KAMARAJ IAS ACADEMY
Only IAS Academy by Grandson of "Perunthalaivar Kamarajar"

Regulation of Stock Markets in India

Published On: 20-02-2023

Why is in news? Recently the Supreme Court asked the Securities and Exchange Board of India (SEBI) and the government to produce the existing regulatory framework in place to protect investors from share market volatility

Laws governing stock market in India

The securities market in India is regulated by four key laws

lThe Companies Act, 2013

lthe Securities and Exchange Board of India Act, 1992 (SEBI Act)

lthe Securities Contracts (Regulation) Act, 1956 (SCRA)

lthe Depositories Act, 1996.

The framing of these laws reflect the evolution and development of the capital market in India.

The SEBI Act empowers SEBI to protect the interests of investors and to promote the development of the capital/securities market, besides regulating it.

SEBI was given the power to register intermediaries like stock brokers, merchant bankers, and portfolio managers and regulate their functioning by prescribing eligibility criteria, conditions to carry on activities and periodic inspections.

It also has the power to impose penalties such as monetary penalties, including suspending or cancelling the registration.

The SCRA empowers SEBI to recognise (and derecognise) stock exchanges, prescribe rules and bye laws for their functioning, and regulate trading, clearing and settlement on stock exchanges.

As part of the development of the securities market, Parliament passed the Depositories Act and SEBI made regulations to enforce the provisions.

This Act introduced and legitimised the concept of dematerialised securities being held in an electronic form.

Today almost all the listed securities are held in dematerialised form. SEBI set up the infrastructure for doing this by registering depositories and depository participants.

The depository regulations empower SEBI to regulate functioning of depositories and depository participants by prescribing eligibility conditions, periodic inspections and powers to impose penalties including suspending or cancelling the registration as well as monetary penalties.

SEBI step in to curb market volatility

While SEBI does not interfere to prevent market volatility, exchanges have circuit filters such ad upper and lower to prevent excessive volatility.

But SEBI can issue directions to those who are associated with the market, and has powers to regulate trading and settlement on stock exchanges.

Using these powers, SEBI can direct stock exchanges to stop trading, totally or selectively. It can also prohibit entities or persons from buying, selling or dealing in securities, from raising funds from the market and being associated with intermediaries or listed companies.

Guidelines on fund-raising

The Companies Act, which regulates companies incorporated/registered in India, has delegated the authority to enforce some of its provisions to SEBI, including the regulation of raising capital, corporate governance norms such as periodic disclosures, board composition, oversight management and resolution of investor grievances.

In order to regulate fund-raising activities, SEBI first brought out a set of guidelines called the Disclosure and Investor Protection Guidelines which were thereafter subsumed into a more comprehensive Issue of Capital and Disclosure Requirement Regulations.

In order to ensure that listed companies followed corporate governance norms, SEBI notified the Listing Obligations and Disclosure Requirements Regulations in 2015.

Besides these regulations, the Collective Investment Regulations define a CIS (collective investment scheme) and provide for penal actions against those running unregistered CIS schemes.

Entities involved in fund-raising through issue of capital such as merchant bankers are also regulated through specific regulations.

Regulation of Stock exchanges

The SCRA has empowered SEBI to recognise and regulate stock exchanges and later commodity exchanges in India; this was earlier done by the Union government.

In fact, the term “securities” is defined in the SCRA and powers to declare an instrument as a security remain vested in SEBI.

The rules and regulations made by SEBI under the SCRA relate to listing of securities like equity shares, the functioning of stock exchanges including control over their management and administration.

These include powers to determine the manner in which a settlement is done on stock exchanges (and to keep them with the times for e.g. T+1) and recognising and regulating clearing corporations, which are central to the management of the trading system.

An important aspect of the regulation of stock exchanges is also the provision for arbitrating disputes that arise between stock brokers who trade on stock exchanges and investors who are clients of such stock brokers.

The Act also seeks to protect the interests of investors by creating an Investor Protection Fund for each stock exchange.

The safeguards against fraud

Fraud undermines regulation and prevents a market from being fair and transparent. SEBI notified the Prohibition of Fraudulent and Unfair Trade Practices Regulations in 1995 and the Prohibition of Insider Trading Regulations in

1992 to prevent the two key forms of fraud, market manipulation, and insider trading.

These regulations, read with provisions of the SEBI Act, define species of fraud, who is an insider and prohibit such fraudulent activity and provide for penalties including disgorgement of ill-gotten gains.

It must be noted that violation of these regulations are predicate offences that can lead to a deemed violation of the Prevention of Money Laundering Act.

SEBI has been given the powers of a civil court to summon persons, seize documents and records, attach bank accounts and property, and to carry out investigations.

Using these powers, SEBI has acted against entities and individuals like Satyam, Sahara India, Ketan Parekh and Vijay Mallya.

Corporate activities include acquisition of other companies, merger of companies and buy back of shares; SEBI has notified the Substantial Acquisition of Shares and Takeovers Regulations to ensure that acquisitions and change of management are done only after giving an opportunity to public shareholders to exit the company if they want to.

The wealth of investors includes a portfolio of securities. SEBI ensures protection of investors’ interests by regulating the listing and trading of equity shares and other securities, and by registering and regulating institutions handling public funds.

Appeals against orders of SEBI and the stock exchanges can be made to the Securities Appellate Tribunal (SAT) comprising three members. Appeals from the SAT can be made to the Supreme Court.