UNIT - III

SECURITIES AND EXCHANGE BOARD OF INDIA

The Securities and Exchange Board of India was established by the Government of India on 12th April 1988 to develop and regulate the stock market in India. The Securities and Exchange Board of India Act, 1992 conferred SEBI comprehensive powers in all aspects of capital market operations.

Objectives of SEBI:

1. To promote healthy and orderly growth of the securities market.
2. To protect the interest of investors so that there is a steady flow of savings into the capital market.
3. To regulate the securities market and ensure fair practices by the issuers of securities so that they can raise resources at minimum cost.
4. To promote efficient services by brokers, merchant bankers and other intermediaries so that they become competitive and professional.

Reasons for the establishment of SEBI:

The capital market has witnessed a tremendous growth during the 1980s particularly by the increasing participation by the public. The government realised the necessity of creating a broad based and a more secure environment for the business to grow. With the growth of securities market, the number of malpractices also increased in both the primary and secondary markets. The malpractices prevalent in the capital market where manipulation of security prices, price rigging, insider trading, delay in settlement and delay in listing and commencement of trading in shares. SEBI was established to curtail the malpractices and to overcome the following deficiencies in the Indian stock market:

1. Lack of diversity in financial instruments: Lack of variety in the financial instruments available is one of the defects of the stock market. Equity shares and convertible debentures are the only available securities.
2. Disclosure of financial information: The prospectus issued by many a company does not contain adequate and relevant information to enable investors to take correct investment decisions. Further the brochures and pamphlets and advertisements issued at the time of public issue tend to present a biased profile of the company.
3. Preponderance of speculative trading: A major portion of transactions in stock market are done by speculative motive. The main motive is to derive benefit from short term price fluctuations.
4. Poor Liquidity: Only a small portion of shares are actively traded and highly liquid. Most shares are traded infrequently and hence lack liquidity.
5. Lack of control over brokers: Lack of control over the activities of brokers and jobbers is another deficiency of capital market. Significantly few people are able to cause fluctuations in the market activity. Many of the brokers lack high professional standards.

Functions of SEBI:

The functions of SEBI has been classified under two heads: 1. Regulatory functions and 2. Developmental functions.

1. Regulatory functions:
2. Regulation of stock exchange and self regulatory organisations.
3. Registration and regulation of stock brokers, registrar to all issue, merchant bankers, underwriters, portfolio managers and such other intermediaries who are associated with securities market.
4. Registration and regulation of the working of collective investment schemes including mutual funds.
5. Prohibition of fraudulent and unfair trade practices relating to securities market.
6. Prohibition of insider trading in securities.
7. Regulating substantial acquisitions of shares and take over of companies.
8. Developmental functions:
9. Promoting investors’education.
10. Training of intermediaries.
11. Conducting research and publish information useful to all market participants.
12. Promotion of fair practices and code of conduct for self – regulatory organisation.
13. Promoting self-regulatory organisations.

Powers of SEBI:

SEBI has been vested with the following powers:

1. To call periodical returns from recognised stock exchanges.
2. To call for any information or explanation from recognised stock exchanges or their members.
3. To direct enquiries to be made in relation to affairs of stock exchanges or their members.
4. To grant approval to bye-laws of recognised stock exchanges.
5. To make or amend bye-laws of recognised stock exchanges.
6. To compel listing of securities by public companies.
7. To control and regulate stock exchanges.
8. To grant registration to market intermediaries.
9. To levy fees or other charges for carrying out the purpose of regulation.
10. To grant licences to dealers in securities.

Organisation of SEBI:

The SEBI Act provides for the establishment of a statutory body consisting of six members. The chairman and two members are to be appointed by the Central Government, one member to be appointed by the Reserve Bank and two members having experience of securities market to be appointed by the Central Government.

SEBI has divided its activities into four operational departments namely primary market department, issue management and intermediaries department, secondary market department and institutional department, each headed by an Executive Director. Apart from these there are two other departments viz., Legal department and investigation department, also headed by officials of the rank of Executive directors.

Primary market department: This department deals with all policy matters and regulatory issues relating to primary market, market intermediaries and matters pertaining to SRO’s and redressal of investor grievances.

Issue management department: This department is concerned with the vetting of offer documents and other things like registration, regulation and monitoring of issue related to intermediaries.

Secondary market department: It looks after all the policy and regulatory issues for the secondary market; administration of the major stock exchanges and other matters related to it.

Institutional investment department: This department is concerned with framing policy for foreign institutional investors, mutual funds and other matters like publications, membership in international organisations, etc.

SEBI has two advisory committees, one each for primary and secondary markets. The committees are constituted from among the market players, recognised investor associations and eminent persons associated with the capital market. They provide advisory inputs in framing policies and regulations.

SEBI GUIDELINES

SEBI has brought out a number of guidelines separately, from time to time, for primary market, secondary market, mutual funds, merchant bankers, foreign institutional investors, investor protection etc.

**SEBI GUIDELINES ON INITIAL PUBLIC ISSUE**

A company proposing to issue capital to public through the on-line system of the stock exchange for offer of securities shall comply with the requirements as contained in Chapter XI A

**Agreement with the Stock exchange.**

The company shall enter into an agreement with the Stock Exchange(s) which have the requisite system of on-line offer of securities. Where the Regional Stock Exchange has the requisite system of on-line offer of securities, the company shall also, enter into an agreement with the Regional Stock Exchange for offering securities to public through on-line system.

**Appointment of Brokers**

The stock exchange, shall appoint brokers of the exchange, who are registered with SEBI, for the purpose of accepting applications and placing orders with the company. The brokers, so appointed accepting applications and application monies, shall be considered as ‘collection centres’. The broker/s so appointed, shall collect the money from his/their client for every order placed by him/them and in case the client fails to pay for shares allocated as per the Guidelines, the broker shall pay such amount.

The company/lead manager shall ensure that the brokers so appointed are financially capable of honouring their commitments arising out of defaults of their clients, if any.

The company shall pay to the broker/s a commission/fee for the services rendered by him/them. The exchange shall ensure that the broker does not levy a service fee on his clients in lieu of his services.

**Appointment of Registrar to the Issue**

The company shall appoint a Registrar to the Issue having electronic connectivity with the Stock Exchange/s through which the securities are offered under the system.  
**Listing**

Subject to the requirement of listing on the Regional Stock Exchange, the company may apply for listing of its securities on an exchange other than the exchange through which it offers its securities to public through the on-line system.

**Responsibility of the Lead Manager**

The Lead Manger shall be responsible for co-ordination of all the activities amongst various intermediaries connected in the issue / system.

The names of brokers appointed for the issue along with the names of the other intermediaries namely Lead managers to the issue and Registrars to the Issue shall be disclosed in the prospectus and application form.

**Mode of operation**

The company shall, **before opening of the issue**, make an issue advertisement in one English and one Hindi daily with nation wide circulation, and one regional daily with wide circulation at the place where the registered office of the issuer company is situated.

The advertisement shall contain the following:

* 1. The date of opening and closing of the issue
  2. The method and process of application and allotment
  3. The names, addresses and the telephone numbers of the stock brokers and centres for accepting the applications.

**During the period the issue** is open to the public for subscription, the applicants may

1. Approach the brokers of the stock exchange/s through which the securities are offered under on-line system, to place an order for subscribing to the securities. Every broker shall accept orders from all clients who place orders through him;
2. Directly send the application form along with the cheque/Demand Draft for the sum payable towards application money to the Registrar to the Issue or place the order to subscribe through a stock- broker under the on-line system.

In case of issue of capital of Rs. 10 crores or above the Registrar to the Issue shall open centres for collection of direct applications at the four metropolitan centres situated at Delhi, Chennai, Calcutta and Mumbai.

The broker shall, thereafter, enter the buy order in the system, on behalf of the clients and enter details including the name, address, telephone number and category of the applicant, the number of shares applied for, and give an order number/order confirmation slip to the applicant.

The broker may collect an amount to the extent of 100% of the application money as margin money from the clients before he places an order on their behalf.

The broker shall, at the end of each day while the issue is open for subscription, download/forward the order data to the Registrar to the Issue on a daily basis. This data shall consist of only valid orders. On the date of closure of the issue, the final status of orders received shall be sent to the Registrar to the issue/company.

**On the closure of the issue**, the Regional Stock Exchange, along with the Lead merchant banker and Registrars to the Issue shall ensure that the basis of allocation is finalised in fair and proper manner on the lines of the norms with respect to basis of allotment.

On receipt of the basis of allocation data, the brokers shall immediately intimate the fact of allocation to their client /applicant. The broker shall, thereafter, hand over the application forms of the successful applicants who have paid the application money, to the exchange, which shall submit the same to the Registrar to Issue/company for their records.

The broker shall refund the margin money within 3 days, to the applicants who did not receive allocation.

In the event of the successful applicants failing to pay the application money, the broker through whom such client placed orders, shall bring in the funds to the extent of the client’s default. If the broker does not bring in the funds, he shall be declared as a defaulter by the exchange.

The subscriber shall have an option to receive the security certificates or hold the securities in dematerialised form.

On payment and receipt of the sum payable on application for the amount towards minimum subscription, the company shall allot the shares to the applicants as per these Guidelines. The Registrar to the issue shall post the share certificates to the investors or, instruct the depository to credit the depository account of each investor.

Allotment of securities shall be made not later than 15 days from the closure of the issue failing which interest at the rate of 15% shall be paid to the investors.

**SEBI GUIDELINES ON SECONDARY MARKET**

The SEBI has been consistently endeavoring to promote a market which is both efficient and fair and also one which protects the rights of investors. Modernisation of market infrastructure improves market transparency and trading efficiency. Risk containment measures improves market integrity and credibility. These have been the main focus of the SEBI’s efforts in the secondary market. The SEBI also directed its efforts towards encouraging the stock exchanges to become effective and self regulatory organisations. The measures taken by the SEBI in 1997-98 in the secondary market are discussed below.

**Strengthening the safety and integrity of the secondary securities market**

Intra-day trading and exposure limits

SEBI decided that the upper limit for gross exposure of the member brokers of the stock exchanges would be fixed at 20 times the capital of the broker.

Setting up of Trade/Settlement Guarantee Fund by stock exchanges

One of the shortcomings of the clearing and settlement process of the Indian stock markets was the absence of a system to reduce counter-party risk. The principal objective of this Fund is to provide the necessary funds and ensure timely completion of settlements in cases of failure of member brokers to fulfill their settlement obligations.

Delisting of securities

Delisting is an extreme measure of disciplinary action which an exchange might take against a company, which if indiscriminately used, would adversely affect the interests of the investors. Also the exchanges were adopting different approaches and procedures towards the delisting of securities. The Committee prescribed the uniform conditions and norms under which delisting can take place and the manner in which the interests of the investors can be safeguarded in such cases.

**Disclosure Standards**

SEBI has accepted the Bhave committee report on the measures for improving the continuing disclosure standards by corporates and timely dissemination of price sensitive information to the public.

**Bhave Committee Report on Disclosure Standards**

1. The company is required to furnish to the stock exchange and to publish un-audited financial results on half-yearly basis.

2. To provide for publishing by the companies which mobilise funds from the public through public/rights issues, the details of deployment of such funds on an half-yearly basis instead of the yearly basis.

3. The company to inform immediately to the stock exchange of events such as strike, power cuts, etc. This should be applicable for all events which will have bearing on the performance/operations of the company as well as price sensitive information.

**SEBI GUIDELINES FOR BONUS ISSUE**

A listed company proposing to issue bonus shares shall comply with the following:

(a) No company shall, pending conversion of FCDs/PCDs, issue any shares by way of bonus unless similar benefit is extended to the holders of such FCDs/PCDs, through reservation of shares in proportion to such convertible part of FCDs or PCDs.

(b) The shares so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the bonus issues were made.

1. The bonus issue shall be made out of free reserves built out of the genuine profits or share premium collected in cash only.

2. Reserves created by revaluation of fixed assets are not capitalised.

3. The declaration of bonus issue, in lieu of dividend, is not made.

4. The bonus issue is not made unless the partly-paid shares, if any existing, are made fully paid-up.

5. The Company -

(a) has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof and

(b) has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.

6. A company which announces its bonus issue after the approval of the Board of Directors must implement the proposal within a period of six months from the date of such approval and shall not have the option of changing the decision.

7. (i) The Articles of Association of the company shall contain a provision for capitalisation of reserves, etc.

(ii) If there is no such provision in the Articles the company shall pass a Resolution at its general body meeting making provisions in the Articles of Associations for capitalisation.

8. Consequent to the issue of Bonus shares if the subscribed and paid-up capital exceed the authorised share capital, a Resolution shall be passed by the company at its general body meeting for increasing the authorised Capital.

SEBI GUIDELINES ON RIGHTS ISSUE:

A listed issuer making a rights issue of specified securities shall make disclosures, as specified in Part E of this Schedule in the offer document and abridged letter of offer. The promoters or promoter group of the issuer, shall not renounce their rights.

The abridged letter of offer shall also include the following disclosures:

(a) Provisions pertaining to applications referred to in sub-regulations (1), (2) and (3) of regulation 78;

(b) Rights entitlement ratio;

(c) Fractional entitlements;

(d) Renunciation;

(e) Application for additional equity shares;

(f) Intention of promoters to subscribe to their rights entitlement;

(g) Statement that a copy of the offer document of the immediately preceding public or rights issue is available to the public as a document for public inspection.

SEBI GUIDELINES ON DEBENTURES:

A company offering Convertible/ Non Convertible debt instruments through an offer document, shall comply with the following provisions:

**Requirement of credit rating**

No public or rights issue of debt instruments shall be made unless credit rating from a credit rating agency has been obtained and disclosed in the offer document.

For an issue greater than or equal to Rs.100 crores two ratings from two different credit rating agencies shall be obtained.

Where credit rating is obtained from more than one credit rating agencies, all the credit rating/s, including the unaccepted credit ratings, shall be disclosed.

All the credit ratings obtained during the three (3) years preceding the public or rights issue of debt instrument shall be disclosed in the offer document.

**Requirement in respect of Debenture Trustee**

In case of issue of debenture with maturity of more than 18 months, the issuer shall appoint a Debenture Trustee. The names of the debenture trustees must be stated in the offer document.

**Creation of Debenture Redemption Reserves (DRR)**

A company has to create DRR in case of issue of debenture with maturity of more than 18 months.

**Distribution of Dividends**

Distribution of dividend shall require approval of the trustees to the issue and the lead institution. Dividends may be distributed out of profit of particular years only after transfer of requisite amount in DRR.

**Redemption**

The issuer company shall redeem the debentures as per the offer document.

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

1. In case, the convertible portion of any instrument such as PCDs, FCDs etc. issued by a listed company, whose conversion price was not fixed at the time of issue, holders of such instruments shall be given a compulsory option of not converting into equity capital.
2. Conversion shall be done only in cases where instrument holders have sent their positive consent and not on the basis of the non-receipt of their negative reply.

**Other requirements**

No company shall issue FCDs having a conversion period of more than 36 months. If the conversion takes place at or after 18 months from the date of allotment, but before 36 months, any conversion in part or whole of the debenture shall be optional at the hands of the debenture holder.

Premium amount and time of conversion shall be determined by the issuer company and disclosed. The interest rate for debentures can be freely determined by the issuer company.

**Additional Disclosures in respect of debentures**

The offer document shall contain:-

1. Premium amount on conversion, time of conversion.
2. In case of PCDs/NCDs, redemption amount, period of maturity, yield on redemption of the PCDs/NCDs.
3. Full information relating to the terms of offer or purchase including the name(s) of the party offering to purchase the khokhas (non-convertible portion of PCDs).
4. The discount at which such offer is made and the effective price for the investor as a result of such discount.
5. The existing and future equity and long term debt ratio.
6. Servicing behaviour on existing debentures, payment of due interest on due dates on debentures.

SEBI GUIDELINES ON UNDERWRITERS:

**REGISTRATION OF UNDERWRITERS**

**Application for grant of certificate**

An application by an underwriter for grant of a certificate shall be made to the Board in form A.

**Capital Adequacy Requirement**

The capital adequacy shall not be less than the networth of rupees twenty lakhs.

**Procedure for registration**

The Board on being satisfied that the applicant is eligible, shall send an intimation that he has been found eligible for the grant of certificate and grant a certificate in form B subject to payment of fees.

**Renewal of certificate**

An underwriter may, if he so desires, make an application in form A for renewal of certificate before three months of the expiry of the period of certificate.

**GENERAL OBLIGATIONS AND RESPONSIBILITIES**

Every underwriter shall at all times abide by the Code of Conduct.

The underwriter shall not derive any direct or indirect benefit from underwriting the issue other than the commission or brokerage payable under an agreement for underwriting. The total underwriting obligations under all the agreements 4 shall not exceed twenty times the networth.

Every underwriter, in the event of being called upon to subscribe for securities of a body corporate shall subscribe to such securities within 45 days of the receipt of such intimation from such body corporate. Every underwriter shall keep and maintain (i) records in respect of all sums of money received and expended by them and the matters in respect of which the receipt and expenditure take place; and (ii) their assets and liabilities.

Every underwriter shall preserve the books of account and other records and documents mentioned under this chapter for a minimum period of five years.

**INVESTORS PROTECTION**

An investor is a person who is an individual or a corporate investing his capital in another venture or business. The term Investor Protection is designed to protect the investors from malpractices of companies, merchant bankers, depository participants and other intermediaries.

Need for Investors protection

An investor has three objectives namely safety of invested money, liquidity position of invested money and return on investment.

Protection of investors means safeguard and enforcement of the rights and claims of a person in his role as an investor.

Investor protection mechanisms need to be in place to handle crisis, misrepresentation by intermediaries and institutions, accountability in case of frauds, insider trading, and cross-jurisdictional cooperation.

Credit rating for the cross-border listings and regional corporate bond issuances will be essential to develop investor interest. That may help filter out the companies with questionable governance and doubtful disclosures.

Corporate governance standards in many local companies are a cause for concern. Basic norms relating to Board composition (including Independent Directors), maintaining quorum attendance, conducting of regular Shareholder, Board and Committee meetings, periodic disclosure of financials, hiring of External Auditors, etc. are sometimes evaded through allowable loopholes. This reduces the confidence of investors, which is a loss for the company. Strengthening of corporate governance standards can facilitate an attractive investment climate.

**Measures taken by SEBI for Investors protection:**

Securities and Exchange Board of India (SEBI) has been established with the prime mandate to protect the interest of investors in securities. SEBI has taken the following measures to protect investors:

Investor Education:

**First**, SEBI endeavours to ensure that the investor learns investing, obtains and uses information required for investing, evaluates various investment options to suit his specific goals, ascertains his rights and obligations in a particular investment, deals through registered intermediaries, takes necessary precautions, seeks help in case of any grievance, etc. SEBI has been organizing investor education and awareness workshops directly, and through investor associations and market participants, and been encouraging market participants to organize similar programmes. It maintains an updated, comprehensive web site for education of investors. It publishes various kinds of cautions through media. It responds to the queries of investors through telephone, e-mails, letters, and in person for those who visit SEBI office.

Inform the investors:

**Second,** SEBI has made available every detail relevant for investment in public domain. SEBI has made compulsory for the issuers and intermediaries to disclose relevant details about themselves, the products, the market and the regulations so that the investor can take informed investment decisions based on such disclosures. SEBI has prescribed and monitors various initial and continuous disclosures.

Ensures safety:

**Third,** SEBI ensures that the market has systems and practices which make transactions safe. SEBI has taken various measures such as screen based trading system, dematerialization of securities, T+2 rolling settlement, and framed various regulations to regulate intermediaries, issue and trading of securities, corporate restructuring, etc. to protect the interests of investors in securities. It also ensures that only the fit and proper persons are allowed to operate in the market, every participant has incentive to comply with the prescribed standards, and the miscreant are awarded exemplary punishment.

Redressal of Investor grievances:

**Fourth,** SEBI facilitates redressal of investor grievances. SEBI has a comprehensive mechanism to facilitate redressal of investor grievances against intermediaries and listed companies. It follows up with the companies and intermediaries who do not redress investors' grievances, by sending reminders to them and having meetings with them.

It has set up a comprehensive arbitration mechanism in stock exchanges and depositories for resolving disputes of the investors. The stock exchanges have investor protection funds to compensate investors when a broker is declared a defaulter. Depository indemnifies investors for loss due to negligence of depository or depository participant.