SECURITIES EXCHANGE BOARD OF INDIA & CAPITAL MARKET REFORMS

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CERTIFICATE

This is to certify that the research work entitled **"_Securities Exchange Board of India and Capital Market Reforms"** is the work done by **______________** under my guidance and supervision for the partial fulfillment of the requirement of <u>B.A., LL.B. (Hons.)/B.B.A., LL.B. (Hons) degree</u> at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

Signature & Name of Supervisor
Designation

Date

DECLARATION

I declare that the dissertation entitled **"Securities Exchange Board of India"** is the outcome of my own work conducted under the supervision of Dr./Prof.________________, at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

Signature & Name of Student

Date

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Chapter 1-Introduction

The capital market is a market in which borrowing and lending of long term funds both debt & equity takes place. It is a financial market which functions like a channel for the supply and demand of debt and equity capital.[1]

It channels the money provided by institutions like banks insurance company credit unions and savers and other such entities to the borrowers and investees through a variety of financial instruments such as bonds shares and notes called securities.

A capital market is not a vast and highly decentralized system which comprises of three major units-:

1. Stock Market[2]: It refers to a market in which shares of publicly held companies are issued and traded either through exchanges or over-the-counter. Examples of stock markets/equity markets are Bombay Stock Exchange National Stock Exchange & NASDAQ. Stock market is a critical component of a free-market economy. This is because it gives companies way to raise capital in exchange for giving investors a slice of ownership & along with a share in the profits of the company. It enables growing small initial sums of money into large ones, and to gives a chance to the investors to become wealthy without taking the risk of starting a business or making the sacrifices that accompany high-paying jobs.

The stock market enables an investor to participate in the financial achievements of companies whose shares they have purchased. Companies that make profit may choose to

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[1] Article on Difference b/w Money Market & Capital Market, By Investor Guide Staff, Dated: 29-Oct.-2014
http://www.investorguide.com/article/15433/difference-between-the-money-market-and-the-capital-market-igu/

[2] Bhole L M(1992), Financial Institutions & Markets : Structure Growth and Innovations, II Edition, Tata McGraw Hill

give back returns to the investors in the form of dividends. The investor may also earn by selling appreciated stocks at a profit. Such a profit is called a capital gain & is liable to be taxed in some countries if it is earned in a short duration. The downside to investing in stock markets is that an investor can also lose money if the companies whose stocks they hold lose money. Stock prices of unprofitable companies go down and the investor may have to sell the stocks at a discount on their purchase price.

The stock market can be split into two main sections: the primary market and the secondary market. Primary market involves issuing & selling of new shares through initial public offerings to both retail & institutional investors. Majority of institutional investors purchase most of these shares in the primary market from investment banks. The subsequent trading of these shares goes on in the secondary market where participants include both institutional and individual investors in varying proportion.[3]

2. Bond Market: The bond market also known as the credit market or the debt market is a financial market where participants can issue new debt, called the primary market, or buy/sell debt securities, called the secondary market. This can be in the form of bonds and may include notes, bills et al. The primary goal of the bond market is to provide long-term funding for expenditures which may be either public or private in nature. The United States' bond market is the biggest accounting for about forty four percent of the market.[4]

3. Money Market: It is used by participants for borrowing and lending in the short term periods ranging from several days to just under a year. Money market securities include negotiable certificates of deposit, municipal notes, banker's acceptances, commercial paper, U.S. Treasury bills, federal funds and repurchase agreements. There is a wide

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[3] Comparative analysis of Indian Stock market with International Stock Markets, By Debjiban Mukherjee, Issue:1 Volume:1 Great Lakes Herald Journal April 2007
http://www.greatlakes.edu.in/pdf/DebijanMukherjee.pdf

[4] Financial Markets and Institutions by Frederick S. Mishkin; ISBN: 9780321374219
https://books.google.co.in/books?id=5gYkAgAAQBAJ&pg=PT284

range of participants in the money market ranging from a company raising money by selling commercial paper into the market to an investor purchasing CDs as a safe place to park their money for short term duration. The highly liquid nature of the securities and short maturities makes money market a safe place to put money, but the investor must be aware of certain risks including but not limited to the risk of default on securities such as commercial paper.

In addition to the above mentioned units, the money market also works as an exchange for trading of existing claims on capital invested in the form of debentures and shares.[5]

Capital markets help the corporates raise capital. Many times Central & state governments also raise funds here through the issue of government securities. It includes all the institutes and mechanisms for raising medium to long-term funds. It may be accomplished through a diverse range of instruments available like shares, bonds, debentures et al.

The accelerating pace of economic reforms in India has made the capital markets overly critical. Every year many and many crores of rupees are raised by corporate houses both in the private sector & the public sector.

Post liberalization in that particular year the Indian economy has seen a tremendous growth of its capital markets with many Initial Public Offerings[6] exceeding a high number second only to United States of America. Even though the quantum of capital raised by Indian firms initially was lower as compared to that of the developed world and other BRIC nations yet they have managed to attract capital from across the world. Even

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[5] Money Market Trends-Reserve Bank of India: FAQs
http://www.rbi.org.in/commonman/english/scripts/FAQs.aspx?Id=711

[6] Globalization and Indian Capital Market, By Ms. Feeona Jeelani, International Journal of Management and Social Sciences Research Volume 2, Issue No. 8, August 2013
http://www.irjcjournals.org/ijmssr/Aug2013/24.pdf

that year turned out to be a really nice year overall for India with the total capital raised shooting to all-time highs of many billion dollar.

The years after that have not been equally promising due to widespread recession across the world following the global financial crisis. India stood at a good ranking in the recent financial year[7]. These stats give us an interesting outlook of the capital markets growth story of the India and its role in the increasingly connected global financial world. The writing on the wall seems to indicate that the Indian capital markets has begun to lose its growth momentum in the years after the financial crisis hit the world and that China is increasingly attracting a higher share of the global funds although the recent years have shown the trend reversing..

The aggressive pricing of IPOs has been quoted as the major reason behind the slowing pace of growth in the primary market in the Indian economy. The Indian primary market is yet to yield favorable returns for investors over the last few years compared to the listing premium enjoyed by investors before.

Many of the critical analysts blame the problem of investment bank's fees being linked to the issue price as a reason for such high pricing while others blame the performance and fluctuations of the secondary market. While there would never be a meeting of mind on reasons for gloomy performance of the companies listed the concern of pricing still lingers over the primary market. This has to be taken care of very soon.[8]

The governments through RBI and other financial institutes also raise a lot of money from the above discussed markets. The capital market serves a very useful purpose by

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[7] Globalization and Indian Capital Market, By Ms. Feeona Jeelani, International Journal of Management and Social Sciences Research Volume 2, Issue No. 8, August 2013; ISSN: 2319-4421
http://www.irjcjournals.org/ijmssr/Aug2013/24.pdf

[8] Reforms in Indian Capital Markets by Vyapak Desai & Anil Choudhary: Legal Era-Nishith Desai Associates
http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Reforms_in_Indian_Capital_Markets.pdf

pooling the savings & encourages large scale capital formation in the country. They help mobilize household and industrial savings. These savings are later routed towards more productive investment opportunities. They also have a capacity for providing funds for the projects in backward areas also helping in employment opportunities in these areas.

Chapter 2-Indian Capital Market: An Overview

History of Indian Capital Market

The history of the capital market in India can be traced back to the eighteenth century when the British were ruling and securities were traded in the country. Before the end of nineteenth century trading in India was unorganized and the main trading centers were Mumbai and Kolkata with Mumbai being the chief trading center for financial shares.

During Civil war of American which had taken place in 1861 the presidency town of Bombay was an important source of supply for cotton. This led to a boom in share prices. This first boom in the history of the Indian capital market lasted for close to five years. The bubble burst in 1865 and it was only after this that the share rates witnessed a humungous slump.[9]

Trading at that time was limited to a dozen brokers and their trading place which was under a banyan tree which was in front of the Town Hall in Bombay. The Bombay Stock Exchange was recognized in May 1927 under the Bombay Securities Contracts Control Act, 1925 making it the oldest stock exchange in Asia.

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[9] Financial Sector Reforms in India By Bhargab Kumar Kalita, Guhati University
http://www.academia.edu/3491864/Financial_Sector_Reforms_in_India

As the East India Company and their ruling government were indifferent towards Indias economic expansion. The capital market was not well organized and developed during the British rule. This meant that many foreign companies depended on the London capital market for funds instead of the Indian capital market. In the post-independence period also, the size of the capital market remained small.[10]

During the first and second five-year plans the Indian government‘s emphasis was on the development of the agricultural sector and public sector undertakings so as to make the country self-sufficient and benefit large number of people. Although the public sector undertakings were healthier than the private undertakings in terms of paid-up capital but their shares were not listed on the stock exchanges. In addition to that, the Controller of Capital Issues (CCI) closely supervised and controlled various aspects of the new issue including the timing composition, interest rates, pricing, allotment, and floatation costs. These strict regulations demotivated and prevented many companies from going public for almost four and a half decades after independence.

In 60s wars and droughts dominated the landscape in the country. The market trends were goaded by the ban on forward trading technically called “contracts for clearing” in the year sixty nine. It provided a mechanism for carrying forward positions as well as borrowing funds. Financial institutions such as LIC and GIC helped to revive the sentiment by emerging as the most important group of investors. The first mutual fund of India, the Unit Trust of India came into existence in Nineteen sixty four.

In the seventies of the nineteenth century the badla trades started happening once again under the disguised from of hand-delivery contracts leading to a revitalization in the

[10] Indian Financial Systems: Markets Institutions & Services, By- Pathak Bharti V., Pearson Education India, 2011
https://books.google.co.in/books?id=18iJsAxmK0gC&pg=PA102&lpg=PA102&dq=In+the+post-independence+period+also,+the+size+of+the+capital+market+remained+small.&source

market. Moreover the capital market received another severe setback in July of nineteen seventy four when the government passed the Dividend Restriction Ordinance.[11]

This was leading to prohibition of the payment of dividend by companies to twelve per cent of the face value. As a result the total value of the market at the BSE went down by about twenty per cent overnight and the stock market did not open for nearly a fortnight.

Resilience came back to the market later when the multinational companies were forced to dilute their majority stocks in their Indian ventures in favor of the Indian public under FERA. Several MNCs opted out of India while one hundred twenty three offered shares although they were lower than their intrinsic worth.

Hence for the first time the FERA dilution created an equity glut in India. It was the spate of FERA issues that gave a real fillip to the Indian stock markets. For the first time, many investors got an opportunity to invest in the stocks of such MNCs as Colgate, and Hindustan Liver Limited. Then, in nineteen seventy seven a little – known entrepreneur Dhirubhai Ambani tapped the capital market. The scrip reliance is still a hot favorite and dominates trading at all stock exchanges.[12]

The 1980s witnessed an explosive growth of the securities market in India with millions of investors suddenly discovering lucrative opportunities. Many investors jumped into the stock markets for the first time. The liberalization process initiated by the government during the mid1980s spurred this growth.

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[11] Indian Financial Systems and Markets by Saha: Tata McGraw Hill Education, 2013
https://books.google.co.in/books?id=voI77SqQm64C&pg=PA350&lpg=PA350&dq=In+the+1970s,+badla+trading+resumed+under+the+disguised+from+of+hand-delivery+contracts&source

[12] Indian Financial Systems: Markets Institutions & Services, By- Pathak Bharti V., Pearson Education India, 2011
https://books.google.co.in/books?id=18iJsAxmK0gC&pg=PA102&lpg=PA102&dq=In+the+post-independence+period+also,+the+size+of+the+capital+market+remained+small.&source

The ten years beginning in nineteen nineties was understood to be of supreme importance for the Indian capital markets. Liberalization and globalization were the new terms devised and promoted during these ten years. The decade was characterized by a new industrial policy emergence of SEBI as a regulator of capital market advent of FIIs free pricing new trading practices new stock exchanges entry of new players such as private sector mutual funds and private sector banks and primary market boom and bust. [13]

Major capital market scams also took place in within these ten years. These shook the capital market and drove away small investors from the market due to highly volatile trading. The securities scam of nineteen ninety two involving brokers as well as bankers was one of the biggest scams in the history of the capital market. In the years that followed owing to free pricing many dishonest promoters who raised money from the capital market disappeared overnight.[14]

This led to serious erosion in the investors' confidence. The Shoes of M case one such scam which took place in March nineteen ninety five put a break on new issue activity. The securities scam revealed later years highlighted the inadequacies of and inefficiencies in the financial system overall. It was the scam which prompted a reform of the equity market and in hindsight it had far reaching impact on the way the capital market functions.

The Indian stock market witnessed a sea change in terms of technology and market prices. Changing technology brought radical changes in the trading mechanism. The Bombay Stock Exchange was subject to nationwide competition by two new stock exchanges the NSE set up in 1994 and Over the Counter Exchange of India set up in 1992.

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[13] The Capital Issues (Control) Act, 1947

[14] Chapter : Concept of Stock Market; Shodhganga: Information and Library Network http://shodhganga.inflibnet.ac.in/bitstream/10603/28842/6/06_chapter%201.pdf

The National Securities Clearing Corporation and National Securities Depository Limited were set up in 1995 and established in 1996 respectively from better clearing and settlement and dematerialized trading. Changes were made to The Securities Contracts Regulating Act 1956 in which changes were made to introduce options trading. Moreover rolling settlement was brought into force in nineteen ninety eight for the demat segment of all companies. With automation of trading and geographical spread stock market participation slowly started to increase.

Before the beginning of the millennium the Information Technology financial shares were ruling Indian market. These stocks included Infosys Wipro and Satyam. They were known as New Economy stocks. The new economy companies are knowledge intensive and asset light.

Important Views on the Indian Capital Market

Various researchers and scholars have expressed their views about the Indian Capital Market and the reforms therein; these views are discussed below-:

I. **Mr. Gupta in 1992**[15] in his widely published and well regarded work on the Indian Capital Market in detail with reference to the trading systems in the Stock Exchanges in particular. In his research he suggested that the systems therein were relatively old-fashioned and incompetent and suffered from major flaws and derelictions. As per his study substantial reforms were needed if the Stock Exchanges were to be escalated up to the envisioned development in the Indian Capital Market.

   The study established that-

   a. The Indian capital market was highly speculative in nature

[15] **Gupta L C**(1992), *Stock Exchange Trading in India : Agenda for Reform*, Society for Capital Market Research and Development, Delhi, p. 123

b. The investors in India were discontented with the service provided by the brokers for trading of securities
c. The margins charged by Stock Exchanges of the country were insufficient
d. There was extremely low liquidity in a large number of stocks in the Indian Capital market.

While evidently a thorough work has been done, the conclusions except the one regarding margins charged by the stock exchanges seemed to be built on wrong or questionable arguments. It was somewhat too soon to judge the success rate or failure factors of Securities Exchange Board of India.

Dhillon (1993)[16], in his doctoral dissertation scrutinized the regulatory policies of Bombay Stock Exchange over a period of 4 years period starting from July 1986 to June 1990. The findings exhibited the facts that regulatory authorities decided to reform their margin policy based on the market activities and fluctuations. It was discovered that the margins were stimulated by changes in settlement returns of the stock's price volatility of the shares trading volumes as well as the open positions.

The causality in the reverse direction was to an extent limited, this finding was displayed in the Granger causality results which also stated that margin changes did not have any impact on returns this had a narrow impact on price volatility, trading volume and open positions. Similar results were seen in the event study methodology when applied to the daily margins charged by stock exchanges, apart from the fact that daily margin on sellers did not seem to be impacted by market variables and such other factors.

Moreover, it was seen in the studies that there was some evidence with respect to under margining leading to positions of high leverage, thus escalating the insolvency risk. The findings disclose that regulations through these instruments have had very little effect on the dual objectives of monitoring the activities of the stock market.

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[16] **Dhillon N** (1993), "Market Regulations and Stock Market Activity", Doctoral Dissertation, Indian Institute of Management, Ahmedabad.
http://www.iimahd.ernet.in/~jrvarma/papers/Vik19-1.htm#Dhillon N

Pandya (1992)[17] observed in his research work that as a watchdog of the securities market and as a regulator, the Securities Exchange Board of India took steps in the direction of investor protection these measures were varied and large in number. SEBI took steps to reform the areas relating to capital allocation efficiency in the primary capital market with a high degree of transparency, measures were taken in the secondary market for reforming securities and mutual fund sectors, regulation of various financial intermediaries and all in all for the protection of the investors interest. The measures discussed above were undertaken with an aim to achieve Capital Market stability & sustainability.

Stability and Sustainability of the Indian Capital Market

The credit of bringing stability and sustainability in the Capital Market of the country, to a large extent, goes to the watchdog of the securities market the SEBI for the various significant efforts made by it.

The objective of the Securities Exchange Board of India Act was to aid in establishment of a Board which had the powers to protect investor's interest in the Indian Capital Market and to promote the growth of the Capital Markets in India along with these objectives it was SEBI's responsibility to carefully regulate the working of the stock markets. In order to fulfill its obligations properly as the regulator of the Indian capital market, various powers have been granted to the Board by the Indian Legislators and the Indian courts, these powers have been enumerated below-:

i. To carefully regulate and monitor the business in all the Stock Exchanges and other Capital Markets of the country

[17] **Pandya V H** (1992), "Securities and Exchange Board of India: Its Role, Powers, Functions and Activities", *Chartered Secretary*, Vol. 22, No. 9 (Sept), p. 783.

ii. Properly registering and monitoring the working of all stock brokers, brokerage firms, registering and transferring agents RTA, banking institutions, a registrar w.r.t an issue, investment bankers and other Capital Market intermediaries as may be prescribed
iii. Accurately registering and monitoring the working of the depositories and the depository participants. Also the FIIs and the credit rating agencies are to be regulated
iv. Checking and preventing deceitful and fraudulent practices in the Indian Capital Market
v. Prevention of insider trading in the Securities Market of India
vi. Promoting investor education and encouraging training of Capital Market participants in order to create awareness
vii. Prudently monitoring substantial acquisitions shares and take overs
viii. Obtaining and inspecting information from of Stock Exchanges other capital market participants

The powers and functions of SEBI are discussed at length in Chapter 3.

Chapter 3-Market regulator: SEBI

For a developing country like India capital markets act a reflection of the state of affairs in the economy. To ensure investor confidence it is critical that our capital markets have a strong and non-manipulative market regulator. SEBI-Securities and Exchange Board of India takes care of this tough role.

With changing times and while facing newer challenges every day, SEBI has always taken responsibility for everything that is right or wrong in India’s capital markets.

Just weeks after SEBI's had started its operations, the Securities Market Scam led by Harshad Mehta hit Dalal Street leading to the introduction of numerous regulatory changes both in the primary along with the secondary markets.

At the same time it also brought in a notification prohibiting insider trading and making it a criminal offence. In 1999-2000, after the Ketan Parekh scam broke out SEBI completely discarded account settlement and rolling settlement was introduced to cover the loopholes in the existing system.

Forward trading was formally introduced in the form of exchange traded derivatives and short selling in spot markets was banned. Another learning curve for SEBI was the IPO scam which led to further tightening of the implementation of Know Your Customer norms and made the Permanent Account Number card compulsory for all categories of investors.

SEBI - Securities and Exchange Board of India

Introduction

With the growth in the dealings of stock markets, lot of malpractices also started in stock markets such as price rigging, unofficial premium on new issue, and delay in delivery of shares, violation of rules and regulations of stock exchange and listing requirements. As a result of such malpractices the customers started losing confidence in the stock exchange. This prompted the government of India decided to set up an agency or regulatory body known as Securities Exchange Board of India (SEBI).[18]

The **Securities and Exchange Board of India** (**SEBI**) is the regulator for the securities market in India established in the year 1988 and given statutory powers on 12 April 1992 through the SEBI Act, 1992.[19]

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[18] SEBI The Purpose, Objectives and Functions by Saritha Pujari [http://www.yourarticlelibrary.com/education/sebi-the-purpose-objective-and-functions-of-sebi/8762/]

[19] About SEBI [http://web.archive.org/web/20101003235606/http://www.sebi.gov.in/sebiweb/stpages/about_sebi.jsp]

Prior to the SEBI Act, 1992, there were three principal Acts governing the securities market: (a) the Capital Issues (Control) Act, 1947, which restricted issuer's access to the securities market and controlled the pricing of issues; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; and (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges.

The Capital Issues (Control) Act, 1947 had its origin during the war in 1943 with the intent of channeling resources to support the war effort. Later on the Act was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were properly channeled for desirable purposes, for the government's priorities and protect the investors' interests. Under the Act, any firm wishing to issue securities had to obtain approval from the Central Government. The amount, type and price of the issue were decided by the government.

It can issue directions to all intermediaries and other persons associated with the securities market in the interest of investors or for orderly development of securities market; and can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. In short, it has been given necessary autonomy and authority to regulate and develop an orderly securities market.[20]

Initially SEBI was a non-statutory body without any statutory power. However later in 1995 the SEBI was given additional statutory power by the Government of India through an amendment to the Securities and Exchange Board of India Act, 1992. In April 1988 the SEBI was constituted as the regulator of capital markets in India under a resolution of the Government of India.[21]

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[20] Working Paper on Price Discovery and Volatility on NSE future Market: By M T Raju and Kiran Karnade. [http://shodhganga.inflibnet.ac.in:8080/jspui/bitstream/10603/7800/9/09_chapter%203.pdf]

[21] A Rendevous: CV Bhave's 3 years at SEBI by CNBC TV18 [http://www.moneycontrol.com/news/cnbc-tv18-comments/a-rendezvou-cb-bhave%60s-3-years-at-sebi_524022.html]

Composition of Sebi

All the decisions which are made by Securities Exchange Board of India are collectively taken by the board which comprises of *one Chairman along with eight members*. Furthermore, Securities Exchange Board of India appoints several committees, if and when required to look into the persistent issues existing at that time. Moreover, a securities appellate tribunal that is SAT has been established for protecting the interest of the investors, entities and other market participants that feel aggrieved by any of Securities Exchange Board of India's decision. Securities Appellate Tribunal, consists of *a Presiding Officer as well as two other Members* the SAT has the similar powers as that of a *civil court.* Furthermore if an entity feels aggrieved by the tribunal's decision or order given by it then it can appeal to the Supreme Court of India.[22]

Functions of the Board

The power and functions of the board as per act are very wide and effective. This has been done to ensure that the shareholders' interests are protected. They are as follows: **[23]**

Functions of Board[24] - it shall be the duty of the Securities Exchange Board to protect investors' interest in the capital market to promote the development of the stock market along with regulating the securities market by whatever measures those are necessary.

These measures include:

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[22] Article on Securities Exchange Board of India; Last Updated: 17th June 2014
http://www.clearias.com/sebi-securities-and-exchange-board-of-india/

[23] Chapter IV of the SEBI Act 1992 which deals with the powers and functions of the Board.
http://www.sebi.gov.in/cms/sebi_data/attachdocs/1379572440984.pdf

[24] Section 11 of the SEBI ACT 1992
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1379572440984.pdf]

a. Regulating the stock exchanges and other securities markets

b. Regulation of stock brokers sub-brokers and any other intermediary associated with the stock market. This includes registering the members as well and defining their role and issuing guidelines for their working and ensuring that these regulations are adhered to

c. Regulating the working of the depositories participants custodians of securities FII the agencies that do credit rating and various other intermediaries which may be specified by the Board

d. Regulation of the working of venture capital funds and other collective investment schemes like mutual funds including registration of such schemes as well
e. Regulation of self-regulatory organizations and their promotion

f. Enhancing investors' education along with training of intermediaries of securities markets to ensure that people are equipped to take best investment decisions and brokers are able to give the right advice

g. Prohibiting and preventing insider trading in the stock market and ensuring that no manipulation takes place

h. Streamline and regulate acquisition of shares and take-over of companies in the capital market thereby ensuring clear guidelines and fair deals

i. Asking for info from inspections and also holding inquiries and audits of the intermediaries and self- regulatory organizations' information and record from any bank or any other authority or board or corporation established or constituted by or under any Central State or Provincial Act in respect of any transaction in securities which is under investigation by the Board. This would ensure the proper working of these bodies

j. Performing functions and exercising powers specified under the provisions of the Securities Contracts Act 1956 and other additional functions that may be delegated to by the Central Government

k. Levying appropriate charges or fee for carrying out the functions mentioned above

l. Conducting research as and when required for the above mentioned functions

m. Asking for or sharing details with any agencies as may be specified by the Board whichever information is considered necessary by it for discharging its functions efficiently

n. Performing any other function that may be prescribed from time to time

o. The Board may take measures to undertake inspection of any book register or other document or record of any listed public company or a public company which intends to get its securities listed on any recognized stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market. The board may at any time ask such a company to furnish necessary documents whenever the board requests. In addition to this the listed companies need to file regular disclosures with the board in case any changes take place in the composition of board of directors of the company or any other such major change.

The court said, “Having heard learned Counsels for both the sides at length and looking at the facts and circumstances of the case and the documents on record along with judicial pronouncements which are referred hereinafter I see no reason to entertain the petitions and to interfere the Scheme 2004 and the method of calculation followed by SEBI for the Registration Fees payable by stock brokers under Section 12 of the Act 1992. This has to be read with Regulations 10 of Regulation 1992 as the same is true correct and legal in consonance with the Act 1992 and the Regulations 1992 especially for the following facts and reasons:

(i) The Securities and Exchange Board of India has floated the Scheme viz. Securities and Exchange Board of India (Interest Liability Regularization) Scheme 2004 in exercise of the powers conferred under Section 11(1) and Section 11(2) (k) and Section 12 of the Act, 1992 for the regularization of the interest liability in respect of Registration Fees payable by stock brokers under the Regulations 1992.

The Registration Fees fixed by SEBI initially was found excessive by brokers leading to a nationwide strike. Following this development An Expert Committee under the Chairmanship of Mr. R. S. Bhatt was set up by the Board to look into the interpretation of turnover in context of fees to be payable by the brokers.

The Committee in its report was of the opinion that the turnover was fair basis for determination of Registration Fees and the fee prescribed by the board was reasonable in that sense. The committee also recommended concessional rate of fees for certain types. This would help bring down the total amount of fee that the brokers are required to pay.

As per the committee's recommendations these type of transactions were removed from the definition of turnover and thus the load on the brokers was reduced. The Board and the Central Government accepted the recommendations of the Committee in principal and the Board advised brokers on 7th Jan 2003 to pay the fees in the manner recommended by R.S. Bhatt Committee[25]."

Similarly the calculation of registration fees adopted by SEBI in absence of break up turnover and in absence of Auditor's report before the cutoff date was considered true correct legal and in consonance with the Act and Regulations 1992. The Court cannot extend the benefit of the Scheme after the cutoff date especially in the facts of the present

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[25] Virendra Bansal's Case; Manner of taking Turnover Date on Record http://www.sebi.gov.in/cms/sebi_data/docfiles/11370_t.html

case when enough extensions have been given by SEBI and whereby a large number of stock-brokers of Ahmedabad Stock Exchange have already availed the benefit of the Scheme.

The cutoff date forms an important part of the benefit under the Scheme. It is a matter of Government policy stating what to give as a concession for what is to be achieved promptly without keeping the policy ambiguous. The Scheme is optional and is in consonance with the Act. For these reasons the petitions fail. In all the Special Civil Applications Rule is discharged with no order as to costs. Interim relief grated earlier is vacated by the court.

POWERS OF THE SEBI BOARD: The SEBI board has been bestowed upon with following powers to govern and regulate the securities market of India. Let us now discuss these powers in detail -:

1. POWER OF CIVIL COURT

The securities exchange board has been given the power to carry out its duties the way Civil Court u/a CPC does. It means that SEBI will have the same power as that of a Civil court as enshrined in the Code of Civil Procedure, 1908 for carrying out its duties as have been bestowed upon it by the SEBI Act. The said powers will be applicable during the proceedings of a matter as given in the act. For eg. Power to summon, power to take evidence, power to demand production of documents etc.[26].

2. POWERS TO SUSPEND AND RESTRAIN

The SEBI shall have power to suspend or restrain any pending inquiry or investigation as it may deem necessary, but the reasons for the same shall be mentioned by it in writing. This power shall be exercised for the wellbeing and in interest of the investors and participants of the securities market of India. Such power is necessary for maintain a

[26] Section 11 (3) of the SEBI Act, 1992
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1379572440984.pdf]

decorum in the market and to ward off any fiasco that might befall because of the miscreants of the market.[27].

3. POWERS TO REGULATE OR PROHIBIT ISSUE OF PROSPECTUS, OFFER DOCUMENT OR ADVERTISEMENT SOLICITING MONEY FOR ISSUE OF SECURITIES

The SEBI shall have the power of regulating or prohibiting issue of any offer document or a prospectus, if it deems fit and proper in the light of investor's interest. The board shall prohibit an advertisement which solicits money or funds in the matter of issuance of the securities. These powers shall be exercised wrt the matters relating to transferring securities or issuing capital or any such matter related to issuance of capital and transfer of security. The board has power to direct the companies regarding the manner in which they are required to disclose any such material information. If the board feels that pursuant to certain conditions a prospectus/advertisement or a document shall be issued, then it may specify the same.

The board also has the power to specify requirements for transfer of securities and raising of capital[28].

4. POWER TO ISSUE DIRECTIONS

This is one of the most important powers of SEBI as it aids in preventing capital market scandals, frauds and mis-happenings. If the board, after making necessary investigations and thorough research, feels that for the smooth functioning of the market and for healthy progress of the securities markets and its participants, or that if it is important to issue directions in order to prevent any fishy or malafide action of any market participant, member, investor or an intermediary which may prove to be injurious to the functioning of the securities market and its investors, then it may issue directions to-:

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[27] Section 11 (4) of the SEBI Act, 1992
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1379572440984.pdf]

[28] section 11A (1) of the SEBI Act, 1992
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1379572440984.pdf]

a) to any person or class of persons referred to in section 12 of the Act, or related with the securities market of India

b) to any company with respect to matters as stated in section 11-A of the Act as may be appropriate in the interests of investors in securities and the securities market[29].

Now let us discuss a case law in which facts in the prospectus of a company were wrongly stated in order to mislead the investors-:

In Ajay Agarwal case it was contended that facts in prospectus of company were false and misleading the investors. SEBI under its power to issue directions as stated in Section 11-B of the act, executed a restraint order, which prohibited the company from accessing the securities exchange market of India While using powers the SEBI restrained Director of Company from accessing securities market on prima facie case that facts that were given in the prospectus of the company were misleading in nature, and to publish such facts during public issue of shares meant only one thing, that the company had an intention of misguiding the investors.

The SEBI's Appellate Board gave a decision favoring the Respondent. The appellate board was of the view that the powers enshrined in section 11-B of the Act cannot be exercised by SEBI with respect to the allegations of mere misconduct which took place at a point of time when Section 11B was not on include in the Act itself. The issue was whether Section 11B of the Securities and Exchange Board of India Act 1992 could be invoked by the Chairman of the in conjunction with Sections 4(3) and 11 for restraining the Respondent.

Supreme Court: Retrospective nature of power given u/s 11-B of the Act.

The supreme court of India decided differently, it said that the powers mentioned in Section 11B are procedural in nature and hence they can be applied retrospectively. It was further stated by SC that even in the case of prospective application of the law the

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[29] section 11 (B) of the SEBI Act, 1992

[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1379572440984.pdf]

SEBI can't be prohibited from taking actions in terms of the law which exists on the day on which the Board has passed its orders.

The Bombay High Court has decided in favor of powers exercised by board under SEBI Act.

In the following case we will discuss the validity of a SEBI circular which is inconsistent with the provisions of Arbitration and Conciliation Act.

In Banhem Securities case The brief facts of the case are: The Circular Dated 09/07/1999 issued by SEBI, was challenged in the following petition. The circular stated that: "The Stock Exchange must on receiving the arbitration award, debit the amount of the arbitration award from the security deposit or any other monies of the member against whom an award has been passed. Furthermore the stock exchanges were instructed to keep the amount in a separate account.

Only after which a confirmation shall be attained from that member against whom the award has been passed, that he hasn't filed an appeal within the prescribed time, as mentioned u/s 34 of the Arbitration and Conciliation Act. And after receiving that confirmation, payment shall be made to the member in favor of whom the award has been passed, i.e the Awardee.

But if in case an application for appeal has been filed and is pending in a court of law in in the country then the payment to the awardee shall be made in a manner as stated by the court orders. For purposes of such payment, the amount in question has to be kept separate.

While the amount mentioned above is being debited, and is the concerned stock exchange if feels necessary and appropriate to do so may inform the member that in case where award has been modified by the court and because of which any loss in business has occurred or any such other losses have been incurred, then the stock exchange shall not be liable for the same.

Also if any part of the award or any amount of interest from the award is still pending then the stock exchange, if it deems fit, may let the member, in favor of whom the award has been passed, know that the exchange shall not be held liable for payment for the same, and the awardee may recover it from the concerned member.

The validity of the said circular was questioned on the basis that very nature of the circular is in contravention to the provisions of the Arbitration and Conciliation Act, 1996. It was section 36 of the Arbitration act which was being contradicted. Section 36 states that if the time for setting aside of an award or for an appeal has, as mentioned in section 34 of the Arbitration Act, has collapsed or expired also an application for the same has not been filed in the stipulated time then in that case the award shall become enforceable. The award shall be enforced as a decree is enforced under the provisions of Code of Civil Procedure. Also if the application for setting aside of the award or for appeal against the award is refused by the appellate board then in that case too the award shall be held enforceable.

The argument was that if the award is not enforceable under the provisions of the said Act, it cannot be made executable by virtue of the administrative instructions issued by the SEBI. It is also contended that the impugned circular makes provision for deposit only in the case where the award is passed in favor of the constituent and against a broker but does not make any provision where the award is passed in favor of the broker. Therefore it is contended that the circular is in contradiction to Article 14 of the Constitution of India. It is contended that in any event once award is set aside then the amount with accrued interest is liable to be refunded. The circular, however, provides only for refund of the principal amount.

The Honorable High court in this case held that - In our opinion the challenge to the impugned circular is without any substance. The circular has been issued by the SEBI

Board in exercise of powers under section 11 and 11B of the SEBI Act in order to protect interest of the investors. The main motive behind enacting this circular was the protection of the investors' interest. Only by providing such immunity to the investors, their confidence in the securities market can be reinstated, which was thoroughly shaken after the giant scams of 1991 & 1992. This circular was not for the brokers but for the investors thus the question of violation of Article 14 of COI is not applicable. Honorable High Court found this challenge to be weak.

High court further supported the decision taken by SEBI by stating – "In our opinion the decision taken by the SEBI is in the right direction. It helps to protect the investor's interest."

The circular issued by the SEBI is confined to members of the Stock Exchanges and is aimed at the well-being of the investors thus there is no question of the circular being contrary to the provisions of section 36 or any other provisions of the Arbitration and Conciliation Act, 1996.

5. POWER TO INVESTIGATE

Where the Board has affordable ground to believe that the transactions in securities area unit being prohibited during a manner harmful to the investors or the stock market or any go-between or anyone related to the stock market has profaned any of the provisions of this Act or the foundations or the rules created or directions issued by the Board it should at any time by order in writing direct anyone per the order to research the affairs of such go-between or persons related to the stock market and to report on it to the Board.

It shall be the duty of each worker of the corporate and each go-between named in section twelve in conjunction with every body related to the stock market to preserve and to provide to the investigation Authority or anyone approved by it during this behalf all the books registers alternative documents and record of or concerning the corporate or because the case could also be of or concerning the go-between or such person that area unit in their custody or power.

The investigation Authority could need any go-between or anyone related to stock market in any manner to furnish such data to, or manufacture such books, or registers, or alternative documents, or record before it or anyone approved by it during this behalf because it could think about necessary if the furnishing of such data or the assembly of such book registers or alternative documents that it considers relevant or necessary for the needs of its investigation.

The investigation Authority could detain its custody any documents and record created for 6 months and thenceforth shall come back an equivalent to any go-between or anyone related to stock market by whom or on whose behalf the documents area unit created on condition that the investigation Authority could incorporate the other document and record if needed. If the person on whose behalf the documents area unit created needs certified copies of the documents created before the investigation Authority it shall offer certified copies of such documents and record to such person or on whose behalf the documents were created.

6. POWER TO ISSUE CEASE AND DESISTS PROCEEDING30

If the Board finds when inflicting Associate in Nursing inquiry to be created that someone has profaned or is probably going to violate Associate in Nursing provisions of this Act or any rules or rules created there thereunder might pass an order requiring such person to stop and abstain from committing or inflicting such violation providing the Board shall not pass such order in respect of any listed public company or a public company that intends to induce its securities listed on any recognized securities market unless the Board has cheap grounds to believe that such company has indulged in trading or market manipulation.

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[30] Section 11 D of the SEBI Act, 1992

[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1379572440984.pdf]

7. REGULATION OF INTERMEDIARIES: REGISTRATION OF STOCK BROKER, SUB BROKER, SHARE TRANSFER AGENTS31

Many of the intermediaries who are related or in any way or manner connected to or with securities exchange market in purchasing or making a sale of the shares or in any such method related to working in connection with the securities or shares such as mentioned below

(i) As a Stock-broker or

(ii) As his Sub- broker (of that stock broker)

(iii) Rta or registrar and transferring agent, banker to an issue

(iv) Or as trustee of a trust deed of a company or a joint hindu family or as the case may be

In accordance with the section 12-1 of that act there is no stock-broker, sub- broker, share transfer agent, banker to an issue, trustee of trust deed, or an RTA and any such other intermediary who may be connected with securities and shares market of India and shall purchase sell off or contract in shares except under the circumstances and in agreement with the terms of a certificate or authorized document of registration attained from the Board in agreement with the guidelines made under this statute.

Given that an individual purchasing or offering securities or generally managing the securities showcase as a stock- specialist, sub-merchant offer exchange specialists investor to an issue trustee of trust deed recorder to an issue shipper broker guarantor

8. POWER TO CANCEL CERTIFICATE

The SEBI has the power of suspending or canceling any certificate of registration if thinks is necessary in the interest of the investors. This cancellation or suspension has to be made as per the regulations of the act.

The board can only exercise the power if it has given prior notice to the member. In case where a proper notice has not been served then this power cannot be exercised.

This provision thus gives SEBI the power to suspend or revoke any certificate granted by it. But it is not an arbitrary power, rather the power is granted for the wellbeing of the investors and not for their oppression. Thus it is strongly advised that both the parties be heard and only after that a just fair decision be granted.

In a famous case law where the honorable Supreme court of India has decided a question of vital importance, that the tribunal has to follow the law given in relation to the way in which a penalty has been given. The arbitral tribunal does not hold the right to change or go against the very nature of that law, it has to follow it.

9. POWERS TO PROHIBIT THE MANIPULATIVE AND DECEPTIVE DEVICES, INSIDER TRADING AND SUBSTANTIAL ACQUISITION OF SECURITIES OR CONTROL[32]

According to Section 12 A of the act, no person shall directly or indirectly

1- Utilize or utilize as a part of association with the issue buy or offer of any securities recorded or proposed to be recorded on a perceived stock trade any manipulative or beguiling gadget or contraption in repudiation of the procurements of this Act or the standards or the regulations made there under

2- Utilize any gadget plan or ingenuity to swindle regarding issue or managing in securities which are recorded or proposed to be recorded on a perceived stock trade

3- Take part in any demonstration practice course of business which works or would work as extortion or misleading upon any individual regarding the issue managing in securities which are recorded or proposed to be recorded on a perceived stock trade in contradiction of the procurements of this Act or the principles or the regulations made thereunder

4- Involve it in insider trades

5- to transact in shares even when in ownership of material or personal information or communicating such material or any such kind of information to any other member in a method which is in infringement of the sections of this enactment or the rules or the regulations made under the act

10. POWERS TO IMPOSE PENALTIES AND ADJUDICATION

SEBI Act 1992 in chapter six contains Section 15A to Section 15 JA that deal with penalties that can be imposed under the Act for various failures defaulters' non-disclosures and other such felonies.

11. POWER TO ADJUDICATE

For the purpose of adjudging under sections 15A to 15HB the Board shall appoint any of its officers to be an adjudicating officer for holding an investigation in the recommended way after giving any person concerned a reasonable chance of being heard for the purpose of imposing any punishment.

12. POWER TO MAKE REGULATIONS

The act allows SEBI to make regulations to carry out the purposes of the act and every regulation must be made and published as an announcement.

Such systems may provide for all or any of the following substances mentioned below:

a. The times and places of seminars of the Board and the procedure to be followed at such meetings including minimum attendance necessary for the transaction of business

b. The terms and related conditions of officers and other workers of the Board

c. The matters relating to issue of funds transfer of securities and other matters supplementary to it and the method by which such matters shall be disclosed by the companies

d. the conditions subject to which certificate of registration is to be issued the amount of fee to be paid for certificate of registration and the manner of suspension or cancellation of certificate of registration.

Every rule and regulation made under this act shall be laid before both the House of Parliament. If houses make alterations in rule and regulation then the rules should also be altered accordingly.

Chapter 4-Capital Market Scams In India

The large scams and frauds have taught us that growth without a stout governance structure falls short of global expectations and can be detrimental to the faith of the stock market in the long run. The regulators have been active in responding to such events and in certain cases have undertaken proactive measures to stop such events from occurring at all.

The period since nineteen ninety one witnessed two major stock market scams- first one in nineteen ninety two and other in two thousand and one. These scams seriously eroded investor confidence. Subscriptions to Initial Public Offerings fell drastically leading to a setback to the primary market. Trading in stock exchanges also fell. The performance of financial institutions like IFCI, IDBI et al has been worrisome as nonperforming assets have become quite large. Thus the flow of funds from the financial institutions to the corporate sector was also inadequate.

Harshad Mehta: the high-profile stockbroker

Born in a lower middle-class Gujarati Jain family he spent his early childhood in Mumbai where his father was a small-time businessman. Later the family relocated to Raipur in Chhattisgarh erstwhile Madhya Pradesh.

Transition from an ordinary broker to Big Bull

Harshad quit his job at The New India Assurance Company in 1980 and sought a new job with Bombay Stock Exchange affiliated stockbroker Ambalal before going on to become a jobber on the BSE for stockbroker Shukla.

In 1981 Mehta became a sub-broker for stockbrokers J.L. Shah and Nandalal Sheth. Having gained considerable experience as a sub-broker he teamed up with his brother Sudhir to float a new venture.

By 1990 Mehta had become a prominent name in the Indian stock market. He started buying shares heavily. He is known to have taken the price of ACC from four hundred to nine thousand.

Later it was realized that Mehta used the replacement cost theory to explain the reason for the high-level bidding. According to this theory the older companies should be valued on the basis of the amount of money that would be needed to create another similar company at this point in time thereby factoring in the competitive advantage of these firms.

The making of the 1992 security scam

Mehta along with his associates was accused of manipulating the rise in the Bombay Stock Exchange. They misused the many loopholes in the banking system and drained off funds from inter-bank transactions. Subsequently they bought huge amounts of shares at a premium across many industry verticals causing the Sensex to rise dramatically.

However this was not to continue for long. The exposure of Mehta's ways of working prompted banks to start demanding their money back causing the Sensex to plunge as theatrically as it had gone up. Mehta was later charged with seventy two criminal offences while over six hundred civil action suits were filed against him.

The 1992 security scam and its exposure

Mehta's illicit methods of manipulating the stock market were exposed on April 23, 1992, when veteran columnist Sucheta Dalal wrote an article in India's national daily The Times of India. Dalal’s column read: “The crucial mechanism through which the scam was affected was the ready forward deal. The RF is in essence a secured short-term loan from one bank to another. Crudely put the bank lends against government securities just as a pawnbroker lends against jewelers.

Mehta and his associates used another instrument called the bank receipt (BR). Securities were not traded in reality in a ready forward deal but the seller gave the buyer a BR which is a confirmation of the sale of securities. A Bank Receipt is a receipt for the money received by the selling bank and pledges to deliver the securities to the buyer. In the meantime, the securities are held in the seller’s trust by the buyer.

Complicit lenders

Armed with these schemes all Mehta needed were banks which would readily issue fake BRs or ones without the guarantee of any government securities. His search ended when he found that the Bank of Karad in Mumbai and the Metropolitan Co-operative Bank two small and little known lenders were willing to comply with the terms and conditions of Mehta.

The two banks agreed to issue BRs as and when required. Once they issued the fake BRs Mehta passed them on to other banks who in turn lent him money under the false assumption that they were lending against government securities. He used the money thus secured to enhance share prices in the stock market. The shares were then sold for significant profits and the BR retired when it was time to return the money to the bank.

Outcome

Mehta continued with these manipulative tactics triggering a meteoric rise in the prices of stock and thereby creating a feel-good market trajectory. However upon the exposure of this scam several banks found they were holding BRs of no value at all. He had by then cheated the banks of a mind boggling four thousand crore rupees. The scam came under biting criticism in the Parliament and lead to Mehta's imprisonment.

I-T, PSBs recover dues nine years after Mehta's death

Nine years after the death of Harshad Mehta the Income Tax department and public sector banks have managed to successfully recover a significant portion of their claims emerging out of the securities scam from his liquidated assets. The Supreme Court directed the Custodian of the attached properties and assets of the Harshad Mehta Group in March 2011 to make payments of over two thousand crore rupees to the Income Tax department and two hundred crore rupees to the State Bank of India making the two institutions two of the earliest claimants to recover their dues.

The Ketan Parekh Scam:

The Man Who Triggered the Crash

Ketan Parekh was a CA by profession and used to manage the family business started by his father. He always maintained a low profile. The only suspicious claim which became the talk of the town was when he was accused of triggering a stock exchange scam. He not only has connections with movie stars influential politicians and public figures but he had business relations with leading global tycoons like Kerry Packer who partnered with him in KP Ventures a two hundred and fifty million dollar undertaking.

Over the years he slowly and steadily built a network of companies dealing in capital markets. Toward the end of the nineteen nineties there was a rise of Information Communications and Entertainment stocks across the globe and Indian markets were no exception.

He acquired stakes in certain companies by inputs from his research team. They short-listed high growth companies that had a very small capital base. According to news published in various papers, Ketan took undue advantage of low liquidity in such stocks. His company held over one point two million shares stocks in Global which comes to around sixteen percent of Global Company's stocks trading in the exchange. He also controlled twenty five percent of Infosys shares and fifteen percent in both Zee Ltd. and HFCL.

The floating stock markets between Jan & July 99 led to major escalation in prices of these stocks. While HFCL rose by fifty seven percent Global Co. grew by as much as two hundred percent within this short duration. This led to a great interest and investment into these stocks by brokers as well as the fund managers. Leading and renowned Mutual funds like ICICI Prudential & Life Insurance Fund and UTI also invested in these stocks which continued to do well in the coming months.

Financial analysts & regulators pondered on the question as to how he had managed to purchase such large stakes in these companies without being noticed.

The factors that helped the man:

As per the market sources although Ketan was an efficacious broker even then he did not have enough resources to purchase such large stakes in these big companies by himself. As per the report just the 1.2 million shares of Global Company itself would have cost him over twenty crore rupees. Analysts claimed that he had borrowed huge sums of money from various companies and banks for these substantial purchases.

He started purchasing stocks when they were being traded at lower prices. Once the stocks were purchased he saw the rates increase while continuously trading too. When the price of the share has reached a high enough level he pledged the same stocks with the banks as collateral to garner more funds.

This same tactic was repeated to raise funds from multiple sources including companies and other financial institutions. But such a scheme could not have succeeded without the involvement of banks. This involvement was uncovered later. Madhavapura Cooperative Bank was a small bank in Allahabad and was his main partner in the scam. He along with his team started to tap this bank for funds.

When he stated encountering capital crunch he misused the bank in two ways. One he started borrowing large sums of money without proper collaterals from the same branch where his companies had accounts by influencing people there. He also used the Pay Order Route in which he issued cheques drawn on Bank of India to Madhavapura Bank for which pay orders were issued by Madhavapura Bank.

This was sometimes done directly and other times through other brokers to avoid raising any suspicions. This method of raising funds was doing well till the time the stock market was in an upswing, but once the stock prices started dipping the method started proving useless to raise any more funds.

The stock market fiasco preceded by NASDAQ's descent led to a dip in all the stocks including those owned by Ketan and his companies. At this stage the banks other financial institutions from where he had borrowed these funds started asking him to either pledge more stocks with them or pay back at least a part of the borrowed funds

Either choice meant straining his financial resources. Eventually the mutual funds and other institutions who had invested in these stocks cut their exposure to shield themselves and their investors from any adverse impact. This proved to be a right step for them as in the next few weeks the Sensex dipped by twenty three percent and NASDAQ went down by over thirty five percent the highly inflated stocks help by Ketan Parekh fell flat eventually dropping down by an alarming sixty seven. Although eventually with improving global market conditions these stocks started picking up too.

But towards the end of the year NASDAQ crashed again and technology stocks took the hardest beating ever. This was primarily due to the doubts over the future of technology stocks. This prompted all the major investors globally to start selling these stocks. During this phase Ketan again faced liquidity crunch and also seems to have suffered huge losses.

It was alleged that excessive fall in the stocks held by Ketan eventually led to problem of payments in the stock markets. The Calcutta Stock Exchange payment crisis the biggest setbacks for him due to the following reasons:

1. The lack of regulations and surveillance on the bourse allowed a highly illegal and volatile badla business.
2. The exchange had the third-highest volumes in the country behind only the NSE and BSE.
3. CSE helped him cover his operations from his rivals in Mumbai. Brokers at CSE used to buy shares on his behalf.

Although on paper the stocks officially were in the brokers' names unofficially they were held by Ketan. He would cover any losses incurred by the brokers also paid a generous interest of two and a half percent weekly to the brokers. By the end of Feb in 2001 the stocks held by these brokers at CSE were reduced to half of the value to estimated six to seven billion rupees from their initial worth of twelve billion rupees.

The situation deteriorated further when his badla payments of around a few hundred millions were not honored on time for the settlement and about seventy Calcutta Stock Exchange brokers including the top three brokers together defaulted on their payments. By the mid of March the value of stocks held by Calcutta Stock Exchange brokers fell further to around three billion rupees.

The CSE brokers started pressurizing him for payments. This prompted him to approach the bank for loans. The outflow of funds increased considerably. Also it was alleged that this time Ketan was allowed to borrow without any security.

By this time SEBI had sprung into action and had already initiated several measures to control the damage like imposing an additional ten percent deposit margin on outstanding net sales in the stock markets. In addition to the above the limit for application of the additional volatility margins was lowered from eighty percent to sixty percent.

In order to revive the markets SEBI imposed restriction on short sales and made share delivery after the sale to be mandatory. It also suspended all the broker member directors of Bombay Stock Exchange governing board. The regulatory body also banned trading of all stocks by the stock vice-presidents and treasurers. The most historical decision to ban the badla system in the country was taken effective from July 2001 and rolling settlement system for 200 Group A shares was introduced on the BSE. [33]

The Midas touch

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[33] http://mba.mit.asia/waves-2014/Case-study-on-ketan-scam.pdf

Parekh was a sought after figure in the stock market as whatever he seemed to lay hands on turned to gold. But he still preferred to keep a low profile except when he hosted a millennium party that was attended by politicians well known businessmen and Bollywood stars. By the advent of the new millennium the technology industry began embracing the entire world and Indian stock markets also started showing signs of hyperactivity as well and this was when he struck and struck gold.

Almost everyone from investment firms which were mostly controlled by promoters of listed companies to foreign corporate bodies and cooperative banks were eager to entrust their money with him which he in turn used to inflate stock prices by making his interest obvious.

Almost immediately stock prices of Visual soft witnessed mind boggling appreciation from six hundred forty five rupees to eight thousand four hundred and forty eight rupees per unit while those of Sonata Software went up from ninety rupees to over two thousand one hundred rupees. However price rigging was not the end of this scheme as these inflated stocks needed to be dumped on someone at the end of the streak who would have to bear the risk and loss if the stock prices crash. Financial institutions such as UTI were used for this purpose.

Companies seek the help of stock brokers to help them increase the price of stocks when they are planning to raise money. He leveraged this fact by forming a network of brokers from smaller bourses such as the Allahabad Stock Exchange and the Calcutta Stock Exchange and also purchased stocks in the names of fictitious people or poor people living in Mumbai’s shanties.

He also had large borrowings from Global Trust Bank and rigged the share prices at the time of merger with UTI so as to draw maximum profit. Reportedly the actual amount of rupees two hundred and fifty came into Parekh's kitty as loan from Global Trust Bank. The chairman seems to have repeatedly asserted that Parekh had received less than hundred crores which is as per the RBI norms.

His company and colleagues also had secured another loan of gigantic sum of rupees one thousand crores from the Madhavpura Mercantile Co-operative Bank. All this was happening despite RBI regulations capping the maximum loan amount to a broker at fifteen crore rupees.

The stock market crash on the first of March in the year 2001 came as a major shock for the stock markets the investors along with the government.

This major crash was preceded by a sharp rise post the union budget which was acclaimed for being growth oriented. This sudden crash prompted SEBI to immediately launch investigations into the volatility of stock markets. SEBI also decided to confiscate and inspect the books of several brokers who were suspected of triggering the crash. Meanwhile the RBI had also ordered some banks to furnish data related to their capital market exposure to track the actual source of this crash.

Sadly this was also after media reports regarding a private sector bank having exceeded its prudential norms of capital exposure thereby contributing to the stock market volatility. The panic runs on the bourses continued and the Bombay Stock Exchange (BSE) President Anand Rathi's (Rathi) resignation added to the downfall. He had to resign post allegations that he used privileged information which also contributed to the crash. Post the scam the investor's confidence in the overall functioning of the stock markets was completely shaken. By the end of March 2001 at least eight people were reported to have committed suicide and hundreds of investors had reached to the brink of bankruptcy.

The scam opened up the debate over banks funding capital market operations and lending funds against collateral security. It also raised questions about the validity of dual control of co-operative banks. It was pointed out by analysts that RBI was inspecting the accounts once in two years which created ample scope for violation of rules.

The first arrest in the scam was of the noted bull Ketan Parekh towards the end of march 2001 by the Central Bureau of Investigation. Soon reports started surfacing as to how he had single handled caused one of the biggest scams in the history of Indian financial markets’ history.

He was charged with defrauding Bank of India of about $30 million among other charges. KP's arrest was followed by yet another panic run on the bourses and the Sensex crashed by 147 points in a single day

The System That Bred These Factors

The small investors who lost their life's savings felt that all parties in the functioning of the market were responsible for the scams. They were of the opinion that the broker-banker-promoter nexus, which was deemed to have the acceptance of the SEBI itself was the main reason for the scams in the Indian stock markets. The SEBI's measures were widely criticized as being reactive rather than proactive.

The market regulator was blamed for being lax in handling the issue of unusual price movement and tremendous volatility in certain shares for over an 18-month period prior to Feb 2001. Analysts also shared the view that SEBI's market intelligence was very poor. Media reports commented that Ketan Parekh’s arrest was also not due to the SEBI's timely action but the result of complaints by Bank of India.

A market watcher said "When prices moved up SEBI watched these as normal market movements. It ignored the large positions built up by some operators. Worse it did not ask any questions. It had to investigate these things not as a regulatory body but as deep-probing agency that could coordinate with other agencies. Who will bear the loss its inefficiency has caused? “An equally crucial question was raised by media regarding the regulator’s ignorance about the existence of an unofficial market at the Calcutta Stock Exchange. Interestingly there were reports that the arrest was motivated by the government's efforts to diffuse the Tehelka controversy.

Many exchanges were not happy with the decision of banning the badla system as they felt it would bring the liquidity in the market. Analysts who opposed the ban argued that the ban on badla without a suitable alternative for all the stocks which were being moved to rolling settlement would rig the volatility in the markets.

They argued that the lack of finances for all players in the market would enable the few persons who were able to get funds from the banking system including co-operative banks or promoters to have an undue influence on the markets.

The People That the System Duped

Ketan Parekh was released on bail in May 2001 and the duped investors could do nothing knowing that the legal proceedings would drag on for years. In most experts' opinion the scam had set back the Indian economy by at least a year and would have an adverse impact on the investor confidence in the market. Reacting to the scam all he said was "I made mistakes."

Analysts commented that if the regulatory authorities had been alert in doing their job then huge erosion in values could have been avoided or at least controlled to an extent.

SEBI's post crisis damage control measures

Investigations led by Security Exchange Board of Indian into Parekh's money laundering scam revealed that he had used the bank and promoter funds to manipulate the stock markets. This prompted SEBI to initiate the plugging of loopholes in the stock market. It started by cutting short the trading cycle from a week to a day. The carry-forward system in stock trading called badla was banned and operators could no longer trade using this method. A formal forward trading mechanism in the form of exchange-traded derivatives was introduced to ensure a well-regulated futures market. The stock exchanges were also freed of the brokers control and this allowed them to function more freely and fairly. In the case against Ketan Parekh SEBI found prima facie evidence of price rigging in the stocks of Global Trust Bank Zee Telefilms HFCL Lupin Labs Aftek Infosys and Padmini Polymer.

Furthermore another startling revelation by the RBI to the Joint Parliamentary Committee during the investigation revealed that financial institutions such as IDBI Bank and IFCI had given loans of over one thousand four hundred crore rupees to companies known to be close to Parekh.

Criticism of SEBI

Some of the regulatory actions undertaken by SEBI came under harsh criticism from certain sections which felt that the body was stilling unable to grasp its supervisory duties. Observers said that as per the actions of the regulator it seemed that it still felt that its only priority was to prevent a fall in stock prices.

It was rumored that the banning of short sales and increased margins shrank the stock market to a sixth of usual levels.

SEBI fired all broker directors from the Bombay Stock Exchange and Calcutta Stock Exchange and declared the completion of three controversial settlements of the Kolkata bourse by retaining a sizeable proportion of the payout of operators who had allegedly tied-up for collusive deals. It also ended up rounding the bear operators and launched an inquiry into their alleged short sales.

Stringent regulatory measures follow Parekh episode

Parekh's fraudulent operations motivated the authorities to take necessary steps that have transformed India's stock markets into a relatively much safer market in present times. Strong reforms in the financial system were also initiated as a reaction to this entire episode.[34]

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[34] http://flame.org.in/knowledgecenter/scam.aspx

Capital market reforms in India:

Growth and Evolution of Indian capital market

During the period of the banking institutions and main financial institutions dominated the capital market; primarily resource mobilization for industrialization came predominantly from financial institutions throughout the country. Transformed by the process of liberalization which commenced in the 1980s and the new economic policy of 1991, the role of capital markets changed drastically from being just an inactive onlooker to being a dynamic source for corporate mobilization.

The capital issues by public limited companies attained highest level during mid-nineteen nineties.

- During the period of year to year it dropped drastically.
- Primary market resource mobilization displayed a decline during the period from month to year.
- From year 1995 to 2000 public issues had gone down while private placement surged.

Secondary Markets or Stock Exchanges In India - An Overview

The beginning of the stock market can be traced back to the time when securities in lieu of property or promise to pay were 1st issued as well as made transferable from one person to another person. During 1830s East India Company was the dominant institution. In the year 1860 and 1861, the American civil war totally stopped supply of cotton from U.S.A. to Europe. This resulted in unlimited demand on India. Now the country had to rely mainly on the Bombay presidency for its cotton demands. There was a flow of export payments in the form of silver and gold as a result of large exports of cotton from the Bombay presidency. Investors now started exploring new avenues for investing the newly accrued wealth which resulted in the share obsession which occurred in the year 1861 to 1865.

Following stock exchanges are the oldest in India:

THE BOMBAY STOCK EXCHANGE (BSE), 1875

The trading of shares thrived in Mumbai during the share mania and the number increased gradually from about more than two fifty brokers. Till 1874 the brokers gathered in a street to carry out trading, this street is now called the Dalal Street, business in securities were carried out there. In the year 18-77 they instituted the present native stock along with the share brokers association. The word 'Native' meant that no one but only the citizens of India were to be admitted as members of this association of share brokers. This share broker's association presently known as the 'Stock Exchange'. The participants entry fees was rupee one and only 318 members were a part of this association in 1875 there the number increased to 595-6 in the 1990s.

THE AHMEDABAD SHARE AND STOCK BROKERS ASSOCIATION FOUNDATION (ASSBAF)

The brokers of the city of Ahmedabad had created an association under the name 'Ahmadabad Share and Stock Broker's Association". This organization was a voluntary Non Profit making organization which used to follow the rules and regulations established in Bombay Stock Exchange. Members of this organization would to assemble and carry out securities trade in an open area at the Man Chowk. But post World War a building was constructed, now this structure is known as A. Stock Exchange Association Ltd.

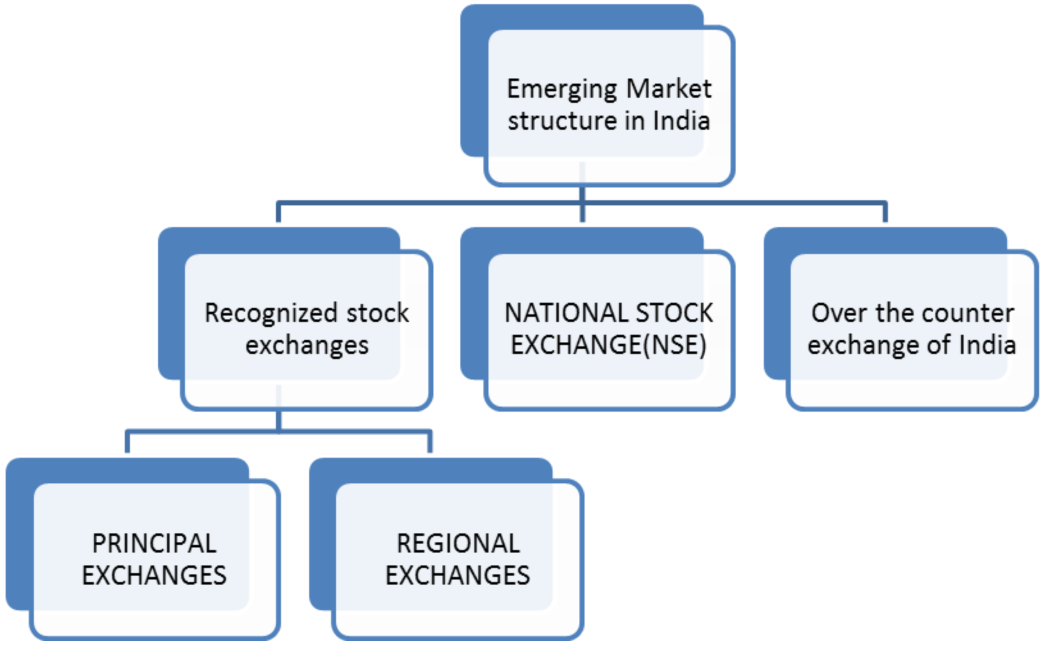
THE CALCUTTA STOCK EXCHANGE ASSOCIATION, 1908

During the period of year 1904 and year 1908 there was a coal boom in Calcutta which initiated a rise in prices of coal shares. An association of leading stock brokers was formed on June 15, 1908 under the title of the Calcutta Stock Exchange Association, it had 150 members initially. There were 9 members in the 1st committee of exchange of the association. The founding office of this stock exchange was in a building at new China Bazaar Street which afterwards came to be known as the place of Calcutta.

THE MADRAS STOCK EXCHANGE (MSE), 1937

On September 4, 1937 a stock exchange was established in the city of Madras under it was called "the Madras Stock Exchange Association Private Limited". MSE commenced with only 5 members, it had 84 companies listed officially whose securities could be traded under it. On 29th April 1957, MSE was reorganized as company limited by guarantee known as "Madras Stock Exchange Limited". This newly reorganized company had 35 members.

NSE i.e. the National Stock Exchange of India Limited was set up in Worli, Mumbai. The growth in the number of stock exchanges points out the escalating number of companies in the country. The upcoming market structure in India can be diagrammatically shown as below.



A recognized stock exchange means the stock exchange which is for the time being recognized by the central government under section 4 of the act.

Chapter 5: Efforts Made By SEBI to Bring Reforms in Indian Capital Market

The capital market in India has seen numerous changes over the last few years and the securities exchange board of India continues to journey forward with a view of establishing a more efficient market, which is transparent and investor friendly. Many measures have been introduced since July of ninety one with the intent of improving the productivity and efficacy of the system. Securities Exchange Board of India as well as other agencies expects professionalism along with functional forte assisted by moral and ethical behavior from the stock brokers moreover a comprehensive and widespread approach towards businesses is expected.

Substantial modifications have brought about by the liberalization policies of the government. The capital market has seen many reforms over these years. Some of them are discussed below

1) SIMPLIFICATION OF PUBLIC ISSUES:

The Finance Minister of India in his speech while presenting the union budget 2012 - 2013 declared that "Simplifying the procedure of issuing Initial Public Offers, reducing their costs and assisting companies in reaching more retail investors in small towns. To attain this, in addition to the prevailing initial public offer procedure, I recommend, to make it compulsory for companies to issue IPO of INR10 crores or above in electronic form via nationwide broker network of stock exchanges".[35]

Pursuant to the speech by the finance minister, Securities Exchange Board in its meeting held on 16th August 2012, approved a suggestion in this regard. Consequently, Securities Exchange Board of India issued a circular on 4th October 2012, which thereby provided an additional mechanism for investors to submit application forms in public issues using the stock broker network of stock exchanges, who may not be association members in an issue. The instant benefit of this regime was the extended geographical reach of the distribution channel by making use of the stock broker network of the stock exchanges. The additional mechanism was to function parallel to the prevailing processes and regimes of submission of applications in public issues.

Investor will be able to submit his/her application to make an order with any Securities Exchange Board of India certified Stock Broker, Depository Participant or a Registrar and Transfer Agent and Self Certified Syndicate Bank (SCSB). Depositories can take admittance to the Stock Exchange platform and in return provide the same to their Depository Participants, Registrar and transfer agents apart from a registrar transfer agent, who acts as the R.T.A to that issue in particular, to cater the concerns of conflict of interest. Investor will continue to have an alternative of submitting Application supported by blocked amount application to a stock broker. To start with the depository participant and the registrar transfer agent will accept only ASBA, application supported by blocked

[35]Discussion Paper on "Revisiting the capital raising process"
http://www.sebi.gov.in/cms/sebi_data/attachdocs/1420712345287.pdf

amount application. Nevertheless, they might be enabled to accept non-application supported by blocked amount in future subject to appropriate changes in the regulatory structure, as may be required.

Investors may also file the application form online i.e. an e-form and make the submission on the web portal of trading member, depository participant or registrar and trading agent, if provided by the intermediary. In this situation, the investor will not be obligated to physically sign on any paper as even the Companies Act of 2013 recognizes the e-form of a document or any such agreement. This will aid in elimination of printing application form hence the overall cost of public issuance will be reduced.

2) ABOLITION OF CONTROLLER OF CAPITAL ISSUES

Prior to the establishment of SEBI, the Capital Issues Control Act 1947 administered capital issues in India. The most important objectives of the Act were

i. Making sure the investments in the private corporate sector are in line with the vision in the five year plan
ii. Promote the growth and expansion of private corporations and individual companies to expand the framework
iii. Timely allocation to ensure that overloading does not occur

In the issues made via book building, the investors have liberty to subscribe for the securities at the rates they consider suitable.

Eventually the groundwork was complete and the market regulatory authority came through and replaced direct government intervention. The passing of Securities and Exchange Board of India Act made SEBI into a statutory corporate body.

3) ESTABLISHMENT OF SEBI AND ITS REGULATORY MECHANISM

SEBI was established with the objective to control the primary markets draw up framework to regulate the working of secondary market and control the functioning of stock market intermediaries to ensure better working and scam free stock market which has the investors' welfare in mind.

4) **PRIVATE SECTOR ENTRY INTO MUTUAL FUNDS**

The entry of the private sector into the mutual fund space marked the dawn of a new era in the regulation of already complex stock market. The increasing challenges of the market working forced SEBI to continuously keep on evolving and ensure that the markets are functioning properly and the investors' interest are being taken care of. Many foreign funds also came into India and the mutual fund space also saw a lot of mergers and acquisitions happening which meant that the regulator had to be very dynamic to remain relevant with the changing times.

5) PERMISSION TO ISSUE GDR'S AND ADR'S.

Post liberalization the Indian capital markets also started integration with the international markets. The companies were allowed to raise capital in foreign markets under the condition that they take prior approval from SEBI and the Indian government by submitting the required documents to the finance ministry. The first GDR was issued to RIL followed by Grasim Industries around the mid of 1992.

Eventually the process evolved and became such that once the procurement of the necessary approval from the Government of India was done the Indian company was required to submit an application to the GM - foreign investment division in Reserve Bank of India.

6) DESIGNING NEW FINANCIAL INSTRUMENTS

A new financial instrument may be one in which there are some new features with respect to terms of agreements in comparison to presently available instruments. Very few financial instruments are absolutely new in character. Most of them are just new products with additional features added to them in order to make them marketable. Some of the conventional financial products are-:

- Equity Shares
- Preference Shares
- Debentures – Fully and Partly Convertible Debentures
- Also Non-convertible Debentures

Post reform in the Indian capital market many new financial instruments have been introduced with a view to cater the needs of the changing economy and capital markets around the globe. Many of these instruments and products are Debt Instruments which have been designed and formulated as per the requirements, and these instruments have been marketed successfully as well.

Some of the new financial instruments have been listed below-:

- Floating Rate Bonds: The rate of interest on these bonds is anchored to a bench mark rate which keeps fluctuating according to the current market rate, hence is not fixed. This product was introduced to provide a cushion to the falling market rates in case of bad economy.[36]

- Zero Interest Bonds: In this financial instrument there is no periodic payment of interest and when they are sold they are sold at a huge discount on the face value of the product. They are beneficial to both the investor as well as the issuer since they

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[36] National Stock Exchange of India: Capital Market-FAQ on Corporate Bonds, Dated: 29th September 2011
http://www.nseindia.com/products/content/debt/corp_bonds/FAQ_corporate_bond.pdf

limit the cost of funding when the interest rate are volatile for the issuer, also reduce the risk of reinvestment faced by the investor.

- Deep Discount Bonds: this is a kind of zero coupon bond where maturity period is quite high, for example 15 years onwards, it is offered at a discount rate on the face value of the bond. The first financial institution to offer Deep Discount Bonds was Industrial Development Bank of India in year 1992.

- Revolving Underwriting Finance Facility: it's a kind of debenture whose maturity is 90 days. It gets rolled over after the maturity period. It has two basic features which are mentioned below-:
  - If the lot is not fully sold then an underwriter will be prepared to take up the whole leftover lot.
  - After expiry of the maturity period which is 90 days the whole lot will be rolled over which means that this debenture will be redeemed and again auctioned. This process enables the financial product to be in the market till five years.
- Domestic Convertible Bonds: it is a hybrid security which gives the investor an option segregate the rooted equity share and enables it to be traded in the market separately.

Debt can be raised at a lower interest rate due to this special feature of converting the debt into equity, thus is beneficial to the issuers.

7) SEBI AND STOCK EXCHANGES BECOMES MORE INVESTOR FRIENDLY

Stock Exchanges under the SEBI guidelines are required to maintain a Protection Fund to compensate investor claims arise out of non-settlement of onuses by the defaulter trading member of that particular stock exchange, this fund is known as Investor Protection

Fund. The maximum amount of claim which is payable from the Fund is ten lakh rupees with respect of trades which have taken place on that exchange.[37]

8) OPENING UP CAPITAL MARKETS TO THE EXTERNAL SECTOR WHICH HAS RESULTED IN THE INFLOW OF FOREIGN CAPITAL:

One of the major market stimulator has been the impact of the FII's and the other FPIs. Liberalization has flung open the gates of international finance to the Indian market but along with it has come the challenges of competition which our industry now faces. The domestic industry is now enabled to privately place equity to the mutual funds and foreign institutional investors according to the SEBI guidelines. The Indian companies can now raise capital from the foreigners themselves and then to compete in the international market, this capital is cheaper in nature and is hence a convenient source of capital for businesses.[38] These measures are bound to give a boost to Indian market in the global community and will ensure healthy completion.

9) ESTABLISHMENT OF NSE

National Stock Exchange of India was a forerunner in the international securities market, it specialized in the use of demutualized regime, where the exchanges were not owned by the broker firms. It aided in keeping national stock exchange focused on the requirements of investors as opposed to the profit maximization approach employed by the brokers and their firms.

NSE gave rise to serious implementation of the rules and regulations in comparison to other stock exchanges in India. In the month of November, 1994 trading at national stock exchange had commenced.

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[37] Guiding Light: Some Frequently Asked Investor Questions; Retrieved On: 02-04-2015 http://www.nseindia.com/content/press/glfi.pdf

[38] Cities of the Future: PwC Report https://www.pwc.com/gx/en/government-public-sector-research/pdf/cities-final.pdf

Eventually national stock exchange became country's leading stock exchange. There are not many equivalents to this chapter even on the international upfront where a new exchange replaced the position of an existing stock exchange in one year.

National stock exchange and the Bombay stock exchange are situated in the one city and have the similar trading time, most of principal stocks are traded on these two exchanges. The NSE and BSE are competitors for both listing of stocks as well as for the order flow. The advent of NSE has resulted in reforms in the Bombay stock exchange like the establishment of Bombay on line trading.

10) OPEN ELECTRONIC LIMIT ORDER BOOK MARKET AND SCREEN BASED TRADING[39]

The Open Electronic Book Market System was substituted by the Open Outcry System. The Open Electronic Limit Order Book generally referred to as E.L.O.B is a nationwide system which is a computer based matching system.

Few Advantages of Open Electronic Limit Order Book

The prices mirror the resources of the traders as well as their information

- It enables transparent screen based trading
- It facilitates liquidity

National Stock Exchange was established in 1994 with this new screen based trading facility.

11) THE INTEGRATION OF STOCK MARKETS IN INDIA

The national stock exchange established satellite communication system whose resultant effect was the emergence of an integrated national market, which is, if an order is to be

[39] Reforms in Capital Market: Chapter 4; Shodhganga INFLIBNET Center; Extracted on 29-03-2015 http://shodhganga.inflibnet.ac.in/bitstream/10603/13010/11/11_chapter%204.pdf

bought from Kolkata, it can be tallied through computers with an order to sell from any part of India.

Advantages of Integration of Markets

- This eliminated price fluctuations, now the arbitrageur could not take unfair advantage of pricing discrepancies.
- It increased market efficiency as well as transparency
- It decreased the number of intermediaries which eventually lead to a decrease in the cost of transaction.

12) ESTABLISHMENT OF CLEARING HOUSES

The formation of National Securities Clearing Corporation, the N.S.C.C in year 1996 aided in removing the issue of counter-parity risk.[40] The national securities clearing house executes "NOVATION", which is the authorized counterparty to the net settlement obligation. The brokerage firms which were bound by family bonds and ethnic ties affected the working of traditional exchanges. Such relations were misused in responding to crises in the stock markets.

The national stock exchange on the other hand admitted brokerage firms devoid of any cultural or family bonds, but due to this the national stock exchange was exposing itself to a larger risk of Counter-parity. Thus the answer to the problem resulted in the birth of national securities clearing house. The National Securities Clearing Corporation precludes the externalities linked with defaults and non-payments.

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[40] National Securities Clearing Corporation: A trading of Service; Annual Report 2006 http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1990/1996_0101_NSCCAR_1.pdf

The National Securities Clearing Corporation uses a blend of “online real-time task monitoring and initial margin” as well as “the daily mark to market margin system” as the risk containment method.

The National Securities Clearing Corporation has efficaciously sailed across the markets in the times of high volatility. Even though the national securities clearing corporation is condemned for being overly conservative in their marginal calculations yet the truth remains that it has created an unparalleled reliability in the stock markets and their functioning.

13) DEPOSITORY SERVICES[41]

The problems emerging from the physical share certificates were removed by the “Depository Act, 1996”. The transaction costs were huge, delays and reduced liquidity were common occurrence as a result of transfer of Physical Shares. Depository act of 1996 established “depositors” these are institutions which dematerialize shares. These establishments convert the shares into electronic form, which enabled e-transfer of shares. Thus the process of transfer of shares became faster and more efficient.

Advantages of Depository Services:

- The difficulties of storing and handling of e-records of the ownership of shares is done away with due to the depository services.
- It has aided in reducing the costs involved in trading of shares like the transaction expenses, costs arising out of transfer of shares, maintenance charge etcetera.
- It increased liquidity of shares, improved prices and market efficacy.

14) ROLLING SETTLEMENT

[41] A Study of Derivatives Market in India and its Current Position in Global Financial Derivatives Markets: By- Ms. Shalini HS & Dr. Raveendra PV: IOSR Journal of Economics and Finance, Vol. 3 Issue 3, April 2014

http://www.iosrjournals.org/iosr-jef/papers/vol3-issue3/D0332542.pdf

"T+n" Rolling settlement was introduced in the stock exchanges of India. In this method 'T' stands for trading day and 'n' represents the number of days subsequent to the trading day. Entire shares in the market were compulsorily transferred to Rolling Settlement System, starting in December of year 2001. Each and every stock exchange in the country was moved to the same settlement day.
At first the 'T+5' system was adopted, then came the 'T+3' system and eventually 'T+2' settlement system was also adopted. 'T+1' settlement mode was introduced in 2004.

Advantages of the Rolling Settlement System:

This system reduced the risk arising out of large open positions throughout the country which have a vast volatility potential moreover all the stock exchanged were moved to the same settlement date which made the monitoring of exchanges easier and the system became more fair and transparent.

15) DERIVATIVES TRADING

Derivatives' trading was introduced in June 2000. A derivative is a kind of security which obtains it value from the underlying assets, and fluctuations which occur in the market. These are characterized by high level of leverage. Some of the common underlying assets include stocks, debentures, bonds and currencies etc. Derivatives trading brought about a boom in investor participation in the market, and capital flow increased.

Two organizations which deal with derivatives trading are-

- N.S.D.L: 'The National Securities Depository Limited', this organization is promoted by National Stock Exchange.
- C.S.D.L: 'The Central Depository services Limited' it is promoted by Bombay Stock Exchange.

Each and every trade occurring in the derivatives market is guaranteed by the National Securities Clearing Corporation (NSCC).

Advantages of derivatives trading:

Derivatives' trading facilitates better risk management system and also help in reducing risk. Techniques like hedging and arbitrage is used to assess the risk based on the future fluctuations that may occur in the market.

16) FOREIGN PORTFOLIO INVESTMENT WAS ALLOWED:

Foreign Portfolio Investor is as a person who holds less than ten percent stake in a company.[42] Investment in form of portfolio by an investor or by a group of investors cannot exceed more than ten percent on an Indian Company. Any investment beyond that would be considered Foreign Direct Investment.

Foreign institutional Investors, American Depository Receipt, Global depository Receipt etc. were allowed in the capital markets post reform. This resulted into integration of Indian Capital Market with the rest of the world. Indian companies could join hands with the foreign investors on the global upfront.

On 07, January 2014 the Foreign Portfolio Investors Regulations had been notified in the official gazette of India. As per SEBI (Foreign Portfolio Investors) Regulations, 2014, no person shall be allowed to buy sell or deal in securities as a foreign portfolio investor until he/she has obtained a certificate by an authorized depository participant on behalf of SEBI.

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[42] Foreign Institutional Investor: Contributed by-Rosemary Abraham; Last Updated: 30th June, 2014 http://www.arthapedia.in/index.php?title=Foreign_Institutional_Investor_(FII)

National Securities Depository Limited and Central Securities Depository Limited are required to maintain data on foreign portfolio investors. The Foreign Portfolio Investor Regulations, 2014 replace the present FII Regulations, 1995 SEBI QFI framework.

17) BOOK BUILDING:

The year 1995 was marked by advent of book-building concept in our country resulting from the recommendations of an expert committee which was appointed by SEBI under the chairmanship of Mr. YH Malegam 'to review the, then, prevalent disclosure requirements in respect of offer documents', 2 key terms of reference were 'the basis on which pricing of issue was done' and the other one was 'whether or not significant reduction in time required for processing of applications was by Securities Exchange Board of India was possible or not."

The committee suggested certain guidelines and same were accepted by the regulator in November 1995, which stated that the process of book building should be open to issuer companies subject to certain terms and conditions as may be specified.
Book Building a method of offering securities based on bids received from investors as opposed to the previous fixed price method. It helps in assessing the demand and fix price accordingly.

18) CORPORATIZATION OF STOCK EXCHANGES

In the start of the millennium the demutualization and corporatization reforms came into existence. It comprises of separation of ownership of stock exchanges their management and the trading membership of that exchange also the very vital Comprehensive Risk Management System was also introduced.

CRMS integrated many essential measures to ensure that the market functioning was properly regulated and was done to ensure that any scams that could hurt the economy and investors at large were avoided.

The Set Backs of SEBI as a Capital Market Regulator

Initially the Capital Market was resilient but following inducements from external forces things started going wrong. Such inducement started in the late nineteen-eighties and caused a lot of panic in the Capital Market in the early nineties. SEBI’s efforts to boost investments in the Capital Markets faced a severe setback in the nineties with the exposure of the Harshad Mehta scam.

He had managed to obtain huge funds from top Indian Banks and other financial institutions across the country including housing banks and mutual funds to influence stock prices. His activities led to a significant rise in the Stock prices between Sept. ninety-ninety one and Apr. ninety-ninety two During this period the BSE went up by a staggering percent of 156 only. However when the prices started crashing several small investors lost their money which was earned with lots of efforts.

The approximate amount involved in the scam was over many billions. The scam brought to light SEBI's inefficiency in regulating the markets. After the Harshad Mehta scam, SEBI's role as a regulator of the Indian Capital Markets was once again questioned in march two thousand one when the BSE index crashed by 176 points. This happened as the result of the large position taken by a stockbroker- Ketan Parekh (KP) in ten stocks popularly known fouled shares.

The companies in which KP held high equity stakes included Amitabh Bachchan Corporation Limited. He had huge exposures in these stocks which required a lot of money. He reportedly borrowed from various companies and banks for this purpose. His borrowing power went against the legal regulation of the Banking Industry as set by the Reserve Bank of India (RBI).

Chapter 6-Conclusion

We have seen that how Indian capital market plays a vital role in promoting the growth of economy of the country by mobilizing long term savings, which can be put to productive use. The Indian capital market is a well-assimilated structure and its constituents include stock exchanges, banking institutions and other such financial institutions like the insurance companies, the provident fund organization etc.[43]

The capital market is considered as most appropriate investment for the common people as it allows them to invest their money into the varied portfolios at a comparatively lower price. It might be said that due to various reforms that have occurred in the Indian capital market, the market has developed a lot and improvements can be seen. Also, these developments have made it possible to compare Indian capital market with the global capital markets.

Securities Exchange Board of India as the overseer of the industry has a significant and crucial role in the stock market in ensuring that the market members perform their duties in harmony with the regulatory framework laid down by SEBI. The Stock Exchange as a Self-Regulatory Organization works to regulate the market and its rates according to the established regulations. Securities Exchange Board of India plays complimentary roles to improve the investor protection as well as the general quality of the market.[44]

Quite a lot of work is being done by Securities Exchange Board of India for the development of Indian capital market. Even though efforts by SEBI have not provided optimum results, it has still been able to bring greater transparency in the affairs of organizations and stock exchanges. Still the investors do not have 100% confidence in

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[43] INDIAN CAPITAL MARKET actful Management Research Journal: Vol. 2 Issue 4, January 2014; By: Shallu
http://tmgt.lsrj.in/UploadedArticles/122.pdf

[44] Securities and Exchange Board of India -
g/casestudies/catalogue/Finance/FINC036.htm

capital market. It seems that Securities Exchange Board of India worked gradually in converting Indian stock market into an internationally competitive and contemporary market.

The Capital Market in India was dominated by a few influential players, in addition to this it was poorly developed, impervious, and was concentrated only in some cities. The market was filled with unfair trade practices and the moral delinquency was at its peak, this scenario led the foreign investors to believe that Indian Capital Market was an extremely unsafe place to do business.[45] But once the securities board was established the face of Indian Capital market started changing. It was board's primary objective to look after the wellbeing of and in the best interests of the investors. Also the board worked very hard to provide the shaking Indian market a stable platform. For these function the board was granted powers, such in nature as would enable it to function smoothly and wipe out any irregularity. Owing to such strong and substantial changes that the regulator introduced, the investor's confidence in the market arose again. It was now the duty of SEBI to maintain and uphold the integrity of the securities market. This sure was no child's play and many reforms had to in be traduced to bring changes in the system.

There were numerous impediments that the securities regulator had to face and tackle while creating the regulations and legal framework for monitoring the securities market. Framing of such regulations was a rather tough job since the members who wre accruing profits from the existing system were resisting vigorously.

But the immense efforts made by the watchdog of Indian Securities markets proved to be fruitful, and a final skeleton of all the rules and laws related to it were given. These regulations aided heavily in monitoring and administering the market.

But does SEBI frame laws arbitrarily? The answer is no, it has the method of consultative functioning, where in the board takes advise from the public and incorporates the ones which it deems fit. The public can post comments and posts,

[45] Chapter 4: Indian Capital Market and Risk Management Therein, Shodhganga: Information and Library Network

remarks, ideas etc. and these are taken into consideration by the board while framing any policy. Thus it is very safe to assume that the securities regulator is extremely considerate of investor’s interest and is determined to safeguard it.

Not only the general public but opinions of legal experts is taken into consideration, and thus a legally sound framework can be obtained.

Such an open minded and modern approach not only provides us with a strong law which is free of any errors and is sound in nature but also aids in implementation, as the public can easily accept the law which has incorporated its suggestions.

For carrying out its objectives and duties SEBI has establishes various committees which comprise of experts from varied fields. These experts are mainly highly qualified in the field of finance and capital markets. Even help and advice from well-established market practitioners is also taken.

SEBI makes sure that all the orders passed by it are posted duly on its website. Even where an appeal against it order lies, the board has to display the same on its web portal.

This helps in maintain transparency in the process and also keeps the market participants aware of the norms and regulations of the board.

It can be said that without SEBI’s control the capital market would have going hay wire. This not only puts the Indian investor funds at risk but also the foreign investor is not lured to invest in Indian market. If the functioning of the market seems fishy the investors chose to keep away from it owing to the prior capital market scams, which were a lesson learnt hard. Moreover the foreign investment in the Indian market is slowed down, which means that the inflow of foreign currency is reduced too. Thus strong efforts are required to keep up the good reputation of the market on the global upfront as well.

The SEBI is one regulatory authority and the capital investment market is limitless. At times certain miscreants pass by unnoticed. This happens because some loopholes are still left in the legal framework. Sadly such loopholes become visible only when a shrewd market participant takes advantage of it and is caught red handed. Only when the loophole is in light, the efforts to amend it are made. In my point of view if the penalty mechanism of the board and powers relating to it are strengthened then the immoral anf fraud activities can be reduced.

Thus it is safe to say that SEBI has to go along way before it becomes a flawless regulator.

SEBI follows a self-disciplining methodology. Where in, if the board comes up with any guideline it makes sure that the same has been enforced or amended in a timely manner, as the case may be. Time lines are set and the board strives to pace up with the time lines.

The capital market in India in the present day mirrors the success of the SEBI over the past years. This has been witnessed in a recent research where it was found out that, the investor's faith in the capital market has become stronger because of the board. People have now started considering the securities market as a great place to mobilize their savings. This has eventually led to an increase in the number of investments and participants in the stock market of the country. Also the foreign participation, the FPI's, have increased as well. Even the mutual fund industry has seen tremendous growth after the establishment of SEBI.

The changes in the market have been very fast-paced and they have been possible with the cooperation of all the market participants other regulators and the government of India. The idea is not that in the Indian Securities Market everything was fine and needed no development refining or renovating. The dynamics of the global environment commands that those charged with the responsibility of bringing about changes must always seek out learning by experience criticism and decisions.

The market gravity needs to be complemented with further product modification mortgage and asset-backed securities warrants and disinvestment in the municipal sector. The debt market of India though enormous and next in size only to Japan in Asia was devoid of vibrancy and did not provide sufficient choices for gathering medium to long term funds necessary for Undeveloped projects to be exact. Infrastructure funding which is precarious for persistent high economic advancement has become a concern in the deficiency of a effervescent debt market.

Regardless of all the reforms that had taken place in the Indian Capital Market and the escalating regulatory powers over the years, Securities Exchange Board of India has been highly unsuccessful in preventing capital market scams. This shows that a lot of work still needs to be done in order to provide perfection to the Indian Capital Market. Yet commendable work has been done by SEBI as a regulator of the Capital Market, gradually it has been able to bring stability to the market, while also invoking a substantial degree of confidence amongst the investors, which was shaken time and again by the numerous scams and fiascos that occurred in the stock market.

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