

# Compliance with IOSCO Principles of Securities Regulation

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In February 2002, IOSCO released a new version of the *Objectives and Principles of Securities Regulation*, which supersedes the one released in September 1998. It aims to provide advice and a yardstick against which progress towards effective regulation can be measured. IOSCO members, including SEBI, through their endorsement to these principles, intend to use their best endeavours within their jurisdiction to ensure adherence to these principles. The extent of compliance of the Indian Securities Market Regulation with these principles is presented in this paper, a perusal of which indicates that India has almost complied with all the thirty principles.

## A. Principles relating to the Regulator

*1. The responsibilities of the regulator should be clear and objectively stated. This requires a clear definition of responsibilities, preferably set out by law; strong cooperation among responsible authorities through appropriate channels; and adequate legal protection of regulators and their staff acting in bona fide discharge of their functions and powers. Any division of responsibility should avoid gaps and inequities in regulation.*

This has been achieved to a large extent through the SEBI Act, 1992, which established SEBI and clothed it with responsibilities to protect the interest of investors and to promote the development of and to regulate the securities market. SEBI administers the Depositories Act, 1996. SEBI also exercises powers relating to securities market under the Securities Contracts (Regulation) Act, 1956 and the Companies Act, 1956 concurrently with Central Government. The areas of responsibility among SEBI, RBI, DEA and DCA

have been clearly specified in the Acts, and notifications issued thereunder. For example, section 55A of the Companies Act, 1956 divides the responsibility between DCA and SEBI. Similarly, a notification issued under the SCRA in 2000 demarcates areas between RBI and SEBI in respect of Government securities. In order to ensure coordination among regulators, the SEBI board comprises of representatives of RBI, DEA and DCA. The High Level Committee (HLC) on Capital Markets, consisting of heads of these regulators and also Insurance Regulatory and Development authority, coordinates securities market regulations. The regulator, and its members, officers and other employees enjoy legal protection for their *bona fide* acts in discharge of their functions and powers.

However, greater clarity in SEBI's regulatory authority and responsibilities is desirable. Fragmentation of the regulatory authority and responsibilities among Registrar of Companies (ROC), DEA, RBI and SEBI create confusion among the regulated.

*2. The regulator should be operationally independent and accountable in the exercise of its functions and powers. Independence is enhanced by a stable source of funding for the regulator. Accountability implies: a regulator that operates independently of sectoral interests; a system of public accountability of the regulator; and a system of permitting judicial review of decisions of the regulator.*

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SEBI, the regulator for securities market, is an independent body established under the SEBI Act, 1992. It has been vested with authority to discipline market participants and develop markets without any recourse to Government. In the matters of policy only, Government can issue directions to SEBI. In cases of grave emergencies or in public interest, SEBI can be superceded by the Central Government. The regulations framed by SEBI and its annual report providing an account of its activities, policies and programmes are laid before Parliament through Central Government. The orders of SEBI can be appealed before Securities Appellate Tribunal. Appeals against the orders of Securities Appellate Tribunal can be preferred before the Supreme Court. The jurisdiction of civil courts is expressly barred.

SEBI has been empowered to levy fees and other charges for the performance of its functions. It has a general fund to which all grants, fees, charges are credited. The accounts are audited by the Comptroller and Auditor General of India and the audited accounts and the audit report are laid before the Parliament. It is exempted from any tax in respect of its wealth, income, profits or gains. During its initial days, Central Government had provided an interest free loan which is being repaid by SEBI from its fund. The penalties levied under the SEBI Act are credited to the Consolidated Fund of India.

*3. The regulator should have adequate powers, proper resources and the capacity to perform its function and exercise its powers. The regulator should have powers of licensing, supervision, inspection, investigation and enforcement and also access to adequate funding.*

SEBI's regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. All market intermediaries are registered and regulated by SEBI. They are also required to appoint a compliance officer who is responsible for monitoring compliance with securities laws and for redressal of investor grievances. It has powers of licensing, supervision, inspection, investigation and

enforcement and to issue directions, impose monetary penalty, suspend/cancel certificates of registration, launch prosecution etc.

The SEBI (Amendment) Act, 2002 enhanced powers of SEBI substantially in respect of inspection, investigation and enforcement. SEBI can (i) call for information and record from any authority, including statutory authorities, in respect of transactions in securities under investigation, (ii) conduct inspection of any intermediary, person associated with securities market and listed company, (iii) suspend the trading of a security in a recognised stock exchange, (iv) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities, (v) impound or retain the proceeds or securities in respect of any transaction under investigation, (vi) attach for a period not exceeding one month, one or more bank account(s) relating proceeds involved in violation, (vii) direct any person not to dispose of assets forming part of transaction under investigation, (viii) prohibit issue of any offer document, (ix) specify the requirements of listing and transfer of securities, (x) issue a cease and desist order to any person. The investigating authority appointed by SEBI can enter a place, search the place and seize documents and records considered necessary for investigation.

SEBI meets its expenditure through the fees collected from the intermediaries registered with SEBI and for filing of offer documents with SEBI. It is not liable to pay any tax in respect of its wealth, income, profits or gains derived.

Central Government appoints Chairman and other members who are persons of ability, integrity and standing. SEBI, in turn, appoints professionals in management, economics, accountancy and law. SEBI has a few standing committees such as Primary Market Advisory Committee, Secondary Market Advisory Committee, Legal Advisory Committee etc. to provide inputs for its policy making. Besides, specific expert committees are appointed to guide SEBI on specific issues.

*4. The regulator should adopt clear and consistent regulatory processes. The regulator should have*

*a process for consultation with the public including the regulated, publicly disclose its policies, observe standards of procedural fairness and have regard to the cost of compliance with the regulations. It should also play an active role in the education of investors and other participants in the capital market.*

SEBI has substantial powers of subordinate legislation. It has framed regulations to regulate conduct of all kinds of intermediaries and for orderly development of market. These regulations contain substantive as well as procedural laws. The rules, regulations, guidelines, circulars etc. are put on the SEBI website for easy public access. The regulations framed by SEBI are published in the Gazette of India and also laid before each House of the Parliament. They are reviewed by the Parliamentary Committee on Subordinate Legislation.

SEBI is transparent in making regulation. It has instituted a consultative process before framing regulations. All reports/concept papers/policy proposals are posted on SEBI website for comments from market participants and public. The comments received are considered before finalising regulations. This has profound impact not only in terms of receiving valuable inputs, but also building public opinion before framing regulations/guidelines. This also provides 3/4 months advance intimation to the market and regulated of likely changes.

SEBI is consistent and transparent in administration of regulations. All orders passed by SEBI are reasoned orders and passed following principles of natural justice. These are placed on SEBI website for public scrutiny. The order of SEBI is subject to review by Securities Appellate Tribunal.

SEBI is mandated to promote investors' education. It has launched an intensive investor education exercise aimed at protecting the interests of investors in securities market. It helps the investors in redressal of complaints regarding securities investments. It also disseminates through its website and press briefings the policy develop-

ments and enforcement actions for the information of investing community. It has published a number of booklets on policy and market developments for education of the investors. It also registers and supports investor associations engaged in education of investors and redressal of investor complaints. At the end of March 2002, nine Investors Associations were registered with SEBI. These associations are eligible for reimbursement of a specified sum from SEBI to meet their one time capital expenditure towards setting up of computer terminals and installation of database on companies and internet connectivity. They are also entitled to reimbursement of expenditure for organising seminars for investor education on capital market and expenditure on publication and circulation of material on investor education.

*5. The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality. They should be given clear guidance on conduct relating to conflict of interest, appropriate use of information obtained in course of duty, observance of confidentiality and secrecy provisions, observance of procedural fairness, etc.*

A code of conduct has been specified in the service regulations of SEBI. The staff members are required to undertake and declare fidelity and secrecy in terms of the regulations. They are prohibited from investing in equity and equity related instruments and speculating in securities/commodities. The employees of stock exchanges follow a code of ethics.

## **B. Principles of Self-Regulation**

*6. The regulatory regime should make appropriate use of Self-Regulatory Organisations (SROs) that exercise some direct oversight responsibility for the respective areas of competence to the extent appropriate to the size and complexity of the markets. SROs should undertake those regulatory responsibilities which they have incentive to perform efficiently.*

SEBI is mandated to promote and regulate SROs. The law permits plurality of structures, models,

styles, etc. of SROs. However, these have not developed appreciably. Most of the association of intermediaries like, AMFI, AMBI, RAIN do not exactly regulate, though promote the activities of their members. The stock exchanges are SROs in true sense. They make bye laws, rules and regulations for their members and for regulating the conduct of respective members and contracts in securities. They issue licence to the members for trading in securities and discipline them. They provide mechanism for resolution of dispute between the members *inter se* and between members and client through arbitration.

The current ownership and governance structure of many stock exchanges do not seem adequate to deal with conflict of interest objectively. A few exchanges, on line with international trend, are working on to demutualise to avoid conflict of interest.

*7. SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities. The regulator must ensure that no conflict of interest arises because of SRO's access to valuable information about market participants. The conflict may be acute when SRO is responsible both for supervision of its members and regulation of the market sector. Where powers of a SRO are inadequate to address a particular misconduct or conflict of interest necessitates it, the regulator should take over the responsibility. SROs should also follow similar professional standards as expected of the regulator.*

The exchanges are under the direct oversight of SEBI, which periodically issues guidelines and directions to ensure safety, integrity and improvement of the market. SEBI also approves and amends the rules of SROs and inspects them to ensure that the rules are adhered to. SEBI supercedes the governing boards and appoints administrators to take over the affairs of the exchanges where misconduct or conflict of interest necessitates it.

To deal with conflict of interest in the stock exchanges, SEBI has mandated that the brokers

shall constitute less than 50% of the Governing Board of the exchanges and cannot be elected as Presidents, Vice-Presidents or Treasurers of the stock exchanges. A code of ethics has been laid down for the members of the Governing Board and employees of the exchanges. SEBI has approved a scheme for demutualisation of the stock exchanges.

### **C. Principles for the Enforcement of Securities Regulation**

*8. The regulator should have comprehensive inspection, investigation and surveillance powers. It should have power to require the provision of information, or to carry out inspections of business operations to ensure compliance with relevant standards.*

SEBI has powers to require the provision of information, or to carry out inspections to ensure compliance with prescribed standards. It can call for information and record from any authority, including statutory authorities, in respect of transactions in securities under investigation, and conduct inspection of any intermediary, person associated with securities market and listed company. While calling for information, it has the powers of a civil court in respect of discovery and production of records, summoning and enforcing attendance of persons and inspection of book/documents.

*9. The regulator should have comprehensive enforcement powers, including regulatory and investigative powers to obtain data/information, to impose administrative sanctions and/or seek orders from court, to initiate or refer matters for criminal prosecution, to suspend trading in securities, to enter into enforceable settlements etc. It is, however, not necessary that all aspects of enforcement of securities law be given to a single body.*

SEBI has powers of inspection, investigation and enforcement and to issue directions, impose monetary penalty, suspend/cancel certificates of registration, launch prosecution etc. It also has powers to obtain data, information, documents,

statements and record from persons involved or having access to information relevant to enquiry.

SEBI has comprehensive powers of inspection: it can undertake inspection, conduct inquiries and audits of stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and SROs. It may also undertake inspections of any book or register or other document or record of any listed company or a public company which intends to get its securities listed. The officers authorized by SEBI can inspect books of account and other books and papers of a company in respect of specified matters. It can appoint investigating authority to investigate the affairs of an intermediary or persons associated with the securities market. The investigating authority has vast powers, including power to call for information, search and seizure etc. The adjudicating officers appointed by SEBI can impose monetary penalties of a high magnitude upon adjudication. SEBI can issue appropriate directions to an intermediary or person associated with securities market and also to a company in respect of specified matters. It can pass an order requiring a person to cease and desist from committing or causing any violation. It can initiate prosecution proceedings under the SEBI Act, the Companies Act, the Depositories Act and the SCRA. It can suspend trading of any security in a recognized stock exchange.

The SAT or a court where proceedings are pending can compound an offence not punishable with imprisonment. The Central Government can grant immunity to any person on the recommendation by SEBI subject to certain conditions.

However, there is no provision to let off an offender who simply pays up without admitting or denying an offence.

*10. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program. The powers of regulator should be sufficient to ensure its effectiveness in cases of cross border misconduct. The regulator should require market intermediaries have in place policies and proce-*

*dures to prevent use of their business as a vehicle for money laundering.*

SEBI has established an effective and credible system of investigation, surveillance and enforcement in many areas including risk containment measures, market wide circuit breaker, development of stock watch system, suspension of intermediaries, prohibitive orders, etc.

The SEBI conducts inspection of intermediaries registered with SEBI every year. SEBI conducts inspection of the mutual funds, funds schemes and also of other market intermediaries such as brokers, custodians, registrars, merchant bankers, etc. It also conducts inspection or investigation of market intermediaries on receipt of any specific complaints against them. The intermediaries are required to appoint a compliance officer who is responsible for monitoring compliance with securities laws and for redressal of investor grievances.

Though the statute does not provide for specific mechanism for cooperation between SEBI and regulators overseas, SEBI has entered into MOUs with some of them for cooperation in dealing with cross border misconduct. SEBI is contemplating to mandate intermediaries to have mechanism to avoid their business being used for money laundering.

#### **D. Principles for Co-operation in Regulation**

*11. The regulator should have authority to share both public and non-public information with domestic and foreign counterparts. Domestic laws need to remove impediments to international cooperation.*

There is no specific provision in law which enables SEBI to share public and non-public information. Nor is there any provision prohibiting from entering into MOU with other regulatory authorities. However, SEBI has informal arrangements with DEA, DCA and RBI for sharing information. It can, however, call for information and record from any authority, including statutory authorities, in respect of transactions in securities under investigation. It has also entered into MOU with overseas regulators for sharing information.

*12. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.*

Government, RBI and SEBI have been sharing information regularly depending on need. SEBI has also arrangement to share information with stock market regulators of other countries. All actions/orders/policies are disseminated through its website.

*13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers. There should be arrangements which identifies the circumstances under which assistance may be sought, identification of the types of information and assistance that can be provided, safeguards of confidentiality of information transmitted, and a description of permitted uses of information.*

Powers of the regulator to assist foreign regulators or to enter into MOUs or other co-operation arrangements are not explicitly provided in the legislation. However, SEBI has arrangements for sharing of information with regulators overseas.

#### **E. Principles for Issuers**

*14. There should be full, timely and accurate disclosure of financial results and other information which is material to investors' decisions. Disclosures should be clear, reasonably specific and timely.*

The Companies Act, SEBI DIP Guidelines and the listing agreement of the exchanges require the issuers to make full, timely and accurate disclosure of material facts to enable investor to make informed decisions. Disclosure extends to material having bearing on price of security, people who have significant interest in or who seek control of company, etc.

The issuer is required to file with the regulator, a draft prospectus, for offering to public of any types of security. The regulator reviews the prospectus and may give its observations, if any, on the draft prospectus within 21 days. It can also prohibit issue of any issue document. The final

prospectus is registered with the Registrar of Companies and printed copies of the registered prospectus are furnished to the regulator. The issuer is required to publish and distribute this prospectus 10 days prior to opening of the issue. The prospectus contains information on description of the securities offered, description of the issuer's business and property and the legal environment in which the company operates, details of related/affiliates party transactions and their purpose, description of the company's financial condition and results of operations, audited financial statements updated to 6 months prior to the date of opening of the issue, etc. The issuer as well as the concerned merchant banker(s) takes legal responsibility for the contents in the prospectus, except for the expert opinion for which the experts are responsible. There are different disclosure requirements for different types of securities or according to the different circumstances in which securities are issued. For debt securities, for example, credit rating, name of Trustees, rights and obligations of trustees and rights of debt-security holders, details of assets to be charged/pledged are disclosed. If the information is such that its disclosure may mislead the investors (as in the case of incomplete negotiations), offering may be allowed without such disclosure. There are restrictions on, or disclosure requirements with respect to, the content of information that an issuer discloses outside the prospectus during an offering, such as in advertisements, 'roadshows' materials or on the issuer's internet website. No advertisement or other material during the issue period shall contain any information which is extraneous to the prospectus. Such restrictions also extend to those acting on behalf of the issuer in connection with the offering, such as the underwriters or advisors.

All public issues are mandatorily listed. The company signs a standardized listing agreement with the exchange(s). The listing agreement stipulates the disclosures to be made and the corporate governance practices to be followed by all listed companies. They are subject to a general and continuing obligation to disclose promptly any material information that affect the price of their

securities. The specific events that must be disclosed are declaration of dividend, issue of rights shares or bonus shares, any action which will result in the redemption, cancellation or retirement in whole or in part of any securities listed on the stock exchange, all events which will have a bearing on the performance/operations of the issuer as well as price sensitive information, revision in ratings, substantial acquisition of securities in the issuer, etc. The Exchange monitors such compliance. Failure to comply with the requirements invites suspension of trading of the security for a specified period, or withdrawal/delisting, in addition to penalty prescribed in the SCRA.

The listing agreement requires all listed companies to publish on an annual basis financial statements audited by an external auditor and unaudited quarterly results. Statements of variations between projected and actual profitability also have to be published. They are required to furnish segment wise revenue, results and capital employed along with the quarterly unaudited financial results and publish Consolidated Financial Statements in the annual report in addition to the individual financial statements. They also make disclosures in compliance with the Accounting Standard on "Related Party Disclosures" in the annual reports. They disclose the audit qualifications along with the audited financial results in addition to the explanatory statement as to how audit qualifications in respect of the audited accounts of the previous accounting year have been addressed in the financial results. They are required to give prior notice of at least 7 days to the stock exchanges about the board meetings at which the proposal for buy back of securities is to be considered. It requires them to intimate the stock exchanges within 15 minutes of the closure of the board meeting about the decision on buy back of securities.

SEBI has set up an Electronic Data Information Filing and Retrieval (EDIFAR) System to facilitate an electronic filing of certain information by listed companies. This is an automated system for filing, retrieval and dissemination of time sensi-

tive corporate information. The primary objective is to centralise the information and accelerate its dissemination and thereby enhance transparency and efficiency for the benefit of various classes of market participants. The companies are required to file (i) financial statements comprising of balance sheets, profit and loss account and full version of annual report, half-yearly financial statements including cash flow statements and quarterly financial statements, (ii) corporate governance reports, (iii) shareholding pattern statement, (iv) statement of action taken against the company by an regulatory agencies and (v) such other statement, information or report as may be specified by SEBI from time to time.

Continuous disclosure of price sensitive information also has been mandated by the Code of Corporate Disclosure Practices laid down in the Prohibition of Insider Trading Regulations.

*15. Holders of securities in a company should be treated in a fair and equitable manner.*

They are treated equitably. SEBI Takeover Code, the Companies Act, the buy back and delisting regulations contain provisions for protection of minority shareholders. The takeover code requires an acquirer to make a public offer to acquire at least 20% of shares in case it acquires shares/voting rights of a listed Indian company in excess of certain threshold limits. In case of public shareholding falling to 10% or less after a public offer, the acquirer has to either disinvest to increase the public holding to satisfy listing requirements or make another public offer for the balance and then seek delisting of the shares. The issuers are also required to disclose publicly the identity and ownership position of major shareholders. Additionally, there is a trigger of 5% ownership which requires an intimation to the company within 4 days by the acquirer of the acquisition and subsequent disclosures by the company to the stock exchanges. The Companies Act, 1956 has provisions to protect minority against oppression and mismanagement and empowers them to initiate legal proceedings or cause to convene a meeting of the members of the company.

*16. Accounting and auditing standards should be of a high and internationally acceptable quality.*

Financial statements are prepared and audited in accordance with the provisions of the Companies Act, 1956. Under the listing agreement, companies are required to mandatorily comply with all the accounting standards issued by ICAI from time to time. A National Advisory Committee on Accounting Standards has been set up by Government to advise Government on the formulation and laying down of accounting policies and accounting standards for adoption by companies.

**F. Principles for Collective Investment Schemes**

*17. The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme. The criteria may include honesty and integrity of the operator, competence to carry out the functions and duties of a scheme operator, financial capacity, internal management procedures, etc.*

Eligibility criteria in terms of net worth, track record, internal management procedure have been specified in Regulations for Mutual Funds, Collective Investment Schemes and Venture Capital Funds. The regulations provide for registration and authorisation of scheme, inspection to ensure compliance, investigations and remedial action.

*18. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.*

Structure of collective investment schemes have been specified in respective regulations. Mutual funds and Venture Capital funds can be trusts or companies, while CIS schemes can be floated only by companies. The roles and responsibilities of asset management companies have also been clearly specified.

*19. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.*

Disclosure standards including format of offer document have been specified in the respective regulations. These aim to provide investors with sufficient information to know if the scheme is an appropriate investment vehicle for him and provide information on a timely basis in an understandable manner. The FAQs on the Regulations have been posted in the SEBI website for public guidance.

*20. Regulation should ensure that there is a proper and disclosed basis for assets valuation and the pricing and the redemption of units in a collective investment scheme.*

Specific provisions have been made in respective regulations for asset valuation and pricing of units. For example, applicable load as a percentage of NAV is added to NAV to calculate sale price and is subtracted from NAV to calculate repurchase price. The disclosure relating to these are made in new offer document and while updating existing offer documents.

**G. Principles for Market Intermediaries**

*21. Regulation should provide for minimum entry standards for market intermediaries. It should reduce the risk to investors of loss caused by negligent or illegal behaviour or inadequate capital. The licensing process should require a comprehensive assessment of the applicant and the licensing authority should have power to withdraw or suspend the license. The regulator should ensure that the public have access to relevant information concerning the licensee.*

The eligibility criteria have been prescribed for the intermediaries by SEBI as well as SROs, which need to be fulfilled before granting registration. For example, a broker is admitted to membership of an exchange in terms of the provisions of the Securities Contracts (Regulation) Act, 1956, the SEBI Act, 1992, the rules, circulars, notifications, guidelines, etc. prescribed thereunder and the bye laws, rules and regulations of the concerned exchange. No stock broker or sub-broker is allowed to buy, sell or deal in securities, unless he or she holds a certificate of registration granted by SEBI. A broker/sub-broker complies with the

code of conduct prescribed by SEBI. The standards for admission stress on factors, such as, corporate structure, capital adequacy, track record, education, experience, etc. and reflect a conscious endeavour to ensure quality broking services. The brokers are subject to limits on trading volumes in a day as well as exposure at any point of time. An on-line monitoring and surveillance system monitors exposure of the brokers on a real time basis. They are not allowed to commingle their assets with the assets of clients. In case of their failure to meet their settlement obligations towards settlement agency or clients, there are arrangements in the form of settlement guarantee fund/investor protection fund to make up for their inability. There is an established procedure provided in the regulations for granting as well as revoking license of the intermediaries. The intermediaries are required display their registration certificate in their places of operation. The details of registered intermediaries are available on the website of the regulator and SROs. The penal actions taken against intermediaries are also disseminated through website of SEBI.

*22. There should be initial and on going capital and prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake. The regulations should provide for right to inspection, investigation, enforcement, discipline and revocation of license.*

The entry norms for the intermediaries provide for the capital clause as well as the maintenance of the same on a continuing basis. The risk assumed by intermediaries are related to their capital adequacy. The SEBI Regulations as well as the rules of the SROs provide for inspection, investigation, enforcement and disciplinary measures including revocation of licence.

*23. Market intermediaries should be required to comply with standards for internal organisations and operational conduct that aim to protect the interest of clients, ensure proper management risk, and under which management of the intermediary accepts primary responsibility of these matters.*

All listed companies and organisations associated with securities market including the intermediaries, asset management company, trustees of mutual funds, self-regulatory organisations, stock exchanges, clearing house/corporations, public financial institutions, professional firms such as auditors, accounting firms, law firms, analysts, consultants etc. assisting or advising listed companies are required to frame a code on internal procedure and conduct. These entities shall abide by the Code for Corporate Disclosure Practices specified in the regulations. Regulations for intermediaries specify a code of conduct, which contains provisions to protect the interest of the clients and ensure proper management of risk. An intermediary is expected to observe high standards of integrity and fair dealing and act with due care and diligence in the best interests of its customers and integrity of the market. Every market intermediary appoints a compliance officer to ensure compliance with the prescribed standards.

*24. There should be a procedure for dealing with the failure of a market intermediary in order to minimise damage and loss to investors and to contain systemic risk.*

There are arrangements like Settlement/Trade Guarantee Funds and the Investor Protection Funds for dealing with the eventuality of failure by market intermediaries. The regulations provide for maintenance and inspection of records to ensure compliance with relevant requirements, investigatory and enforcement remedies, fair and expeditious process leading to discipline, etc. SEBI and SROs have developed mechanism for resolution of investor complaints.

## **H. Principles for Secondary Market**

*25. The establishment of trading systems including securities exchanges should be subject to regulatory authorisation and oversight. The relevant factors for authorisation could be operator competence, operator oversight, admission of products to trading, admission of participants to trading, provision of trading information, etc.*

The trading systems (stock exchanges) are regulated by a process of recognition and continued supervision by Central Government/SEBI under the SCRA.

*26. There should be on-going regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants. Approval of trading system should be re-examined or withdrawn by the regulator when considered necessary.*

Fair and equitable rules have been framed by stock exchanges, SEBI and Central Government under the SCRA and SEBI Act for supervision of trading system and stock exchanges. The amendments to rules of the trading system are provided or approved by SEBI. Approval of the trading system may be withdrawn by the regulator when it is determined that the system is unable to comply with the conditions of approval or with laws/regulations.

*27. Regulation should promote transparency of trading.*

It has been mandated that all trades have to be executed only through on-line automated price and order matching mechanism of stock exchanges. It enables the market participants to see the full market on real time, making the market transparent. The information relating to trading is available to public on real time basis.

*28. Regulation should be designed to detect and deter manipulation and other unfair trading practices. The regulation should prohibit market manipulation, misleading conduct, insider trading and other fraudulent or deceptive conduct which may distort price discovery system, distort prices and unfairly disadvantage investors. Such conduct may be addressed by direct surveillance, inspection, reporting, product design requirements, position limits, market halts, etc.*

Regulations have been framed to prevent insider trading, and fraudulent and unfair trade practices. These have been expressly prohibited under the SEBI Act and penalties for such offences

extend upto Rs. 25 crore or three times the illegal profits made whichever is higher. The punishment on prosecution is also exemplary being imprisonment upto 10 years, fine upto Rs. 25 crore or both. Stock Exchanges have set up surveillance departments which continuously monitor trading and launch inquiry whenever unusual and potentially improper trading occurs. The on-line surveillance mechanism also generates various alerts/reports on any price/volume movement of securities not in line with past trends/patterns. For this purpose the exchange maintains various databases to generate alerts. Alerts are scrutinised and if necessary taken up for follow up action. Open positions of securities are also analysed. Besides this, rumours in the print media are tracked and where they are price sensitive, companies are contacted for verification. Replies received are informed to the members and the public. It has been mandatory for all brokers to use unique client code for all clients. The brokers are subject to limits on trading volumes in a day as well as exposure at any point of time. An index based market-wide circuit breaker system applies at three stages of the index movement either way at 10%, 15% and 20%. These circuit breakers bring about a coordinated trading halt in all equity and equity derivatives markets nationwide. The breakers are triggered by movement of either S&P CNX Nifty or Sensex whichever is breached earlier. As an additional measure of safety, individual scrip-wise price bands of 20% either way have been imposed for all scrips, including debentures and warrants.

*29. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.*

Limits have been specified on turnover and exposure in relation to the base minimum capital which a member keeps with exchange/clearing corporation. The exposure of members is monitored on real time basis. Members exceeding the limits are automatically and instantaneously disabled by the trading system. The clearing corporation assumes counter-party risk of each member. In the event of a failure of a trading member to meet settlement obligations, the settlement

guarantee fund is used for successful completion of settlement.

*30. Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.*

The clearing corporation and the settlement guarantee fund guarantee settlement of net obliga-

tions of the members, reducing counterparty risk. Oversight over the clearing and settlement of securities transactions is maintained by obtaining regular reports from the clearing corporations/ clearing houses of the stock exchanges. Also routine inspections are carried out to ensure that guidelines/regulations and procedures are properly followed.