the Indian capital market correspond to SEBI itself.

Reasons Of Emergence Of SEBI: In the late 1970s, the capital market became a well-known term in India. During the fall of the 1970s and the boom of the 1980s, the people of India preferred to work in the capital market as the market was trending. However, with the popularity of the shares, a series of malpractices such as price manipulation, unofficial private placements, non-compliance with the provisions of the Public Limited Companies Act, insider trading, violation of the rules and regulations of the stock market, delay in the delivery of shares and many others. On this occasion, the Government of India realized the need to establish an authority to reduce these malpractices and regulate the functioning of the Indian stock market, as the majority of the Indian population began to lose their trust in the stock market brand. The Government felt the immediate need to establish a regulatory body to regulate its operation and find solutions to all the problems that the market was going through, as people were losing interest in the market. This led to the establishment of the India Security and Exchange Board.

Meaning: All the matters in the Securities market in India is regulated, maintained and looked after by SEBI. SEBI received statutory powers through the SEBI Act of 1992. It is the major regulator of securities markets and a counterpart of the Securities Exchange Commission which is operative in the U.S. The object of it 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 therewith or incidental thereto. SEBI's responsibility is to ensure that the stock market in India operates in an orderly manner. It is made to protect the interests of investors and traders in the Indian stock market by providing a healthy environment in stocks and to promote the development and regulate the stock market. Furthermore, one of the main reasons for establishing SEBI was to prevent bad practices in the Indian capital market.

5.2 About SEBI: Role And Framework

Indian capital markets are regulated and supervised by the Ministry of Finance, the Securities and Exchange Board of India, and the Reserve Bank of India. The Ministry of Finance looks over and oversees the capital market through the Capital market section of the Department of Economic Affairs. The division is responsible for formulating policies related to the growth and orderly development of the securities markets, that is, equities, debt and derivatives, as well as protecting the interests of investors. Regulation) Act 1956 and India Securities and Exchange Board Act 1992. SEBI is the principal regulator for Stock Exchanges in India. SEBI is the main body which has tried to ensure that investors are protected from any malpractice and regulates the country's capital market efficiently for its smooth functioning. All financial intermediaries²¹ permitted by their respective regulators to participate in the Indian securities markets are governed by SEBI regulations, whether domestic or foreign. Foreign Portfolio Investors²² are required to register with DDPs in order to participate in the Indian securities markets.

SEBI having corporate structure including various departments, all of which are controlled by a department head. Such various departments are commodity and derivatives, market regulation, foreign portfolio investors, human resource department, collective investment schemes, legal department and several other departments. SEBI's organizational structure consists of 9 members:

1. a chairman is elected by the Government of India,
2. 2 members are officials of the Union Ministry of Finance,
3. 1 member from RBI,
4. 5 members elected by the Government of India.

²¹SEBI (*Intermediaries*) (Amendment) *Regulations*, 2017

²²SEBI (Foreign Portfolio Investors) (Amendment), 2020

Various pivotal function performed by SEBI can be broadly categorized into three :

1. Protective Functions: SEBI protects the interests of investors and financial institutions. These functions are verification related to price manipulation, prevention of insider trading, promotion of fair practices, enhancing investor's knowledge to help them take informed decision, and prohibiting fraud as well as other unfair business practices.
2. Regulation : SEBI has numerous regulations for different intermediaries, there are different regulations for underwriters, brokers, merchant bankers, depositories etc which heavily determines the health of stock market. It formulates the guidelines and code of conduct for various intermediaries and also provide regulations for mergers, amalgamations, and takeovers takeover of companies. It also carries out inquiries and provisions for auditing in stock exchange. It envisages provisions for registrar to facilitate brokers, sub-brokers, merchant bankers²³ and many others. The capital market market participants, have to pay fees to SEBI if the regulator asks for it. SEBI regulates credit rating agencies²⁴ and supervises functions of organisations trading and ensure systematic dealings and provide license to dealers and brokers and control the Merge, Acquisition and Takeover the companies²⁵.
3. Development Functions: Within SEBI's list of such functions, one is providing training to intermediaries. It promotes fair trade and the reduction of bad practices. It aims to educate and sensitize investors about stock market through use of funds in the IEPF²⁶. It promotes research and investigations to ensure the achievement of the above objectives. The stock market is the most prominent indicators of economic health of a country. When people lose faith in market, the rate of participation fall. The country would start to lose FDI and FII rapidly, which in turn will hamper foreign exchange inflows.

The security market was a place of manipulation and personal profit before SEBI became a statutory body. One legendary stock market scams was "Harshad Mehta scam."²⁷ After SEBI took over stock market affairs, it started becoming healthier, transparent as well as well managed. Even after the establishment of SEBI as a statutory body, there were certain

²³SEBI (Merchant Banker) (Amendment) Regulation, 2020

²⁴SEBI (credit rating agencies)(AMENDMENT) regulation

²⁵SEBI (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2020

²⁶SEBI (INVESTOR PROTECTION AND EDUCATION FUND), 2009

²⁷Harshad Mehta vs. Central Bureau of Investigation 1992 (24) DRJ 392, ILR 1993 Delhi 274

loopholes which were misused against the investors to commit huge scams like “Ketan Parekh scam²⁸”.

Although unfair practices occur even today, the frequency is less. Further, acts and regulations are updated regularly. Hence, with time SEBI is becoming stricter with its authority.

ROLE of SEBI:

1. Issuer of securities-They are publicly traded companies that raise funds by issuing shares. SEBI not only protects the investors but also supervises primary market so that the issuers cannot indulge in any malpractice and the initial public offering is carried out effectively and in a good health.
2. Players i.e. the traders and investor-Stock market work only because traders exist. SEBI is responsible for making sure investors do not become victims of any fraud in the stock market.
3. Investor Protection:It pays attention to the following four aspects: fairness, transparency, safeguarding of clients' money, competent and honest service, integrity of the market and quality of the markets.
- 4.They act as mediators in stock market ensuring smooth and safe transaction. It monitor activities of intermediaries like brokers and sub-brokers²⁹.
5. SEBI has adopted revolutionary programs and policies in order to re-establish the credit of capital market, like Control on Utilizing' Application Amount' ,Share Price and Premium Determination,Underwriters³⁰,Control on Share Brokers,Insider Trading³¹, SEBI's Control over Mutual Funds³², Control on Foreign Institutional Investors³³.Hence,SEBI plays a supreme role in the smooth operation by regulating the market, protects investors and trims down the fraudulent activities so that, not only the big players can gain profit but an individual who is a retail investor can also gain from the market without being deceived.

²⁸Ketan Parekh vs. Securities Exchange Board of India on 14 July 2006

²⁹SEBI (Stock Brokers and Sub-brokers)(Amendment) Regulations, 2017

³⁰SEBI (UNDERTWRITER) (AMENDMENT) REGULATION ,2006

³¹SEBI(Prohibition of Insider Trading) (Amendment) Regulations, 2020.

³²SEBI (Mutual Funds) (Amendment) Regulations, 2020

³³SEBI (Alternative Investment Funds) (Amendment) Regulations 2020.

6. While striking off any undesirable trend, the regulatory framework must not stifle innovation that is considered to be the source of all economic progress, aided by advances in IT, risk exposure, other participants engaged in practice of derivatives trading who get attracted to speculative chances such trading offers due to high leverage. Due to this, the risk posed by derivatives traders as well as speculators is high. Hence, the regulatory framework in derivatives trading, must be stricter than the one that exists for spot trading. The scope of regulation should cover derivatives exchanges, derivatives traders, brokers and sellers, derivative contracts or products, derivatives trading rules as well as clearing corporations.

The four main laws that govern the stock market are:

- (a) the SEBI Act of 1992
- (b) the Companies Act of 1956,
- (c) the Securities Contracts (Regulation) Act of 1956;
- (d) the Depositories Act of 1996,

SEBI developed regulations under the SEBI Law and the Depositories Law for the registration, regulation and supervision over all market intermediaries and prevention of unfair trade practices, use of privileged information, by market participants.

The powers of the Department of Economic Affairs under SCRA are simultaneously exercised by SEBI. Such powers with respect to contracts for the sale these securities together with ready forward contracts on debt securities are simultaneously exercised by RBI. SEBI Law and the Depositories Law are applicable primarily by SEBI. The powers of the Corporations Law relating to the issuance of securities, transfer of securities and the non-payment of dividends are dealt by the SEBI in the case of public listed and public companies that propose that their securities be listed on the stock market. The SEBI has two advisory committees for both primary and secondary markets, for providing advisory inputs in formulation of policies and regulations. These committees being advisory in nature, are not statutory which makes their advice rather non mandatory.

5.3 SEBI-Important Regulations Affecting Capital Markets

5.3.1 SEBI

- The regulations of SEBI have not stayed unvaried but have evolved with the requirements of changing time. Security and Exchange Board of India has reformed the capital market in a way that protects the investors from the fraudulent activities and manipulation of the major market players.
- SEBI has taken the utmost care towards the investors by providing, investors education. It has also included study material on its website for easy accessibility which can be used by anyone to make an informed decision.
- It has also published study material for investors to understand the security market deeply.
- In addition to it, investors can also lodge online complaint on the platform of SCORES against any registered entity, listed company or about any manipulation and fraudulent activity.³⁴
- The brokers have to be now registered under SEBI and any stock exchange³⁵, on the other hand, the sub brokers have been asked to act as ‘authorised person’.
- The clearing and settlement are to be done by clearing corporation through digital method which has now reduced the delays in the settlement.
- Before the initial public offering the companies first approach the underwriter who underwrites or subscribes to certain number of shares when the existing shareholders do not subscribe to the security, so that the company can raise full amount of capital.³⁶ The capital adequacy requirement has been fixed at rupees twenty lakh.³⁷
- Any connected person or a person having some secret information which can affect the prices of the shares and uses such information for buying, selling, agreeing to subscribe to the shares or communicates or allow access to it, is called insider

³⁴ Investor Grievance Redressal mechanism at SEBI, Security Exchange Board of India, <https://investor.sebi.gov.in/inv-grie-redre.html#>

³⁵Dr. Himanshu Agarwal, Healthy Capital Market Practices & Role of SEBI , Financial Management: Contemporary Thoughts 16, 19 (2019)

³⁶Security Exchange Board Of India (Underwriters) Regulations, 1993 Section 2 (fa) “underwriting” means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them.

³⁷Security Exchange Board Of India (Underwriters) Regulations, 1993 , 1993 Section 7. (1) The capital adequacy requirement referred to in sub-regulation (d) of regulation 6 shall not be less than the net worth of rupees twenty lakhs.

trading.³⁸ SEBI has significantly prevented the fraud and manipulation by banning insider trading under, Security Exchange Board Of India (Prevention of Insider Trading) Regulations, 2015.

- Mutual fund is a fund created by issuing units to investors and invests it in stock market, money market or gold related instruments.³⁹ SEBI has also taken under it the mutual fund regulation which has increased the flexibility and supervision on the mutual funds.⁴⁰ Every mutual fund has to be registered under SEBI.
- The unfair trade practices has been prevented by introduction of a regulation by SEBI⁴¹. The regulations provides for investigation with regard to selling, buying, subscribing of the shares or dealing in the securities market. Even if a transaction has been made through a broker even then proceeding can be against the person suspected to be involved in unfair trade practices.⁴²

On evaluation of the Annual report of SEBI of the year 2018-19, the following are the observations:

In context of primary securities market, certain new regulations were introduced. The introduction of SEBI (Buy-back of Securities) Regulations, 2018 (Buyback Regulations) has incorporated Sections 68 and 70 of the Companies Act. Certain relaxations have been provided to companies undergoing the Corporate Insolvency Resolution Process wherein under the SEBI (SAST) Regulations, 2011, acquisitions pursuant to an approved resolution plan have been exempted from the proviso that prohibits acquisition beyond maximum permissible non-public shareholding under Regulation 3 (2) of Takeover Regulations. Other regulations such as SEBI (ICDR) Regulations, 2018, SEBI (LODR) Regulations, 2015 have also been modified in order to accommodate the interest of companies undergoing CIRP. The transfer of securities is now mandatory to be held in the dematerialized form to improve ease,

³⁸Security Exchange Board Of India (Prevention of Insider Trading) Regulations, 2015,

³⁹ SEBI (Mutual Fund) Regulation, 1996, Section 2 (q)“mutual fund” means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities including money market instruments or gold or gold related instruments or real estate assets

⁴⁰Pallavi Tripathi, Dr. Javed Qadri, Study on role of SEBI as a Regulatory Authority in Indian Capital Market International Journal of Research in IT and Management (IJRIM) 28, 35 (2017)

⁴¹Securities and Exchange Board Of India (Prohibition of Unfair Trade Practices relating to the Securities Market), 1955

⁴²Avtar Singh, Company Law 172 (16th ed. 2013)

efficiency and transparency. SEBI has introduced a payment mechanism through UPI along with the provision of blocking funds through ASBA facility to reduce the time period for listing of issues. A framework was laid out to establish an Innovators Growth Platform to accredit investors. In addition to that, SEBI has permitted the distribution of dividends through depositories, extended the system driven disclosures to non-promoters by non-promoters⁴³.

In the Secondary Securities Market, SEBI has issued guidelines to facilitate ease of doing business in international financial services centre (IFSC) by permitting the clearing corporations operating in IFSC to invest their own funds in AAA rated foreign sovereign securities, apart from central government securities, fixed deposit receipts of banks and liquid schemes of debt mutual funds, subject to a limit of 10 per cent of the total investible resources, excluding funds lying in core settlement guarantee fund of the clearing corporation⁴⁴. Guidelines have been issued by SEBI to enhance the interoperability framework between clearing corporations, revision of haircut in government securities and review of risk management framework for financial market infrastructure. A review of regulations with respect to stock markets, depositories and clearing corporations under the recommendations of the Gandhi Committee was done and permitted eligible domestic and foreign entities to hold upto 15 per cent shareholding in case of depository and clearing corporation, as is the case for stock exchanges. The concept of sponsor has been eliminated and the existing sponsors have been given five years to reduce their shareholding to 15 percentage. Separate BSDA limit has been introduced for boosting participation in the debt holdings in demat account for retail individual investors by relaxing the limits. SEBI has also encouraged the use of Artificial Intelligence and Machine Learning and has directed MIIs to submit quarterly report of the mechanisms incorporated by them.

SEBI AND FOREIGN INVESTMENT

Post liberalisation foreign investment was encouraged and regulated under the Foreign Exchange Management Act. Foreign Direct Investment was seen as a tool for economic development and integration. It boosted capital formation and strengthened global ties with

⁴³Regulation 29(1) and 29(2) of SEBI(SAST) Regulations

⁴⁴vide circular dated May 21, 2018

other countries. While FDI is not directly connected with the stock markets and focuses primarily on the optimization of resource management, technological upgradation and expansion of the company, FII directly contributes towards the growth of capital markets. It increases the size of the stock markets alongwith the transparency, technology, investor protection, informational standards and operational standards at par with international stock markets⁴⁵. In 1996-97, several changes have been made to the SEBI (Foreign Institutional Investors) Regulations, 1995 to diversify the foreign institutional investor base and to further facilitate inflow of foreign portfolio investment. The changes have also aimed at facilitating investment in debt securities through the FII route. The changes are as follows:

- the eligible categories of FIIs have been expanded to include university funds, endowments, foundations, charitable trusts and charitable societies which have a track record of 5 years and which are registered with a statutory authority in their country of incorporation or establishment
- each FII or sub-account of an FII has been permitted to invest upto 10% of the equity of any one company, subject to the overall limit of 24% on investments by all FIIs, NRIs and OCBs
- the 24% limit may be raised to 30% in the case of individual companies who have obtained shareholder approval for the same
- FIIs have been permitted to invest in unlisted securities
- FIIs have been allowed to invest their proprietary funds
- FIIs who obtain specific approval from SEBI have been permitted to invest 100% of their portfolios in debt securities. Such investment may be in listed or to be listed corporate debt securities or in dated government securities, and is treated to be part of the overall limit on external commercial borrowing.⁴⁶

⁴⁵Impact of FDI & FII on Indian Stock Markets, Dr. Sandeep Kapoor And Mr. Rcoy Sachan, Volume 5, Issue 4 (April, 2015), International Journal of Research in Finance and Marketing (IMPACT FACTOR – 4.088)

⁴⁶ https://www.sebi.gov.in/sebi_data/commondocs/pt1b5_h.html

Very recently, in a circular issued by SEBI, the foreign investment limit per fund has been increased from 300 million USD to 600 million USD, while capping the overall industry limit at \$7 billion.

2. COMPANIES ACT

Companies Act, 2013 is the latest Act which replaced the older Companies Act, 1954. Companies Act, 2013 has provisions which not only further cuts down on fraudulent activities but also ensures higher standards of corporate governance by guaranteeing investors their rights.

- If a person induces another one to acquire, dispose, subscribe or underwrite securities by making false and misleading statement then such person would be said to have committed fraud under section 447 of the Companies Act, 2013⁴⁷ and will be imprisoned for a minimum of six months which may extend up to ten years.
- If a person uses fake names to get multiple shares from the company or uses false names for obtaining shares then the person⁴⁸ will be guilty of fraud under section 447 of the Act.
- The Act also states about Global Depository Receipts which can only be issued by a company in a foreign country after the special resolution in general meeting is passed.⁴⁹
- It is an obligation on the issuing company to deliver share certificate to the investor within two months of allotment.⁵⁰ In addition to it, every share certificate should have a distinct number.⁵¹
- According to the SEBI guidelines for Disclosure and Investor Protection, 1992 90% of the total number of shares to be issued in the IPO should be subscribed by investors for a successful IPO. Therefore, before going for the IPO issuer approaches the underwriter, who underwrites certain number of shares. The underwriter takes a huge amount of risk by underwriting the securities and therefore, is entitled for commission under section 40 (6) of the Act.

⁴⁷Section 36 of the Companies Act, 2013

⁴⁸Section 38 of the Companies Act, 2013.

⁴⁹Section 41 of the Companies Act, 2013

⁵⁰Section 46 of The Companies Act, 2013

⁵¹Section 45 of The Companies Act, 2013

- The issuer can also issue 'sweat equity shares' under section 53 to the directors or employees of the company for providing the know-how to the company.

CHAPTER 6: LOOPHOLES

1. Insider Trading

It is an inevitable problem that persists in India's capital market. The person occupying a relative higher position of the company use their powers and get access to the price sensitive information of the market. And when they use this for their own benefit it is called insider trading. Even though there are several Sebi regulations to keep this loophole under check but it cannot be eradicated completely.

To resolve any case of insider trading, SEBI first needs to establish who an insider is, which is basically anyone related to the company in any position, such as key management personnel, board of directors, auditors, promoters, or even the pawn. Even these people's family members are considered insiders, insiders, and therefore have a way of accessing the information.⁵² To solve any insider trading case, SEBI first needs to establish who an insider is, which is basically anyone related to the company in any position, such as key management personnel, board of directors, auditors, promoters, or even the pawn. Even the family members of these people are considered internal, internal, and therefore have a way of accessing information.⁵³

Looking into cases like the HUL case⁵⁴ and Dilip Pendse case⁵⁵ its an easy inference that due to lack of proper and efficient investigative mechanism along with corroboration of evidences, many offenders either escapelaw or get away with lesser or no punishments as

⁵² Regulation 2(d), SEBI (Prohibition of Insider Trading) Regulations, 2015

⁵³ Sandeep Parekh, Prevention of Insider Trading and Corporate Good Governance in India, 32 Int'l Bus. Law. 132 (2004).

⁵⁴ Hindustan Lever Limited vs SEBI 18 SCC 311 MOF

⁵⁵ Dilip Pendse vs SEBI 90 SCL 302 (SAT: 2009)

such. This again contributes to the illegal practice of insider trading with the aid of these loopholes.⁵⁶

The regulations for insider trading was an important step towards a market of transparency. The Insider Trading regulations has not remained static but has improvised over the years and has come up with the latest regulation, which is, the SEBI (Prohibition of Insider Trading) Regulations, 2015, the latest regulation has also inculcated amendments over the years.

The Insider Trading Regulations has become turned to have become more strong with the introduction of rewards for the person informing about the offence or irregularity, removing ambiguities and there have been addition of provisions for increasing transparent transactions by mandating more and more disclosures.⁵⁷

2. Price Rigging

Some buyers/ sellers artificially increase the price of the shares much before the issue of the securities by the companies among themselves or group of individuals who are engaged in this activity resulting into a major push up of the results in the market.

3.Lack Of Transparency

Large number of brokers involved in unethical practices ,violations of the rules and regulations of the market, no proper and full proof system to inform the investors regarding the volume of trades being carried out at its lowest and highest prices, there are innumerable numbers of crisis that are still need to addressed and solved. There is also no maintainability of the time at which the transactions are being executed and hence, resulting into price distortion. Even though SEBI has come up with many regulations to maintain transparency but it is not completely successful.

⁵⁶Prateek Bhattacharya, India's Insider Trading Regime: How Connected Are You, 16 N.Y.U. J.L. & Bus. 1 (2019).

⁵⁷Reema Bali, Insider Trading in India Rules Till Now, International Journal of Research -

4. Volatility

There is a huge increase in the volatility of the capital market because of the increase in the indices like Sensex and Nifty. The volatility is the result of mainly two reasons-

Day- trading activities is preferred over delivery based trading nowadays. Day trading is considered to be speculative in nature while delivery based trading is indeed a genuine investment activity. Secondly, there is an unavoidable influence of FIIs in the capital market which contributes to the volatility of the market.

5. Timing of New Issues

Whenever the companies are queuing up to raise capital or whenever there is a higher performance in the secondary market, the primary market gets clogged with the new and fresh issues by the companies. This divides the investors among several companies and an individual company might not get entire subscription. Due to the gaining advantage in the primary market, most of the companies prefer primary market over the secondary one but this crowding of the primary market makes it hazardous for the company as well as the investors.

6. Odd Lots

Apart from the securities that are listed in Group A and B there are also the odd lots which are the securities that are listed in the Group C and are not traded actively. They are always sold at a discount and at a premium of 10-15% and the investors who are involved in such transactions always had to incur a loss. This demotivates them and consequently decreases the trading activities in the market.

7. Drawback For The New Company

The investors always prefer well established companies over the newly registered companies. Even though the new company has a good prospectus and the primary market is known for issuing new capital for the companies, the new companies still faces problems in raising funds because the investors will always opt for a sound and reputed company to avoid the risk factor.

The the latest amendment to the Delisting Regulations⁵⁸ of SEBI introduced the concept of ‘counter offer’ in light of which if the acquirer / promoter will not be satisfied regarding the price discovery under the Reverse Book Building process, then such acquirer / promoter may proceed with a counter offer to the public shareholders. Before amendment, the acquirer / promoter have two options, either

(a) accept a price equal to otherwise more than the price discovered.

or

(b) reject the offer price, provided in that case the delisting exercise in entirety or fully shall become futile.

Before amendment, the Delisting Regulation stated the offer price to be determined by book building process after the floor price is fixed and determined as per the SAST Regulations⁵⁹. The latest amendment tries to ensure that the floor price is not inflated by market speculations.

Portfolio Management System in India are governed by the SEBI (Portfolio Managers) Regulations, 1993. PMS services have been affected by the lack of a standardized and easily comprehensible reporting format and a lack of transparency regarding fees and charges.⁶⁰

⁵⁸ Securities and Exchange Board of India (Delisting of Equity Shares) (Second Amendment) Regulations, 2018 (**Amended Delisting Regulations**) on November 14, 2018

⁵⁹ Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

⁶⁰ Neil Borate, SEBI proposes landmark changes to PMS regulations, some loopholes remain, LIVEMINT, (last accessed: 2019), <https://www.livemint.com/market/stock-market-news/sebi-proposes-landmark-changes-to-pms-regulations-some-loopholes-remain-1564820384067.html>

CHAPTER 7: RECOMMENDATIONS

There are few instances which suggest that despite having a well formulated legal framework scandals emerged in our capital market. This calls for the regulatory system in the capital market revised. Hence, the recommendations are listed as follows:-

1. National Stock Exchange of India (NSE) was set up with computerized online screen based nationwide electronic trading, Counter Exchange of India (OTCEI) was set up with computerized mechanism with the facility of online electronic trading for much transparency in the capital market.
2. In order to eliminate problems relating to loss of allotment letters, share certificates, etc., and to induce the investors to opt for allotment of dematerialised shares, the trading for IPOs in dematerialised form had been made compulsory with an option available to the investors for physical shares.
3. "The purpose for which the SEBI was established was to ensure the protection of the interests of the investors, to monitor or regulate and stimulate the growth of the securities market. There are a number of actions taken by the Board on persons, intermediaries for violating or contravening the rules or guidelines that might endanger the development of the securities market. The work done by the SEBI so far is promising for the progress of our stock market.
4. To facilitate greater participation in foreign portfolio investment (FPI), SEBI may consider modifying some aspects of the new FPI regulatory framework for promoting FPI investments. For example, the investment limit for a single FPI investor can be increased from the existing limit of 10 percent of a company's equity capital to allow those investors to build significant positions in Indian companies without triggering the "control" provisions."
5. Instead of introducing more regulations, SEBI can better address corporate governance issues by strengthening the application of existing provisions and by establishing accountability for directors who fail to perform their fiduciary duties. In this regard, SEBI could provide a principle-based guidance note that elaborates the context and examples of the fiduciary duties of board members, such as due diligence, duty of loyalty, etc.

6. There is an urgent need to redefine the regulatory architecture. gaps. There are currently more than half a dozen regulatory agencies. SEBI, IRDA, PFRDA, EPFO, RBI, FMC plus several ministries leading to jurisdiction overlap, narrow sectoral attitudes and regulatory gaps, regulatory arbitrage. The most recent were conflicts between IRDA and SEBI over Insurance Unit Linked (ULIP) plans. This overlapping regulatory body is the main cause of ineffective regulation, inability and delay in exploring new markets and product design, etc. India needs to streamline the regulatory structure of the financial market and move to the single window approval process.
7. The development of innovative capital market tools is needed in order to reduce the risk to investors and promote the financing of long-term projects in infrastructure. It is necessary to establish a certain framework for the duration of holding investments in the market for stable capital market.
8. Investigations are to be undertaken to examine alleged or suspected violations, to gather evidence, and to identify persons/entities behind irregularities and violations, such as: price manipulation, creation of artificial market, insider trading, etc. As per the Annual Report 2006-07, grievances, investor protection mechanism and investor complaints should be taken efficiently.