

Understanding the SEBI (Amendment) Act, 2002

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The authorities have been quite sensitive to requirements of development of securities market, so much so that during last decade, there were seven special legislative interventions, including two new enactments, namely the SEBI Act, 1992 and the Depositories Act, 1996, to accommodate developments in the securities market. The SEBI Act and the Securities Contracts (Regulation) Act (SCRA), 1956 were amended five times each in the last decade. The developmental need was so urgent at times that the last decade witnessed four ordinances relating to securities laws. Besides, a number of other legislations (the Income Tax Act, the Companies Act, the Indian Stamps Act, the Bankers' Book Evidence Act, the Benami Transactions (Prohibition) Act etc.) were also amended. These indicate importance of reforms in securities laws for development and regulation of the securities market and protection of investors in securities.

The legal reforms began with enactment of the *SEBI Act, 1992*, which established SEBI with statutory responsibility to (i) protect the interests of investors in securities, (ii) promote the development of the securities market, and (iii) regulate the securities market. This was followed by repeal of *the Capital Issues (Control) Act, 1947* in 1992 which paved way for market determined allocation of resources. Then followed *the Securities Laws (Amendment) Act in 1995*, which extended SEBI's jurisdiction over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. It empowered SEBI to appoint adjudicating officers to adjudicate a wide range of violations and impose monetary penalties and set up Securities Appellate Tribunal (SAT) to hear

appeals against the orders of the adjudicating officer. Then followed *the Depositories Act in 1996* to provide for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security. It made securities of public limited companies freely transferable subject to certain exceptions; dematerialised the securities in the depository mode; and (c) provided for maintenance of ownership records in a book entry form. It also exempted stamp duty in respect of transactions in demat securities. *The Securities Laws (Amendment) Act, 1999* was enacted to provide a legal framework for trading of derivatives of securities and units of collective investment schemes. *The Securities Laws (Second Amendment) Act, 1999* was enacted to empower SAT to deal with appeals against orders of SEBI under the Depositories Act and the SEBI Act, and against refusal of stock exchanges to list securities under the SCRA. *The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002* included security receipts issued by securitisation and reconstruction companies within the ambit of the 'securities' under the SCRA. The latest intervention is *the SEBI (Amendment) Act, 2002* which enhanced powers of SEBI substantially in respect of inspection, investigation and enforcement. Another legislative intervention is on anvil to amend the SCRA to provide for demutualisation of stock exchanges, as indicated by the Finance Minister in his budget speech for 2003-04.

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While responding to a calling attention motion in early March 2001 by the leader of the opposition on extreme volatility in the stock markets, Finance Minister had proposed legislative changes to further strengthen the provisions in the SEBI Act, 1992 to ensure investor protection. In pursuance to this, the *SEBI (Amendment) Act, 2002* was enacted to make provisions to (i) strengthen the Securities Appellate Tribunal (SAT) and the SEBI in terms of organisational structure and institutional capacity, (ii) enhance powers of SEBI substantially, particularly in respect of inspection, investigation and enforcement, and (iii) strengthen penal framework by prescribing a few more offences in the SEBI Act and enhancing the monetary penalties for various offences. This paper attempts to understand these provisions.

A look at the *Statement of Objects and Reasons* attached to the *SEBI (Amendment) Bill, 2002* may be helpful to better appreciate and understand the *SEBI (Amendment) Act, 2002*. It reads: "...Recently some shortcomings in the legal provisions of the SEBI Act, 1992 have been noticed, particularly with respect to inspection, investigation and enforcement. Currently the SEBI can call for information, undertake inspections, conduct enquiries and audits of stock exchanges, mutual funds, intermediaries, issue directions, initiate prosecution, order of suspension or cancellation of registration. Penalties can also be imposed in case of violations of the provisions of the Act or rules or the regulations. However, the SEBI has no jurisdiction to prohibit issue of securities or to preventing siphoning of funds or asset stripping by any company. While SEBI can call for information from intermediaries, it cannot call for information from any bank and other authority or board or corporation established or constituted by or under any Central, State or Provincial Act. The SEBI cannot retain books of account, documents, etc. in its custody. Under the existing provisions contained in the SEBI Act, 1992, the SEBI cannot issue commissions for the examination of witnesses or documents. Further, the SEBI has pointed out that existing penalties are too low and do not serve as effective deterrents. At present, under section 209A

of the Companies Act, 1956, the SEBI can conduct inspection of listed companies only for violations of the provisions contained in sections referred to in section 55A of that Act but it cannot conduct inspection of any listed public company for violation of the SEBI Act or rules and regulations made thereunder...". Obviously, the *SEBI (Amendment) Act, 2002* tries to remove these deficiencies. Let us look understand the specific provisions.

I. Strengthening Organisations

Before the Amendment Act, 2002, SEBI consisted of a Chairman and five other members to be appointed by the Central Government. Of the five members, three represented Ministry of Finance, Ministry of Law and the Reserve Bank of India. In view of the growing importance of the securities markets in the economy and the responsibilities of the SEBI under the SEBI Act, it was necessary to strengthen it further. The Amendment Act seeks to strengthen it by increasing the number of members from five to eight, providing for at least three whole-time members and substituting the representation of the Ministry of Law by the Ministry dealing with administration of the Companies Act, 1956. SEBI would now benefit from the expertise of three additional members, full time attention of at least three additional members, and the representation of the Department of Company Affairs whose operations have bearing on the working of the securities market. This is parallel to established securities market regulators such as the Securities and Exchange Commission (USA) which has five full-time Commissioners and the Financial Services Authority (FSA) which has fourteen members, including three full time members.

The SEBI Act provides for establishment of one or more Securities Appellate Tribunals (SATs) to hear appeals against the orders of SEBI. Prior to this amendment, the SAT consisted of one person called the Presiding Officer. Since it hears appeals against the orders of SEBI which is very high powered statutory body and which is strengthened further by this amendment, and in the interests of objectivity and potential workload, it was necessary to strengthen the SAT. The Amendment Act

converted the SAT to a three member body consisting of a presiding officer and two other members to be appointed by the Central Government. It enhanced the level of the SAT by prescribing higher eligibility criteria for appointment of the presiding officer and the members. It provided that only a sitting or retired judge of the Supreme Court or a sitting or retired Chief Justice of a High Court would be eligible to be appointed as presiding officer of the SAT and such appointment shall be made in consultation with the Chief Justice of India or his nominee. The presiding officer will hold the office for a term of five years or until he attains the age of sixty eight years, whichever is earlier. It further provided that a person shall be qualified for appointment as a member of the SAT if he is a person of ability, integrity and standing, who has shown capacity in dealing with problems relating to securities market and has qualification and experience of corporate law, securities laws, finance, economics or accountancy. A member of SAT can hold office for a term of five years or until he attains the age of sixty two years, whichever is earlier. A member of SEBI or a senior officer of SEBI at the level Executive Director shall not be eligible to be appointed as a member or Presiding Officer of the SAT during the tenure of his office with the SEBI or within two years from the date on which he ceases to hold such office. This will avoid conflict of interest in the sense that an official of SEBI responsible for a particular order should not uphold the order as a member of the SAT. Any person aggrieved by any decision or order of the SAT can prefer an appeal before the Supreme Court (it was High Court earlier) only on a question of law.

II. Empowering SEBI

The Amendment Act conferred on SEBI a lot of additional powers to deal with any kind of market misconduct and protect the investors in securities. For example, it can now prevent issue of any offer document if it has any misgivings about the antecedents of promoters/companies concerned. Under the amended provisions, SEBI can now:

- (i) call for information and record from any bank or any other authority or board or cor-

poration established or constituted by or under any Central, State or Provincial Act in respect of transactions in securities which are under investigation or enquiry by SEBI;

- (ii) conduct inspection of any book or register or other document or record of any listed public company; If, however, the said company is not a registered intermediary, SEBI can inspect only if it has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.
- (iii) issue commissions for examination of witnesses or documents while exercising powers to call for information or conduct inspection;
- (iv) take any of the following measures in the interest of investors or securities market, either pending investigation or inquiry or on completion of such investigation or inquiry, but after giving an opportunity of hearing—
 - (a) suspend trading of a security in a recognised stock exchange;
 - (b) restrain persons from accessing the securities market and prohibit any person associated with securities market from buying, selling or dealing in securities;
 - (c) suspend any office bearer of a stock exchange or self-regulatory organisation from holding such position;
 - (d) impound and retain the proceeds or securities in respect of any transaction which is under investigation;
 - (e) attach for a period not exceeding one month, with the prior approval of a magistrate, 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
 - (f) direct 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 case of a listed public company, which is not a registered intermediary, the SEBI can exercise its powers of impounding and retaining proceeds or securities, attaching bank accounts or directing non-alienation of assets only if it has reasonable grounds to believe that the company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.

- (v) prohibit, for the protection of investors, any company from issuing any offer document including a prospectus or advertisement soliciting money from the public for the issue of securities, and specify the conditions subject to which such offer documents can be issued;
- (vi) specify the requirements for listing and transfer of securities; and
- (vii) pass an order requiring a person to cease and desist from committing or causing a particular violation of any of the provisions of the SEBI Act, or any rules or regulations made thereunder, if it finds, after an enquiry, that such person has violated or likely to violate the said provisions. In case of a listed public company, which is not a registered intermediary, the SEBI can exercise this power only if it has reasonable grounds to believe that the company has been indulging in insider trading or market manipulation.

In addition, SEBI has been armed with powers of investigation. If SEBI has reasonable ground to believe that the transactions in securities are being dealt in a manner detrimental to the investors or the securities market or any intermediary or any person associated with the securities market has violated any of the provisions of the SEBI Act or the rules or the regulations made or directions issued by SEBI thereunder, it can appoint a person as investigating authority to investigate the affairs of such intermediary or persons associated with the securities market. In order to provide re-

quired teeth to the investigating authority, it has been provided that any person failing to produce any document or information to the investigating authority or appear before the investigating authority or sign the notes of examination shall be punishable with imprisonment or with fine or with both. Further, if the investigating authority has reasonable ground to believe that the books, registers or documents or records of or relating any intermediary or any person associated with securities market in any manner, may be destroyed, mutilated, altered or falsified or secreted, he can obtain an authorisation from a Magistrate to (a) enter the place or places where such books or records are kept, (b) search the place or places and (c) seize the books or records, as considered necessary for investigation. Such authorisation would not be available to investigating authority in case of books or documents of any listed public company, which is not a registered intermediary, unless such company indulges in insider trading or market manipulation. Such search and seizure shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973. The investigating authority can keep such record and documents in his custody till the conclusion of the investigation.

III. Strengthening Penal Framework

Section 11 of the SEBI Act, 1992 enjoins upon SEBI to take measures to provide for prohibiting insider trading in securities and fraudulent and unfair trade practices relating to securities markets, regulating substantial acquisition of shares and takeover of companies etc. However, these terms were not explained and these activities were not expressly forbidden in the Act. In order to clarify the matter, the Amendment Act added a new chapter, Chapter VA, relating to prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control and empowered SEBI to regulate these practices by regulations. It now provides that it shall be unlawful for any person, directly or indirectly—

- (a) to use or employ any manipulative or deceptive device or contrivance in contravention

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- of regulations in connection with the issue, purchase or sale of any securities listed or proposed to be listed;
- (b) to employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed;
- (c) to engage in any act, practice, course of business which operates or would operate as a fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed, in contravention of the provisions of the Act, or the rules or the regulations made thereunder;
- (d) to engage in insider trading;
- (e) to deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of
- (f) to acquire control or securities beyond threshold limit of a company, whose securities are listed or proposed to be listed, in contravention of the regulations made under the SEBI Act.

In order to equip SEBI with wherewithal to bring all types of culprits to book to ensure orderly development of market, the Amendment Act prescribed a few more offences along with associated penalties and enhanced penalties for the offences committed under the Act from a maximum of Rs. 5 lakh to a maximum of Rs. 25 crore or three times the amount of profit made out of violation, whichever is higher, and from imprisonment of one year to 10 years. Such enhanced punishment should serve as enough deterrent for the potential violators of law. Table 1 illustrates the changes in this regard.

Table 1: Scheme of Penalties envisaged under the SEBI (Amendment) Act, 2002

Section	Violations	Penalty	
		Before Amendment	After Amendment
11C(6)	Failure to produce books, records, etc. or furnish information or appear before the investigating authority or to sign the note of any examination by investigating authority	New provision	Imprisonment for a term which may extend to one year or fine which may extend to Rs. 1 crore or both and a further fine which may extend to Rs. 5 lakh for every day after the first during which the failure or refusal continues
15A(a)	Failure by any person to furnish any document, return or report to SEBI required under the Act or any rules or regulations made thereunder	Not exceeding Rs. 1.5 lakh/ Failure	Rs. 1 lakh for each day during which such failure continues or Rs. 1 crore, whichever is less
15A(b)	Failure by any person to file any return or furnish any information, books or other documents within the time specified in the regulations	Not exceeding Rs. 5,000 for each day during which such failure continues	
15A(c)	Failure by any person to maintain books of account or records required under the Act or any rules or regulations made thereunder.	Not exceeding Rs. 10,000 for each day during which such failure continues	

Section	Violations	Penalty	
		Before Amendment	After Amendment
15B	Failure by an intermediary to enter into agreement with clients required under the Act	Not exceeding Rs. 5 lakh/ Failure	
15C	Failure by an intermediary to redress the grievances of investors after having been called upon by SEBI to do so	Not exceeding Rs. 10,000/ Failure	
15C	Failure by a listed company to redress the grievances of investors after having been called upon by SEBI to do so	New provision	
15D(a)	Sponsoring or carrying on any Collective Investment Scheme (CIS), including mutual funds, by any person, without obtaining a certificate of registration from SEBI	Not exceeding Rs. 10,000 for each day during which he carries on any such CIS or Rs. 10 lakh, whichever is higher	Rs.1 lakh for each day during which he sponsors or carries on any such CIS or Rs. 1 crore, whichever is less
15D(b)	Failure by a registered CIS to comply with terms and conditions of registration	Not exceeding Rs. 10,000 for each day during which such failure continues or Rs. 10 lakh, whichever is higher	Rs.1 lakh for each day during which such failure continues or Rs. 1 crore, whichever is less
15D(c)	Failure by a registered CIS to apply for listing of its schemes as provided in the regulations	Not exceeding Rs. 5,000 for each day during which such failure continues or Rs. 5 lakh, whichever is higher	
15D(d)	Failure by a registered CIS to despatch unit certificates in the manner provided in the regulations	Not exceeding Rs.1,000 for each day during which such failure continues	
15D(e)	Failure by a registered CIS to refund application monies within the period specified in the regulations	Not exceeding Rs. 1,000 for each day during which such failure continues	
15D(f)	Failure by a registered CIS to invest money in the manner or within the period specified in the regulations	Not exceeding Rs. 5 lakh/ Failure	
15E	Failure by any asset management company of a registered mutual fund to observe rules and regulations	Not exceeding Rs. 5 lakh/ Failure	Rs. 1 lakh for each day during which such failure continues or Rs. 1 crore, whichever is less
15F(a)	Failure by a registered stock broker to issue contract notes in the manner specified by the exchange	Not exceeding five times the amount for which the contract note was required to be issued	No change
15F(b)	Failure by a registered stock broker to deliver any security or make payment of the amount due to investor in the manner specified in the regulations	Not exceeding Rs. 5,000 for each day during which such failure continues	Rs.1 lakh for each day during which such failure continues or Rs. 1 crore, whichever is less

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Section	Violations	Penalty	
		Before Amendment	After Amendment
15F(c)	Charging brokerage in excess of the amount specified in the regulations by a registered stock broker	Not exceeding Rs. 5,000 or five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher	Rs. 1 lakh or five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher
15G	Insider trading	Not exceeding Rs. 5 lakh	Rs. 25 crore or three times the amount of profits made out of insider trading, whichever is higher
15H	Failure by any person to disclose the aggregate shareholding in the body corporate or make public announcement as required under the Act or rules or regulations	Not exceeding Rs. 5 lakh	Rs. 25 crore or three times the amount of profits made out of such failure, whichever is higher
15H	Failure by any person to make a public offer or make payment of consideration to shareholders who sold their shares pursuant to the letter of offer, as required under the Act or rules or regulations	New provision	
15HA	Indulging in fraudulent and unfair trade practices relating to securities	New provision	Rs. 25 crore or three times the amount of profits made out of such practice, whichever is higher
15HB	Failure to comply with any provision of the Act, the rules or regulations made or directions issued by SEBI thereunder for which no separate penalty has been provided	New provision	Penalty which may extend up to Rs. 1 crore
24(1)	Contravenes or attempts to contravene or abets the contravention of the provisions of the Act or of any rules or regulations made thereunder	Imprisonment for a term which may extend to one year, or fine, or both	Imprisonment for a term which may extend to ten years, or fine which may extend to Rs. 25 crore, or both
24(2)	Failure to pay the penalty imposed by adjudicating officer or to comply with any of his directions or order	Imprisonment for a term which shall not be less than one month but which may extend to 3 years, or fine which shall not be less than Rs. 2,000 but which may extend to Rs. 10,000, or both	Imprisonment for a term which shall not be less than one month but which may extend to 10 years, or fine which shall not be less than Rs. 25 crore or both

The Amendment Act, however, provides that all sums realised by way of penalties would be credited to Consolidated Fund of India instead of SEBI. This is probably to avoid conflict of interest that SEBI may impose higher penalty when it needs more funds.

The Amendment Act empowered the SAT and the Courts to compound offences. They can compound any offence under the SEBI Act, not being

an offence punishable with imprisonment only, or with imprisonment and also with fine, either before or after the institution of the proceeding.

In order to reduce delays, avoid unnecessary litigation and get cooperation of the accused, Central Government has been empowered to grant immunity, before institution of prosecution, to any person from prosecution for any offence under the SEBI Act or rules or regulations made there-

under or from the imposition of any penalty under the Act with respect to alleged violation. Such immunity can be granted only if SEBI recommends it and the person makes a full and true disclosure in respect of the alleged violation. If any person to whom immunity has been granted does not comply with the conditions on which immunity was granted or had given false evidence, the immunity can be withdrawn and on such withdrawal, the accused would face normal prosecution/penalty.

Any offence punishable under the Act or any rules or regulations made thereunder shall be tried by a 'court of session' instead of 'a metropolitan magistrate or a judicial magistrate of the first class' as provided earlier.

It thus appears that SEBI has been given all the required powers to develop and regulate the securities market and protect the interests of investors in securities.