Chapter 5

Financial Regulations

Introduction:

The rapid economic growth of any country depends on an efficient, articulate and developed financial system. Therefore, the regulating of Financial System is very essential in any country for efficient functioning of financial institution, financial markets, financial instruments and financial servkes.

In India we have Ministry of Finance (MoF), SEBI, RBI, NABARD, IRDA etc. to regulate the activities of financial system of our country.

Role of Market Regulators:

1. Regulate activities of market intermediaries.
2. Protect and promote the interest of investors.
3. Contribute to healthy development of 'securities and capital market'.

NEED FOR MARKET REGULATORS:

1. For envisaged and orderly economic growth: The adequate, efficient and proper regulatory framework shall put in place the process of smooth financial growth in the country.
2. To promote savings and investments in the country: The rate of economic growth of a country depends upon the savings rate of the household public sector and the domestic as well as foreign private corporate sector.

3. Investor protection: Regulations are required for sustaining and safeguarding interest of the investors, who are gullible, ignorant and who can easily cheated by organize institutional financial intermediaries.
4. To provide efficient financial services: The efficiency with which the various institutions in financial market such as stock brokers, mutual funds, merchant, bankers, credit card companies, insurance companies etc. render their sercives, depends upon the functioning of the regulatory authorities.
5. To curb monopolies: Government intervention through the establishment of regulatory institutions may promote healthy competition by curbing monopolies.
6. To minimize scams: Scams, market crashes and rumours can be minimized if not eliminated by implementing measures to check them.
7. To prohibit unfair trade practices: Prohibits fraudulent and unfair trade practices to protect the financial market.
8. To promote investors education: Promotes investors education so as to increase their participation in financial markets.
9. To train financial intermediaries: Training the financial intermediaries to provide better and efficient financial services.

10.To provide accurate and reliable information: Conducting research and publications financial market information which are useful to all market participants.

11. Promotes self regulatory organizations.

THE SEBI

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI) was established to protect the interest of investors in securities and to promote the development securities market and to regulate it.

To develop and regulate the stock markets in India, SEBI was set up in April 12, 1988 as a non-statutory body. Almost after 4 years, government brought a separate legislature in the name of "SEBI act 1992" conferring statutory powers to the already established

SEBI.

Mal Practices in Securities Market

1. Price Rigging: A common way of pushing up the prices was by resorting to circular trading between three to four parties to buy and sell stocks among themselves and thus push the prices up artificially.
2. Manipulation of Securities Prices: The companies planning to issue shares in primary market artificially push up price in secondary market before seeking permission from the government for the issue of shares.
3. Insider Trading: The purchase or sale of a firm's securities by its officers or managers who are seeking to benefit from their knowledge of non-profit information about the firm's financial prospectus is a malpractice of the nature of inside trading.
4. Delay in Settlement: Due to badla and carry forward contracts operating in stock markets, undue and delay takes place I settlement of contracts.

5. Scams: The Indian Stock Market have witnessed two big scams viz. Harshad Mehta Scam and Ketan Parekh Scam. These scams sent tremors in the Indian financial markets. To avoid scams the strict regulatory authorities are required.

RECOMMENDATIONS OF A COMMITTEE FOR REGULATORS:

a. Reorganization of existing stock exchanges registered under Sec. 25 of Indian Companies Act, 1956.
b. Reorganize only the stock market registered under sec. 25 of Indian Companies Act, 1956
c. Stock exchanges should be governed by a chairman appointed by government, the committee should consist of 50:50 of elected and non-elected members.
d. Council for securities to be set up to teach functioning of stock exchange to members.

Formation of SEBI as a Regulator:

Securities and Exchange Board of India (SEBI) was first established in 1988 as a non-statutory body for regulating the securities market. It became an autonomous body on 12 April 1992 and was accorded statutory powers with the passing of the SEBI Act 1992 by the Indian Parliament. Soon SEBI was constituted as the regulator of capital markets in India under a resolution of the Government of India. SEBI has its headquarters at the business district of Bandra Kurla Complex in Mumbai and has Northern, Eastern, Southern and Western Regional Offices in New Delhi, Kolkata, Chennai, and Ahmedabad respectively. It has opened local offices at Jaipur and Bangalore and has also opened offices at Guwahati, Bhubaneshwar, Patna, Kochi and Chandigarh in Financial Year 2013 - 2014.

Controller of Capital Issues was the regulatory authority before SEBI came into existence; it derived authority from the Capital Issues (Control) Act, 1947.

The SEBI is managed by its members, which consists of the following:

- The chairman is nominated by the Union Government of India.
- Two members, i.e., Officers from the Union Finance Ministry.
- One member from the Reserve Bank of India.
- The remaining five members are nominated by the Union Government of India, out of them at least three shall be whole-time members.

After the amendment of 1999, collective investment schemes were brought under SEBI except nidhis, chit funds and cooperatives.

Organization of SEBI:

Ajay Tyagi was appointed chairman on 10 February 2017, replacing U K Sinha,[3] and took charge of the chairman office on 1 March 2017. In February 2020, Ajay Tyagi's term as chairman of SEBI was extended by another six months.[4]

The board comprises:[5] [6]

Name	Designation
Ajay Tyagi	Chairman
Gurumoorthy Mahalingam	Whole time member

S.K Mohanty	Whole time member
Ananta Barua	Whole time member
Madhabi Puri Buch	Whole time member
N S Vishwanathan	Part-time member
Anand Mohan Bajaj	Part-time member
K V R Murty	Part-time member
V Ravi Anshuman	Part-time member

List of Chairmen:[7]

Name	From	To
Ajay Tyagi	10 February 2017	present
U K Sinha	18 February 2011	10 February 2017
C. B. Bhave	18 February 2008	18 February 2011
M. Damodaran	18 February 2005	18 February 2008
G. N. Bajpai	20 February 2002	18 February 2005
D. R. Mehta	21 February 1995	20 February 2002

S. S. Nadkarni	17 January 1994	31 January 1995
G. V. Ramakrishna	24 August 1990	17 January 1994
Dr. S. A. Dave	12 April 1988	23 August 1990

Departments of SEBI:

- Commodity Derivatives Market Regulation Department (CDMRD)
- Corporation Finance Department (CFD)
- Department of Economic and Policy Analysis (DEPA)
- Department of Debt and Hybrid Securities (DDHS)
- Enforcement Department – 1 (EFD1)
- Enforcement Department – 2 (EFD2)
- Enquiries and Adjudication Department (EAD)
- General Services Department (GSD)
- Human Resources Department (HRDM)
- Information Technology Department (ITD)
- Integrated Surveillance Department (ISD)
- Investigations Department (IVD)
- Investment Management Department (IMD)
- Legal Affairs Department (LAD)
- Market Intermediaries Regulation and Supervision Department (MIRSD)
- Market Regulation Department (MRD)
- Office of International Affairs (OIA)
- Office of Investor Assistance and Education (OIAE)
- Office of the Chairman (OCH)
- Regional offices (ROs)

Objectives of SEBI:

The overall objectives of SEBI are to protect the interest of investors and to promote the development of stock exchange and to regulate the activities of stock market. The objectives of SEBI are:

1. To regulate the activities of stock exchange.

2. To protect the rights of investors and ensuring safety to their investment.

3. To prevent fraudulent and malpractices by having balance between self regulation of business and its statutory regulations.

4. To regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc.

Functions of SEBI:

The SEBI performs functions to meet its objectives. To meet three objectives SEBI has three important functions. These are:

i. Protective functions

ii. Developmental functions

iii. Regulatory functions.

1. Protective Functions:

These functions are performed by SEBI to protect the interest of investor and provide safety of investment.

As protective functions SEBI performs following functions:
(i) It Checks Price Rigging:

Price rigging refers to manipulating the prices of securities with the main objective of inflating or depressing the market price of securities. SEBI prohibits such practice because this can defraud and cheat the investors.

(ii) It Prohibits Insider trading:

Insider is any person connected with the company such as directors, promoters etc. These insiders have sensitive information which affects the prices of the securities. This information is not available to people at large but the insiders get this privileged information by working inside the company and if they use this information to make profit, then it is known as insider trading, e.g., the directors of a company may know that company will issue Bonus shares to its shareholders at the end of year and they purchase shares from market to make profit with bonus issue. This is known as insider trading. SEBI keeps a strict check when insiders are buying securities of the company and takes strict action on insider trading.

(iii) SEBI prohibits fraudulent and Unfair Trade Practices:

SEBI does not allow the companies to make misleading statements which are likely to induce the sale or purchase of securities by any other person.

(iv) SEBI undertakes steps to educate investors so that they are able to evaluate the securities of various companies and select the most profitable securities.

(v) SEBI promotes fair practices and code of conduct in security market by taking following steps:

(a) SEBI has issued guidelines to protect the interest of debenture-holders wherein companies cannot change terms in midterm.

(b) SEBI is empowered to investigate cases of insider trading and has provisions for stiff fine and imprisonment.

(c) SEBI has stopped the practice of making preferential allotment of shares unrelated to market prices.

2. Developmental Functions:

These functions are performed by the SEBI to promote and develop activities in stock exchange and increase the business in stock exchange. Under developmental categories following functions are performed by SEBI:

(i) SEBI promotes training of intermediaries of the securities market.

(ii) SEBI tries to promote activities of stock exchange by adopting flexible and adoptable approach in following way:

(a) SEBI has permitted internet trading through registered stock brokers.

(b) SEBI has made underwriting optional to reduce the cost of issue.

(c) Even initial public offer of primary market is permitted through stock exchange.

3. Regulatory Functions:

These functions are performed by SEBI to regulate the business in stock exchange. To regulate the activities of stock exchange following functions are performed:

(i) SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries such as merchant bankers, brokers, underwriters, etc.

(ii) These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive.

(iii) SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers and all those who are associated with stock exchange in any manner.

(iv) SEBI registers and regulates the working of mutual funds etc.

(v) SEBI regulates takeover of the companies.

(vi) SEBI conducts inquiries and audit of stock exchanges.

Why do Investors Need Education And Protection?

investor education and protection fund or IEPF is a fund set up under the Section 205C of the Companies Act, 1956 to pool all the dividends of the Asset Management Companies, matured deposits, share application interests or money, debentures, interests, etc. that are unclaimed for seven years. All the money collected from the mentioned sources has to be transferred to IEPF. Investors, who are trying to seek a refund for their unclaimed rewards can now do so from the Investor Protection and Education Fund (IEPF).

Investor Education And Protection Fund:

investor education and protection fund or IEPF is a fund set up under the Section 205C of the Companies Act, 1956 to pool all the dividends of the Asset Management Companies, matured deposits, share application interests or money, debentures, interests, etc. that are unclaimed for seven years. All the money collected from the mentioned sources has to be transferred to IEPF. Investors, who are trying to seek a refund for their unclaimed rewards can now do so from the Investor Protection and Education Fund (IEPF).

How the IEPF is created?

Step 1: Dividend Declaration (AGM)

A dividend is declared by the company in the Annual General Meeting (AGM). Post the declaration of dividend in the AJM the company is required to file e-FormIEPF-2 along with a statement or information of unclaimed and unpaid dividend within 60 days of the AGM. These statements are to be separately filed for each of the previous seven financial years.

Step 2: Dividend payment to shareholders

The dividend declared by the company has to be transferred to the separate dividend bank account of the company within 5 days of AGM and then the dividend needs to be remitted or paid to the shareholders within 30 days from the date of the AJM. At this point, the company needs to file e-FormIEPF-7 in order to report that the dividend that has been directly remitted to PNB account of the IEPF authority on the shares which have already been transferred to IEPF in compliance of rule6 sub rule12 of the IEPF authority rules 2016. It means the payment of the dividend on those shares which the company has already transferred to the IEPF in the previous financial years.

Step 3: Transfer to unpaid dividend account

Further, the dividend remained unpaid and unclaimed is required to be transferred to a separate unpaid dividend account within 7 days.

The date on which the unclaimed dividend is transferred would become the base date for calculating the due date or cut-off date for transferring the unclaimed dividend and underlying shares to IEPF in future.

Step 4: Due date

This step deals with due date calculation for transferring to IEPF. The company to calculate 7 years from the date when the company has transferred the unclaimed dividend to unpaid dividend account as explained in step 3. The date we get after adding 7 years would be the due date or cut-off date for transferring unclaimed dividend and underlying shares. This is in compliance with section 124 of the Companies Act, 2103 read with rule 6 of IEPF authority rules 2016 as amended. The company shall inform the latest available address of the concerned shareholder regarding transfer of shares at least 3 months before that due date of transfer of shares. The company is also required to simultaneously publish a notice in a leading newspaper in English and regional language having wide circulation informing the concerned shareholders to claim unpaid dividend failing which the unclaimed dividend and underlying shares would be transferred to IEPF. The notice also notifies about the availability of the details of such shares along with the folio number or DP ID, client ID are available on the company's website, mentioning the website address.

Step 5: Transfer of unclaimed dividend and underlying shares to IEPF

The transfer needs to be made within 30 days thereof. There are slightly different processes for transferring unclaimed dividend and underlying shares.

For unclaimed dividend, the company needs to file e-FormIEPF-1 on MCA portal along with uploading and confirming the excel sheets containing the list of shareholders whose dividend is to be transferred. The e-FormIEPF-1 to contain the amount of unclaimed dividend in the unpaid dividend account as on that due date then from the pay miscellaneous section on MCA portal that dividend is required to be remitted to the IEPF authority PNB account.

For underlying shares, firstly the corporation is required to be executed by both the depositories NSDL and CDSL for transferring the underlying shares as on the due date to the IPF authority D-mat account as per the documents shared by the company. Then afterwards, e-FormIPF-4 is required to be uploaded on MCA portal and the excel sheets detailing the list of shareholders whose shares have been transferred to be uploaded and confirmed on IEPF portal.

Step 6: Financial year-end

Lastly, at the end of the financial year the company is required to report the shares being eligible for transfers but has not been transferred to IEPF due to any specific order of court or tribunal or statutory authority or due to the shares be pledged or hypothecated restraining such transfer of shares and payment of dividend. This report is to be made in e-FormIEPF-3

Functions of IEPF:

- To plan out different activities for Investor Education and Protection in the form of seminars, symposiums and proposals for registration of voluntary association or institution engaged in IEPF projects.

- To plan out proposals for registration of voluntary associations, institutions or other organisations involved in IEPF activities.
- Co-ordination with institutions involved in investor education and awareness activities.
- To plan out proposals for projects for IEPF including research activities and proposals for financing such projects.
- Appoint one or more subcommittees to ensure smooth functioning of the fund.
- To furnish reports for the central government after every six months

Investor Protection Fund:

The investor can ask for the compensation if a member (broker) of the National Stock Exchange (NSE) or Bombay Stock Exchange (BSE) or any other stock exchange fails to pay the due money for the investments made. The Stock Exchanges have put certain limits on the level of compensation paid to the investors. This limitation has been put according to the discussions and guidance with the IPF Trust. The limit allows that the money to paid as a compensation for a single claim shall not be less than INR 1 lakh - for the case major Stock Exchanges like BSE and NSE - and it should not be less INR 50,000 in case of other Stock Exchanges.

Objectives of IEPF

- To educate the investors about how the market operates.
- Making investors educated enough so that they can analyse and make informed decisions.
- To educate investors about the dynamism of the markets.
- Making investors realise their rights and various laws about investing.

- Promoting research and surveys to spread knowledge among investors.

How Investor Protection Fund Is Created?

The Exchange shall establish and maintain an Investors' Protection Fund to protect the interests of the clients of the trading members of the Exchange, who may have been declared defaulters or who may have been expelled, under the provisions of the Rules, Bye-laws and Regulations of the Exchange.

Powers Of SEBI:

For the discharge of its functions efficiently, SEBI has been vested with the following powers:

- to approve by−laws of Securities exchanges.
- to require the Securities exchange to amend their by−laws.
- inspect the books of accounts and call for periodical returns from recognised Securities exchanges.
- inspect the books of accounts of financial intermediaries.
- compel certain companies to list their shares in one or more Securities exchanges.
- registration of Brokers and sub-brokers

SEBI committees:

- Technical Advisory Committee
- Committee for review of structure of infrastructure institutions
- Advisory Committee for the SEBI Investor Protection and Education Fund

- Takeover Regulations Advisory Committee
- Primary Market Advisory Committee (PMAC)
- Secondary Market Advisory Committee (SMAC)
- Mutual Fund Advisory Committee
- Corporate Bonds & Securitisation Advisory Committee