A Historical Perspective of Securities Laws

M. S Sahoo*

The two exclusive legislations that governed the securities market till early 1992 were the Capital Issues (Control) Act, 1947 (CICA) and the Securities Contracts (Regulation) Act, 1956 (SCRA). The CICA had its origin during the war in 1943 when the objective was to channel resources to support the war effort. Control on capital issues was introduced through the Defence of India Rules in May 1943 under the Defence of India Act, 1939. The control was retained after the war with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channeled into proper lines, i.e., for desirable purposes to serve goals and priorities of the government, and to protect the interests of investors. The relevant provisions in the Defence of India Rules were replaced by the Capital Issues (Continuance of Control) Act in April 1947. This Act was made permanent in 1956 and enacted as the Capital Issues (Control) Act, 1947. Under the Act, the Office of the Controller of Capital Issues was set up which granted approval for issue of securities and also determined the amount, type and price of the issue. This Act was, however, repealed in 1992 as a part of liberalization process to allow the eligible companies to approach the market directly, provided they issue securities in compliance with the prescribed guidelines relating to disclosure and investor protection.

Though the stock exchanges were in operation, there was no legislation for their regulation till the Bombay Securities Contracts Control Act was enacted in 1925. This was, however, deficient in many respects. Under the Constitution of India which came into force on January 26, 1950, stock exchanges and forward markets came under the exclusive authority of the central government. Government appointed the A. D. Gorwala Committee in 1951 to formulate a legislation for the regulation of the stock exchanges and of contracts in securities. Following the recommendations of the Committee, the SCRA was enacted in 1956 to provide for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and to prevent undesirable transactions in securities. It has undergone several modifications since its enactment. It gives the central government regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with the conditions prescribed by the central government. Organised trading activity in securities is permitted on recognised stock exchanges.

The authorities have been quite sensitive to the requirements of the development of securities market, so much so that the last decade (1992-2004) witnessed nine special legislative interventions, including two new enactments, namely the Securities and Exchange Board of India (SEBI) Act, 1992 and the Depositories Act (DA), 1996. The SCRA, the SEBI Act and the DA were amended six, five and three times respectively during the same period. The developmental need was so urgent at times that the last decade witnessed six 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.) having a bearing on the securities markets have been amended in the recent past to complement amendments in securities laws.

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 the 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 provided for establishment of the Securities Appellate Tribunals (SATs) to hear appeals against the orders of the adjudicating officers. 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 provided for

* C.G.M., SEBI. The views expressed and the approach suggested in this article is of the author and not necessarily of NSE or his employer. The Author is thankful to Mr. R. Venkateswaran & Mr. Prabhas K. Rath, Research Officers with SEBI for the assistance in preparation of this paper and to Ms Patricia Crasto for her, secretarial assistance.

maintenance of ownership records in a book entry form. *The Depositories Related Laws (Amendment) Act, 1997* amended various legislations to facilitate dematerialization of 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 scheme (CIS). *The Securities Laws (Second Amendment) Act, 1999* was enacted to empower SAT to deal with appeals against orders of SEBI under the DA and the SEBI Act, and against refusal of stock exchanges to list securities under the SCRA. The next intervention is *the SEBI (Amendment) Act, 2002* which enhanced the powers of SEBI substantially in respect of inspection, investigation and enforcement. The latest and the ninth legislative intervention namely the Securities Laws (Amendment) Act, 2004 provides for demutualisation of stock exchanges and fills up certain identified regulatory gaps. This paper explains the provisions of these nine legislative interventions in a historical perspective.

A. Enactment of the SEBI Act, 1992[1]

Liberalisation does not mean scrapping of all codes and statutes, as some market participants may wish. It rather means replacement of one set by another set of more liberal code / statute, which allows full freedom to economic agents, but influences or prescribes the way they should carry out their activities so that the liberalised market operates in an efficient and fair manner and the risks of systemic failure are minimized.

In the context of securities market, the regulations and a regulator to enforce regulations are necessary to regulate the conduct of market participants and market practices:

i. Law provides an inclusive definition of securities. It says that securities include shares, bonds, debentures, units of CIS, etc. It does not define the securities in terms of ingredients an instrument must have to be considered as securities. It is probably because the securities are the most insecure instruments. The only ingredient common to all types of securities is their associated insecurity. It is like a blind man named *padmalochan*. If it is a market for such insecure instruments, market would collapse if some body does not regulate away the insecurities and ensures good conduct of the issuers of and investors in securities.

ii. Though it is believed that the securities market disintermediates by establishing direct relationship between the suppliers of funds and the suppliers of securities, the market requires the services of a large number of intermediaries such as merchant bankers, brokers etc., who carry out transactions for or on behalf of their clients. The disintermediation in the securities market is in fact an intermediation with a difference; it is a risk-less intermediation, where the ultimate risks are borne by the suppliers of funds/ securities, and not the intermediaries. Hence it is necessary to ensure that the intermediaries have the capability, motivation and accountability to act in the best interests of their clients and the market at large.

iii. We need regulations to correct for identified market imperfections which produce sub-optimal outcomes and prevent market failures. There are many potential market imperfections in securities market such as inadequate information, asymmetric information, and difficulty in ascertaining the quality of contracts at the point of purchase, imprecise definitions of products and contracts, under-investment in information, agency costs and principal agent problems.

With these objectives, it was considered necessary to create a statutory agency, which would ensure fair play in the market, develop fair market practices, prescribe and monitor conduct of issuers and intermediaries so that the securities market enables efficient allocation of resources. The enactment of the SEBI Act, 1992 was an attempt in this direction.

Constitution: The Act established a Board, called Securities and Exchange Board of India (SEBI), to protect the interests of investors in securities and to promote the development of, and to regulate the securities market. It prescribed that the Board would consist of a Chairman, one member each from amongst the officials of the finance ministry, the law ministry and the RBI and two other members. In order to avoid conflict of interest, it was provided that a member shall be removed from office if he is appointed as a director of a company.

Functions: In addition to its general responsibility, it was assigned the following specific responsibilities:

a. regulating the business in stock exchanges and any other securities markets,

b. registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustee of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio mangers, investment advisors and such other intermediaries,

c. registering and regulating working of CIS, including mutual funds,

d. promoting and regulating self regulatory organizations (SROs),

e. prohibiting fraudulent and unfair trade practices relating to securities market,

[1] This repealed the Ordinance promulgated on 30th January 1992.

f. promoting investor education and training of intermediaries,

g. prohibiting insider trading in securities,

h. regulating substantial acquisition of shares and takeover of companies,

i. calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, intermediaries and SROs,

j. performing such functions and exercising such powers under the CICA (which was repealed on 29th May 1992) and SCRA as may be delegated by the central government, (This was done in the interest of integrated regulation. Then all the powers under the SCRA were exercisable by central government. Until SEBI stabilizes, it was considered desirable that important powers are not transferred from central government, but delegated to SEBI.)

k. levying fees or other charges for carrying the above purposes,

l. conducting research for the above purposes, and

m. performing such other functions as may be prescribed.

The Board was empowered to delegate any of its powers and functions under the Act (except powers to make regulations) to any member, officer of the Board or any other person.

Autonomy and Accountability: The central government being accountable to Parliament, the SEBI Act granted powers of last resort to central government. It obligated SEBI, in exercise of its powers and performance of its functions, to be bound by the directions of the central government on questions of policy. Whether a question is one of policy or not shall be decided by the central government. Further, the central government was empowered to supersede the Board for a period not exceeding six months if it is of the opinion that the Board is unable to discharge the functions and the duties under the Act on account of grave emergency, or the Board has persistently defaulted in complying with any directions issued by the central government under the Act and as a result of such default the financial position or the administration of the Board has deteriorated, or the circumstances exist which render it necessary in the public interest to do so. The Board was obligated to furnish to the central government such returns and statements and such particulars in regard to any proposed or existing programme for the promotion and development of the securities market, as the central government may, from time to time, require. The Board was also obligated to submit to central government a report in the prescribed form giving a true and full account of its activities, policy and programmes during the previous year within 60 days (increased to 90 days by 1995 amendment) of the end of each financial year. A copy of this report shall be laid before each House of Parliament. While the Act empowered central government to make rules for carrying out the purposes of the Act, it empowered SEBI to make regulations, with the previous approval of central government (approval dispensed by 1995 amendment), consistent with the Act and the rules, to carry out the purposes of the Act. In order to ensure accountability, it was provided that all the rules and regulations made under the Act shall be laid before each House of Parliament. It was also provided that any person aggrieved by an order of the Board under the Act may prefer an appeal to the central government. The Act empowered central government to exempt, in public interest, any person or class of persons dealing in securities from the requirements of registration.

In the interest of autonomy of SEBI, it was empowered to levy fees or other charges for carrying on the purposes of the Act. This power to levy fees has been upheld by the Supreme Court in the matter of BSE Brokers' Forum and Others Vs. SEBI and Others.

It was provided that no court shall take cognizance of any offence punishable under the Act or any rules or regulations made there under except on a complaint made by the Board with the approval of central government. It was further provided that no suit, prosecution or other legal proceedings shall lie against central government or any officer of the central government or any member, officer or other employee of the Board for anything which is done or intended to be done in good faith under this Act or the rules or regulations made there under.

Amendments to the SCRA: All the powers under the SCRA were exercised by central government. The SEBI Act, however, created a Board to regulate the securities market. In the interest of integrated regulation of securities market, it was felt that only one agency (SEBI) as far as possible, should regulate the securities market. In order to do so, the SEBI Act transferred some of the powers of the central government under the SCRA to SEBI and empowered central government to delegate other powers, except power to make rules, under the SCRA to SEBI. In exercise of this power, central government has delegated almost all the powers under the SCRA by notifications issued in 1992 and 1994. All the powers under the Securities Contracts (Regulation) Rules, 1957 have also been transferred to SEBI in 1996.

Trading of government securities was not subject to any regulatory framework as these were not 'securities' under the SCRA. In order to enable SEBI to protect the interests on investors in government securities and to develop and regulate the market for government securities, the definition of 'securities' was amended to include government securities within its ambit so that the whole regulatory framework applicable to trading of securities

could apply to trading of government securities also. Further, in order to avoid frequent amendments, which is time consuming, the SCRA was amended to empower central government to declare any other similar instrument to be securities.

B. Repeal of Capital Issues (Control) Act, 1957

It is believed that a liberalised securities market helps promote economic growth. The more liberalised a securities market is, the better is its impact on economic growth. Interventions in the securities market were originally designed to help governments expropriate much of the seigniorage and control and direct the flow of funds for favoured uses. These helped governments to tap savings on a low or even no-cost basis. Besides, government used to allocate funds from the securities market to competing enterprises and decide the terms of allocation. The result was channelisation of resources to favoured uses rather than sound projects. In such circumstances accumulation of capital *per se* meant little, where rate of return on some investments were negative while extremely remunerative investment opportunities were foregone. This kept the average rate of return from investment lower than it would otherwise have been and, given the cost of savings, the resulting investment was less than optimum. Hence it was necessary to do away with the interventions hindering optimum allocation of resources.

As a part of the liberalisation process, the CICA was repealed by an Ordinance on May 29, 1992 paving way for market determined allocation of resources. With this the Office of the Controller of Capital Issues was abolished and the cost of rationing the resources was saved. The Act earlier required a firm wishing to issue securities to obtain prior approval from the government, which also determined the amount, type and price of the issue. Now the eligible firms comply with the specified requirements and access the market to raise as much resources and at such terms as the market can bear. In the issues made through book building, the investors have freedom to subscribe for the securities at prices they consider appropriate.

C. The Securities Laws (Amendment) Act, 1995[2]

In the light of experience gained with the working of the SEBI Act, 1992, it was considered desirable to expand the jurisdiction of SEBI, enhance its autonomy and empower it to take a variety of punitive actions in case of violations of the Act.

Composition of Board: As mentioned earlier, the SEBI Act made it obligatory for the central government to remove a member from the Board if he was appointed as a director of any company. This was so presumably to ensure that a person would not be able to do justice to his roles as member of the Board and as a member of board of directors of a company simultaneously. His interests as member of the Board might clash with that of a director of a company. SEBI, being a quasi-judicial body, the members of the Board were not just expected to be impartial, they should also appear to be impartial. This was precluding the appointment of people with adequate knowledge and experience in the area of securities market to the Board as many of them were also involved with corporate management in various capacities. The amendment Act deleted the provision relating to disqualification of a member of the Board on his being appointed as a director of a company from the statute. It inserted a new provision to make it obligatory for a member of the Board, who is director of any company and who has any direct or indirect pecuniary interest in any matter coming up for consideration at a meeting of the Board, to disclose the nature of interest and refrain from participating in the deliberations or decisions of the Board with respect to that matter. Now the government can appoint people of eminence with experience in matters relating to securities market to the Board. This was expected to improve the decision making potential of SEBI and enable the Board to lead and guide more effectively the team of professionals working for SEBI.

Jurisdiction of SEBI: The jurisdiction of SEBI was enlarged to register and regulate a few more intermediaries and other persons associated with the securities market. The amendment Act empowered SEBI to register and regulate the working of the intermediaries like depositories, custodians of securities and also certain other persons associated with the securities market like foreign institutional investors, credit rating agencies, venture capital funds etc. SEBI was also given blanket authority to regulate other intermediaries or persons, not named specifically in the statute, by specifying them through a notification. This obviated the need for amending SEBI Act every now and then to deal with a particular type of intermediary or a person associated with the securities market that may emerge in future.

Before the amendment Act, SEBI was being perceived as ineffective and toothless in protecting the interests of investors. This was essentially because SEBI did not have any power to control or regulate the issuers of securities. The SEBI Act listed all kinds of intermediaries to be registered and regulated by SEBI, but excluded the issuers of securities. As a result, SEBI could not directly regulate the issuers (Companies) on matters relating to issue and transfer of securities. In the absence of clear statutory mandate to SEBI to regulate issuers of securities which

[2] This repealed the Ordinance promulgated on 25th January 1995.

are governed by the Companies Act, 1956, SEBI was not able to compel the issuers to make adequate disclosures. It was rather directing its efforts only at the lead managers and merchant bankers who are intermediaries and signatories to prospectus requiring them to make adequate disclosures. Even this was being challenged in courts of law, as this was perceived beyond the jurisdiction of SEBI. This debilitating infirmity was done away with by the amendment Act which incorporated section 11A to confer on SEBI regulatory jurisdiction over corporates in the issuance of capital, transfer of securities and other related matters. SEBI can now specify by regulations the matters to be disclosed and the standards of disclosure required for the protection of investors in respect of issues made by companies.

Monetary Penalties: The SEBI Act originally provided for penalty of suspension and cancellation of a certificate of registration of an intermediary. Such suspension/ cancellation led to cessation of business and affected innocent third parties, often adversely, who were dealing with the intermediary. Besides, there were many persons other than intermediaries associated with the securities market on whom the penalty of suspension/cancellation had no bearing. In order to tackle this, the amendment Act provided for monetary penalties as an alternative mechanism to deal with capital market violations.

SEBI was empowered to adjudicate a wide range of violations and impose monetary penalties on any intermediary or other participants in the securities market. The amendment Act listed out a wide range of violations along with maximum penalties leviable. It provided for the highest penalty of Rs.10 lakh and the violations listed were failure to submit any document, information or furnish any return, failure to maintain required books of accounts or records, carrying on any CIS without registration, failure to enter into agreement with clients, insider trading, failure to redress the grievances of investors, failure to issue contract notes, charging excessive brokerage by brokers, failure to disclose substantial acquisition of shares and take-overs, etc. The amendment Act provided for three types of monetary penalties *viz., - (a)* a lump sum penalty for a specific violation of the Act, (b) a penalty for every day during which the violation continued, and (c) a multiple of the amount involved in the violation. The amount of penalty was determined, subject to the ceiling, by the adjudicating officer who would be guided by the factors including amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default, the amount of loss caused to an investor or any group of investors as a result of default, and the repetitive nature of the default. It amended section 24 to provide that non-payment of penalty would be an offence punishable with fine or imprisonment under the Act.

The adjudicating officer is required to be appointed by SEBI. He shall not be an officer below the rank of a division chief of SEBI. He will hold an enquiry after giving the person a reasonable opportunity of being heard for the purpose of determining if any violation has taken place and imposing penalty. To ensure fair enquiry and penalty, it was provided that appeal against the orders of adjudicating officers would lie only to the SAT, which was also constituted by the amendment Act.

While the suspension or cancellation of registration continued to be regulated by regulations framed by SEBI and the appeal from the orders of the Board suspending or canceling a registration would lie to central government, the amendment Act provided that the monetary penalties would be imposed only in cases of violations listed in the Act by an adjudicating officer as per the Rules prescribed by the central government. Appeals against the orders of an adjudicating officer can be preferred to the SAT. The appeals against the orders of SAT can be preferred to the High Court.

Empowerment: The amendment Act inserted section 11B to empower SEBI to issue directions to all intermediaries and other persons associated with the securities market (i) in the interests 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 (MF) from being conducted in a manner detrimental to the interests of investors or of the securities market, or (iv) to secure the proper management of any such entity. The Act also empowered SEBI to call for and furnish to any agency such information as necessary for efficient discharge of its functions. It vested SEBI with powers of a civil court under the Code of Civil Procedure, 1908 in respect of the following: (i) summon and enforce attendance of persons and examine them on oath, (ii) inspect any books, register and other documents, (iii) discover and enforce production of books of accounts and other documents. These helped SEBI considerably to carry out investigations, conduct inquires and inspections and levy fines against the erring intermediaries, issuers of securities and other persons associated with the securities market. SEBI was also empowered to call for information and conduct enquiries, audits and inspection of MFs, and other persons associated with the securities market, in addition to stock exchanges, self regulatory organizations and intermediaries provided earlier.

Autonomy of SEBI: The autonomy of SEBI was reinforced by the following provisions: (i) SEBI was vested with the powers of a civil court; (ii) Section 20A barred the jurisdiction of civil court in respect of actions or orders passed by SEBI. One can, however, prefer an appeal to the central government against the orders of SEBI and the jurisdiction of the High Court was not barred. This made SEBI's functioning independent of the lower civil courts and allowed quick disposal of cases by SEBI without

being hamstrung by stay orders from civil courts; (iii) Section 23 was amended to extend immunity from suit, prosecution or other legal proceedings to SEBI or any of its members, officers or employees in respect of action taken in good faith; (iv) Section 26 was amended to permit SEBI to file complaints in courts under section 24 in respect of offences under the SEBI Act without previous sanction of the central government which was mandatory till then even for filing routine prosecutions; (v) By amendment to section 28, the power of last resort of the central government to exempt any person or class of persons dealing in the securities market from the requirement of registration with SEBI was withdrawn; (vi) Sections 29 and 30 were amended to provide that the conditions for grant of registration would be determined by Regulations and not by Rules; (vii) Section 30 was amended to provide that the SEBI can notify regulations without the approval of the central government. These enabled SEBI to respond speedily to changing market conditions and enhanced its autonomy.

SEBI was armed with better weapons to regulate various participants in the securities market. The amendment Act provided that henceforth the conditions of registration shall be determined by Regulations and not under Rules as it used to be before the amendment. The enactment of Rules under the Act is the prerogative of the central government and is a very time consuming process in contrast to Regulations which required only prior approval of the central government. By this amendment, the requirement of prior approval was dispensed with and regulation making was brought within the exclusive domain of SEBI. This enabled SEBI to expeditiously notify and modify regulations to keep pace with rapidly changing market conditions, facilitate maintenance of market discipline, prudence and transparency and thereby strike on time.

Securities Appellate Tribunal: An efficient and effective system of regulation calls not only for firmness, but also for fairness. The amendment Act provided for establishment of one or more SATs to hear the appeals from the orders of the adjudicating officers. Anybody not satisfied with the orders of the SAT can prefer an appeal to the High Court. This ensured fairness in the process of adjudication.

Amendments to the SCRA: The amendment Act also amended SCRA. In the last few years, there had been substantial improvements in the functioning of the securities market. However there were inadequate advanced risk management tools. In order to provide such tools and to deepen and strengthen the cash market, a need was felt for trading of derivatives like futures and options. But it was not possible in view of the prohibitions in the SCRA. Its preamble stated that the Act was to prevent undesirable transactions in securities by regulating business of dealing therein, by prohibiting options, etc. Section 20 of the Act explicitly prohibited all options in securities. Section 16 of the Act empowered central government to prohibit by notification any type of transaction in any security. In exercise of this power, government by its notification in 1969 prohibited all forward trading in securities. Introduction of trading in derivatives required withdrawal of these prohibitions. The amendment Act withdrew the prohibitions by repealing section 20 of the SCRA and amending its preamble.

Traditionally, the operations of the stock exchanges were limited to the area earmarked at the time of its recognition. This prevented an exchange from expanding its operations beyond the area, though it was considered desirable to introduce competition among the exchanges and technology permitted such expansion. The SCRA was amended to allow an exchange to establish additional trading floor outside its area of operation with the approval of SEBI.

The SCRA, before the amendment, provided that SEBI could compel a company to list its securities on any stock exchange. Such coercion from authorities was not considered desirable in the liberalised market environment. This provision was removed from the SCRA.

The exchanges enter into listing agreements with the listed companies. The agreement casts a lot of obligations on the listed companies in the interests of investors. However, this agreement was not having any statutory backing. As a result, in cases of non-compliance with the listing agreement, the exchanges used to suspend / withdraw trading of the security, which was not in the interest of investors. In order to provide statutory backing to the listing agreement, which is being increasingly used to improve corporate governance, it was prescribed that where securities were listed on the application of any person, such person shall comply with the conditions of listing with the stock exchange.

The rules made under the SCRA used to be published before formal notification. Though this practice helped to consult the regulated and the public on the proposed rules, it was time consuming and the regulated could derive regulatory arbitrage before the new rule came to effect. The amendment Act did away with the requirement of prior publication.

D. The Depositories Act, 1996[3]

The system of transfer of ownership of securities prevailing till mid 1990s was grossly inefficient as every transfer was

[3] This repealed the Depositories (Third) Ordinance, 1996 which was first promulgated on 20th September 1995.

required to be accomplished by the physical movement of paper securities to the issuer for registration and the ownership was evidenced by the endorsement on the security certificate. The process of transfer in many cases took much longer time than two months stipulated in the Companies Act, 1956 or the SCRA. A significant proportion of transactions ended up as ' bad delivery' due to faulty compliance of paper work, mismatch of signatures on transfer deeds with the specimen records of the issuer or for other procedural reasons. Theft, forgery, mutilation of certificates and other irregularities were rampant. The inherent right of the issuer to refuse the transfer of a security added to the misery of the investors. The cumbersome paraphernalia associated with the transfer of securities under section 108 of the Companies Act, 1956, along with huge paper work, printing of stationary, safe custody of securities, transportation and dispatch added to the cost of servicing paper securities, delay in settlement and restricted liquidity in securities and made investor grievance redressal time consuming and at times intractable. All these problems had not surfaced overnight but these were compounded by the burgeoning trade volumes in secondary market and increasing dependence on securities market for financing trade and industry. This underscored the need for streamlining the transfer of ownership of securities which was sought to be accomplished by the DA. The Act provides a legal basis for establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by *(a)* making the securities of public limited companies freely transferable; *(b)* dematerializing the securities in the depository mode; and *(c)* providing for maintenance of ownership records in a book entry form.

Legal Basis: The DA, read with section 12 of the SEBI Act, 1992, provides a legal basis for establishment of multiple depositories and entrusts them with responsibility of maintaining ownership records of securities and effecting transfer of securities through book entry only. The depositories render, through participants, any service connected with recording of:

(a) allotment of securities; and
(b) transfer of ownership of securities.

By fiction of law, under section 10 of the DA, the depository is deemed to be the registered owner of securities with the limited purpose of effecting transfer of ownership of security. In respect of securities held in a depository, the name of the depository appears in the records of the issuer as the registered owner of the securities. The depository has right to effect the transfer of securities and shall not have any other right associated with them. The owners of the securities become beneficial owners on the records of the depository in respect of the securities held in a depository. The beneficial owner has all the rights and liabilities associated with the securities. The depositories holding the securities maintain ownership records in the name of each participant. Each such participant, as an agent of the depository, in turn, maintains ownership records of every beneficial owner in book entry form. The depository and participants have a principal and agent relationship and their relations are governed by the bye-laws of the depository and the agreement between them.

Both the depository and participant need to be registered with SEBI under section 12 of the SEBI Act, 1992, and are regulated by SEBI. Only a company formed and registered under the Companies Act, 1956 can be registered as a depository. However, before commencing business, the depository registered with SEBI has to obtain a certificate of commencement of business from SEBI. Such certificate is issued by SEBI on being fully satisfied that the depository has adequate systems and safeguards to ensure against manipulation of records and transactions. SEBI is empowered to suspend or cancel the certificate of registration of a depository as well as of the participants after giving a reasonable opportunity of hearing.

The ownership records of securities maintained by depositories/participants, whether maintained in the form of books or machine readable form, shall be accepted as *prima facie* evidence in legal proceedings. The depository is treated as if it were a bank under the Bankers' Books of Evidence Act, 1891.

The depository services shall be available in respect of the securities as may be specified by SEBI. The type of securities and the eligibility criteria for admission to the depository mode shall be determined by the SEBI regulations. This provides flexibility to SEBI, for example, to admit certain instruments like units of MFs and to prohibit admission of certain securities like shares of private limited companies from depository mode.

Free Transferability of Securities: The securities of all public companies have been made freely transferable. The Act took away the companies' right to use discretion in effecting transfer of securities by deleting section 22A from the SCRA and by inserting section 111A in the Companies Act, 1956. These provisions, read with section 7 of the DA make the transfer of securities in any company, whether listed or not, other than a private company and a deemed public company, free and automatic. That is, once the agreed consideration is paid and the purchase transaction is settled, the buyer is automatically entitled to all the rights associated with the security. As soon as the intimation regarding delivery of security against the payment of cash (*delivery versus payment*) is received, the transfer will be effected by the depository or company and the transferee will enjoy all the rights and obligations associated with the security immediately. If the securities are in the depository mode, depository would effect the transfer on the basis of intimation (contract notes or some other suitable evidence)

from the participants. If the securities are outside the depository mode, the company would effect the transfer on receipt of the transfer deed. For the securities in the depository mode, no transfer deed is required and other procedural requirements under section 108 of the Companies Act were dispensed with. The transferee in both the modes would be entitled to all the rights including voting rights and obligations associated with the security.

However, if it is felt that the transfer of a security is in contravention of any of the provisions of the SEBI Act, 1992 or Regulations made there under or Sick Industrial Companies (Special Provisions) Act (SICA), 1985, the company, depository, participant, investor or SEBI can make an application to the Company Law Board (CLB) to determine if the alleged contravention has taken place. After enquiry, if the CLB is satisfied of the contravention, it can direct the company/ depository to make rectification in ownership records. In other words, transfer has to be effected immediately even if the transfer is in contravention of SEBI Act, 1992 or SICA, 1985, subject to subsequent rectification by the direction of CLB. Pending the completion of enquiry, CLB can suspend voting rights in respect of the securities so transferred. The transferee will continue to enjoy economic rights (bonus, dividend, rights etc) which can not be suspended under any circumstances. During the pendency of the application with CLB, the transferee can transfer the securities and such further transfer will entitle the transferee to the voting rights also unless the voting rights in respect of transferee has also been suspended.

Partial Dematerialisation of Securities: Section 9 of the DA provides that the securities held by a depository shall be dematerialized and be fungible. The Act envisages dematerialization of securities in the depository mode as against immobilization of securities. The latter refers to a situation when the depositories hold securities in physical form side by side with ownership records. In such a case, physical movement of securities does not accompany the transfers but securities are in existence in the custody of the depository. What the Act envisages is that ownership of securities shall be reflected through book entry system and this will not require existence of security certificates. However, the securities outside the depository would be represented by physical security certificate. Hence, the depository mode envisaged is one of partial dematerialization, that is, a portion of securities is dematerialized and the other portion remains in physical form.

Supremacy of Investor: The investor has been given the option to hold physical securities or opt for a depository based ownership records. At the time of fresh issue, the issuer is under obligation to give the option to the investors either to seek physical securities under the paper based system (non-depository mode) or to opt for book entry system of recording ownership (depository mode). The decision on whether or not to hold securities within the depository mode, and if in depository mode, with which depository or participant, would be entirely with the investor. Such freedom can be exercised either at the time of the initial offer of the security by indicating his choice in the application form or at any subsequent time. He will also have the freedom to switch from depository mode to non-depository mode and vice versa.

At the time of initial offer, if the investor opts to hold a security in the depository mode, the issuer shall intimate the concerned depository the details of allotment of securities and record the depository as registered owner of the securities. On receipt of such information, the depository shall enter in its records the names of allottees as the beneficial owners.

An investor who holds physical securities and seeks to avail the services of a depository will have to surrender the certificates to the issuer. The issuer on receipt of the certificates shall cancel them and substitute in its records the name of the depository as the registered owner in respect of that security and inform the depository accordingly. The depository shall thereafter enter the name of the investor in its records as the beneficial owner.

If a beneficial owner or a transferee of securities seeks to opt out of a depository in respect of any security, he shall inform the depository of his intention. The depository in turn shall make appropriate entries in its records and shall inform the issuer. The issuer shall make arrangements for the issue of security certificate to the investor.

The depository shall record all transfers made within the depository mode only on receipt of intimation from the participant. The type of intimation would be specified by SEBI regulations.

An investor, before availing the services of a depository, shall enter into an agreement with a depository through a participant. The participant is also required to enter into an agreement with the depository to act as the latter's agent. There will also be an agreement between the depository and the issuer of securities. The rights and obligations of depositories, participants, issuers and investors would be governed by the agreement among them, the bye-laws of the depository and the regulations of SEBI.

Amendments to Other Acts: To provide for the smooth operation of the depositories, the DA amended a few other Acts such as the Indian Stamps Act, 1881, the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Income-tax Act, 1961, the Benami Transactions (Prohibition) Act, 1988 and the Securities and Exchange Board of India Act, 1992. The major amendments in these Acts are discussed below:

Amendment to the Indian Stamps Act: Section 8A was inserted in the Indian Stamps Act to provide for the following:

i. At the time of issue of securities, shares or otherwise, the issuer shall pay the Stamp duty on the total amount of the security issued by it, whether through a depository or directly to investors, even though there will be no physical securities (instrument) which can be stamped (executed).

ii. Entry into depository involves change of registered ownership as the investor becomes the beneficial owner and the depository becomes the registered owner in respect of the security. As it involves change in registered ownership, it attracts stamp duty under the existing provisions. The new section 8A, however, exempted such change of registered ownership of shares from an investor to a depository from the stamp duty.

iii. All transactions of securities involving change in registered ownership and/or beneficial ownership of shares within the depository mode shall not attract any stamp duty.

iv. If an investor opts to exit from the depository and seeks the issue of physical certificate of securities from the issuer, the issue of such certificates shall attract stamp duty as is payable on the issue of duplicate certificates.

v. All transactions outside the depository mode shall attract stamp duty.

Amendments to the Income Tax Act: Sub-section 2A was inserted in section 45 to provide that the depositories as well as the participants would not be liable to pay any capital gains tax in respect of profits or gains arising from transfer of securities held in depositories and transacted from time to time since these securities are held on behalf of the beneficial owners. In other words, *inter-se* transfer of securities between the participants in the books of a depository as well as between the depositories in the records of an issuer shall not be treated as transfer unless it involves change in beneficial ownership. If it involves any change in the beneficial ownership, only the beneficial owner shall be chargeable to capital gains tax, not the registered owner.

Due to fungibility of the securities, while calculating capital gains tax, the cost of acquisition of securities shall not be determined with reference to cost of acquisition of specific identifiable securities, but on the principle of first-in-first-out. That is, the securities acquired first by the beneficial owner would be deemed to have been transferred first irrespective of the intention of the investor. This principle would be applicable only in respect of securities held in a depository.

Amendment to the Companies Act: Section 83 of the Companies Act was deleted. This did away with the mandatory requirement of each company limited by shares to distinguish the shares by distinguishing numbers, in order to introduce the concept of fungibility. The abolition of section 83, however, did not prohibit a company from having distinct numbers, although there was no mandatory requirement to that effect.

Section 108 was amended to provide that the provisions of section 108 shall apply to transfer of securities effected outside the depository mode. The provisions of section 108 shall not apply to transfers of securities effected within the depository mode.

Section 111 was amended to provide that the provisions of section 111 shall apply to a private company and a deemed public company. The new section 111A was inserted to govern the transfer of securities of a public limited company. The shares or debentures and any interest therein of a company were made freely transferable and all the rights and obligations associated with them immediately accrue to the transferee.

E. ***The Depository Related Laws (Amendment) Act, 1997:*** While amending the DA, this amendment Act amended the Companies Act, 1956, the Indian Stamp Act, 1899, the State Bank of India act, 1955, the State Bank of India (Subsidiary Banks) Act, 1959, the Industrial Development Bank of India Act, 1964, the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 to facilitate dematerialization of securities. The Act amended the DA to provide that the provision of the Companies Act relating to securities held in trust shall not apply to a depository in respect of such securities, even though the depository is the registered owner of the securities. It restored section 83 in the Companies Act relating to distinct numbers for securities. However, the securities held in a depository may not have distinct numbers. It amended section 111A to restrict free transferability of securities provided originally in the DA. It provided that if a company refuses to register securities within 2 months, the transferee can appeal before the CLB for registration of securities in his favour. It also provided that if the transfer is in violation of any law for the time being in force, the depository, depository participant, company, SEBI or investor can apply to CLB within 2 months for rectification of register or records. It amended the Indian Stamp Act to exempt stamp duty on transfer of beneficial ownership of units of MFs dealt with by a depository. (Subsequently the stamp duty was exempted on transfer of beneficial ownership of debt securities also.)

F. The Securities Laws (Amendment) Act, 1999[4]

This Act inserted provisions relating to derivatives, units of CIS and delegation of powers under the SCRA to RBI.

Derivatives: Despite withdrawal of prohibitions on derivatives by the Securities Laws (Amendment) Act, 1995, the market for derivatives did not take off, as there was no regulatory framework to govern trading of derivatives. SEBI set up a 24 member Committee under the Chairmanship of Dr. L. C. Gupta on 18th November 1996 to develop an appropriate regulatory framework for derivatives trading in India. The Committee submitted its report on March 17, 1998 recommending among others, that the derivatives may be declared as securities under section 2(h) (iia) of the SCRA, so that the regulatory framework applicable to trading of securities could govern trading of derivatives also. Section 2 (h) of the SCRA, which provides an inclusive definition of 'securities', empowers central government to declare "such other" instruments as "securities". Government, however, did not declare derivatives to be securities. Rather it amended the SCRA, to explicitly define securities to include derivatives, probably because its power to declare any instrument as "securities" was limited by the words "such other".

The Act inserted clause (aa) in section 2 to define derivatives to include: (a) a security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security, and (b) a contract which derives its value from the prices, or index of prices, of underlying securities. It also inserted sub-clause (ia) in section 2 (h) to include derivatives within the ambit of securities so that trading in derivatives could be introduced and regulated under the extant regulatory framework applicable for securities under the SCRA.

Since derivative contracts are generally cash settled, these may be classified as wagers. The trading in wagers being null and void under section 30 of the Indian Contracts Act 1872, it may be difficult to enforce derivatives contracts. In order to avoid such legal uncertainties, a new section 18A was inserted to provide that notwithstanding anything contained in any other law for the time being in force, contracts in derivatives shall be legal and valid if such contracts are traded on a recognised stock exchange and settled on its clearing house in accordance with rules and bye-laws of such stock exchange. Section 23 was amended to provide that anybody who enters into contract in contravention of section 18A shall be punishable.

In exercise of its powers under section 16 of the SCRA, Government had prohibited, by a notification issued in 1969, forward trading in securities in order to curb certain unhealthy trends that had developed in the securities market at that time and to prevent undesirable speculation. In the changed financial environment, the relevance of this prohibition had vastly reduced. Through appropriate amendments in the byelaws of the stock exchanges, carry forward transactions in securities were permitted. Similarly, periodic amendments to the aforesaid notification were made to permit repo transactions in government securities by authorised intermediaries. Even though the notification of 1969 was in force, exceptions had been carved out in course of time as market needs changed and some form of forward trading (carry forward/ready forward) was prevalent. Hence, by a notification issued on 1st March 2000, Government lifted the three-decade-old prohibition on forward trading in securities by rescinding 1969 notification paving way for trading of derivatives.

Collective Investment Scheme: During mid 1990s, many companies especially plantation companies had been raising capital from investors through schemes, which were in the form of CIS. Though SEBI is authorised under the SEBI Act, 1992 to register and regulate CIS, there was no suitable regulatory framework to allow an orderly development of market for units/instruments issued by them. Since SEBI's jurisdiction is limited to protect the interests of investors in securities, it could not take steps to protect the interests of investors in CIS units which were not securities. In order to allow for this and to strengthen the hands of SEBI to protect interests of investors in plantation companies, the Act amended the definition of "securities" to include within its ambit the units or any other instruments issued by any CIS to the investors in such schemes. The Act empowered the central government to make rules to provide for the requirements, which shall be complied with by CIS, for the purpose of getting their units listed on any stock exchange. Such rules have been incorporated in the Securities Contracts (Regulation) Rules. This is aimed at an orderly development of market for these units while protecting the

[4] The Securities Contracts (Regulation) Amendment Bill, 1998 was introduced in the Lok Sabha on 4th July 1998 proposing the amendments effected through this Act. The Bill was referred to the Standing Committee on Finance (SCF) on 10th July 1998 for examination and report thereon. The Committee submitted its report on 17th March 1999. The Committee was of the opinion that the introduction of derivatives, if implemented with proper safeguards and risk containment measures, will certainly give a fillip to the sagging market, result in enhanced investment activity and instill greater confidence among the investors/participants. The Committee after having examined the Bill and being convinced of the needs and objectives of the Bill, approved the same for enactment by the Parliament with certain modifications. The Bill, however, lapsed following the dissolution of 12th Lok Sabha. A fresh bill, the Securities Laws (Amendment) Bill 1999 was introduced in the Lok Sabha on 28th October 1999 incorporating the amendments proposed in the Securities Contracts Regulation (Amendment) Bill, 1998 as well as the modifications suggested by the SCF. This Bill was converted into an Act on 16th December 1999.

interests of investors therein. The Act also inserted a definition of the CIS in the SEBI Act, 1992. The CIS was defined to mean any scheme or arrangement made or offered by any company under which (a) the contributions, or payments made by the investors, by whatever name called, are pooled and utilised solely for the purposes of the scheme or arrangement; (b) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property whether movable or immovable from such scheme or arrangement; (c) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors; and (d) the investors do not have day-to-day control over the management and operation of the scheme or arrangement. The CIS, however, does not include any scheme or arrangement (a) made or offered by a cooperative society, (b) under which deposits are accepted by non banking financial companies, (c) being a contract of insurance, (d) providing for any Scheme, Pension Scheme or the Insurance Scheme framed under the Employees Provident Fund and Miscellaneous Provision Act, 1952, (e) under which deposits are accepted under section 58A of the Companies Act, 1956, (f) under which deposits are accepted by a company declared as Nidhi or mutual benefit society under section 620A of the Companies Act, 1956, (g) falling within the meaning of Chit business as defined in clause (d) of section 2 of the Chit Fund Act, 1982 and (h) under which contributions made are in the nature of subscriptions to a MF.

Delegation of Powers to RBI: The Government had power to delegate regulatory authority to SEBI. To provide additional flexibility, the Act amended section 29A of the SCRA so as to empower the central government to delegate powers to RBI also along with SEBI, to enable the former to regulate such transactions under the SCRA as may be necessary. Now the central government, the SEBI, and the RBI, depending on their jurisdiction as may be mutually agreed upon, can exercise the powers under the Act.

With the repeal of the 1969 notification in 2000, the then prevailing regulatory framework, which governed repo transactions, disappeared. It was, therefore, necessary to work out an arrangement whereby the regulators could regulate such transactions. In pursuance to this and in exercise of its newly acquired power, central government issued a notification on 2nd March 2000 delineating the areas of responsibility between RBI and SEBI. In terms of this notification, the powers exercisable by central government under section 16 of the SCRA in relation to the contracts in government securities, gold related securities, money market securities and in securities derived from these securities and in relation to ready forward contracts in bonds, debentures, debenture stock, securitised debt and other debt securities shall also be exercised by RBI. Such contracts, if executed on stock exchanges, shall, however, be regulated by (i) the rules and regulations or the byelaws made under the SCRA, or the SEBI Act or the directions issued by SEBI under these Acts, (ii) the provisions contained in the notifications issued by RBI under the SCRA, and (iii) the rules or regulations or directions issued by RBI under the RBI Act, 1934, the Banking Regulations Act, 1949 or the Foreign Exchange Regulation Act, 1973.

RBI and SEBI have also issued consequential notifications on 2nd March 2000 specifying the regulatory framework in their respective areas. In terms of RBI notification, no person can enter into any (a) contract for the sale or purchase of government securities, gold related securities and money market securities other than spot delivery contract or such other contracts traded on a recognised stock exchange as is permissible under the SCRA, rules and byelaws of such stock exchange, and (b) ready forward contracts in bonds, debentures, debenture stock, securitised debt, and other debt securities. Ready forward contracts may, however, be entered into by permitted persons in all government securities put through the Subsidiary General Ledger Account held with RBI in accordance with the terms and conditions as may be specified by RBI. SEBI, by its notification, has prohibited all contracts in securities other than such spot delivery contract or contract for cash or hand delivery or special delivery or contract in derivatives as is permissible under the SCRA or the SEBI Act and rules and regulations made thereunder and rules, regulations and byelaws of a recognised stock exchange.

G. The Securities Laws (Second Amendment) Act, 1999

The SCRA provided the right of appeal to the central government against refusal, omission or failure by a stock exchange to list the securities of any public company. The SEBI Act, 1992 provided for two kinds of appeals. Under section 20 of the Act, any person aggrieved by any order of the SEBI under the Act or rules or regulations made thereunder, may prefer an appeal to the central government. Accordingly, the central government had notified the SEBI (Appeal to the Central Government) Rules, 1993 and constituted an Appellate Authority for disposal of appeals. Section 15K of the Act provided for establishment of one or more SATs to hear appeals against orders of adjudicating officer of SEBI imposing monetary penalty as per Rules framed by the central government. Government has accordingly established a SAT at Mumbai to hear appeals from the orders of adjudicating officers. Under section 23 of the DA, any person aggrieved by an order of SEBI under the DA or Rules and Regulations made thereunder may prefer an appeal to the central government. Accordingly, the central government had notified the Depositories (Appeal to the Central Government) Rules, 1998 and constituted an Appellate Authority for disposal of appeals. Thus the central government was conferred

with powers to dispose of appeals in respect of all matters (except disposal of appeals against the orders of adjudicating officer under the SEBI Act, 1992) under all the three Acts.

In addition, the central government was empowered to issue directions to SEBI and make rules under these Acts. It was empowered to approve / amend / make rules / byelaws / regulations of the stock exchanges. Further, central government was represented on the management of SEBI as well as of the stock exchanges. The powers of the central government to issue direction, to make rules and to appoint members of the SEBI as well as all governing bodies of the stock exchanges were perceived as compromising on its appellate powers. The Appellate Authorities appointed by the government under the SEBI Act and the DA Act had been receiving and disposing of appeals in accordance with the Rules. However, since government constituted these, their orders were perceived at times as orders of the government. When an order of SEBI was struck down, even on merits, there was a feeling that SEBI's autonomy as the regulator had been compromised. In order to remove such misgivings, impart transparency and impartiality to the process of disposal of appeals and make the administration of penal provisions in the securities laws by the regulators more accountable and impartial, the Securities Laws (Second Amendment) Act 1999 amended all the three Acts to transfer appellate functions from the central government to an independent body, SAT.

The amendment Act froze section 22 of the SCRA and inserted a new section 22A to provide for right of appeal before SAT against refusal, omission or failure by a stock exchange to list the securities of any public company, within 15 days of such refusal, omission or failure. An obligation was cast on SAT to dispose off appeals as expeditiously as possible, and to endeavour to dispose of finally within six months. Section 23 was amended to provide penalty for failure to comply with orders of SAT. Similar amendments were effected in the SEBI Act, 1992 and the DA. Section 15K of the SEBI Act was amended to expand jurisdiction of SAT to deal with appeals also under any other law. Section 15T was amended to empower SAT to deal with appeals from any person aggrieved by an order of SEBI as well as of an adjudicating officer under the SEBI Act. Section 20 of the SEBI Act, which provided for appeals to central government, was frozen. Section 23 of the DA, which provided for appeals to the central government, was also frozen. A new section 23A was inserted to provide for appeals to SAT under the Act. Hence, all appeals, namely the appeals against the orders of SEBI under the SEBI Act and the DA, appeals against the orders of the adjudicating officers under the SEBI Act, and appeals against refusal of stock exchanges to list securities were allowed to be preferred to SAT. It was further provided that any person aggrieved by the order of SAT may prefer appeal to High Court within 60 days.

Provisions were made in all the three Acts to provide for appearance of the appellant in person or through one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers before a SAT.

Central government was empowered to make rules to provide for the form in which an appeal may be filed before the SAT and the fees payable in respect of such appeals. Consequently, the SEBI (Appeal to the Central Government) Rules, 1993 and the Depositories (Appeal to the Central Government) Rules, 1998 were repealed. Government notified on 18th February 2000 three Appeal Rules, Viz. (a) Securities Appellate Tribunal (Procedure) Rules, 2000 under the SEBI Act, 1992, (b) The Depositories (Appeal to Securities Appellate Tribunal) Rules, 2000 under the DA, and (c) The Securities Contracts (Regulation) (Appeal to Securities Appellate Tribunal) Rules, 2000 under the SCRA. These rules provide for fees, form and procedure for filing of appeal and the process of their disposal by the SAT. The appeals (except appeals against adjudication orders under the SEBI Act) under all three Acts need to be accompanied by a fee of Rs. 5,000/- only. The appeals against the adjudication orders need to be accompanied by a fee of Rs. 500/- if the penalty imposed is less than Rs.10,000/-, Rs. 1,200/- if the penalty imposed is more than Rs. 10,000/- but less than Rs. 1,00,000/- and an additional Rs. 1,000/- for every additional one lakh of penalty or fraction thereof.

H. The SEBI (Amendment) Act, 2002[5]

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.

[5] This replaced the Ordinance promulgated on 29th October 2002.

Strengthening Organisation: 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 RBI. 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 strengthened it by increasing the number of members from five to eight (Excluding Chairman), 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 a bearing on the working of the securities market.

The SEBI Act provides for establishment of one or more 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 a very high powered statutory body and which is strengthened further by this amendment, and in the interests of objectivity and the potential work load, 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 would 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.

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 the 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 corporation 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 interests 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 account(s) 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 there under; 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 powers only if it has reasonable grounds to believe that the company has been indulging in insider trading or market manipulation.

In addition, SEBI was armed with powers of investigation. If SEBI has reasonable grounds 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 there under, 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 required 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 to any intermediary or any person associated with the 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.

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 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 there under;

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 the Act, or the rules or the regulations made there under; and

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 the 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 scheme of penalties.

All the violations under section 15 shall be adjudicated by an adjudicating officer appointed by SEBI. The

Amendment Act, however, provides that all sums realised by way of penalties would be credited to the 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 proceedings.

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 the 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 the 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 there under shall be tried by a 'court of session' instead of 'a metropolitan magistrate or a judicial magistrate of the first class' as provided earlier.

Table 1: Scheme of Penalties 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 accounts 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	
15B	Failure by an intermediary to enter into agreement with clients as 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 CIS, including MFs, 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

Contd...

Table 1: *Contd...*

Section	Violations	Penalty	
		Before Amendment	After Amendment
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 MF to observe rules and regulations	Not exceeding Rs. 5 lakh / Failure	
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
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
15 H	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	Penalty which may extend up to Rs. 1 crore
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	
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 may extend to Rs. 25 crore or both

I. The Securities Laws (Amendment) Act, 2004[6]

The Securities Laws (Amendment) Act, 2004 was enacted to insert / amend provisions in the SCRA and the DA to: (a) enable demutualization and corporatisation of the stock exchanges, (b) fill up certain identified regulatory gaps such as units of MFs, delisting of securities, clearing corporation, for which there were no statutory provisions, (c) allow a broker of one exchange to trade with that of another so as to consolidate the market of the small exchanges, and (d) strengthen the penal framework for violation of securities laws.

A. Demutualisation of Exchanges

The stock exchanges, except two, are organised as "mutuals" which is considered beneficial in terms of tax benefits and matters of compliance. The trading members, who provide broking services, also own, control and manage the exchanges for their common benefit, but do not distribute the profits among themselves. In contrast, in a demutualised exchange, the ownership and management and the trading membership are segregated and vested generally with different sets of persons. The exchanges frame and enforce rules, which may not always further the public interest (interests of investors and society) and the private interest (interests of trading members) simultaneously. Theoretically public interest gets precedence in a demutualised exchange while private interest gets precedence in a mutual exchange in formulation and implementation of the rules. As the self (private interest) sometimes gets precedence over regulation (public interest), mutual exchanges do not offer an effective model for self-regulatory organisations, while demutual model eliminates conflict of interests and helps the exchange to pursue market efficiency and investor interests aggressively. Besides addressing the conflict of interest, the demutualisation offers several advantages. The limitations of a mutual structure has been realised time and again by the exchanges and the regulators. Recent happenings, particularly the 2001 stock market scam, made it clear that failure of the 'mutual' stock exchanges to resolve conflict of interest satisfactorily contributed to undesirable transactions in securities, which the SCRA aims to prevent. In order to address the malaise, the Finance Minister in March 2001 proposed corporatisation of stock exchanges by which ownership, management, and trading membership would be segregated from each other. The Joint Parliamentary Committee on the Stock Market Scam called for expeditious corporatisation and demutualisation of the stock exchanges. Its implementation, however, required certain amendments in the SCRA. The Securities Laws (Amendment) Act, 2004 made these amendments.

The SCRA permitted different structures for stock exchanges. That is why some exchanges are associations of persons, some are companies limited by shares, and some others are companies limited by guarantee. Since the law permitted any structure of organisation for a stock exchange, it was not possible to mandate a particular structure (corporate form) for all exchanges. Similarly, the SCRA did not prohibit brokers from owning and managing an exchange. That is why most of the exchanges are mutual exchanges which are owned and managed by brokers. Only two exchanges, on their own volition, have adopted demutual structure. Since the SCRA permitted either structure, it was not be possible to mandate only demutual structure for all exchanges. In order to mandate these, the Act has amended the SCRA to specify that all exchanges, if not already corporatised and demutualised, shall be corporatised and demutualised.

The process of demutualisation involves segregation of ownership and management from the trading rights of brokers. However, the process of corporatisation involves offering shares to public, including brokers. It is possible that the brokers subscribe for the shares and in terms of their rights under the Companies Act, 1956 get themselves elected to the board of directors. It may so happen that a stock exchange has only broker shareholders in the general body and broker directors in the governing body. Thus, even though an exchange is corporatised, it would not be demutualised, as the same set of people would be owning and managing the exchange and also trading on the exchange. The Act, therefore, restricts the participation of broker-shareholders in the general body as well as in the management of the exchange to ensure that the corporatised exchange is really demutualised.

The Act makes it mandatory that all stock exchanges, if not corporatised and demutualised, shall be corporatised and demutualised on and from the appointed date so notified in the official gazette by SEBI. It obligates the non-corporate and mutual exchanges to submit within such time, as may be specified by SEBI, a scheme for corporatisation and demutualization to SEBI for its approval. SEBI may, by a notification in gazette, specify the names of exchanges which are not required to submit a scheme. The scheme may provide for the issue of shares for a lawful consideration and provision for trading rights in lieu of membership cards, the restriction on voting rights, and the transfer of property, business and employees etc. SEBI may approve the scheme with or without modification if it is satisfied that it is in the interest of trade and also in the public interest. SEBI shall not approve any scheme of

[6] The Securities Laws (Amendment) Bill, 2003 was introduced in the Lok Sabha proposing the amendments effected through this Act. The Bill was referred to the Standing Committee on Finance for examination and report thereon. Before the Committee could submit its report, the Bill lapsed following the dissolution of the Lok Sabha. An Ordinance was promulgated on 12th October 2004 to give effect to the provisions of the Bill. This Act repealed the Ordinance.

demutualization and corporatisation if the issue of shares for a lawful consideration or provision of trading rights in lieu of membership card of the members of an exchange or payment of dividend to members is proposed out of any reserves or assets of the exchange. If a scheme is approved, it shall be published immediately by SEBI in the official gazette and by the Exchange in the newspapers. On such publication, the scheme shall have effect and shall be binding on all persons and authorities, notwithstanding any thing to the contrary contained in the Amendment Act or any other law for the time being in force. SEBI may reject a scheme if it is satisfied that it would not be in the interest of trade and also in the public interest, after giving a reasonable opportunity of hearing to all the persons and the exchange concerned. Such order of rejection shall also be published in the gazette. While approving the scheme, it may, by order, restrict (a) voting rights of the broker shareholders, (b) the rights of shareholders or brokers to appoint representatives on governing board of the Exchange, and (c) the maximum number of broker directors on the governing board, which shall not exceed one fourth of the total strength of the governing board. This order shall be published in the official gazette and on such publication, the order shall have full effect notwithstanding anything to the contrary contained in any other law for the time being in force. Within 12 months of such publication, the stock exchange concerned shall, either by fresh issue of equity shares to the public or in any other manner, as may be specified by the regulations made by SEBI, ensure that at least 51% of its equity shares is held by the public other than shareholders having trading rights. SEBI may extend this period by another 12 months in public interest. Any person aggrieved by an order of SEBI approving / rejecting the scheme can prefer an appeal before the SAT. If an exchange is not corporatised and demutualised by the appointed day or fails to submit a scheme for the same within the specified time or the scheme is rejected by SEBI, the recognition granted to such exchange shall stand withdrawn. The central government shall notify such withdrawal of recognition in the official gazette.

The Act envisages that entire assets / reserves of the exchange shall remain with the exchange even after demutualization. The shareholders / brokers can get full value through divestment of their holding only after the exchange is demutualised. They can not get any value if the exchange is not demutualised.

B. Regulatory Gaps

In view of so many regulators and so many statutes governing securities market, it is quite natural that there are a few regulatory gaps. The Act seeks to remove a few such regulatory gaps.

a. Units of Mutual Funds: Units of MFs resemble securities. They represent the interests of the unit holders in the specific scheme just as securities represent the interests of the holder in the issuer. The unit holder has similar rights as a security holder has on the future performance of any underlying asset or group of assets. Special kinds of units (units of assured return schemes), which represent the rights of investors on a fixed income flow over the future years or a fixed maturity value at the end of a specified period, are similar to debentures issued by companies. The units are issued, dematerialised, listed, and traded on exchanges in a manner similar to any other security. These are transferred from one holder to another or sold back to the issuer, at pre-specified or market determined values, just like shares, debentures and other securities are. The holders of units and securities have the same need for safety, liquidity and return. Despite such close similarities between units and securities, they were not explicitly treated legally at par. While the trading of securities issued by corporates is governed by SCRA and regulatory framework developed thereunder, trading of units were not subject to similar regulatory framework. In fact, trading of units was not subject to any regulatory framework. This presented a case of regulatory gap and this is one of the reasons why the secondary market for units has not developed appreciably. The easiest way to develop the market for units of MFs and protect the investors investing in them was to consider the units to be securities so that the regulatory framework applicable to trading of securities would also apply to trading of units and SEBI which has the responsibility to protect the interests of investors in securities, can protect the interest of holders of units of MFs also. Since the jurisdiction of SEBI is limited to securities market and the units of MFs were not explicitly recognised as securities in law, the actions of SEBI in protecting the interests of investors in units of MFs and developing a market for them was being challenged before the courts of law. In an appeal before SAT, an appellant contended that he was not covered by the Rules as he was not dealing in securities, but in units of MFs which were not securities and hence the SEBI had no powers, authority or jurisdiction to conduct any enquiry or impose any penalty on him. While disagreeing with this, the SAT considered the units of MFs to be securities in view of the object and purpose underlying the SEBI Act. This judicial pronouncement needed to be codified in law. The Act, therefore, expanded the definition of 'securities' to include units or any other such instrument issued to the investors under any MF scheme.

b. Delisting of Securities: Listing and delisting are two sides of the same coin. There is a substantial body of law that governs listing. The Companies Act makes it mandatory for a company issuing shares to public to list its securities on a stock exchange. The SCRA obliges the company to comply with the conditions of listing. It also allows a company to prefer an appeal before the SAT if a stock exchange refuses listing. The SCRR prescribe

requirements for listing on a stock exchange. It also regulates suspension and withdrawal of trading. So much of care and concern about listing; there are provisions about suspension of listing in statutes, rules and regulations. Unfortunately, delisting did not find place in any statute, rules or regulations. It was so far being regulated through a circular of government / SEBI, and recently by the guidelines of SEBI. Since the delisting is at least as important as listing, it was necessary that both have the same level of legal backing.

Since no such statutory provision existed, doubts were raised if delisting was permissible at all under the laws. It was argued in some circles that delisting should not be permitted at all. They argued that it was the intention of legislature, as there were statutes and rules to govern listing, but no statute/rule provided for delisting. It was probably considered that listing was so sacrosanct that once a security was listed, it should not be delisted. An investor subscribes to an issue on the basis of the contents in the prospectus which may state that the security would be listed on stock exchanges. Once he subscribes to the issue, he takes an irreversible decision, as the promises in the prospectus are irreversible. Hence if one considers investors' interests to be the predominant and sole factor, there should not be any delisting of securities. Another school argued that listing agreement was essentially a contract between a company and an exchange. Like any contractual relations, it must have also a way to terminate the relationship in certain circumstances. If there was a way to get in, there must also be a way to get out. Should the exchange and the company consider terminating their relationship, after taking care of the interests of the affected third parties (investors), they should be permitted to do so. In view of pros and cons of delisting, it may not be desirable to put an absolute ban on delisting but it may be regulated. The statute and rules must provide a framework for delisting, as it provided for listing. If it is in the interests of investors, it must be permitted. If it is not in the interests of investors, delisting may be allowed only if investors are adequately protected.

The Act, therefore, incorporates a new provision to allow delisting of securities. A stock exchange may delist securities, after recording reasons therefore, on any of the grounds as may be prescribed in the rules, after giving the company concerned an opportunity of hearing. A listed company or an aggrieved investor can file an appeal before SAT against the decision of the exchange to delist the securities.

c. Clearing Corporation: The securities laws did not explicitly recognize the existence of clearing corporation. They talked about trading and not much about settlement, which was left to byelaws of the exchanges. The byelaws are supposed to provide for clearing house (not clearing corporation) for settlement of securities transactions. However, clearing house has limitations in the age of anonymous order book ushered in by screen based trading system. The current trading system does not allow participants to assess the counter party risk and, therefore, requires the exchanges to use a clearing corporation to provide novation and settlement guarantee.

The Act inserted a new section in the SCRA to provide that an exchange may, with the approval of SEBI, transfer the duties and functions of a clearing house to a clearing corporation for the purpose of periodical settlement of contracts and differences thereunder, and delivery of and payment for securities. SEBI shall approve such transfer if it is in interest of trade and also in the public interest. Every clearing corporation must be a company and its byelaws must be approved by SEBI. The various provisions in the SCRA such as grant and withdrawal of recognition, supersession of management, suspension of business etc. applicable to stock exchanges shall, mutatis mutandis, apply to clearing corporations. This means that the clearing corporations must be recognized and subjected to the same regulatory framework as the stock exchanges are.

C. Integration of Trading Platform

As a matter of practice, the central government used to make two additional notifications while notifying the recognition of a stock exchange. One notification specified that section 19 of the SCRA shall come into force in the area earmarked for the recognized stock exchange. This notification prohibited trades in the earmarked area outside the exchange. The other notification specified that section 13 shall apply to the said area. This notification prohibited trades other than those between the members of the recognized stock exchange in that area. These provisions / notifications fuelled the mushrooming of exchanges in the nook and corner of the country as it ensured a geographical monopoly for them. However, with the advent of NSE and intensive use of IT in trading, these provisions worked to their disadvantage, as they could not expand their area of operation. In course of time SEBI allowed them to expand their operations to anywhere in the country making notifications under section 19 irrelevant.

21 small exchanges put together reported only 0.36% of turnover during 2003-04 while the two big exchanges accounted for the balance. Thus many exchanges have in course of time lost the *raison d'être* for their existence. They have been generating innovative ideas which can extend their life line. These included setting up of the Interconnected Stock Exchange and floating subsidiaries to become members of big exchanges. The market participants, exchanges and authorities now realize that no single exchange on its own can compete with the two big exchanges. They have been toying with an idea of *indonext* which would consolidate the trading platforms of small exchanges and provide an alternative to the trading platforms of the two big exchanges. It would be accessible

to all brokers of small exchanges and would provide business indirectly to small exchanges. In line with this thinking, small exchanges and one of the big exchanges, namely BSE, have come up with a variant of *indonext* in the name and style of BSE Indonext Segment where small cap companies listed on small exchanges or on BSE will be traded initially and only small and medium companies will be listed in this segment in future. This complements the Finance Minister's proposal in the last budget to create an alternative trading platform for small and medium enterprises to raise equity and debt from the market. This segment will be accessible to the members of the BSE and of the small exchanges. Since such a segment inevitably meant trading between members of two different exchanges, this was not possible in view of the restrictions in section 13 of the SCRA. The Act has, therefore, amended section 13 to allow trades within notified area among the members of recognized stock exchanges. With this amendment, it will be possible for trades to be executed on BSE Indonext Segment between, say, a broker of Jaipur Exchange and a broker of Gauhati Exchange. In such a case, the issue that arises is: the rules and byelaws of which exchange would govern trading and enforce settlement. This has been clarified in the Act that the contracts between two brokers of two different exchanges shall be subject to the terms and conditions of the respective exchanges with the prior approval of SEBI. This means that the trades on BSE Indonext Segment will be regulated in the manner specified by SEBI.

D. Scheme of Penalty

The securities market is an integral part of the economy. It has the potential to destabilise other sectors. It is, therefore, necessary that the penalty for offences in the securities market is deterrent. This is possible if the statutes identify the offences, prescribe stringent associated penalties and provide a fair and objective mechanism for imposition of such penalties. The Act has inserted / modified provisions in the SCRA and the DA to make the penalties really deterrent, mostly in synchronization with the provisions in the SEBI Act, 1992.

If an offence is cognizable, it is less likely to be committed. The offences which have the potential to destabilize the system or have serious implications otherwise have been declared cognizable under the Code of Criminal Procedure to reduce the likelihood of their occurrence. In view of their gravity, a few offences in the securities market, as listed in section 23 (1) of the SCRA, were cognizable. The Act made all the offences listed in section 23 of the SCRA cognizable. It further provided that these offences and all offences listed in section 23M (1) of the SCRA and section 20 (1) of the DA, on conviction, shall attract punishment in terms of imprisonment and / or fine, without prejudice to any award of penalty by the adjudicating officer.

The penalty prescribed under the SCRA and the DA was ridiculously low. Many of the offences under the SCRA attracted a penalty of Rs. 1,000, on conviction. For example, non-compliance of listing agreement, which can put investors to untold miseries and make a mockery of corporate governance norms, could be punished only up to Rs. 1,000. If listing agreement is to be effectively used to discipline a listed company, its non-compliance must invite a stringent punishment. Accordingly, the Act has increased the penalty to an imprisonment up to 10 years or fine up to Rs. 25 crore or both for all the offences listed in sections 23 and 23M (1) of the SCRA and section 20 of the DA.

Only a few offences were listed in the SCRA and the DA. These offences attracted punishment on conviction through prosecution. For obvious reasons, prosecution is not always the most efficient means of punishing the accused. Besides, a large number of offences were not listed in the statutes and hence there was no means to deal with such offences. For example, the failure to dematerialize or rematerialise securities within the specified time or failure to segregate the assets of clients was not listed as an offence. It was therefore necessary to identify all possible violations and prescribe a mechanism to deal with them. Further, certain entities like exchanges / depositories could not be punished adequately for violations by them. Only recourse available to the regulator in such cases was to withdraw the recognition of the exchange or supercede its management or cancel or suspend the registration of a depository. Such penalty leads to cessation of business and affects innocent third parties, often adversely, who deal with the exchange / depository. Monetary penalty is more efficient to deal with such violations. In order to address these infirmities, the Act has identified various possible violations, created a mechanism to establish the violation and, if warranted, impose monetary penalties.

The Act inserted provisions in the SCRA and the DA to empower SEBI to appoint adjudicating officers to adjudicate a wide range of offences, as listed under sections 23A to 23H in the SCRA and 19A to 19G in the DA, and impose monetary penalties for such offences. The adjudicating officer shall be an officer not below the rank of a division chief of SEBI. He will hold an inquiry after giving a person a reasonable opportunity of hearing for the purpose of determining if any violation has taken place and imposing penalty. He will hold inquiry in the manner prescribed in the Rules made by the government. He shall have powers to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or produce any document relevant for the inquiry. While adjudging the quantum of penalty, he shall have due regard to amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default, the amount of loss caused to an

investor or any group of investors as a result of default, and the repetitive nature of the default.

The Table 2 presents the penalties envisaged in the Act for different violations in the SCRA and in the DA:

Table 2: Penalties Provided in the Securities Laws (Amendment) Act, 2004

Sections	Violations	Penalty
Violations under the Securities Contract (Regulations) Act, 1956		
23 (1) & (2)	Various violations such as trades in contraventions of various sections of the Act, operating non-recognised exchanges, non-compliance with the orders of SAT, non-compliance with the conditions of listing etc.	Imprisonment up to 10 years or fine up to Rs. 25 crore or both, without prejudice to any award of penalty by the adjudicating officer
23A (a)	Failure by any person to furnish any information, document, books or returns or report to a stock exchange required under the Act or any rules made there under within specified time	Rs. 1 lakh for each day during which such failure continues or Rs. 1 crore, whichever is less
23A (b)	Failure by any person to maintain books of accounts or records as per listing agreement or conditions	
23B	Failure by any person to enter into agreement with his client under the Act or any byelaws of stock exchange made there under	
23C	Failure by a broker / sub broker / listed company / proposed to be listed company to redress the grievances of investors after having been called upon by SEBI to do so	
23D	Failure by a broker / sub-broker to segregate the assets of client(s) or uses the assets of a client(s) for self or any other client(s)	Penalty not exceeding Rs. 1 crore
23E	Failure by a company or any person managing collective investment scheme or MF to comply with listing / delisting conditions	Penalty not exceeding Rs. 25 crore
23F	Any issuer dematerializes securities more than the issued securities or delivers unlisted securities in the exchange	
23G	Failure or neglect by an exchange to furnish periodical returns to SEBI or make or amend its rules / byelaws as directed by SEBI or comply with directions of SEBI	
23H	Failure by any person to comply with any provision of the Act, the rules or articles or byelaws or the regulations of the exchange or directions issued by SEBI for which no separate penalty has been provided	Penalty not exceeding Rs. 1 crore
23M (1)	Contravenes or attempts to contravene or abets the contravention of the provisions of the Act or of any rules or regulations or byelaws made there under	Imprisonment up to 10 years or fine up to Rs. 25 crore or both, without prejudice to any award of penalty by the adjudicating officer
23M (2)	Failure to pay the penalty imposed by adjudicating officer or to comply with any of his directions or orders	Imprisonment up to 10 years (not less than one month) or fine up to Rs. 25 crore or both
Violations under the Depositories Act, 1996		
19A (a)	Failure by any person to furnish any information, document, books, returns or report to SEBI required under the Act or any rules or regulations or byelaws made there under within specified time	Rs. 1 lakh for each day during which such failure continues or Rs. 1 crore, whichever is less
19A (b)	Failure by any person to file any return or furnish any information, books or other documents required under the Act or any rules or regulations or byelaws made there under within the time specified	
19A (c)	Failure by any person to maintain books of accounts or records required under the Act or any rules or regulations or byelaws made there under.	
19B	Failure by an intermediary, including depository and depository participant, or an issuer to enter into agreement required under the Act or any rules or regulations made there under	
19C	Failure by an intermediary, including depository and depository participant, or an issuer to redress the grievances of investors after having been called upon by SEBI to do so	
19D	Failure by an intermediary or an issuer to dematerialize or rematerialize the securities within the time specified in the Act or regulations or byelaws or abetting the delay	

Table 2: *Contd...*

Sections	Violations	Penalty
19E	Failure by an intermediary or an issuer to reconcile the records of dematerialized securities with all the securities issued by the issuer as specified in the regulations	
19F	Failure by any person to comply with the directions issued by SEBI under section 19 within specified time	
19G	Failure by any person to comply with any provision of the Act, the rules or regulations or byelaws made or directions issued by SEBI there under for which no separate penalty has been provided	Penalty not exceeding Rs. 1 crore
20 (1)	Contravenes or attempts to contravene or abets the contravention of the provisions of the Act or of any rules or regulations or byelaws made there under	Imprisonment up to 10 years or fine up to Rs. 25 crore or both, without prejudice to any award of penalty by the adjudicating officer
20 (2)	Failure to pay the penalty imposed by adjudicating officer or to comply with any of his directions or orders	Imprisonment up to 10 years (not less than one month) or fine up to Rs. 25 crore or both

The Act, however, provides that all sums realised by way of penalties imposed by the adjudicating officers would be credited to the Consolidated Fund of India. This is probably to avoid conflict of interest that the beneficiary of the penalty should not determine if penalty is to be levied and if so, the amount of penalty. It further provides that non-payment of penalty imposed by an adjudicating officer or non-compliance with any of his orders or directions would be an offence punishable with imprisonment for a term between one month and ten years, or with fine up to Rs. 25 crore or with both.

To ensure fair inquiry and penalty, the Act provides that appeal against the orders of adjudicating officers (in addition to the orders of SEBI and of Exchanges as stated earlier) would lie to the SAT. Any person aggrieved by an order of SAT can prefer an appeal before the Supreme Court only on a question of law.

The Act empowers the SAT and the Courts to compound offences. They can compound any offence under the SCRA or the DA, 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, the Act empowers the central government to grant immunity, before institution of prosecution, to any person from prosecution for any offence under the SCRA / DA or the rules or the regulations made there under or from the imposition of any penalty under these Acts with respect to the 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 Acts or any rules or regulations or byelaws made there under shall be tried by a 'court of session' instead of 'a metropolitan magistrate or a judicial magistrate of the first class' as provided earlier. The court can take cognisance of the offences only on a complaint made by the central government or state government or SEBI or a stock exchange or any person.

The Act has inserted section 12A in the SCRA to empower SEBI to issue appropriate directions in the interest of investors and the securities market to any stock exchange, clearing corporation, such other person or agency providing trading, clearing or settlement facility in respect of securities or to any company whose securities are listed or proposed to be listed in a stock exchange. It can issue such directions if it is satisfied that it is necessary (a) in the interests of investors or orderly development of the securities market, or (b) to prevent the affairs of any stock exchange, clearing corporation, such other person or agency providing trading, clearing or settlement facility being conducted in a manner detrimental to the interests of investors or the securities market, or (c) to secure the proper management of any such entity.

The Act empowers central government to make rules under section 30 of the SCRA to provide for (a) the grounds for delisting of securities, (b) the manner of appeal before the SAT and (c) the manner of inquiry by the adjudicating officer. It also empowers government to make rules under section 24 of the DA to provide for the manner of inquiry by the adjudicating officer. These provisions are similar to those existing in the SEBI Act. It empowers SEBI to make regulations to provide of the manner for reducing the equity holding of brokers in exchanges to less than 49%.

Nine special legislative interventions since 1992 indicate generosity of authorities. Probably no sector of the Indian economy or elsewhere has witnessed so frequent legislative interventions. These have supported the participants to translate their imaginations in the market place and the authorities to undertake further reforms, which is an ongoing process.