

Financial Regulation

Chapter Objectives

This chapter will enable you to develop an understanding of the following:

- 1 *Regulation of the capital market*
- 2 *Role and functions of the SEBI*
- 3 *Role and functions of the Reserve Bank of India*

- SEBI protects the interests of investors in securities and promotes the development of securities market.

REGULATION OF THE CAPITAL MARKET

The securities market is regulated by various agencies such as the Department of Economics Affairs (DEA), the Department of Company Affairs (DCA), the Reserve Bank of India (RBI), and the SEBI. The activities of these agencies are coordinated by a high level committee on capital and financial markets. The High Level Co-ordination Committee for Financial Markets (HLCCFM) discusses various policy level issues which require inter-regulatory coordination between the regulators in the financial market, viz., RBI, SEBI, Insurance Regulatory and Development Authority (IRDA), and Pension Fund Regulatory and Development Authority (PFRDA). The Committee is chaired by the Governor, RBI., Secretary-Ministry of Finance, Chairman—SEBI, Chairman—IRDA and Chairman—PFRDA are members of the committee.

The capital market, *i.e.*, the market for equity and debt securities is regulated by the Securities and Exchange Board of India (SEBI). The SEBI has full autonomy and authority to regulate and develop the capital market. The government has framed rules under the Securities Contracts (Regulation) Act (SCRA), the SEBI Act and the Depositories Act. The SEBI has framed regulations under the SEBI Act and the Depositories Act for registration and regulation of all market intermediaries, for prevention of unfair trade practices, and insider trading. Under the acts, the Government and the SEBI issue notifications, guidelines, and circulars which need to be complied with by market participants. All the rules and regulations are administered by the SEBI. The powers in respect of the contracts for sale and purchase of government securities, money market securities and ready forward contracts in debt securities are exercised concurrently by the RBI.

The four main legislations governing the capital market are as follows:

- The SEBI Act, 1992 which establishes the SEBI with four-fold objectives of protection of the interests of investors in securities, development of the securities market, regulation of the securities market and matters connected therewith and incidental thereto.
- The Companies Act, 1956 which deals with issue, allotment and transfer of securities, disclosures to be made in public issues, underwriting, rights and bonus issues and payment of interest and dividends.
- The Securities Contracts (Regulation) Act, 1956 which provides for regulations of securities trading and the management of stock exchanges.
- The Depositories Act, 1996 which provides for establishment of depositories for electronic maintenance and transfer of ownership of demat securities.

THE SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

With the announcement of the reforms package in 1991, the volume of business in both the primary and secondary segments of the capital market increased. A multicore securities scam rocked the Indian financial system in 1992. The then existing regulatory framework was found to be fragmented and inadequate and hence a need for an autonomous, statutory, and integrated organization to ensure the smooth functioning of capital market was felt. To fulfill this need, the Securities and Exchange Board of India (SEBI), which was already in existence since April 1988, was conferred statutory powers to regulate the capital market.

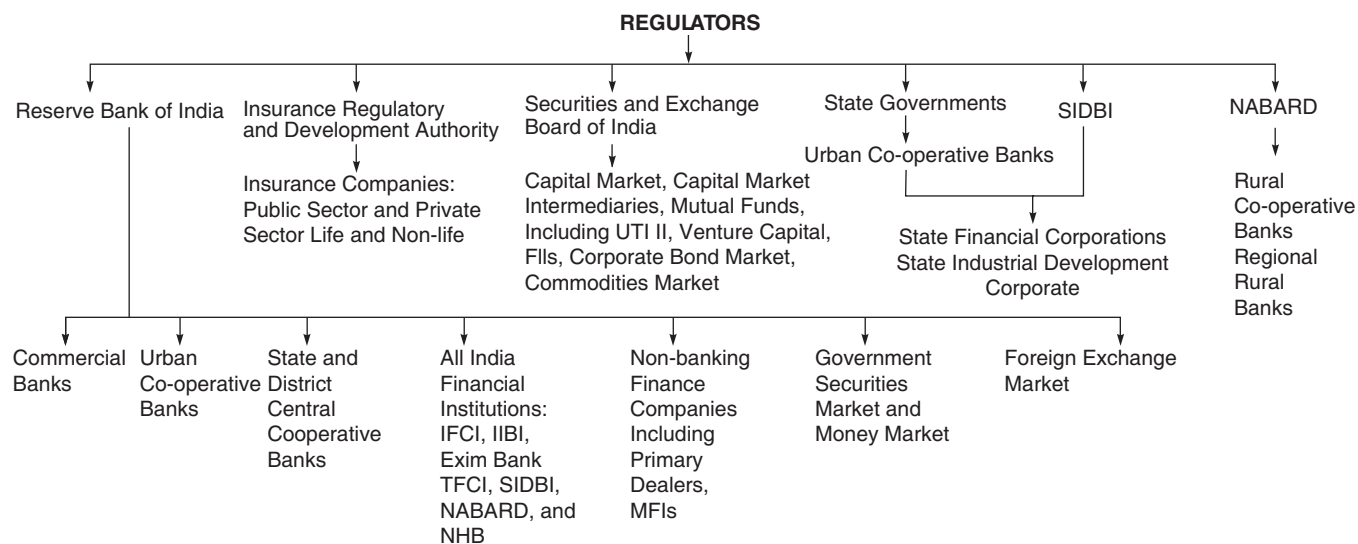


Figure 24.1 Regulatory Structure of Financial Institutions and Markets

Objectives of SEBI

- Protect the interest of the investor in securities.
- Promote the development of securities market.
- Regulating the securities market.

The SEBI got legal teeth through an ordinance issued on January 30, 1992. The ordinance conferred wide-ranging powers on the SEBI, including the authority to prohibit ‘insider trading’ and ‘regulate substantial acquisition of shares’ and ‘take over of business’. With this, the Capital Issues (Control) Act was repealed and the office of the Controller of Capital Issues (CCI) was abolished in 1992. The SEBI was set up with statutory powers on February 21, 1992. The objectives defined by the ordinance for the board were: (i) investor protection; and (ii) promotion and development of the capital market while simultaneously regulating the functioning of the securities market. The function of market development includes containing risk, broad basing, maintaining market integrity and promoting long-term investment.

The ordinance was repealed by the SEBI Act on April 4, 1992. The Securities and Exchange Board of India Act, 1992, provides for the establishment of the board to: protect the interest of the investors in securities, promote the development of, and regulate the securities market and matters connected therewith or incidental to. Certain powers under certain sections of the Securities Contracts (Regulation) Act and the Companies Act were delegated to the SEBI. The regulatory powers of the SEBI were increased through the Securities Laws (Amendment) Ordinance of January 1995, which was subsequently replaced by an act of parliament. The SEBI works under the Ministry of Finance. It has been given a status of an independent organization regulating each and every aspect of the securities market backed by a statute and accountable to the parliament.

Management of the SEBI Under the SEBI Act, 1992

Section 4 of the act lays down the constitution of the management of the SEBI. The board of members of the SEBI shall consist of a chairman; two members from amongst the officials of the ministries of the central government dealing with finance and law; one member from amongst the officials of the RBI constituted under Section 3 of the RBI Act, 1934; two other members to be appointed by the central government, who shall be professionals and, inter alia, have experience or special knowledge relating to the securities market.

Figure 24.1 provides an overview of regulatory structure of financial institutions and markets.

Powers and Functions of the SEBI

Section 11(1) of the act casts upon the SEBI the duty to protect the interests of investors in securities and to promote the development of and to regulate the securities market through appropriate measures. These measures provide for the following:

- Regulating the business in stock exchanges and any other securities markets;
- Registering and regulating the working of stock brokers, sub—brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters,

portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

- Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf;
- Registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds;
- Promoting and regulating self-regulatory organisations;
- Prohibiting fraudulent and unfair trade practices relating to securities markets;
- Promoting investors' education and training of intermediaries of securities markets;
- Prohibiting insider trading in securities;
- Regulating substantial acquisition of shares and takeover of companies;
- Calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisations in the securities market;
- Calling for information and records from any person including any bank or any other authority or board or corporation established or constituted by or under any central or state act which, in the opinion of the Board, shall be relevant to any investigation or inquiry by the Board in respect of any transaction in securities;
- Calling for information from, or furnishing information to, other authorities, whether in India or outside India, having functions similar to those of the Board, in the matters relating to the prevention or detection of violations in respect of securities laws, subject to the provisions of other laws for the time being in force in this regard.

Provided that the Board, for the purpose of furnishing any information to any authority outside India, may enter into an arrangement or agreement or understanding with such authority with the prior approval of the central government;

- Performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956 (42 of 1956), as may be delegated to it by the central government;
- Levying fees or other charges for carrying out the purposes of this section;
- Conducting research for the above purposes;
- Calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions.
- Performing such other functions as may be prescribed.

The SEBI exercises powers under Sections 11 and 11B of the SEBI Act, 1992, and 17 other regulations. The SEBI, with its powers, can carry out the following functions:

- Ask any intermediary or market participant for information.
- Inspect books of depository participants, issuers or beneficiary owners.
- Suspend or cancel a certificate of registration granted to a depository participant or issuer.
- Request the RBI to inspect books of a banker to an issue. And suspend or cancel the registration of the banker to an issue.
- Suspend or cancel certification issued to the custodian of securities.
- Suspend or cancel registration issued to foreign institutional investors.
- Investigate and inspect books of accounts and records of insiders.
- Investigate an acquirer, a seller, or merchant banker for violating takeover rules.
- Suspend or cancel the registration of a merchant banker.
- Investigate the affairs of mutual funds, their trustees, and asset management companies.
- Investigate any person dealing in securities on complaint of contravention of trading regulation.
- Suspend or cancel the registration of errant portfolio managers.
- Cancel the certification of registrars and share transfer agents.
- Cancel the certification of brokers who fail to furnish information of transactions in securities or who furnish false information.

Regulations and Guidelines Issued by the SEBI

Regulations

- SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.
- Guidance note to SEBI (Prohibition of Insider Trading) Regulations, 2015.

- SEBI (Merchant Bankers) Regulations, 1992.
- SEBI (Portfolio Managers) regulations, 1993.
- SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993.
- SEBI (Underwriters) Regulations, 1993.
- SEBI (Debenture Trustees) Regulations, 1993.
- SEBI (Bankers to an Issue) Regulations, 1994.
- SEBI (Foreign Portfolio Investors) Regulations, 2014.
- SEBI (Custodian of Securities) Regulations 1996.
- SEBI (Depositories and Participants) Regulations, 1996.
- SEBI (Mutual Funds) Regulations, 1996.
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.
- SEBI (Buyback of Securities) Regulations, 1998.
- SEBI (Credit Rating Agencies) Regulations, 1999.
- SEBI (Collective Investment Schemes) Regulations, 1999.
- SEBI (Foreign Venture Capital Investors) Regulations, 2000.
- SEBI (Procedure for Board Meeting) Regulations, 2001.
- SEBI (Issue of Sweat Equity) regulations, 2002.

With a view to making markets more competitive and compliant, the SEBI brought in the following new regulations:

- SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003.
- SEBI (Ombudsman) Regulations, 2003.
- SEBI (Central Database for Market Participants) Regulations, 2003.
- SEBI (Self Regulatory Organizations) Regulations, 2004.
- SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015.
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
- SEBI (Procedure for Search and Seizure) Repeal Regulations, 2015.
- SEBI (Infrastructure Investment Trusts) Regulations, 2014.
- SEBI (Real Estate Investment Trusts) Regulations, 2014.
- SEBI (Research Analysts) Regulations, 2014.
- SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014.
- SEBI (Share Based Employee Benefits) Regulations, 2014.
- SEBI (Investment Advisers) Regulations, 2013.
- SEBI (Issue And Listing Of Non-Convertible Redeemable Preference Shares) Regulations, 2013.
- SEBI (Alternative Investment Funds) Regulations, 2012.
- Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012.
- SEBI {KYC (Know Your Client) Registration Agency} Regulations, 2011.
- SEBI (Delisting of Equity Shares) Regulations, 2009.
- SEBI (Investor Protection and Education Fund) Regulations, 2009.
- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.
- SEBI (Intermediaries) Regulations, 2008.
- SEBI (Issue and Listing of Debt Securities) Regulations, 2008.
- SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.
- SEBI (Certification of Associated Persons in the Securities Markets) Regulations, 2007.
- SEBI (Regulatory Fee on Stock Exchanges) Regulations, 2006.

As a measure of regulatory productiveness, the existing regulations are frequently reviewed and amendments notified. Regulations are superior to guidelines as the former have a stronger legal force. Regulations are passed by the SEBI, tabled in the Parliament and are subject to explicit penalties and remedial actions.

Guidelines

- Guidelines for opening of trading terminals abroad.
- Guidelines for Anti-money laundering measures.
- SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.
- Framework for recognition and supervision of stock exchanges/platforms of stock exchanges for small and medium enterprises.

- SEBI (Aid for Legal Proceedings) Guidelines, 2009.
- SEBI (International Financial Services Centres) Guidelines, 2015.

The orders of the SEBI under the securities laws are appealable before a securities appellate tribunal (SAT)-the body that hears appeals against the SEBI's orders. The orders of the SAT are appealable before the high court or the supreme court.

An order passed by the SEBI against market participants such as brokers, custodians, depositories, or mutual funds can be challenged before the SAT. The market participants can move the high court or the Supreme Court if they are not happy with the SAT order. The entire process can take years before a case is finally resolved. There is a provision for out-of-court settlements in the SEBI guidelines. The out-of-court settlement system attempts to resolve administrative, civil, and criminal disputes with the consent of the involved parties and the SEBI. This system saves time, efforts, and money of both the involved parties and the regulator as they do not have to go through long range of legal proceedings.

Under SEBI guidelines, the proposal to settle a dispute is first placed before a high-powered advisory committee of the regulator. If the proposal gets the committee's approval, the terms of settlement are drafted and orders are passed by a panel of two whole-time directors of the SEBI after the cause and nature of violation is established. The panel normally imposes penalty on the offenders and can also temporarily suspend a market participant. If a case is pending before the SAT, the committee files the terms of settlement before the tribunal. It is mandatory for the accused to give an undertaking to the regulator that it will refrain from taking any legal action against it. If the accused violates any condition of the settlement, the regulator can revive its legal action.

Regulation of the Securities Market

The SEBI has powers to register and regulate all market intermediaries. The SEBI has powers to penalize them in case of violations of the provisions of the act, rules and regulations made thereunder.

It can conduct enquiries, audits, and inspection of all market intermediaries and adjudicate offences under the SEBI Act, 1992.

The SEBI registers and regulates the intermediaries in the primary market. Some of the major intermediaries it regulates are merchant bankers, underwriters, bankers to an issue, registrars to an issue and share transfer agents and debenture trustees. The SEBI registers and regulates various intermediaries in the secondary market such as brokers, subbrokers, stock exchanges, foreign institutional investors (FIIs) custodians, depositories, mutual funds, and venture capital funds. Market intermediaries registered with the SEBI are as follows (*see* Table 24.1).

TABLE 24.1 Sebi Registered Market Intermediaries/Institutions	
<i>Market Intermediaries</i>	<i>As on March 31, 2017</i>
Stock Exchanges (Cash Market)	5
Stock Exchanges (Equity Derivatives Market)	3
Stock Exchanges (Currency Derivatives Market)	3
Stock Exchanges (Commodity Derivatives Market)	12
Brokers (Cash Segment)*	3,192
Corporate Brokers (Cash Segment)*	2,775
Brokers (Equity Derivatives Market)	2,651
Brokers (Currency Derivatives Market)	1,985
Brokers (Debt Segment)	6
Brokers (Commodity Derivatives Market)	1162
Sub-brokers (Cash Segment)*	30,610
Foreign Portfolio Investors (FPIs)	7,807
Deemed FPIs	974
Custodians	19
Depositories	2
Depository Participants-NSDL	276

(Continued)

TABLE 24.1 (Continued)

<i>Market Intermediaries</i>	<i>As on March 31, 2017</i>
Depository Participants-CDSL	588
Merchant Bankers	189
Bankers to an Issue	64
Underwriters	2
Debenture Trustees	32
Credit Rating Agencies	7
KYC Registration Agency (KRA)	5
Registrars to an Issue & Share Transfer Agents	73
Venture Capital Funds	198
Foreign Venture Capital Investors	218
Alternative Investment Funds	303
Portfolio Managers	218
Mutual Funds	45
Investment Advisors	577
Research Analysts	351
Infrastructure Investment Trusts (InVIT)	6
Collective Investment Management Company	1
Approved Intermediaries (Stock Lending Schemes)	2
STP (Centralised Hub)	1
STP Service Providers	2

Source: SEBI, Bulletin, April 2017 .

Box 24.1 Capital Adequacy Norms for Intermediaries Prescribed by the SEBI

Intermediary	Net Worth	Paid-up Capital	Base Minimum Capital (BMC/Exposure Limits)
Category I merchant banker	₹5 crore	NP	NP
Portfolio manager	₹50 lakh	NP	Limits placed by the clients
Category I registrar to an issue	₹6 lakh	NP	NP
Underwriter	₹20 lakh	NP	20 times of the network
Debenture trustee	₹1 crore. The entity should also be a scheduled bank or PFI or an insurance company or body corporate.	NP	NP
Banker to an issue	Should be a scheduled bank.	NP	NP
Custodian of securities	₹50 crore	NP	NP
Depository	₹100 crore	NP	NP
Depository participant	Should be a PFI or scheduled bank or SFC or CC ₹50 lakh, if broker.	NP	100 times of the network, if broker. No limits for others
Mutual funds	Sponsor to have positive net worth, which is more than the capital contribution of the sponsor in the AMC.	NP	NP
Venture capital fund	Each scheme/fund to have firm commitment from the investors for contribution of atleast ₹5 crore.	NP	NP
Collective investment management company	₹5 crore	NP	NP

Credit rating agency	₹5 crore	NP	NP
Stock broker (cash segment)	NP	₹30 lakh for large exchanges	BMC of ₹10 lakh for large exchanges. Gross exposure not to exceed 20 times BMC and additional capital
Trading member (derivative segment)	As may be specified by the derivatives exchange or segment from time to time	NP	NP
Clearing member	₹3 crore (Deposit of atleast ₹50 lakh with CC)	NP	Three per cent of notional value of gross open position in index futures and short index options and five per cent of notional value of futures and short open positions in stocks not to exceed liquid net worth
Self clearing member	₹1 crore (Deposit of ₹50 lakh with the CC)	NP	—do—
Sub-broker	NP	NP	NP
FII	NP	NP	NP
Approved intermediary under SLS	₹50 crore	NP	NP

CC=Clearing Corporation NP=Not prescribed

Source: SEBI

SEBI has specific responsibilities under the SEBI Act, 1992 as listed below:

- Register and regulate the working of the stock brokers, sub-brokers, share-transfer agents, bankers to an issue, trustee of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and such other intermediaries associated with the securities market.
- Register and regulate the working of the depositories, depository participants, custodian of securities, foreign institutional investors, credit rating agencies, or any other intermediary associated with the securities market as the SEBI may specify by notification.
- Register and regulate the working of the venture capital funds, collective investment schemes, including mutual funds.

All the above-mentioned intermediaries can deal in securities or operate in the securities market only after they obtain a certificate of registration from the SEBI. The certificate of registration can be suspended or cancelled by the SEBI in the manner prescribed in the regulations.

As per the existing regulations, if the applicant is a registered stock broker, the board may grant a certificate if the stock broker has a minimum net worth of ₹50 lakh and aggregate value of portfolio of securities of the beneficial owners does not exceed 100 times of the networth of the stock broker. This regulation was amended and notified on June 16, 2003. After the amendment, if the stock broker maintains the networth of ₹10 crore, the limit on aggregate value of portfolio of securities shall not be applicable.

The SEBI has formed a sub-committee which has recommended daily and aggregated disclosure of key information about brokers including aggregate open proprietary position and value at risk and number of open positions.

Besides, the SEBI is also responsible for promoting and regulating self regulatory organizations, prohibiting fraudulent and unfair trade practices relating to securities market, and prohibiting insider trading in securities.

Supervision of Securities Market

The SEBI supervises the securities market through on-site and off-site inspections, enforcement, enquiry against violation of rules and regulations, and prosecutions. It undertakes inspection of the books and records of depository participants and registrar to an issue. It also issues showcause notices to companies on the basis of reports submitted by the depositories.

It also undertakes inspection of stock exchanges to ensure that

- the exchange provides a fair, equitable, and growing market to investors;
- the exchange has complied with the conditions if any, imposed on it at the time of renewal of grant of its recognition under Section 4 of the SC (R) Act, 1956;
- the exchange's organization systems and practices are in accordance with the Securities Contracts (Regulation) Act, 1956 and rules framed thereunder;
- the exchange has implemented the directions, guidelines, and instructions issued by the SEBI from time to time; and
- there are adequate control mechanisms and risk management system.

Inspection of stock exchanges involves a thorough review of operations, organizational structure, and administrative control of each exchange.

It also undertakes inspection of brokers/sub-brokers. It has directed the exchanges to carry out comprehensive inspection of at least 20 per cent of the active brokers every year. In order to avoid excessive exposure, it has directed stock brokers/sub-brokers of an exchange not to deal with brokers/sub-brokers of the same exchange either for proprietary trading or for trading on behalf of clients, except with the prior permission of the exchange. It has initiated cancellation of registration of broker declared defaulter or expelled from the exchange as one-time exercise. It has devised a comprehensive disclosure requirement framework for stock brokers which include information about the registration details of the broker and his associates, their background, and history including details of complaints/arbitration and regulatory action initiated. It is planning to enhance the scope of audit of books of accounts and other records by including reporting of information on collection of margins from clients, maintaining segregation between client funds and arm funds, payment and deliveries to clients and details of related party transaction. Many stock exchanges floated subsidiaries to become members of the NSE and the BSE. These subsidiaries function as brokers of the NSE and the BSE. The SEBI carries out inspection of the books and records of subsidiaries to verify whether the books of accounts, records and other documents are maintained in the manner specified by the Securities Contracts (Regulations) Rules 1957 and the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992, provisions of the SEBI Act, the Securities Contracts (Regulations) Act, 1956 are complied with by the subsidiary and provisions of the bye-laws to business rules of the exchange and subsidiary are adhered to.

- **Inspection of depositories:** The SEBI undertakes an inspection of the two depositories to examine their functioning and compliance.
- **System audit:** In order to ensure the quality of technology and software systems used by the stock exchanges, the SEBI has advised all the active stock exchanges to carry out a system audit.
- **Surveillance:** The SEBI has set up market surveillance mechanisms and systems to ensure safety and integrity of the market. The front line responsibility for market surveillance lies with the stock exchanges. They have a separate surveillance department which monitors market movements, identifies price volatility, analyses, its causes and takes prompt action in close coordination with stock exchange and depositories. Besides, keeping a close oversight on the surveillance activities of stock exchanges, the SEBI holds periodical meetings with market intermediaries to gather information and exchange views.

SEBI's market surveillance essentially focuses on the following:

- Policy formulation for introduction of surveillance systems at the stock exchanges to bring integrity, safety, and stability in the Indian securities markets.
- Overseeing the surveillance activities of the stock exchanges, including the monitoring of market movements by them.
- Inspection of the surveillance cells of the stock exchanges.
- Preparation of reports and studies on market movements, which the SEBI circulates periodically to the Government of India and to securities markets regulators from other countries.

The primary responsibility of market surveillance has been entrusted to the stock exchanges. However, the SEBI keeps a proactive oversight on market monitoring and in exceptional circumstances it analyses the same.

The market surveillance systems are developed and consolidated on a continuous basis. Some of the surveillance systems and risk containment measures that have been put in place are briefly given below:

- Risk containment measures in the form of elaborate margining system and linking of intra-day trading limits and exposure limits to capital adequacy.
- Daily price bands to curb abnormal price behaviour and volatility.
- Reporting by stock exchanges through periodic and event driven reports.

- Establishment of independent surveillance cells in stock exchanges.
- Inspection of intermediaries.
- Imposition of trading restrictions, including suspension of trading in scrips by exchanges to prevent market manipulation.
- Formation of Inter-Exchange Market Surveillance Group for prompt, interactive, and effective decision making on surveillance issues and co-ordination between stock exchanges.
- Implementation of online automated surveillance system (stock watch system) at stock exchanges.
- Dissemination of daily trading data of domestic institutional investors by stock exchanges on their website to reflect their extent of participation and thereby provide investors with meaningful information.

In order to effectively discharge its regulatory functions, the SEBI has put in place an Integrated Market Surveillance System (IMSS) which generates alerts arising out of unusual market movements. This system helps in analyzing, detecting, identifying, and taking preventive actions in number of cases where abnormal trading pattern is observed. This, in turn, ensures market integrity, promotes professional standards of participants and their orderly conduct which is vital for smooth functioning of the securities market.

Pursuant to the decisions taken at the weekly surveillance meetings, the SEBI takes surveillance actions which include placing select scrips on a trade to trade basis for a certain period and banning entities involved in illegal trading and *dabba* trading.

- **Investigations:** The SEBI is empowered to investigate the affairs of any securities market intermediary or persons associated with security market or any other persons suspected to have violated any regulatory provisions. It undertakes investigations to probe into possible or suspected or alleged infringements of security market regulations such as price manipulation, artificial volume creation, insider trading, violation of takeover code or any other regulations, public issue related irregularities or any fraudulent or unfair trade practices. Investigations are initiated based on evidence available from various sources including the SEBI's own surveillance activities, stock exchanges, other intermediaries, complaints from various sources including press reports. The SEBI then calls for information, compels production of documents, summons persons interrogation, examines witnesses and where necessary, with the magistrate's approval carries out even search and seizure operations. On completion of investigation, the SEBI takes actions such as warning, suspension of activities, cancellation of registration, denial of access to the capital market for a specified period, imposition of monetary penalties and initiation of prosecution proceedings.

The act has armed the SEBI with powers to discipline the intermediaries.

- Issuing directions to all intermediaries and other persons associated with the securities market, (i) in the interest of investors, (ii) in the interest of orderly development of the securities market, (iii) to prevent the affairs of any intermediary including a mutual fund from being conducted in a manner detrimental to the interest of investors or of the securities market, or (iv) to secure the proper management of any such entity.
- Calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries, and SROs.
- Appointing a person as investigating authority to investigate the affairs of an intermediary or persons associated with the securities market.
- Appointing adjudicating officers to adjudicate a wide range of violations and impose monetary penalties on any intermediary or other participants in the securities market. The penalty can be upto ₹25 crore or three times the amount of profits made out of violations. The violations include failure to submit any document, information or furnish any return, failure to maintain required books of accounts or records, failure to enter into agreement with clients, insider trading, failure to redress the grievances of investors, failure to issue contact notes, and charging excessive brokerage by brokers.
- Attaching for a period not exceeding one month, one or more bank accounts of any intermediary or any person associated with the securities market in any manner involved in violation of any of the provisions of the act or rules or regulations made thereunder, and directing any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of any transaction which is under investigation, in the interest of investors or securities market.
- Suspending or cancelling registration of an intermediary in the manner prescribed in the regulations.

Investigation of Cases The focus of SEBI has shifted to speedy completion of the investigations in the recent years. The number of pending cases has declined substantially. The majority of cases taken up and completed pertained to market manipulation and price rigging. Such investigations coupled with effective

market surveillance under the oversight of the SEBI have resulted in significant reduction in cases of market manipulation and price rigging.

Prosecutions The prosecutions are launched under the Companies Act, the SEBI Act, the Depositories Act, the Securities Contract Regulations Act and the Indian Penal Code. Maximum number of prosecutions relating to violation of the SEBI (Substantial Acquisition of Shares and Take-overs) Regulations, 1997, Violation of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 1995, Unregistered Entities, Violation of SEBI (Insider Trading) Regulations, 1992, Violation of SEBI (Portfolio Managers) Rules, 1993, Non-payment of Penalty Amount Imposed by the Adjudicating Officer and others are launched under the SEBI Act.

Inspection of Mutual Funds

Inspection of mutual funds is carried out by independent chartered accountant firms. SEBI issues warning and deficiency letters to mutual funds considering the magnitude and seriousness of violations of SEBI regulations/guidelines. Of the total warnings, majority of the warnings were issued for violating the advertising code and the investment restrictions. Deficiency letters are issued based on the inspection report, and mutual funds were asked to strengthen their systems and improve compliance standards. SEBI has made it mandatory for mutual funds to pay interest @15 per cent per annum for delays in the dispatch of repurchase/redemption proceeds to the unit holders. Because of such action, the interest amount paid by mutual funds has declined.

Self Regulatory Organizations (SROs)

For effective regulation, there is a segregation of regulation of the market and the regulation of market participants all over the world. The Indian capital market is characterized by large number of participants operating in a complex and dynamic market place. Hence, a single centralized regulatory agency may not have sufficient resources and expertise to regulate the entire market effectively. Moreover, proper governance requires feedbacks and participation of market participants in the process of framing and implementing regulations. Therefore, the involvement of market participants is important. Keeping this in view, self regulation by participants is preferred and setting up of SROs is promoted.

An SRO is the first level capital market regulator which is a non-government body, having statutory responsibility to regulate its own members for fair and efficient practices. SROs are expected to share the responsibility with the regulator in framing and administering regulations. The activities generally undertaken by the SRO are—registering members, establishing rules and regulations for its members to effectively promote market integrity and market efficiency, ensuring compliance of such rules and regulations by imparting training to members, conducting examinations, conducting inspections of members, enhancing the level of investor protection, and also mediating in broker-investor disputes. As SROs have greater understanding of ground reality, development of SROs results in greater acceptance of rules by the members of SROs, provide market players with greater flexibility to respond to securities market, and avoid duplication of responsibilities. For SROs to function effectively, they should be able to establish and enforce bye-laws, rules and regulations to proven manipulative trade practices and permit just and prevent equitable principles of trade. Stock exchanges in India are already acting as SROs. The Association of Merchant Bankers of India, the Association of Mutual Funds of India (AMFI), the Indian Banks' Association (IBA) and the Association of NSE Members of India (ANMI) perform the functions of SROs.

The SEBI has framed the SEBI (Self Regulatory Organizations) Regulation, 2004, which obligate SROs to undertake the following:

- Always abide by the directions of the SEBI.
- Be responsible for investor protection and education of investors or its members and shall ensure observance of securities laws by its members.
- Specify standard of conduct for its members and also shall be responsible for the implementation of the same by its members.
- Conduct inspection and audit of its members on a regular basis, through independent auditors.
- Submit its annual report to the SEBI.
- Treat all its members and the applications for membership in a fair and transparent manner.
- Collect admission and membership fees from its members for carrying out the purposes of the regulations.

- Promptly inform the SEBI of violations of the provisions of the act, the rules, the regulations, the directions, the circulars or the guidelines by any of its members.
- Conduct screening and certification tests for its members, agents and such other persons as it may determine.
- Conduct training programmes for its members or agents and also conduct awareness programmes for securities market investors.
- Make endeavor for introduction of best business practices among its members.
- Act in utmost good faith and shall avoid conflict of interest in the conduct of its functions.
- Comply with the norms of corporate governance as applicable to listed companies.
- Discharge such other functions and obligations as may be specified by the SEBI, from time-to-time.

Self-regulation is not an independent tool, it complements other tools. The SRO assist the regulators in use of the other tools such as registration, monitoring, and enforcement. Further, they are also subject to same tools of registration, monitoring, and enforcement by the SEBI as the other intermediaries are.

There are three alternative models existing in different countries: *limited SRO model* which performs front-line regulation functions for its market and acts as the agent of the regulator, *strong SRO model* which performs extensive market and member regulation function and regulator only acts as the oversight authority and *independent member SRO model* which performs only regulation functions thereby enabling greater use of industry expertise and resources and minimizing conflicts of interest between business and SRO functions. Financial Industry Regulatory Authority (FINRA), an independent member SRO, is the largest non-governmental regulator for all securities firms doing business in the US.

In order to make regulation more effective and responsive, the SEBI is contemplating to modify SRO regulations in order to promote the formation of more self regulatory organizations (SROs) in the Indian capital market.

Investor Protection Measures

The SEBI has introduced a variety of measures to protect the interests of investors. With a view to creating an awareness among issuers and intermediaries of the need to redress investor grievances quickly, the SEBI issues fortnightly press releases, publishing the names of the companies against whom maximum number of complaints have been received. To ensure that no malpractice takes place in the allotment of shares, a representative of the SEBI supervises the allotment process. It issues advertisements from time-to-time to guide and enlighten investors on various issues related to the securities market and of their rights and remedies.

In order to protect the interests of investors in collective investment schemes and in accordance with the mandate given by the government, the SEBI framed regulations for collective investment schemes. The regulatory authority took several measures with a two-pronged approach to discipline and take action against erring entities and at the same time to educate the investors about the risks associated with investing in unregulated schemes. The actions taken by the SEBI included issuing show cause notices to defaulting entities, initiating court proceedings to obtain appropriate relief in the interest of investors, conducting a special audit of the books of accounts of the larger entities, making credit rating mandatory for existing schemes, disseminating information to investors through the issue of press releases/public notices.

The SEBI has introduced an automated complaints handling system to deal with investor complaints. The complaints received by the SEBI from investors have been categorized as under:

- Type-I: Non-receipt of refund orders/allotment letters/stock invest.
- Type-II: Non-receipt of dividend.
- Type-III: Non-receipt of share certificates/bonus shares.
- Type-IV: Non-receipt of debenture certificates/interest on debentures/redemption amount of debentures/interest on delayed payment of interest on debentures/redemption amount of debentures.
- Type-V: Non-receipt of annual reports, letter of offer for rights, rights forms, interest on delayed payment of refund orders/dividends.
- Type-VI: Complaints related to collective investment schemes.
- Type-VII: Complaints related to mutual funds, FIIs, portfolio managers, venture capital funds, custodians.
- Type-VIII: Complaints related to brokers, sub-brokers, securities lending intermediaries, registrars and transfer agents, bankers to issue, underwriters, credit rating agencies, depository participants, merchant bankers.
- Type-IX: Complaints related to stock exchanges, clearing and settlement organizations, depositories.
- Type-X: Complaints related to derivative exchanges.
- Type-XI: Complaints related to corporation finance such as corporate governance, corporate restructuring, substantial acquisition and takeovers, buyback, delisting, compliance with listing conditions.

Investors' Education

Some of the steps taken by the SEBI for educating investors during the year 2000–01 were as under:

- The SEBI distributed the booklet titled *A Quick Reference Guide for Investors* to the investors.
- The SEBI wrote to stock exchanges and various corporates to distribute the booklet titled *A Quick Reference Guide for Investors* to their shareholders/investors.
- The SEBI also issued a series of advertisements/public notices in national as well as regional newspapers to educate and caution the investors about the risks associated with the investments in collective investments schemes.
- The SEBI also broadcasts messages for investors in the collective investment schemes through the national hook-up and regional stations of *Vividh Bharati*.
- The SEBI issued messages in the interest of investors on the national channel and regional stations on *Doordarshan*.

Investors' Grievances Redressal

The SEBI has established a comprehensive investor grievances redressal mechanism. The Investor Grievances Redressal and Guidance Division of the SEBI assists investors who prefer to make complaints to the SEBI against listed companies. A standardized complaint format is available at all SEBI offices and on the SEBI website for the convenience of investors. Each complaint is taken up with the company and if the complaint is not resolved within a reasonable time, a periodical follow up is also made with the company. Errant companies are warned of stern action for their failure to redress grievances. Recalcitrant companies are referred for prosecution.

Regulations relating to redressal of investor grievances—surrender of certificate of security and audit were notified on September 2, 2003. According to these regulations, the issuer/its agent/an intermediary shall redress the beneficial owners' grievances within 30 days of the date of receipt of the complaint and keep the depository informed about the nature of grievance, number of disposed/pending complaints.

Within 15 days of receipt of certificate of securities, the issuer shall confirm to the depository that the securities comprised in the said certificate have been listed on the stock exchange where the earlier issued securities are listed and shall also after due verification immediately mutilate and cancel the certificate of security and substitute in its record the name of the depository as the registered owner and shall send a certificate to this effect to the depository and to every stock exchange where the security is listed.

All matters relating to transfer of securities, maintaining of records of holders of securities, handling of physical shares, and establishing connectivity with the depositories should be collectively handled and maintained at a single point, *i.e.*, either inhouse by the company or by a SEBI registered share transfer agent.

Every issuer shall submit an audit report on a quarterly basis, starting from September 30, 2003, to the concerned stock exchanges audited by a qualified chartered accountant or a practicing company secretary, for the purposes of reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form.

The SEBI claims to have resolved an increasing proportion of investors' grievances. The redressal rate is 94 per cent.

The SEBI setup a new institution in 2003 called the 'ombudsman' for the capital market. The dictionary meaning of ombudsman is 'an official appointed to investigate individuals' complaints against public authorities'. The SEBI ombudsman is an office to redress the grievances of the investors against the intermediaries and the listed companies by mutual agreement or by award on adjudication. Regulation 2 (l) of the SEBI (Ombudsman) Regulations, 2003 defines ombudsman as 'any person appointed under Regulation 3 of these regulations, and unless the context otherwise requires, includes stipendiary ombudsman'. Regulation 3 states that the 'board may, on recommendation of a selection committee appoint one or more ombudsmen for such territorial jurisdiction as may be specified from time to time by an order', Regulation 2 (n) defines 'stipendiary ombudsman' as 'a person appointed under Regulation 9 for the purpose of acting as an ombudsman in respect of a specific matter or matters in a specific territorial jurisdiction and for which he may be paid such expenses, honorarium or sitting expenses as may be determined by the board from time to time'.

Regulations 11 and 12 deal with the powers and functions of the ombudsman. They are as follows:

- To receive complaints specified in Regulation 13 against any intermediary or a listed company or both.
- To consider such complaints and facilitate resolution thereof by amicable settlement.
- To approve a friendly or amicable settlement of the dispute between the parties.
- To adjudicate such complaints in the event of failure of settlement thereof by friendly or amicable settlement.

- Ombudsman is an office to redress the grievances of the investors against the intermediaries and the listed companies by mutual agreement or by award on adjudication.

The ombudsman has to submit an annual budget and furnish such other information as may be required by the SEBI.

Regulation 13 provides for the grounds under which a person may lodge a complaint either to the SEBI or ombudsman concerned. A wide gamut of issues relating to non-receipt of refund orders, allotment letters, share certificates, unit certificates, debenture certificates, bonus shares, interest on debentures, redemption amount of debentures, delayed payment of interest on debentures, interest on delayed refund of application amount, annual reports or statements pertaining to the portfolios, redemption amount from a mutual fund or collective investment scheme; letter of offer or consideration in take over or buy back offer or delisting; and grievance in respect of issue or dealing in securities against an intermediary or a listed company can be the grounds for filing a complaint.

The complainant can make a complaint to the ombudsman subject to certain conditions.

- The complainant has made a written representation to the listed company for the intermediary and the complaint has remained unredressed for a period of one month or more from the date of receipt of the said representation.
- The complaint should be made within a period of seven months from the date of receipt of representation by the company or the intermediary, or within six months from the date of rejection of his complaint by the company or the intermediary.
- The complaint should not be in respect of the same subject matter that has already been settled either through the SEBI or through the ombudsman and for which any proceedings before the SEBI or any court of law or tribunal or any other forum is pending, or a decree or award or a final award has already been passed by such forum.

The ombudsman may award compensation, costs and interest. The award of ombudsman may be reviewed by the SEBI on grounds of substantial miscarriage of justice or an error apparent on the face of the award. Failure to obey the award of the ombudsman or order of the SEBI is liable for penalty under Section 15C, Section 11 (4), and Section 12 of the SEBI Act. In addition, the party shall also be liable for suspension or cancellation of certificate of registration.

The Ombudsman shall be appointed for a term of three years and shall be eligible for appointment for another period of two years.

It is mandatory for every listed company and intermediary to display their name and address of the ombudsman in its office premises and the offer documents or other agreements with clients.

Investors' Associations

With a view to creating a greater degree of awareness among the investors, the SEBI has encouraged forming of investors' associations. During the year 2000–01, the SEBI renewed the registration of six investors' associations for a period of three years and granted provisional registration to five investors' associations for a period of one year. Accordingly, the following investors' associations are registered with SEBI:

- All Body Corporate Shareholders' Forum, Hyderabad.
- Consumer Education and Research Society, Ahmedabad.
- Jagrut Grahak Mandal, Patan (Gujarat).
- Kovai Investors' Association, Coimbatore.
- Tamil Nadu Investors' Association, Chennai.
- The Gujarat Investors' and Shareholders' Association, Ahmedabad.
- Investors' Grievances Forum, Mumbai.
- Kolhapur Investors' Association, Kolhapur.
- Midas Touch Investor's Association, Kanpur.
- Consumer Unity and Trust Society, Jaipur.
- Ghatkopar Investors' Welfare Association, Mumbai.

The recognized investors' associations are eligible to draw a sum upto ₹1 lakh each from the SEBI to meet their one-time capital expenditure towards setting up computer terminals and installation of data base on companies and internet connectivity. They are also entitled to draw upto ₹5 lakh per association for organizing seminars for investor education on capital market subject to a limit of ₹50,000 per seminar and for publication and circulation of investor education material and upto ₹5,000 per association for translating, printing, and circulating the SEBI booklet titled *A Quick Reference Guide for Investors*.

Corporate governance is an important instrument of investor protection and it is, therefore, a priority on the SEBI's agenda. The development of capital market is dependent on good corporate governance without which investors do not repose confidence in companies. It is imperative for companies to maximize the shareholders' value and wealth. Hence, to ensure that the Indian investors are in no way less informed and protected as compared to their counterparts in the developed capital markets, the SEBI appointed a committee on corporate governance under the chairmanship of Shri Kumar Mangalam Birla, member, SEBI Board.

The committee framed the codes of corporate governance and suggested the implementation of the code through stock exchanges. The SEBI asked the stock exchanges to make amendments in the listing agreements on corporate governance keeping in view the diversity of business and size of the companies entering the market. The SEBI is planning to review the corporate governance norms currently applicable to listed companies. A new committee to be headed by N. Narayana Murthy, Chairman and Chief Mentor of Infosys, will review all recommendations made by earlier committees on the subject and recommend changes to enhance corporate transparency. Recently, the SEBI has proposed corporate governance rating. According to the SEBI chairman, G. N. Bajpai, 'Just as the rating of a financial instrument and the company's financial health are closely linked, the market valuation of a company is influenced by the quality of its corporate governance practices'. It has asked the rating agencies, namely, CRISIL and ICRA to prepare a comprehensive instrument for rating of good corporate governance practices of listed companies. This instrument will enable the securities market regulator judge the compliance status of corporates on parameters such as effective creation, management, and distribution of investors wealth.

For prohibiting fraudulent and unfair trade practices, the SEBI enacted the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) regulations, which enabled the SEBI to investigate into market manipulation. Vigorous efforts were undertaken to enforce these regulations.

In order to make the securities markets fair and transparent and for enhanced investor protection, the SEBI had taken further initiatives to strengthen insider trading regulations. A group was set up under the chairmanship of Shri Kumar Mangalam Birla, to suggest measures to be taken for strengthening of the regulations as well as requirements of procedures, code of conduct and reporting for entities in the capital market which may have access to non-public information. The Insider Trading (Amendment) Regulations were notified on February 20, 2002. The following changes were made through these amendment regulations for enhancing market transparency and for strengthening the insider trading regulations:

- Strengthening existing provisions by including changes in the definition of 'connected person', broadening the meaning of dealing in securities, redefining the term 'deemed to be connected', refraining the term 'unpublished price sensitive information'.
- Incorporation of disclosure requirements by insiders such as directors and large shareholders. These disclosures to be made to stock exchanges within the prescribed time limit.
- Creation of preventive framework and consisting of code of conduct for listed companies and other entities associated with securities markets. The codes of conduct cover the following aspects: maintaining confidentiality of 'Unpublished Price Sensitive Information', trading regulations such as trading windows, restricted lists of securities and pre-clearance of trades, internal reporting requirements for transactions in securities and provisions for internal enforcement, and penalty to be imposed by companies/other entities for contravention of code of conduct.
- Creation of a code of corporate disclosure practices for listed companies. This code covers the areas of prompt disclosure of price sensitive information by listed companies, responding to market rumours, timely reporting of shareholdings/ownership and changes in ownership, disclosure of information with special reference to analysts, institutional investors, and dissemination of information by companies, including through company websites.
- Dealing with market rumours. Companies are required to designate compliance officers who can be contacted by the stock exchanges whenever such verification of rumours is needed. Exchanges required to take up quick verification of rumours and ensure proper dissemination of the relevant information.
- Coordination and sharing of information between exchanges.

The SEBI has created an Overseas Investors Cell to facilitate investments by overseas investors and to enhance their confidence in India's regulatory and redressal mechanism.

Achievements of the SEBI

Throughout its twenty six existence as a statutory body, SEBI has sought to balance the two objectives by constantly reviewing and reappraising its existing policies and programmes, formulating new policies

and crafting new regulations in areas hitherto unregulated, and implementing them to ensure growth of the market.

The SEBI introduced an array of reforms in the primary and secondary markets and catalysed modernization of the market infrastructure to prepare the market for the twenty-first century. India is probably the only country in the world where all the exchanges have screen-based trading. Computerized trading has led to reduction in the scope for price-rigging and manipulation, since a paper trail can easily lead the regulators now to the doorsteps of the guilty. Dematerialization has pushed the process further.

Computerization has also given a boost to surveillance. The basic surveillance is carried out by the stock exchanges, while the SEBI monitors the process. Introduction of price caps, price bands, circuit filters, margins and stock watch are some ways of keeping a strict vigil on the market.

Improvements have been made in the clearance and settlement system. A major step in this direction has been the establishment of depositories—the National Securities Depository Limited (NSDL) and the Central Depository Services of India Limited (CDSL)—and a clearing corporation—the National Securities Clearing Corporation Limited (NSCCL).

For reviving primary markets, the SEBI further streamlined and simplified the issue procedure, imparted greater flexibility to the issue process and strengthened the criteria for accessing the securities market. The SEBI introduced the option of making an issue through book building.

The development of mutual funds, which are important investment vehicles in a mature securities market, was given a major impetus, with the revision of mutual funds regulations which now provide greater operational flexibility to the fund managers and increase their accountability and supervision. The SEBI scored its biggest public successes in the mutual funds arena, particularly in their regulation. When some funds planned to renege on their promises to investors by unilaterally amending the assured return schemes, the SEBI put its foot down and compelled them to make good their promises.

Due to directions by the SEBI, the sponsors and asset management companies of nine mutual funds contributed a total amount of ₹4,558.96 crore to meet the shortfall in case of 32 schemes as on March 31, 2003. Many of these schemes were launched even before the enactment of the SEBI Act 1992.

The regulator introduced a host of investor-friendly regulations in case of mutual funds. The SEBI scrapped the entry load charged while investing in mutual funds for investments directly with the asset management company (AMC). In other words, investors can now bypass the agent/distributor and save this cost. The SEBI also scrapped initial issue expenses and amortization thereof on close-ended funds for reducing expenses on funds and thereby aiding the investor's interest. SEBI also introduced measures to instill discipline among mutual funds and also ensure investor interest and protection. If a debt fund is close-ended, the mutual funds must not repay its investors pre-maturely and all close-ended debt funds should be traded in the market. It made FMPs strictly close-ended and listing of these FMPs mandatory. Fund managers would have to structure their portfolio by buying assets that will mature along with the tenure of the scheme so that there will be no mismatch between tenure of the scheme and maturity of the holdings under the scheme. Disclosure of portfolios of FMP schemes has become mandatory to help investors make informed and timely redemption decisions. Moreover, mutual funds were also banned to declare indicative returns and yields under FMPs.

Far reaching changes were made in the SEBI regulations for substantial acquisition of shares and takeovers. The regulations for foreign institutional investors (FIIs) were liberalized to provide greater flexibility and for widening the scope of their investments in the Indian securities market.

Some merchant bankers were found to be unscrupulous. They had not performed their duties diligently in scrutinizing the prospectus and had taken advantage of the loopholes by concealing some facts in their prospectus. The SEBI reduced the categories of merchant bankers from four to one. Moreover, it prohibited merchant bankers from undertaking activities such as leasing, bills, and discounting.

The SEBI took stringent action against those companies which floated collective schemes. It also came down heavily on plantation forms.

To empower investors make informed decisions and facilitate fair dealing, the SEBI introduced online filing and dissemination of time sensitive price information, benchmarking of mutual fund schemes, valuation norms for unlisted scrips in mutual fund portfolios, rationalization of depository participants' charges and new regulations for portfolio managers.

The SEBI revolutionized the settlement system by introducing T+2 rolling settlement across all scrips across exchanges. It issued guidelines for demutualization and corporatization of stock exchanges and all the 20 stock exchanges in the country are demutualized. The regulator has made the rights issue process short and simple and last year reduced the 'post-approval timeline' from 109 days to 30 days by making changes in the notice period for record date and board meeting.

To create an effective regulatory regime in which all stakeholders have confidence, the SEBI has posted the securities appellate tribunal orders on the SEBI website, initiated consultative process for framing regulations, and shortened the inquiry process. SAT provides a grievance redressal platform against the SEBI's orders. Public dissemination of such appellate orders is vital as these act as a precedent for other similar cases and on the decision-making process of the SEBI.

The SEBI investigated certain irregularities in the transactions of the shares issued through 21 IPOs during the period 2003–05, before their listing on the stock exchanges. The regulator investigated action against 105 entities including the two depositories—NSDL and CDSL involved in these transactions under the SEBI Act by prohibiting them to trade in the securities market and imposing penalties on them. The SEBI levied disgorgement amount on these entities and is in the process of disgorging further sums from other entities. It levied a disgorgement amount of ₹116 crore on NSDL and CDSL. The disgorged amount collected was disbursed to 12.8 lakh investors till April 2010.

The SEBI is trying to bring down various forms of risk that are there in the securities market. A securities market has three kinds of risk—structural, systemic, and operational.

1. **Structural:** Large infrastructure can be a risk; India has a large infrastructure. An over-or under-utilized structure can always be risky. This is receiving the SEBI's attention. This risk is low because most of the regional stock exchanges have no volumes.
2. **Systemic:** These are broadly classified into three parts: disclosure standards, accounting standards and corporate governance. Under disclosure standards, India ranks the best in the world. Accounting standards of India today are by and large aligned completely with the international accounting standards. Many companies have adopted world best corporate governance practices and the others are in the process. The SEBI is asking for risk management factors in corporate governance.
3. **Operational:** Operational efficiency of the Indian market is comparable to the rest of the world. The Indian stock exchanges follow a T+2 settlement cycle. Secondly, every transaction on the trading platform is guaranteed for settlement by a third party. Stock exchanges have a relative monitoring of margining and positions. Today, our settlement stands shoulder to shoulder with the rest of the world.

As far as systemic reforms are concerned, the SEBI has done outstanding work. The SEBI has done a commendable job in developing equity markets and pushing for operational reforms.

However, the market regulator was heavily criticized as it failed to take timely actions during the spate of scams that took place in the last decade. The SEBI, as a watch dog, remained a silent spectator when the small investors were robbed off their savings. The SEBI has been criticized on the following grounds:

- The SEBI, as a regulator, proved to be ineffective in the series of scams that took place in the last decade. The SEBI has been accused of shutting the stable door after the horse had bolted. For instance, the SEBI had occasions to review the affairs of CRB capital markets but took a lenient view and as a result, scores of investors lost crores of rupees.
- The SEBI has gone more than half away to help out potential defaulters to avoid a major payments crisis. Whenever the real racketeers get up to new tricks, surveillance takes a long time to catch up.
- The SEBI acts as the handmaiden of the government instead of an independent regulator. The government also perceives the SEBI to be an extension of the finance ministry.
- The guidelines issued by the SEBI are ambiguous and frequently revised which creates confusion amongst the market participants.
- New concepts are introduced without putting in place the requisite infrastructure. For instance, the dematerialization concept was introduced without the requisite infrastructure and this created a chaotic situation for the investors, companies, and stock exchanges.
- The SEBI banned *badla*, a time-tested hedging-cum-financing mechanism in India, in December 1993, after its repeated requests to stock exchanges to ensure that brokers maintained capital adequacy norms failed. It banned *badla* without providing an alternative mechanism. In the face of persistent demands by the broking community, the SEBI appointed the G. S. Patel Committee and introduced a modified *badla* in July 1995. The modified *badla* proved unacceptable and the Jayant Verma Committee was appointed, which suggested a modified carried forward system. All deferral products, including *badla*, were banned in July 2001. The SEBI introduced rolling settlement after the ban of ALBM and BLESS. The ban on deferral products killed liquidity in the markets which, in turn, dampened the market sentiments.

- The SEBI is perceived to be more corporate-friendly than investor-friendly. It not only failed to penalize fraudulent companies, but remained a spectator when the same companies re-entered the market with new issues.
- The SEBI does not have the requisite number and a competent staff to regulate and develop the capital market. There are only two dozen officers who are involved in surveillance, investigation, and prosecution, as compared to a large army of over 1,000 in the Securities Exchange Commission (SEC) of the US. It does not have the necessary machinery to achieve all its objectives and bring discipline and transparency in the market.
- The Investor Grievance Cell of the SEBI merely forwards the grievance letters to the companies. Investors are not happy with the functioning of this cell as they feel that timely action is not taken. In order to ascertain correct status of redressal of grievance, the SEBI has been conducting an exercise of sending reply-paid post cards to investor, requesting them to reply as to whether their complaint has been resolved by companies or not. During 2000–01, out of 69,131 reply-paid postcards sent to investors, 44,915 postcards were received back, of which 3,621 replied that the complaints were resolved and 40,629 replied that the complaints were not resolved. This reveals that the SEBI's claims of having resolved around 95 per cent of investors grievances is not true.
- The SEBI has failed to balance its twin objectives—regulation and growth of capital market. For instance, after the CRB scam was unearthed, the SEBI stipulated many stringent norms for NBFCs, thereby ringing the death bell for many NBFCs.

Recently, most of the orders of the SEBI were overturned by the SAT. The tribunal had quashed SEBI's order in BPL, Videocon, and Sterlite for lack of evidence. In L&T's case, SAT struck down the order against Reliance for violation of takeover code. In the case of HCL, definition of insider was found to be vague and confusing. The SAT totally exonerated Samir Arora, former chief investment officer of Alliance Capital Mutual Fund of all the charges levied by the SEBI on October 15, 2004. The three-member tribunal said that there was no substance in any of the three charges brought by the SEBI. Thus, the SEBI's orders were set aside primarily due to lack of evidence, vagueness of definition of insider and defective/improper investigator. Many of its orders were upheld by SAT and in many cases, where SAT reversed the orders, the SEBI preferred appeal before the higher court. The SEBI's inability to successfully defend its cases before the appellate authority raises questions regarding its investigating and enforcement credibility. The SEBI requires an adequate and skilled staff for effective enforcement and prosecution and a sound legal team to present and defend the SEBI's case. The SEBI should train people in writing proper orders, appreciating the evidence, and interpreting provisions of law so as to make SEBI orders foolproof.

The SEBI, being a watchdog, should always be careful and adopt a cautious approach and use the legal expertise available to it so that it can continue to play its rightful role.

SEBI has done a commendable job in transforming the Indian capital market putting it on par with world equity markets in terms of technology, risk management, supervision, surveillance which are now system-driven and investor protection by strengthening its regulatory purview and internal capacity.

The primary markets have got a new lease of life through measures such as setting up a framework for e-IPO, reducing the gap between closure of an issue to listing/trading to six days from twelve days and reducing the length of the abridged prospectus from 60 to 70 pages to 10 pages enabling the investor to take informed decisions. SEBI has created a specialized institutional platform for start-ups encouraging them to raise capital from the capital market.

SEBI has played a major role in case of state municipalities who are always facing fund crunch for creating infrastructure by setting up norms for issue of municipal bonds which, in turn, would lead to the development of active municipal bond market. Moreover, SEBI has established a framework of REITs and InvITs which will help unlock capital tied into real estate and infrastructure projects.

Looking to the mounting NPAs in the economy, both the regulators of the financial system—the RBI and the SEBI—assisted each other in developing a framework for successful implementation of the strategic restructuring of debt scheme.

On September 28, 2015, the forward market commission—regulator of the commodities futures market—was merged with SEBI to bring about convergence and regulations and to harness the economies of scope and scale for the government, exchanges, financial firms and other stakeholders at large. This additional responsibility was given to SEBI as the activities and movements in the commodities derivatives market have significant repercussions on the real economy. Besides regulating the securities market, SEBI has now to ensure the smooth conduct and functioning of the commodities derivatives market.

Future Plans

The SEBI has chalked out a vision of becoming the ‘most dynamic and respected regulator—globally’. In order to realize this vision, the SEBI has drawn a comprehensive strategic action plan which envisages achievement of strategic aims laid down for: (a) investors, (b) corporates, (c) markets, and (d) regulatory regime.

Investors

Aim: To empower investors make informed decisions and achieve fair dealings in their financial dealings.

It does not have the necessary machinery to achieve all its objectives and bring discipline and transparency in the market.

Progress: Online filing and dissemination of time sensitive price information; benchmarking of mutual fund schemes; valuation norms for unlisted scrips in MF portfolios; rationalization of depository participants’ charges; new regulations for portfolio managers.

Plans: Launch of nationwide investor awareness campaign; enhancing continuous disclosure standards; implementation of the Malegam Committee recommendation on disclosures in offer documents.

Corporates

Aim: To ensure that firms and their managers understand and meet their regulatory obligations.

Progress: Institutionalized feed back; code of conduct specified for listed entities and regulated firms under the insider trading regulations; instituted a scheme to enable individuals and companies to disclose the irregularities in reporting of acquisition of shares under the SEBI (SAST) Regulations, 1997.

Plans: Strengthening corporate governance code; improving quality of intermediaries.

Markets and Intermediaries

Aim: To ensure that consumers and other participants believe that the markets are efficient, orderly, and clean.

Progress: T+2 rolling settlement across all scrips across exchanges; demutualization of stock exchanges; abolition of no-delivery period; introduction of surveillance reporting for derivatives; dual fungibility of ADR/GDR; inter-depository transfer through online connectivity established between CDSL and NSDL; straight through processing (STP) on the securities market made operational.

Plans: Strengthening of secondary market; strengthening of derivatives market; review of market infrastructure; review of depository services; development of debt market.

Regulatory Regime

Aim: To create an appropriate and effective regulatory regime in which all stakeholders have confidence.

Progress: Posting of securities appellate tribunal orders on the SEBI website; consultative process for framing regulations; shortening of enquiry process; quicker regulatory responses; the SEBI Act, 1992 amended in October 2002 and SEBI’s powers enhanced; the SEBI Board enlarged with the provision of three full time board members.

Plans: Review of regulations making the regulatory process more transparent; reengineering systems and processes; introduction of T+1 settlement and new products.

The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations), were notified on August 26, 2009. The matters relating to issue of capital, the manner in which such matters shall be disclosed, and other matters incidental thereto were hitherto provided in the SEBI (Disclosure and Investor Protection) Guidelines, 2000 (DIP Guidelines) issued under Section 11(1) of the SEBI Act, 1992. As these provisions, along with few changes, have since been incorporated in the ICDR Regulations, the DIP Guidelines stand rescinded. With ICDR Regulations, it has removed the ambiguities, rationalized the rules and regulations and enhanced transparency. It has also converted the DIP guidelines into a form recognized by law.

The SEBI plans to put in place a new online reporting system where the company-related information, including annual reports, can be put up. The SEBI’s future plans include moving the settlement cycle to T+1, and introducing market makers and call auction risks. In a move to improve transparency, the SEBI will also put up the agenda papers of all policy issues on the website. The minutes of the meetings on such items will also be available on the SEBI website once the Board has approved them.

The SEBI's vision in case of regulating commodities market is to evolve this market with new products and new categories of participants leading to better liquidity thus facilitating fair price discovery for the benefit of stakeholders.

Conclusion

The SEBI is a regulatory body which is twenty six years old and the capital market system is more than 100 years old. This matured capital market system requires monitoring rather than over-regulation. The SEBI is now supervising this capital market system in such a manner that all sub-systems become self regulatory organizations gradually. The SEBI has laid down the boundaries within which these subsystems should operate.

Moreover, the fundamental infrastructure for regulation, disclosure, surveillance and trading are all in place. Hence, the SEBI has now become more of a visionary.

Technological changes and integration of Indian financial markets with world markets will pose a greater challenge to the SEBI. As the markets become more interconnected the world over, there will be consolidation of regulations. The SEBI will have to acquire sweeping powers like powers of search and seizure, or banning an individual for life from the securities market or sending an accused to jail without court intervention and prove that it is really an autonomous impartial regulator.

In October 2002, the Union Cabinet approved the ordinance that was the first big attempt at strengthening market regulations a decade since the SEBI Act came into being. Under Chapter VIA of the SEBI Act, 1992, the SEBI now has more powers to investigate market offences, enforce regulations, and impose deterrent penalties. The SEBI has got more teeth for investigation, including powers of search and seizure, only constrained by the requirement to obtain an order from a magistrate. The SEBI has the power to impose deterrent fines, which can be as much as ₹25 crore or three times the 'undue profit' derived through market offences, whichever is higher. The quantum of fines goes up from the present range of ₹5,000 to ₹5 lakh to a minimum of one lakh going upto ₹25 crore or even more. The ordinance also amended the SEBI Act, to better clarify and define offences such as 'insider trading', 'fraudulent and manipulative trade practices', and 'market manipulation'.

Additional search and seizure powers have strengthened the SEBI's investigative process and hefty penalties act as a deterrent for those corporates and entities indulging in malpractices. The SEBI now has a stronger organization with three full-time members other than the chairman, all appointed on the basis of the recommendations of a selection committee.

The SEBI should aim to become a regulator who is not only respected but is fair and just and follows the law to the letter as well as in spirit, taking into account ground realities. The challenge for the SEBI now is to clamp down on price manipulation and rampant trading based on inside information. Being a nodal agency, it should ensure better compliance by the corporate sector and enhance the quality of their disclosures.

The SEBI has to balance between the costs of regulation and market development. There should be cross-border cooperation between various regulators and between regulators and industry.

During August 2013, the government gave SEBI the powers to conduct search and seizure operations and access call data records and also the power to crack down on ponzi schemes.

The major challenge before the SEBI is now developing an active corporate bond market.

The SEBI being given the additional responsibility of regulating the commodities derivatives market has now more challenges to be faced in the future. It will have to strive hard to reshape the commodities derivatives market in terms of strengthening the risk management, developing new products and regulatory framework.

THE RESERVE BANK OF INDIA

The Reserve Bank of India was established by legislation in 1934 through the Reserve Bank of India Act, 1934. It started functioning from April 1, 1935. Its central office is at Mumbai since 1937. Though originally privately owned, since nationalization in 1949, it is fully owned by the Government of India. The Reserve Bank of India is the central bank of our country.

Objectives of the Reserve Bank

The preamble of the act states that, 'Whereas it is expedient to constitute a Reserve Bank for India to regulate the issue of bank notes and the keeping of reserve with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage....' The

preamble prescribes the objectives as: (i) to secure monetary stability within the country; (ii) to operate the currency and credit system to the advantage of the country.

In other words, the objectives of the RBI are price stability and ensuring adequate credit availability to finance economic activities for the benefit of the country.

Organization of the Reserve Bank

The bank is managed by a central board of directors and four local boards of directors.

- Central Board of Directors consists of fourteen non-executive independent directors nominated by the Government, one Governor and four deputy governors.

Central board: The central board is appointed/nominated by the central government for a period of four years. It consists of official directors and non-official directors.

Official directors: The governor and not more than four deputy governors are full-time official directors.

Non-official directors: They are fifteen in number. Ten directors from various fields and one government official are nominated by the government while four directors from four local boards are nominated as non-official directors.

The functions of the central board are general superintendence and direction of the bank's affairs.

Local boards: There are four local boards, one each for the four regions of the country in Mumbai, Kolkata, Chennai, and New Delhi. The membership of each local board consists of five members appointed by the central government for a term of four years.

The functions of the local board is to advise the central board on local matters; to represent territorial and economic interests of local cooperative and indigenous banks' interests, and to perform such other functions as delegated by the central board from time to time.

Offices: The RBI has 22 regional offices, most of them in state capitals.

Training Establishments: The Reserve Bank has six training establishments:

- Three training establishments, namely, the College of Agricultural Banking, the Banker's Training College, and the Reserve Bank of India Staff College are part of the RBI.
- Others such as the National Institute for Bank Management, Indira Gandhi Institute for Development Research (IGIDR), and the Institute for Development and Research in Banking Technology (IDRBT) are autonomous.

Subsidiaries

The Reserve Bank has fully owned three subsidiaries: National Housing Bank (NHB), the Deposit Insurance and Credit Guarantee Corporation of India (DICGC), and Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL).

The Reserve Bank has a majority stake in the National Bank for Agriculture and Rural Development (NABARD).

The National Housing Bank (NHB) is wholly owned by the RBI. It was set up in July 1988, under an act of the parliament. The NHB was conceived and promoted to function as the apex institution in the housing sector. It promotes housing finance institutions both at local and regional levels and provides financial and other support to such institutions. The Reserve Bank added to the equity of its 100 per cent owned National Housing Bank.

The DICGC, a fully-owned undertaking of the RBI, operates both deposit and credit guarantee schemes. A committee was appointed in 1995 to review the credit guarantee schemes and it recommended that the credit guarantee schemes should be terminated as they were not viable. However, the DICGC continued the schemes but by increasing the premium amount. As a result, many banks opted out of credit guarantee schemes. The Union Budget 2002–03 announced that the DICGC would be converted into the Bank Deposits Insurance Corporation (BDIC) to make it an effective instrument for dealing with depositors risks and distressed banks.

The RBI, during 2001–02, disinvested its holdings in the Discount and Finance House of India (DFHI) and the Securities Trading Corporation of India (STCI) which were promoted for activating and deepening the money market and developing an active secondary market for government securities and PSU bonds, respectively.

The committee on banking sector reforms suggested that the Reserve Bank should not own the institutions it regulates. The Reserve Bank accepted the recommendation for transfer of ownership of its shares in the State Bank of India, National Housing Bank, and National Bank for Agriculture and Rural Development to the central government.

The State Bank of India till the beginning of the 1990s was almost wholly owned by the RBI. As the SBI accessed capital market twice, the RBI's shareholdings have come down to about 60 per cent of the total share capital. The Reserve Bank of India has recently transferred its holding in State Bank of India to the Government of India.

Legal Framework

There are various acts governing the Reserve Bank functions, specific functions, banking operations, and individual institutions owned by RBI. They are:

Umbrella Acts

- The Reserve Bank of India Act, 1934, governs the Reserve Bank functions.
- The Banking Regulation Act, 1949, governs the financial sector.

The RBI Act, alongwith the Banking Regulation Act, 1949, provides wide-ranging powers to the Reserve Bank to issue directions to the banking and financial sectors.

Acts Governing Specific Functions

- The Public Debt Act, 1944/the Government Securities Act (proposed); governs government debt market.
- The Securities Contract (Regulation) Act, 1956, regulates government securities market.
- The Indian Coinage Act, 1906, governs currency and coins.
- The Foreign Exchange Regulation Act, 1973/Foreign Exchange Management Act, 1999, governs foreign exchange market.

Acts Governing Banking Operations

- The Companies Act, 1956, governs banks as companies.
- The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980, relates to nationalization of banks.
- The Banker's Books Evidence Act.
- The Banking Secrecy Act.
- The Negotiable Instruments Act, 1881.

Acts Governing Individual Institutions

- The State Bank of India Act, 1954.
- The Industrial Development Bank of India Act.
- The Industrial Finance Corporation of India Act.
- The National Bank for Agriculture and Rural Development Act.
- The National Housing Bank Act.
- The Deposit Insurance and Credit Guarantee Corporation Act.

Main Functions of the RBI

The main functions of the Reserve Bank are as follows:

- To formulate, implement, and monitor the monetary policy.
- To prescribe broad parameters of banking operations within which the country's banking and financial system functions.
- To facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.
- To issue and exchange or destroy currency and coins not fit for circulation.
- To perform a wide range of promotional functions to support national objectives.
- To perform merchant banking function for the central and the state governments.
- To maintain banking accounts of all scheduled banks.

Role of the Reserve Bank of India

Monetary Authority of the Country Monetary policy-making is the central function of the Reserve Bank. The broad objectives of monetary policy in India are (a) maintaining price stability and (b) ensuring

adequate flow of credit to productive sectors to assist growth. Monetary policy creates conditions for growth by influencing the cost and availability of money and credit. Monetary policy represents policies, objectives, and instruments directed towards regulating money supply and the cost and availability of credit in the economy. The RBI conducts the monetary policy with the help of an intermediate target, the operating instruments, and procedures. The intermediate target is one which bears a close relationship with the ultimate objectives of monetary policy. The operating instrument is the particular mode of central bank intervention. Macro-economic variables are the information variables used by the central bank to set the intermediate target. The RBI usually sets the broad money (M3) as the intermediate target. M3 is equal to money supply with the public plus demand and time deposits with banks and other deposits with the RBI. For aiming at the intermediate target, the underlying operating target is reserve money, particularly the banks' reserves, while the supplementary operating target is the short term interest rate provided by the overnight call money rates.

Since 1998–99, the RBI has been using multiple indicators such as interest rates, credit extended by banks and financial institutions, the fiscal position, trade, capital flows, the inflation rate, the exchange rate and transactions in foreign exchange together with broad money to draw monetary policy perspectives.

Since 1993–94, monetary policy has become the vehicle for instituting financial sector reforms in India. The reforms in the monetary and financial sectors have enabled the RBI to expand the array of operating instruments and procedures of monetary policy. The liquidity management in the system is carried out through open market operations (OMOs), both outright and repos. The RBI has reduced reliance on direct instruments such as cash reserve ratio which is used to control reserve requirements of banks. The liquidity adjustment facility (LAF) operations combined with OMOs have emerged as the principal operating procedure of monetary policy. In LAF, liquidity is injected or absorbed through reverse repo or repo auctions with a view to imparting stability to short-term money market rates and enabling orderly development of the market. The objective of the RBI is to develop the LAF as the primary instrument of liquidity adjustment and as the key interest rate signal for the short-term money market. Monetary policy and its instruments are discussed in detail in Chapter IV.

The RBI has made efforts to improve the volume and terms of credit by directing bank credit to certain sectors such as agriculture, exports, small-scale industries, infrastructure, housing, and micro-credit institutions, and simplifying the access to credit by simplifying documentation and decentralizing the sanctioning to the branch level.

It has used regulatory policies in conjunction with monetary measures. The regulatory policies relate to risk weights, provisioning requirements for banks with regard to exposure to NBFCs, sensitive sectors, and oil companies.

Regulator and Supervisor of the Financial System The objectives of the Reserve Bank as a regulator and supervisor of the financial system are to maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public. In order to attain these objectives, the bank prescribes broad parameters of banking operations within which the country's banking and financial system functions.

The RBI regulates and supervises the banking system in India under the provisions of the Banking Regulation Act, 1949, and the Reserve Bank of India Act, 1934. The RBI regulates select financial institutions (FIs) and non-banking financial companies (NBFCs) under Chapter IIIB of the Reserve Bank of India Act.

The process of issue of regulations is in three stages:

1. Preliminary discussion with representative bodies and select market participants.
2. Appointment of working groups consisting of regulators, market participants, and academicians to prepare the technical report.
3. Placement of the report in the public domain for a feedback. Based on the feedback, draft guidelines and then final guidelines are issued.

The Reserve Bank set up in November 1994 the Board for Financial Supervision (BFS), to supervise commercial banks, select FIs and NBFCs. The directions of the BFS are implemented by the Reserve Bank's Department of Banking Supervision (DBS), which supervises scheduled commercial banks (except regional rural banks), the Financial Institutions Division (FID) of the DBS which supervises select FIs and the Department of Non-banking Supervision (DNBS), which supervises the NBFCs. The BFS carries on on-site inspections of domestic banks and NBFCs on the basis of the CAMELS model (Capital adequacy, asset quality, management, earnings, liquidity, and systems and controls) and foreign banks on the basis of the CACS model (capital adequacy, asset quality, compliance and systems). The board introduced an off-site monitoring and surveillance system for banks in 1995 which was later

extended to select FIs and NBFCs as well. The BFS also monitors bank frauds and oversees issues in house-keeping in public sector banks including reconciliation of entries in inter-branch and inter-bank accounts and balancing of the books of accounts.

The RBI undertook structural measures to strengthen the financial system and improve the efficiency of financial intermediation. These structural measures have focused on improving the institutional infrastructure, strengthening prudential and supervisory norms, developing technology, improving risk management and internal control mechanism, debt recovery and upgradation of the payment and settlement system. In line with international practices, the RBI is developing a risk-based supervision methodology and refining on-site inspection procedures.

The RBI has been making efforts to ensure the convergence of its supervisory norms and practices to global standards. Recently, several steps have been taken to empower supervisors to undertake consolidated supervision of the bank groups. Consolidated supervision is qualitative as well as quantitative evaluation of the strength of a group to which a large bank belongs, in order to assess the potential impact of other group companies on the bank. This approach emphasizes on the preparation of financial reports on a consolidated basis of banks and their related companies, treating them in effect as if they were a single entity. It has developed a framework for monitoring the systemically important individual banks. It has encouraged banks to not only monitor unhedged foreign currency exposures of their clients, but also keep an oversight as to whether their derivative exposures have been appropriately disclosed.

The Reserve Bank is entrusted with the function of the development and regulation of money, foreign exchange, and government securities markets. The RBI undertakes this function as it is a monetary authority as well as debt manager to the government and is responsible for the stability of the financial system.

The structural rigidities in the financial markets hindered the operational effectiveness of the transmission of monetary policy. The first phase of financial sector reforms aimed at removing the structural rigidities—both price and quantity based. For orderly development of the financial markets, competition was infused, new financial instruments and innovative market practices were introduced, and the institutional and technological infrastructure was developed. In the second phase of reforms, the Reserve Bank's emphasis is on those policies which aim at stability of financial markets.

The RBI has taken steps to develop a pure inter-bank money market and broaden the repo market and to widen other money market segments. The system of primary dealers was introduced in the government securities market to increase liquidity and secondary market trading. The introduction of the negotiated dealing system and operationalization of Clearing Corporation of India Limited (CCIL) will impart greater flexibility to the RBI to operate its instruments of monetary policy.

The SEBI is a regulator of the securities market. The Securities Contract (Regulation) Act, 1956, was amended in March 1, 2000, to demarcate the regulatory roles of the Reserve Bank and the SEBI with respect to financial markets. The RBI has jurisdiction over transactions in government securities, money market securities, gold-related securities, derivatives based on these securities, and ready forward contracts in all debt securities, in conjunction with the RBI's regulation of foreign exchange transactions under the Foreign Exchange Management Act, 1999.

In spite of these efforts the regulatory authority is facing problems of slow recovery of debt, mounting non-performing assets (NPAs), and deteriorating health of some financial institutions and cooperative banks. The Reserve Bank has not been in a position to perform its regulatory role effectively due to the multiplicity of regulatory authorities in several segments of the financial system. In the cooperative sector, there are dual/triple regulatory and supervisory authorities which hinder the effective functioning of the cooperative institutions. Moreover, the blurring of the distinction between banking, non-banking, and insurance activities has questioned the existence of multiple regulators in the financial system.

Banker to the Government The Reserve Bank manages the public debt of the central and the state governments and also acts as a banker to them under the provisions of the Reserve Bank of India Act, 1934. These functions are to be mandatorily undertaken in the case of the central government under Sections 20 and 21 of the RBI Act. Sections 20 and 21 of the Reserve Bank of India Act, 1934, provide that the central government shall entrust the RBI with all its money, remittance, exchange, and banking transactions in India and the management of its public debt and shall also deposit all its cash balances with the RBI free of interest. The RBI may, by agreement with any state government, take over similar functions on behalf of that government under Section 21A of the Reserve Bank of India Act. The Reserve Bank undertakes this function for all the state governments except Jammu and Kashmir and Sikkim. The agreement with two states—Jammu and Kashmir and Sikkim—is restricted to management of their public debt.

The RBI provides a range of banking services such as acceptance of money on government account, payment/withdrawal of funds, and collection and transfer of funds by various means throughout India.

The governments principal accounts are maintained at Central Accounts Section (CAS), Nagpur. The government accounts are handled by the Reserve Bank at 15 offices, besides two state government cells at Bhopal and Chandigarh. It has appointed public sector banks (PSBs) and two private sector banks to handle government accounts. These agency banks handle government transactions of around ₹12 lakh crore per annum through 20,800 branches.

In July 2001, a state-of-the-art technological system was set up at CAS, Nagpur, to provide information on a real time online basis to central and state governments in respect of their cash balance position and other transactions. In addition, a virtual private network (VPN) is being established to act as a hub for electronic interchange of information, between CAS, Nagpur, and various civil and non-civil ministries. This will enable various principal accounts officers of government to transmit inter-government transactions to CAS electronically and receive confirmation advices instantly eliminating most of the reconciliation problems.

The Reserve Bank also provides safe custody facility; manages special funds like the Consolidated Sinking Fund, the Guarantee Redemption Fund, the Calamity Relief Fund, and the National Defence Scheme; Issues and manages bonds like relief bonds; and administers schemes for disbursal of pensions of central and state governments' employees through PSBs.

The objective of the debt management policy is raising resources from the market at the minimum cost while containing the refinance risk and maintaining consistency with the monetary policy objectives.

The RBI provides ways and means advances to both the central and state governments. The system of automatic monetization of budget deficit through creation of ad hoc treasury bills was phased out and subsequently abolished by an agreement with the central government in 1994. It was replaced with a new scheme—ways and means advances—to facilitate bridging of temporary mismatches in the central government's cash flows. With this, the Reserve Bank's autonomy to implement the tools of monetary policy increased.

The Reserve Bank introduced the primary dealer system in 1996 with a view to developing the government securities market. To reduce the cost of borrowing and refinancing risk, the bank has taken initiatives to consolidate loans, reissue existing loans and elongate the maturity structure of government loans. New debt instruments such as floating rate bonds (FRBs) have been issued to reduce the interest rate risk of holders of government securities. The Reserve Bank is actively pursuing the creation and development of the separate trading for registered interest and principal of securities (STRIPS) market.

The bank coordinates the borrowing programmes of the central and state governments. The large borrowing programme of the central government constraints the public debt management of the RBI. In order to facilitate the large borrowing programme of the central government and minimize the cost of public debt, the RBI has adopted the policy of combining auctions, private placements, and open market operations.

Both monetary policy and debt-management policy determine the composition of debt. Both these functions reinforce one another in maintaining an appropriate structure of long-term interest rates. These two functions should be separated and carried out independently to avoid conflict of interest in market operations. The committee on capital account convertibility recommended the separation of debt management from monetary management. The RBI has proposed amendment to the Reserve Bank of India Act, 1934, to take away the mandatory nature of management of public debt by the RBI and rest the discretion with the central government to undertake the management of the public debt either by itself or assign it to some other independent body, if it so desires.

Manager of Exchange Control The function of the Reserve Bank is to develop and regulate the foreign exchange market. The bank's role is to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India. The foreign exchange transactions are regulated under the Foreign Exchange Management Act, 1999.

The medium-term policy of the RBI is to develop the foreign exchange market in terms of depth and liquidity, enable the introduction of new instruments and pricing strategies and enhance integration of the foreign exchange market with other markets. The short-term policy aims at managing volatility and allowing demand and supply conditions to determine exchange rate movements in an orderly manner. The foreign exchange market in India comprises customers, authorized dealers (ADs), and the RBI. The ADs are essentially banks authorized by the RBI to do foreign exchange business. There are over 100 ADs operating in the foreign exchange market. The customer segment is dominated by large public sector units, such as IOC, ONGC, and BHEL, the Government of India, large private sector corporates, such as Reliance, TATA, and Larsen and Toubro.

The RBI undertakes two-way operations in the forex markets to even out lumps or lows in demand/supply and reduce volatility. Sometimes, during bouts of large capital inflows, the Reserve Bank com-

bines operations in the forex market with sterilization through open market operations, repos, bank rate, and changes in reserve requirements.

The Reserve Bank also enters periodically into foreign exchange transactions to prevent undue fluctuations in the exchange rate and to ensure orderly market conditions. The net intervention sales of the RBI generally coincided with conditions of excess demand in the market, while net intervention purchases coincided with surplus market conditions and contributed to reserve build up. The exchange rate system was transformed from a discretionary, basket-pegged system to a market determined unified exchange rate.

The Reserve Bank liberalized the foreign exchange market as well as the exchange and payments system for current and capital transactions with a view to (i) paving the way for a smooth transition to the Foreign Exchange Management Act (FEMA), 1999, from the Foreign Exchange Regulation Act (FERA), 1973, (ii) enabling a phased movement to capital account convertibility, and (iii) providing a hassle free and prompt exchange and payments system.

Indian companies were allowed to acquire foreign companies or make direct investment in joint ventures/wholly aimed subsidiaries abroad. A two-way fungibility in ADR/GDR issues of Indian Companies, subject to sectoral caps was allowed to improve the climate for foreign investment in India.

In order to develop the forex market, the Reserve Bank gave freedom to banks to (i) fix net overnight position limits and gap limits, (ii) initiate trading position in the overseas market, and (iii) determine the interest rates of NRI deposits and maturity period. Banks were permitted the use of derivative products for asset–liability management. Authorized dealers were allowed to borrow abroad. Foreign institutional investors (FIIs) were allowed to invest upto 49 per cent of the paid-up capital of Indian companies with the approval of the shareholders by a special resolution.

The Reserve Bank has published a Citizen's Charter to educate the public about the various facilities available for the use of foreign exchange. Customer service meetings are held every quarter in each of the bank's regional offices. Banks have also been advised to provide easy encashment facilities of foreign currency and travellers cheques at a number of locations, especially airports and other important tourist centres.

Issuer of Currency The RBI is entrusted with the function of note issue and currency management by the preamble to the Reserve Bank of India Act, 1934, and by the specific provisions of Section 3 of the act. It acts as the sole currency authority under Section 22 for the issue of bank notes on which there would be no stamp duty. It issues notes in the following denominations: ₹2, ₹5, ₹10, ₹20, ₹50, ₹100, ₹500, and ₹1,000. The Government of India issues one rupee coins and one rupee notes but they are put into circulation only through the RBI.

Currency management involves efforts to achieve self-sufficiency in the production of currency notes and coins with a judicious denomination mix, improvement in the efficiency of distribution networks and withdrawal and destruction of notes, technology upgradation and enhancement in the security features of currency notes.

The function of note issue and currency management is discharged through 18 regional Issue offices/sub-offices and a wide network of currency chests maintained by banks and government treasuries spread across the country.

Bank notes are printed at four notes presses, of which the Currency Note Press, Nasik, and Bank Note Press, Dewas, are owned by the central government and the presses at Mysore and Salboni are owned by the Bharatiya Reserve Bank Note Mudran Limited, a wholly-owned subsidiary of the Reserve Bank. The printing capacity at the four notes presses has been augmented with a view to meeting the demand–supply gap in currency. The RBI is exploring new channels for distributions of coins. Automatic coin dispensing machines have been commissioned at select regional offices of the Reserve Bank on a pilot basis to cater to low volume requirements.

The Reserve Bank has commissioned currency verification and processing systems at the Bhopal and Chandigarh issues offices to sort the notes into issuable and non-issuable characteristics, detect counterfeit notes, and destroy the non-issuable notes in an eco-friendly manner through shredding and briquetting systems.

The Reserve Bank has proposed to set up a currency museum in Mumbai with display and archival facilities of contemporary and ancient monetary artefacts and coins for preserving and educating the public about the currency history in India.

Developmental Role The Reserve Bank performs a wide range of promotional functions to support national objectives.

The RBI helped to set up a number of development financial institutions such as the Industrial Development Bank of India, the National Bank for Agriculture and Rural Development, the Industrial

- The RBI is entrusted with the management of foreign exchange reserves which include gold holding also.
- The RBI is entrusted with the responsibility of issuing currency and distributing coins.

Reconstruction Bank of India, the National Housing Bank, and, recently, the Infrastructure Development Finance Company Limited to provide project and infrastructure finance. It has also helped to set up the Unit Trust of India, the Discount and Finance House of India, and the Securities Trading Corporation of India to promote and foster financial markets.

Since 1991–92, the RBI has played an activist role of promoting financial sector reforms for attaining sustainable economic growth and stability.

The Reserve Bank has made priority sector lending mandatory for both public and private sector banks. As agriculture continues to provide productive employment opportunities for two-thirds of the population, a higher amount of credit is directed to agriculture. Banks have been advised to manage the rural credit delivery systems and processes to ensure a higher credit flow to small and medium scale industries. Micro-credit schemes to help the poor and artisans in rural areas have been initiated by the bank. It is striving to strengthen the cooperative credit structure to reap productivity and employment gains.

Banker to the Banks The bank's medium-term objective is to bring down the cash reserve ratio to three per cent of the banks demand and time liabilities. The scheduled banks maintain balances in their current account with the RBI mainly for maintaining the Cash Reserve Ratio (CRR) and as working funds for clearing adjustments. As the Reserve Bank maintains banking accounts of all scheduled banks, it has powers to collect credit information from banking companies and appoint any bank as its agent.

The central bank provides a variety of financial facilities and accommodations to scheduled banks. It takes care of temporary liquidity gaps in the banking system through refinancing schemes. It acts as lender of last resort to foster financial stability.

Conclusion

The RBI has done a commendable job as a monetary authority and regulator of the financial system. It has adopted the best international practices in dissemination of information and rationale of policies (*i.e.*, the extent of information disclosed helps market to make its own projections of interest rates). The bank has intervened in markets where necessary and allowed the market participants to build skills and gain maturity to accept the new system. It has adopted a consultative and participative approach to introduce changes. The Reserve Bank has managed foreign exchange resources effectively. The current level of foreign exchange reserves, which is around USD 385 billion, is adequate to meet the liabilities.

The RBI's policy actions have brought about macro economic stability to the economy. It now focuses on lowering the inflation rate, speedy resolving the issue of stressed assets and cleaning up the balance sheet and governance of the banks.

KEY TERMS

Capital Market

Reserve Bank of India and Monetary Policy

Securities and Exchange Board of India

Ombudsman

Securities Appellate Tribunal

SUMMARY

1. The Securities and Exchange Board of India was set up with statutory powers on February 21, 1992. The objectives defined by the ordinance for the board were (i) investor protection and (ii) promotion and development of the capital market while simultaneously regulating the functioning of the securities market.
2. Section 11(1) of the act casts upon the SEBI the duty to protect the interests of investors in securities and to promote the development of and to regulate the securities market through appropriate measures.
3. The orders of the SEBI under the securities laws are appealable before a securities appellate tribunal (SAT). The orders of the SAT are appealable before the supreme court.
4. The SEBI has powers to register and regulate all market intermediaries. It has powers to penalise them in case of violations of the provisions of the act, rules and regulations made thereunder. It can conduct enquiries, audits and inspection of all market intermediaries and adjudicate offences under the SEBI Act, 1992.
5. In order to make regulation more effective and responsive, the SEBI is contemplating to promote self regulatory organizations (SROs) in the Indian capital market. The SROs are expected to share the responsibility with the regulator in framing and administering regulations. The SEBI has framed the SEBI (Self Regulatory Organisations) Regulation, 2003.
6. The SEBI has introduced a variety of measures to protect the interests of investors. It issues fortnightly press releases, publishing the names of the companies against whom maximum number of complaints have been received. The Investor Grievances Redressal and Guidance Division of the SEBI assists investors who prefer to make complaints to the SEBI against listed companies. The SEBI set up a new institution in 2003 called the 'Ombudsman' for the capital market. It has encouraged forming of investors' associations.
7. The SEBI has drawn a comprehensive strategic action plan which envisages achievement of strategic aims laid down for: (a) investors (b) corporates (c) markets and (d) regulatory regime.

8. The SEBI has to balance between the costs of regulation and market development. There should be cross-border cooperation between various regulators and between regulators and industry.
9. The RBI is the central bank of our country. The preamble of the act states that, 'Whereas it is expedient to constitute RBI to regulate the issue of bank notes and the keeping of reserve with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage....'
10. The objectives of the RBI are price stability and ensuring adequate credit availability to finance economic activities for the benefit of the country. The bank is managed by a central board of directors and four local boards of directors. There are various acts governing the Reserve Bank functions, specific functions, banking operations, and individual institutions owned by the RBI.
11. The main functions of the Reserve Bank are: (i) to formulate, implement, and monitor the monetary policy; (ii) to prescribe broad parameters of banking operations within which the country's banking and financial system functions; (iii) to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India; (iv) to issue and exchange or destroy currency and coins not fit for circulation; (v) to perform a wide range of promotional functions to support national objectives; (vi) to perform merchant banking function for the central and the state governments; and (vii) to maintain banking accounts of all scheduled banks.
12. The RBI has done a commendable job as a monetary authority and regulator of the financial system. The RBI has adopted the best international practices in dissemination of information and rationale of policies.

REVIEW QUESTIONS

1. State the powers and functions of the SEBI.
2. How far has the SEBI been in a position to protect the interest of investors in securities market?

3. Discuss the role of RBI as a monetary authority.
4. Discuss the role of the RBI as a regulator and supervisor of financial system.

REFERENCES

1. *Business Today*, various issues.
2. *Capital Market*, various issues.
3. Chandrashekhar C. P. and Jayati Ghosh (2000), 'Monetary Policy, Post-Reforms', *Business Line*, September 5, p. 6.
4. Goodhart, Charles A. E., (2001), 'Whither Central Banking', in Raj Kapila and Uma Kapila (eds.), *India's Banking and Financial Sector in the New Millennium*, vol. 1, Academic Foundation, New Delhi.
5. Reddy, Venugopal Y. (2000), *Monetary and Financial Sector Reforms in India: A Central Banker's Perspective*, UBS Publishers Distributors Limited, New Delhi.
6. Reddy, Y. V. (2001), 'Development of Forex Market: Indian Experience', in Raj Kapila and Uma Kapila (eds.), *India's Banking and Financial Sector in the New Millennium*, vol. II, Academic Foundation, New Delhi.
7. Reserve Bank of India, *Annual Report*.
8. Reserve Bank of India, *Report on Currency and Finance*.
9. Reserve Bank of India, *Report on Trend and Progress of Banking in India*.
10. Securities and Exchange Board of India, *Annual Report*, 2000–01 and 2001–02.
11. Shekhar and Shekhar (1999), *Banking Theory and Practice*, Vikas Publishing House Pvt. Ltd., New Delhi.
12. Tarapore, S. S. (2001), 'Central Banking Policy Issues at the Frontiers', in Raj Kapila and Uma Kapila (eds.), *India's Banking and Financial Sector in the New Millennium*, vol. I, Academic Foundation, New Delhi.
13. Vasudevan, A. (2003), *Central Banking for Emerging Market Economics*, Academic Foundation, New Delhi.