

# **UNIT 10 REGULATORY FRAMEWORK FOR CAPITAL MARKET**

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## **10.0 OBJECTIVES**

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After reading this Unit, you will be able to :

- familiarise yourself with the regulatory framework governing the capital market in India,
- describe the statutory powers vested with SEBI as regulatory authority,
- state the norms for free pricing of new issues and entry for new issues,
- discuss the reforms introduced in the primary and secondary capital market, and
- summarise regulatory measures over insider trading.

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## **10.1 INTRODUCTION**

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We have learned in Unit 8 and 9 that several reforms have been introduced in both segments of capital market, namely primary market and secondary market. Keeping in view the role and significance of capital market in the economy and the volatile nature of reforms in general, and in the context of globalisation of economy in the particular, the regulation of the capital market is highly needed. Both these segments

and various participants therein are at present within the purview of a single regulatory authority i.e., the Securities and Exchange Board of India (SEBI). SEBI came into existence through a Resolution of the Government of India dated 12th April, 1988. Later, it acquired statutory recognition and status after the enactment of the Securities and Exchange Board of India Act, 1992.

SEBI has been constituted as a corporate body, having perpetual succession and a common seal. It consists of a chairman, two members each from amongst the officials of the Government of India and the Reserve Bank of India, besides two other members appointed by the Government of India.

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## 10.2 FUNCTIONS OF SEBI

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**SEBI** has been designated as the sole regulatory authority over the securities market. It has been entrusted with the duty –

- i) to protect the interests of investors in securities,
- ii) to promote the development of and securities market, and
- iii) to regulate the securities market.

Thus **SEBI** is not only a regulator, but is also a promoter of the securities market. Section 11 (2) of the Act outlines the regulatory activities of the Board as follows:

- 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, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and such other intermediaries who may be associated with securities markets in any manner.
- c) Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies, and any other intermediaries.
- d) Registering and regulating the working of venture capital funds and collective investment schemes including the mutual funds.
- e) Promoting and regulating self-regulatory organisations.
- f) Prohibiting fraudulent and unfair trade practices relating to securities markets.

- g) Promoting investors' education and training of intermediaries of securities markets.
- h) Prohibiting insider trading in securities.
- i) Regulating substantial acquisition of shares and take over of companies.
- j) Calling for information from companies, undertaking inspection, conducting inquiries and audit of the stock exchanges, mutual funds and other persons associated with the securities markets and intermediaries, and self-regulatory organisations in the securities market.
- k) Performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act 1956 as may be delegated to it by the Central Government.
- l) Levying fees and other charges for carrying out the purposes of Section 11.
- m) Conducting research for the above purposes.
- n) Calling from or furnishing to any such agencies, as may be specified by the Board, such information, as may be considered necessary by it for the efficient discharge of its functions.
- o) Performing such other functions as may be prescribed.

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### **10.3 POWERS OF SEBI UNDER THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992**

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Securities and Exchange Board of India has been conferred the following powers under the SEBI Act:

- i) **Power to Grant Registration Certificates to Intermediaries**

Section 12 of the Act provides for compulsory registration of the various intermediaries associated with the securities market. Hence all intermediaries, namely, stock broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment advisor, depository participant, custodian of securities, foreign institutional investor, credit rating agency and any other agency are required to buy, sell, or deal in securities in accordance with the conditions of a certificate of registration granted by SEBI.

SEBI is also empowered to suspend or cancel a certificate of registration after giving the person concerned a reasonable opportunity of being heard.

ii) **Registration of Venture Capital Funds and Collective Investment Schemes**

The Act requires a certificate of registration to be obtained from SEBI for sponsoring or carrying on any Venture Capital Fund and Collective Investment Scheme including Mutual Fund.

iii) **Power to Issue Directives to Intermediaries**

The Act confers upon SEBI powers to issue directions to any person or class of persons mentioned in (1) above, or who may be associated with the securities market, if SEBI is satisfied that such directions are necessary –

- a) in the interest of investors, or orderly development of the securities market, or
- b) to prevent the affairs of any of the above mentioned intermediaries/persons, being conducted in a manner detrimental to the interests of investors or securities market, or
- c) to secure proper management of any such intermediary or person.

iv) **Power to issue Directions to Companies**

For the protection of investors, the Board may specify the matters relating to issue of capital, transfer of securities and other matters incidental thereto, which shall be disclosed by the companies and also the manner in which to be disclosed.

v) **Power to Impose Penalties**

The Board may appoint any of its senior officers as Adjudicating Officer for holding an enquiry into various defaults and offences under the Act and for imposing penalties. Monetary penalties may be imposed on capital market intermediaries and other participants for a listed range of violations. An Appellate Tribunal may also be set up to hear appeals against the decisions of the adjudicating authority.

vi) **Power to Investigate into Irregularities**

SEBI possesses the power to investigate into irregularities and for this purpose it may summon the attendance of, and call for documents from all categories of market intermediaries, including persons in the securities market. SEBI is also empowered to issue directions to the aforesaid persons

## **10.4 SEBI'S POWERS UNDER SECURITIES CONTRACTS (REGULATION) ACT, 1956**

The following powers vested with the Government under the Securities Contracts (Regulation) Act, 1956 shall also be exercisable by SEBI to ensure more effective protection of the interests of investors and to create an efficient and well regulated stock market:

### **i) Recognition of Stock Exchanges**

A stock exchange may be recognised by SEBI, if it is satisfied that –

- a) the rules and bye-laws of the stock exchange are in conformity with the conditions prescribed to ensure fair dealings and to protect investors, and
- b) the stock exchange is willing to comply with any other conditions which may be imposed by the Government for carrying out the objectives of the Act.

The recognition may be granted subject to imposition of certain conditions also regarding qualifications of members, manner of entering contracts, representation of the government and maintenance of accounts. A stock exchange other than a recognised stock exchange is prohibited to function.

Every recognised stock exchange shall furnish to SEBI periodical returns regarding its affairs. SEBI is also authorised to appoint one/more person(s) to make an enquiry in relation to the affairs of the governing body of the stock exchange or any of its members.

SEBI is authorised to withdraw recognition granted to a stock exchange in the interest of the trade or in the public interest. It may supersede the Governing Body of a stock exchange and may appoint any person/persons to exercise all the powers and perform duties of the governing body. It is authorised to direct a recognised stock exchange to suspend its business for a period upto seven days in case an emergency arises. The period of suspension may also be extended.

SEBI also enjoys the authority to approve the bye-laws of the stock exchange or to make such bye-laws. A stock exchange may also establish additional trading floor with the prior permission of SEBI. The Central Government/

SEBI is authorised to prohibit the sale or purchase of any specified security, except with the permission of the Central Government, in order to prevent undesirable speculation in that security/securities in any state/area.

ii) **Listing of Securities**

Where securities are listed on the application of any person in any recognised stock exchange, such person is required to comply with the conditions of the listing agreement with that stock exchange.

A stock exchange may refuse to list the securities of any public company in accordance with the powers vested in it in its bye-laws. The company may in that case appeal to the Central Government, whose decision shall be final.

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## **10.5 ORGANISATIONAL SET-UP OF SEBI**

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To exercise its powers and perform its functions, SEBI has set up the following Departments:

i) **Primary Market Department**

This department looks after all policy matters and regulatory issues for primary market, registration, regulation and monitoring of merchant bankers, portfolio management services, investment advisors, debenture trustees, etc.

ii) **Issue Management and Intermediation Department**

This department vets prospectus, letters of offers for public and right issues, coordinates with primary market policy for framing rules, issues guidance notes and clarifications, etc.

iii) **Secondary Market Department** (Policy, Operating and Exchange Administration New Investment Products, Insider Trading)

This department is responsible for all policy and regulatory issues for secondary markets, and new investment products, registration and monitoring of stock exchanges.

iv) **Secondary Market Department** (Exchange Administration, Inspection and Non-Member Intermediaries).

v) **Institutional Investment Department** (Mutual funds and Foreign Institutional Investment).

This department is responsible for policy, registration, regulation and monitoring of foreign institutional investors, domestic mutual funds, policy and regulation of substantial acquisition of shares.

### Check Your Progress 1

- 1) Give three important regulatory functions and three promotional functions of SEBI as given in the SEBI Act, 1992.
- 2) Name the intermediaries who are regulated by SEBI under the SEBI Act, 1992.

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- 3) Identify the powers of SEBI to issue directives to the intermediaries and the companies.

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- 4) Explain the provisions regarding recognition of Stock Exchanges by SEBI.

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## 10.6 GUIDELINES FOR DISCLOSURE AND INVESTOR'S PROTECTION

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The Securities and Exchange Board of India issued these guidelines in June, 1992 after the Capital Issues (Control) Act, 1947 was repealed. These guidelines, apply to all issues made subsequently. In these guidelines, SEBI has permitted certain categories of companies to fix the premium on new issues of shares themselves. Moreover, the guidelines require the issuer (companies) to disclose full facts and particulars to the intending investors in their offer documents and also prescribe other rules in connection with the issue of shares, which we shall study subsequently.

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## 10.7 FREE PRICING OF NEW ISSUES

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These guidelines have categorised the companies going for public issues into three categories. Within each category, companies fulfilling certain conditions are allowed to fix the premium freely and the rest are permitted to issue shares at par only:

- i) new companies,
- ii) existing private/closely held companies
- iii) existing listed companies

**i) First Issue of New Companies**

A new company is one, which has not completed 12 months of commercial operations and its audited results are not yet available. If a new company is set up by entrepreneurs without a track record, it will issue capital to public only at par.

But, if a new company is being set up by an existing company with a five year track record of consistent profitability, it will be free to price its issue, provided the promoting company contributes 50% of the equity of the new company. The issue price is made applicable to all new investors uniformly and the prospectus contains justification for issue price. If more than one company promotes a new company, each of them must fulfil the profitability criterion, i.e., profits must exist in five out of seven preceding years with profits in the last two years.

**ii) First Issue by Existing Closely Held Unlisted Companies**

Such companies with a three year track record of consistent profitability are permitted to freely price the issue of the share and list the securities on the stock exchanges. Three years track record means profits in three out of preceding five years with profits during the last two years prior to the issue. In case of public sector banks, the track record of consistent profitability should be for two years only.

A company which does not have three years track record of consistent profitability, can issue capital to public for raising additional capital only at par provided not less than 20% of the total issued capital (expended capital) is offered to public.

A company without a three year track record of consistent profitability, which has been promoted by other company/companies with a five years track record of consistent profitability will have the freedom to price the share, provided the promoting company/companies contribute not less than 50% of the total issued capital subject to lock-in-period.

The pricing will be determined by the issuer and the lead managers to the issue and would be subject to specific disclosure requirements including -

- a) disclosure of the net asset value of the company as per the last audited balance sheet, and
- b) justification for the issue price.

These companies are allowed to raise fresh capital by freely pricing their further issues. The issue price will be determined by the issuer in consultation with the lead managers to the issue. The prospectus or offer document should contain the net asset value of the company and a justification for the price of the issue. High and Low prices of the shares for the last two years should also be mentioned.

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## **10.8 ENTRY NORMS FOR NEW ISSUES**

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In order to improve the quality of paper entering the primary market, SEBI introduced a very effective regulatory step by prescribing the entry norms for the issuer companies. The guidelines issued by SEBI on April 16, 1996 as subsequently amended, are as follows:

- i) No company, intending to get its securities listed on any stock exchange, shall make the first offer to the public of equity or bonds convertible into equity, unless it has a track record of dividend payment in immediately preceding three years. By track record of dividend payment is meant that dividend has been declared in each of the three years.
- ii) If the company is a manufacturing company and does not satisfy (i) above, it can make for the first time an offer only if –
  - a) a scheduled bank or a public financial institution has appraised the project to be financed through the public issue, and
  - b) the bank/public financial institution is partly financing the project by way of loan/equity to the extent of 10% of the project cost.

This condition has been extended to the services sector also.
- iii) An existing company, whose securities are listed on any stock exchange, shall have to satisfy either of the above conditions (i.e. (i) or (ii) above) before the public issue, if its net worth, after the offer to the public, becomes more than five times the net worth prior to such offer.
- iv) The above entry norms will not apply to the public sector banks. If they want to issue capital at a premium, two years profitability record will be sufficient as against three years' requirement for others. New private sector banks are allowed issues at par.

In June 2000, the SEBI further tightened the entry norms for IPOs as follows:

- a) IPO of size upto 5 times the pre-issue networth is allowed

only if the company has a record of profitability and networth as specified above.

- b) Companies without such track record or the issue size beyond 5 times the pre-issue networth are allowed to make IPOs only through the Book Building route and 60% of the issue to be allotted to qualified institutional borrowers.
- v) The above entry norms are also not applicable to offer for sale/bought out deals to be listed on the OTCEI, provided these were registered with OTCEI on or before April 16, 1996.

In March 1999, SEBI relaxed entry norm (No. (i) above) by changing the requirement of actual payment of dividend in three years to 'ability to pay dividend' in terms of Section 205 of the Companies Act, 1956. In such cases, an additional requirement has also been prescribed for the companies intending to come out with an initial public issue based on ability to pay dividend i.e., they should have a minimum pre-issue net worth of not less than Rs. 1 crore in three out of the preceding five years, with a minimum net-worth to be met during the immediately preceding two years.

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## **10.9 PRIMARY CAPITAL MARKET REFORMS**

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Following the acquisition of statutory status by SEBI and enhancement of its powers, the Securities and Exchange Board of India has introduced a number of regulatory measures with the object to reform the capital market and to protect the investors' interest. In this section, we shall deal with the various regulatory steps undertaken by SEBI in the primary new issues market.

### **i) Regulation over Intermediaries**

All intermediaries in the primary and secondary markets have been brought under the SEBI's regulatory purview for the first time. SEBI has notified rules and regulations for the intermediaries, namely, merchant bankers, brokers and sub-brokers, portfolio managers, underwriters, registrars, share transfer agents, etc. These rules and regulations prescribe, besides others, for their registration with SEBI, capital adequacy norms, obligations and responsibilities, procedure for inspection by SEBI and action to be taken against defaulting intermediaries. They have to abide by the Code of Conduct prescribed for them.

The multiple categories of merchant bankers have been abolished and replaced by a single category. Moreover, only corporates are allowed to function as Merchant Bankers. Merchant Bankers are permitted to carry out issue

management activity only and are prohibited from undertaking any fund-based activity such as acceptance of deposits, leasing and bills discounting. They are required to acquire a certificate granted by SEBI for carrying on their business. The registration can be suspended or cancelled by SEBI if it decides to do so. Separate rules and regulations have been prescribed by SEBI for registrars to issue and share transfer agents, stock brokers and sub-brokers, portfolio managers, etc. Thus all these intermediaries are within the regulatory supervision of SEBI. The latter is vested with the powers to take action against them if defaults/irregularities are noticed in their functioning.

#### ii) **Disclosures in Offer Documents**

To enable the investors to make informed investment decisions based on full transparency of facts, SEBI has issued detailed guidelines for the disclosures of full facts in the Prospectus/offer documents by the issuer companies. The latter are required to disclose all material facts and specify the risk factors associated with their projects, while making public issues. In case of the existing companies, financial performance of the company for the last five years, along with justification of premium and risk factors and management perception of risk factors are also required to be published in the prospectus/offer document.

Though the Public Issue offer document is now not vetted by **SEBI**, a draft prospectus/offer document is filed with SEBI, and it is deemed as a public document. Merchant bankers are required to file its copies with stock exchanges where the shares are proposed to be listed. Copies are also to be made available to the public. Thus the prospectus/offer document is made available for scrutiny by all concerned before its finalisation. Lead Manager to the issue is required to give a due diligence certificate regarding disclosures made in the offer document. Such certificate will be a part of the offer document itself for better accountability and transparency on the part of the Lead Manager.

#### iii) **Code of Advertisement**

SEBI has issued a code of advertisement for public issues to ensure that the advertisement is truthful, fair and clear, and does not contain any statement which is untrue or misleading. It shall be the responsibility of the Lead Manager to ensure strict compliance with the code of advertisement by the issuer company.

#### iv) **Underwriting**

Underwriting of new issues is not mandatory since 1994. If the issue is underwritten, the Lead managers must satisfy

themselves about the net worth of the underwriters and the outstanding commitments and disclose the same to SEBI.

If the issue is not underwritten and the company is unable to collect 90% of the amount offered to the public, or if the issue is underwritten and the company is unable to receive 90% of issued amount from public subscription plus accepted devolvement from underwriters, within 60 days from the closure of the issue, the company shall refund the full subscription amount. Minimum subscription clause is applicable to both public and right issues and not to offer of sale of securities.

**v) Allotment of Securities**

The following rules have been laid down in connection with allotment of securities:

- a) The minimum percentage of securities to be issued to the public for the purpose of listing was reduced from 60% to 25%.
- b) Allotment procedure was revised to introduce the requirement that shares be allotted on a pro-rata basis.
- c) A norm of five shareholders for every Rs. 1 lakh of fresh issue of capital and ten shareholders for every Rs. 1 lakh of offer for sale was prescribed as an initial and continuing listing requirement.
- d) Payment of any direct or indirect discounts or commissions to persons receiving firm allotment has been prohibited.
- e) The practice of making preferential allotment of shares at prices unrelated to the prevailing market prices has been stopped and fresh guidelines issued by SEBI in this regard. Issue of shares on a preferential basis can be made at a price not less than the higher of the following:

average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during six months preceding the relevant date

OR

the average of the weekly high and low of the closing prices of the share during the two weeks preceding the relevant date.

- f) A system of appointing SEBI representatives to supervise the allotment process was introduced to minimise malpractices in allotment of over-subscribed public issues.
- g) Public Sector bonds are now within the regulatory authority of SEBI.

- 1) Fill up in the blanks:
  - i) Under the new guidelines issued by SEBI relating to free pricing of new issues the companies have been divided into ..... categories for public issues.
  - ii) Existing private companies having ..... year track record of consistent profitability are permitted to freely price the issue of share and list the securities on the stock exchanges.
- 2) State true or false:
  - i) All intermediaries in the primary and secondary markets have been brought under the SEBI regulation. (T/F)
  - ii) Lead Manager is not required to give a due diligence certificate regarding disclosures made in the offer document. (T/F)
  - iii) The minimum percentage of securities to be issued to the public for the purpose of listing has been reduced from 60% to 25%. (T/F)

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## **10.10 SECONDARY MARKET REFORMS**

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The Securities and Exchange Board of India has undertaken a number of measures for streamlining the functioning of the secondary market. These measures aim at improving market efficiency, making stock market transactions more transparent, curbing unfair trade practices and bringing capital market upto international standard.

### **i) Regulation over Stock Exchanges**

As already noted, the Government of India delegated its powers to SEBI to regulate the Stock Exchanges. SEBI directed the Stock Exchanges to broad base their Governing Boards and change the composition of their arbitration, default and disciplinary committees. The Governing Board should comprise of equal number of elected stockbroker directors and SEBI/Government nominees. Representation of stockbroker directors shall be limited to 40 percent on the disciplinary committee.

SEBI has commenced inspecting the affairs of Stock Exchanges and enquiries have been ordered into the affairs of their Governing Boards.

### **ii) Capital Adequacy Norms for Brokers**

SEBI has prescribed capital adequacy norms for brokers so as to ensure that such brokers' firms are adequately

capitalised in relation to their outstanding position. These norms prescribe a base Minimum Capital plus additional capital related to the volume of business. Stock Exchanges have amended their bye-laws in this regard.

iii) **Transparency in Client-broker Relationship**

SEBI has made it mandatory for brokers to maintain separate accounts for their clients and for themselves. They must disclose the transactions price and brokerage separately in the contract notes issued to their clients. Brokers must get their account books audited and the audit report filed with SEBI. Contract notes are to be issued within 24 hours.

iv) **Revision of Listing Agreements**

SEBI advised the Stock Exchanges to amend the listing agreements to ensure that a listed company furnishes annual statement to the Stock Exchanges showing variations between financial projections and projected utilisation of funds made in the offer documents and actuals. Thus, the shareholders can make a comparison between promises and performance.

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## **10.11 REGULATION OVER INSIDER TRADING**

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With a view to ensure fairness in securities trading, and to eliminate the ill effects of insider trading, SEBI framed SEBI (Insider Trading) Regulations in 1992. According to these regulations an insider is prohibited from:

- a) dealing either on his own behalf or on behalf of any other person in securities of a company, listed on any stock exchange on the basis of any unpublished price sensitive information, or
- b) communicate any unpublished price sensitive information to any person, except as required in the ordinary course of business or under any law, or
- c) counsel any other person to deal in securities of any company on the basis of unpublished price sensitive information.

**Unpublished Price Sensitive information** is defined, as any information, which relates to the following matters and is generally not published by the company for general information, but which, if published or because known, is likely to materially affect the price of the securities in the market.

- i) financial results,
- ii) intended declaration of dividends,

- iii) issue of bonus, right shares,
- iv) any major expansion plan/execution of new projects,
- v) amalgamations, mergers, take-overs,
- vi) disposal of undertaking, and
- vii) any change in policies, plans or operations of the company.

**An insider** is a person who is or was connected with the company and is reasonably expected to have access to unpublished price sensitive information.

Any insider who contravenes any of the above provisions will be guilty of Insider Trading. SEBI has the power to investigate into and inspect the books of accounts, either records or documents of an insider upon receipt of any complaint-alleging insider trading, or upon its own knowledge and information. On the basis of the investigation report, SEBI may give necessary directions to the insider to protect the interest of investors as well as of securities market.

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## **10.12 REGULATION OVER SECURITY DEPOSITORIES AND PARTICIPANTS**

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The Securities Depositories and the participants have also been brought within the regulatory authority of SEBI. It has made SEBI (Depositories and Participants) Regulations in 1996. The salient features of these regulations are as follows:

- i) A securities depository may be sponsored by any one of the followings, namely, a public financial institution, a scheduled bank, a foreign bank, a recognised stock exchange, a financial services company (at least 75% of its capital must be held by the above mentioned institutions jointly or severally), a foreign company providing custodial, clearing or settlement services in securities market and foreign financial services company approved by the Central Government.
- ii) The sponsor shall hold at least 51% of the equity capital of the depository. The balance shall be held by participants. No participant shall hold more than 5% of the equity capital of the depository.
- iii) A certificate of registration and a certificate of commencement of business must be obtained by the sponsor from SEBI.
- iv) The depository must have a net worth of not less than Rs.100 crores and must have established the infrastructure facilities and systems.

- v) The participants are required to obtain a certificate of registration from SEBI, which shall be valid for a period of five years and may be renewed thereafter. Besides, the institutions mentioned in (i) above, a clearing corporation (or a clearing house) of a stock exchange, a stock broker (with minimum net worth of Rs.50 lakhs), and a non-banking finance company (with minimum net worth of Rs.50 lakhs) may also apply for registration as participant.
- vi) SEBI has the right to undertake inspection of the books of accounts, records, documents, infrastructure, systems and procedures or to investigate the affairs of a depository, a participant, a beneficial owner, an issuer or its agent.
- vii) SEBI possesses the power to suspend the certificate of registration granted to a depository or a participant if it contravenes any provision or defaults otherwise.
- viii) SEBI may cancel the certificate of registration granted to a depository or participant if:
  - a) it is guilty of fraud, or has been convicted of an offence involving moral turpitude, or
  - b) has been guilty of repeated defaults.

SEBI has taken several initiatives to promote dematerialised or paperless trading. SEBI has introduced compulsory trading in shares in dematerialised form in specified scripts by institutional investors (i.e. mutual funds, banks, financial institutions and foreign institutional investors) with effect from January 15, 1998. The list of shares for compulsory dematerialising trading is gradually expanding.

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### **10.13 SUBSTANTIAL ACQUISITION OF SHARES AND TAKE-OVERS**

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Substantial acquisition of shares and take-over have been brought within the regulatory umbrella of the SEBI. It has issued SEBI (Substantial Acquisition of Shares and Take-over) Regulations, which provide a transparent process to be followed by the acquirer of the shares. Its main objective is to protect the interest of minority shareholders. The main features of these Regulations are as follows:

- i) Every shareholder holding more than 10% shares of a company or voting rights or having control over the company shall have to declare to the company the number and percentage of shares held by him.
- ii) An acquirer, who wants to acquire shares/voting rights/control (which alongwith his existing voting rights/shares shall exceed 10% of the shares of the company), shall have to make a public announcement through advertisement in

newspapers to acquire shares. A copy of the public announcement shall be sent to SEBI and all stock exchanges where the shares are listed. A letter of offer shall also be sent to the SEBI, who may suggest changes therein. Thereafter it is sent to the shareholders of the Company concerned.

- iii) The offer to acquire the shares shall be made at a minimum offer price, which shall be fixed in the manner prescribed.
- iv) The public offer shall be made to the shareholders of the target company to acquire from them an aggregate minimum of 20% of the voting capital of the company.
- v) Any other person who is desirous of making any offer shall, within 21 days of public announcement of the first offer, make a public announcement of his offer for acquisition of the shares of the same target company.
- vi) Upon the public announcement of the competitive bid/bids, the first acquirer shall have the option to announce:
  - (a) a revision of the offer, or
  - (b) withdrawal of the offer with the prior approval of the Board.
- vii) By way of security for performance of his obligations under the regulations, the acquirer shall deposit in an escrow account the sum which will be 25%, if the consideration payable is upto Rs. 100 crore and 10% thereafter.
- viii) Within thirty days after the closure of offer, the acquirer shall make payment for shares offered for sale.

**Check Your Progress 3**

- 1) What do you understand by Insider Trading? What regulation has been imposed on it by SEBI?

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- 2) List three salient features of regulation over securities depositories.

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3) Which option can the acquirer have upon the public announcement of the competitive bid?

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## 10.14 LET US SUM UP

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The primary market and secondary market and the various participants are regulated by Security and Exchange Board of India (SEBI). It has been given the statutory recognition under Securities and Exchange Board of India, Act, 1992. On the one hand, it protects the interests of investors in securities through various regulatory measure, on the other hand, it also promotes the development of securities market. SEBI has been conferred the powers to grant registration certificates to intermediaries and issue directives to them and the companies. It also has the powers to investigate into irregularities and impose the penalties.

Securities and Exchange Board of India has brought about reforms in the new issues market by issuing guidelines for disclosure and Investor Protection, pricing of new issues by companies, entry norms for new issues. SEBI has also taken various steps for reforms in the primary new issues market. All these measures have been duly discussed.

SEBI has made a number of efforts to reform the secondary market, which include regulation over stock exchanges, prescription of capital adequacy norms for brokers, regulation over insider trading, regulation over depositories and participants and rules for substantial acquisition of shares and take-overs.

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## 10.15 KEY WORDS

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**Capital Market** : Capital market is that segment of the financial market wherein transactions involving long term funds are undertaken. For example, the securities market, where transactions in long and medium term securities are under-taken is known as the capital market.

**Closely held company** : Closely held company is that company in which the majority of shares are held by a few shareholders.

**Entry Norms for new Issues** : Securities and Exchange Board of India has prescribed certain conditions to be satisfied by a company before it issues its securities in the primary market. Such conditions are known as Entry Norms for new issues.

**Free Pricing of New Issues** : The price at which a new security is to be issued to be determined freely by an issuer of a security is called free pricing of new issues. In other words, the premium to be charged is decided by the issuer company itself.

**Insider Trading** : Insider trading is dealing, either on his own behalf of a company listed on any stock exchange on the basis of any unpublished price sensitive information (i.e. information, if published, is likely to materially affect the price of the security).

**Intermediaries** : Intermediaries are those persons who are associated with the securities market and act in between the investors and the issuers of securities. They facilitate the securities transactions, for example, merchant bankers, brokers, underwriters, Registrar to an issue, depository participants, etc.

**Listing of Securities** : When a particular security is approved by the Stock Exchange for being transacted at that Exchange, it is called as listing of the security. The company whose security is listed is called a listed company.

**Merchant Bankers** : Merchant Bankers are the intermediaries in the financial markets, who render various non-fund based services to their company clients, e.g. management of new issues, syndication of loans, etc.

**Mutual Fund** : A mutual fund is a collective investment devise established as trusts. Mutual fund collects the

savings of the investors by issuing units under various schemes and invest them in transferable securities in the capital market.

- Primary Market** : That segment of the capital market in which new securities are issued by the issuer to the investors for the first time.
- Scheduled Bank** : A bank whose name has been included in Second Schedule to the Reserve Bank of India Act. The bank must satisfy the conditions prescribed in Section 42 of the Reserve Bank of India Act.
- Secondary Market** : That segment of the capital market in which existing (i.e. already issued) securities are dealt with.
- Securities Depository** : Securities depository keeps the record of the securities held by investors in dematerialised form, i.e. transactions in securities are recorded in the books itself and physical securities no more remain in existence.
- Stock Exchange** : Stock Exchange is an organised market for undertaking secondary market transaction in securities.
- Underwriters** : Underwriters are those intermediaries who take upon themselves the responsibility to subscribe to that portion of the securities issued by a company which remain un-subscribed by the investing public.

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## 10.16 SOME USEFUL BOOKS

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*Annual Reports of Securities and Exchange Board of India* (1996), RBI.

Avadhani, V.A. (1996): *Investment Management*.

Avadhani V.A. (1996): *Investment and Securities Markets in India*.

*Economic Survey (Government of India) (Relevant Chapters)*, 2002.

L.M. Bhrole (2000): *Financial Institutions and Markets*. Himalaya Publishers, Mumbai.

Machiraju, H.R. (1998): *Indian Financial System*, Vikas Publishing House.

*Report on Currency and Finance (Reserve Bank of India)* (Relevant Chapters), 1996.

Sundharam, K.P.M. and Varshney, P.N. (2000): *Banking and Financial System*, Sultan Chand and Sons, Delhi

Taxman (1998): *Companies Act with SEBI Rules/Regulations and Guidelines*.

Varshney P.N. and Mittal D.K. (2002): *Indian Financial System*, Sultan Chand and Sons, Delhi

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## **10.17 ANSWERS/HINTS TO CHECK YOUR PROGRESS**

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### **Check Your Progress 1**

- 1) See Section 10.2
- 2) Stock broker, sub-broker, share transfer agent, banker to an issue, transfer of trust deed, merchant banker, underwriter, port-folio manager, investment advisor, depository participant, credit rating agencies, foreign institutional investment etc.
- 3) See Section 10.3 under point 3 and 4.
- 4) See Section 10.4

### **Check Your Progress 2**

- 1) (i) three (ii) three
- 2) (i) True (ii) False (iii) True

### **Check Your Progress 3**

- 1) Insider trading refers to dealing in securities of a company by a person who is or was connected with the company and having access to unpublished price sensitive information. Such a person is prohibited from dealing in security of a company communicating any unpublished price, and counselling another person who deals in securities on the basis of unpublished price sensitive information.
- 2) See Section 10.12
- 3) A revision of the offer or withdrawal of the offer.