

ROLE OF SEBI IN PRIMARY MARKET: A CRITICAL STUDY

Satyam Singh

Research Scholar

DDU Gorakhpur University Gorakhpur.

Dr. Shailesh Kumar Singh

Assistant Professor

DDU Gorakhpur University Gorakhpur.

INTRODUCTION

Every modern economy is based on sound financial system which helps in production, capital and economic growth by encouraging savings habit, mobilizing savings from households and other segments and allocating savings into productive usage such as trade, commerce, manufacture, etc.

1. Financial Markets:

Efficient transfer of resources from those having idle resources to others who have a pressing need for them is achieved through financial markets. Stated formally, financial markets provide channels for allocation of savings to investment. These provide a variety of assets to savers as well as various forms in which the investors can raise funds and thereby decouple the acts of saving and investment. The savers and investors are constrained not by their individual abilities, but by the economy's ability, to invest and save respectively.¹ The financial markets, thus, contribute to economic development to the extent that the latter depends on the rates of savings and investment. The financial markets have two major components; the money market and the capital market.

❖ *Money Market*

The money market refers to the market where borrowers and lenders exchange short-term funds to solve their liquidity needs. Money market instruments are generally financial claims that have low default risk, maturities under one year and high marketability.

❖ *Capital Market*

The Capital Market is a market for financial investments that are direct or indirect claims to capital. It is wider than the Securities Market and embraces all forms of lending and borrowing, whether or not evidenced by the creation of a negotiable financial instrument.² The Capital Market comprises the complex of institutions and mechanisms through which intermediate term funds and long term funds are pooled and made available to business, government and individuals. The Capital Market also encompasses the process by which securities already outstanding are transferred.

¹ Data retrieved from, <http://www.studymode.com/essays/Markets-And-Financial-Instruments-1485500.html>, on 20 April, 2013

² *Ibid*

❖ Securities Market

The Securities Market, however, refers to the markets for those financial instruments/claims/obligations that are commonly and readily transferable by sale. The Securities Market has two inter-dependent and inseparable segments, the new issues (primary) market and the stock (secondary) market.³ We will be dealing with the same in 3rd chapter of the project.

2. SEBI: A brief Introduction:

The Government has set up the Securities & Exchange Board of India (SEBI) in April, 1988. For more than three years, it had no statutory powers. Its interim functions during the period were (i) To collect information and advice the Government on matters relating to Stock and Capital Markets (ii) Licensing and regulation of merchant banks, mutual funds etc. (iii) To prepare the legal drafts for regulatory and development role of SEBI and (iv) To perform any other functions as may be entrusted to it by the Government. The need for setting up independent Govt. agency to regulate and develop the Stock and Capital Market in India as in many developed countries was recognised since the Sixty Five Year Plan was launched (1985) when some major industrial policy changes like opening up of the economy to outside world and greater role to the Private Sector were initiated. The rampant malpractices noticed in the Stock and Capital Market stood in the way of infusing confidence of investors which is necessary for mobilisation of larger quantity of funds from the public and help the growth of the industry.⁴

The malpractices were noticed in the case of companies, merchants bankers and brokers who are all operating in the Capital Market. The need to curb these malpractices and to promote healthy Capital Market in India was felt. The security industry in India has to develop on the right lines for which a competent Govt. agency as in U.K. (SIB) or in U.S.A. (SEC) is needed.

As referred to earlier, malpractices have been reported in both the primary market and secondary market. A few examples of malpractices in the primary market are as follows:

- a) Too many self style Investment Advisors and Consultants.⁵
- b) Grey Market or unofficial premiums on the new issues.
- c) Manipulation of market prices before new issues are floated.
- d) Delay in allotment letters or refund orders or in despatch of share certificates.
- e) Delay in listing and commencement of trading in shares.

³ A K Majumdar, *Company Law and Practice*, Taxmann, (2000), at p 56

⁴ K.C. Garg, *Company Law*, Kalyani Publishers, 18th edn.

⁴⁵ Recently SEBI came out with (Investment Advisers) Regulations, 2013.

A few examples of malpractices in the secondary Market are as follows:

- a) Lack of transparency in the trading operations and prices charged to clients.
- b) Poor services due to delay in passing contract notes or not passing contract notes, at all.
- c) Delay in making payments to clients or in giving delivery of shares.
- d) Persistence of odd lots and refusal of companies to stop this practice of allotting shares in odd lots.
- e) Insider trading by agents of companies or brokers rigging and manipulating prices.
- f) Takeover bids to destabilise management.

The SEBI has been entrusted with both the regulatory and developmental functions. The objectives of SEBI are as follows:

- a. Investor protection, so that there is a steady flow of savings into the Capital Market.
- b. Ensuring the fair practices by the issuers of securities, namely, companies so that they can raise resources at least cost.
- c. Promotion of efficient services by brokers, merchant bankers and other intermediaries so that they become competitive and professional.

Pending the legislative sanction to SEBI it carried out the functions of supervisory and advisory body of the Govt. It has initiated the basis for control and regulation of the market, arranged for the licensing of merchant banks, mutual funds etc. and performed the advisory functions to the Government.

SECURITIES MARKET

The Securities Market allows people to do more with their savings than they would otherwise could. It also provides financing that enables people to do more with their ideas and talents than would otherwise be possible. The people's savings are matched with the best ideas and talents in the economy. Stated formally, the Securities Market provides a linkage between the savings and the investment across the entities, time and space. It mobilises savings and channelises them through securities into preferred enterprises.⁶

⁶ Sanjeev Aggarwal, *Guide to Indian Capital Market*, Bharat Law House.

The Securities Market also provides a market place for purchase and sale of securities and thereby ensures transferability of securities, which is the basis for the joint stock enterprise system. The existence of the Securities Market makes it possible to satisfy simultaneously the needs of the enterprises for capital and the need of investors for liquidity.

As we have learned the capital market functioning in India in the first chapter of the project it becomes relevant for us to bifurcate securities market. Securities market like any other market can be classified into primary and secondary market.

- **Primary Market:**

The primary market provides the channel for sale of new securities. Primary market provides opportunity to issuers of securities; Government as well as corporates, to raise resources to meet their requirements of investment and/or discharge some obligation. They may issue the securities at face value, or at a discount/premium and these securities may take a variety of forms such as equity, debt etc. They may issue the securities in domestic market and/or international market.⁷

The primary market enables the government as well corporates in raising the capital that is required to meet their requirements of capital expenditure and/or discharge of other obligations such as exit opportunities for venture capitalist/ PE firms. The most common primary mechanism for raising capital is an Initial Public Offer (IPO), under which shares are offered to the public as a precursor to trading in the secondary market of an exchange. The price at which the shares are to be issued is decided with the help of the book building mechanism; in the case of oversubscription, the shares are allotted on a pro rata basis.

When securities are offered exclusively to the existing shareholders of company, as opposed to the general public, it is known as Rights Issue. Another mechanism whereby a listed company can issue equity shares, as well as fully and partly convertible debentures that can be later converted into equity shares, to a Qualified Institutional Buyer (QIB) is termed as Qualified Institutional Placement. In addition to raising capital in the domestic market, companies can also issue securities in the international market through the ADR/GDR/ECB route to raise capital.⁸

The primary market provides the channel for sale of new securities, while the secondary market deals in securities previously issued. The issuer of securities sells the securities in the primary market to raise funds for investment and/or to discharge some obligation.

⁷ V.L. Iyer, *SEBI Practice Manual*, Taxman Allied Service P Ltd

⁸ M Y Khan, *Indian Financial Systems*, Tata McGraw Hill.

In other words, the market wherein resources are mobilised by companies through issue of new securities is called the primary market. These resources are required for new projects as well as for existing projects with a view to expansion, modernisation, diversification and up gradation.⁹

The issue of securities by companies can take place in any of the following methods:

- d. Initial public offer (securities issued for the first time to the public by the company);
- e. Further issue of capital;
- f. Rights issue to the existing shareholders. (On their renunciation, the shares can be sold by the company to others also);
- g. Offer of securities under reservation basis to:
 - (1) foreign partners and collaborators,
 - (2) mutual funds,
 - (3) merchant bankers,
 - (4) banks and institutions,
 - (5) non resident Indians and overseas corporate bodies,
 - (6) employees;
- h. Offer to public;
- i. Bonus Issue.

The Primary Market (New Issues) is of great significance to the economy of a country. It is through the primary market that funds flow for productive purposes from investors to entrepreneurs. The latter use the funds for creating new products and rendering services to customers in India and abroad. The strength of the economy of a country is gauged by the activities of the Stock Exchanges. The primary market creates and offers the merchandise for the secondary market.

⁹ *Securities laws and Compliances*, The Institute of Company Secretaries of India.

- **Secondary Market:**

The secondary market enables those who hold securities to adjust their holdings in response to changes in their assessment of risk and return. They also sell securities for cash to meet their liquidity needs. The price signals, which subsume all information about the issuer and his business including, associated risk, generated in the secondary market, help the primary market in allocation of funds.

Secondary market essentially comprises of stock exchanges which provide platform for purchase and sale of securities by investors. The trading platform of stock exchanges are accessible only through brokers and trading of securities is confined only to stock exchanges. The corporate securities market dates back to the 18th century when the securities of the East India company were traded in Mumbai & Kolkata. The brokers used to gather under a banyan tree in Mumbai and under a neem tree in Kolkata for the purpose. However, the real beginning came in the 1850s with the introduction of joint stock companies with limited liability. The 1860s witnessed feverish dealings in securities and securities speculation. This brought brokers to Bombay together in July 1875 to boom the first organised stock exchange in the country, viz. The Stock Exchange, Mumbai, Ahmedabad Stock Exchange in 1894 and 22 others followed with 20th century.¹⁰

The stock exchanges are the exclusive centres for trading in securities and the trading platform of an exchange is accessible only to brokers. The regulatory framework heavily favours the recognised stock exchanges by almost banning trading activity outside the stock exchanges.

The stock market or secondary market ensures free marketability, negotiability and price discharge. For these reasons the stock market is referred to as the nerve centre of the capital market, reflecting the economic trend as well as the hopes, aspirations and apprehensions of the investors. This secondary market has further two components, First, the spot market where securities are traded for immediate delivery and payment, The other is futures market where the securities are traded for future delivery and payment. Another variant is the options market where securities are traded for conditional future delivery. Generally, two types of options are traded in the options market. A put option permits the owner to sell a security to the writer of the option at a pre-determined price before a certain date, while a call option permits the buyer to purchase a security from the writer of the option at a particular price before a certain date.

SEBI: INTRODUCTION

The legislation giving powers to SEBI was passed on 4th April 1992 in the form of the Securities & Exchange Board of India Act to protect the interests of investors in securities and to promote the development of and to regulate the securities market and for matters connected therewith or incidental thereto.

¹⁰ S. Suryanarayanan, V. Varadarajan, *SEBI – Law, Practice & Procedure*, Commercial Law Publishers Pvt. Ltd..

The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as¹¹:

“...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto.”

- **SEBI Act, 1992**

Chapter I of the Act covers the definitions of various terms under the Act, while Chapter II deals with establishment of SEBI and its management. In terms of section 3 of the Act, SEBI is a body corporate having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable and to contract, sue and be sued in its own name. SEBI has its Head Office at Mumbai and has powers to establish its offices at other places in India. SEBI presently has offices also in Kolkata, New Delhi, Chennai and Ahmedabad.¹²

Section 4(1) of SEBI Act provides that the SEBI Board shall consist of the following members, namely: (a) a Chairman; (b) two members from amongst the officials of the Ministry of the Central Government dealing with Finance and administration of the Companies Act, 1956; (c) one member from amongst the officials of the Reserve Bank; (d) five other members of whom at least three shall be the whole time members, to be appointed by the Central Government.¹³

The Chairman and the other members are from amongst the persons of ability, integrity and standing who have shown capacity in dealing with problems relating to securities market or have special knowledge or experience of law, finance, economics, accountancy, administration or in any other discipline which, in the opinion of the Central Government, shall be useful to SEBI.

The terms and conditions of service of Chairman and members are determined in the rules framed by Government in this regard. The general superintendence, direction and management of the affairs of SEBI vests in a Board of members, which exercises all powers and do all acts and things which may be exercised or done by SEBI. Unless determined otherwise through regulations, the Chairman shall also have all these powers.

- **Power and Functions**

Chapter IV of SEBI Act, 1992 deals with the powers and functions of the Board. Section 11 of the Act lays down that it shall be the duty of SEBI to protect the interests of the investors in securities and to promote the development of, and to regulate the securities markets by such measures as it thinks fit. These measures would include¹⁴:

¹¹ Preamble, *The Securities and Exchange Board of India, Act 1992* .

¹² *Ibid*, section 3

¹³ *Ibid*, section 3

¹⁴ *Supra* note, 11, section 11.

- 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 advisers 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 such other intermediaries as SEBI may, by notification, specify in this behalf;
- d. registering and regulating the working of venture capital funds and collective investment schemes, including 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 takeover of companies;
- j. calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisations in the securities market;
- k. calling 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 any transaction in securities which is under investigation or inquiry by SEBI;
- l. 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;
- m. levying fees or other charges for carrying out the purposes of this section;
- n. conducting research for the above purposes;
- o. calling from or furnishing to any such agencies, as may be specified by SEBI, such information as may be considered necessary by it for the efficient discharge of its functions;

p. performing such other functions as may be prescribed.

As per Section 11(4) SEBI, may, by an order or for reasons to be recorded in writing take any of the following measures either pending investigation or inquiry or on completion of such investigation or enquiry:

- a. suspend the trading of any security in a recognised stock exchange.
- b. restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities.
- c. suspend any office-bearer of any 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 prior approval of a magistrate, one or more bank accounts of any intermediary or any person associated with the securities market in any of the Act or rules or regulations made thereunder.
- 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.

- **Consent Orders**

SEBI has brought the concept of consent order/compounding of offence into force for resolving the disputes in more smooth manner through negotiations and discussions instead of lengthy litigation. SEBI has issued Guidelines for (i) Consent Orders and (ii) For considering requests for composition of offences, under SEBI Act, SC(R) Act and Depositories Act.¹⁵

Consent Order means an order settling administrative or civil proceedings between the regulator and a person (Party) who may prima facie be found to have violated securities laws. Here, Administrative/Civil enforcement actions include issuing directions, suspension or cancellation of certificate of registration, imposition of monetary penalty, pursuing suits and appeals in Courts and Securities Appellate Tribunal (SAT). It may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved. Consent Order provides flexibility of wider array of enforcement and remedial actions which will achieve the twin goals of an appropriate sanction, remedy and deterrence without resorting to litigation, lengthy proceedings and consequent delays.

¹⁵ Vide its Circular No. EFD/ED/Cir- 1/2007 dated 20th April 2007.

- **Registration of Intermediaries**

Chapter V of the Act provides for registration of various intermediaries such as stock broker, sub-broker, share transfer agents etc. Section 12(1) of the Act provides that no 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 adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from SEBI in accordance with the regulations made under this Act.¹⁶

A person buying or selling securities or otherwise dealing with the securities market as a 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 adviser and such other intermediary who may be associated with securities market immediately before the establishment of SEBI for which no registration certificate was necessary prior to such establishment, may continue to do so for a period of three months from such establishment or, if he has made an application for such registration within the said period of three months, till the disposal of such application.¹⁷

Also no depository, participant, custodian of securities, foreign institutional investor, credit rating agency or any other intermediary associated with the securities market as SEBI may by notification in this behalf specify, shall buy or sell or deal in securities except under and in accordance with the conditions of a certificate of registration obtained from SEBI in accordance with the regulations made under this Act.

No person shall sponsor or cause to be sponsored or carry on or cause to be carried on any venture capital funds or collective investment schemes including mutual funds, unless he obtains a certificate of registration from SEBI in accordance with the regulations.

Every application for registration would in such manner and on payment of such fees as may be determined by regulations. The Board may, by order, suspend or cancel a certificate of registration in such manner as may be determined by regulations. However no such order shall be made unless the person concerned has been given a reasonable opportunity of being heard.

- **Penalties for Failures**

Chapter VIA of SEBI Act, 1992, contains Section 15A to 15JA which deals with penalties which can be imposed under the Act for various failures, defaults, nondisclosure and other offences.¹⁸

Section 15A lays down that if any person who is required under SEBI Act or any rules or regulations made thereunder:

¹⁶ *Supra* note, 11, section 12.

¹⁷ Mamta Bhargava, *Compliances and Procedures under SEBI Law*, Shreeji Publishers

¹⁸ *Supra* note, 11, section 15A- 15JA.

(a) to furnish any document, return or report to the Board, fails to furnish the same, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

(b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations, fails to file return or furnish the same within the time specified therefor in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

(c) to maintain books of accounts or records, fails to maintain the same, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

Section 15B lays down that if any person who is registered as an Intermediary and is required under this Act or any rules or regulations made thereunder, to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to pay a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

Section 15C lays down that if any listed company or any person who is registered as an Intermediary, after having been called upon by SEBI in writing to redress the grievances of Investor, fails to redress such grievances within the time specified by SEBI, such company or intermediary shall be liable to pay a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

- **Penalty for Insider Trading**

Section 15G lays down that if any insider:

(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price sensitive information; or

(ii) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or

(iii) counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price sensitive information, he shall be liable to a penalty of twenty five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

- **Securities Appellate Tribunal**

In order to afford proper appellate remedies, Chapter VIB of SEBI Act provides for the establishment of the Securities Appellate Tribunals to consider appeals against SEBI's orders, of penalties.

As per Section 15K, the Central Government is empowered to establish by notifications one or more Appellate Tribunals, to be known as the Securities Appellate Tribunals to exercise the jurisdiction, power and authorities conferred on such Tribunal by SEBI Act or under the Act or any other law for the time being in force. The Central Government has set up a tribunal at Mumbai.

According to Section 15L, which deals with the composition of the Tribunal, the Securities Appellate Tribunals shall consist of a Presiding Officer and two other members to be appointed by the Central Government by notification.

- **Power to make Rules**

Section 29 empowers the Central Government to make rules for carrying out the purposes of this Act. Such rules may provide for all or any of the following matters, namely¹⁹:

- a. the term of office and other conditions of service of the Chairman and the members of SEBI;
 - b. the additional functions that may be performed by SEBI under section 11 of the Act;
 - c. the manner in which the accounts of SEBI shall be maintained under section 15;
- d. the salaries and allowances and other terms and conditions of service of the Presiding Officers, members and other officers and employees of the Securities Appellate Tribunal;
- e. the procedure for the investigation of misbehaviour or incapacity of the Presiding
- f. Officers or other members of the Securities Appellate Tribunal;
- g. the form in which an appeal may be filed before the Securities Appellate Tribunal and the fees payable in respect of such appeal;
- h. the form and the manner in which returns and report to be made to the Central Government under section 18;
- i. any other matter which is to be, or may be, prescribed, or in respect of which provision is to be, or may be, made by rules.

¹⁹ *Supra* note, 11, section 29

- **Power to make Regulations**

Section 30 empowers SEBI by notification to make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act. Such regulations may provide for all or any of the following matters, namely²⁰:

- a. the times and places of meetings of SEBI and the procedure to be followed at such meetings including quorum necessary for the transaction of business;
- b. the terms and other conditions of service of officers and employees of SEBI;
- c. the matters relating to issue of capital, transfer of securities and other matters incidental thereto and the manner in which such matters shall be disclosed by the companies under section 11A.

SEBI REGULATIONS

Capital market intermediaries are a vital link between the regulators, issuers and investor. Any aberrations in the capital markets has presumably direct bearing on the intermediaries, their governance processes and practices which in turn affect the confidence of the markets. It is therefore necessary to ensure good governance practice of the intermediaries and also to have constant monitoring and surveillance on the acts of intermediaries. Securities and Exchange Board of India Act, 1992 was framed to provide for the establishment of a Board to protect the interest of investors in securities and to promote the development of and regulate the securities market and for matter connected therewith and incidental thereto.²¹

As per Section 11 of SEBI Act, it is the duty of SEBI to register and regulate 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 market in any manner.

SEBI has issued regulations in respect of each intermediary to ensure proper services to be rendered by them to the investors and the capital market.

The regulation is primarily principle based and some significant changes in the framework are given below:

1. Permanent Registration

Subject to compliance with the SEBI Act, regulations, updation of relevant disclosures and payment of fees registration shall be permanent.

²⁰ *Supra* note, 11, section 30

²¹ *Supra* note, 10

2. Registration for multiple activities

The process for registration for undertaking multiple activities by the same intermediary has been simplified.

3. Registration Form- information divided into two parts

Part 1 of the form will be disclosed and available to the public and Part II will contain such information which will be retained with the Board as regulatory filing.

4. Fit and Proper person requirements

The criteria to determine whether the intermediary is a Fit and Proper person have been revised and are now principle based.

5. Suspension/Cancellation of certificate of registration

The manner of suspension/cancellation of any certificate granted to any person has been provided in the regulations. Consequently the SEBI (Procedure for holding enquiry by enquiry officer and imposing penalty) Regulations, 2002 has been repealed and SEBI (Intermediaries) Regulations, 2008 has taken place.

• **Regulations for Intermediaries in Primary Market**

➤ *Merchant Bankers*

Merchant Banker' means any person engaged in the business of issue management by making arrangements regarding selling buying or subscribing to securities or acting as manager/consultant/advisor or rendering corporate advisory services in relation to such issue management. SEBI has advised that merchant bankers shall undertake only those activities which relate to securities market. These activities are²²:

- a. Managing of public issue of securities;
- b. Underwriting connected with the aforesaid public issue management business;
- c. Managing/Advising on international offerings of debt/equity i.e. GDR, ADR, bonds and other instruments;
- d. Private placement of securities;
- e. Primary or satellite dealership of government securities;
- f. Corporate advisory services related to securities market including takeovers, acquisition and disinvestment;
- g. Stock broking;
- h. Advisory services for projects;
- i. Syndication of rupee term loans;

²² SEBI (Merchant Bankers) Rules, 1992; SEBI (Merchant Bankers) Regulations, 1992.

j. International financial advisory services.

The activities of the merchant bankers in the Indian capital market are regulated by SEBI (Merchant Bankers) Rules, 1992 and SEBI (Merchant Bankers) Regulations, 1992. While the rules were notified by the Central Government in exercise of the powers conferred by section 29 of SEBI Act, 1992, the regulations were notified by SEBI in exercise of the powers conferred by section 30 of SEBI Act, 1992 after approval of the Central Government. Both the rules and the regulations took effect on 22nd December, 1992 on their publication in the Gazette of India. Central Government vide its notification dated 07 September, 2006 has rescinded the SEBI (Merchant Bankers) Rules, 1992.

➤ *Registrars and Share Transfer Agents*

The Registrars to an Issue and Share Transfer Agents constitute an important category of intermediaries in the primary market. They render very useful services in mobilising new capital and facilitating proper records of the details of the investors, so that the basis for allotment could be decided and allotment ensured as per SEBI Regulations.²³

They also render service to the existing companies in servicing the share capital contributed by the investors. The system of share transfers gives liquidity to the investment and helps the investors to easily acquire or dispose off shares in the secondary market. The share transfer agents who have the necessary expertise, trained staff, reliable infrastructure and SEBI licence render service to the corporate by undertaking and executing the transfer and transmission work relating to the company's shares and securities. Thus they have a role to play both in the primary and the secondary markets.

Though, after the introduction of the Depository system in India, very large corporates are required to switch-over to dematerialised system of share holding which does not involve issue of individual share certificates or securities to the investors, large existing companies still continue in the old system of security issue and their transfer and transmission are being handled by the company's own securities department or in the alternative by the share transfer agents.

Unless and until the old system is totally eliminated, the share transfer agents will continue to have a role to play in the Indian capital market by rendering service to the corporates in the area of public issue as well as share transfer and share transmission.

SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 were notified by SEBI on 31st May, 1993 in exercise of the powers conferred by Section 30 of SEBI Act, 1992, with the approval of Central Government.

²³ SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993

➤ *Underwriters*

Underwriting is an arrangement whereby certain parties assure the issuing company to take up shares, debentures or other securities to a specified extent in case the public subscription does not amount to the expected levels. For this purpose, an arrangement (agreement) will be entered into between the issuing company and the assuring party such as a financial institution, banks, merchant banker, broker or other person.²⁴

It is necessary for a public company which invites public subscription for its securities to ensure that its issue is fully subscribed. The company cannot depend on its advertisements to bring in the full subscription. In case of any short-fall, it has to be made good by underwriting arrangements made in advance of the opening of the public issue.

Underwriters represent one of the key elements among the capital market intermediaries. They facilitate raising of capital by assuring to take up the unsubscribed portion up to a specified limit. SEBI (Underwriters) Regulations, 1993 were notified by SEBI in exercise of the powers conferred by Section 30 of SEBI Act, 1992 with the approval of Central Government. They came into force from 8th October, 1993.

➤ *Bankers to an Issue*

The Banks render crucial service in mobilisation of capital for companies. While one or more banks may function as Bankers to the Issue as well as collection banks, others may do the limited work of collecting the applications for securities along with the remittance in their numerous branches in different centres. The banks are expected to furnish prompt information and records to the company and to the lead manager for monitoring and progressing the issue work. For this purpose, the company has to enter into an agreement with different banks specifying the conditions, terms and remuneration for services to be rendered by each such bank.

SEBI (Bankers to an Issue) Regulations, 1994 were notified from 14th July, 1994 in exercise of the powers conferred by Section 30 of SEBI Act, 1994 after approval by the Central Government.

➤ *Debenture Trustees*

Debentures, Bonds and other hybrid instruments in most cases unless otherwise specified, carry securities for the investors unlike in the case of equity and preference shares. It is necessary that the company makes proper arrangements to extend assurances and comply with legal requirements in favour of the investors who are entitled to this type of security. Intermediaries such as Trustees who are generally Banks and Financial Institutions render this service to the investors for a fee payable by the company. The issuing company has to complete the process of finalising and executing the trust deed or document and get it registered within the prescribed period and file the charge with the Registrar of Companies (ROC) in respect of the security offered.²⁵

²⁴ SEBI (Underwriters) Regulations, 1993.

²⁵ SEBI (Debenture Trustees) Regulations, 1993.

SEBI (Debenture Trustees) Regulations, 1993 were notified by SEBI effective from 29th December, 1993 in exercise of the powers conferred by Section 30 of SEBI Act, 1992 after previous approval of the Central Government.

- **Regulations for activities and procedures in Primary Market**

- *Issue of Equity Shares*

SEBI (ICDR) Regulations, with reference to issue of equity shares are important and cover the following²⁶:

- a. a public issue
- b. a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more
- c. a preferential issue
- d. an issue of bonus shares by a listed issuer
- e. a qualified institutions placement by a listed issuer
- f. an issue of Indian Depository Receipts.

- *Eligibility Norms for Public Issue*

- ❖ **Unlisted Company**

An unlisted company can make an initial public offering (IPO) of equity shares or any other security which may be converted into or exchanged with equity shares at a later date, only if it meets all the following conditions²⁷:

- (a) The company has net tangible assets of at least Rs. 3 crores in each of the preceding 3 full years (of 12 months each), of which not more than 50% is held in monetary assets;
- (b) The company has a track record of distributable profits in terms of Section 205 of the Companies Act, 1956, for at least three (3) out of immediately preceding five (5) years;
- (c) The company has a net worth of at least Rs. 1 crore in each of the preceding 3 full years (of 12 months each);

²⁶ *Supra* note, 9.

²⁷ Regulation 26, *SEBI (ICDR) Regulations, 2009*.

(d) The aggregate of the proposed issue and all previous issues made in the same financial year in terms of size, does not exceed five (5) times its preissue net worth as per the audited balance sheet of the last financial year.

(e) In case the company has changed its name within the last one year, at least 50% of the revenue for the preceding 1 full year is earned by the company from the activity suggested by the new name; and

❖ Listed Company

A listed company shall be eligible to make a public issue of equity shares or any other security which may be converted into or exchanged with equity shares at a later date: the aggregate of the proposed issue and all previous issues made in the same financial year in terms of size, issue size does not exceed 5 times its pre-issue network as per the audited balance sheet of the last financial year.

However, in case there is a change in the name of the issuer company within the last 1 year reckoned from the date of filing of the offer document, the revenue accounted for by the activity suggested by the new name is not less than 50% of its total revenue in the preceding 1 full-year period

➤ *Alternative Eligibility Norms for Public Issue*

To provide sufficient flexibility and also to ensure that genuine companies do not suffer on account of rigidity of the parameters, SEBI has provided alternative route to company not satisfying any of the above conditions, for accessing the primary Market, as under²⁸:

(a) (i) The issue is made through the book-building process, with at least 50% of net offer to public) being allotted to the Qualified Institutional Buyers (QIBs), failing which the full subscription monies shall be refunded.

OR

(a) (ii) The —projectl has at least 15% participation by Public Financial Institutions/ Scheduled

Commercial Banks, of which at least 10% comes from the appraiser(s). In addition to this, at least 10% of the issue size shall be allotted to QIBs, failing which the full subscription monies shall be refunded.

AND

(b) (i) The minimum post-issue face value capital of the company shall be Rs. 10 crores.

OR

²⁸ *Ibid.*

(b) (ii) There shall be a compulsory market-making for at least 2 years from the date of listing of the shares, subject to the following:

(a) Market makers undertake to offer buy and sell quotes for a minimum depth of three hundred specified securities;

(b) Market makers undertake to ensure that the bid-ask spread difference between quotations for sale and purchase for their quotes shall not at any time exceed 10%;

(c) The inventory of the market makers, as on the date of allotment of securities, shall be at least 5% of the proposed issue of the company.

In addition to satisfying the aforesaid eligibility norms, the company shall also satisfy the criteria of having at least 1000 prospective allottees in its issue.

Public Issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus. For raising capital from the public by the issue of shares, a public company has to comply with the provisions of the Companies Act, the Securities Contracts (Regulation) Act, 1956 including the Rules made thereunder and the guidelines and instructions issued by the concerned Government authorities, the Stock Exchanges and SEBI etc.

➤ *Different means of raising funds/ issuing securities in Primary Market*

A company can raise funds from the primary market through different method:

(a) Public issue: When an issue/offer of securities is made to new investors for becoming part of shareholders' family of the issuer it is called a public issue. Public issue can be further classified into Initial public offer (IPO) and Further public offer (FPO). The significant features of each type of public issue are illustrated below²⁹:

(i) Initial public offer (IPO): When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an IPO. This paves way for listing and trading of the issuer's securities in the Stock Exchanges.

(ii) Further public offer (FPO) or Follow on offer: When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called a FPO.

(b) Right issue (RI): When an issue of securities is made by an issuer to its shareholders existing as on a particular date fixed by the issuer (i.e. record date), it is called a rights issue. The rights are offered in a particular ratio to the number of securities held as on the record date.

²⁹ V.K. Bhalla, *Investment Management - Security Analysis and Portfolio Management*, S. Chand & Co. Ltd.

- (c) Bonus issue: When an issuer makes an issue of securities to its existing shareholders as on a record date, without any consideration from them, it is called a bonus issue. The shares are issued out of the Company's free reserve or share premium account in a particular ratio to the number of securities held on a record date.
- (d) Private placement: When an issuer makes an issue of securities to a select group of persons not exceeding 49, and which is neither a rights issue nor a public issue, it is called a private placement. Private placement of shares or convertible securities by listed issuer can be of two types:
- (i) Preferential allotment: When a listed issuer issues shares or convertible securities, to a select group of persons in terms of provisions of Chapter VII of SEBI (ICDR) Regulations, it is called a preferential allotment. The issuer is required to comply with various provisions which inter alia include pricing, disclosures in the notice, lock in etc., in addition to the requirements specified in the Companies Act.
- (ii) Qualified institutions placement (QIP): When a listed issuer issues equity shares or securities convertible in to equity shares to Qualified Institutions Buyers only in terms of provisions of Chapter VIII of SEBI (ICDR) Regulations, it is called a QIP.

➤ *Other salient features of ICDR, regulations*

❖ *Debarment*

An issuer can not make a public issue or rights issue of specified securities if the issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by SEBI. If any of the promoters, directors or person in control of the issuer was or also is a promoter, director or person in control of any other company which is debarred from accessing the capital market under any order or directions made by SEBI.³⁰

❖ *Filing of offer document*

An issuer company can not make any public issue of securities, unless a draft offer document has been filed with SEBI through a Merchant Banker, at least 30 days prior to registering the prospectus with the Registrar of Companies (ROC) or filing the letter of offer with the designated stock exchange.

However, if SEBI specifies changes or issues observations on the draft Prospectus within 30 days from the date of receipt of the draft Prospectus by SEBI the issuer company or the Lead Manager to the Issue shall carry out such changes in the draft Prospectus or comply with the observations issued by SEBI before filing the Prospectus with ROC. SEBI may specify changes or issue observations, if any, on the draft prospectus within 30 days from the later of the date of receipt of the draft offer document or the date of receipt of satisfactory reply from the lead merchant bankers. Where SEBI has sought any clarification or additional information from them or the date of receipt of clarification or information from any regulator or agency, where SEBI has sought any clarification or information from such regulator or agency or the date of receipt of a copy of in-principal approval letter issued by the recognized stock exchanges.

³⁰ *Supra* note, 9.

The lead merchant banker should while filing the offer document with SEBI, file a copy of such document with the recognized stock exchanges where the specified securities are proposed to be listed and a soft copy of the offer document should also be furnished to SEBI.

❖ Issue of securities in dematerialised form

A company cannot make public or rights issue or an offer for sale of securities, unless the company enters into an agreement with a depository for dematerialization of securities already issued or proposed to be issued to the public or existing shareholders; and the company gives an option to subscribers/ shareholders/ investors to receive the security certificates or hold securities in dematerialized form with a depository.

❖ Fast Track Issues (FTIs)

Considering the need to enable well established and compliant listed companies to access Indian primary market in a time effective manner through follow-on public offerings and rights issues, it has been decided by SEBI to enable listed companies satisfying certain specified requirements to make Fast Track Issues (FTIs).³¹ Accordingly such listed companies are now able to proceed with follow-on public offering/rights issue by filing a copy of the Red Herring Prospectus (in case of book built issue)/Prospectus (in case of fixed price issue) registered with the Registrar of Companies or the letter of offer filed with Designated Stock Exchange, as the case may be, with SEBI and stock exchanges. Such companies are not required to file draft offer document with SEBI and stock exchanges.

❖ Introduction of ASBA

In its continuing endeavour to make the existing public issue process more efficient, SEBI has introduced a supplementary process of applying in public issues, viz., the Applications Supported by Blocked Amount (ASBA) process.³² The ASBA process is available in all public issues made through the book building route. It shall co-exist with the current process, wherein cheque is used as a mode of payment. ASBA is an application for subscribing to an issue, containing an authorization to block the application money in a bank account. Self Certified Syndicate Bank (SCSB) is a bank which offers the facility of applying through the ASBA process.

An ASBA investor submits an ASBA physically or electronically through the internet banking facility, to the SCSB with whom the bank account to be blocked, is maintained. The SCSB then blocks the application money in the bank account specified in the ASBA, on the basis of an authorization to this effect given by the account holder in the ASBA. The application money remains blocked in the bank account till finalisation of the basis of allotment in the issue or till withdrawal/failure of the issue or till withdrawal/rejection of the application, as the case may be. The application data shall thereafter be uploaded by the SCSB in the electronic bidding system through a web enabled interface provided by the Stock Exchanges. Once the basis of allotment of finalized, the Registrar to the Issue sends an appropriate request to the SCSB for unblocking the relevant bank accounts and for transferring the requisite amount to the issuer's account.

³¹ Regulation 10, ICDR, 2009

³² Regulation 2(d), ICDR, 2009

❖ Minimum Subscription

The minimum subscription to be received in an issue should not be less than ninety percent of the offer through offer document. In the event of non-receipt of minimum subscription all applications moneys received should be refunded to the applicants forthwith, but not later than³³:

- a. fifteen days of the closure of the issue, in case of a non-underwritten issue.
- b. seventy days of the closure of the issue, in case of an underwritten issue.

Where minimum subscription including devolvement obligations paid by the underwriters is not received within 60 days of the closure of issue.³⁴

The requirement of minimum subscription is not applicable to offer for sale. The requirement is also not applicable to an eligible infrastructure company, provided disclosures regarding the alternate source of funding is made in the prospectus.

❖ Green Shoe Option Facility

Green Shoe Option means an option of allocating shares in excess of the shares included in the public issue and operating a post-listing price stabilizing mechanism in accordance with the provisions of Regulation 45 of SEBI (ICDR) Regulations, 2009.³⁵

GSO in the system of IPO using book-building method was recognised by SEBI in India through its new guidelines on 14th August 2003 (vide SEBI/ CFD/DIL/DIP/ Circular No. 11). ICICI bank has used Green Shoe Option in the first time in case of its public issue through book building mechanism in India. A company desirous of availing this option, should in the resolution of the general meeting authorising the public issue, seek authorisation also for the possibility of allotment of further shares to the Stabilising Agent (SA) at the end of the stabilisation period.³⁶

The company should appoint one of the merchant bankers or book runners, amongst the issue management team, as the stabilising agent (SA), who will be responsible for the price stabilisation process, if required. The SA shall enter into an agreement with the issuer company, prior to filing of offer document with SEBI, clearly stating all the terms and conditions relating to this option including fees charged/expenses to be incurred by SA for this purpose.

³³ Regulation 14, *ICDR, 2009*.

³⁴ *Ibid.*

³⁵ Regulation 38 & 45, *ICDR, 2009*.

³⁶ *Ibid.*

The SA should also enter into an agreement with the promoter(s) or pre-issue shareholders who will lend their shares under the provisions of this scheme, specifying the maximum number of shares that may be borrowed from the promoters or the shareholders, which shall not be in excess of 15% of the total issue size.³⁷

In case of an initial public offer by a unlisted company, the promoters and pre issue shareholders and in case of public issue by a listed company, the promoters and pre-issue shareholders holding more than 5% shares, may lend the shares subject to the provisions of this scheme. The SA should borrow shares from the promoters or the pre-issue shareholders of the issuer company or both, to the extent of the proposed over-allotment. However, the shares so referred shall be in dematerialized form only.

The allocation of these shares should be pro rata to all the applicants. The stabilisation mechanism should be available for the period disclosed by the company in the prospectus, which shall not exceed 30 days from the date when trading permission was given by the exchange(s).

The money received from the applicants against the over-allotment in the green shoe option should be kept in the GSO Bank Account, distinct from the issue account and shall be used for the purpose of buying shares from the market, during the stabilisation period.

The shares bought from the market by the SA, if any during the stabilization period, should be credited to the GSO Demat Account.

The shares bought from the market and lying in the GSO Demat Account should be returned to the promoters immediately, in any case not later than 2 working days after the close of the stabilisation period. The prime responsibility of the SA should be to stabilise post listing price of the shares. To this end, the SA should determine the timing of buying the shares, the quantity to be bought, the price at which the shares are to be bought etc. On expiry of the stabilisation period, in case the SA does not buy shares to the extent of shares over-allotted by the company from the market, the issuer company shall allot shares to the extent of the shortfall in dematerialized form to the GSO Demat Account, within five days of the closure of the stabilisation period. These shares shall be returned to the promoters by the SA in lieu of the shares borrowed from them and the GSO Demat Account shall be closed thereafter. The company shall make a final listing application in respect of these shares to all the exchanges where the shares allotted in the public issue are listed. The provisions relating to preferential issues shall not be applicable to such allotment.³⁸

³⁷ *Supra* note, 35.

³⁸ *Ibid.*

❖ IPO Grading

IPO grading is a service aimed at facilitating the assessment of equity issues offered to public. The grade assigned to any individual issue represents a relative assessment of the fundamentals' of that issue in relation to the universe of other listed equity securities in India. Such grading is assigned on a five-point point scale with a higher score indicating stronger fundamentals. IPO grading is different from an investment recommendation. Investment recommendations are expressed as buy, hold or sell and are based on a security specific comparison of its assessed fundamentals factors' (business prospects, financial position etc.) and market factors (liquidity, demand supply etc.) to its price.

On the other hand, IPO grading is expressed on a five-point scale and is a relative comparison of the assessed fundamentals of the graded issue to other listed equity securities in India

CONCLUSION

Our review of SEBI's performance in the eighteen years since its establishment in its current incarnation as an adequately empowered and independent regulator indicates that there has been an all-round improvement in the institutional framework in which the securities trade in India is conducted. Progressively, over time, nearly every actor who is directly connected with the securities trade has been brought under the regulatory ambit of SEBI. A combination of registration, licensing, eligibility conditions, and incentives allows SEBI to rein in non-compliant behaviour that could potentially affect the functioning of the securities market adversely.

Similarly, many of the important processes have been regulated such as takeover activities, insider trading, manipulative practices, issuance of employee share options and so on. It is thus reasonable to claim that the regulatory framework is fairly comprehensive in its coverage of the securities trade.

In terms of the functioning of the market, SEBI has mandated an enormous increase in the flow of information at the time of listing, after listing and relating to the trade. The long history of the functioning of the capital market and securities industry in India suggest that voluntary disclosure may not have become a pervasive trend and that without a regulatory push, there would have been underproduction of information. SEBI has secured for itself a say in the process of writing accounting rules through NACAS.

In terms of enforcement, the data suggest that SEBI has achieved considerable progress in terms of detecting and disposing of instances of non-compliance or infractions. This has also been borne out by the relatively orderly functioning of the trading and settlement systems with hardly any instances of payment crises shutting down the exchanges as in the past until the mid-nineties. However, both the primary and secondary markets have been affected from time to time by various other troubles that sometimes assumed the proportion of a scam as in the case of the IPOs of Yes Bank, IDFC and several others. Most recent is the much hyped Sahara case, where more than crore investors are being affected due to lack of regulatory/statutory measures.

BIBLIOGRAPHY

- Black, Bernard S, and Khanna, Vikramaditya S (2007). “Can Corporate Governance Reforms Increase Firm Market Values? Event Study Evidence from India,” *Journal of Empirical Legal Studies*, 4(4), 749-796.
- Franklin, Allen; Chakrabarti, Rajesh and De, Sankar (2007). “India’s Financial System,”
Unpublished working paper, Electronic copy available at <http://ssrn.com/abstract=1261244>
- Gokarn, Subir (1996). “Indian Capital Market Reforms, 1992- 96: An Assessment,”
Economic and Political Weekly, April 13.
- Goswami, Omkar (2000). “The Tide Rises Gradually – Corporate Governance in India,” downloaded from <http://www.oecd.org/dataoecd/6/47/1931364.pdf> on July 4, 2005.
- KPMG Audit Committee Institute (2008). “The State of Corporate Governance in India -- A Poll,” KPMG India.
- Khurshed, Arif; Paleari, Stefano; Pandey, Alok and Vismara, Silvio (2008). “IPO Garding in India: Does It Add Value to the Book Building Process,” Unpublished
Working Paper accessed from www.unibg.it/dati/bacheca/530/36104.pdf
- Madhusoodanan, T P and Thiripalraju, M (1997). “Underpricing in Initial Public Offerings: The Indian Evidence,” *26 Vikalpa*, 22(4), 17-30.
- NSE (2009). *Indian Securities Market: A Review*, Mumbai: National Stock Exchange of India.
- Patibandla, Murali (2005). “Equity Pattern, Corporate Governance and Performance: A Study of India’s Corporate Sector,” *Journal of Economic Behaviour and Organisation*,
Vol 30, 1-16.
- Planning Commission (2008). *A Hundred Small Steps-Report of the Committee on Financial Sector Reforms*, New Delhi: Sage Publications India.
- SEBI: Various reports of the annual report from 1992-93 to 2008- 09.
- Sabarinathan, G (2007). “A Critique of SEBI’s Regulation of Public Offerings of Equity Shares and Convertible Securities in India,” Unpublished Thesis submitted to the National Law School of India University.
- Sabarinathan, G (2010). “Securities and Exchange Board of India and the Regulation of Indian Securities Market” Working Paper No 2010-06-309, Unpublished working paper, Indian Institute of Management, Bangalore.

- Sen, Dilip Kumar (2004). Clause 49 of Listing Agreement on Corporate Governance, The Chartered Accountant, December, pp 806-811.
- Shah, Ajay (1999). "Institutional Change on India's Capital Markets," Economic and Political Weekly, 34(3-4), 183-194.
- Shah, Ajay and Thomas, Susan (2000a). "David and Goliath Displacing A Primary Market, Global Financial Market, Spring, 14-23.
- Shah, Ajay and Susan Thomas (2000b), "Policy Issues in India's Capital Markets in 2000, in New Economic Policies for a New India, Ed. Surjit S Bhalla, ICSSR, pp 185-210.
- Shah, Ajay; Thomas, Susan and Gorham, Michael (2009). India's Financial Markets – An Insider's Guide to How the Markets Work, Noida, UP: Elsevier.
- Singh, Jitendra; Useem, Mike and Singh, Harbir (2007). "Corporate Governance in India: Has Clause 49 Made a Difference?" Published in IndiaKnowledge@Wharton: January 25.
- Subramanian, Samanth (2010). "What is this Sebi-Irda-Ulip Issue all about," available at <http://www.livemint.com/2010/04/14162251/What-is-this-SEBIIRDAULIP-is.html> World Bank (2004). Report on Observance of Standards and Governance, Corporate Governance Country Assessment, India.

